



**Financing Public Security**  
**Tax and Non-tax Instruments**  
**to Finance Citizen Security and**  
**Crime Prevention**

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**Inter-American  
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### **Abstract\***

Drawing on the innovative sources of financing for public security that have developed in Latin American and the Caribbean in recent years, this paper reviews the main revenue instruments that can be used to finance various aspects of citizen security. The paper focuses on the structure of financing for the security budget and does not attempt to provide an assessment of expenditure needs and efficiency. If an in-depth country analysis concludes that more resources are needed, the paper provides a guideline on how to think about the merits of different new financing instruments and of earmarking these funds.

**JEL code:** H8

**Keywords:** Citizen security, financing, fiscal revenues, security budget, security expenditure, Seguridad ciudadana, financiamiento, ingresos fiscales, presupuesto en seguridad, gasto en seguridad

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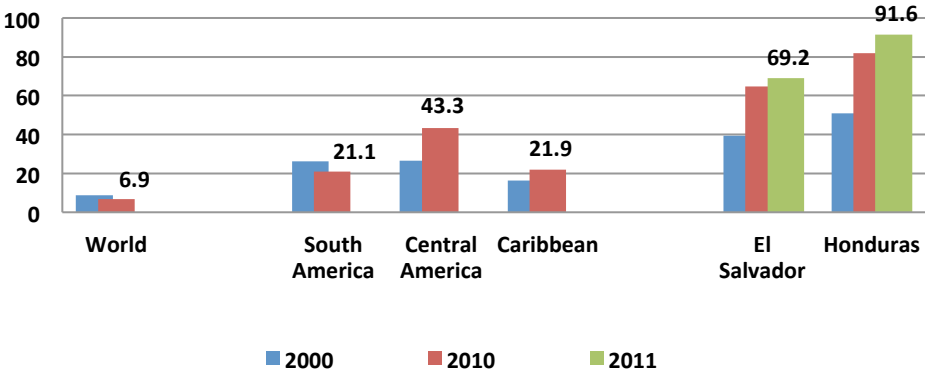
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**1. Introduction**

One of the state’s core functions is to provide public security and crime prevention. A climate that empowers families and individuals to use public and private spaces lawfully, without fear of violence or compulsion, and protects public and private property against predators, goes a long way to create citizen wellbeing. Citizen security is also required to efficiently provide other public services, such as basic education and healthcare. Crime destroys lives and property, and, together with corruption and rent-seeking, has a negative impact on investment and entrepreneurship, thus constricting opportunities and lowering the prospects for social and economic development. Economic and social losses from crime and violence are much higher than observed pilferage and destruction of life, work capacity, and property.

Public security is a first-order problem everywhere, but especially in Latin America and the Caribbean (LAC). While in 2010 the homicide rate—the most visible indicator of violence—was estimated to be an average of 6.9 per 100,000 people worldwide, it reached 21.1 in South America, 21.9 in the Caribbean, and 43.3 in Central America, and was growing in the latter two regions. The following figure shows that the corresponding rates for El Salvador and Honduras are even more dramatic, since they are very high and continued growing through 2011 (OAS, 2012).<sup>1</sup> The Caribbean and South and Central America are the only regions where homicides by firearms exceed 60 percent of total homicides (UNODC, 2011). The whole of LAC, a region lodging only 9 percent of world population, accounts for about 20 percent of all homicides on earth (Corbacho, 2012).

**Figure 1. Homicide Rates (per 100K population)**



<sup>1</sup> Based on police records of intentional homicides. The rates for 2010 reflect data for 2010 or the latest available year. The regional averages include 13 countries in the Caribbean, 7 in Central America, and 11 in South America.

Crime, violence, and the threat of violence are commonplace in the daily life of people everywhere in LAC. No wonder the region's citizens express a generalized sense of insecurity and helplessness. Since 1995 delinquency has increasingly been perceived as the most important problem in Latin America, and since 2010, it has passed unemployment as a major concern (see Latinobarometro, 2011; Lagos and Dammert, 2012). The notable expansion of private security services in the region, as well as the appearance of militias in certain metropolitan areas, indicate that public authorities are falling short in providing this critical public service. Governments scramble to meet citizen demands for public security in a democratic society and look for innovative ways to advance this agenda.

The analysis of crime and violence has made important progress in LAC in recent years, and it now receives the sustained attention of a number of dedicated think tanks set up by governments, academia, and civil society organizations. The design of public policies in this field of research and the coordination and sharing of successful experiences have been greatly facilitated by initiatives led by such organizations as the Inter-American Development Bank (IDB),<sup>2</sup> Organization of American States (OAS), and the United Nations Development Programme (UNDP).

In recent years, a growing body of literature has developed regarding the economic, psychological, and sociological dimensions of violence and crime, as well as about public policies aimed to achieve citizen security.<sup>3</sup> Nevertheless, to a great extent, financing has been neglected. To help close the gap, this paper explores new instruments created in Latin America<sup>4</sup> to secure the means to attend to the growing financial needs of citizen security.

## **2. Financing Needs of Public Security**

Data regarding the finances of citizen security, comparable across countries or regions, are extremely scarce. When available, data compiled by official international organizations on government expenditures are normally presented in a minimalist, "economic" classification. Public expenditures distributed by function can be found for certain countries, but presentation

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<sup>2</sup>In the broad scope of citizen security, the IDB has focused its technical and financial support in the areas of institutional strengthening, social and situational prevention, preventive police, and judiciary and rehabilitation. See IDB (2012a).

<sup>3</sup>For a recent survey, see IDB (2012b).

<sup>4</sup>To date, efforts to create tax instruments with revenue dedicated to security have been limited to Latin America. This could be related to the higher prevalence of crime and violence in this region. The only area of public spending where financing by dedicated taxes (hypothecation) is accepted internationally is social security.

varies and no uniformity in coverage can safely be expected. Sometimes, citizen security appears bundled with national defense and internal security, including suppression of insurgency. The cost of judicial services often includes all types of contract enforcement, and violence prevention, where it exists, is spread over various ministries and functions.

Outlays in citizen security, an important area of government activity, is not included in either infrastructure spending or in social expenditures, although it is no less important for living in society than basic education and public healthcare. Therefore, data on citizen security obtained from national statistics are often unreliable and unfit for international comparisons. Notable exceptions are two international groups of countries—the European Union (EU) and the Organisation for Economic Co-operation and Development (OECD)—which consistently compile statistics in the category “public order and safety” (distinct from “defense”). These are public expenditures of their member countries at the general-government level of aggregation.

On average, EU countries spent the equivalent to 1.8 percent of GDP on public order and safety in 2002 and 1.9 percent in 2010. For the purposes of comparison, these figures correspond to only a tenth of the expenditures on social protection in those years. In the countries that comprise the OECD, general government expenditures on public order and safety were equivalent to 1.7 percent of GDP in 2004 and 1.8 percent in 2009.

Data regarding expenditures on citizen security outside the OECD and EU is patchy. This gap in information is compounded by the difficulty in strictly separating national defense from police services. In some countries with a problem of insurgency, expenditures on policing and internal combat operations are often intertwined. Also, in various countries in LAC, the military exercise certain functions that are civil in nature, thus blurring the classification.<sup>5</sup> The *Government Finance Statistics Yearbook*,<sup>6</sup> which the International Monetary Fund (IMF) ceased publishing in 2007, has precious—although sparse—information for 2006 (or latest year available) as follows.

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<sup>5</sup> A good survey of the mandates of armed forces regarding certain civil functions in the LAC region is available in Dammert (2007).

<sup>6</sup> Data published in IMF’s GFS Yearbook was subject to standardization as per the *Government Finance Statistics Manual 2001 (GFSM 2001)*, an internationally recognized statistical reporting framework.

