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**'ROBIN HOOD IN REVERSE':  
PERSISTENCE AND BARRIERS TO  
REDISTRIBUTIVE FISCAL POLICY**

**Pedro Cavalcante**



## **'ROBIN HOOD IN REVERSE': PERSISTENCE AND BARRIERS TO REDISTRIBUTIVE FISCAL POLICY<sup>1</sup>**

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## ABSTRACT

Despite improvements in the living conditions of the population, there has not been a significant change in income disparities. Since the growth of left-wing parties and political competition as per the median voter hypothesis do not stand in the Brazilian case, what could explain the tenacity of inequality in the country? To answer this, the paper, grounded in new institutionalism theory, employed a process-tracing method to explore the causes of the continuity of unequal income distribution in Brazil. The inquiry tests the mechanism using the case of redistributive fiscal policy and the literature of electoral rules and business influence in the political system. This analysis reinforces that the Brazilian government not only misuses its fiscal instruments to distribute income, but also acts as a 'Robin Hood in reverse': that is, it withdraws from those who have less to subsidize or pay transfers to those who have more.

**Keywords:** Brazil; fiscal policy; inequality; institutions; political economy.





## 1 INTRODUCTION

The paper's objective is to discuss an institutional explanation for income inequality's persistence in Brazil, a country with one of the worst inequality levels in the world. The study focuses on analyzing the determinants of the maintenance of dysfunctional levels of income distribution, using Brazil as the case study of choice. This continental-sized developing country with a long and persistent history of inequality presents an interesting object of study from the lens of public administration, especially regarding its fiscal policy.

The worsening or at least the stabilization of inequality worldwide has been affecting both emerging and developed economies over the last thirty years, albeit with distinct patterns and intensities for each. In Brazil, there is an intense debate about changes in inequality patterns in the past years. During this period, the social protection system undertook a comprehensive strategy of inclusion of the marginalized population. This process occurred mainly in the areas of education and welfare. As a result, it positively affected the population's income and quality of life.

Arretche (2018) analyzes the process that, to some extent, reduced the differences between the insiders and outsiders of the social policy system. She tested the causal influence of two assumptions: i) changes in the design of Brazilian social policies; and ii) under universal suffrage, the left and right parties converged around the preferences of the beneficiaries of redistributive policies, health, and education. Based on the study results, the author argues that the primary determinant of this trajectory is the role of political competition in the democratic context rather than the median voter hypothesis or the growth of left-wing parties.

However, in the same period, despite the improvements in the living conditions of the poorest Brazilians, there was no significant change in the income disparities in the Brazilian population at large. Since the growth of left-wing force (which in Brazil occurred mostly in the Executive branch from 2003 to 2016) and political competition do not stand in this case as significant determinants in the perpetuation of this pattern, as per the median voter hypothesis, what instead could explain the persistence of income inequalities in Brazil?

To address this question, the paper, grounded in new institutionalism theory, departs from the premise that the political process is central in building functional institutions oriented toward development, with ‘development’ in this case taken to mean a better income distribution level. Rather, it assumes that they are a matter of politics and policies resulted from collective choices that reflect differences in political institutions and different political power-sharing. The inquiry thus aims at exploring the relationship between inequality’s resilience in Brazil and the Brazilian political system that generates dysfunctionality in economic institutions.

To do so, the paper presents a framework to analyze these institutions, understood as rules of the game that set “constraints” on human behavior (North, 1990), since they entail a political equilibrium and collective choices resilient to change in the inequality dimension. Then, it employs a process-tracing method in order to depict this analytical framework showing the causal mechanism responsible for the maintenance of the status quo regarding inequality. In order to explain the process, the paper focuses on the updated literature of electoral rules effects, campaign financing, and corporate influence in Brazil.

Empirically, the article tests this analytical framework based on the case of the (re)distributive fiscal policy in Brazil since this dimension is considered crucial in the strategies to tackle inequality. Thus, the configuration of Brazilian fiscal policy with its collection and spending issues often characterizes it as ‘Robin Hood in reverse,’ and in alignment with the causal mechanism of the framework, the paper discusses the political and institutional barriers that inhibit changes to this scenario.

The paper as follows contains five other sections. The first emphasizes the persistence of the income concentration in Brazil and the recent methodological improvement regarding its estimation. The second discusses the institutional theory behind the analytical framework used to approach the tenacity of inequality and its causal mechanism, which is the subject of the third section. Moreover, the case of Brazilian fiscal (re)distribution policy is addressed with a focus on the tax system, considering its features, paradox, and barriers to change. Finally, the paper ends with some conclusions and further research agenda recommendations.

## **2 INCOME INEQUALITY IN BRAZIL: A PERSISTENT ISSUE**

Much of the contemporary emphasis on inequality stems from the recent research that demonstrates the persistence of inequalities in the world (Atkinson, Piketty and Saez, 2011; Piketty, 2014; 2015a; Atkinson, 2015). In Latin America, research based on household surveys shows that both poverty indicators and labor income inequality in the region decreased between 2002 and 2014, mainly due to the revenue growth of the low-income population. However, there is an evident slowdown of this trend in recent years.

