



## Latin America's Middle Sectors: Key Players in a Renewed Social Contract?

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- ◆ A strengthened social contract in Latin American countries relies on the improved quality of public services such as health and education, which would build a constituency for a broader tax base.
- ◆ Latin American middle-income sectors express strong support for democracy but they are critical of how it works, largely due to the low quality of public services.
- ◆ Fiscal policy is at the heart of the state's relationship with its citizens – all the more so in Latin America, given the weak social contracts and the consolidation of its democracies.

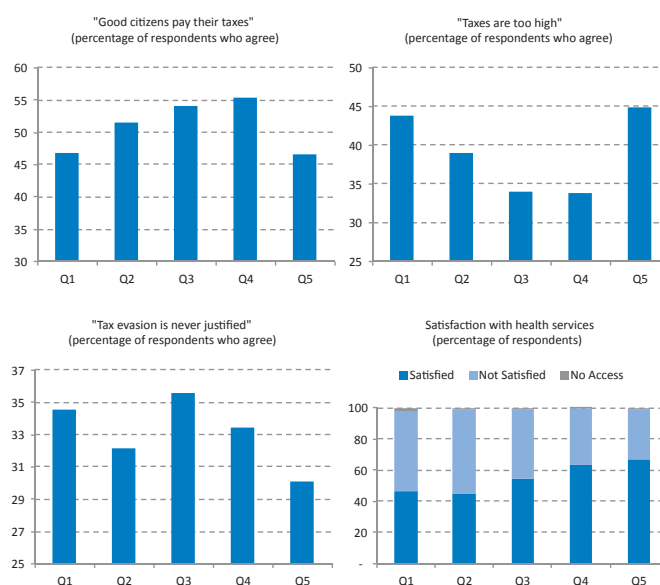
Most countries in Latin America and the Caribbean have weathered the international financial turmoil with a new-found resilience, increasing citizens' confidence in the quality of economic management in their countries. Expanding middle-income sectors and their contribution to domestic demand have played a part in the region's performance during the financial crisis. Given the region's optimistic economic outlook and advances in poverty reduction prior to the crisis, the current moment is in many ways timely for reforms. In this context, the middle sectors have the potential to become an agent of change in the region and to play a key role in a strengthened social contract in Latin America.

### Latin America's middle sectors as a dissatisfied customer

Democratic consolidation is often associated with increased demand for social expenditure, as segments of the population who were previously excluded from the decision-making process begin to exert their civil rights. Fiscal policy constitutes the core of public policy and sets the political equilibrium in a society. This pattern is observed in Latin America and the Caribbean, a region having undergone a wave of democratic consolidation since the 1980s. Democracy as a political system enjoys the wide support of the population; in fact, in public-opinion surveys, satisfaction with democracy increases steadily with perceived economic status. However, a measure of satisfaction with the actual functioning of

democracy paints a different picture. Members of the countries' middle sectors, while relatively supportive of taxation, are not satisfied with the public services they receive, confirming their relationship with the state as "dissatisfied customers".

### The middle sectors, taxation and satisfaction with public services



Source: Based on Latinobarómetro surveys 2007 and 2008.

## The case of Chile and Mexico: Who benefits from fiscal policy?

How then do the middle sectors fare given current fiscal policy in the region? A detailed tax-benefit incidence analysis for Chile and Mexico, combining information on household data characteristics with government statistics, dismisses the commonly held belief that middle-sector households are the ones bearing the heaviest tax burden. Instead, the bulk of the overall tax intake is generated by the highest deciles. Indeed, while affluent families are net tax payers in both countries, net transfers have a clearly pro-poor profile, providing a significant boost to the income of disadvantaged households.

For the middle sectors, things are much less clear-cut: what they pay is close to what they receive in the form of social spending and, while they pay less than the affluent, they benefit less than the disadvantaged. For instance, the fifth decile in Chile pays on average taxes equivalent to 18.3% of its disposable income, while receiving benefits of 20.6%. Similarly, in Mexico taxes amount to 13.2% of disposable income and benefits are equal to 23.8%. The net transfer for middle-sector families is not large and they benefit most from in-kind services such as education and health care.

In this context, if publicly provided services are of low quality, then the middle sectors are more likely to consider themselves losers in the fiscal bargain and less willing to contribute to financing of the public sector. The low perception of quality of public services such as education and health care also makes their provision by the private sector an attractive alternative, even where the extra cost imposes a significant additional burden on household budgets.

## Looking forward to a renewed social contract

How can governments continue to foster more pragmatic economic policies while strengthening the social contract? Reform needs to start by improving the quality and management of existing public services so that current users increase their demand and support for them. This would build a social constituency for the expansion of public spending and for the taxes necessary to finance it, thereby avoiding the trap of economies plagued by low tax revenues, where a lack of resources acts as a hindrance to public action.

Given the predisposition of the middle sectors to support moderate political platforms and to view taxation favourably, their role in this new social contract is key.

### Further reading

Castelletti, B. and H. Gutierrez (2010), "The Impact of Fiscal Policy on the Middle Class", forthcoming *OECD Development Centre Working Paper*, OECD, Paris.

Daude, C. and Á. Melguizo (2010), "Taxation and more representation? On fiscal policy, social mobility and democracy in Latin America", *OECD Development Centre Working Paper 294*, OECD, Paris.

OECD (2010), *Latin American Economic Outlook 2011*, OECD, Paris.