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Fiscal Contracting in Latin America☆

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Summary. — Latin America has long been characterized as a region of high income inequality. In recent years, however, many Latin American countries have seen a decrease in income inequality and poverty levels and an increase in economic mobility. Fiscal policies have played a role in achieving these results. One important explanation for changing fiscal policies is the increasing economic and political role played by the growing middle class in shaping the level and quality of collective goods and services and the types of taxes and relative tax burdens to fund these expenditures. Through a process we call "fiscal contracting," less unequal societies may be willing to pay more in taxes for expanded, relatively universal public services.
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Key words — fiscal redistribution, taxation, inequality, fiscal contracting, middle class, Latin America

1. INTRODUCTION

Latin America has long led the world in income inequality (Blofeld, 2011). Latin American fiscal policy, especially tax policy, did little to remedy this state of affairs (Mahon, 2011). Recently, however, much of Latin America has become less unequal, with lower levels of poverty and likely greater economic mobility (Lustig, Lopez-Calva, & Ortiz-Juarez, 2012), partly because fiscal policies throughout the region have become slightly more progressive (Mahon, 2012).

Tax and spending policies in all countries are notoriously sticky. They reflect a rough political equilibrium among the various interests that shape policies. Changes in fiscal outcomes are thus likely to follow changes in the political balance. The recent fiscal changes in Latin America reflect a marked increase in democracy in the region (Focanti, Hallerberg, & Scartascini, 2013), a substantial expansion of the middle class (Ferreira *et al.*, 2013), and the emergence of an increasing number of left-of-center governments (Stein & Caro, 2013). However, the links between democracy and increased fiscal redistribution are not as simple or unidirectional as the dominant Meltzer and Richard (1981) model suggests (Acemoglu *et al.*, 2013). Nor have progressive fiscal reforms been confined to countries with left-oriented governments (Fairfield, 2010).

Although experiences in Latin America are as varied as the countries of the region, the story of recent developments is both economic and political (Lopez-Calva & Lustig, 2010). Economic growth has produced more and better jobs and hence a less unequal pre-tax (market-generated) distribution of income, with an expanding middle class and an increasing income tax base. [1] While tax burdens (tax-to-GDP ratios) in most Latin American countries (other than Argentina and especially Brazil) remain relatively low for the level of economic development, tax burdens have been increasing faster over the last 20 years in Latin America than in any other region in the world (Ter-Minassian, 2012). Although taxes have become a little more progressive, transfers and social spending in many countries have increased sharply, contributing to poverty reduction in both relative and absolute terms. [2] No Latin American country has yet managed to tax the rich very effectively, and the long-term sustainability of recent trends is far from certain. But the scale and nature of recent changes in inequality and redistribution and the role played by fiscal systems differ greatly from those widely predicted a few years ago. We discuss these developments in the next two sections of the paper.

Countries make different choices on collective government goods and services and the types and level of taxes necessary to fund them. Some suggest that modern democratic societies tend to gravitate toward two distinct fiscal equilibria: big government, with redistributive expenditures but less progressive taxes (like Sweden), and small government, with more progressive taxes but less redistribution (like the United States) (Alesina & Angeletos, 2005). Are major Latin American countries likely to follow the small government model with relatively low levels of taxes and public social spending? Or will different countries in the region go different ways, with some (e.g., Mexico) continuing to be relatively small welfare states and others (e.g., Brazil) moving over time to a more European approach with relatively large welfare states? Whichever model countries follow, countries are likely to increase social spending to maintain social stability, financed partly by increased revenues from the VAT and, at least in some countries, by increased revenue from personal income taxes. [3] Whichever revenue road is followed, both the middle class and the wealthy are likely to be required to pay more taxes.

In the final two sections of the paper, we sketch a "fiscal contracting" model and explore some of its possible implications for future developments in the region. One important explanation for changing fiscal policies is the increasing economic and political role played by the growing middle class in shaping the level and quality of collective goods and services and the types of taxes and relative tax burdens to fund these expenditures. We call this process fiscal contracting and argue it plays an important role in understanding changing fiscal policies. In some countries, the expanding middle class may be willing to pay more taxes in return for expanded, relatively universal public services. While there is much we do not yet understand about the links between growth, inequality,

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political institutions, and social structures, this framework may prove helpful in guiding future work in this complex area.

2. INEQUALITY, POVERTY, AND ECONOMIC MOBILITY

The most common summary measure of income inequality is the Gini coefficient, with a higher number representing greater inequality. Table 1 shows Gini coefficients for income inequality for the last 40 years for five major countries in Latin America as well as for the United States and Canada.[4] Although income distribution remains far more unequal south of the border, over the last 40 years the average Gini coefficient has risen by 12% in the United States and Canada, compared to only about 4% in the five Latin American countries. Moreover, the coefficients for these countries declined from an average of .56 in 2000 to .52 in 2010, in striking contrast to the continued rise in the Gini coefficient for the United States and Canada over the same period. For Latin America as a whole, the unweighted regional Gini coefficient (for household per capita income) declined from .53 in the late 1990s to .50 in 2010, with 12 of the 17 countries for which reasonably comparable data are available showing a statistically significant decline (Lustig *et al.*, 2012).

Several different ways exist to measure income inequality. Table 2 sets out different measures of changes in income distribution over the last two decades.[5] Over this period, the share of income going to the top 10% of the population declined sharply in Brazil, Mexico, and Peru, remained almost unchanged in Argentina, and increased in Colombia. While the ratio of per capita income in the top decile to that in the bottom four deciles rose in Argentina and Colombia, it declined significantly in the other three countries. The share of income for the top decile decreased by 9% since 1990 in the five countries as a group, while the share of the bottom 40% (the poor) increased by 9%.[6] Finally, in all five countries, the share of the population living below the poverty line declined sharply. In summary, income inequality and especially poverty decreased sharply in recent years, particularly in Brazil, Mexico, and Peru.

Income equality is linked to social mobility largely through its effects on the extent to which people have equal access to opportunities for improvement, rather than on its direct effects on individual effort (Brunori, Ferreira, & Peragine, 2013). Economic mobility can be measured both by intra-generational mobility (focusing on individuals to determine how much their absolute or relative position improves over time compared with the general population) and inter-generational mobility (estimating how much of a person's income is attributable to parental income).