This same pattern occurred in Brazil, which is the region's most unequal nation and has one of the worst income distributions in the planet. Since 1988, Brazil's Gini coefficient has dropped by 16%, from 0.61 to 0.51 in 2015; however, the latest studies incorporating other data sources in addition to household surveys have shown that the concentration patterns continue to be high and stable (Medeiros and Souza, 2013; 2016; WIL, 2017; Assouad, Chancel and Morgan, 2018). Moreover, the public sector itself contributes to worsening this situation, since governmental transfers that were supposedly created to tackle inequality, such as welfare benefits and direct taxes, lose their impact due to the regressive transfer practices of social security pensions and high civil service wages for some careers (Medeiros, Galvão and Nazareno, 2015).

Despite implementation of contemporary structural transformations in the Brazilian economy such as monetary stabilization in combination with the advances in redistributive public policies, they have not been sufficient to change the entrenched pattern of income concentration in the country. The gains of the poorest 50% explain the reduction in poverty and absolute poverty indicators, but they did not change the share of the wealthiest 10%. Therefore, it is evident that those who lost out from this policy were in effect the average 40%, who objectively dropped from 34% to less than 31% in the national income share.

Besides, more recent studies, even those based on household surveys, also demonstrate that the ongoing economic crisis has increased Brazil's poverty and inequality rates. Put differently, since 2015, the misery and poverty rates are increasing, and the Gini index, after a long decline since 2002, has started to grow again (Neri, 2018). In this sense, this paradox of prolonged and persistent inequality presents itself as a relevant subject of study in the political economy. If the literature has advanced

in determining the reasons for the inadequate distribution of wealth in Brazil and its deleterious effects on the country's development, how could the failure of the Brazilian public sector to change this scenario be explained?

### **3 AN INSTITUTIONAL APPROACH**

Economic determinism no longer stands as the only explanatory strategy for the distribution of wealth and income, mainly because the problem is also political in nature (Piketty, 2014). For decades, most social scientists addressed the research on how to make the 'right' economic policies, with principles and examples of different political, social and economic contexts. By contrast, the current and more realistic emphasis of the research is on investigating what, and especially why, developing nations continue to make the 'wrong' ones. To this end, identifying the institutions that generate the persistence of inequalities is a promising analytical strategy. Logically, history matters, primarily due to path dependence processes, which means that previous decisions or events limit the set of decisions at a specific moment (Pierson, 2000). However, it is not necessary to go far back in time to explain income concentration, especially since the view of inequality's origins as strictly tied to the colonial past is already seen as a myth (Williamson, 2015).

Nonetheless, it does not mean that historical and cultural heritages are irrelevant. As Eclac (2018a, p. 48) affirms: "the culture of privilege operates as a deep substrate on which inequality is cemented and reproduced in Latin America and the Caribbean." This culture naturalizes the differences in society that are also established by actors (namely elites) who benefit from the social hierarchy embedded in rules and practices.

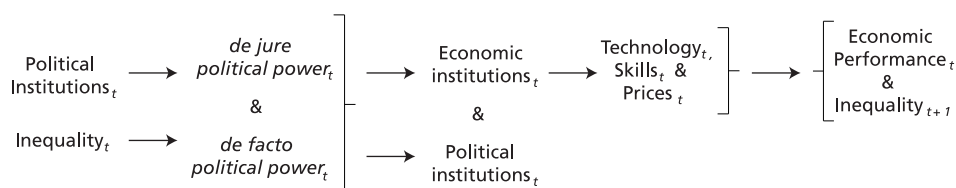
The main point here, though, is not in the reasons for inequalities, but in the factors that reproduce them and keep them unchanged nowadays. The argument for this analysis relies on the fact that economic performance is directly related to the institutional arrangement and political process that determine the economic institutions (Acemoglu, Johnson and Robinson, 2005; Acemoglu and Robinson, 2008). Wealth inequalities, therefore, can be explained by the interaction between political and economic institutions, from which in unequal societies the exploitative and inefficient institutions prevail (Easaw and Savoia, 2009).

Acemoglu and Robinson (2012) deepen characterization of these complex causal mechanisms. To do so, the authors classify institutions as inclusive and extractive. In the first case, the institutional arrangement is likely to generate economic growth, since the political environment fosters pluralism, encourages broad citizen participation, and imposes restrictions and controls on politicians' behavior. Inclusive economic institutions tend to ensure rights of property, law, and order, free openness for new business, access to education and opportunities for a vast majority of citizens. In the interaction between these institutions, investments in new technologies are encouraged, and the process of creative destruction is not contained (Schumpeter, 1941).

