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TAXATION IN PARAGUAY: MARGINALIZATION OF SMALL-SCALE FARMING

Déborah Itriago

Intermón Oxfam

May 2012

Paraguay's tax system is insufficient to provide the resource base to eradicate poverty in the country, and has done little or nothing to achieve a more equal distribution of income and wealth. Two major taxation reforms over the last decade have done little to alleviate the fiscal injustice that is generated partly by the low tax reciprocity of the soy agribusiness – Paraguay's main export crop. Meanwhile, programmes to support small-scale farming receive a level of public financing accounting for just 5 per cent of public expenditure. With one of the highest levels of unequal land ownership in the world, labour informality at very high levels and poor environmental regulation of soy producers, the livelihoods and ecosystems of Paraguay's small-scale producers are at risk. There are serious loopholes in Paraguay's tax system that must be addressed in order to deliver a fairer, progressive taxation system that will allow the country to meet its social objectives.

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EXECUTIVE SUMMARY

In Paraguay, the poverty that in 2002 affected 52 per cent of the rural population now stands at around 49 per cent. The extreme poverty, which in urban areas affected 9 per cent of the population in 2009, in the countryside accounted for 32.4 per cent. Farms smaller than 20 hectares (smallholdings), despite comprising 83.5 per cent of the total number of farms, occupy only 4.3 per cent of the farmed land. To a great extent, one of the underlying causes is tax injustice, characterized by a very low and unstable tax burden which determines the effectiveness of governance to eradicate poverty and is excessively biased towards indirect taxes on consumption, further increasing the inequality that characterizes Paraguay. Furthermore, the emphasis on an excluding economic growth model sustains this reality – a model based on the agricultural exports of natural soy which, due to the inefficiency of the state, has had a negative impact on family farming (in Spanish, agricultura familiar campesina – AFC). In 1991, AFC generated 70 per cent of the gross value of agricultural production, whereas in 2008 its role had decreased drastically, falling to 32.1 per cent.

Almost 75 per cent of public spending in Paraguay is allocated or relatively fixed. That is, despite progress in tax collection over the last decade, the Paraguayan state has a low margin for saving and/or for supporting and stabilizing investment in major national projects. In fact, improvements in tax collection in the last decade have only allowed a level of social spending per capita which is three-and-a-half times lower than the average for Latin America. This gap is even wider when comparing Paraguay with neighbouring countries such as Argentina, Brazil and Uruguay, which also have economies based on agricultural exports.

In the rural sector in particular, despite higher public spending, programs and projects related to AFC have received public funding at the levels of two decades ago and is subject to the swings in the country's political polarization. Today, the family farming sector absorbs about 5 per cent of public spending, although more than 40 per cent of the Paraguayan population lives in the countryside.

In the period 1990–2010, the rate of increase of the tax burden (including contributions to social security) in the Latin America and Caribbean region was 34.5 per cent. However, the increase in the tax has been unequal in different countries. Despite the tax reforms in 1991 and 2004, Paraguay is among the countries with the lowest increase in tax collection in the region. The same applies to its level of tax burden: it is one of the lowest in the region (13.5 per cent of the GDP) and is low compared with its potential.

With the enactment of Law 125/91, as amended and extended by Law 2.421/04, the tax scheme in force in Paraguay was systematized as a limited set of taxes. Among the main direct taxes on business income, the tax on the income derived from commercial or industrial activities or those services that are not of a personal nature (in Spanish, Impuesto a las Rentas de actividades comerciales, industriales o de servicios IRACIS), and the tax on income derived from agricultural activity (el Impuesto a las Rentas de las actividades agropecuarias, IMAGRO) are still in force. Among others, the IRACIS taxes agro-exporters and the income from industrial commercial activity or services related to agribusiness. It does not apply to agricultural producers, who pay taxes through the IMAGRO. There is no personal income tax. The sole tax on capital is the property tax (land), which is currently under the administration of local government. With regard to indirect taxes, the system is essentially based on the value added tax (VAT), the selective consumption tax (ISC) and import tariffs. There is no tax on exports.

The primary strength of the 1991 law can be summarised as being in advances relating to efficiency, achieved by simplifying and rationalising the current tax system. Meanwhile, in its purest version, the 2004 tax reform included the formalisation of the economy and sought to correct the still very low tax burden.

Unfortunately, the reform of 2004 was only partly implemented. The personal income tax did not overcome the obstacles imposed by powerful groups, and the agribusiness sector got a privileged position, thus eroding the contribution of the wealthiest sectors of the population. This was due both to a clear intention to lighten the tax burden, as well as to the loopholes and contradictions that remained in the tax and fiscal scheme as a whole.

In addition to low tax rates, the Paraguayan tax system is a victim of major tax evasion (estimated at 50 per cent only in VAT) and has loopholes that encourage tax avoidance. The most important of these gaps is the absence of a personal income tax. This, coupled with low levels of control over the operations of the transnational corporations controlling the soybean value chain, and in particular the very low contribution of IMAGRO and almost no contribution derived from the property tax (land) largely explain the lack of revenue collection. Additionally, this system coexists with a large number of tax exemptions for which there is no clear measurement of their impact on public finances and equity.

The IMAGRO contributes less than 1 per cent of the total revenues from taxes, and the very low level of revenue to date is mainly the result of specific and general design flaws in the Paraguayan tax system, of 'ad hoc' decrees favouring agribusiness, and of obstacles to its implementation, including effective controls and sanctions. As for the land tax, the lack of a proper rural cadastre and the use of tax values as a basis for its estimation which are well below the market value of the land are the main causes of its non-existent contribution.

The other issue that merits serious consideration is the inequity of the Paraguayan tax system. The result of adding VAT, other consumption taxes (such as fuel) and the rights or tariffs on imports accounted for 79 per cent of Paraguay's total tax revenues in 2010 (74 per cent if contributions to social security are included). In contrast, income taxes, which are potentially progressive, accounted for 17 per cent of total tax revenues, while in other South American countries this figure was on average 31 per cent of total tax revenues.

VAT is applied to all goods except those that are in a raw or unprocessed state, and there is little difference between the rates levied on basic consumer goods and luxury goods. In 2011, a study concluded that VAT implemented in Paraguay in 1991 and updated as part of the reform of 2004 is regressive with regard to income. A more recent study confirms that the average rate (payment of VAT/income) tends to decline as income increases: the poorest 20 per cent of people pay 18 per cent of their income as VAT, while the richest 20 per cent pay 14 per cent.

Finally, to complete the picture, there are large-scale unfair subsidies. Petropar, the state company that supplies fuels, sells at a loss and has an estimated debt of $400m, fundamentally due to subsidies (gasoil). Approximately 30 per cent of diesel fuel is consumed by the agriculture sector (mainly soy producers with more and better machinery), 50 per cent is consumed by middle and upper-class households with private cars and vans, and only 20 per cent is used for industry and transportation in general. Between 1995 and 2000 over 70 per cent of public expenditure on agriculture was used for subsidies, most of which benefited large agro-export producers. Some analysts suggest that from 2003 to 2008, the subsidy received by the soy agribusiness sector, based on the reduction of its production costs, was greater than $100m.

In order to achieve a more progressive and fairer tax collection, it is essential to complete the picture of the existing opportunities which, in combination with other necessary reforms on the side of public revenues (social security system and hydroelectric royalties received by municipalities) and also in environmental and labour matters, help to articulate the possibilities for the Paraguayan state to effectively address the protection of the most vulnerable and the support the fight against poverty and inequality.

It is crucial that the potential to increase the public expense that may arise from those reforms is really productive, clearly identifying where, how and how much should be invested so that the collection can result in a real and integral development of small-scale farming and thereby overcome poverty.

This roadmap should contain the analysis and design of strategies for overcoming not only the technical and legal obstacles in Paraguay but above all the political and sociological ones in order to achieve a tax system consistent with social demands. Civil society should clearly get involved and fully understand the deficiencies and effects of the injustice of the Paraguayan tax and fiscal system, demand the relevant reforms and answer with a greater compliance with the obligations incumbent upon them.

This report, notwithstanding the scarcity of data and analysis available, is part of a series of works that aim to contribute to a constructive, thorough debate that gives rise to greater fiscal justice in Paraguay.

1 INTRODUCTION

Paraguay's economy is based on the export of soybeans and beef. Despite achieving positive economic growth rates (+4.7 per cent annually from 2002 to 2009),[1] and recent progress in devising public policies to meet the country's enormous social needs, rural poverty (at 52 per cent in 2002) remains high, at 49 per cent in 2012. Disparities in income and land ownership are among the highest in the world.

Worse yet, levels of extreme poverty are still very high, especially in rural areas. These figures reflect the difficulty of obtaining the basic levels of food necessary for survival. While extreme poverty in urban areas affected 9 per cent of the population in 2009, in the countryside the figure was 32 per cent.[2] Farms smaller than 20 hectares ('mini-farms'), despite comprising 84 per cent of the total number of farms in Paraguay, occupy only 4.3 per cent of farmed land.[3] This data shows the numerous inequalities that characterise the country.

Although not very different from its recent past when its star income earner was cotton, today Paraguay is an agribusiness paradise, particularly for producers and exporters of soy. The problem is that, on the one hand, there has been a strong emphasis on increasing soy production and exports, which are controlled by foreign investors and medium- or large-scale landowners.[4] But this growth has come at the expense of small-scale farmers who depend on the family-based agriculture sector for their livelihoods. Yet it is these small-scale farmers who are the key to the reduction of poverty and inequality and to the development of agricultural production strategies that are ecologically sustainable. In 1991, small-scale farmers generated 70 per cent of the gross value of agricultural production, while by 2008, their role had decreased dramatically, falling to 32 per cent. In spite of this, the sector's importance in food production is key. This can be seen by comparing the food items that make up the basic food basket in the country (both in urban and rural areas) with the products that are produced by small-scale farmers.[5]

On the other hand, the exponential growth of soy agribusiness has occurred in an environment characterised by institutional weakness and dysfunction (including weak laws, fragmentation of institutional resources, politicisation of the public sphere, and legal impunity). Powerful soybean producers have also acquired privileges such as low direct taxes and weak or ineffective environmental regulation.[6]

Without doubt, levels of poverty in Paraguay will not change unless the unfair taxation system is changed. Paraguay's current tax system contains loopholes, contradictions and flaws that *de facto* are translated into unjustifiable privileges for sectors such as the soy agribusiness sector. This is in spite of the fact that in many fields, and without the effective presence of the state, the situation has had a negative impact on the survival and development of small-scale producers[7]. It is important to point out that the taxation system in Paraguay is not only instrumental in the marginalization of AFC (family farming), but also maintains poverty and increases inequality in general.

The question of taxation has been an important element of the heated political polarisation of the country that has been going on since 1993, and which has intensified since Fernando Lugo became president in 2008. However, there has not yet been a wide-ranging debate about taxation to give rise to a real agenda for change that would specify the opportunities which could be obtained from a significant improvement in the taxation system to help the development of small-scale farming and to fight poverty.

This report, notwithstanding the scarcity of data and analysis available, is part of a series of works that aim to contribute to a constructive, thorough debate that gives rise to greater fiscal justice in Paraguay.

Structure of this paper

In Chapter 1, the background and the Paraguayan taxation policies in general are described. Chapter 2 gives details of the loopholes that result in low tax revenues from the agribusiness sector and increasing inequalities. Chapter 3 presents the conclusions.

2 TAX INJUSTICE AND AGRIBUSINESS

A strong agricultural export sector can be a powerful driver of economic growth and a source of employment, able to generate significant income for the national economy. But to really be a force for development, the wealth created must contribute to better living conditions for the population in general, and this requires steps such as greater redistribution of income and wealth.[8] This is where tax policy plays a fundamental role.

In order to combat poverty and inequality, redistributive policies are needed. This is especially true in conditions of economic growth, when the varying abilities and assets of different population groups to make the most of the economic boom become more marked. Those people who have capital, land, credit sources, access to the market and access to technology will obviously make the most of the boom (in Paraguay, these people are the large agribusiness producers and exporters), whereas other sectors (such as the small family-based agriculture), need strong support from the state to ensure that economic growth benefits them too; this is not an automatic outcome.[9] [10]

It is widely recognised that the fiscal policy instrument that functions best for redistributive purposes is public social expenditure. However, it is fundamental to emphasise that there are taxes with redistributive capacity, such as income tax; the absence of such a tax is a major weakness in Paraguay's tax system.

Tax revenues, however, must be sufficient to support social objectives. In contexts where there is a high degree of inequality – such as in Paraguay – the tax system needs to be as progressive as possible, so that the potentially positive effects of an increasing of public social expenditure are not cancelled out. In these contexts, a more progressive tax policy can make public investment more efficient, or strengthen it.