Intra-generational mobility in Latin America has increased in recent years. Ferreira *et al.* (2013) find that the impressive change in income distribution in Latin America over the last decade or so has resulted in a substantial expansion of the middle class (which they define as those with income, at purchasing power parity exchange rates, of between USD 10 and USD 50 per person per day) from 20% to 30% of the population.[7] Although an annual per capita income of $3650 may not sound like much to North Americans, Ferreira *et al.* (2013) suggest that it is sufficient to provide both a basic middle class standard of living and some resilience to economic shocks. A 50% increase in the size of this group in so short a period is a remarkable achievement. Over two-thirds (68%) of the population of Latin America were still below the middle class level (as defined above) in 2009, but this was much better than in 1995, when 78% were below this point. Those classified as poor (with incomes of less than USD 4 per day) constituted only 30% of the total in 2009 compared to 44% in 1995.

Few people move from poverty to middle class quickly. Most who exit the poor category instead move into what Ferreira *et al.* (2013) call the vulnerable class, with an income between $4 and $10 a day—that is, a level decidedly better than poverty but not enough for comfort. This vulnerable group (which grew from 34% in 1995 to 38% in 2009) is now the largest group in Latin America.[8] Although the absolute size of this group has remained relatively constant, its composition has changed substantially over the last 15 years, with many moving up to the middle class and being replaced by others who were formerly poor.

In contrast, inter-generational income mobility, defined by comparing the incomes of children to the income of their parents (the inter-generational elasticity of earnings) remains considerably less in Peru (0.67) and Brazil (0.58) than in the United States (0.47), although the gap between Chile (0.52) and Argentina (0.47) and the United States is smaller (Corak, 2012). The higher the inter-generational income elasticity, the more likely it is that the children of high-income parents will also have higher incomes. For example, in Peru, if one father makes 100% more than another, then the son of the first is likely to earn about 70% more than the son of the second. In the U.S. (and Argentina), the son of the richer parent is likely to earn about 50% more, and in Canada (and northern Europe), the son of the richer parent will earn only 20% more.[9]

A major factor explaining differences in economic mobility across generations and among countries is access to good education. The United States was a world leader in providing first

Table 1. *The Distribution of Income: Gini Coefficients*

Country	1970	1980	1990	2000	2010
Argentina	.36	.41	.50	.54	.51
Brazil	.58	.60	.63	.64	.56
Colombia	.43	.53	.53	.57	.56
Mexico	.54	.50	.54	.54	.49
Peru	.56	.57	.51	.53	.46
United States	.32	.34	.35	.36	.38
Canada	.30	.30	.29	.32	.32

Sources: For Latin America: Gini coefficients for earlier years from WIDER http://www.wider.unu.edu/research/Database/en_GB/wiid/ and since 1990 from CEPAL http://website.eclac.cl/sisgen/ConsultaIntegrada.asp; coefficient shown is for year nearest date indicated and coverage varies from country to country (e.g., only urban sector for Argentina). For North America: Gini coefficients from stats.oecd.org (for mid-decade in 1970s and 1980s and for late 2000s for last column). Although every effort has been made to make the data as comparable in coverage, concept, and year as possible, there are wide variations from country to country and, over time, even within particular countries. Details of data concepts and sources may be found in the sources indicated.

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Table 2. *Income Inequality and Poverty in Latin America, 1990–2010*

Country and Year		Share of personal income going to top decile	Ratio of per capita income in top decile to that in bottom 40%	Share of population living below poverty line
Argentina	1990	39.4	13.5	16.1
	2000	42.8	16.6	23.7
	2010	39.8	15.1	8.6
Brazil	1990	50.6	31.2	48.0
	2000	53.0	31.9	37.5
	2010	45.0	21.1	24.9
Colombia	1990	42.6	16.7	56.1
	2000	46.4	22.3	54.9
	2010	44.0	20.1	37.3
Mexico	1990	43.8	17.2	47.7
	2000	43.2	17.9	41.1
	2010	37.4	12.8	36.3
Peru	1990	n.a	n.a.	n.a.
	2000	43.6	19.5	48.6
	2010	34.6	11.4	31.3
Average change 2010/1990		−8.8%	+2.4%	−33.7%

Source: CEPAL http://website.eclac.cl/sisgen/ConsultaIntegrada.asp; Argentina for urban only; for years closest to those indicated. As for Table 1, although we have tried to be as comparable as possible over both countries and time, this table should be considered only an approximation, and other numbers may be found in other sources for what seems to be the same concept: for more detailed information on the data, see the source cited.

common school and later high school and university education (Goldin & Katz, 2008), while Latin American countries did much less to support public education (Engerman & Sokoloff, 2001). In recent years, however, while the academic achievement gap between rich and poor groups has widened substantially in the United States (Reardon, 2011), some Latin American countries, although still notably unequal in terms of access to quality education, have made substantial progress in improving the educational attainment of previously disadvantaged groups (OECD, 2012), as well as in improving the quality of education by international standards. [10]

3. THE ROLE OF FISCAL REDISTRIBUTION

Countries differ in the priorities attached to the related but distinct objectives of reducing inequality, reducing poverty, and increasing economic mobility. Moreover, such priorities may change over time. We focus on how fiscal policy affects redistribution between three groups: the rich (the top end of the income distribution, defined variously depending on the data), the poor (the bottom 40% or so), and the huge and varied group in between these extremes called, for want of a better word, the middle. [11]

(a) *Social spending*

Table 3 highlights the recent substantial increase in public social spending in Latin America. [12] Much of the increase in spending levels is attributable to increases in social security expenditures (notably in Colombia and Mexico). Despite the better educational outcomes mentioned earlier, the share of social spending going to education surprisingly declined in many Latin American countries. The effects of increased public expenditure on education in reducing inequality do not appear to be strong in Latin America (Ospina, 2010), perhaps because of the substantial funding of free (or low cost) university education that largely benefits children of higher income groups (Higgins *et al.*, 2014). On the whole, however, social spending (which also includes health, housing, and transfer programs) has reduced income inequality in Latin America. In Brazil and Mexico, for example, cash transfer policies accounted for about 20% of the decline in inequality (Ferreira *et al.*, 2013), while in Colombia an educational voucher scheme allowing poorer students to attend better schools appears to have had significant effects in improving educational outcomes (Angrist *et al.*, 2002). Such programs may provide models for other Latin American countries that seek to increase the inclusivity of different income groups in such key public institutions as schools (Ferreira *et al.*, 2013).

Table 3. *Social Spending in Latin America, Selected Years, 1990–2008 (as percent of GDP)*

Country	1990	2008	Percentage increase over period	Education as percent of social spending 2008	Social security as percent of social spending 2008
Argentina	18.6	24.0	29	24.9	46.1
Brazil	17.6	24.8	41	21.9	51.6
Colombia	6.4	12.6	97	22.3	55.8
Mexico	5.5	10.0	82	35.6	26.4
Peru	4.0	8.7	118	32.1	35.1

Source: Data from http://website.eclac.cl/sisgen/ConsultaIntegrada.asp. Central government only for Colombia and Peru. Figures for Mexico are probably underestimated owing to difficulty in estimating some subnational expenditures. Social spending includes public sector expenditure on education, health and nutrition, social security, employment, social welfare, housing, and water and sewerage.