At the other extreme, extractive institutions in politics culminate in the concentration of power in the hands of a few individuals and/or social groups, weaknesses, and volatility in accountability in the checks and balances mechanisms or the rule of law. In economics, there is a lack of law and order, unsafe property rights, barriers to entry and regulations that hinder the efficient and free operation of markets. As a result, although there have been cases of growth in the context of extractive institutions, they usually are short and mid-term and, above all, tend to favor elites (Acemoglu and Robinson, 2012).

Considering this taxonomy, what would explain the persistence of these extractive institutions? In short, inequalities, since their impact consists of the concentration of state benefits and wealth in the hand of a small part of the population. To understand the dynamics of inequities accurately in societies, Acemoglu and Robinson (2015) proposed an alternative approach that takes into account both the effect of different types of institutions on the distribution of resources and the endogenous evolution of these institutions. The framework is an adaptation from the one presented in Acemoglu, Johnson and Robinson (2005), used to explain countries' economic growth. Figure 1 outlines the interaction between political and economic institutions and their impact in terms of development (growth and equity).

FIGURE 1  
Institutions and development cycle



Source: Acemoglu and Robinson (2015).

In this framework, the arrows describe influence, mediated by various stochastic events and political economy interactions which produce very different institutional answers depending on the prevailing political equilibrium (Acemoglu and Robinson, 2015).

At any particular time, the prevailing political institutions, together with inequality in society, affect the distribution of de jure political power as well as the de facto political power. The former term refers to the political institutions formally present in a country, including the form of government (democracy versus autocracy) and the extension of restrictions to political elites, as well as the distribution of resources in society. Political power is still influenced by the logic of collective action and by the effective sharing of power. All these factors affect both the setting of economic institutions and the maintenance or change in the political status quo in  $t + 1$ . Obviously, in a nation with a high concentration of resources in the hands of a few, when extractive political institutions prevail, the probability of  $t + 1$  reinforces this context in both politics and economics.

It is de facto power which is the agent of the status quo. The uneven distribution of resources in the society favors the wealthy minority in establishing rules of the game, both formal (de jure) and informal (de facto), that strengthen its political power. Similarly, the economic institutions tend to affect the supply of skills – essential as a determinant of inequality – and technology, including whether and how efficiently existing technologies are employed and improved in a particular economy.

Consequently, the elite not only reproduces these extractive political institutions but, above all, preserves the economic institutions, such as a regressive tax system or pro-employer labor legislation, that reinforce the income concentration. The extreme inequality persistent in Brazil affects and is influenced by these extractive institutions.

In this political context, it fosters the pursuit of predatory rent-seeking and constant distributive conflicts.

It is the framework of these institutional arrangements composed by de jure – (institutional design) and de facto rules (stemming from electoral results and party systems) that determines decision logic, parameters of government action, and the influential capacity of interest groups.

#### **4 INEQUALITY'S PERSISTENCE IN BRAZIL: A TENTATIVE FRAMEWORK**

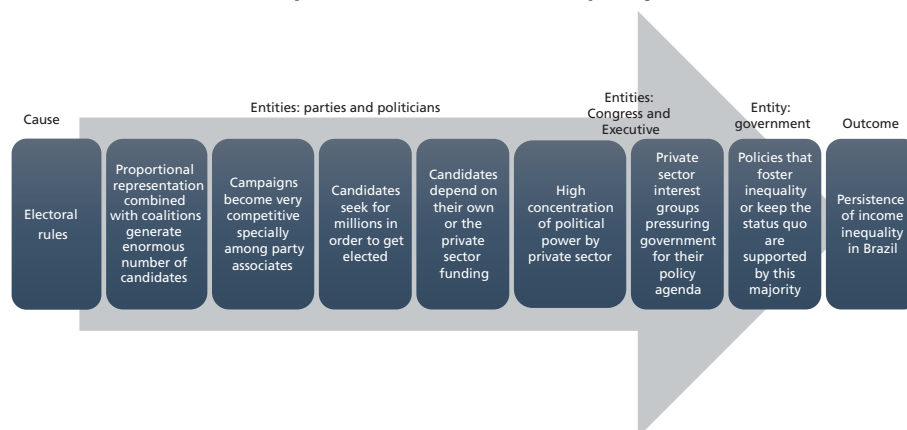
The paper's explanation for the tenacity of inequality in Brazil relies on the premise that the political process is central to understanding how dysfunctional institutions can hinder development, in this case regarding inadequate income distribution level. It is a matter of politics and policies which resulted from collective choices that reflect differences in political institutions and political power-sharing.

The main theoretical claim is that the extractive institutions in Brazil, along with the high level of inequality in the economy, generate a concentration of de jure and de facto political power. As a result, the elite tends to keep the political status quo and prevent effective distributive public policies. As Acemoglu and Robinson (2015) argue, the institutional arrangement dominated by extractive institutions consists of a vicious cycle that can explain inequality's persistence.