**Table 1. General Government Expenditures on Public Order and Safety**  
Simple Average, 2006 or Latest

<b>Region</b>	<b>Percent of total outlays</b>	<b>No. countries available</b>
Industrial countries	3.78	14
Africa	6.20	2
Asia	8.35	5
Europe (non-industrial)	6.37	16
Middle East	6.12	3
Western Hemisphere	6.71	2
<b>All countries considered</b>	<b>5.73</b>	<b>42</b>

Source: IMF GFS Yearbook 2007

The shortage of data for the American countries (only two countries appear in the table above) makes it difficult to compare across regions. However, more data on public order and security expenditures is available in the GFS Yearbook at the *central* government level. On average, under this concept, expenditures in 2006 or the latest year represented for the eight central governments that provided data to GFS were 6.44 percent of total outlays, or much lower if the outlay was measured in percentage of GDP. A study undertaken by the World Bank estimated that the central government outlays of three countries in Central America were as shown in the following table. The same study pointed out that only a modest proportion of those resources were used for crime prevention.

**Table 2. Public Security Expenditures (Central Government) in Selected Central American Countries, 2007**

<b>Country</b>	<b>Percent of total expenditures</b>	<b>Percent of GDP</b>
Costa Rica	3.9	1.8
Nicaragua	12.9	2.9
Panama	10.6	1.9

Source: World Bank (2010)

More recently, Noé Pino (2011) revisited the cost of security in Central America. Based on data obtained by the *Instituto Centroamericano de Estudios Fiscales* (ICEFI) from the various ministries of finance, Pino was able to build statistics based on budget allocations, not actual outlays. For each country, the study separates expenditures in defense, security (policy), security (other), justice (courts), and justice (prisons). The table below reflects the total excluding defense spending.



**Table 3. Central America: Public Security Outlays by Country, 2007–10**

	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
	<b>(percent of GDP)</b>			
Costa Rica	1.5	1.6	1.9	2.3
El Salvador	2.2	2.5	2.7	2.6
Guatemala	1.5	1.5	1.5	1.4
Honduras	1.7	1.9	1.9	1.9
Nicaragua	2.3	2.2	2.5	2.1
Panama	1.8	2.0	2.5	2.1
<b>Average</b>	<b>2.0</b>	<b>1.9</b>	<b>1.9</b>	<b>2.1</b>
	<b>(percent of total spending)</b>			
Costa Rica	7.5	7.7	8.6	9.2
El Salvador	13.7	15.5	12.0	14.2
Guatemala	9.5	10.3	9.8	9.1
Honduras	8.4	8.3	8.7	8.6
Nicaragua	8.9	9.7	10.6	8.3
Panama	5.5	6.0	4.8	6.6
<b>Average</b>	<b>9.9</b>	<b>10.4</b>	<b>9.7</b>	<b>10.3</b>
Memo item:				
percent of social spending (avg.)	20.0	20.4	19.1	19.2

Source: Noé Pino (2011) and author's calculations.

These estimates indicate that Central America's public security budget, in percent of GDP, is comparable to the corresponding averages for the EU and OECD countries, mentioned above. Since the tax ratio in Central American countries is much lower than the tax ratio in European countries, clearly Central American countries are making an effort to meet the financial needs of public security.

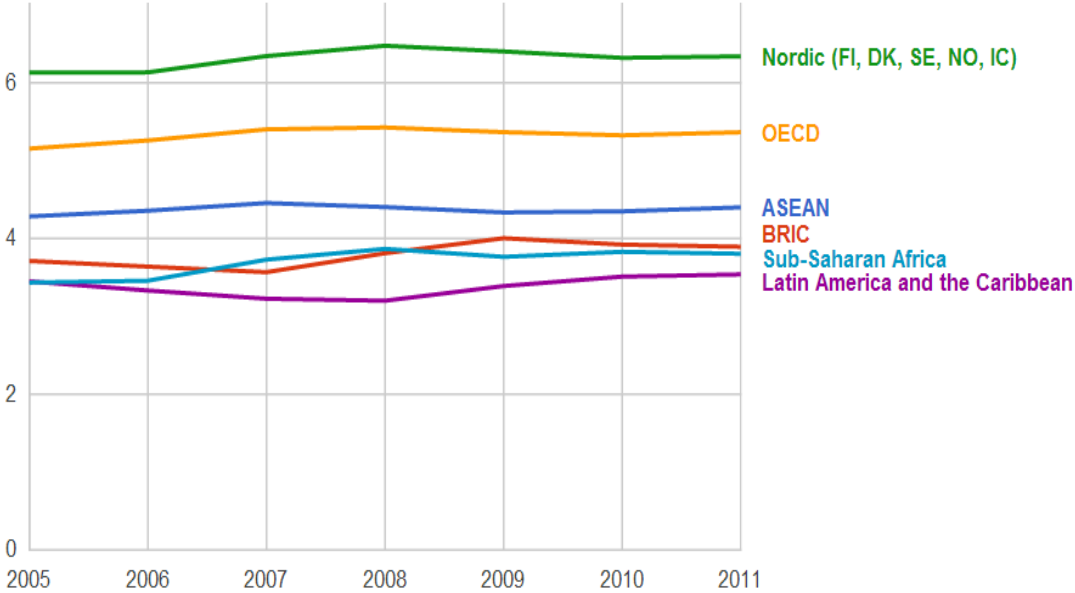
Available figures are incomplete and insufficient to confidently analyze expenditures on public security in LAC in relation to similar expenditures in the rest of the world. Nevertheless, there must be a problem either with the dimension or the effectiveness and/or efficiency of security spending in the region because citizen perception, represented in the chart below, is that police services in the region are consistently deficient and unreliable.<sup>7</sup> Surveys reveal that police are less trusted in LAC than in advanced economies such as the Association of Southeast Asian Nations

<sup>7</sup> The WEF (2012) index of police reliability varies from 1 ("cannot be relied upon at all") to 7 ("can be completely relied upon").

(ASEAN) and Brazil, Russia, India, and China (BRIC). Even people in Sub-Saharan countries have, year after year, expressed higher regard for their police services than citizens of LAC.

Figure 2. Reliability of Police Services

Reliability of police services



Source: WEF 2012 and Google Public Data.

Citizen security is a public good. Its benefits are not divisible, forestalling financing through user charges, and excluding particular individuals is not practical either. The fact that the damage from crime and violence—both monetary and psychological—is difficult to quantify does not make it any less real. In society, there is commonness in citizen security, and externalities (spillovers) in its production and consumption; the insecurity of one is the insecurity of all.

It is true that the immediate protection of persons and property has a spatial dimension, frequently allowing the provision of security services to be concentrated in certain areas, such as neighborhoods where politically influential people live and main touristic sites, leaving large swaths of territory under protected—typically where the poor live.

The proliferation of private providers of security services reflects the limitations, in some cases even breakdown, of publicly provided security services in the various dimensions of

prevention, enforcement, justice, and rehabilitation. Contracting out security services (beyond the ordinary protection of property) involves extra costs for those who can afford them, and a lack of protection to those who cannot. In areas densely populated with low-quality urban equipment (*asentamientos, barrios, campamentos, favelas, villas*), the absence of public security creates a fertile ground for gangs, *maras*, and other forms of organized crime, as well as militias dedicated to retributive justice, all providing “protection” on their own terms.<sup>8</sup>

Also part of this picture is the spread of walled complexes for the security of those who can afford to live in upscale developments, even if they are an attack on the idea of community, village, and city life. The development of the informal, illegal, and haphazard settlements and organizations mentioned above reflects a failure of the state in one of its most basic functions.