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One important outcome of extending and improving such critical public services may be to encourage the growing middle class to buy into the expansion of the state sector rather than to follow the well-established path of the wealthy elite and opting out. Latin America's historical inequality has been sustained in part by persistent inequity in access to education (De Ferranti *et al.*, 2004). Better educational opportunities for the children of the emerging middle class were a main driver in building local and state capacity in North America in the 19th and the first half of the 20th century (Sokoloff & Zolt, 2006). In Latin America, however, the wealthy have long avoided public health and education services in favor of costlier, higher quality private services (Higgins *et al.*, 2014). The "exit" of much of the politically articulate population from public services means that their "voice" has not been heard with respect to the need for improving public services (Hirschman, 1970). With greater economic prosperity, increased democracy, and an expanding middle class (much of which remains vulnerable), it may be both possible and desirable to establish stronger links between taxing and spending policies.

Poorly designed social spending systems are another factor sustaining inequality in Latin America (de Ferranti *et al.*, 2004). Services can be provided at the public level (financed through general tax revenues), the private level (perhaps subsidized through tax expenditures), or through social insurance systems (financed by payroll taxes, primarily from workers in the formal sector). For example, educational services can be provided at the public or private level, and old age pensions and health services can be provided at all three levels (public, private, and social insurance programs). Some countries in Latin America, such as Argentina, Brazil, and Chile, introduced traditional compulsory social insurance systems financed by payroll taxes even before World War II. Others, including Colombia, Mexico, and Peru, followed in the 1950s, with Central American countries following suit in the 1960s and 1970s (Mesa-Lago, 2008). The coverage and benefits of these systems varies from country to country, but in all cases the social insurance system is financed through payroll taxes and the benefits may generally be claimed only by those who are or have been employed in the formal sector. [13]

Social insurance systems in Latin America have been characterized as deeply flawed, given their limited coverage of only the formal sector, the marked evasion even within that sector, and the regressive nature of transfers. A careful study of social transfers in eight Latin American countries (including the five on which we focus here) concluded that the existing social insurance system is both "grossly inefficient and regressive" (Lindert, Skoufias, & Shapiro, 2006, p. 4), with the partial exception of the conditional cash transfer systems introduced recently in a few countries. Goñi *et al.* (2011) estimate that about 70% of direct transfers go to the two top income quintiles in Latin America, as compared to only about 40% in Europe (although including in-kind transfers changes the distribution of benefits across income groups).

(b) *Taxation*

Table 4 summarizes some key quantitative facts about taxation in the larger Latin American countries as well as, for comparison, the United States and Canada. The major difference between the two regions is that consumption taxes are the primary source of tax revenue in Latin America while income taxes are the primary source of tax revenue in North America. The regions also differ in the composition of income tax revenues, as the personal income tax is the major source of income tax revenues in North America and the corporate income tax is the major source of income tax revenue in Latin America. Over the last decade, most Latin American countries have seen increases in both tax-to-GDP ratios and the share of taxes coming from income taxation, in contrast to the decline in both ratios in North America.

Over the last 20 years, the key structural features of the tax system did not change significantly in Latin America. In most Latin American countries, corporate and personal income tax rates have declined over this period while VAT rates have increased slightly (Lora, 2012). In general, personal income tax rates have become flatter (with top rates declining to levels comparable to the lower corporate tax rates) and the scope of the personal income tax has become broader (increases in the number of households with income tax liability). As shown in Table 5, the average entry level (threshold) into the personal income tax declined from 2.3 times per capita income in 2001 to 1.4 in 2010, while the level at which the maximum marginal tax rate applies fell from 20.7 times per capita income in 2001 to only 9.1 in 2010, with wide variations from country to country.

These lower initial tax thresholds combined with rising median income have contributed to a substantial increase in personal income tax revenue in some countries (Table 5). In Brazil, for example, a combination of changes in income tax thresholds, increases in income, formalization of employment, and strengthened tax administration resulted in over 50% of those declaring income in 2011 paying income tax, compared to only 36% a decade earlier. [14] In Colombia, personal income tax revenues more than doubled as a share of GDP from 2000

Table 4. *Trends in Taxation, 1990–2010*

Country	Tax ratio (percent of GDP)				Of which income tax				Ratio of Corporate Income Tax to Personal Income Tax (c. 2007)
	1990	2000	2010	Change 2010/1990 (%)	1990	2000	2010	Change 2010/1990 (%)	
Argentina	16.1	21.5	33.5	108	3.7	18.5	16.2	338	2.3
Brazil	28.2	30.1	32.4	15	18.1	19.3	21.2	17	2.0
Colombia	9.0	14.0	17.3	92	29.9	29.3	27.9	−7	n.a.
México	15.8	16.9	18.8	19	27.1	27.3	27.8	2	1.1
Peru	11.8	13.9	17.4	47	5.7	19.8	37.6	460	4.2
Unweighted Average	16.2	19.3	23.9	48	16.9	22.8	26.1	54	2.4
United States	27.4	29.5	24.8	−10	46.8	50.5	43.6	−7	0.3
Canada	41.9	35.6	31.0	−26	48.6	50.1	46.8	−4	0.3

Sources: Tax ratios from OECD (2012a, 2012b); excludes local government for Argentina (provincial government included) and for Peru (except for 2010), and does not include fees levied on hydrocarbon production as taxes. "Income tax" includes all taxes classified as such in GFS (personal, corporate, withholding). Ratio of corporate to personal income taxes for Latin America from Cornia *et al.* (2012); for North America, calculated from data in OECD (2012a).

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Table 5. *Personal Income Taxes in Selected Countries. (as multiple of average per capita income)*

Country	Threshold 2001	Threshold 2010	Maximum 2001	Maximum 2010	Share 2000 (%)	Share 2012 (%)
Argentina	1.4	0.3	16.5	3.7	34.8	38.9
Brazil	1.5	1.1	3.1	2.7	5.0	6.5
Colombia	4.1	2.8	16.6	10.7	1.6	2.0
Mexico	0.1	0.5	49.4	3.4	n.a.	49.5
Peru	2.9	1.7	22.3	14.7	41.3	24.3
Average Latin America	2.3	1.4	20.7	9.1	n.a.	n.a.