In this sense, the inquiry employs process tracing to identify this cycle and, mainly, its causal mechanisms. In short, process tracing is a qualitative method used to investigate in dynamic contexts the interactive influence of causes upon outcomes and, in particular, how causal forces are transmitted through a series of interlocking parts of a causal mechanism to produce an outcome (Beach and Pedersen, 2013). Figure 2 traces the process of how the sequence of these interactions, the causes affecting a variety of entities (parties, politicians, legislative and executive branches), explains the outcome of persistent inequality.



FIGURE 2

**Causal mechanisms of the persistence of income inequality in Brazil**

Author's elaboration.

The first cause comes from the electoral rules. Brazil is a relatively new democracy with a complex and confusing political system, which is mostly due to party and electoral rules that have changed continuously since the Federal Constitution of 1988. Although the country is formally considered free by the Freedom House ranking, in a more comprehensive approach of democracy, such as the concept of polyarchy introduced by Robert Dahl (1973), the quality of democracy in Brazil could be less positively assessed. Polyarchy is a system that manages to supply a high level of inclusiveness and a high level of liberalization to its citizens. Thus, the existence of inequalities in these two dimensions is a barrier to an effective democracy (Dahl, 1989).

Since 1988, every election in Brazil has suffered changes because of the party and electoral reforms; however, none of these reforms has actually brought significant modification in the political system. The main reason is that the system combines proportional representation with party coalitions without any barrier clause that overall generates an enormous number of candidates. For example, the last election for the House of Representatives (lower chamber) had over seven thousand candidates and 35 different parties competing for 513 seats.

In this sense, the literature argues that the system induces the candidates to compete not only against other parties' rivals but also against members of their coalition (Nicolau, 2013; Mancuso, Horochovski and Camargo, 2016). This situation increases

the level of competition, including among party associates (Silva and Cervi, 2017), that together with the large size of the electoral district (Silva et al., 2015; Silva and Cervi, 2017) and the universalization and mandatory voting, make the campaigns more and more expensive.

The campaign costs are also growing because of their professionalization process, the new forms to reach voters (principally by sophisticated advertising), and the decline of mass parties (Silva and Cervi, 2017). For instance, according to the Superior Electoral Court (Tribunal Superior Eleitoral – TSE), on average, to be elected as a representative in Congress costs over US\$ 2 million. This figure does not include parts of the campaign financing which are not declared to the electoral justice, a common practice in the Brazilian political system.

Although public funding covers part of the costs, for the legislative posts this amount is insufficient to undertake a successful campaign, which leaves the candidates with two choices: self-funding or search for private funding. Although citizens are allowed to donate to parties and candidates, it is not a usual practice in Brazil (Speck, 2011; Mancuso and Ferraz, 2012).

Theoretically, corporate sectors finance electoral campaigns for different reasons: i) ideological preferences; ii) social ties with the beneficiary (e.g., friendship, family and links, class identity); iii) a pragmatic strategy to foster closer relationships with the ruling party or opposition parties with a higher chance of winning; iv) as compensation for benefits given in the past (government contracts, favorable legislative or administrative decisions); and v) expectation of gaining these same type benefits in the future (Mancuso, Horochovski and Camargo, 2016).

In this context, campaign financing in Brazil varies according to the elective position, election year, and the candidates' and parties' profiles. Since democratization after 1988, the majority of the funding in all type of elections, for the legislative and executive branches as well as at the local, state and federal level, has come from corporate firms. For instance, in the 2014 presidential campaign, approximately 94% of the financial resources stemmed from corporations.

Furthermore, most of the corporate campaign donations come from only a few sectors of the economy, such as banks and building contractors, which usually have strong links with government policies, whether for regulatory issues or large contracts (Mancuso, Horochovski and Camargo, 2016). This percentage decreases in the funding for congressional elections, but not to the point of withdrawing the leading role of the private sector. In the 2010 Brazilian elections, over 75% of the electoral funding came from private companies; however, only seventy companies made half this donation (Mancuso and Ferraz, 2012). Corporate campaign finance also varies according to political factors and candidates' characteristics, which additionally demonstrate how unequal the funding distribution is. Besides, in the same elections, self-financing corresponded to 10% of electoral funding, which usually is supplied by the wealthiest candidates (Mancuso, 2015). These facts reinforce the next part of the causal mechanisms (figure 2) which consists of the candidates seeking private funding or, in the case of wealthy politicians, investing a considerable amount of their own money in their campaigns (Silva et al., 2015).

The literature has shown that the private sector favors incumbents instead of challengers, center and right-wing candidates, bigger parties, and the ones part of the presidential coalition (Lemos, Marcelino and Pederiva, 2010; Speck, 2011; Mancuso and Ferraz, 2012; Cervi et al., 2015; Mancuso and Speck, 2015). In individual terms, the private sector prioritizes men with college education and businesspeople. Subsequently, not only are the top raisers in corporate funding more likely to be elected than the other candidates, but also the rules of the political game promote a reduction in the turnover rate as well as a close relationship (if not dependence) between private sector interest groups and the government. Conversely, a smaller part of the campaign funding comes from individual donors, most of them designated to left-wing parties (Speck, 2011).