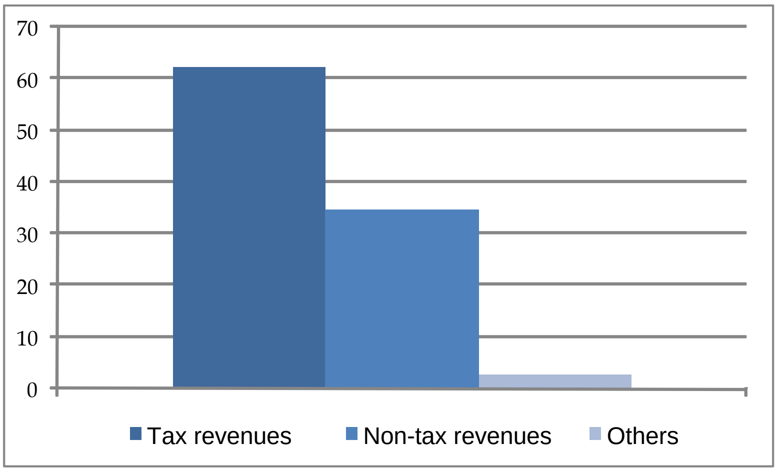
Taxes are a key instrument for government to finance public policies in a way that is stable and does not depend on international aid or incur debt, particularly from foreign sources. In addition, comprehensive fiscal policy (taxes and spending) is at the heart of the social contract between citizens and governments. Therefore, a progressive tax system, consistent with the circumstances of the most vulnerable section of the population and with the structure of the production system, is fundamental to creating a strong and democratic state that has legitimacy in the eyes of its citizens.

Paraguayan taxation policies: a weak and unstable tax system with an emphasis on indirect consumer taxes

Paraguay's fiscal income (that which is not derived from external debt) comes mainly from taxes (just over 62 per cent) and from various non-tax revenues (see Figure 1), principally the Itaipú and Yacyretá hydroelectric plants. On average, these two plants accounted for almost 63 per cent of non-tax revenue between 1998 and 2007. By law, this income is dedicated mainly to capital investment expenditure (assets) in the municipalities.[11] It is followed (in order of importance) by contributions to retirement funds and other non-tax income, accounting for 18.8 per cent, and 18.6 per cent of non-tax income respectively.

The situation of the Paraguayan social security system is critical and does little or nothing to complement the taxes towards meeting the objectives of social protection: until at least 2007, four-out-of-five people were not involved in any social welfare system in health, and only three-out-of-ten elderly people enjoyed a retirement pension.[12] Despite the reforms, the great evasion (estimated at around 70 per cent in the statutory scheme[13]), the discontinuity of contributions and the increasing casualization of the labour market, among other issues, remain a burden that affects the system.[14]

Figure 1: Composition of ordinary tax revenues in Paraguay 1998–2007 (per cent)

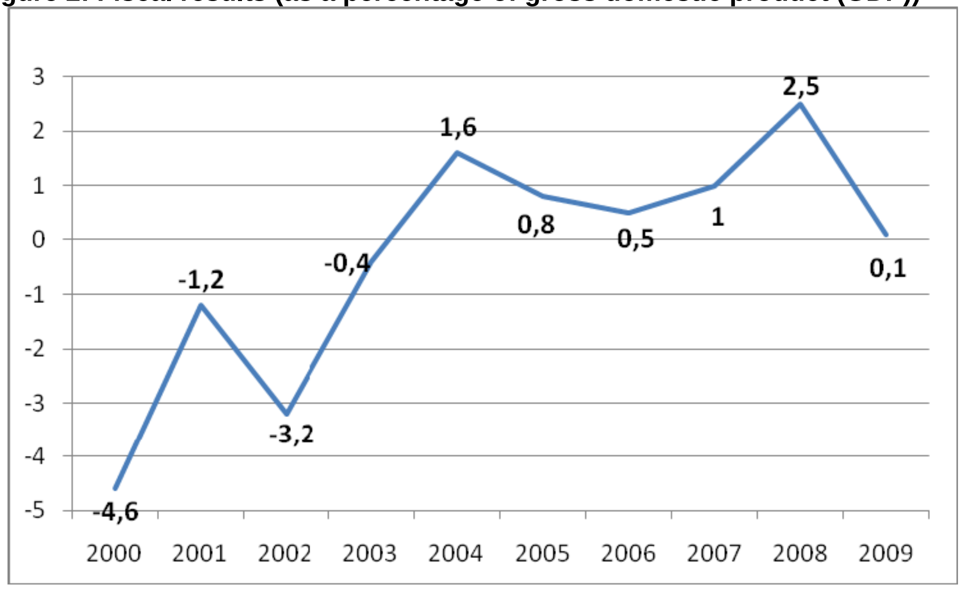


Source: Zárate (2008).

To a lesser extent, the Paraguayan state receives loans to finance public expenditure on physical and social infrastructure (capital income) and institutional resources generated by public institutions and administered by the recipient organisation.[15] From 1998 to 2007, capital income represented, on average, 0.2 per cent of annual fiscal income.

Because of the limited collection of taxes, the Paraguayan government has a very narrow margin for saving and/or for supporting investment in large-scale national projects of a public nature using national resources. This limitation is reflected in Figure 2: from 2000 to 2009, the available tax revenue or surplus[16] (the amount that remained after subtracting public expenditures from income) was often negligible, and was also somewhat volatile.

Figure 2: Fiscal results (as a percentage of gross domestic product (GDP))



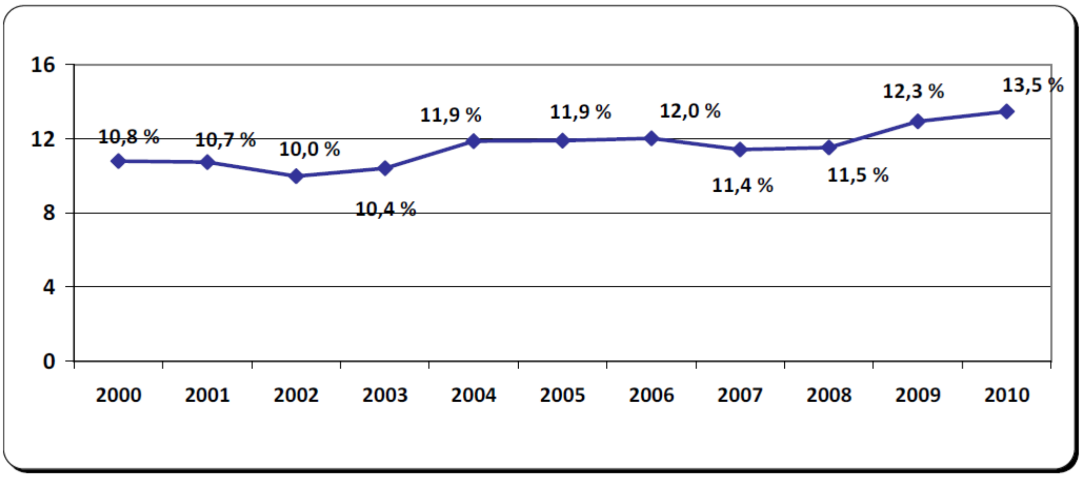
Source: Alarcón (2010) using Treasury data.

This limitation represents an ongoing threat to social policy. In 2011, Treasury Minister Dionisio Borda warned that it was impossible to finance the 2011 Expenditures Budget: '…since economic resources to finance the whole budget are not available, a cutback scheme must be implemented which will reduce the budgets of various public institutions, principally the part that corresponds to social expenditure … these budget cuts will come to more than 629 billion *guaraníes* …'[17] (In other words, 1 per cent of the spending budget for 2011).[18]

Moreover, from 2002 to 2009, salaries, pensions and retirements represented 57.4 per cent of expenditure on average.[19] If payments for external debt are added to this (15 per cent of public expenditure),[20] the result shows that almost 75 per cent of public money is allocated or quite fixed.

Although the treasury has improved its collection of taxes and its balance sheet since 2004 (see Figures 2 and 3), tax revenues have only increased moderately. This is especially noticeable when compared with other economies in the region and, above all, when compared with the country's enormous social needs.

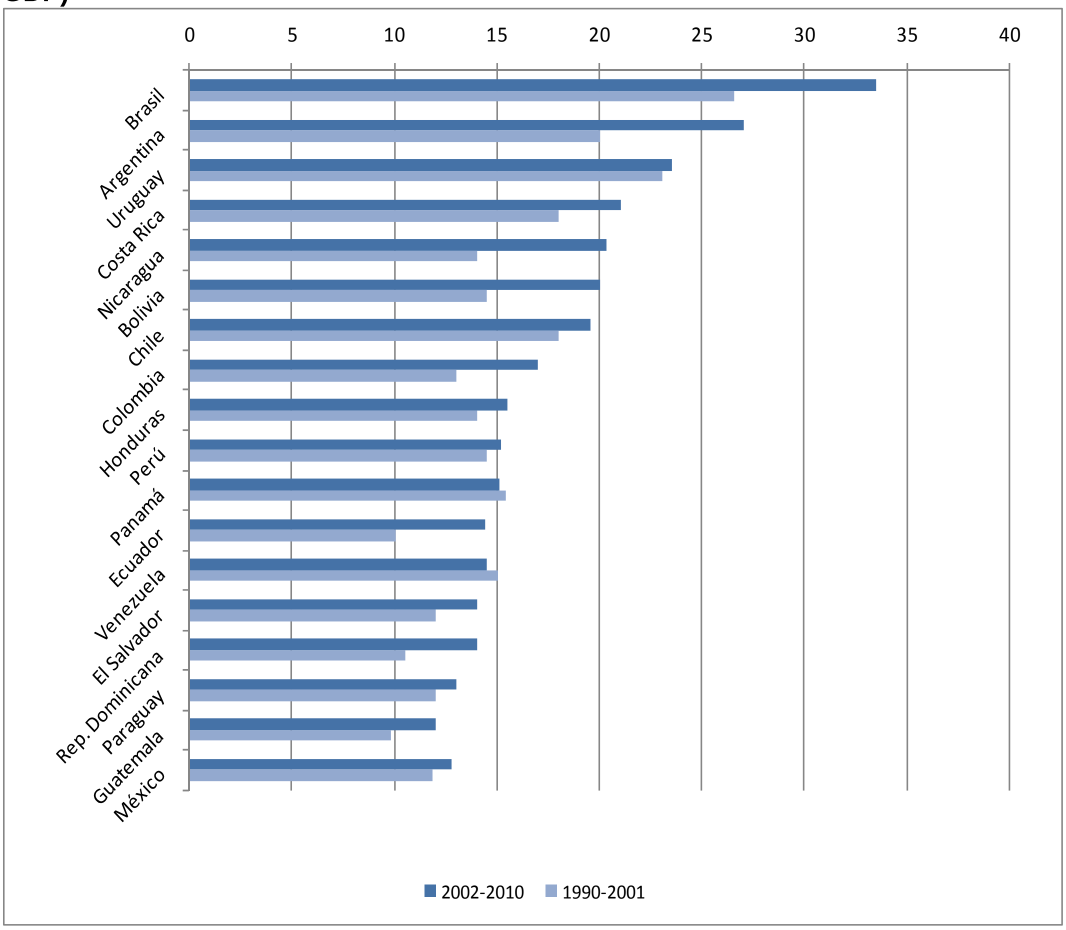
Figure 3: Tax collection in Paraguay (as a percentage of GDP)[21]



Source: Secretary of State for Taxation.

From 1990 to 2010, the rate of increase of the tax burden (including contributions to social security) in the Latin America and Caribbean (LAC) region was 34.5 per cent.[22] However, the increase in the tax burden has been unequal in different countries. Paraguay is among the countries with the lowest increase in tax collection (see Figure 4).

Figure 4: Latin America tax burden, 1990–2001, 2002–2010 (as a percentage of GDP)

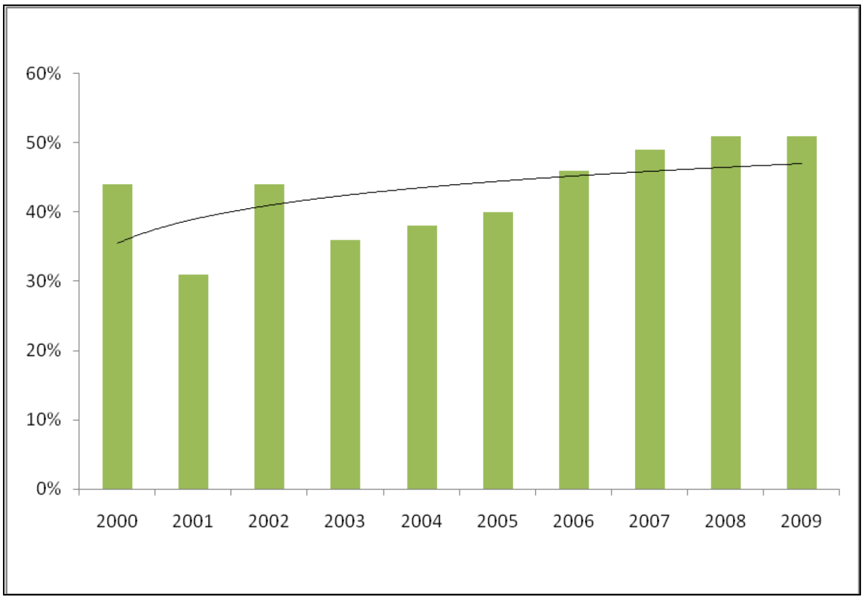


Source: Kacef (2009).

