

Inequality

IMPROVING POLICIES TO REDUCE INEQUALITY AND POVERTY

- ▶ Income inequality in Brazil has steadily decreased since the early 2000s, in sharp contrast with most OECD countries, where inequality increased during the same period.
- ▶ Nevertheless, income inequality is still very high by international standards. The long-term fall of income inequality was driven by improvements in education and labour market policies on the one hand, and social transfers on the other.
- ▶ Further progress in reducing inequality requires a policy package built on three pillars: promoting inclusive employment, improving the redistributive effectiveness of the tax and benefit system and investing more into education and skills.

What's the issue?

Despite a sharp fall in income inequality since the early-2000s as a result of the implementation of intersectoral universal social policies, combined with measures focusing on vulnerable groups, Brazil is still a very unequal country. This is in line with most Latin American countries but in sharp contrast to most OECD countries. In 2013, the average pre-tax income of households at the top 10% of the distribution was 43 times higher than at the bottom 10%. This ratio is down from around 60 in the early 2000s. Measured by the Gini coefficient inequality of disposable income in Brazil in 2013 was 0.47, almost 50% higher than the OECD average (0.315). According to the National Household Sample Survey (PNAD), annually prepared by the Brazilian Institute of Geography and Statistic (IBGE), the share of population living in absolute poverty fell from 7.6% in 2004 to 2.8% in 2014

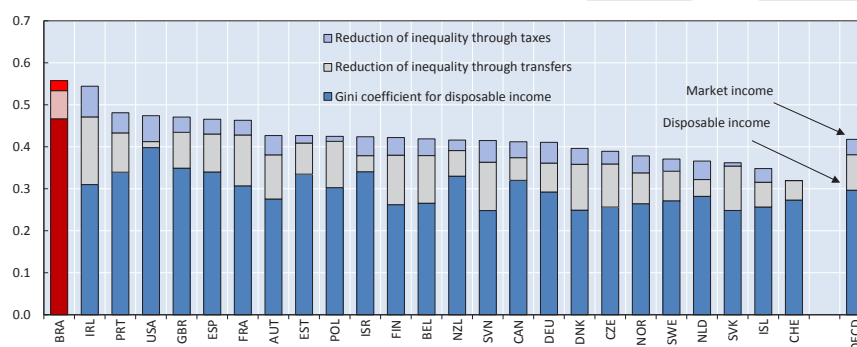
In Brazil, social spending and taxation play a much weaker

role in reducing inequality than in most OECD countries. The challenge today is to rely more strongly on the instruments that are most effective in tackling inequality. In particular, this means giving a higher priority to increasing expenditure on conditional cash transfers and increasing the progressivity of the tax system.

Social spending plays a significant role in fighting poverty and reducing income inequality. Although the spending level in Brazil is close to the OECD average, the redistributive impact is much weaker. The pension system holds the lion's share of social spending. Although the pension system has been very successful in reducing old-age poverty, it could be brought more into line with current practice in OECD countries, such as reducing incentives for early retirement. Part of the resulting savings of such measures could be directed to conditional cash transfers. Bolsa Familia and other social

▶ The redistributive potential of the Brazilian tax system is underexploited

Inequality reduction through taxes and transfers, working-age population



Note: The overall height of each column corresponds to the Gini coefficient for market income, i.e. before taxes and transfers. Sample restricted to households headed by a working-age individual. Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>.

Source: OECD Income Distribution Database (<http://oe.cd/idd>); data for Brazil from Luxembourg Income Study Database (LIS), www.lisdatacenter.org.

programmes under *Brasil sem Miséria* are very effective policy tools for combating inequality and poverty. Despite accounting for less than 1% of GDP, conditional cash transfers are responsible for 13% of the inequality fall in Brazil¹.

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The redistributive role of the Brazilian tax system is underexploited. Despite an overall tax burden similar to the OECD average (above one third of GDP), the tax system as a whole, i.e. taking into account both direct and indirect taxes, actually increases inequality (OECD, 2013). This is due to: a high reliance on indirect taxes – which are regressive, as in most countries; low progressivity of the personal income tax, partly as a result of significant loopholes that favour those with above-average incomes; and a cap on social security contributions. In Brazil, direct taxes reduce income inequality (measured by the Gini coefficient) by 5%, compared to 12% on average in the OECD area (Figure).

Improved access to education has played a key role in reducing inequality and poverty in Brazil as it has allowed more Brazilians to move into better-paid jobs but more needs to be done to strengthen the quality of education, to improve education opportunities for disadvantaged students and to gear learning content stronger towards labour market needs, including by providing more vocational education and training.

Health policy is another key instrument to reduce inequality and poverty. Progress in universal, publicly-provided primary healthcare has played a major role in raising Brazilians' health, especially for those who cannot afford private health insurance. Despite this success, long waiting times and difficulties in accessing specialist care reflect underfunding of the Brazilian public health system, a need to raise efficiency in the use of its resources and improvements in the quality of its services.

Why is this important for Brazil?

Reducing income inequality would contribute not only to a fairer but also to a stronger economy. Recent OECD research suggests that the long-term increase in income inequality has curbed economic growth in the OECD area. Over a 25-year horizon, a 1 Gini point increase in inequality is estimated to drag down average growth by around 0.1 percentage point

¹ OECD Economic Surveys: Brazil 2013, OECD Publishing, Paris, page 86

Key OECD Recommendations

- ▶ Increase the progressivity of direct taxes by closing loopholes, reviewing the rate schedule, exemption thresholds and reconsidering the cap on social security contributions paid by employees.
- ▶ Give higher priority to increasing *Bolsa Família* and other policies under the *Brasil Sem Miséria* programme compared to pension expenditure. Introduce a general minimum retirement age and strengthen the disincentives for early retirement.
- ▶ Scale up early childhood education and improve its quality with more training and supervision of educators. Tackle school drop-outs by reducing grade-repetition, increasing flexibility and subject choice in secondary education. Increase the funding for public health services.

per year, with a cumulative loss of some 3% in the long run. Removing obstacles to potential economic growth is important, especially in a context of slowing growth in Brazil.

OECD work shows that redistribution through taxes and benefits per se does not lower economic growth. While this does not mean that all redistribution measures are equally good for growth – poorly targeted policies that do not focus on the most effective tools can lead to a waste of resources and inefficiencies – it means that tax and benefit policies can have both an efficiency and equity role, especially when they are linked to inclusive labour market, education and training policies.



Further reading

OECD (2015a), *In It Together: Why Less Inequality Benefits All*, OECD Publishing.

OECD (2015b), *OECD Economics Surveys Brazil 2015*, forthcoming.

OECD (2014), *Focus on Top Incomes and Taxation in OECD Countries: Was the crisis a game changer?*, OECD Publishing.

OECD (2013), *OECD Economic Surveys: Brazil 2013*, OECD Publishing, Paris.

OECD (2011), *Divided We Stand: Why Inequality Keeps Rising*, OECD Publishing.