In this sense, Brazilian scholars conclude that corporate campaign finance strongly facilitates electoral performance in the elections for both legislative and executive branches: the higher the funding, the higher the winning chances (Peixoto, 2010; Cervi et al., 2015; Mancuso, Horochovski and Camargo, 2016; Speck and Mancuso, 2017).

The leading corporate role in funding Brazilian democracy has an impact on political competition, the candidates' performance, and the dependence of the political

class on this sector. Thus, the pattern of electoral financing generates imbalances in democratic representativeness, considering that it benefits professional politicians as well as the right-wing candidates and parties aligned with the government which tend to maintain the status quo.

These effects also generate a high concentration of political power in the hands of the private sector, especially business and rural sectors. The distribution of power de jure and de facto in the National Congress is also reflected in the size of the business and the rural caucuses. For example, both caucuses are over-represented in Congress in comparison to their percentage in the general population of the country. Table 1 shows the number and percentages of these caucuses in the current legislature.

TABLE 1  
Business and rural caucuses in the National Congress<sup>1</sup>

	Total	Business caucus		Rural caucus	
	N	N	%	N	%
House of Representatives	513	246	48	228	44
Senate	81	27	33	27	33
National Congress	594	273	16	255	43

Source: Cámara dos Deputados. Available at: <<https://bit.ly/37H6P35>>.  
Note: <sup>1</sup> 55<sup>th</sup> Legislature 2015-2019.

Regarding the ideological dimension, it is also worth mentioning how uneven the seat distributions in both chambers are. Left-wing parties are historically associated with redistribution policies, whereas these are not the primary concern of the right-wing parties (Bobbio, 1996). Based on the estimations of party ideology from Power and Zucco (2013), in the last four legislative elections (2002-2014) the center-right parties represent the vast majority, controlling approximately 70% of the National Congress. While in the lower chamber this disparity has not changed during this period, in the Senate the center-left parties increased their seat percentage from 25% in 2002 to 34% in 2014. However, this percentage is not enough even to approve an ordinary bill. Therefore, either the private sector caucuses or the center-right parties can gather a considerable number of congressional representatives that allows them the ability to control strategic committees, propose any bills, filibuster, or act as veto players in any legislative proposal in course in the Parliament.

This representative issue also occurs in the executive branch since the businesspersons and property owners have also historically occupied strategic posts, primarily in the ministries related to economic policies (Palotti and Cavalcante, 2019). Furthermore, the parties in Congress allied to the president appoint most of these positions. The national elite is also well represented in the administration's most important posts. The ministers in the new democratic period (since 1990) are mostly white men who possess a high level of education, graduated from the top universities in the country, and hail from the wealthiest states, i.e. the southern and southeast regions (D'Araujo and Ribeiro, 2018; Palotti and Cavalcante, 2019).

In sum, the political institutions and their effects that generate a high concentration of political power in these specific groups are also responsible for the dependence of the majority of the congressional representatives on the private companies that funded their campaigns. It is not only *de jure* political power, but mainly, it is *de facto*. The interaction between the inequality in the economic field and the prevailing electoral rules culminate in a setting of *de jure* and *de facto* political power that, invariably, culminate in economic institutions or policies, supported by this governing elite, that foster inequality or keep the status quo.

This corporate influence is also a subject of study in the Brazilian political economy literature. Regarding the business and rural sectors, Simionatto and Costa (2012) and Rangel, Bolonha and Faroni (2015) show that they are often successful in several initiatives. Figueiredo Filho (2009) analyzes more than twenty scientific papers and finds that, although the effects may vary according to the policy issue or the politician's profile, the bulk of the studies demonstrate the influence of campaign contributions on legislative behavior.

The corporate influence may occur in different forms. Claessens, Feijen and Laeven (2008), identified a positive relationship between financing and access to credit from public banks, whereas Lazzarini et al. (2011) showed that firms with the highest donations to electoral campaigns received more loans from the National Bank for Economic and Social Development (BNDES).

Boas, Hidalgo and Richardson (2014) found a positive relationship between the financing of winning candidates and access to public contracts. Gonçalves (2012) demonstrated that several business sectors that donated to the presidential elections in 2002 and 2006 received tax benefits. Focused on the same elections, but in the congressional sphere, Mezzarana (2011) analyzed articles published in newspapers to map general benefits to major corporate funders.

In the economic arena, Santos (2014) and Santos et al. (2017) investigate the voting of Brazilian federal representatives concerning the projects of interest to the National Confederation of Industry. The results show that there is indeed a powerful lobbying influence on such outcomes, but that it is more effective to create a barrier to new legislation than to change the status quo in its favor. Finally, the paper concludes that the synergy between the executive branch and the private sector is the primary determinant of the success of the industry within the parliament.

