

## 21. Income inequality in Brazil: new evidence from combined tax and survey data

Marcelo Medeiros

*Inequality in Brazil fluctuates over time, but has been high since at least 1928, as a result of an impressive concentration of income among the rich. This contribution analyses the viability of commonly proposed strategies to reduce inequality. It argues that a realistic expansion of education, the eradication of poverty, the expansion of social assistance programmes, economic growth and a more efficient management of current policies will not have major impacts on inequality within a reasonable time frame of, say, two decades.*

For many decades of the twentieth century, Brazil was ranked among the most unequal countries in the world. In the mid-1990s, household surveys showed that this was changing. Inequality in labour earnings began to decline and after 2001, household per capita income inequality fell systematically for eleven years. A combination of the labour market's good performance, systematic increases in the minimum wage, increases in the coverage of social assistance programmes and a better distribution of pensions were the cause of these changes. Encouraged by political campaigns, a triumphalist discourse of good government greeted the decline in the inequality that the household survey data showed. The Bolsa Familia programme,<sup>1</sup> a trademark of Brazilian President Lula's administration, was especially emphasized.

This apparent decline in Brazilian income inequality drew attention: a large economy could reduce inequality while it was increasing in various other countries. Nevertheless, it was not an exception in the region. Income inequality was declining in several South American countries, suggesting that changes in the region were affecting the way income was distributed.

However, household surveys only tell part of the story. They do not accurately measure top incomes, and as a consequence they underestimate total inequality. Income tax data painted a different picture. It showed that inequality in Brazil was higher than previously thought and remained stable, at least between 2006 and 2013.

The top 1 per cent of the richest people in Brazil accrued 25 per cent of all incomes, with only minor changes, during this period. Over a longer period, income inequality has gone up and down since 1928, reaching a peak when Brazil entered the Second World War, followed by a long decline. This decline was completely reversed when a coup d'état led to two decades of dictatorship. Since the country's return to democracy, inequality seems to be fluctuating within a relatively narrow band (Souza and Medeiros, 2015). Given this evidence, we must revise what we know about inequality, its determinants and the policies that could help reduce it.

Yet, while tax data are better than survey data at measuring what happens to the distribution of top incomes, they give no information about the distribution of the bottom incomes, since people with low incomes in Brazil do not have to submit tax returns. Moreover, tax tables offer almost no information on who falls into the top income group, making it impossible to compare this group with those at the bottom. Much more could be done if the Brazilian tax agency were to give researchers access to unidentified microdata (personal data that cannot be linked to specific persons). Until this happens, methods that correct surveys by using tax data are one of the few alternatives to cope with the underestimation of incomes. These methods are still being developed and because their results are preliminary, they should be used with caution.

The corrected survey data point out that occupational and educational elites contribute disproportionately to the inequality between adult individuals. In this context, 'contribution' is a statistical measure calculated as the product of the income of a social group, as a share of total income, and its concentration coefficient.<sup>2</sup> These contributions are higher than the household surveys estimate. Employers, who are only 1 per cent of the population, make up 13 per cent of the inequality; workers with an 'elite education' – those with university degrees in professional areas (medicine, engineering and law, for example), and those with Master's degrees and PhDs – who represent no more than 3 per cent of the population, are responsible for 25 per cent of the inequality. Those with any type of university education, who represent about 8 per cent of the adult population, contribute half of all the inequality. Gender, racial and generational inequalities are also higher than commonly estimated: this is not a surprise, as the rich are often white men older than 45 (Medeiros, Galvao et al., 2015).

A large mass of low-income people, separated from a small, but quite rich, elite, characterize the Brazilian income distribution. Economic and political powers are intermingled and this elite controls both.

### Which policies would be suitable to reduce inequalities?

A survey by Elisa Reis (2005) on what elites think of inequality, and the public policies that would be required to reduce it, shows that in general, the rich tend to confuse the reduction of inequality with anti-poverty policies. They also believe that equality should be achieved without redistribution or any radical changes in the status quo: that is, without immediate losses for those at the top. Elites explain the failure of policies aimed at reducing inequality in terms of mismanagement or issues of attitude, rather than in terms of structural constraints. As in many other countries, Brazilian elites believe that the solution for inequality is a combination of education, growth and efficient public administration, but without a major increase in taxes to fund these policies.

A quick look at the data suggests that the solutions these elites envisage are not sufficient to reduce inequality considerably and cannot be implemented without a reasonable amount of redistribution. Data and research suggest that without important changes in the status quo, inequality will take a very long time to decline.

### Poverty is morally unacceptable and should therefore be eradicated

The concentration of incomes in Brazil is so great that simple calculations show that even if poverty was eradicated, inequality would remain very high. Brazil was very successful in expanding its two main cash transfer programmes to fight poverty during the first decade of the twenty-first century. Consequently, the number of poor people declined and so did their degree of poverty. But the effect of these transfers on inequality is very small. Even though the cash transfers reach the poor very well, they contribute to reducing the concentration of income much less than people think<sup>3</sup> (Medeiros and Souza, 2015). Compared with poverty eradication, equality is harder to achieve and costs more, both economically and politically.

### More and better quality education for all is a priority

Not only is education intrinsically necessary for a good life, it also may help lower income inequality.

Education in Brazil is very unequally distributed, and the majority of adults do not have any secondary schooling. Public education is free at all levels but the quality of public basic education is low, making a good education highly dependent on students' social origin. Richer families send their children to private schools for their basic and secondary education so that they will have a better chance of passing the higher education entrance exam and enter the far better public university system. This unequal access to quality education is a major driver of the country's inequality in the long run. The resulting structure for career opportunities is the most obvious result of this inequality. In addition, education is strongly related to labour earnings as well as to social and cultural capital. This means that there is an educational inequality trap that reproduces social status over generations. Long-distance social mobility – that is, mobility from the bottom to the higher levels of the social pyramid – is very low (Ribeiro, 2012).