'Countries with a GDP (Gross Domestic Product) per capita equivalent to that of Paraguay, such as Bolivia, Honduras, Morocco, Georgia and Armenia, have a tax burden of between 14.7 per cent and 21.8 per cent of the GDP. Careful IMF calculations indicate that the country should have greater revenues. Its revenue potential in 2009 was 21.8 per cent of the GDP...'[23] This means that there is a major gap, with the current tax revenues amounting to 13.5 per cent of GDP (close to 15 per cent if contributions to social security are included). Other estimates indicate, for example, that Paraguay's potential tax revenues for the 2007–2008 period were 18.8 per cent of GDP – much higher than the 13.2 per cent actually collected.[24]

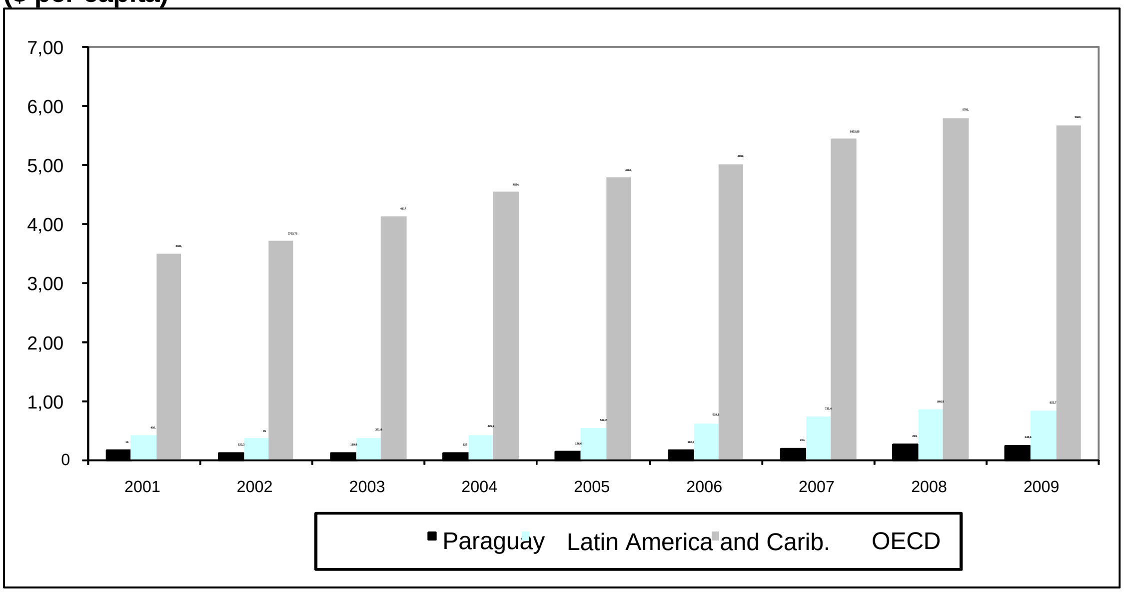
In practice, public spending on social services has increased significantly in recent years (see Figure 5), thanks in part to improvements in tax collection. But Paraguay continues to fare badly compared with other countries in the region (see Figure 6). For instance, social expenditure per capita was three-and-a-half times less than the average for Latin America from 2001 to 2009. This gap is even wider when Paraguay is compared with neighbouring countries such as Argentina, Brazil and Uruguay, which also have economies based on agricultural exports. The annual health expenditure per capita in these countries is about 700 dollars, while in Paraguay it is only 159 dollars per capita.[25]

Figure 5: Percentage of public expenditure on social services in Paraguay, 2000–2009[26]



Source: Oxfam analysis using data from Zárate (2010a).

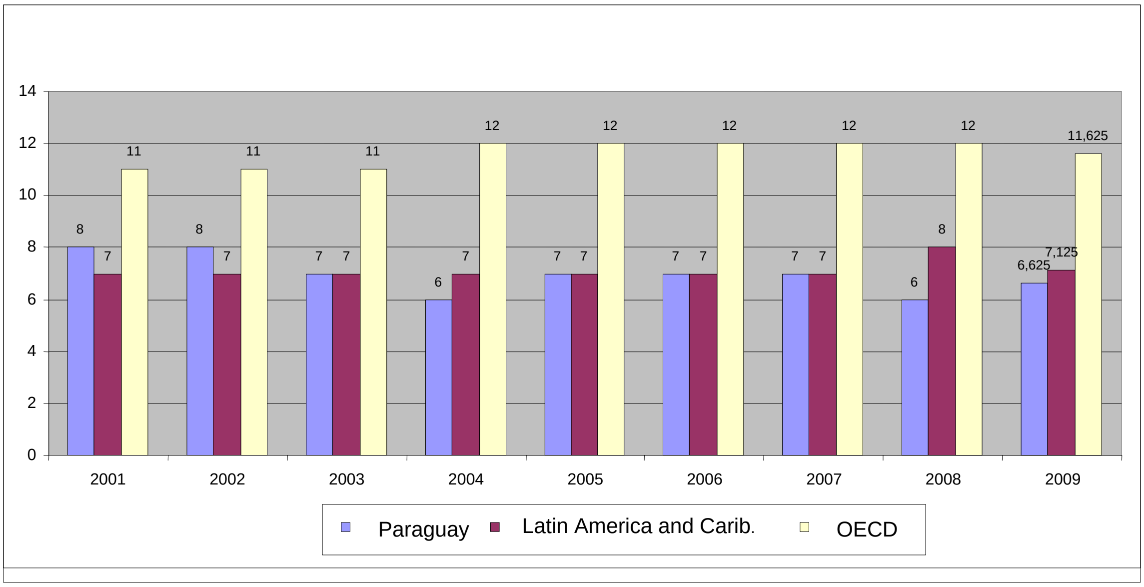
Figure 6: Social expenditure in Paraguay compared with the LAC region and OECD ($ per capita)



Source: Oxfam analysis using World Bank and OCDE data.

When social expenditure is compared with the size of the economy, in proportion to its GDP, Paraguay's social expenditure is similar to that of other countries in Latin America (see Figure 7).

Figure 7: Expenditure on education and health care in Paraguay as a percentage of GDP

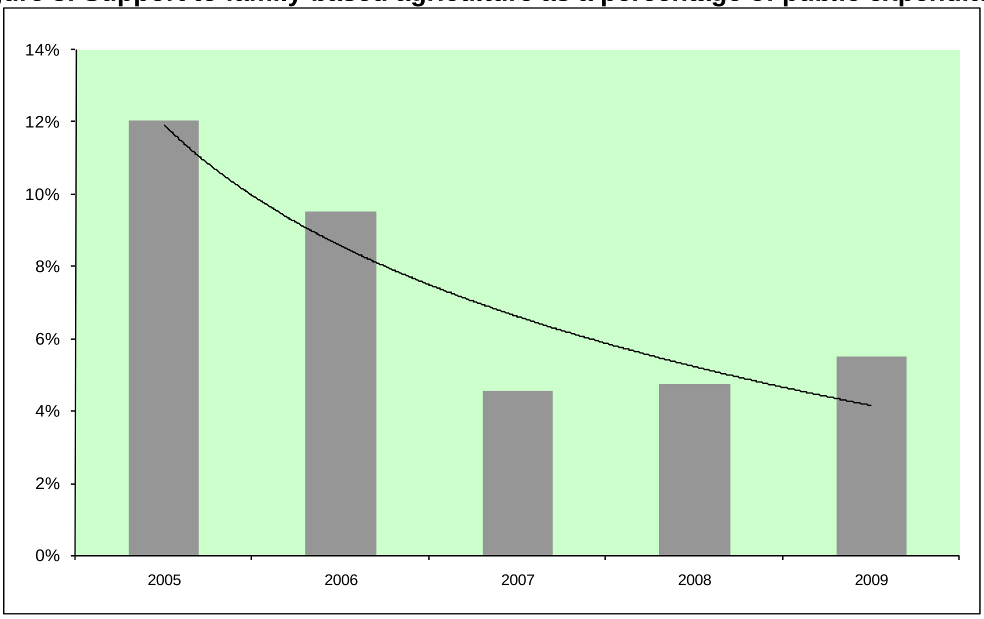


Source: Oxfam analysis using World Bank data and data from Zárate (2010a).

In recent years, public financing for programmes and projects to support small farmers has remained static, at the same level it was at 20 years ago, despite greater public spending.[27] From 2005 to 2009, Paraguay's government budgeted $902m for spending on agriculture. Out of this, it actually spent approximately $588.1m.[28] This represents an average annual expenditure of $118m, with an average implementation rate of 66.3 per cent.[29]

On average, real growth in public expenditure on family-based agriculture was 15.5 per cent, starting at $146.5m in 2005 and reaching $236.5m in 2009. In absolute terms, agricultural spending increased by $66m in the period studied. However, in relative terms, the proportion of public spending dedicated to family-based agriculture has fallen over time: from 10–12 per cent at the beginning of the decade to approximately 5 per cent in 2009.

Figure 8: Support to family-based agriculture as a percentage of public expenditure



Source: Oxfam analysis with data from Ramírez and Zárate (2010a).

The other main problem is Paraguay's tax structure. It is not only important to know how much is collected, but also who is being taxed and what the taxes are levied on. Tax policy has important implications for social cohesion.

With the approval of Law 125/91 (1991), modified and amplified by Law 2421/04 (2004), the tax scheme in force became systematised as a limited set of taxes. Among the direct taxes on business income, four remain in force: the corporate tax on income derived from commercial or industrial activities or those that are not of a personal nature (IRACIS), the tax on income derived from agricultural activity (IMAGRO), the tax on income from services of a personal nature, and the tax on small taxpayer income. Among others, the IRACIS taxes agro-exporters and the income from industrial commercial activity or services related to agribusiness. It does not apply to agricultural producers, who pay tax through the IMAGRO.

There is no personal income tax. The sole tax on capital is the property tax, which is currently under the administration of local governments.

Table 1: IMAGRO (tax on income derived from agricultural activity) in force until 16 January 2012

TAX	**EXTENT**		**METHOD FOR CALCULATING THE AMOUNT OF TAXES TO BE PAID**
IMAGRO	Tax income derived from domestic agricultural activity	WHO PAYS Individuals; companies with or without legal status; associations, corporations and other private entities of any kind; public companies, independent institutions, decentralised organisations and mixed-economy companies; persons or entities that are domiciled or constituted abroad and their branches, agencies or establishments within the country	LARGE PROPERTIES[(1)] Tax base (if cultivable land[(2)] is more than 30 per cent)[(3)]: -Accounting result or simplified scheme (very general or global data on income minus expenses and costs) Tax rate 10 per cent Tax base (if cultivable land is less than 30 per cent): Estimate scheme (COPNAS – natural soil productivity coefficient)[(4)] Tax rate 10 per cent MEDIUM PROPERTIES -Tax base: Estimate scheme (COPNAS)[(4)] Tax rate 2.5 per cent (They can opt for an accounting scheme but must stay for 3 years) SMALL PROPERTIES These are exempt

Source: Oxfam analysis based on various sources. See endnotes 1-4.[30]

After the recent update of the IMAGRO regulation (Act No.8279 of 16 January 2012) tax rates will be maintained at 10 per cent for large properties and at 2.5 per cent for medium properties, and the form of liquidation will be: a) Accounting Scheme: for large estates (natural and legal persons) and b) Estimate scheme: for medium estates, liquidated using the formula: Net income = Zone Productivity (established by the Law) x SAU (agriculturally useful surface) x Average Price. Large estates can only be declared in the Estimate scheme if their SAU is less than 30 per cent.

Table 2: The property tax

TAX	EXTENT	METHOD FOR CALCULATING THE AMOUNT OF TAXES TO BE PAID
PROPERTY TAX (LAND)	Acts as a capital tax; taxes ownership of rural properties, whether they are productive or not. A tax rate of 1 per cent is applied on the tax value.	Rural properties smaller than 5 hectares pay a 0.5 per cent tax rate on their tax value. A property's taxable value is determined by the National Cadastre Service. Large properties (over 10,000 hectares in the Eastern Region and over 20,000 hectares in the Western Region) pay differential tax rates that vary from 0.5 per cent to 1 per cent. Unproductive estates (large properties that are not efficiently or rationally worked) have an additional charge of 50 per cent on the preceding scale.

Source: Oxfam analysis based on various sources.

With regard to indirect taxes, the system essentially bases itself on value added tax (VAT), selective consumption tax (Impuesto Selectivo al Consumo, ISC) and import tariffs.[31] There is no tax on exports.

VAT, a potentially regressive tax,[32] is the main source of tax income for the national government. Its importance has increased over time. In 1993, VAT accounted for 3.74 per cent of GDP, rising to 6.13 per cent in 2008.[33]

As shown in Figure 9, the result of adding VAT, other consumption taxes (such as fuel) and the rights or tariffs on imports accounted for 79 per cent of Paraguay's total tax revenues in 2010 (74 per cent if contributions to social security are included). In contrast, income taxes, which are potentially progressive, represent 17 per cent of total fiscal revenues, while in other South American countries this figure is 31 per cent (Table 3).

Direct taxes, levied on more direct forms of wealth (on both individuals and companies), accounted for just 2.2 per cent of GDP (slightly more than 20 per cent of the amount brought in by indirect taxes). To provide some context: in OECD (Organization for Economic Cooperation and Development) countries, direct taxes account for about 13 per cent of GDP. Part of the reason for this low level of direct taxes in Paraguay is the difficulty of monitoring company transactions and activity. But it is also partly because the IMAGRO contributes less than 1 per cent of total revenues; personal income is not taxed; and the property (land: real estate tax) tax is practically non-existent. In fact, the land tax is included in the 'other income' category in Figure 9 previously referenced, due to its marginal contribution to total revenues.