Finally, in a recently released paper that describes the results of a survey with a Brazilian lobbyist, Santos et al. (2017) show that the legislative branch is the most critical arena for lobbying influence, followed by the executive branch. Besides, the majority of the respondents concentrate their investments on conservative politicians; in other words, they prefer to finance candidates whose position is already known and who are their allies.

In short, the literature highlights how institutional effects during and after campaigns deviate the Brazilian political system from the polyarchy system. On the contrary, it can be approximated to an elite arrangement similar to the iron triangle relationship in policymaking (Gordon, 1981). Consequently, this dysfunctional democracy impacts how public policies in Brazil are designed, implemented, or not changed.

## **5 FISCAL POLICY IN BRAZIL: FEATURES, PARADOX, AND BARRIERS TO CHANGE**

This section analyzes the interactions between political and economic institutions and their effects on (re)distributive fiscal policy in Brazil to test the proposed framework.

The fiscal dimension is notoriously considered one of the main loci from which to tackle inequality.

The article's hypothesis states that the Brazilian government is unable to employ fiscal policy to distribute income, and even in some situations performs as a 'Robin Hood in reverse,' i.e. transferring from the poorest to subsidize or pay transfers to those who have the most. The features of the tax system (taxes and exemptions) and government transfers perpetuate this scenario of inequality. The notorious knowledge about the problem is highlighted by the specialized literature (Afonso et al., 2017) and, paradoxically, by the own state organizations. Additionally, the inequalities in sharing political power also constitute an obstacle to changes since the ruling elite or stakeholders occupying strategic posts in the executive and legislative branches are veto players (Tsebelis, 2002), preventing adoption of a fiscal policy that effectively redistributes income. Thus, this section discusses the characteristics and problems of Brazil's fiscal policy, its evolution, and proposals for changes in the last two decades.

In general, the Brazilian fiscal redistribution system is highly complex. This is due mostly to tripartite federalism, which sets a range of responsibilities that in some cases overlap for all levels of government: federal, state, and local. Tax collection is also divided, basically into twelve distinct taxes, among the three levels of government, in which the participation of the federal government is much more representative than the others.

Besides the system's complexity, other aspects on the collection side are also always emphasized, mainly because of their weak capacity to provide income distribution. The tax burden for Brazil is very close to the average of the Organization for Economic Cooperation and Development (OECD) countries, at 33% of GDP. After a period of growth in the 1990s, stabilized since 2005, little has changed in low income and wealth taxes, and in tax regressivity on wages and consumption. The tax system is notably regressive, mainly in the taxation of services, low progressivity of income tax, and several exemptions and deductions to the wealth and private sectors. In short, those who have more ironically paid less.

The low redistributive effectiveness of the tax policy is directly related to the high regressivity, considering the focus on the indirect taxes on consumption to the detriment

of taxation on income, rents, financial investments, profits and dividends, and property. Consequently, tax collection aims at increasing revenues without concerns regarding taxation isonomy. The tax on consumption aggravates social inequality and moves the system further away from distributive justice. When all citizens nominally pay the same consumption tax, the less wealthy families end up delivering a more significant portion of their income to the state than the richer – income which the former then also cannot afford to save. This setting can be summarized as follows:

- while in the OECD countries, on average, the income and profit tributes represent over 35% of the tax revenue, in Brazil, they are around 18%. On the contrary, the taxes on goods and services, less progressive taxes, exceed 50% of tax revenue while the OECD average is less than half;
- personal income tax has five different rates: the highest is 27.5%, which may be deducted using education, health and welfare expenses, among others. This is much less than the USA (40%) or Canada (50%). Total exemption from income tax on profits and dividends distributed to companies' shareholders has also been adopted since 1995, the reverse of what most countries do;
- the possibility of deducting from taxable income a fictitious expense related to the so-called "interest on own capital";
- the Brazilian tax burden on rents, profits, and capital gains declined by 0.23% in the 2005-2014 period (due to several exemptions) and accounted for only 6.9% of the total, against 11.5% on the OECD average. Considering the wealthiest population, the average rate grows up to 12% at the beginning of the last hundredth of the income distribution and falls to 7% among the wealthiest 0.05%.

Another distributive issue involves the minimal taxation of property in Brazil. For example, in 2011, property taxes accounted for only 1.40% of GDP, or about 4% of the all tax collection, while that percentage exceeds 10% in nations such as Canada and the United States (Salvador, 2016; Gobetti and Orair, 2015; 2016). In the Brazilian case, there is no legal provision for tax collection for watercraft or aircraft; in other words, all boats, yachts, and private airplanes are exempt.