In LAC, the growing levels of crime and violence, and the persistence of high rates of delinquency, defy simple analysis and befuddle government policies. Public insecurity is, more than ever, a multifaceted problem,<sup>9</sup> that to be addressed successfully, requires a multi-pronged approach well beyond law enforcement and police action. It could be said that, without fear of losing sight of feasibility, public security begs a more holistic vision.<sup>10</sup>

Nonetheless, the financing required for a rigorous security policy is demanding and perhaps out of reach for many governments with current resources. This is especially so for a large number of LAC countries where servicing accumulated government debt and appeasing growing demands for public services such as education, healthcare, and sanitation with the imperative of fiscal prudence leave little room for financing a qualitative and quantitative increase in citizen security. With such fiscal limitations, citizen security does not command a high priority and funds are squeezed.

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<sup>8</sup> A by-product of “security” provided by organized crime or vigilantes is reduced reporting of violence. In areas where control was repossessed by official police forces, with improved citizen security, the recorded levels of violence tends to increase significantly as people, less afraid of retribution, report crime to authorities. In circumstances where the risk of retribution, or the expectation of impunity, may deter reporting of crime and violence, victimization surveys, although subjective, may provide a better picture than official statistics.

<sup>9</sup> This problem has become more complex with the globalization of drug trafficking and organized crime.

<sup>10</sup> “Facing the growth of crime and the risk it causes, the role of the state security has changed from one single provider to responsible and senior partner of civil society actors and the various agencies of the central or local government. This trend is worldwide, and is illustrated by the growth of the private security system, local coalitions for coproduction of security, and the evolution of justice and police reforms. [...] These public policies that create coalitions require coordination with urban planning policies, as well as with social policies aimed at families and young people” (Vanderschueren, 2005) (translated by author).

### 3. Public Security: Financing Mechanisms and Efficiency

#### *Competing for Budgetary Resources*

In the absence of internationally accepted standards or benchmarks for public expenditures to deliver security services, it would be difficult to assess whether a given country is spending too little or too much. However, judging from results, there is ample evidence that providing citizen security in many LAC countries is insufficient, inefficient or both:<sup>11</sup> overcrowded prisons, high or rising levels of crime and violence, negative survey responses about police reliability, little community participation in security programs, and lack of transparency of citizen security financing and activities.

The absence of high regard for security services makes it more difficult to give priority to spending on security in the preparation and approval of the public budget. As a result, the security budget tends to replicate, or increase only modestly, previous levels of financing for personnel and other operating expenses. The slack is partially covered by private security providers, which further distorts the unequal access to this basic service.

The components of security likely to suffer the most from limited financing are the less visible activities of prevention, incarceration, rehabilitation, and fairness in dealing with victims and offenders. A degree of sophistication in planning and budgeting is needed to meet the requirements of security in manpower, equipment, and technology with a minimum of redundancy to enhance prevention and face surges in crime and violence. If budgetary resources are inadequate, police services are restricted financially and are poorly prepared for contingencies. When a swell of violence occurs, emergency resources are mobilized to face the crisis, only to be withdrawn when the danger has receded. It is therefore understandable that security policies are often seen as *mano dura* (strong arm) and consist mostly of repressive tactics.<sup>12</sup> This cycle further alienates the populace from the security services.

#### *The Cost of Violence*

Several studies estimate the cost of crime and violence in LAC. This cost involves institutional outlays (e.g., police and the criminal courts), the revenue forgone by the loss of life and limb, material losses, and private spending in security. Acevedo (2008) estimated the cost of violence

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<sup>11</sup> Poor delivery does not necessarily imply underfinancing. In some cases, spending may be poorly allocated (lack of effectiveness) or poorly implemented (lack of efficiency), or resources may be diverted from their intended use.

<sup>12</sup> For a critique of the *mano dura* (strong arm) approach, see Kliksberg (2007).

in Central American countries in 2006. Expressed as percent of GDP, it ranged from 3.6 percent in Costa Rica to 10.8 percent in El Salvador, with a simple average of 7.7 percent for the five SICA<sup>13</sup> countries.

Cerqueira et al. (2007) put the cost of violence in Brazil at 5 percent of GDP in 2004. Medina et al. (2011) estimated that the shortening of life expectancy as a result of crime in Colombia costs about 9.7 percent of GDP. Still, methodological problems and estimation gaps remain, prompting the IDB to call, in 2012, for research proposals on the cost of crime and violence.

Acevedo (2008) has pointed out that the cost of violence in El Salvador was more than twice the budgetary allocation for healthcare and education combined. This suggests that the cost of crime prevention through social policies could be self-financed. The problem with this approach is that most costs of violence (e.g., emotional losses, stolen property, and private security) are not budgetary, thus are not available for reallocation. Prevention vs. repression is a false dilemma, as noted by Arriagada and Godoy (2000).

### ***Bases for Efficiency in Citizen Security Spending***

Since the security problem has existed for so long time, and many different strategies have been tried out, there is a body of knowledge or good practices that elucidates, at least to some extent, public spending on citizen security and its financing. The first lesson from theory and experience is that policies and action on public security should be comprehensive. State policies should lie out objectives, resources, and actors. Formulation and implementation of programs should involve several ministries of the central government, regional, and local governments, as well as concerned civil society organizations. The scope of planning and execution should involve prevention (in the moral, social control, and legal dimensions<sup>14</sup>), enforcement (intelligence, preemption, reaction), and justice (including alternative sanctions, incarceration, rehabilitation, and social reintegration).

The second principle for efficient use of public funds for public security is the relentless recording and disclosure of performance. Performance indicators should be chosen *ex ante* and

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<sup>13</sup> *Sistema de la Integración Centroamericana*, which comprises Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.

<sup>14</sup> This corresponds to the trilogy legal regulation (fear of legal punishment), moral compass or self-regulation (fear of guilty feeling), and mutual regulation (fear of social censure) proposed by Mockus (2011) on the basis of the ideas of institutional economist Douglass North.

used to gauge execution and *ex post* evaluation. Cost accounting helps keep programs financially lean and allows the planning process to be improved further. This practice is valid for the entire public sector, but the adoption of standards and performance indicators, involving record keeping, reporting, preparation of financing statistics, and a practice of transparency, would go a long way toward improving efficiency in providing citizen security.

The third pillar of a sound security policy is a multi-year planning strategy. A long-term view is needed in planning, projecting, executing, and evaluating. This allows meaningful yearly budgets to be prepared, and a rolling multi-year plan offers a clearer picture of resources and needs in the next yearly cycle, embedded in a sustainable medium-term path.

Multi-year planning is especially needed in LAC countries because recently their public expenditures have by and large been procyclical. Further, public security, which relies on strong institutions and multi-year programs, requires steadiness of means—to keep the level of effort and upgrade capacity—and should not be at the vagaries of short-term financing. Of course this raises the question of whether public security should have dedicated sources of financing. This question is addressed in the following sections.

#### **4. Latin American Practice in Innovative Financing of Citizen Security**

In instances where the desire to expand public security could not be accommodated within the regular budgetary framework, a number of Latin America governments have resorted to new forms of financing, especially earmarked taxes. This section surveys this development with a focus on the design of the new instruments.

##### ***Piggybacking on Income Tax***

Facing severe insurgencies and the rising cost of providing public security, over time **Colombia** has mobilized a number of financial instruments dedicated to fund extraordinary security needs.<sup>15</sup> In April 1991, a surtax dubbed the War Tax (*Impuesto de Guerra*) was introduced at the rate of 5 percent on the income tax liability of enterprises and individuals for the duration of the internal conflict and state of siege.<sup>16</sup> To allow collection to start in the same year, the levy was designed as an advance payment creditable against the income tax payment due in 1992, which

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<sup>15</sup> The insurgent movements FARC-EP and ELN also raised revenue (kidnapping for ransom, extortion, “war tax”, “taxes” on coca and poppy, etc.) between 1994 and 1999, which are not covered here.

<sup>16</sup> Decree No. 1017. The official name of the levy was Special Contribution for the Restoration of Public Order.

in turn was based on income obtained in 1991. The proceeds of the surtax were earmarked for military and police outlays, both current and investment.