The small contribution of the IMAGRO and the property tax contrasts with the importance of the agricultural sector in the general economy and with soy agribusiness. In fact, the farming GDP between years 2005 and 2010 was in average 20 per cent of the total and in contrast, the collection of IMAGRO was barely 0.03 per cent of the total GDP[34] and 0.1 per cent of the farming GDP (effective rate) on average[35]. According to the data published by the Paraguay agricultural ministry, the average profit of conventionally cultivated soy agriculture was 69 per cent in 2008. In this estimate, the direct costs of sowing and recollection as well as the indirect costs of machinery amortization and land renting, among others, are included[36]. In the case of direct sowing agriculture the costs are less, and hence the profit was, in this case, 82.08 per cent (according to the data published by the Paraguayan federation of direct sowing for a sustainable agriculture).[37]

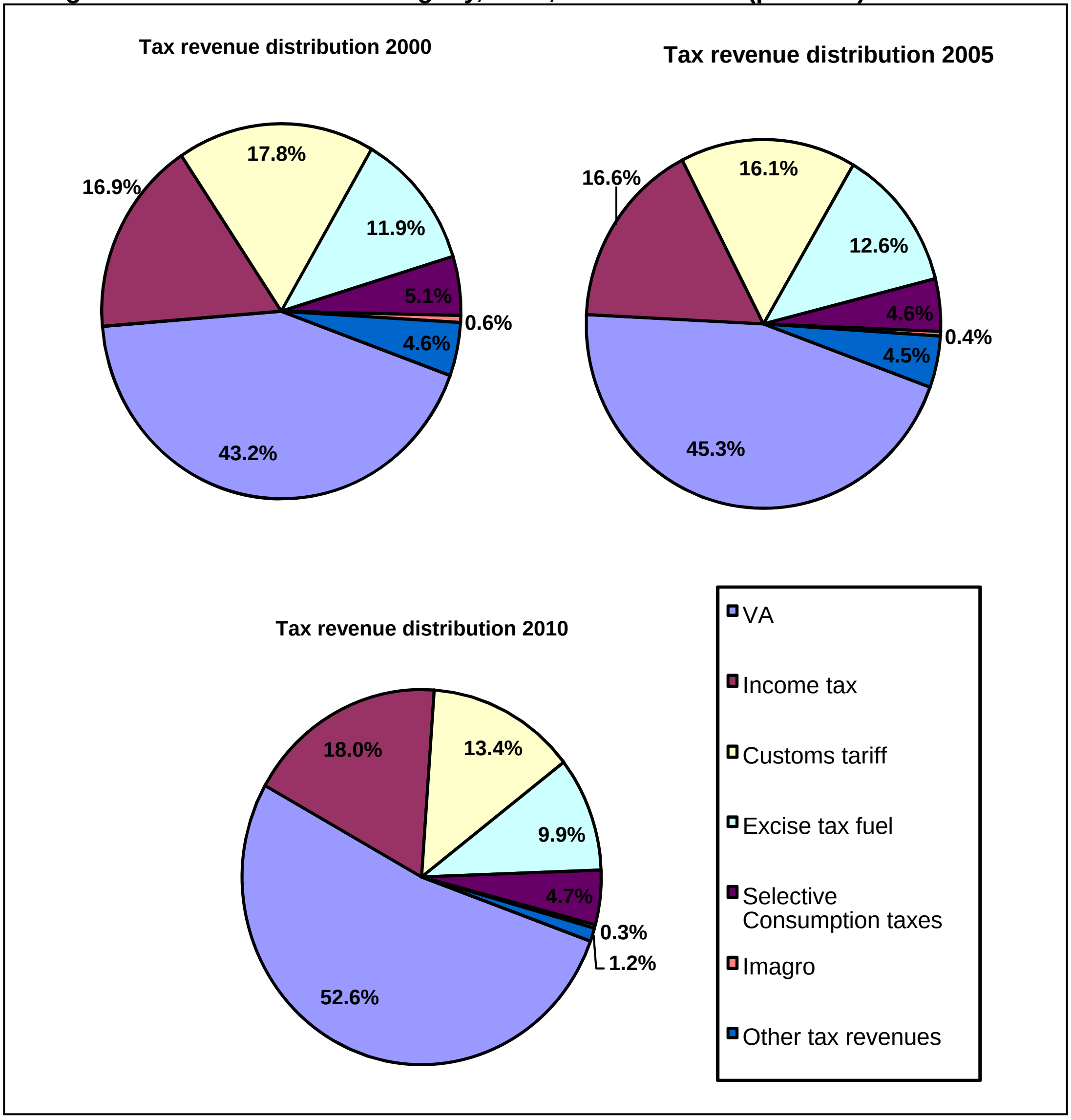
Given the importance of Brazilian investors in the soy sector, another way to calculate the profits obtained by agribusiness investors in Paraguay is to look at the performance of the Brazilian stock index over the past 10 years.

It is fairly reasonable to assume that a rational investor who intends to invest for a period of time in a foreign country – with all the risks involved in exchange rates and geographical distances – would expect that his or her investment would bring greater returns than any that could be made in their own country, in a completely liquid market like the stock exchange. To make this calculation, the Bovespa stock index[38] is used as a reference. In 2001, it stood at 13,936 points,[39] compared with 63,673 points at the close of business on 17 May 2011. In other words, over these 10 years, the index value has risen by 457 per cent.[40] This is without the annual dividends sent out by companies in the market, which would increase the investor's profits even more.

Although gaining access to other markets may be a necessity in order to achieve economies of scale or for diversification, it is not unreasonable to conclude that agribusiness in Paraguay must have brought in an average expected annual profit to its investors of at least 45.7 per cent. Otherwise, rational Brazilian investors would not invest in the soy sector in Paraguay, and would instead have put their money into their own securities market, which is more accessible, totally liquid and risk-free with regard to the exchange rate.

One of the main boasts of the soy farmers is the contribution they make to the treasury via VAT, as a direct or indirect result of this business. Nevertheless, according to the data from the SET, the VAT tax incomes generated by the soy agricultural sector were less than 5 per cent of the total VAT collection in 2010. An internal report of the employer's organization Production Trades Union (Unión de Gremios de la Producción, UGP), access to which was obtained during this research, states that this contribution can reach 20 per cent (data for 2006). Nevertheless, in the report, revenue calculations are not performed with the amount actually collected by the treasury, but based on an estimate, in which tax evasion is not reflected (estimated at around 50 per cent on average). Moreover, among other omissions, the VAT refund of the exports which are exempt is not taken into account.

Figure 9: Tax structure in Paraguay, 2000, 2005 and 2010 (per cent)



Source: Oxfam analysis using Secretary of State for Taxation data.

Table 3: Distribution of taxes as a percentage of fiscal income in Paraguay, Latin America, and other regions of the world

TAX	OECD	EU	USA	SOUTHEAST ASIA	AFRICA	LATIN AMERICA	PARAGUAY
DIRECT	42%	42%	60%	47%	31%	31%	17%
INDIRECT	31%	30%	17%	48%	61%	52%	74%
SOC SEC	25%	39%	24%	5%	8%	16%	9%
TOTAL	100%	100%	100%	100%	100%	100%	100%

Source: Rodríguez (2011) based on data from CEPAL and González (2008).

Finally, as will be shown later in this paper, this bias in the tax structure towards indirect taxes such as VAT has exacerbated existing inequalities. To sum up: in Paraguay, 'taxation is an expression of the vicious circle of poverty and fiscal injustice. The poverty of taxes (low revenues) explains the poverty of the population and is a consequence of the lack of public strength. Tax injustice (the predominance of indirect taxation) conditions social injustice and is a consequence of the poor ability of the people to implement a fairer society.'[41]

Tax reforms and their effects on agribusiness

Law 125/91 and the law modifying it, Law 2421/04, cover all matters related to Paraguay's tax policy. The primary strength of the 1991 law can be summarised as advances relating to efficiency, achieved by simplifying and rationalising the tax system. However, it would seem that the achievements in this area were compromised in part by the numerous exemptions and tax incentives that were granted in the 1990s, which negatively affected the efficient collection of taxes (see Box 1).

Box 1: The precedents: Law 125/91 (1991)

Prior to 1991, the tax system was anachronistic and obsolete. Its main component was the tax on stamped paper and tax stamps that had been regulated most recently under Law 1003 of 1964.[42] '...It was absolutely necessary to carry out a tax reform that would simplify and make objective the rules and regulations with taxpayers, and generate real tax revenues that through their logic would maintain due correlation to the evolution of the real economy and prices…'[43]

Under Law 125/91, the number of taxes was reduced from more than 80 to 9, the administrative system was simplified, and a value added tax (VAT) was implemented. Tax income began to rise in the first half of the 1990s, principally due to the implementation of the new tax system, as well as the strengthening of trade at the triple frontier.[44]

However, starting in 1994, when Law 125/91 should have come into full effect, a number of laws were approved that granted benefits, incentives or privileges to certain economic sectors. In this way, the most important tax bases began to be eroded, particularly corporate income tax and VAT.[45]

From 1992 to 2002, Congress made the most of its ability to present bills on tax matters and other topics involving the private sector, and approved 42 reform laws. It added various exemptions, especially for the industrial sector. The main exemption consisted of a five-year moratorium on the payment of all taxes for companies that presented reasonable investment projects, even if they were never carried out. In this way, any company could avail itself of the moratorium and renew it. During this period, the tax rate on profits remained at 30 per cent, but companies, on average, paid only one-tenth of that as a consequence of exemptions and semi-legal alternatives.[46]

Likewise, the agriculture-livestock interest groups in particular, who wielded tremendous political and economic power, were able to prevent an updated assessment of property values for tax purposes, for example.[47]

At the end of 2003, there were more than 40 laws that provided for tax advantages or incentives. It must be emphasised that there is an urgent need to establish the real magnitude of the tax revenue losses stemming from the exemptions granted by successive Paraguayan governments.[48] It is also important to know exactly what kind of tax incentives have been used, and their impact on jobs and productive investments.[49]

Source: Oxfam analysis based on Alarcón (2010), Stein, Tommasi, Echebarría, Lora y Payne (2006) and Itriago (2011).

However, the tax reform of 2004 (see Box 2) was more positive with regard to generating tax revenues (the impact of which can be seen in Figure 2). But despite the fact that the tax burden in Paraguay in 2010 was the highest in the country's recent history, the tax structure is not consistent with either the economy or its level of development (measured in terms of GDP), aside from bringing in low revenues and being biased toward regressive taxes. In fact, public accounts began a modest improvement in 2004 that continues to this day (Figures 1 and 2). However, Paraguay's tax revenues continue to be fairly low by regional standards. It has only registered a moderate increase, especially compared with other economies, and particularly if the country's immense social needs are factored into the equation.

Box 2: The 2004 tax reform: a small step forward

In April 2003, Nicanor Duarte Frutos[50] was elected as President for the 2003–08 term. That year, a partial tax reform was undertaken with the enactment of Law 2345 on the National Treasury (December 2003). This reform involved changes to the retirement and pension system for the public sector, which had a growing operational deficit that was absorbed by central government.[51]

In the first two years of the Duarte Frutos administration, and under the leadership of Treasury Minister Dionisio Borda, there were four important treasury reforms aimed at improving the tax balance by combating internal corruption.[52] Nicanor Duarte replaced the government's top elite with people known for their professionalism. The heads of the Tax Administration and the National Customs Management were replaced and full support was given to a group of technocrats who were given responsibility for drawing up new policies.

The Duarte Frutos administration also decided to undertake a thorough tax reform in exchange for the support of an emergency plan funded by the International Monetary Fund (IMF). In 2004, the administration proposed the implementation of a broad tax reform (Fiscal Adjustment Act – 2421/04).

In its purest version, the tax reform included the formalisation of the economy and sought to correct the very low tax burden. The strategy to accomplish this consisted of maintaining low tax rates (it made the rate for direct and indirect taxes the same, at 10 per cent), broadening the tax base, and incorporating new taxes. Among these were a personal income tax (thwarted in the previous reform) for individuals with high income, as well as adjustments to the agricultural income tax in order to tax the income of large producers. At the same time, it included a greater generalisation of VAT and the elimination of tax exemptions. It also strengthened the Tax Administration, giving it independence and greater responsibility, and increased its funding by assigning it a portion of the taxes collected.

The reform was only partially implemented. One of the greatest successes was the increase in the number of taxpayers, which indicated greater formalisation in the economy[53]. However, the personal income tax was not implemented, and the agribusiness sector retained its privileged position (see Box 3), thus eroding the contribution of the wealthiest sectors of the population. This was due both to a clear intention to lighten the tax burden, and to the loopholes that remained.

Source: Oxfam analysis based on various sources.

Special treatment for agribusiness

In effect, the 2004 reform resulted in a tax framework that was favourable for the agribusiness sector (see Box 5).