As a result, it is not sufficient that the country give lower-class students access to education; it must also compensate them for their disadvantages. This implies providing public education that is better than private schools offer. Obviously, this will be very expensive and even if such an ideal settlement is possible, it will probably take years to implement. Even under a perfect, classless educational system, it will take decades before a generation of properly educated

children begin their working lives and become a majority in the labour force. Therefore, education is necessary, although it will probably not be enough to reduce the country's inequality to acceptable levels within a reasonable time frame.

'Growth is the best social policy' is a good slogan. It sounds particularly good to elites, because it dismisses the need for redistribution. After all, the saying is that a rising tide lifts all boats. This image is not only old-fashioned, but also wrong. Growth can actually increase inequality. There are different types of growth that benefit different types of people. If the country wants to use growth as a policy tool to reduce inequality, this growth must be much better explained, making clear who is to get what. In Brazil, the top 1 per cent accumulated 28 per cent of all personal income growth between 2006 and 2012 (Medeiros, Souza et al., 2015). The poor would have to benefit from much faster growth for inequality to decrease within a reasonable time frame.

Finally, the perception of elites that the good management of public policies is necessary to reduce inequality is correct, if we understand this belief in broad terms. It is always possible to make the administration of social expenditures more efficient, but we should not expect too much from it. Pensions are the most important social expenditure, but in this area it is difficult to reduce expenditure significantly even if administrative efficiency is improved. In fact, better management of public affairs would have stronger effects on inequality if it were focused on redesigning policies and their funding. For example, interest paid to creditors of the public debt amounts to 5 per cent of GDP, almost half the cost of the entire pension system. If management has room for improvement, it is definitely in this area and in other macroeconomic policies.

A complicated web of taxes and required contributions funds all these payments. They are all very complex, but they share one characteristic: they are neither socially progressive nor economically efficient. Brazil has an outdated taxation system inherited from the time when the country was still industrializing. The system has been adjusted several times, but never reformed. Progressive personal income taxes are actually a minor part of the system, and taxation on property and inheritances is limited.

Expanding education, solving debt problems and reforming the pension and taxation systems will require huge efforts. Yet without such efforts, Brazilians will have to cope with inequality for a long time to come.

## Notes

1. Bolsa Familia is a poverty alleviation programme consisting of targeted transfers conditional on school attendance and health checks for family members if these apply. Together with the BPC – the targeted unconditional social cash transfer for older people or those with disabilities – it forms the core of the Brazilian social assistance policy. The BPC was included in the 1988 Constitution and cannot therefore be associated with a single government. Bolsa Familia was created during President Lula's administration and became one of his trademarks. Bolsa Familia came from the Bolsa Escola of President Cardoso, which in turn had its origin in previous city-level programmes.
2. The concentration coefficient is a measure of the concentration of one source of income on the distribution of incomes from all sources. The share of a social group's contribution to total income is the share of the income of that group's members compared with the total income of the population. We calculate a source of income's contribution to inequality by multiplying this source's concentration coefficient by the share of that income in the total income. A group's contribution to inequality is a measure of how the income of this group's members contributes to the composition of the total inequality. It cannot be interpreted in counterfactual terms: that is, if a group's contribution to inequality is 10 per cent, inequality would not decline by 10 per cent if the group ceased to exist. This is because removing such a group would affect the total income and therefore all the concentration coefficients.
3. More specifically, the static contribution of all cash-transfer programmes together to the Gini index is not even minus 1 per cent (Medeiros and Souza, 2015).

## Bibliography

- Medeiros, M., Galvao, J. C. and Nazareno, L. 2015. A composição da desigualdade no Brasil: conciliando o Censo 2010 e os dados do Imposto de Renda [The composition of inequality in Brazil: conciliating the 2010 census and income tax data]. Social Science Research Network (SSRN) Scholarly Paper. Rochester, N.Y., SSRN. <http://papers.ssrn.com/abstract=2636586> (Accessed 30 September 2015).
- Medeiros, M. and Souza, P. H. G. F. 2015. State transfers, taxes and income inequality in Brazil. *Brazilian Political Science Review*, Vol. 9, No. 2, pp. 3–29.
- Medeiros, M., Souza, P. H. G. F. and Castro, F. A. de. 2015. The stability of income inequality in Brazil, 2006–2012: an estimate using income tax data and household surveys. *Ciência & Saúde Coletiva*, Vol. 20, No. 4, pp. 971–86.
- Reis, E. P. 2005. Perceptions of poverty and inequality among Brazilian elites. E. P. Reis and M. Moore (eds), *Elite Perceptions of Poverty and Inequality*. New York, Zed Books, pp. 26–51.
- Ribeiro, C. A. C. 2012. Quatro décadas de mobilidade social no Brasil [Four decades of social mobility in Brazil]. *Dados*, Vol. 55, No. 3, pp. 641–79.
- Souza, P. H. G. F. and Medeiros, M. 2015. Top income shares and inequality in Brazil, 1928–2012. *Sociologies in Dialogue*, Vol. 1, No. 1, pp. 119–32.

■ **Marcelo Medeiros** (Brazil) is professor in the Department of Sociology of the University of Brasilia and senior researcher at Ipea, the Institute for Applied Economic Research. He studies income inequality in developing countries, both today and in historical perspective.