In June 1992, the rate of the War Tax was raised to 25 percent, for application through 1997<sup>17</sup> on the same base except that a base reduction was provided for investors in the stock exchange. However, the tax was abolished at the end of 1995.<sup>18</sup> It is plausible that a combination of a fivefold increase in rate coupled with fresh tax preferences for the wealthy had eroded support for the War Tax, leading to its revocation.

### ***Flat Tax on Businesses***

**Costa Rica** also resorted to a security tax, but to be collected in a flat amount from all registered businesses, including corporations, partnerships, and sole proprietorships.<sup>19</sup> Effective on April 2, 2012, the Tax on Legal Entities (*Impuesto a las Personas Jurídicas*) is due annually in January at a fixed amount equivalent to 50 percent of a minimum monthly wage as fixed by law. Inactive legal entities are liable for half of that amount. An exemption is available for micro and small enterprises. The proceeds of Costa Rica's tax on legal entities are earmarked as follows:

- a) 5 percent for the Ministry of Justice and Peace (in charge of the penitentiaries) to cover collection costs, with the remainder used to finance the General Directorate of Social Adaptation; and
- b) 95 percent for the Ministry of Public Security to be applied in its programs for citizen security and to combat delinquency.

Given its fixed amount and very broad base, the Costa Rican tax can only be applied at a modest rate (which can be afforded by all businesses regardless of size) and is therefore bound to produce limited revenue.

### ***Tax on the Surpluses of Cooperatives***

In **Honduras**, cooperatives are exempt from income tax. The Law on Citizen Security (2011, see below) established a Special Contribution from the Cooperatives Sector, levied at the rate of 3.6 percent on the net annual surplus, defined as the excess of revenue over expenditure.<sup>20</sup> The contribution will be collected over five years for a trust fund for citizen security.

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<sup>17</sup> Law No. 6 of June 30, article 11.

<sup>18</sup> Law No. 223 of December 20, article 285.

<sup>19</sup> Law No. 9024 of December 23, 2011.

<sup>20</sup> Article 44-A of National Congress Decree No. 105-2011 of June 24 (Law on Citizen Security), added by Article 2nd of National Congress Decree No. 166-2011 of September 14.

### *Wealth Taxes*

**Colombia** has successfully put the burden of expanding the state presence of security operations across the territory on the shoulders of the wealthiest members of society. This was accomplished by using special powers granted to the government during an emergency situation to establish a wealth tax (*Impuesto al Patrimonio*), popularly known as War Tax. This tax is earmarked for defense and citizen security. The first of such taxes was collected on a one-off basis in 2002 and yielded 5 percent of government revenue or 1 percent of GDP. A total of 420,000 taxpayers contributed in that year, of which 120,000 were high-income individuals and 300,000 were legal persons (Flores-Macias, 2012). The proceeds were entirely earmarked for security.

Starting in 2004, the War Tax was extended through 2011; however, payments will continue through 2014 in the form of surtax on the tax due in 2011. The surtax will be payable in eight semiannual installments beginning in 2011. The following table summarizes the four cycles of Colombia's wealth tax for security. The tax base is the net worth of individuals and legal persons. Equity participations in Colombia are excluded from the base, as is the value of the owner-occupied house up to a limit adjusted annually.

**Table 4. Colombia: Wealth Taxes for Security, 2002–14**

<b>Law</b>	<b>Period</b>	<b>Rate</b>	<b>Exemption threshold (COP million)</b>
Dec. 1838-2002	2002 (one-off)	1.2%	169.5
Law 863-2003	2004–2006	0.3%	3,000
Law 1111-2006	2007–2010	1.2%	3,000
Law 1370-2009 & Dec. 4825-2010	2011	1.0% 1bi to 2bi 1.4% 2bi to 3bi 2.4% 3bi to 5bi 4.8% > 5bi	1,000 (bi=billion COP)
Dec. 4825-2010	2011-2014	25%/4 of 2011 tax	1,000

### *Financial Transaction Taxes*

To address the imbalance between resources available to common and organized criminals on one hand and the budgets of agencies in charge of preventing and combating crime on the other,



in June 2011 **Honduras** enacted the Law on Citizen Security (*Ley de Seguridad Poblacional*), creating a Security Fund managed by government and civil society organizations.<sup>21</sup>

The fund is financed by a Special Contribution on Financial Transactions Pro Citizen Security, later renamed Charge on Transactions in Financial Institutions, both referred to in popular parlance as the Security Tax (*Tasa de Seguridad*). The contributions consist of:

- a) a 0.15 percent charge on the amounts that individuals and private enterprises withdraw from financial institutions, and debits to accounts held in said institutions;
- b) 0.2 percent on cashier checks and traveler checks issued; and
- c) a fixed amount, ranging from 500 HNL to 1,000 HNL, varying with the credit limit granted by credit cards.

The many exemptions available are broadly in line with those typically found in this type of tax.<sup>22</sup> Reflecting the perception that the increase in violence was extraordinary and would subside once addressed, the tax was introduced as a temporary duty to be collected over a period of five years.

### ***Compulsory Loans***

As internal armed conflict mounted, in June 1992, **Colombia** introduced the Bonds for Social Development and Internal Security (BDSI) to finance operating and capital expenditures on national security, programs for social reintegration, and other objectives. The bonds were designed to be vehicle for forced investment in the second half of 1992 by persons and legal entities that had, in 1991, income greater than 7 million COP or gross wealth greater than 30 million COP.<sup>23</sup> More generous thresholds were available for workers and professionals.

Given the urgent nature of the loan and the short time available for its collection, the amount to be subscribed by each taxpayer was presumed to be equal to 25 percent of the income tax due in 1992. BDSIs could be redeemed by applying them, at face value plus interest, in the payment of taxes and other fiscal revenue in 1998.

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<sup>21</sup> National Congress Decree No. 105-2011 of June 24, published in the Official Gazette on July 8. Reforms to the law were made in September and October 2011, and regulations were issued by the Finance Secretariat in January 2012. Collection started on April 20, 2012. New changes are being considered in the face of undesired collateral effects—bank disintermediation, increase in cash payments, capital flight, and tax avoidance—which are resulting in declining collection.

<sup>22</sup> For a survey of bank withdrawals taxes in Latin America see Coelho (2009) and Coelho et al. (2001).

<sup>23</sup> Law No. 6 of June 30, 1992, article 17.

At end 1996, Colombia launched Bonds for Security (*Bonos para la Seguridad*) of mandatory subscription.<sup>24</sup> These bonds were paperless, negotiable, and had a maturity of five years, after which they could be used to pay taxes at face value. Interest, payable once a year, was set at 80 percent of the inflation rate. In 1997, individuals with net worth greater than 150 million COP at the end of 1996 and legal persons—other than those who were exempt—were required to buy Bonds for Security in an amount equal to 0.5 percent of their net worth.<sup>25</sup>

### ***Taxes on Lotteries, Casinos, and Slot Machines***

In **Honduras**, the Law on Citizen Security (2011, see above) established a Special Contribution on Casinos and Slot Machines (*Contribución Especial de Casinos y Máquinas Tragamonedas*) on licensed operators of all sorts of chance games, including slot machines. The contribution is levied at a rate of 1 percent on the monthly gross income. The contribution will be collected over five years for a trust fund for citizen security.