Box 3: Main form changes introduced between 1991 and 2004 which had an impact on the taxation of agribusiness

- IRACIS (corporate tax): The general rate was reduced from 30 per cent to 20 per cent in the first year after it came into effect (2005), and from the second year (2006), it was reduced permanently to 10 per cent (one of the lowest rates of the Latin American region with respect to business income taxes[54]). A differential rate of 5 per cent was introduced in the event of profits distribution, with a 15 per cent rate for the remittance of dividends abroad. Various general or particular laws that established special regimes for corporate income tax were repealed,[55] but special regimes for the agricultural export sector remain in place.
- IMAGRO: The determination of estimated gross income[56] (12 per cent of the tax valuation of rural properties) and of net income[57] by approximate values of production costs was replaced by a more objective system of declared values, although these are still difficult to verify (see Box 5). The tax rate was reduced from 25 per cent to 10 per cent for large properties, and to 2.5 per cent for medium-sized properties. Compensation[58] for 100 per cent of the VAT paid for the acquisition of goods and services related to production was introduced for medium-sized producers. Exemption from this tax is maintained for estates smaller than 20 hectares.
- VAT: The taxpayer base was broadened. VAT on medicines and essential items for the family basket was maintained, but with a higher average nominal rate (going from

0–10 per cent to 5 per cent). Raw agricultural products remained exempt. Exports and the manufacture of capital goods were also exempted.[59] [60] VAT was extended to include commercial transactions that were previously exempt, such as the import of crude oil and the marketing of petroleum-derived fuels, among others.

- Selective Consumption Tax: The consumption tax on petroleum fuels was maintained at 50 per cent. However, diesel fuel received a significant state subsidy. The agribusiness sector uses fuel intensively to move sowers, sprayers, harvesters and tractors.
- Tax on Acts and Documents: This was revoked. Among other features, it gave the executive branch legal authority to tax the export of raw products, with a tax of up to 12 per cent.
- Property tax: No changes.

Source: Oxfam analysis based on various sources.

3 LOOPHOLES, CONTRADICTIONS AND INEQUALITY OF THE PARAGUAYAN TAX SYSTEM

Tax dodging

There is no precise estimate of how much the Paraguayan state loses in tax revenues due to tax evasion. Some organisations claim that it loses nearly one-third of its legitimate income due to tax evasion.[61]

Despite the good VAT collection performance[62] observed after the 2004 reforms, the IMF calculates that evasion of VAT in Paraguay stands at between 45 per cent and 55 per cent. It is hard to pinpoint the evasion levels with regard to income tax. This may be consistent with the overall tendency in Latin America, where efforts to estimate income tax evasion have been few and far between.[63] There are even claims of massive imports of merchandise (as part of the black market) without total tariff payment.[64]

The Personal Income Tax (IRP) was created in 2003, but it has not been possible to implement it. In 2007, after four years of strong opposition by powerful economic groups, the IRP was suspended until 2013 by Law 4064/10. The real reason behind this resistance seems to be the fear of having to make a legal declaration of goods and sources of income.[65] But failure to implement the IRP has created a major gap in the general tax system, and is an incentive for businesses to avoid taxes on corporate income in particular (IMAGRO and IRACIS).

The Lack of income tax collection (IRP), not only lessens resources for the treasury, but is also a handicap in the process of normalization of the economy.[66][67] In practice, the absence of an income tax usually makes it easy for the business sector to avoid taxes. In this regard, Paraguay is moving in the opposite direction to the general trend among developing countries, where there is a greater alignment or harmonisation between corporate and personal taxes.[68] This gap, in the case of Paraguay, gives rise to situations of 'arbitration',[69] which makes the tax process carried out by the Tax Administration even more complicated.

Arbitration, in this context, means looking for the option that results in the lowest tax bill. For example, passing off professional income (that of accountants or lawyers, for example) as the operating expenses of other, larger companies in an arrangement that allows the latter to reduce their tax burden. The same thing happens with a businessman who can bill his own company, thus reducing profits. As he does not have to pay tax on his personal income, he could divert potentially taxable resources from the company to other areas where taxation is lower, or that are exempt. In fact, there is in Paraguay a tax on the income of services of personal nature that applies when activities of personal nature are carried out (as is the case of accountants, auditors or commissioners) and incomes are generated.[70] Nevertheless, in 2010, the contribution to treasury of this tax equalled zero, which fuels suspicions of the possibility of tax avoidance.

Moreover, it is worth emphasising that the IRP project would only affect those individuals with non-corporate income greater than $30,000 a year, with a maximum tax rate of 10 per cent. The numerous deductions and exemptions mean that this tax is fairly insignificant in terms of revenue collection.[71] Ironically, the law could even encourage tax evasion, since those who are exempt from the tax (the vast majority of the population) could give or sell their bills for deductible expenses to those who would be obliged to pay it. The people obliged to declare (those earning over $30,000 a year) would be able to deduct family expenses for upkeep, education, health, clothing, housing and even recreation – in other words, almost any expense.

The difficulty of tracing the activities of transnationals

Another element that complicates the state's ability to monitor the taxes owed by businesses, and the agribusiness sector in particular, is the fact that most companies are part of transnational groups, usually with complex structures related to companies based overseas.

The agribusiness sector is made up of a chain of processes that range from the provision of inputs and machinery for agricultural production, to production itself, the harvest, marketing and processing of raw materials, and, finally, distribution of products to the consumer. Different companies carry out different stages in the production and distribution process; some of them specialise in just one process, while others carry out more than one. There is a significant degree of vertical integration in agribusiness (the degree to which a firm owns the different parts of the supply chain).

In Paraguay, exports are controlled by six transnational companies (of which five are also significant players in the imports sector). The process of importing and providing inputs is controlled by eight transnational corporations which carry out their business in the country directly, through a subsidiary.[72] The relatively small amount of goods that are processed within the country is controlled by five companies that represent four transnational corporations. Of the 12 transnationals that operate directly in Paraguay's agribusiness sector, five have their headquarters in the USA, six in Europe, and one in Asia. Other, smaller companies with domestic or regional capital work along with these companies, complementing and supporting their activities.[73]

The larger companies have greater possibilities for tax dodging through conducting transactions between interrelated parties.[74] These facts further complicate the possibility of Tax Administration control (see Box 4).

Box 4: The scant control on the operations of transnationals

A report published by Global Financial Integrity (GFI) shows that even by conservative estimates, the illegal flow of resources (diverted from developing countries and potentially taxable) amounted to between $1.26bn and $1.44bn from 2000 to 2008 on average.[75] From 2002 to 2008, approximately half of these resources were diverted through manipulation of prices in the intra-group transactions of multinational corporations (trade mispricing). The remaining funds were lost due to corruption and criminal activities. In the case of Paraguay, GFI estimates that this loss amounted to between $476m and $582m each year.

Tax havens are a clear incentive to businesses to evade and avoid national taxes: they represent a 'black hole' in international finance. They also promote unfair corporate practices.[76] GFI estimated that from 2002 to 2006, the (very conservative) figure of potentially taxable income lost in Paraguay due to 'under-billing of exports' and 'over-billing of imports' among related or non-related companies was around $60m a year.[77]

Recently, the Vice-Minister of Taxation, Gerónimo Bellasay, criticised those who send soybeans abroad without paying taxes on what they really earn, indicating that the treasury stopped receiving tax income due to price alterations within export companies in that sector.

'Normally, according to declarations of past years, companies declare a profitability of 3 per cent to the Treasury… If these companies had put their money into fixed-term deposits, the profitability would be higher… But apparently (the agro-exporters) are doing us a favour and are losing money in order to take our soybeans abroad… If the sale prices declared by these companies are examined, the declared price (FOB price[78]), including transportation to their destination, differs by 20 per cent from the price of the beans on the international market…'[79]

Calculating how much agro-export companies contribute to the country, the Vice-Minister mentioned that $1.8bn was earned for the export of soybeans in 2010. He stated that, even supposing that the difference in price were only 10 per cent, the losses incurred in 2010 would amount to $54m: $18m from corporate income tax, $9m from the 5 per cent tax on the distribution of profits, and $27m from the 15 per cent tax on the transfer of profits abroad. What is interesting is that this figure is consistent with the GFI's estimate.

Everything related to transfer prices is unregulated in Paraguay. There only exists one general mention of what is to be taxed under the income tax applicable to import and export transactions, and for those transactions carried out between branches and their headquarters abroad. There are no specific legal requirements for minimum sales prices for transactions carried out between local taxpayers, whether or not the parties are connected.[80][81]

Source: Oxfam analysis based on Kar and Cartwright-Smith (2008), Freedom House (2010), Ultima Hora (2011), Amaral and Associates.

Loopholes in the IMAGRO and property tax

In particular, the very low contribution of IMAGRO to the treasury has a special connotation for small farming: '... Law 2419/04 "Which creates the National Institute for Rural and Land Development" (INDERT)[82] adds to its structure the Rural Investment Fund for Sustainable Development (FIDES), whose resources are destined to the planning, design and execution of infrastructure works (roads, schools, health centres, etc.) which are necessary for the settling and development of the communities who receive it, in new and old settlements. Among its financing sources, FIDES includes 80 per cent from collecting the IMAGRO, which has to be made available every year by budgetary means...'[83] [84]

Something similar happens with the property tax. (see Boxes 5 and 6), with the additional element that the limited collection of this tax could have implications for the very unequal pattern of land tenure.

Box 5: Loopholes in IMAGRO

IMAGRO has a number of loopholes. The very low level of revenue it brings is the result of certain design flaws in the Paraguayan tax system, of ad hoc decrees favouring agribusiness, and of obstacles to its implementation, including effective controls and sanctions. The tax contribution per producer under IMAGRO reached in 2010 449,000 *guaraníes*. While still low, tax collection from IRACIS (from all other sectors in the economy, including exports) amounted to 11m *guaraníes* per taxpayer.[85]

During the first transition government (General Andrés Rodríguez), Law 125/91 was passed, which created the IMAGRO. In article 30, which deals with gross income, the law says that 'annual gross income[86] shall be determined in an *estimated* manner, applying a rate of 12 per cent to the sum of the tax value of the hectares in the taxpayer's rural properties, whether the taxpayer is the owner, tenant or holds any type of title on the land'. This method was in force until 2004. As shown in Box 6, the tax value of the land is minimal compared with market prices for land.

Until 2004, certain deductions were made when calculating taxable[87] net income, such as: (a) 40 per cent of gross income for expenses necessary to obtain and maintain the property (or 45 per cent if the taxpayer did not own the property); and (b) the amount of VAT corresponding to the acquisition of goods or services affecting the agricultural activities taxed under this tax.

From its beginnings in 1991, IMAGRO has been applied differently depending on the size of the property. While large properties are subject to the 10 per cent regular tax rate, medium-sized properties are subject to a estimated income tax regime of only 2.5 per cent. Due to the limited capacity to supervise the whole country and the lack of a rural cadastre, this differential treatment creates an incentive to artificially subdivide the properties into small estates in order to pay less tax[88]. Moreover, there continues to be a margin for declaring taxes on an *estimate scheme* and not an *accounting* scheme, which is relatively more reliable. In fact, the vast majority of producers make their declarations using the estimate scheme[89] or the simplified scheme.[90] [91]

On the other hand, as indicated above, there is no thorough accounting or exhaustive monitoring of rural contracts[92] registered with the Tax Administration, let alone any material means, computers or technology for investigating rural contracts that are not registered. The reality, confirmed by the Vice-Minister of Taxation, is that: '...the form for the sworn statements of the... (IRACIS) does not allow identification of the income that rural landowners have obtained from the rental of their estates… This makes it impossible to cross-check data with the sworn statements of the IMAGRO.'[93]

Under Decree 5069/05, VAT payments made by all producers for goods and services could be calculated as a credit against the final balance to be paid for IMAGRO, and could be carried forward to future declarations if the VAT credit was greater than the tax obligation in a given year. According to the 2004 tax reform, this advantage could only be assigned to medium-sized producers. Under pressure from large producers, Nicanor Duarte introduced the 2005 modification, seriously limiting IMAGRO's tax collection capacity.

In September 2008, Fernando Lugo issued a decree that rectified the previous scheme, depriving the large-scale IMAGRO taxpayers of this illegal benefit. However, the same decree made it possible for the VAT payments accumulated in previous years up until September 2008 to be used to pay IMAGRO until they were used up.[94] The Paraguayan state thereby lost several million dollars. According to information supplied by the Secretary of State for Taxation, the total benefit for large producers meant 762m *guaraníes* in losses for the Treasury between 2006 and 2009: 20 per cent of the public spending in health during this period and 50 per cent of the health budget in year 2009.[95] According to witnesses of this same organization, some controls show corrupted data, namely, invoices that were purchased in order to appeal for more tax credit with the consequent harm to the public funds: "The SET detected the misuse of tax credits with a value of *Guarani* 56,000 million ($14 million) by the IMAGRO contributors".[96]

In order to complete this picture, there are deductions whose monitoring difficulty creates doubts about the nature of their aims: for example, there is a deduction of 20 per cent for costs in helping natural persons who own small adjacent properties. Following this same logic, Law 3001/06 of Valuation and Retribution of Environmental Services also has an impact on the IMAGRO collection. According to it, the Certificate of Environmental Services is a negotiable title that can compensate taxes like IMAGRO and others.[97]

Recently (16 January 2012) the legislation of IMAGRO has been modified, and although it is too soon to appreciate the global impact not only on collector sufficiency[98] but also on equity, it is true that some of the amendments are aimed to overcome some of the limitations described here: large properties have until the year 2012 to deduct the tax credits (accumulated until 2008) derived from the purchase of goods or the contracting of services which include the payment of VAT.

Source: Oxfam analysis based on various sources.