Sources: Gómez-Sabaini and Morán (2014) for rate levels and OECD (2012b) for revenue data.
Notes: "Threshold" is the minimum income level at which personal income tax has to be paid; "Maximum" is the income level at which the highest tax rate is applied; "Share" is personal income tax revenues as a share of total income tax revenue.

to 2010; similar, though smaller, increases occurred in Argentina, Brazil, and Peru. [15]

Before 1970, most Latin American tax systems collected relatively little tax revenue, and did so in an inefficient and regressive way. Over the next few decades, while income tax rates were cut (in most countries without any offsetting base expansion), the role of the VAT was greatly expanded, with the important effect of strengthening the tax administrative capacity of the state. However, the main responsibility for redistribution remained on the expenditure side, and increases in social spending toward the end of the century (Table 3) resulted in social spending programs becoming more redistributive in some countries (Barrientos, 2011). Although most tax reforms in the region have shifted tax structures away from reliance on income taxes and toward consumption taxes, some countries have recently increased their reliance on income tax, and all countries in the region have increased their tax-to-GDP ratios.

Economic and technological changes alter the relative costs of imposing taxes, resulting in changes in both tax structures and tax levels (Gordon & Li, 2009; Kenney & Winer, 2006). The widespread adoption of the VAT has played a central role in improving the effectiveness of tax administration in Latin America, because the successful implementation of this tax usually requires a substantial upgrading of the capacity to administer taxes (Mahon, 2011). The early adoption in Brazil of a (very imperfect) state VAT strengthened both accountability within the public sector and the degree of trust between taxpayers and tax officials (Pinhanez, 2008). Provided the political will exists to increase tax revenues, the improvement made to administrative capacities by adopting a VAT makes it more feasible to reform other parts of the tax system, such as the personal income tax.

While experience differs from country to country, on the whole it appears that most Latin American fiscal systems have become somewhat more redistributive since 2000 (Mahon, 2012, p. 1). Table 6 reports the results of 15 recent studies of fiscal redistribution in the five Latin American countries examined here. This table illustrates several important points. First, the first-order measures of the distributive effect of the fiscal system are small when measured in terms of changes in the Gini coefficient (which is more sensitive to changes in the middle of the income distribution than at the extremes). Second, such measures also often vary substantially from one year to another (or even for the same year, in the case of Colombia), in part because they are derived from a variety of different studies, often using different assumptions, particularly with respect to the incidence of the corporate income tax. Third, social spending programs are generally more effective than taxes in achieving redistribution. Fourth, in three countries, total fiscal redistribution increased over this short period, while in Colombia and Peru it appears to have decreased slightly. Finally, although there are exceptions, consumption taxes generally appear to be either slightly regressive or neutral, while income taxes are generally progressive. [16]

Although income tax revenues have increased in importance in most major Latin American countries in recent years, the effects have not been strongly redistributive. [17] One reason is because relatively little income tax revenue in Latin America comes from personal income taxes, the only clearly progressive

Table 6. *Recent Studies of Fiscal Redistribution in Latin America*

Country	Year	RS index spending	RS index taxation	Combined RS index	RS index consumption taxes	RS index income taxes
Argentina	2001	.00	+.01	+.01	.00	+.01
	2004		−.009	−.01		
	2006	+.091	+.019	+.11		
Brazil	1998	+.03	.00	+.03	.00	.00
	2003	+.015	−.005	+.01	−.018	+.013
	2006	+.07	+.014	+.08		
Colombia	2003	+.050	.000	+.05	−.004	+.008
	2003	.00	.00	.00	−.01	+.01
	2004	+.006	−.001	+.005		
Mexico	2000	+.01	+.01	+.02	.00	+.01
	2004	+.018	.000	+.02		
	2006	+.037	+.003	+.04		
Peru	2000	+.035	−.008	+.03	−.012	+.0013
	2002	.00	−.01	−.01	−.02	+.01
	2004	+.005	.000	+.005		

Source: Mahon (2012). The RS (Reynolds–Smolensky) index is the difference between the Gini coefficients pre- and post-spending or taxation as the case may be. By convention, a positive value indicates a progressive effect (that is, Gini declines) and a negative value a regressive effect.

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element of the tax system (Bird & Zolt, 2005). The corporate income tax is, as Table 4 shows, much more important in most Latin American countries, but in open economies its incidence may fall more on low-income workers and consumers than high-income profit recipients (Harberger, 2006). On the other hand, market fragmentation and government regulations may mean that a considerable share of corporate profits arises from economic rents which, if not collected in taxes, will accrue to (presumably wealthy) corporate owners (Shah & Whalley, 1991). The rent-generating political and economic structures long characteristic of many Latin American countries has generated tax features that lighten the burden on capital incomes significantly (Fairfield & Jorratt, 2014). Additional rents, especially from extracting natural resources, may flow to multinational investors (Clausing, 2013).[18] If owners rather than workers or consumers pay all or most of the corporate income tax, then tax incidence studies in Latin America may understate (or perhaps, depending on the data and assumptions employed, overstate) the progressivity of the tax system.[19]

4. FISCAL CONTRACTING

Determining the net effect of fiscal policies on individuals and different socio-economic groups requires examination of both tax and spending programs. Understanding how fiscal policies change over time similarly requires examination of the political dynamics that lead countries to adopt different packages of tax and spending policies. We begin with a brief review of the different (and often, overlapping) terminology used by different scholars in examining this issue. We then introduce the concept of fiscal contracting in part to move the analysis toward a more dynamic approach focusing less on why countries differ in fiscal choices than on how such choices may change over time.

(a) *Taxation and government*

Social contract theory holds that government rests on an implicit agreement that the state can exercise power over its citizens in exchange for protecting certain rights and providing certain services. As Daude and Melguizo (2012, p. 353) note, "...fiscal policy is at the very heart of the social contract between citizens and state." Early fiscal contract models grew out of feudal traditions. First, powerful kings and nobles extracted tax revenue to protect residents from outside invaders. Later, kings bargained with nobles to exchange tax revenues for more secure property rights and some influence over government policy (Bates & Lien, 1985). Rulers' need for revenue to fight wars called for changes in the types and level of taxes collected (as well as in how taxes were collected) and the concessions extracted by citizens (Levi, 1988).