### ***Confiscation of Property***

A number of Latin American countries have passed, or are in the process of passing, laws allowing the seizure and forfeiture of property unlawfully acquired or used for criminal purposes. In December 2002, **Colombia** established rules for confiscating property used for, or resulting from, criminal activity or accrual of wealth without a lawful origin.<sup>26</sup>

The assets confiscated, or the net proceeds from their disposal, are made available to the Fund for Rehabilitation, Social Investment, and Combat to Organized Crime (*Fondo para la Rehabilitación, Inversión Social y Lucha contra el Crimen Organizado, Frisco*). This fund is an accounting device managed by the National Directorate of Narcotics (DNE) that is used to:

- finance social investment and security,
- finance combat against organized crime,
- rehabilitate military personnel and policemen hurt in the line of duty
- co-finance the system that handles teenage offenders,
- strengthen the prison infrastructure,
- strengthen court management, and
- operate the DNE.

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<sup>24</sup>Law No. 345 on Civil Forfeiture of Illegal Assets (*Ley sobre Privación Definitiva del Dominio de Bienes de Origen Ilícito*) of December 27.

<sup>25</sup>Equity participations were excluded from a firm's assets for purpose of the forced loan.

<sup>26</sup>Law No. 795 of December 27.

**Mexico** adopted a Federal Law on Property Forfeiture (*Ley Federal de Extinción de Dominio*) to regulate confiscation of assets derived from criminal activity.<sup>27</sup> The proceeds (after disposition of non-monetary assets) are earmarked to a trust fund managed by the *Procuraduría General de la República* and used to support or assist the victims of violence. The various Mexican states, as well as the Federal District (Mexico City), in turn adopted property forfeiture laws in the scope of their jurisdictions.

In May 2010, **Honduras** adopted legislation<sup>28</sup> that allowed assets acquired by the illegal activity of organized crime members to be expropriated. Seized assets include dollars confiscated in airports, property and bank deposits confiscated from narcotics traffickers, and goods confiscated from smugglers. To execute the law and liquidate the assets so obtained, a special body was created: the Administrative Office of Seized Goods (*Oficina de Administración de Bienes Incautados*). The net proceeds are distributed to the Prosecutor's Office, the Department of Security, the Defense Department, the Office of the President, and the Office of Social Development.

Also in 2010, **Guatemala** passed a law allowing the forfeiture of assets obtained through illegal activities and crime, especially organized crime.<sup>29</sup> To administer the system, the National Council for the Administration of Forfeited Assets (*Consejo Nacional de Administración de Bienes en Extinción de Dominio*) was created. The Vice-President of the Republic heads this special office. The proceeds from liquidated assets are distributed to various government agencies with a stake in security, to be applied as follows:

- 20 percent to intelligence units enforcing the Law Against Organized Crime, and to units in charge of intercepting drugs transported by sea or sky;
- 20 percent for programs of witness protection and investigation and trial of money laundering, narcotics trafficking, and organized crime;
- 18 percent for training and equipment purchase in support of investigation units and the National Civil Police's center for analysis and dissemination of criminal data;
- 15 percent to cover costs of managing the system of forfeiture;

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<sup>27</sup> Published in the *Diario Oficial Federal* of May 29, 2009. The law is enabled by Article 22 of the *Constitución Política de los Estados Unidos Mexicanos*.

<sup>28</sup> National Congress Decree No. 27-2010 of May 31.

<sup>29</sup> Congress Decree No. 55 of December 7. The law opens with the following consideration: "Whereas: In recent years, there has been a dramatic increase in the number of crimes against government and individual property, as well as those causing serious harm to life, integrity, liberty and health of the people of Guatemala, related to organized crime and other forms of illicit or criminal activities" (translated by the author).

- 25 percent to funds controlled by the judicial system; and
- 2 percent to the office of the Attorney General.

**Bolivia**'s Plurinational Legislative Assembly is in the process of passing a Law of Forfeiture in Favor of the State that will give the authorities power to confiscate assets obtained unlawfully by narcotic traffickers, smugglers, and public servants whose wealth comes from criminals, as well as assets employed in performing such activities. The proposal faces considerable opposition,<sup>30</sup> so the prospects for its adoption are uncertain.

#### ***Charge on Mining Activities***

**Honduras**' Law on Citizen Security (2011, see above) established a Special Contribution from the Mining Sector, also called Special Contribution to the Environment. The contribution is levied at 2 percent on the FOB value of mineral exports. The contribution will be collected over five years for a trust fund for citizen security.

#### ***Charge on Communications Services***

**Honduras**' Law on Citizen Security (2011, see above) also established a Temporary Special Contribution on Mobile Telephony Pro Citizen Security. The 1 percent rate is levied on the monthly gross revenue of companies providing services of mobile voice telephony. The contribution will be collected over five years for a trust fund for citizen security.

#### ***Charge on Food and Drink Franchises***

In **Honduras**, international fast food franchises enjoy special tax preferences (*régimen especial*). By the Law on Citizen Security (2011, see above), these companies became liable to a Special Contribution by the Sector of Food and Drinks (*Contribución Especial del Sector de Comidas y Bebidas*) at the rate of 0.5 percent of monthly gross income. The contribution will be collected over 5 years for a trust fund for citizen security.

#### ***Charge on Government Contracts***

In 1997, **Colombia** created the National Fund for Security and Citizen Coexistence (*Fondo Nacional de Seguridad y Convivencia Ciudadana*), administered by the Ministry of Interior

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<sup>30</sup> Open opposition comes mainly from the transportation sector (truck owners) and the small traders organizations. On October 23, 2012, the transport sector demonstrated in six large cities, disrupting services, and continued to mobilize. They fear that their vehicles will be confiscated when caught transporting narcotics or contraband. Small traders, who also launched street demonstrations, fear that their informal activity will be severely affected by the proposed law. In view of the lack of consensus among the various stakeholders, on November 5, 2012, President Evo Morales sought the opinion of the Plurinational Constitutional Court.

(until 2011, Ministry of Interior and Justice) and coordinated by the Ministry of National Defense.

The sources of financing for the Fund include a 5 percent withholding charge on public works contracts and addenda awarded by governments; a 0.25 percent withholding charge on contracts for the construction, maintenance, and operation of roads, ports, and airports; and a 3 percent withholding charge on contracts for tax collection services. If a regional or local government signs the contract or addendum, the charge is sent to the Fund for Security corresponding to that government. The charge on government contracts was designed initially to last a couple of years but ended up being extended in 1999, 2002, 2006, and 2010, this last time for three years, such that the charge is to be collected through December 2013.

### ***International Cooperation***

Crime and violence have acquired an international dimension, with spillovers damaging neighboring and far away countries. Small-sized countries, such as those in Central America and the Caribbean, are especially vulnerable to cross-border criminality. Addressing this problem requires not only coordination of policy (and police!) action, but also technical and financial support from international organizations and willing donors.

The United Kingdom's Department for International Development (DfID), the Canadian International Development Agency (CIDA), and the UNDP are among the institutions active in LAC promoting citizen security. Often in partnership with the IDB, which has developed deep specialized knowledge of the region and expertise in project design and implementation, these organizations provide financial support to programs geared to the prevention of crime and violence.

One example of such cooperation is the Citizen Security and Justice Program (CSJP) in Jamaica, which has received soft loan and grant support from the DfID and the IDB. The CSJP is based on strategic interventions in high-crime urban communities. Working together with authorities and civil society, it aims at promoting a culture of lawfulness, curtailing access to crime through greater socioeconomic opportunities for youth at risk, and improving community governance. A combination of grant and long-term lending was also mobilized by the IDB to help Guyana reform its approach to crime management, from a purely reactive attitude to greater reliance on patterns and a systemic analysis of incidents and problems.

Resistance to the introduction of new methods, lack of cooperation among government agencies and between governments, and lack of staff and skills in the agencies tasked with public security are among the barriers to development in this important area. These barriers tend to be overcome, and reform facilitated, when changes are implemented jointly with peer countries. For this reason, multi-country programs stand a better chance of galvanizing enthusiasm. Also, a multi-country approach tends to be more effective in mobilizing donor assistance.