Box 6: The land tax, a risible tax

According to the World Bank,[99] rural properties in Paraguay annually pay barely the equivalent of 0.04 per cent of GDP for property/land taxes, in total. This is lower than the average for Latin America (0.94 per cent of GDP) [100] and much lower than in developed countries (where land taxes account for 1.8 per cent of GDP).[101]

At current values, that means about 28bn *guaraníes* a year (just over $5m). If we take into account that in the whole country there are about 30m rural hectares (excluding urban areas, lakes, rivers, motorways, roads, public land, etc) in the hands of the private sector, the resulting situation is that the average direct tax on rural land in Paraguay is less than 1,000 *guaraníes* per hectare per year[102]: around $0.23 per hectare per year.[103]

This tax is calculated according to the land's tax value, which is not based on market prices. Based on a representative sample of 455 properties, the World Bank's study calculated the average market value of land in Caaguazú at $1,100 per hectare. The land values vary from an average of $360 in the district of Carayao, to an average of $1,969 in the district of José Eulogio Estigarribia, where soy is grown. This wide variation in market values shows a great contrast to the low level and narrow range of the tax values applicable to Caaguazú's 20 districts, which vary from $17 to $29 per hectare. Some of the districts with the highest market value (Mariscal López, for example, at $1,642 per hectare) are still assigned the lowest tax value ($17 per hectare).

On average, it is estimated that the market value of land in Caaguazú ($1,100) is 54 times greater than the average tax value of $20. In other words, the average tax value is only 1.8 per cent of the average market value.

The law specifies that tax values cannot exceed the inflation rate.[104] This results in a permanent situation of sub-valuation that contrasts with the trend in market prices. According to the World Bank, Paraguay's land tax values have dropped in real terms since 1993.

Collection of the property tax is the responsibility of the municipalities. Local authorities do not seem to have real incentives to jeopardise their political position by collecting this ludicrous tax. The municipalities receive royalties (of hydroelectric power stations) that pay for approximately 22 per cent of local expenditures.

The extremely low taxes often promote the use of land as a form of saving and speculation, a factor which could be directly linked with the maintenance of the unequal distribution of land.

Source: Oxfam analysis based on World Bank (2007), CEPAL (2010), De Cesare and Lazo Marín (2008), ABC(2009).

Tax exemptions

Direct taxation is sustained almost exclusively by the IRACIS tax. The general IRACIS rate is 10 per cent, to which 5 per cent is added for profits distribution and an additional

15 per cent for remittances abroad. However, this tax is still subject to some full or partial exemptions such as: the Maquila Act (Law 1064/97);[105] the issuing of shares on the stock exchange (until the advantages granted are exhausted, given that no new privileges can be awarded); processing in Free Trade Zones (Law 523/95);[106] the Forestation law (Law 536/94); and Leasing law (Law 1295/98), among others.

In spite of these 'incentives', both foreign and local investment continues to be very low. Perhaps this is because these advantages are not really perceived as incentives to promote investments with real added value for the country and/or as an effective means to fight poverty.[107] In practice, it seems a good part of foreign investment is in the form of land purchases,[108] and there has not been any great industrial development generating employment that requires intensive local labour. On the contrary, the opportunities for working with decent conditions (a contract, wages at least equal to the legal minimum, working enough hours a week, health insurance and access to a retirement or pension system, among other conditions), are restricted by the large informality of rural labour.[109]

And if we consider the way the size of industry has changed,[110] a de-industrialisation process is under way that became more pronounced starting in the 1990s, which, ironically, was the decade of tax incentive growth in Paraguay. In 2008, industrial production reached its lowest level, accounting for just a 13.7 per cent share of GDP. At the beginning of the 1990s, it accounted for 17.5 per cent. In contrast, agriculture went from less than 13 per cent of GDP in 1986 to 21.8 per cent in 2008.[111]

Inequality in Paraguay's tax system

'The terms of discussion on modification of the tax system (Law 2421/2004) revolved around greater justice and equality (horizontal) in tax payments in order to broaden the tax base [in the number of taxpayers and taxable conditions], but little or nothing with regard to the objective of a better allocation of resources and/or improving the distribution of income and wealth…'

Manuel Alarcón (ex-Vice-Minister of Economy, Treasury)

At present, VAT is applied to all goods except for a limited basket of goods that are exempted, which are generally goods that are in a raw or unprocessed state. Some of the exemptions seek to reduce the burden on the poorest sectors of the population and increase vertical equity, avoiding increases in final sales prices. However, the list of goods and services that are exempt is not limited to basic consumption goods and services, which dilutes its goal of equality (progressiveness) and reduces the tax base. This also reduces the contribution made by VAT to the public treasury for spending on revenue redistribution policies.

Likewise, Box 7 shows the slight difference between nominal rates of excise tax on general goods and services (VAT) compared with those taxed goods and services usually consumed by richer people (selective consumption tax).

Box 7: Tax rates on consumer goods/services (since 2004)

VAT

- Up to 5 per cent on products in the basic family basket (rice, noodles, oil, flour, iodized salt, milk, meat and yerba mate, a herbal drink)
- A permanent 5 per cent on contracts permitting the use of goods (personal, real and intangible property), sales of real property
- 5 per cent in transition for medicines and financing. After two years (2006), it would be increased by one point per year until reaching the general rate of 10 per cent
- 10 per cent on everything else

Selective tax on consumption

- With the exception of the tax on fuel consumption, with a maximum rate of 50 per cent, everything else (luxury goods in general) has a minimum rate of 12 per cent.
- E.g., champagne, and flavoured cigarettes or those made of Egyptian or Turkish tobacco, are taxed at 12 per cent and natural or cultivated pearls at 5 per cent

Source: Oxfam analysis using Law 2421/04.

During the discussions around the 2004 tax reform process, powerful private interests with connections close to the public sector orchestrated a successful media campaign to convince public opinion that the proposed reforms were socially regressive. In the face of this opposition, the executive branch was obliged to withdraw the original proposal for introducing VAT for agricultural areas, due to the resistance put up by powerful soy producers.[112] Although the concerns about the proposed reforms being socially regressive were valid, soy is not a product that is widely consumed (less than 5 per cent of production is destined for internal consumption). The vast majority of soy production is exported in its raw state. Exports are VAT-exempt in most countries because VAT is a tax on consumption, not on production; exported products would never have been taxed even if the measure had been implemented.

The richest households consume a significantly smaller percentage of their incomes than the poorest households, which are not able to save and therefore consume all of their income. Although there are 'well designed exemptions and differential rates', it is likely that VAT as a percentage of income is lower in wealthier households than in poor households. It is therefore a regressive tax, and affects the possibility of saving resources to invest in social services and/or in productive activities.[113]

The results of a study on tax equality in Latin America indicate that VAT implemented in Paraguay in 1991 and updated as part of the reform of 2004[114] is regressive with regard to income (see Box 8).

Box 8: VAT – a regressive tax

The information in Table 4 below classifies households according to their per capita income and per capita consumer spending. Table 4 compares the 1991 tax scheme (Law 125/91) and that of 2004 (Law 2421/04) in order to observe the effects of the tax reform on tax equity indicators.[115]

VAT appears as regressive when households are grouped according to their per capita income: the tax's average rate progression is reduced almost systematically as the income bracket rises. As income rises, the proportion of total income represented by VAT becomes smaller.[116] The 2004 tax reform does not seem to have reduced the regressive effect of the tax, although the tax proportion increased throughout all population deciles. In both law regimes, the tax's regressive nature and, therefore, the deterioration in the distribution of post-tax income, can be seen by observing the tax's quasi-Gini coefficient[117] (0.4408 and 0.4504 respectively), the increasingly negative Kakwani index (-0.1170 and -0.1075)[118] and the Gini index (of the income) before and after the tax policy.

When the focus is shifted to per capita consumption among households, the sales tax becomes progressive. In other words, the proportion of the tax on household consumption becomes greater as consumption increases. But this result is consistent with studies on progressiveness and effect in other developing countries: consumption is distributed in a less unequal way than income.[119]

A tax can be strongly progressive, but if its collection is negligible, its redistributive capacity will also be negligible. Whether considering income or consumption, VAT's redistributive capacity is limited because the Gini coefficient only increases as a result of the distribution of equivalent income (with the tax deducted) by close to five-tenths of 1 per cent (-0.0052 and -0.0054 respectively) according to the Reynolds-Smolensky (R-S) index.[120]

Source: Oxfam analysis based on Alarcón (2010)

Table 4: Indices of VAT progressivity and redistributive capacity based on tax regime

Figures by household	Income according to per-capita income		Income according to per-capita consumption	
	Law 125/91	**Law 2421/04**	**Law 125/91**	**Law 2421/04**
Progressiveness: average rate	7	7.5	4.1	4.5
Decile 1	24.1	24.6	3	3
Decile 2	6.2	6.4	3.3	3.5
Decile 3	6.9	7.1	3.6	3.8
Decile 4	5.1	5.6	3.5	3.9
Decile 5	5.3	6.7	3.9	4.4
Decile 6	5	5.6	4.1	5.4
Decile 7	4.7	5.2	4.6	5
Decile 8	4.3	4.7	4.7	5.2
Decile 9	4.4	4.9	5.2	5.8
Decile 10	4	4.6	5	5.6
Cuasi-Gini	0.4408	0.4504	0.5202	0.5242
Kakwani	-0.117	-0.1075	0.0672	0.0712
Redistributive capacity				
Income Gini before tax policy	0.5578	0.5578	0.453	0.453
Gini after tax policy	0.563	0.5632	0.4498	0.4491
Reynolds-Smolensky	-0.0052	-0.0054	0.0032	0.0039

Source: Alarcón (2010)

A more recent study confirms that the average rate (payment of VAT/income) tends to decline as income increases, confirming the regressivity of the tax using income as a welfare measure – the poorest 20 per cent pay 18 per cent of their income as VAT, while the richest 20 per cent pay 14 per cent.[121] The same report notes that some of the VAT exemptions prevent it from being more regressive because a tax without exemptions would increase the portion of income from relatively poor people (20 per cent poorest of the population) dedicated to the payment of this tax (from 18 per cent to 23 per cent).[122] However, it would also raise the portion (income tax) of the richest 20 per cent (from 14 per cent to 17 per cent).[123] This seems to confirm that, in Paraguay, VAT exemptions affect the entire population.

Another of the consumer taxes relevant to the question of equality is the selective tax on fuels. Analyses of its redistributive effect often provide very different results depending on whether only the direct impact is considered (payment of the selective tax on fuel using a private vehicle) or whether indirect impacts are also examined (payment of the selective tax for the consumption of fuel involved in the transportation of household members). Experience indicates that if only the direct impact is considered, the conclusion is often that the tax is strongly progressive, while if the indirect impacts are also considered, it is regarded as regressive.[124]

The report mentioned above (Alarcón 2010) establishes that if only the part of the tax that directly affects households through the purchase of fuel is considered, in the framework of Law 125/91, the tax is progressive,[125] although it has a marginal redistributive capacity.[126] However, although under the revised 2004 tax regulations the tax does not lose its progressive character,[127] its redistributive capacity is reduced even further.[128] [129]

It is a paradox that Petropar, the state company that supplies fuels, sells to a loss and had in 2008 an estimated debt of $400m. This is fundamentally due to subsidies.[130] [131] According to a report published by ECLAC (Economic Commission for Latin America and the Caribbean),[132] the consumption of diesel fuel represented 80 per cent of total consumption. This is owing to successive governments' policies on prices and subsidies.[133] However, approximately 30 per cent of diesel fuel is consumed by the agriculture sector (mainly soy producers with more and better machinery). Fifty per cent is consumed by middle- and upper-class households with private cars and vans, and only 20 per cent is used for industry and transportation in general.[134] Some analysts suggest that from 2003 to 2008, the subsidy received by the agribusiness sector, based on the reduction of its production costs, was greater than $100m. This estimate only covers soy production; it does not include other mechanised categories such as corn, sunflowers or wheat, which, if included, would mean that the subsidy received by this sector was even greater. [135] All of this is fairly consistent with a general criticism of agribusiness in South American countries: the subsidies, loans, tax exemptions and major irrigation structures provided often benefit large-scale producers at the expense of small farmers, who receive little in the way of funding and technical support. The rural population is assisted through social programmes often based on cash transfers that try to compensate for the low incomes associated with family-based agriculture. In fact, reinforcing this fiscal injustice, some analyses indicate that in Paraguay, between 1995 and 2000, over 70 per cent of public expenditure on agriculture was used for subsidies, most of which benefited large agro-export producers.[136]

4 CONCLUSION

The tax system that results from the two main reforms that have taken place over the last decade in Paraguay is insufficient to provide the resource base to eradicate poverty, and has done little or nothing to achieve a more equal distribution of income and wealth. One of the key causes of this situation is the tremendous fiscal injustice that has prevailed, generated partly by the low tax reciprocity of the soy agribusiness. In fact, the agricultural GDP in the years 2005–2010 accounted for 24 per cent of total GDP on average and, in contrast, the collection of the IMAGRO tax barely reached on average 0.03 per cent of total GDP and 0.1 per cent of the agricultural GDP. However, the direct taxes received from soy producers under IMAGRO are now equivalent to less than 0.5 per cent of the total tax revenues.

Moreover, there are clear indications to feed concerns that, in spite of progress, the IRACIS (corporate tax) – which taxes the income of soy exporters and other companies in the soy value chain (excepting producers) – still has a long way to go before it makes a fair contribution to the Paraguayan state coffers. There are serious loopholes in the tax system that must be addressed in order to deliver a fairer, progressive taxation system that will allow the country to meet its fiscal as well as its social objectives. These loopholes include: the absence of a personal income tax (which permits arbitration, encourages tax avoidance and limits the opportunities for the formalization of the economy); the limited capacity of the Tax Administration to monitor and control multinational companies' practices such as price alterations in intra-group transactions; and the absence of a real rural cadastre. These loopholes limit the ability of the Paraguayan state to collect the taxes it is owed.