At a general level, two broad approaches exist in examining taxation and governments (Hettich & Winer, 1999). The first approach treats taxation as an exchange between citizens and their governments, with taxes seen as the price of public goods and services.[20] Here, the challenge is designing institutions to match preferences for common goods and services with the taxes necessary to fund them. In contrast, the second approach treats taxes as a coercive taking of resources with little direct connection to government expenditures and the challenge being to minimize the efficiency costs of taxation.[21]

Much public finance analysis takes the second approach and assumes that the state is an autonomous entity that can decide the appropriate level of taxation, the mix of tax instruments, and the enforcement strategy.[22] For example, the optimal tax literature (e.g., Boadway, 2012) treats states as though they are (or should be) benevolent social welfare maximizers. The public choice literature, although in many ways closer to the fiscal exchange approach, also often treats those who control states as self-interested actors who can unilaterally decide tax and expenditure policies (Brennan & Buchanan, 1980). While differing in many respects (Buchanan & Musgrave, 1999), both traditions assume that "people pay taxes because they must; there is no relationship between the source of state revenue and state output; and spending is a function of rulers' whims (Timmons, 2005, p. 534)."[23]

In the Latin American context, scholars have focused on fiscal contracts, compacts, or covenants that reflect more or less explicit political agreements about fiscal policies between representatives of different socio-economic interests, implemented through the government.[24] Here there is a strong emphasis on the responsibilities of the wealthy to contribute to the welfare of the poor, often under the implied threat that social order will otherwise break down. A variation of this fiscal contract concept focuses less on the resulting agreements and more on the process whereby states and specific economic groups bargain over taxes and government-provided goods and services. Notably, Timmons (2005) treats the government as a quasi-monopolistic provider of public services seeking to maximize revenue by making deals (fiscal contracts) with specific groups under which they agree to pay more taxes in exchange for spending programs they desire. This view implies that those expected to pay most of the taxes are likely to receive most of the benefits, and that their willingness to pay is tied to the expectation of receiving benefits. These benefits may be direct, as in government-provided cash or services, or indirect, by increasing political stability or providing funds to the poor on the condition that they act in ways taxpayers value (for example, by ensuring that poor children attend school, thus presumably improving the country's economic prospects).

This fiscal contract approach can be used to explain differences in taxing and spending policies across countries. Timmons (2005) finds that states with more regressive taxes have higher levels of social spending (and better social outcomes). In contrast, states with more progressive taxes may have better property rights but lower levels of social spending. This argument supports two key implications: first, that to understand fiscal policies one must consider both sides of the budget together rather than focus primarily on taxation or primarily on spending; and second, that governments generally lack sufficient coercive power to adopt and collect taxes without inducing compliance by providing goods and services to those who pay taxes.

In contrast to Timmons (2005), we do not picture the state as negotiating with specific groups for tax revenue. Rather, we emphasize that the *process* of fiscal contracting is an important key to understanding fiscal developments, as different interest groups participate to differing extents over time in shaping both the level and quality of collective government goods and services and the type of taxes and relative tax burdens funding these expenditures. The key insight is that the inclusion or exclusion of different socio-economic groups can change over time and these changes may be reflected in different taxing and spending policies. The impact of changes may vary from country to country, both in how changes in economic and political power translate into changing tax and spending policies and how preferences and power change with respect to specific groups.

A reasonable assumption for many countries is that the poor want some package of basic public services (in addition

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to jobs), while the rich seek mainly to keep what they have: that is, protection for their property rights. To the extent that the middle class wants both service and protection, its recent rise in Latin America may help explain the apparently changing fiscal policies. In countries in which both growth and democracy have recently flourished, the changes in political equilibrium may alter the nature of the fiscal contract underlying political stability and state legitimacy. The expanding middle class cannot easily emulate either the rich, who pay as little as possible in taxes but also make little use of public services, or the poor, who neither pay much nor benefit much. The middle class have fewer opportunities than the rich to opt out of the tax system by hiding wealth or shifting activities offshore. However, like the poor, those in the vulnerable middle class need a stronger public sector to secure their position. In political terms, "...the fundamental question [is thus] whether the emerging middle class...will see its own interests as aligned with those of the poor and the strugglers [the vulnerable middle class], or as fundamentally different (Birdsall *et al.*, 2013, p. 22)."

The answer to this question is likely to differ from country to country as well as over time within any country. Surveys suggest that middle class values and policy orientations lie between those of the rich and the poor (Lopez-Calva, Rigolini, & Torche, 2011). However, this result reflects the aggregation of individual values and orientations that change with income, education, and other factors rather than any distinct set of middle class values.[25] The implications for fiscal policies are likely to vary among countries, both because of differing economic and political factors and because the middle class itself differs across countries.

(b) *Taxation in the fiscal contract*

The dominant tax policy ideas in different countries (such as equity, efficiency, and growth), along with the dominant economic and social interests (such as capital, labor, regional, ethnic group, rich, and poor) and the key political institutions (democracy, decentralization, budgetary), and economic institutions (free trade, protectionism, macroeconomic policy, and market structure) all interact in tax policy formulation and implementation. Taxation—its level, structure, and administration—is one of the major battlegrounds on which these complex forces meet.

What generates incentives for tax reform in Latin America has changed as countries have become more democratic (Focanti *et al.*, 2013). Many take income taxes as a good proxy for taxes on the rich, and consumption taxes as an equally good proxy for taxes on the poor (Kato, 2003).[26] Although this approximation is at best rough, most income taxes are paid by those in the top part of the income distribution. Much depends, however, on the structure of the personal income tax. Such taxes may, for example, impact relatively most heavily those who have just entered the tax system from the bottom—the lower middle class, who may for the first time have moderate levels of income and some property to protect. As the absolute income level of the emerging middle class increases, the proportion of citizens paying income taxes will increase. Higher tax burdens faced by the expanding middle class may reinforce the normal anti-income tax sentiment of the rich, a phenomenon that may become more important as income tax rate structures become flatter. On the other hand, many of those now caught in the income tax net would seem to be natural allies of the poor, because both groups tend to want expansion of public sector services like health, education, pensions, and basic infrastructure services like transit, water, and sewerage.

Although total taxes and especially personal income taxes are not that high in most of Latin America and tax systems are not very progressive, the extreme inequality of the region means that the rich nonetheless pay a relatively large share of taxes, so that increasing the net fiscal pressure on them may place additional strain on the fiscal contract. Tax reform in Latin America does not require governments to give more fiscal benefits to the rich, and it may, appropriately, be accompanied by steps to remove some existing tax expenditures and subsidies (Villela, Lemgruber, & Jorratt, 2010). Nonetheless, achieving significant tax reform may require assuring those who have to pay more that, in return, their property rights and positions will be more secure than if the present inequalities are perpetuated. As Sanchez (2011, p. 36) said about the Chilean reform of the 1990s, "...entrepreneurs agreed to pay more taxes because the new government went to great lengths (in rhetoric and actions) to reassure them that it would maintain a vocation for free markets and an open economy." The new *Concertación* government was able to negotiate a combined tax and social policy reform, which brought about political peace and the beginning of a move toward a new and, so far, lasting political equilibrium (Boylan, 1996). Fairfield (2010) suggests that elite solidarity was easier to mobilize behind such reforms in Chile when a right-of-center administration was in power, because spending commitments were more credible.