It is worth mentioning that these findings and contradictions are also recurrently found in official documents, both from the executive and legislative branches. The



issue worsens insofar as the Federal Constitution of 1988 has the reduction of social inequalities as one of its four fundamental objectives, which seems like a paradox. Put differently, the authorities have much information about the problem, but they do not advance in its solutions.

On the spending side, this scenario is even further aggravated, since part of the literature states that transfers such as welfare benefits and direct taxes – more specifically, the transfers of social security pensions and high wages in the civil service – tend to reduce the effect of such fiscal policies on inequality (Medeiros and Souza, 2013; 2016; Medeiros, Galvão and Nazareno, 2015). According to the recently released study by the Ministry of Finance (Brazil, 2017), entitled Redistributive Effect of Fiscal Policy in Brazil, the absolute incidence of public spending on monetary transfers is also asymmetric. For example, the share of public resources directed the wealthiest quintile of the population is ten times more than the amount that benefits the quintile in the base of the income distribution. While in 2015, the net effect of the government on income inequality through monetary transfers and direct taxes, as measured against the OECD average Gini coefficient, was impacted by a 34% fall in this index in 2015, double the fall in income inequality was observed in Brazil, even though the Brazilian tax burden is close to the OECD average (Brazil, 2017).

The fiscal policy in terms of equality, therefore, is notoriously problematic. Nevertheless, what has been done to change this scenario? According to the framework of this research, institutional configurations and their underlying effects on the distribution of power *de jure* and *de facto* theoretically would tend to move towards the status quo, i.e. preventing changes that reduce inequalities in the country. In order to test this argument, the investigation analyzes the changes and proposed modifications in the Brazilian tax system in the last two decades.

It is worth noting that previous decisions usually constrain processes or transformation efforts within the perspective of path dependence (Pierson, 2000) which tends to increase transactional costs, creating barriers or possibilities for incremental changes.

However, since the 1988 Constitution, tax reform has been considered a national priority, with a high consensus in government and public opinion regarding its need. Therefore, all presidents elected since then have defended tax system changes during their campaigns and speeches after the inauguration, two of whom sent reform proposals

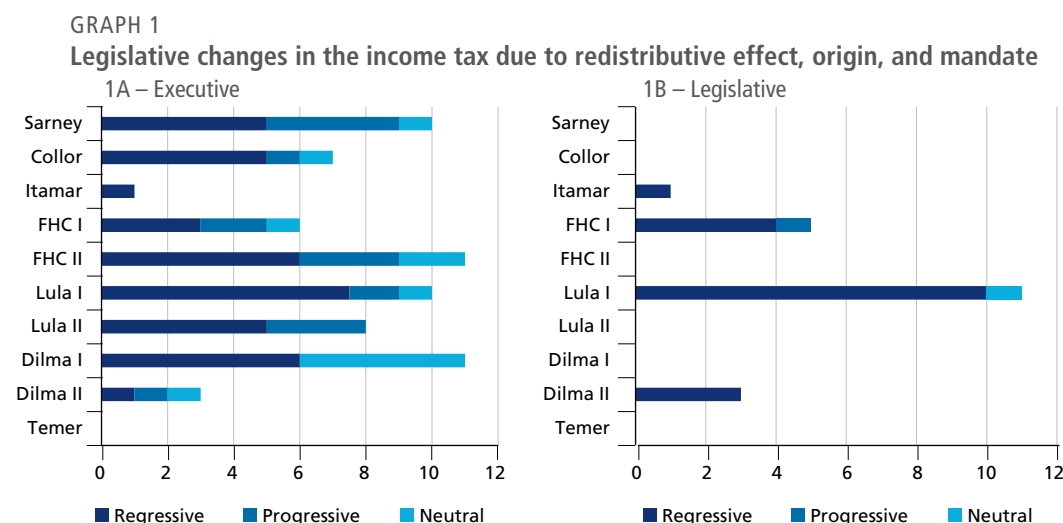
to Congress (Junqueira, 2015; Salvador, 2016). Dozens of tax reform projects were also proposed by congressmen within the legislative branch as well in the same period.

The bulk of these proposals addressed the redistributive issue, such as the Constitutional Amendment Bills 175 of 1995, 41 of 2003, and 233 of 2008. For instance, the first, in its presentation document to the Congress at the beginning of the Cardoso Administration (1995), recognizes that promoting social justice depended on “strengthening the direct taxes – income and property taxes – that are paid by the rich and decreasing taxes on goods that are consumed by all, but have higher effects on the poor’s budget” (Brazil, 1995, p. 10-11). The executive reform proposal envisaged progressivity in patrimony taxes and facilitated the regulation of the wealth tax, already inserted in the Constitution. Nevertheless, the bill, although approved in the special commission, was never put to the vote in the plenary until the end of Cardoso’s second term in 2002 (Junqueira, 2015).

