Research Note

Political Economy of Citizenship Regimes: Tax in India and Brazil

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How do changes in citizenship regimes help explain differences in tax structures? A comparison of Brazil and India

Tax Revenue Gains in Brazil and India

Both Brazil and India have deepened their democracies over recent years, but with different impacts on state capacity as expressed in tax capacity. In Brazil, tax revenue increased steadily from 1994 (27.9% of GDP) to 2010 (34.6% of GDP), even amidst liberalization-induced decreases in tariffs. This was due to tax system reforms driven by an increase in income taxes and contributions linked to social spending outlays.

In India, tax capacity has held steady since the introduction of neoliberal reforms in the early 1990s, only moving from 15.31% of GDP in 1991-92 to 16.64% of GDP in 2011-2012. During this period, fluctuations and downward trends in the 1990s and during the global recession were offset by upward movement from 2001-02 to 2006-07.

This presents a marked difference between the two countries: While both implemented relatively similar liberalization processes, India expanded social rights without generating new revenues but Brazil expanded revenues both as part of fiscal adjustment and to expand social spending.

This paper evaluates changes to state capacity in Brazil and India by looking at the political economy of citizenship regimes and tax. The concept of citizenship regimes refers to stable mechanisms of incorporation that establish social actors as legitimate participants in political processes and claimants on public resources and authority.

Cross-Class Support for Tax Capacity in Brazil

The distinct evolution of revenues and other policies reflects changes in each country's citizenship regime. In Brazil, industrial expansion pursued by military elites after 1964 strengthened the hand of middle class and popular sector actors, who became legitimate collective agents in the struggle for democratization. Later on, these same actors framed demands in opposition to neoliberalism, requesting protection from markets through more extensive social policies, and forming a cross-class coalition in support of enhanced state capacity. When the Workers' Party came to power in 2003, it was buoyed by higher rates of growth, and institutionalized mechanisms of incorporation for both the middle classes and popular sectors in the form of expanded social policy and labour market interventions to increase formal employment, basic services, and consumption.

Yet institutionalized incorporation of a cross-class support base could not tackle ongoing problems caused by a lack of universality in the tax regime. The need to form majority coalitions in the legislature provided conservative elites with veto power which it used to preserve inequitable exemptions and special tax arrangements for commodity-exporting states. A further element compounding horizontal inequity has been the "*fiscal war*" among state governments offering incentives to businesses while pressuring the federal government to alter the tax rates paid in other states. The same elite actors also blocked more progressive changes to tax. While in Brazil the tax burden increased for all sections of the population from 1996 to 2004, this increase was generally greater for the poor.

Coalitional Fragmentation Limits Tax Gains in India

In India, a shifting set of social coalitions has been incorporated into citizenship regimes, fragmenting support for building state capacity through tax. Historically, excluded groups included regionally circumscribed language-groups, backward and lower castes, and an urban, middle sector. They came together against the Congress Party in coalition governments in 1977 and 1989, but these coalition governments were unstable and were eventually replaced by a polarity of electoral competition between the Hindu-nationalist BJP and the Indian National Congress Party, each attempting to patch together a governing majority in coalition with regional and caste actors. When growth returned in the late 1990s, Congress sought to institutionalize its cross-cultural coalition around social programmes for the poor, and reserved employment and education opportunities for "Other Backward Classes", while the BJP offered a combination of Hindu nationalist and neoliberal market ideology to attract regional elites and caste allies to its middle class and upper caste base. The result has been political fragmentation, rival appeals intended to incorporate previously-excluded groups, and cycling coalitions. This situation provides limited support for expanding state capacity for tax revenues, although it does allow state capacity to be expanded in other ways, such as state-level incentives in the technology and service export sectors—one of whose prime beneficiaries has been the middle class.

This is expressed in the tax system which is full of exemptions, most of which are oriented towards internationally-integrated dynamic sectors. Most exemptions occur via indirect taxes, customs and excise duties, as well as over 170 special economic zones and other IT-related parks. Estimated revenues foregone by India from these incentives reached 5.9 per cent of GDP in 2011-12 and 5.7 per cent in 2012-13. This has coincided with a shift in the tax structure towards direct taxes, from 16 per cent of total revenues to a peak of 43 per cent in 2009-10.

Encouraging cross-class coalitions that support expansion in tax capacity

While all efforts to incorporate excluded groups are valuable aspects of deepening democracy, they do not always result in a social coalition that supports increased revenues. In Brazil, cross-class coalitions of the popular sector and the middle classes supported an expansion in state revenues to pay for social policies. By contrast, fragmented and shifting cross-cultural coalitions in India did not support expansion in state revenues, even though they did support other kinds of expansion in state capacity, such as the promotion of dynamic, advanced sectors. While short-term policy advice to alter citizenship regimes is difficult, there are good reasons to consider encouraging cross-class coalitions in support of state capacity for revenue mobilization over the medium- to long-term.

Increasing taxes from internationally competitive and high-income sectors

In addition to this lesson on the social determinants of tax capacity, there are also implications for other aspects of tax policy. In Brazil, elite opposition is manifest in the party system and the legislature, and it blocks efforts to make the tax system more universal and more progressive. These elite obstacles are unlikely to disappear, but there is clearly room to improve direct taxes by more effectively capturing high incomes and incomes in currently privileged agro-export and commodity sectors. There is also room to create a more uniform indirect tax system by standardizing the value-added tax and eliminating exemptions. These modifications would take pressure off over-dependence on social contributions, which are partly paid by the very populations meant to benefit from social spending.

In India, fragmented and shifting social coalitions are unlikely to change any time soon, but there may still be room to raise tax capacity, especially by taxing the dynamic and internationally competitive sectors that currently enjoy excessive incentives. Direct taxes are constrained especially by the small proportion of firms and individuals who contribute, making one of the most important policy interventions an increase in labour formalization, both to raise incomes over minimum thresholds and to bring more contributors into the tax net. In addition, loopholes on direct taxes need to be closed to prevent evasion and avoidance, and state-level incentives need to be eliminated that both weaken capacity as well as harm universality and progressivity. Of most importance at the state level is the virtual absence of any land tax, greatly limiting revenue from the rural sector. On indirect tax, greater formalization would make more transactions taxable, and greater standardization of indirect taxes across states would improve universality and decrease incentives for tax planning and obstacles to national integration.

The paper on which this Research Note is based is available at www.unrisd.org/schneider

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