Even Colombia, often seen as a distributive laggard in the region (Moller, 2012), may also be moving down this path. Since 2002 Colombia has imposed a tax on wealth, currently applying at rates of 2.4% of total liquid assets over USD 1.3 million and 4.8% on assets over USD 2.5 million (Flores-Machias, 2012). Revenues from this tax are significant, fluctuating between 2.5% and 5% of government revenue and sometimes as much as 1% of GDP. How was Colombia able to do this? Essentially, by making a soft but credible fiscal contract with the rich to earmark all the proceeds of this tax to security (financing an increase of about 25% in such expenditures) with the explicit objective of expanding the control of the national government over the entire country and improving the security of both persons and business investments—all objectives toward which considerable and perceptible progress was made. To achieve acceptance of the wealth tax, the government deliberately backed away from attempting more undamental tax reforms that business interests opposed.

More democratic and sustainable outcomes cannot be achieved simply by improving fiscal institutions, because a more encompassing and legitimate state is itself the key ingredient needed for a more balanced and sustainable tax system (Brautigam, Fjeldstad, & Moore, 2007). Even before the recent reduction in inequality and growth of the middle class in Latin America, Birdsall (2002) suggested that countries in the region needed to move to a modern social contract to accommodate the demands and constraints of their more open economies. The two key elements of such a contract are policies (including tax policies) to encourage job-based growth and social spending that focuses not simply on the poor but also on the economically insecure middle-income class. Explicitly social democratic regimes like those in Brazil and Chile have moved in this direction as have less leftist regimes like those in Mexico and Colombia.[27] Tax systems evolve from incremental decisions over time and, like other political constructs, reflect the nature of the basic social norms binding different groups within national boundaries, as well as changing preferences as influenced by the changing local environment (e.g., democracy, in its various forms) and the changing external context (e.g., globalization in its various aspects).[28]

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Table 7. *Voter Turnout Data in Latin America, 1990–2010*

Country and Year		Voter turnout (percent)	Total vote (millions)	Voting age population as percent of total
Argentina	1991	89.4	18.6	63.2
	2001	73.0	18.6	67.6
	2011	77.4	23.0	71.4
Brazil	1990	76.6	70.9	64.0
	2002	68.4	79.2	64.9
	2010	80.6	111.2	68.6
Colombia	1990	40.0	7.6	59.1
	2002	40.6	10.2	62.3
	2010	44.1	13.1	67.0
Mexico	1991	50.1	24.1	55.0
	2000	48.2	30.2	67.5
	2012	63.7	48.4	66.1
Peru	1990	56.9	6.9	56.0
	2000	77.2	11.9	60.1
	2011	87.4	16.7	65.4

Source: International Institute for Democracy and Electoral Assistance (International IDEA) Voter Turnout Website, http://www.idea.int/vt/.
Notes: Data shown are for parliamentary elections. Voter turnout is as percent of voting age population. All countries maintain voter registration lists and all except Colombia have compulsory voting. However, the accuracy and completeness of these lists and the level to which compulsory voting is enforced varies from country to country and over time. Consequently, although voting age population (VAP) is necessarily estimated, measuring turnout in relation to VAP seems a more relevant measure in the present context.

5. OBSERVATIONS AND CONCLUSIONS

One reason Latin America's tax systems were neither efficient nor fair was because the politically relevant domain of the fiscal system was considerably smaller than the population as a whole. Increasing democracy in Latin America in the 1990s initially had little effect on taxation because democratic institutions were either captured by the elite or undermined by short-sighted populism and the extreme weakness of state institutional capacity, particularly with respect to fiscal matters (Profeta & Scabrosetti, 2008). Severe legislative malapportionment also made it easy for elites to block tax changes (Ardanaz & Scartascini, 2013). However, the recent growth of the middle class has increased mobility across income classes and brought more people in direct contact with the tax system, thus raising the political salience of fiscal issues and increasing the importance of having a system perceived as both fair and growth-oriented (Daude & Melguizo, 2012).[29]

For the first time a significant proportion of Latin America's population consists of politically relevant citizens and income taxpayers. Both the number of voters and voter turnout has increased substantially in recent years in most countries considered here (Table 7). Given the substantial increases in the size of the middle class and the increased coverage of the personal income tax (due to lower tax thresholds and higher median income), it is likely that the proportion of voter/taxpayers who care about tax and spending policies has grown substantially over the last 20 years, and will expand further if recent growth patterns persist. This larger middle class may provide a base of support for increased social spending with sustainable market-oriented policies (Birdsall *et al.*, 2011).

Taxpayers who believe that the government is responsive to their interests are more willing to pay taxes and may also believe that their payment of taxes gives them the right to representation and to hold governments accountable on how the funds are spent (Brautigam *et al.*, 2007). As more people become aware (for example, through expansion of more visible taxes on personal income and property) of the taxes they pay and of the extent to which their well-being and the future of their children depend on good state services, the political balance underlying the fiscal contract may change.

Consider how western democracies got into the business of progressive taxation. In the United States, over the course of prolonged discussions from 1860 to 1920, "economic crises and wars helped create a consensus for an income tax that falls most heavily on the wealthiest taxpayers (Weisman, 2002, p. 366)." This lengthy debate about taxes was not so much about tax policy as about what kind of society Americans wanted. This consensus, a sort of fiscal contract, lasted until about 1970. Since then ideas about the balance between taxes and society have again been in flux in the U.S. In particular, progressive taxation appears to have lost much of its political appeal (Blyth, 2002).

Other countries have reached different compromises. Some high-tax countries have substantially blunted the disincentive effect of taxation by lowering tax rates and favoring investment activities (Lindert, 2004). Some advanced democratic states have large public sectors combining redistributive expenditures with not very progressive taxes (Sweden); others have smaller governments pairing more progressive taxes with less redistributive expenditures (the United States).