Regarding the distributive issue, Bill 41 of 2003 formulated in the Da Silva Government (2003-2010) provided for the same proposals of Bill 175, but added more taxes on the financial sector as well as the permission to tax boats and aircraft. This project came to be approved, with numerous amendments, in the Lower House but never advanced in the Senate (Dall’acqua, 2005; Brami-Celentano and Carvalho, 2007). During the same administration, another reformist attempt (Bill 233 of 2008), although approved at the special commission in the same year, was not taken to the plenary session in the last ten years (Junqueira, 2015).

Since 2011, the last two presidents (Rousseff and Temer) have chosen not to submit reform proposals, but have focused on incremental bills with a smaller scope, such as the reduction of rates and indirect taxes on a set of products as a basic food basket and medicines as well as the payroll exemption. Both initiatives, though, remain paralyzed in Congress. It indicates that the executive branch usually includes tax progressivity in official discourse and some proposals. However, despite the historically high success rate in its legislative proposals (Moraes, Miranda and Azolin, 2017), the government is little effective in the sponsorship, commitment, and effectiveness of taxation change approval.

Another analytical strategy is to investigate the pattern of proposals and changes in tax policy in the same period. In general, in the Senate and the Chamber of Deputies, several projects are aiming at modifying the country's taxation system, especially those related to taxes on income and wealth. It is worth noting the predominance of congressmen and congresswomen from left-wing parties among authors of these propositions, especially for the bills creating or raising tax on big fortunes, which have never passed the committees to the floor (Brazil, 2016). However, more important than analyzing projects is to examine which ones were approved and their actual distributive effects. In this sense, Lazzari and Leal (2018) systematically mapped all legislative changes related to personal income tax from the beginning of democratization (1985) to President Temer's administration with reference to their redistributive effects, which is summarized in graph 1.



Source: Lazzari and Leal (2018).

Undoubtedly, the Executive branch performs the leading role in the tax policy agenda, although this is not mean as a positive sign since most of the legislative production during this period did not make the income tax more progressive. For instance, among the changes in the categories of taxation, exemptions, deductions, and regulation, 67% had regressive effects (Lazzari and Leal, 2018). In sum, the current period is far from being tied to income tax progressivity, as might be hypothesized by median voter theory, electoral competition, or even the growth of left-wing power. In the latter case, even if the left-wing parties defend a fairer tax policy, both in congress and in

the executive branch (2003-2016), their efforts are mitigated or barred by the other center and right parties, which have always been the majority in the Brazilian legislative sphere. These findings reinforce the perception of scholars as well as in the government that the recent variations in the population's income pattern have not brought powerful redistributive impact.

## 6 FINAL REMARKS

The paper aimed to present an institutional explanation for income inequality's persistence in one of the most unequal countries in the world: Brazil. The study focused on analyzing the determinants of the maintenance of dysfunctional income distribution levels, which in the Brazilian case has not substantively changed during the last two decades.

The research is grounded in the premise that the explanation for inequality's tenacity in Brazil must come from the new institutionalism approach. Because of that, the theoretical claim is that inequality, like other dimensions of economic performance, is a consequence of the institutional arrangement and political process that determine the economic institutions, which in turn affect inequality patterns. This vicious cycle is possible because of the prevalence of extractive institutions in the political and economic dimensions.

The paper employed a process-tracing method to depict the mechanism describing the causes that often keep the status quo of bad income distribution in the country. Then, it discussed each part of the process based on the literature on the effects of the electoral rules and corporate financing and influence in the Brazilian political system, and tested the argument empirically using the case of the redistributive fiscal policy.

The analysis of the fiscal policy setting and evolution, more specifically in the dimension of taxation, corroborates the main argument of this research: the Brazilian government not only misuses its fiscal instruments to redistribute income, but also acts as a 'Robin Hood in reverse' by withdrawing from those who have fewer resources to subsidize or pay transfers to those who have more. In short, the paper demonstrates that the executive and legislative branches undertook redistributive efforts, mainly led

by left-wing parties. Nonetheless, the institutional setting and the causal mechanism discussed in the paper converge on the perception that the ruling elite, with its strategic posts inside the state (power de jure) and its power de facto, acts as a barrier for changes in the status quo, blocking or even aggravating the redistributive pattern of Brazilian fiscal policy and the country's income inequality.

The causal mechanism discussed and the paper's findings regarding fiscal policy are quite interesting. Mainly, this is because of the Brazilian case's paradox in which the Constitution of 1988 recognizes a series of rights and social benefits, yet at the same time the taxation system acts as an enemy of welfare state effectiveness.

Finally, the tenacity of inequality is a complex subject with multiple causes, so they must be analyzed with particular caution. The causal mechanism analyzed by process tracing must be seen as an analytical strategy in a macro-level perspective. The next steps of this research agenda aim at investigating how other dimensions of economic institutions that also affect inequality, such as the labor market and educational and welfare systems, were established and evolved. It is thus possible to explore the influence of political institutions and the consequent de jure and de facto political power concentrated in the hands of the elite on inequality persistence in Brazil and other emerging economies.

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