Big landowners do not pay anything for their monopoly of Paraguayan land, which allows them to operate production economies of scale that are very significant. Moreover, this fact is usually instrumental for a greater concentration of land ownership, with land used as a means to save and speculate.

The Paraguayan government also needs to reform some of the fiscal measures that have dubious social objectives. These include the provision of general subsidies such as the one for diesel fuel. As these subsidies are generalised, they benefit – at least in theory – both poor and rich people; but in the case of diesel fuel, the subsidies are mostly to the advantage of big soy producers, given their intensive use of machinery. This represents gross inefficiency in the use of public resources, despite the really small margins to meet the country's social needs.

In recent years, the public expenditure budget has benefited from rising tax revenues largely due to VAT and import tariffs, both of which are indirect taxes on consumption. However, all of the elements indicated above reduce the potential positive effects of public expenditure as a tool for the distribution of wealth. In fact, in addition to still-inefficient tax collection mechanisms, partly due to the great tax evasion, studies indicate that VAT, one of the country's primary sources of tax income, may have worsened inequalities in the distribution of income. In other words, it may have reinforced income disparity in the country, given the relative weight attached to spending on consumer goods in the budgets of poorer as opposed to wealthier families. It is worth mentioning that one of the main claims of soy farmers is the contribution they make to the treasury through the VAT, as a direct/indirect result of this business. Nevertheless, the VAT tax revenues generated by the agricultural soy sector accounted for less than 5 per cent of the total VAT collection in 2010.

Meanwhile, programmes and projects related to the AFC (family farming) received a level of public financing at record levels of two decades ago, accounting for just 5 per cent of public expenditure, Paraguay has one of the highest levels of unequal land ownership in the world, labour informality is at very high levels and a poor environmental regulation of soy producers threatens the livelihoods and ecosystems of those small farmers who try to eke out a living in their rural homelands and grow enough food for their families and, if possible, for the Paraguayan people.

In order to achieve a more progressive and fairer tax collection, it is essential to complete the picture of the existing opportunities which, in combination with other necessary reforms on the side of public revenues (social security system and hydroelectric royalties received by municipalities) and also in environmental and labour matters, help to articulate the possibilities for the Paraguayan state to effectively address the protection of the most vulnerable and the fight against poverty and inequality.

Similarly, it is crucial that the potential to increase the public expense that may arise from those reforms is really productive, clearly identifying where, how and how much should be invested so that the collection can result in a real integral development of small farming and thereby overcome poverty.

This roadmap should contain the analysis and design of strategies for overcoming not only the Paraguayan technical and legal obstacles but also and above all the political and sociological ones, in order to achieve a tax system consistent with social demands. To do this, civil society should clearly get involved and fully understand the deficiencies and effects of the injustice of the Paraguayan tax and fiscal systems, demand the relevant reforms and answer with a greater compliance with the obligations incumbent upon them.

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NOTES

[1] Data calculated in current value .

[2] According to data from the Department of Statistics, Surveys and Census (DGEEC).

[3] Ramírez (2011) quoting the Censo Agropecuario (Agricultural Census) (2008).

[4] Defined as landholdings of more than 100 hectares. In Paraguay, as opposed to African countries, 100 hectares cannot be considered a large estate.

[5] Ramírez (2011) using data from the Censo Agropecuario (Agricultural Census) 2008.

[6] The European Comission in the document on the strategy land of Paraguay 2007-2013 (http://eeas.europa.eu/paraguay/csp/07_13_es.pdf) acknowledges "the institutional weakness on environmental issues in Paraguay and "the ampliation of the limit of soy production generated strong social and environmental conflicts in a land with a weak level of application of regulation and a very low existance of specifical development policies."

[7] There has also been criticism on the livestock sector. Nevertheless, this exceeds the analysis carried out in this report.

[8] Guereña (2011).

[9] See Itriago (2011) quoting Gallo (2003) and Adelman and Fuwa (1994), page 53.

[10] For a review of the dual nature of the paraguayan rural productive sector, see UNDP (2010).

[11] 'Transparencia en Royalties', http://www.transparenciaenroyalties.org.py/V3/faqs.

[12] Giménez y Caballero y Cabral Mereles (2007).

[13] Giménez y Caballero y Cabral Mereles (2007) quoting Host (2003) .

[14] Giménez y Caballero y Cabral Mereles (2007).

[15] Zarate (2008).

[16] The surplus of a state is due to the fact that its taxes and retentions income, among others, is larger than what it spends on providing public services and paying debts. In other words, it is the opposite of deficit. Usually, the loans for paying debts and the amortizations of capital are not included in this concept.

[17] 'Borda fue al Congreso a pedir impuestos a la soja y a la carne', E'a, http://ea.com.py/borda-fue-al-congreso-a-pedir-impuestos-a-la-soja-y-a-la-carne/

[18] Our calculations using data from the 2011 budget; Ley no 4.249, 'Que aprueba el Presupuesto General de la nación para el ejercicio fiscal 2011', http://www.hacienda.gov.py/web-presupuesto/archivo.php?a=afbec0b3c1c3bec3b3c1c2bd6e807e7f7f7dbab3c76ebc6e828082876e7b6e807e7f7f7cbeb2b4af04e&x=21210bf&y=19190b7.

[19] Zárate (2010a).

[20] Ibid.

[21] Does not include contributions to social security.

[22] Kacef (2009).

[23] Rodríguez (2011) quoting the IMF.

[24] Jiménez, Sabaini, Podestá (2010) .

[25] Figure obtained from the World Bank; http://data.worldbank.org/indicator/SH.XPD.PCAP . Figure in dolars of year 2009.

[26] According to Zárate (2010a)., 'social expenditure' includes spending on education and culture, social security, health, and social promotion and action.

[27] Ramírez (2011).

[28] Values represented in 2005 constant dollars

[29] Ramírez (2011), see Annex 15A, page 117.

[30] **(1) Large properties** are rural properties that have an Agriculturally useful surface (SAU) greater than 300 hectares of cultivable land in the Western Region. Medium properties are rural properties that have less than 300 hectares of cultivable land (in the Eastern Region), or less than 1,500 hectares (Western Region). Small properties are those with less than 20 hectares of cultivable land (Eastern Region) and less than 100 hectares (Western Region). They are exempt from the

IMAGRO tax. **(2) Cultivable land:** The number of hectares that can be used for production and/or cultivation out of the rural property's total number of hectares. The determination of cultivable land ('S.A.U.') is the result of the difference between the property's total number of hectares according to the deed, less the hectares occupied by: natural forest, planted forest, permanent lagoons, semi-permanent lagoons, wetlands, marginal areas not suitable for cultivation (rocky patches, marshes, salt flats, etc.). The exceptions are marginal areas worked to obtain primary products such as rice, cress and similar products, and protected private areas (Law 352/94), routes, local tracks and/or easements of access and areas declared to be of environmental importance by the competent authorities. **(3) Efficient and rational use of the land:** The efficient and rational use of the property occurs when at least 30 per cent of the cultivable land is used for production and/or exploitation (productive use). If less than 30 per cent of the cultivable land is used, efficient and rational use of the rural property does not exist. **(4)** The gross production value of the agriculturally useful land area (S.A.U.) is determined using the **COPNAS (natural soil productivity coefficient)** and the product yield, multiplied by the average price of said products.

[31] Taxes on foreign trade are regulated by Law 2422/04, which establishes the 'Customs Code', and Law Nº 621/95, 'That approves the Protocol relating to the Customs Code of MERCOSUR'. Other taxes were overturned, among them the tax on internal marketing of cattle, the tax on Acts and Documents (IAD), and the registration tax on cars, which is about to extinct.

[32] When the richest are taxed proportionally more than those whose income is the lowest, then the system isprogressive. In the opposite case, it is regressive.

[33] According to ECLAC (Economic Commission for Latin America and the Caribbean - CEPAL) data; http://websie.eclac.cl/sisgen/ConsultaIntegradaFlashProc.asp

[34] Zárate (2011) .

[35] UNDP(2010).

[36] See IICA, Observatory "Production costs"; http://www.iica.org.py/observatorio/producto-paraguay-soja-costos.htm.

[37] Ibid.

[38] A very long timeframe was used, allowing us to limit the risk of short-term stock market volatility that might cloud the results.

[39] *Conjuntura Econômica*, December 2008 p. xiv and xv.

[40] A very long timeframe was used, allowing us to limit the risk of short-term stock market volatility that might cloud the results.

[41] Rodríguez (2011).

[42] Alarcón (2010) .

[43] Ibid.

[44] Triangular trade promoted by the 'tourism regime' policy.

[45] Alarcón (2010).

[46] Stein et al (2006).

[47] Ibid.

[48] 'In the region of Latin America greater consciousness of the need to identify and estimate tax expenses has gradually emerged… However, in other countries, such as Paraguay, this process has not yet begun.' See Villela et al (2011).

[49] See Itriago (2011), pp. 15-17.

[50] As a candidate of the incumbent Partido Colorado.

[51] In addition to the annual problem of making a transfer to cover the operating deficit, the system required other types of changes. For example, the fact that in the medium term it was unsustainable, and the heterogeneity of the different funds meant a serious lack of equality in the system. The difficulty of ensuring continuity when a senior civil servant changed from one sector to another posed a serious obstacle to being able to organise the public sector.

[52] These reforms consisted of i) improvements in the tax administration; ii) strengthening of the legal department responsible for the collection of back taxes; iii) the creation of an independent customs organisation; and iv) improvement in the public acquisitions or contracting process.

[53] The number of "active" contribuents in Paraguay has increased from 224,491 in 2005 to 457,654 in 2010; see http://www.set.gov.py/pset/hgxpp001?6,18,298,O,S,0,MNU;E;103;12;MNU.

[54] Crivelli (2010)

[55] The special rates of 15 per cent and 10 per cent for the SAECAS (Public Limited Companies) were repealed, and there was a reduction of 95 per cent of the tax determined according to Law 60/90 on the promotion of investment, to mention some of the most significant changes, given that all of the general or particular laws that established special schemes for company income tax were abolished.

[56] Article 7 of Law 125/91. The gross income is consists of the difference between the total income coming from comercial, industrial or service operations and their costs. Article 7 was not modified in the Tax Adequation Law – 2421/04.

[57] Article 8 of Law 125/91. Net income is determined by the deduction from taxed gross income of the expenses which are necessary to obtain it and maintain the source of production, as long as it represents a real outlay and are properly documented and have market prices, when the expense does not represent a taxed income for the beneficiary in the Tax Adjustment Law – 2421/04 this concept does not change.

[58] i.e. the possibility of discounting the payment of IMAGRO the tax credits for the purchase of goods and services related to the farming activities.

[59] The export of goods is exempt from the tax referred to. The local exporter has the right to recover the tax credit associated with the products exported, and to this end, certain procedures must be followed with the Treasury Administration.

[60] Capital goods produced by national producers of direct application in an industrial or farming productive cycle.

[61] According to estimates of the SET (State assistant Secretary of Taxation).

[62] According to Zárate (2010b), average VAT productivity and efficiency are 47 per cent and 62 per cent respectively, which is above average for Latin America. According to Sabaini and O´Farrell (2009), VAT productivity in LAC reached 20 per cent in 2005, while in developed countries it stands at about 60 per cent. The productivity of VAT analizes the tax rate in reference to the collection obtained. It is measured depending on collection/rate. Larger rates are associated to greater collection, but not in a lineal manner, because the larger the rate the more the consumption can be reduced and can act as an incentive for tax fraud. The efficiency of a tax depends on the size of the distortion for the real economy where it is collected. The lesser the distortion, the larger the efficiency.

[63] Sabaini and O´Farrell (2009)

[64] S oto (2009), 'Paraguay maintains a low level of tax collection and a high level of evasion', http://sdpnoticias.com/sdp/contenido/2009/09/29/501684

[65] See discussion on this matter in the summary document of the international conference on 'Fiscalidad, Inclusión social y Estructura Impositiva de la Región', held on 11 August 2010 in Asunción, Paraguay.

[66] Zárate (2011).

[67] 'Ruotti Cosp (2012), 'La renta personal es un impuesto justo y necesario'; http://www.decidamos.org.py/index.php?option=com_k2&view=item&id=493:la-renta-personal-es-un-impuesto-justo-y-necesario&Itemid=1

[68] Alignment does not mean that both revenues (both personal and that coming from economic activities) are integrated into the declaration.

[69] This is a concept that originated in the stock exchange. It refers to the "process of purchasing a real or financial asset in one market to sell it in another one with the objective of making a profit from the price differences that exist between the two."

[70] http://www.hacienda.gov.py/web-hacienda/index.php?c=77#d1.

[71] See Itriago (2011).

[72] There are products from many other transnationals, but they are represented by other companies.

[73] Rojas Villagra (2009a).

[74] See Itriago (2011).

[75] Kar and Cartwright-Smith report (2008).

[76] See Itriago (2011).

[77] 'Freedom in the World 2010 – Paraguay; (2010) http://www.unhcr.org/refworld/country,,FREEHOU,,PRY,4562d94e2,4c0ceadbc,0.html

[78] Free on board: payment formula or key used in international trading to indicate that the sale price of a certain product includes the goods value and the transportation and handling costs.