Only recently have some Latin American countries begun to undergo the evolutionary process that produced the (more or less) redistributive fiscal state now found in most developed countries. Even those governments with some degree of political legitimacy and stability have faced substantial constraints on fiscal policy. Significant tax and social spending changes require a high degree of political consensus. The problem in Latin America for many years was that most countries lacked "...an (implicit) social contract between governments and the general populace of the kind that is embedded in taxation and fiscal principles and practices in politically more stable parts of the world" (Lledo, Schneider, & Moore, 2003, p. 47). Over the last decade, some changes have begun to emerge as economic growth creates a larger and more empowered middle class, leading both to greater economic mobility and more robust democratic governments (Ferreira *et al.*, 2013).

Many ways exist to tax the rich more effectively through higher taxes on income from capital (dividends, interest, and capital gains), higher taxes on vehicles and other luxury goods, and higher taxes on wealth. To the extent that the income reflects rents secured through political connections or monopolies, such additional taxes may have little distortionary costs. On the other hand, attempts to impose substantial redistributive taxes may backfire, resulting in smaller and less redistributive public sectors (IDB, 1998), and even the most redistributive taxes may have little effect on income redistribution (Harberger, 2006). From the perspective of redressing income inequality and poverty, the most important function of the tax system is not to punish the rich, but to provide funding for pro-poor (or at least not pro-rich) spending programs.

The poor have little choice but to rely on public services, no matter how scanty or low-quality they may be. In some countries, the emerging middle class may have some choice in the extent to which they depend on the social security system with respect to health and pensions. In all countries, they must choose whether to educate their children in the public system or in the generally better private system now utilized largely by the wealthy and upper-middle class. The public sector may finance such access to private education (as is done to some extent in Chile and Colombia). It may make the social

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insurance system more equitable and efficient. Or it may improve access to (and the quality of) public sector alternatives. All these approaches will require additional tax revenue. The conundrum facing Latin American policy-makers is whether to focus on expanding and improving traditional public sector services, providing increased access for more people to alternatives available from private providers, or some combination of the two that will deliver perceptible benefits to more people and perhaps increase their willingness to support tax increases needed to finance expanded social spending. Many Latin American countries have already decentralized public sector provisions, at least in part to better match public services with the wishes and needs of local communities (Brosio & Jimenez, 2012).

Social spending and taxation structures in Latin America are on the whole closer to those in the United States than in Europe. Noting this, Breceda *et al.* (2009) suggest that the underlying fiscal contracts in the U.S. and Latin America may be converging because both derive most of their tax revenues from the wealthy, a group that gets little from state social spending in return. In contrast to the more inclusive (and more redistributive) models found in Europe and even in Canada, the result, they suggest, may be that Latin America, like the United States, is more likely to sustain a smaller than a larger welfare state. The emerging welfare state may end up more like the smaller American model than the European one, but it would still be a major improvement for many Latin American countries.

In Latin America, and perhaps even in the United States (Zolt, 2013), the emerging sustainable fiscal contract might include less progressive taxes to support more progressive spending programs. Tax changes increasing the tax burden on the wealthy are no doubt often justifiable and may sometimes be necessary. But achieving the political support and revenue needed to fund additional social spending programs benefiting both the poor and middle class will likely require increasing tax burdens on non-wealthy groups.

To the extent that the wealthy in Latin America receive little benefit from social spending programs, the future sustainability of these programs depends on the expanding middle classes finding these programs valuable and being willing to pay some of the costs. A sustainable consensus in terms of social norms and the acceptance of national political goals (Alesina & Reich, 2013) needs to be created by, among other things, delivering more and better services that people actually want and establishing a fairer and more acceptable tax system. One way to do so, albeit a politically and to some extent technically difficult one, may be to increase taxes on the wealthy through such oft-proposed means as tighter tax administration, heavier property taxes, more effective taxation of capital income, and perhaps even some form of wealth tax. A second approach focuses on the personal income tax and seeks to increase revenue by expanding the scope of the tax to cover more middle-income taxpayers. A third approach is to rely more heavily on consumption taxes. Although such taxes generally impose a relatively large burden on lower than on higher income groups, they are paid much more by the middle class than by the poor, and it is not difficult to think of better and more acceptable VATs. [30] In many countries, all approaches may be required.

Whichever road they follow, countries can maintain or increase state capacity to collect tax revenues only if taxpayers believe that the funds will be spent wisely—that is, in ways that they perceive as benefiting them directly (by providing public services) or indirectly (by strengthening the economy and developing a more adequate legal and political framework to support property rights). How well and in what ways Latin American countries manage the difficult task of restructuring their fiscal contracts in the years to come remains to be seen.

NOTES

1. Azevedo *et al.* (2013) show that the regional decrease in inequality has been driven largely by changes in labor income, reflecting both improved levels of education and demographic factors. They caution that more investment in the right kind of education and training is needed to sustain recent trends.

2. As Lustig and Higgins (2012) show with respect to Brazil, however, even when taxes and transfers have significant effects on poverty and inequality, different 'poor' and 'non-poor' groups may be affected differently.

3. Barreix, Roca, and Villela (2007) emphasize the need to strengthen (and make more progressive) the pillars of the tax system – the VAT and the income tax. However, on the spending side, they follow what we call the "welfarist" approach by urging still more targeting of expenditures on distributive grounds rather than the "universalist" expansion to include significant benefits to the middle class that we suggest may be required for both political and fiscal sustainability.

4. Although the measures shown in Table 1 do not refer to exactly the same concepts in all countries at all periods, they are largely based on household estimates (in per capita terms) of disposable income: that is, gross money income less direct taxes plus direct transfers (Goñi, López, & Servén, 2011). These coefficients provide about as good a set of numbers as exist to make broad comparisons between countries over this time period. (For other ways to measure Gini coefficients, see http://website1.wider.unu.edu/wiid/WIID2c.pdf).

5. How much inequality has changed depends on not only what is measured but for whom it is measured. The data in Tables 1 and 2 are at the household level (in per capita terms). Data on individuals emphasize changes in labor income and wage differentials; household data better measure the economic well-being of individuals living together.

6. Calculated from data in http://website.eclac.cl/sisgen/ConsultaIntegrada.asp.

7. The "middle class" may be defined in many ways e.g., Banerjee and Duflo (2008), Atkinson and Brandolini (2011), Birdsall (2012), and Lora and Fajardo (2013). For the most part in this paper we follow the approach of Ferreira *et al.* (2013).

8. Birdsall, Lustig, and Meyer (2013) apply a somewhat more optimistic label—"the strugglers"—to this group.

9. As with income inequality, there are many ways to measure income mobility and different measures may give very different results. Measuring income persistence across a single generation may not be the best measure of inter-generational income mobility but other studies which employ different measures yield similar results when comparing the United States to European countries (Jantti *et al.*, 2006)—that is, that mobility in the US appears to be comparable to that in Italy and the UK but considerably less than that in most European countries (or Canada). As Krebs, Krishna,

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and Maloney (2013) note with respect to Mexico, all estimates of income mobility are subject to measurement error and transitory income shocks and may provide little evidence of economically significant effects.