An example of a multilateral initiative to promote security is the IDB-managed Multi-donor Fund in support of the Citizen Security Initiative (CSI). The CSI, which complements other activities of the IDB in the area of public security, will support countries in the LAC region in improving the effectiveness of their citizen security policies. Other important initiatives benefitting LAC countries are the *Fondo Regional para la Lucha contra el Crimen Organizado*, which is handled by the secretariat of the Central American Integration System (SICA); the Caribbean Basin Security Initiative (CBSI), an integrated effort of the United States, the CARICOM countries, and the Dominican Republic to combat drug trade and other international crimes in the region; and the Multidimensional Initiative of the OAS, which provides regional support, emphasizing small island states.

Support from international financial institutions is advantageous regardless of concessional financing. The IDB is providing co-financing to various Brazilian states at interest rates that exceed the cost of funds for the Bank. One of these projects is *Paraná Seguro*, which was launched in 2012 to stem the tide of violence in the state of Paraná with a broad approach on the factors and risks of criminality, especially among youth. The project helps bring together the knowledge and effort of various stakeholders, provides a structured framework for action, and establishes a mechanism to monitor and evaluate results.

#### ***Miscellaneous Security Financing Initiatives***

The Honduras initiative of earmarking revenue sources for citizen security has prompted a discussion, in the region, of the pros and cons of that approach, and similar initiatives have been proposed. Earmarked taxes for security have been suggested in **Guatemala** but the idea met with strong resistance. After its inauguration in June 2009, the government of **El Salvador** considered introducing security taxes of the type adopted by Colombia in the early 1990s, but politicians and other stakeholders did not receive the idea well, and thus it was abandoned. In **Mexico**, the concept received some discussion but a clear proposal did not materialize.

In **Argentina**, some provincial governments are trying to create new sources of revenue dedicated to citizen security. In April 2011, the legislative chamber of the province of **Tierra del Fuego**<sup>31</sup> introduced a proposal to create a Provincial Fund for Equipment in Public Security financed by earmarking 1.25 percent of the proceeds from the Tax on Gross Turnover (*Impuesto sobre los Ingresos Brutos*), a sales tax levied at the provincial level, and other provincial revenues. In October 2012, a proposal was advanced in the province of **Santa Fe** to create a Provincial Public Security Fund, although the structure of its financing is still unclear.

### **5. Earmarking or Not Earmarking Funds for Public Security?**

Setting aside revenue to use for specific purposes, also known as earmarking, ring fencing, and hypothecation, has a long and controversial history. Earmarking has advantages and disadvantages, and judgment about the instances where earmarking is justified cannot be made on purely technical grounds.

Public finance has developed a number of general principles for public budgeting, including legality, periodicity, unity, comprehensiveness, publicity, balance, clarity, and non-earmarking. The main argument against earmarking funds rests on the perception that it reduces the space for planning. It is also argued that earmarking “freezes” the tax instrument and makes it more difficult to use in countercyclical policies.

Before the practice of modern budgetary principles developed, many countries had a multitude of taxes, each one created to meet some special need. The result was usually low compliance, insufficient resources, and poor allocation of government revenue. In the beginning of the 19<sup>th</sup> century, before Gladstone reforms were implemented, Britain’s public budget was awash with revenue earmarking (Daunton, 2001). A United Nations study in the early 1950s found more than 400 taxes in Bolivia, a far cry from the few taxes the country has had since the 1986 reform. In the late 1970s, the *Musgrave Report for Bolivia*<sup>32</sup> found that the widespread use of earmarking in large part reflected vested interests in particular revenue sources without any fundamental rationale in good fiscal management. In the 1960s, a study found around 300 separate earmarked taxes in Ecuador (Bird and Jun, 2007).

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<sup>31</sup> *Provincia de Tierra del Fuego, Antártida e Islas del Atlántico Sur.*

<sup>32</sup> Richard A. Musgrave (dir.), *Fiscal Reform in Bolivia: Final Report on the Bolivian Mission on Tax Reform.* Cambridge Mass.: The Law School of Harvard University, 1981.

However, Musgrave's report for Bolivia does not go as far as proposing elimination of all cases of earmarking. The risk of economic waste is greater, the Report asserts, if expenditures on a particular item are financed entirely or largely by earmarked revenues. In this case—especially if the source of income is fully earmarked—there is a tendency to overuse the earmarked source and neglect others. Instead of tagging a specific source of revenue, the Report advises, it would be preferable to earmark a percentage of *total* revenues.

The Musgrave report notes that it is also positive to use earmarked taxes as substitutes for user charges or fees. Such is the case of gasoline taxes used to cover highway maintenance, as well as revenues from the hotel tax to finance tourism services.

### ***A Purist View of Public Finance***

Many public finance specialists believe that there should be no room for earmarking in a properly designed tax system; all revenues should go to a common pool and there should be no relationship between revenue raised in a sector or activity and public expenditures in that sector or activity. As meant, no earmarking would reduce the marginal cost of public finance and maximize efficiency: every peso of financing would be used where its impact on social welfare would be the greatest. Therefore, during the budgeting process, each government program would compete for the total revenue available, and the more meritorious programs would command more resources. The allocation process would continue to the point where the marginal social benefit would be the same across all programs.

This vision is, of course, quite demanding in terms of information,<sup>33</sup> and ignores the difficult, sometimes even messy, process of preparing a budget proposal—not to mention the quality of its implementation. The vision also overlooks the political economy of taxation: taxes are more acceptable if the corresponding benefits (through public expenditures) can be seen easily. The truth is that earmarking, by being more stable than the annual budget decision process, is a double-edged sword: it can be used to maintain the privileges of groups with high political clout and to shield high-value programs that lack strong political support from unjustified cuts.

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<sup>33</sup> This high information requirement is called “the traditional public-finance approach of a monolithic fully informed planner” by Bos (2000).



### *Patterns of Earmarking*

For policy and analytical purposes, it is convenient to consider different types of revenue earmarking:

#### *(a) Revenue from a particular tax used for a particular purpose*

In this case, proceeds of a particular tax are used to finance a program, activity, or institution. For instance, Japan's road tax (on petrol) is earmarked for road repair and construction. A road fund, using the proceeds of fuel taxes for road maintenance, was in place for many years in the United Kingdom before absorption into general government revenue.

Road funds financed by earmarked taxes have been quite popular in various parts of the world. The largest road fund is the U.S. Federal Highway Trust Fund. In Latin America, such funds are found especially in Central America (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua). Some Brazilian states also have road funds. Several road funds were created in Africa, with varying degrees of success.

The rationale for this type of earmarking is that it comes close to replicating user charges, whereby beneficiaries of the goods and services provided pay for the corresponding cost. If a fuel tax is well designed, the cost of road maintenance could be reflected in the price of gasoline.

#### *(b) Broad-based tax revenue used for a particular purpose*

Some priority expenditure programs sometimes have, by constitutional or legal design, a claim on a fixed percentage of all public revenue or a significant part of it. One example of this is Bolivia's longstanding practice of assigning 5 percent of total revenues to the universities.

In Brazil, the constitution earmarks a fraction of the public budget for spending considered high priority.<sup>34</sup> Thus education must receive the lion's share of the budget: at least 18 percent at the federal level and 25 percent at the state and municipal levels. States and municipalities must spend a proportion of their budget not smaller than 12 and 15 percent, respectively, on healthcare.

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<sup>34</sup> In a budget balanced and fully financed by tax revenue—which is not the case in Brazil—earmarking a percentage of budget expenditure is equivalent to earmarking the same percentage of total tax revenue.

Earmarking revenue from a broad base is superior to earmarking a single tax because total revenue is typically less volatile than a single tax, thus minimizing the financing shocks on the financed activity. Further, the main distortions arising from earmarking revenues are a result of excessive financing. If the revenue from the earmarked tax exceeded the corresponding expenditure requirement, inertia would tend to prevent a downward adjustment in the source of revenue, and as a result, inefficiency could develop. While some oases in the government are awash with revenue, other areas, no less important, are starving for financing.