[79] 'Para fisco, agroexportadores no tributan US$54 millones', Ultimahora.com, http://www.ultimahora.com/notas/414217-Para-fisco,-agroexportadoresno-tributan-US$-54-millones

[80] Amaral and Associates, Business Consultants and Auditors. Law 125/91 provides in Art. 16 the following provision: Art. 16: Importers and exporters: For importers it shall be presumed, unless proved otherwise, that the cost of goods introduced in the country cannot exceed the price of the wholesale level prevailing at the origin plus the cost of shipping and insurance until they reach Paraguay, so this difference will represent taxable income for them. In exports with no fixed price or when the declared price is below wholesale selling price in the country plus the cost of shipping and insurance until reaching the destination, the latter value is taken as the basis for determining the income. To these effects, the nature of the goods and the mode of operation will be taken into account.

[81] Ibid.

[82] Whose mission is promoting the harmonious integration of the rural community into the financial and social development, adapting the agricultural structure, promoting the access to rural land, reorganizing and regulating its tenance, coordinating and creating proper conditions for the development that allows the settling and configurating a strategy that integrates participation, productivity and environmental susteinability.

[83] UNDP(2010).

[84] FIDES contains also 5 per cent of the royalties of hidroelectricals, also through the yearly budget; in addition to donations, contributions and counterparts of departamental and municipal governments for common projects.

[85] Our calculations using the Secretariat of State for Taxation (SET).

[86] Article 7 of Law 125/91. The gross income is consists of the difference between the total income coming from comercial, industrial or service operations and their costs. Article 7 was not modified in the Tax Adequation Law – 2421/04.

[87] Article 8 of Law 125/91. Net income is determined by the deduction from taxed gross income of the expenses which are necessary to obtain it and maintain the source of production, as long as it represents a real outlay and are properly documented and have market prices, when the expense does not represent a taxed income for the beneficiary in the Tax Adjustment Law – 2421/04 this concept does not change.

[88] Acosta-Ormaechea, Dabán-Sánchez, Zárate, Crivelli y Nowak (2010); http://www.imf.org/external/spanish/pubs/ft/scr/2010/cr10170s.pdf.

[89] According to an interview with Walter Hermosa (PKF Paraguay Accountant Controller and Paraguay Advertisers Guild) carried out in April, 2011.

[90] According to some information provided by the SET during the telephone interview which took place in April, 2012.

[91] This happened because at least until the recent reform in 2012, another act (after 2005) allowed the large estates the use of any method for obtaining the value of the taxes to pay, and most of them used the "estimate scheme" or "simplified scheme" and not the "accounting scheme", mucho more strict in terms of the information that must be presented to the tax authorities.

[92] The current tax scheme includes three types of rural contracts, with different tax obligation models: a) rental or leasing contracts (where the owners are obliged to pay as taxpayers of the Tax on Business Income or the IRACIS and the VAT, while the tenants or lessees have to pay the IMAGRO; b) sharecropping contracts (where both landlords and tenants are obliged to pay the IMAGRO, depending on the share percentage of each of them); and c) company contracts (where the landlord and whoever is going to work the land form a company and both are obliged to pay the IMAGRO). The rental contract corresponds to the common idea of renting, the sharecropping contract is a sort of shared risk, (for example, one party contributes the land and the other the inputs and work), where both parties share in the results and products, and the third is for a company. According to the tax scheme, all of these contracts must be executed in writing and be registered with the Tax Administration within 30 days following their signing. Information taken from 'Contratos rurales ocultarían una gran evasión del Imagro', Ultimahora.com, http://www.ultimahora.com/notas/308381-contratos-rurales-ocultar per centC3 per centADan-una-gran-evasi per centC3 per centB3n-del-imagro

[93] 'Contratos rurales ocultarían una gran evasión del Imagro'; http://www.ultimahora.com/notas/308381-contratos-rurales-ocultar per centC3 per centADan-una-gran-evasi per centC3 per centB3n-del-imagro

[94]Verón (2010); 'Cómo los medios ocultan los privilegios tributarios de los agroganaderos'; http://ea.com.py/como-los-medios-ocultan-los-privilegios-tributarios-de-los-agroganaderos/

[95] Our calculations using data from Zárate (2010a) and the exchange rate dollar/guarani on 25th April 2012 (1 dollar was 4348 guaranies).

[96] 'Imagro: Misuse of tax credit detected';http://www.ultimahora.com/notas/446832-Imagro:-Se-detecta-uso-indebido-de-credito-fiscal'. 'La SET multará a contribuyentes del IMAGRO que acumulen crédito fiscal en forma irregular'; http://www.set.gov.py/pset/hgxpp001?6,18,273,O,S,0,PAG;CONC;359;2;D;4041;1;PAG..
"

[97] Article 8 of Law 3001/06. The Certificate of Environmental Services is a title document freely negotiable for those who are not obliged by this Law or by court ruling to invest in environmental services, and they can be negotiated in the international market for the payment of environmental compensations carried out by physical or juridical persons obliged thereby by the activities or exploitations that they carry out and which are considered to be damaging for the environment. The property and Personal Income Taxes can also be used for the compensation of local or national taxes such as IMAGRO.

[98] Hermosa (2012); 'La CAP insiste en que cambios en Imagro incidirán en recaudaciones'; http://www.abc.com.py/nota/la-cap-insiste-en-que-cambios-en-imagro-incidiran-en-recaudaciones/

[99] World Bank (2007).

[100] 'One of the unresolved challenges in the region is related to the strengthening of this kind of tax, mainly on a sub-national government level. Specifically, a reinforcement of cadastre data is fundamental for the equity and efficiency of real property taxes '; See CEPAL (2010).

[101] See a detailed analysis on the taxing of wealth in Latin America in De Cesare and Lazo Marín (2008).

[102]'El impuesto a la tierra en Paraguay es irrisorio'http://archivo.abc.com.py/2009-04-05/articulos/510086/el-impuesto-a-la-tierra-en-el-paraguay-es-irrisorio

[103] Our calculations, exchange rate dollar/guarani on 25th April 2012 (1 dollar was 4348 guaranies).

[104] Article 60 of Law 125/91.

[105] The scheme referred to provides for payment of a single tax equivalent to 1 per cent (one per cent) of the value added in the national territory or on the value of the invoice issued by and by order of the headquarters, whichever is greater. 'Headquarters' refers to the foreign contracting company.

With the exception of the Single Tax referred to, the maquila contract and the activities performed to execute it are exempt from any other national, departmental or municipal tax. This exemption extends to:

(1) the temporary import of the following goods included in the maquila contract: raw materials and inputs, machinery and tools among others; (2) the re-exportation of the goods imported under said contract; and (3) the export of the goods processed, manufactured, repaired or assembled under said contract.

[106] The users who carry out commercial, industrial or service-related activities and are dedicated exclusively to export to third countries will pay a single tax called the 'Tax Free Zone Tax'. It has a rate of 0.5 per cent, and the taxable base is the total value of the gross income proceeding from sales to third parties. Aside from the tax referred to, the activities performed by the users referred to and the results they obtain are exempt from any national, departmental or municipal tax. The tax exemption extends to: a) remittances of profits or dividends to third countries; b) the payment of royalties, commissions, honorariums, interest and any other remuneration for services, technical assistance, transfer of technology, loans and financing, rental of equipment and any other service supplied from third countries to the Free Zone Users; c) the introduction of goods from third countries or Customs Territory into Free Trade Zones is totally free of any international, national, departmental or municipal taxes, except for the taxes on services that have been effectively carried out.

[107] See Itriago (2011).

[108] According to the interview with Luis Rojas carried out in April 2011.

[109] UNDP (2010).

[110] Measured in terms of its gross added value with respect to GDP.

[111] 'Hacia el Paraguay Industrial: Una propuesta', Centro de Estudios Económicos, http://www.uip.org.py/c/document_library/get_file?uuid=828ebc82-5079-4def-b2f8-9c381af028fc&groupId=10192

[112] Nickson (2008)

[113] 'Well designed exemptions' refers to those that affect goods and services that play a greater role in the food basket of the poorest households. Where differential rates exist, in general, 'well

designed exemptions and differential rates' refers to those that result in an effective tax rate that is lower on the food basket of the poorest households.

[114] Based on the 2001 EPH (Encuesta Permanente de Hogar—the Permanent Home Survey).

[115] There is theoretical debate with regard to whether income or consumption is the best indicator of wellbeing.

[116] The most common progressivity indicator is the average rate progression. According to this indicator, a given tax is regressive if, expressed as a percentage of a household's income – average rate – it decreases as one moves up the household income scale.

[117] The tax's quasi-Gini coefficient is calculated in a way similar to the income Gini, but on the tax's concentration curve.

[118] Kakwani Index (K) = quasi-Gini (VAT) - Gini (income before the tax policy). If K > 0, in other words, if the VAT is distributed more unequally than income before the tax policy, the tax contributes to reducing the inequality in the distribution of income and is therefore considered progressive. If, on the contrary, K < 0, the tax is regressive. WHile the Kakwani Index allows evaluation of how progressive or regressive a given tax is, since it is not influenced by its collection revenue, the index does not tell us much about the tax's redistributive capacity.

[119] Consumer demand depends on income levels. When income is very low, some consumer demand does exist, called 'independent consumption', because even someone who has nothing has to consume something in order to survive. Beyond that, more income equals more consumption. Consumption grows with income. But savings will also grow; the richer a society is, the greater the proportion of its earnings that it can dedicate to savings. It is to be expected that families with higher incomes save a greater portion of their earnings, while low-income families need to consume even more than they earn. The percentage represented by consumption out of the total amount of income gets smaller and smaller as income increases. We call this percentage the 'average consumer tendency'.

[120] The Reynolds-Smolensky index is an overall indicator of the redistributive capacity of the tax in question. In the case of VAT, this index is defined as:

RS = Gini (income before the tax policy)- Gini (income after the VAT). If RS < 0, its magnitude (in absolute terms) indicates how many Gini points the inequality in wealth distribution has increased as a consequence of the regressive character of the VAT introduced. The opposite is true if RS > 0.

[121] The study was based on the Survey on household budgets 2005-2006, carried out by the General Department of Statistics, Surveys and Census (DGEEC), between july of 2005 and juny of 2006. See Jorrat (2011) page 52.

[122] See Jorrat (2011) page 52.

[123] *Ibid.*

[124] Barreix, Roca and Vilella (2007).

[125] The Kakwani index is positive.

[126] R-S = 0.0004.

[127] The Kakwani index continues to be positive.

[128] R-S = 0,0003.

[129] See Alarcón (2010)

[130] FAO (2010) quoting journal Diario ABC, page 38;
http://www.rlc.fao.org/uploads/media/politicas_publicas_sobe_biocombustibles_paraguay.pdf.

[131] http://www.mercosurtime.com/2012/01/estado-no-podra-mantener-subsidio-al-combustible-por-presion-tributaria-actual/

[132] Bohn (2009).

[133] It is also very important to highlight that, in the specific case of diesel, that represents a major percentage of the businesses of PETROPAR, in many Administrations, they tried to adequate its sale price to real costs of importation based on the price of the international market and the exchange rate dolar/guarani, but it was not possible due to the implications that can bring the adoption of such measures and, logically, this compulsory subsidy to diesel is reflected permanently on the company balance sheets. This is the way things are. But, how to solve it? Easy. Whenever PETROPAR goes back to being an economically profitable company, in other words, when it does not have to carry the heavy weight of colateral socio-economical compromises nor the subsidies that, in the end, favour the big producer entrepreneurs, the Entity will be able to fix, according to its costs structure, the real price of fuel so that it can reach the planned aims. As long as this decision is not taken, things will remain the same..."; http://www.petropar.gov.py/presentacion.php.

[134] Villalba Digalo (2010), 'El mal negocio de subsidiar el gasoil', Sindicato de periodistas del Paraguay'; http://periodistaspy.blogspot.com/2010/12/el-mal-negocio-de-subsidiar-el-gasoil.html

[135]Rojas Villagra (2009b), 'Estado subsidia a los sojeros a través de Petropar por 36 millones de dólares', http://ea.com.py/gobierno-subsidia-a-los-sojeros-a-traves-de-petropar-por-36-millones-de-dolares/

[136] Guereña (2011), quoting De Ferranti et al (2005).

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This report was written by Déborah Itriago. Oxfam acknowledges the assistance of Andrés Campos y Luciana Díaz Frees in its production and the comments of Asier Hernando, Susana Ruíz, Saya Saulière, Mirtha Rodríguez, Oscar López, Luz Mercedes Bello, Luis Rojas Villagra, José Carlos Rodriguez, Enrique Gauto, Galo Bogarin Pojoaju, Susana Ortíz de Carrizosa, Eduardo Sosa Julio Ramírez, América Villegas, Teresa Cavero, Jerome Fauré y Mark Fried. It is part of a series of research reports written to inform public debate on development and humanitarian policy issues.

For further information on the issues raised in this paper please e-mail **advocacy@oxfaminternational.org**.

The information in this publication is correct at the time of going to press.

www.oxfam.org

Published by Oxfam GB for Oxfam International under ISBN 978-1-78077-093-2

in May 2012. Oxfam GB, Oxfam House, John Smith Drive, Cowley, Oxford, OX4 2JY, UK.

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