10. On the latter point, see the analysis of PISA data in Ferreira *et al.* (2013), as well as http://en.wikipedia.org/wiki/Programme_for_International_Student_Assessment#2000.E2.80.932006. Most countries in the region face substantial challenges in increasing instructor quality and improving the learning environment for poor children (Levy & Schady, 2013).

11. Many discussions of redistribution focus on the rich and the poor (Ardanaz & Scartascini, 2013) or largely ignore the critical link between the two sides of the budget (Hart, 2010). In contrast, our focus here is specifically on critical changes in the middle class and the possible implications of these changes for both sides of the budget.

12. A similar rising trend is shown for social spending per capita, especially in Argentina, in Afonso *et al.* (2012) who use essentially the same data set.

13. On average, the level of these payroll tax rates in 2011 was over 20% (compared to 17.35% in the United States), although with wide variation from country to country, ranging from 10.6% in Mexico to 45.148% in Colombia (Social Security Administration, 2012).

14. http://www.pulsamerica.co.uk/2013/02/25/brazil-over-12-million-currently-pay-income-tax/.

15. Calculated from data in OECD (2012b); data on the share of personal income taxes are not available for Mexico in 2000.

16. This conclusion is even more tenuous than the others mentioned because in addition to the general problems of different sources, methods, incidence assumptions, and time periods, the scope and structure of the "consumption" and "income" taxes being compared varies across countries and years.

17. Lustig, Pessino, and Scott (2014) report more recent results (for 2009) for several countries, including some discussed here. They found direct taxes progressive to various degrees in different countries but with little redistributive effect because they were not very important. Cash transfers were generally progressive also, though more than offset by the effect of indirect taxes, other than in Brazil and Bolivia. In all countries, the most important poverty-reducing expenditures were in-kind transfers in education and health.

18. Even for the U.S., however, other studies have found that much of the tax is borne by workers in the form of reduced wages (e.g., Liu and Altshuler (2013).

19. Some assume that most corporate taxes in Latin America are passed on to consumers in the form of increased prices (Arnson & Bergman, 2012). However, no good studies exist on the incidence of the corporate income tax in any Latin American country. Recognizing this fact, Barreix *et al.* (2007) simply leave the corporate income tax out of their analysis, as do Breceda, Rigolini, and Saavedra (2009). In contrast, Higgins *et al.* (2014) make the more common assumption that corporate taxes are borne in part by workers, in part by consumers, and in part by capital owners although there are no good empirical or theoretical arguments to support any particular way of dividing up the burden, let alone to assume that the same divisions occur in very different countries. Given the importance of corporate tax revenues in Latin American tax structures and the uncertainty of the incidence of the tax, conclusions about the distributional effect of increasing "income taxes" in Latin American countries are at best tentative. The interesting recent study of Chile by Fairfield and Jorratt (2014), which adjusts household income data to attribute most undistributed profits to the top income group, further underlines the dependence of the results of such studies on the inevitably somewhat arbitrary assumptions made about who gets the income and who pays the taxes.

20. Usually associated with Wicksell and Lindahl (as reprinted in Musgrave & Peacock, 1958), this "benefit approach" has recently been revived by Mankiw (2013) and explored in depth by Weinzierl (2014).

21. Neither approach fits easily with the "welfarist" view, which takes redistribution as a major goal of the fiscal system and concludes that taxes should be paid mainly by the rich and expenditures should mainly benefit the poor. Arnson and Bergman (2012) illustrate the often implicit acceptance of the welfarist approach when they note that part of the failure of Mexico to introduce major tax reforms may be blamed on what they refer to as the "ideological principle" of the benefit approach.

22. An important variant of this approach assumes that the state is not an actor in itself but simply the instrument of specific groups: social classes (Marxism), organized interest groups (Olson, 1965), or partisan political parties (Hibbs, 1977). These groups act in a self-interested way to increase their command over resources. In all these cases, it is usually assumed that those who control the state can use its power as they wish.

23. This statement is obviously too sweeping, because there is a vast literature on tax evasion and compliance and on the effects of taxation on output. Nonetheless, it captures the flavor of much of the tax policy literature.

24. For example, Mahon (2011), Mahon (2012), Cornia, Gomez-Sabaini, and Martorano (2012) and ECLAC (United Nations Economic Commission for Latin America (2013).

25. Haarstad (2011) suggests that "cross-class" alliances between the middle class and the poor are unlikely to support "universal welfare" in Latin America. Focusing on such growth-supporting and poverty-alleviating policies as better education and improved social protection which are of as much or more interest to the vulnerable middle class as to the poor may lead one to be more optimistic (Torche & Lopez-Calva, 2012).

26. As an example, González and Martner (2012) use the ratio of direct to indirect taxes as their 'tax progressiveness' index.

27. Venezuela and other countries with more "populist" regimes have of course also moved in the same direction. Birdsall, Lustig, and McLeod (2011) suggest that redistribution in such countries may be less structural or sustainable than in "social-democratic" countries like Chile and Brazil where more has been done to build up a supportive political and institutional structure. Such "middle class" characteristics as increased education (Schraufnagel & Sgouraki, 2005) and participatory "social capital" (Klesner, 2009), for example, are strongly associated with increased voter turnout and political participation. However, as a recent useful overview of the extent of political transformation in Latin America as a whole suggests (Bertelsmann Stiftung, 2014), the extent and nature to which recent distributional changes will have a lasting impact on fiscal policy in any country remains to be seen.

28. The importance and persistence of national and regional social and cultural norms and their role in preference formation are emphasized by Inglehart and Welzel (2010) and, in a different way, by Acemoglu and Robinson (2012).

29. Interestingly, the increasing concentration of wealth and income at the highest levels in the United States and the removal of a large percentage of the population from the income tax rolls (Burman &

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Slemrod, 2013) has, by reducing the direct contact of many Americans with the tax system, arguably increased the influence of the wealthy over the structure and level of taxation.

30. Barreix, Bes, and Roca (2012), for example, have suggested a broad-based VAT with an offsetting credit for lower income groups – the so-called "personalized VAT." However, their suggestion that such a credit could be administered in the same way as existing conditional cash transfer systems may present difficult challenges. Some countries may perhaps consider providing a refundable income-conditioned "VAT credit" through the income tax, thus not only increasing the progressivity of the tax system and providing a visible benefit to more people but also expanding the tax-filing population and strengthening the informational base of the tax system.

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