To minimize this risk, earmarked revenues should not cover the full cost of the activity. Some fraction should always come from general revenue so there is room for a discretionary adjustment in the annual budget whenever the earmarked component becomes more robust than initially anticipated. This prevents spending priority being determined by financing.

*(c) Intergovernmental finances: sharing a particular tax*

Large countries organized in federations need a multi-layered structure of taxation, supplemented by a system of equalizing intergovernmental transfers.<sup>35</sup> Often, when a tax base is to be shared by two different governments, it is practical to create one tax collected by one government, which remits part of the proceeds to the other instead of creating two separate taxes. For example, in Brazil, the annual tax on motor vehicles is collected by the states, which automatically remit half of the proceeds to the municipality where the car owner lives. In Australia, the Commonwealth (federal) government collects the Goods and Services Tax (GST)—a tax known elsewhere as Value Added Tax (VAT)—and remits 100 percent of revenue to the states.

*(d) Intergovernmental finances: sharing broad-based tax revenue*

This case also pertains to federations, but unlike sharing a particular tax, it involves substantial transfer of tax revenue from the central government to subnational governments (states and/or municipalities). The amount of the transfers is typically based

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<sup>35</sup> See Ter-Minassian (2012) for an overview and Ter-Minassian (1997) (and other works in the same volume) for a systematic approach.

on a formula that gives more weight to jurisdictions with greater needs and weaker tax bases.

In Argentina, shared taxes (*impuestos coparticipados*) comprise most domestic taxes collected by the federal government. In Brazil, a formula-based fraction of two major federal taxes (income tax and excises—but not the federal general sales taxes PIS and COFINS) are remitted automatically to the states and municipalities.

Intergovernmental finances (c and d) are not earmarked taxes but a split of tax revenue either by sharing a particular tax or providing an equalizing transfer to financially weaker members of the federation, in line with the federalist arrangement. These two forms of tax revenue distribution are, therefore, of lesser interest for our analysis.

### ***Arguments that Support Earmarking***

#### *(a) Public policy school of thought*

In public finance, the public policy school sees government as the agent of citizens. Imperfections in the political process, as well as conflict of interest (the principal-agent problem), contribute to public officials developing interests of their own and, as a result, government agencies becoming over dimensioned and thus excessively costly.

Linking each government activity with a dedicated source of financing would permit better citizen scrutiny and prevent government overruns. Therefore, earmarking would be a good device to restrain public expenditures.

#### *(b) Spending providing support for taxation*

It is sometimes argued that knowing where public money is spent, thus seeing a connection between cost and benefit, citizens would be more willing to accept the burden of financing and willingly comply with tax laws. Therefore, if the public values the goods or services financed by earmarked taxes, taxation would become more palatable. This argument is especially relevant in convincing stakeholders of the benefit of environment taxes, and especially so if one is to wield the double-dividend hypothesis.<sup>36</sup>

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<sup>36</sup> The double-dividend hypothesis assumes that taxing polluting activities can achieve two types of benefits. First, betterment in environment by a curtailment in pollution. Second, a gain in efficiency through the use of the environmental tax revenue to reduce other, more distorting, taxes.

*(c) Islamic finance*

Citizens of predominantly Islamic countries tend to have an appreciation of taxes that is the more negative the broader the base of the tax. Zakat (a religious, redistributive tax) and user charges, together with net income of public enterprises, are more positively viewed. To the extent that earmarking establishes a connection between the tax and the corresponding benefit (even if the beneficiary is not the taxpayer), the tax could be taken in better regard.

*(d) Slicing and advancing in tax reform*

Using political science theory, Camic (2012) argues that the failure of tax reform in the U.S. over several decades stems from the fact that this reform spreads its benefits among broad groups while concentrating its costs in narrow ones. Evidence indicates that U.S. states have successfully escaped tax reform paralysis by earmarking taxes for specific purposes. Therefore, it is argued, the U.S. federal government could pursue a similar approach.

*(e) Fees for specific events*

Although there is much to be said about the jointness or collective nature of consuming public security services, it is also true that certain events where exclusion is possible (concerts, car races, other sport events) require extra effort of police services in the vicinity and along the access roads. More and more a view is firming up that the event should bear these extra costs that presently burden the community at large. Recently, Spain has made legal the possibility of levying fees for security services (not services provided within the premises, which have a private not public nature) in specific cases where providing a service could be pinned down to an event and beneficiary.

***Stabilization and Earmarking***

One disadvantage of tax earmarking is that whenever taxes are raised as a countercyclical, macrofiscal policy, the additional tax revenue, if earmarked, is automatically available for spending, thus militating against expenditure restraint and the macroeconomic objective of creating fiscal savings for stabilization.

### *A Tentative Conclusion About the Desirability of Tax Earmarking*

Since tax earmarking is not presumed to be the policy of choice, it should be used pragmatically. It is not desirable per se, but for certain objectives. Earmarking may be acceptable as the political price to pay for a desirable tax that would not otherwise be implemented. It may help strengthen execution of programs whose time footprints extend over various years.

Earmarking, if used, should be limited to a subset of tax revenue, since a budget fully earmarked would be a straitjacket, an unwieldy instrument. There is a risk of economic inefficiency, so to mitigate this risk, earmarking should be used to finance expenditures that are efficient and socially valuable. Whenever earmarking is used, administrative arrangements—and if possible the quality of expenditures financed—should be transparent and reviewed regularly. The argument for earmarking is strengthened to the extent that environmental considerations do not get traction in the political process compared with other programs, and especially so if earmarked funds finance the minimal capacity to begin applying environmental laws that would otherwise be lacking.

Financing for an activity should not come exclusively from earmarked taxes. Further, variations in earmarked revenue should not translate automatically into equal variations in financing of the activity. Earmarking a percentage of total budget expenditures to some activity is preferable to earmarking a percentage of the revenue from a tax. Intergovernmental transfers are not part of earmarking and have a different rationale.

What is surprising about tax earmarking is that it has almost no effect on the efficiency of public expenditures. Reviewing the literature, Bird and Jun (2007) found that earmarking rarely results in increased spending on the desired category. Money is fungible, so earmarking allows authorities to free-up general fund resources for other purposes according to their own priorities.

Earmarking, however, plays an important symbolic role in reducing taxpayer resistance to new taxes. In Brazil, the tax on bank debits was peddled in congress by the minister of healthcare, who convinced deputies and senators that those resources were needed to improve public health services.<sup>37</sup> In adopting taxes earmarked for public security, governments of Latin America have wielded the argument of urgent specific need, which arouses sympathy in the population, but one can hardly find a rule to ensure additionality of the earmarked resources.

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<sup>37</sup> The revenue collected, however, was channelled to general budget revenue.

Abstracting from issues of fiscal illusion and transparency,<sup>38</sup> earmarking does not seem to fully deserve its bad reputation.

## **6. Policy Alternatives to Finance Citizen Security**

All evidence points to the need to strengthen citizen security in LAC. Although there are gains to be made in efficiency, such that more could be made with resources currently available, the gap in providing public security—prevention, citizen participation, preparedness, enforcement, judicial process, prison with dignity and reeducation, rehabilitation...—is so wide that it is reasonable to presume that new resources will need to be mobilized.

In some countries more than others, it is hard to see how resources devoted to financing security can be reduced or even kept at the current level in the near future. The budgets of LAC countries are tight; there is not much room to raise new taxes or replace other expenditures. Better public security requires financing that is steady, integrates short- and medium-term policies and actions, and is not subjected to the vagaries of the annual budget cycle.

With organized crime increasingly structured domestically and internationally, every country is bound to face surges in criminal activity that are costly and take a long time to overcome. Extraordinary spending should not be made at the expense of ongoing programs. With this in mind, the following financing policies could be considered as beneficial to citizen security.

### ***Planning, Programming, and Budgeting***

Providing public security is a complex and multifaceted activity. Efficient delivery requires defined priorities and strategies over a number of years or possibly a rolling plan where costs and outputs (achievements) are forecast for the various subprograms in each year but in greater detail for the period ahead. The multiyear approach is essential because many programs under the umbrella of citizen security, including technology and information, staff capacity building, interaction with communities, and international cooperation, extend well beyond the budget cycle.

Since *ex post* evaluation is essential, performance criteria should be established *ex ante*. Performance evaluation should be persistent and, to the extent possible, a periodical assessment should be done of the social return on security spending. Also, a strong practice of transparency

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<sup>38</sup> See, for example, Tanzi (2010) and Alm and Torgler (2011).

on *inter alia* structure, objectives, planning, activities, and results would go a long way in garnering credibility and support from the population. Financing plans cannot be open-ended. An envelope of resources could be defined from the start, and iterations between planned outcomes and financing mobilization are desirable.

### ***Protection of Security Financing***

Security is a basic human need. In Maslow's (1943) hierarchy of human needs, safety (security, order, stability) is second only to physiological needs. Also, safety is a prerequisite for socialization and personal development, which are higher up in the pyramid of needs. It follows that public sector budgets should not place citizen security at a lower priority than education and healthcare. The best way to honor this priority would be to ensure financing for the multiyear security plan mentioned above. The existence of a multiyear plan per se does not guarantee the needed budgetary allocations next year and beyond. Such a plan risks being treated as indicative, with good ideas that will be implemented "if and when resources are available." And nothing is more disruptive to security than discontinuity in financing. Achievements are incremental and, to some extent, immaterial, incorporated in human capital, and, as such, dependent on considerable stability of personnel, sequential training, and motivation.

To overcome the risk of underfinancing, high-ranking legislation could ring-fence a fixed proportion of the budget for security, not necessarily of the same amount, but not very far from, the average annual needs expressed in the multiyear security plan. The partial earmarking of a major tax would be second best.

### ***Dealing with Peaks and Valleys of Security Needs***

Security outlays have an ordinary, recurring component and extraordinary needs or peaks. When the expenditure peak is anticipated, for example a major upgrade of computer systems, the extra cost can be smoothed out in the budgets of various years. Normally this is done by servicing (amortization and interest) loans used to finance the one-off investment.

The occurrence of peak spending may, however, be due to unforeseen developments, such as a major outbreak of violence. In this case, additional financing should be obtained in order to avoid disrupting the execution of ongoing security activities. Fresh financing could come from a grant or loan (e.g., a state or province could rely on the central government) or additional revenue would need to be mobilized. The experience of LAC countries (see section 4),

especially Colombia and Honduras, shows that a variety of tax bases could be used if the need arises.

### ***Other Good Candidates for Sources of Security Financing***

There are a number of possibilities to strengthen the financing of citizen security programs, including the following:

- Participation in the lottery margin (revenue minus prizes minus running expenses) could provide a steady source of financing.
- Loans need to be repaid. Therefore, they are generally not adequate for financing operating expenses, although they are important in financing capital outlays that provide a suitable social return. Also, some loans have soft conditions (concessionary financing) with an implicit element of partial subsidization.
- International cooperation in security matters offers a range of possibilities, including grants, joint programs that defray the cost of certain security initiatives, and transfer of technology and knowledge.
- Partnerships with civil society organizations and other stakeholders may provide financing for security or sharing the security burden. For example, it behooves insurance companies to contribute to financing security services that result in less property (e.g., autos) being stolen.
- To correct somehow for the imbalance in security, consideration could be given to earmarking a proportion of the taxes paid by private security enterprises for public security for the poor.

### ***Which Financial Instruments Are Most Effective?***

This paper has outlined tax and other financial instruments that can be—in fact, have been—mobilized to finance citizen security. These experiences are relatively recent and have received scarce analysis. Also, the modern configuration of earmarking (niches of dedicated financing within an otherwise general budget fund) is well known in the Americas but of limited use in other regions of the world.<sup>39</sup>

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<sup>39</sup> The author knows of no tax earmarked for security needs outside Latin America. Even earmarking for education and healthcare is seldom significant outside the region. In contrast, earmarking of taxes and contributions to finance social security programs is widespread. Also common are road funds and petrol taxes collected to finance road maintenance.



With earmarking not being a main issue (see discussion above), *the choice of policy instruments should be based on the basic tenets of tax policy, which emphasize preference for taxes that are less-distorting, non-regressive, easy to comply with and collect, and, in the case of dedicated taxes, having a nexus between the tax and the public services provided.*

These criteria suggest that a tax on bank transactions, as the one adopted in Honduras, is a poor choice. The financial disintermediation caused by taxes on bank transactions is well documented (Coelho, 2009; Coelho et al., 2001). Australia, Brazil, Ecuador, India, Papua New Guinea, Paraguay, Vanuatu, and Venezuela are all countries that have abolished this type of tax.<sup>40</sup> In contrast, the taxes levied by Honduras on mining, communications, profits of cooperatives, and selected provision of food and drinks for public security purposes are smart taxes for that country. Not only do they not create distortions, they *reduce* distortions in the tax system while raising new revenue because the targeted bases have long enjoyed privileges, escaping general taxation and benefitting from tax incentives. In this case, taxation, be it for public security or other uses, reduces tax expenditures and helps level the tax playing field.

A type of tax that would be a good candidate for earmarking for public security in Latin America is taxation of tangible property, especially land, urban real estate property, and motor vehicles. In many LAC countries, political resistance has kept those manifestations of wealth underutilized as tax bases. Improvement in public security and the rule of law, made more viable by setting aside the proceeds on property taxes for security outlays, would directly benefit taxpayers, thus introducing an element of user charges.<sup>41</sup> This would provide a political economy argument for acceptance of the tax. Taxes on the *holding* of property tend to be less distortive than other taxes, such as taxes on the *transfer* of real estate property, which tend to inhibit market transactions (lock-in effect). In addition, property taxes can easily be made non-regressive by introducing an exemption threshold or preference for properties typically owned by

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<sup>40</sup> Colombia is phasing out its financial transactions tax, and Peru reduced the rate of its tax to one-twentieth of its original level. Mexico and Pakistan apply such a tax only on certain cash transactions. This leaves Argentina, Bolivia, Dominican Republic, and Honduras as the residual realm of taxes on bank transactions.

<sup>41</sup> The link between financing and benefit requires that the tax proceeds are made available to the level of government that carries the brunt of public security expenditures. In many Latin American countries, this happens at the subnational level.

low-income families.<sup>42</sup> Finally, property taxes are easy to comply with and among the least demanding in terms of administrative capacity and effort.<sup>43</sup>

Colombia's experience sheds light on revenue mobilization for security. Earmarked taxes are more sustainable the more moderate the rate and the broader the base. Preferences tend to erode tax morale and support. Also, compulsory borrowing is a doubtful strategy to finance running expenditures as repayment of interest and principal create new pressures on the public finances in the medium term. As pointed out by Afonso (2004), for Brazil, no less important than budgetary assignments for security are procedures that guarantee effective and timely delivery of the resources. Finally, international financial support, be it in the form of grants, burden sharing, or concessional lending, has its own rationale and should not be seen as competing with or replacing domestic revenue mobilization.

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<sup>42</sup> The progressive characteristic of the tax is enhanced by the maintenance of good property records (which in turn requires good information systems) and the periodical updating of property values, the base of the tax.

<sup>43</sup> A side benefit of property taxation in countries where property records are unreliable (incomplete titling, deficient cadastre) is to create a presumption of regular ownership therefore contributing to the stabilization of property rights.

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