Welfare state development in Brazil?

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Introduction

The news that Brazil was finally coming to terms with its unrivalled level of economic inequality came as a welcome surprise. Over the first decade of the twenty-first century, or, more accurately, between 2004 and 2014, the country went down a path of economic prosperity and social progress that starkly contrasted with the import substitution industrialization (ISI) era of the late 1960s and 1970s, when sizable levels of economic growth and scant social equilibrium cohabited. Justifiably, the recent experience of “redistributive growth” has attracted the attention of international policy-makers, multilateral organizations, and academics, especially in view of the rather ambiguous achievements of other emerging economies, such as China and India, where increasing inequalities have followed spectacular growth rates.

The purpose of this chapter is not so much to delve into the new growth model, tempting as that might be, but to focus on achievements such as the reduction of poverty and inequality, and thus evaluate the advances, and flag the limits, of the Brazilian experience in these areas. A central tenet of the argument is that Brazil was, in the period here considered, building up a welfare state distinctly reliant on regulatory and redistributive policies. However, it is argued that, while

moving beyond “social safety nets” (e.g. conditional cash transfers to the poor), the social policies implemented stopped short of delivering truly transformative changes to the very segregated structure of welfare provision -- changes which would be needed if advances in public social services and progressive taxation were to be effected. Moreover, the measures undertaken, albeit politically easier to implement in a context of growth, turned out to be particularly susceptible to retrenchment pressures when circumstances changed. In fact, the recession that started in 2015, in combination with recent cost-cutting policies and proposed constitutional change, is set to dismantle the main pillars of the experiment.

The argument offered in this chapter is organized in the following way. The first section reviews the recent evolution of poverty and inequality in Brazil; the second looks into the driving forces behind these developments, with an emphasis on factors shaping the dynamics of inequality; the third qualifies the positive achievements with new data from income tax returns which show a resilient concentration at the top of income distribution; the following section draws attention to bets that were not placed, i.e., social investment policies and progressive taxation; and the concluding section evaluates the achievements from the perspective of recent developments that set the context of welfare state retrenchment in the country.

<h1> Evolving poverty and inequality</h1>

Over the last decade, Brazil has undergone a process of social development, ‘catching up’ with advanced economies in terms of the incidence of poverty and levels of income inequality.
Reduction of poverty was already substantial in the 1990s, in the period shortly after the 1994 Real Plan -- a stabilization plan that reined in hyperinflation and created the new Brazilian currency, the real. Between 1993 and 1995, absolute poverty rates plummeted 7.9 percentage points, to 36 percent of the population. There then came a more stable period, up to 2003, before another wave of decline arose, more extensive and consistent than the previous one, leading to a decrease in poverty of 22 percentage points by 2014. In the end, the incidence of poverty shrank to just 13 percent in 2014. Comparing the two good periods, it is now widely accepted that while the Real Plan had the merit of undercutting the confiscatory impact of high inflation on the income of the poorer sections of the population, after 2003 other poverty-reducing factors such as economic growth and (notably) redistribution were at work.

The reduction of poverty is still shown to be far from negligible when a relative measure -- say, the proportion of the population who live on less than 50 percent of the median income -- is adopted. The use of this measure, while gauging the percentage of those left behind as the majority prospers, also enables equity comparisons with developed economies in the OECD area, which generally adopt relative rates as their poverty indicator. Thus, Brazil, in 2014, presented a

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2 Data from Ipeadata: [www.ipeadata.gov.br](http://www.ipeadata.gov.br).

3 Studies have estimated the impact on poverty of redistributive policies in the first decade of the new century to be almost on a par with that of economic growth, over 40 percent of the total reduction. See Nora Lustig, Luis F. Lopez-Calva and Eduardo Ortiz Juarez, “Declining inequality in Latin America in the 2000s: the cases of Argentina, Brazil and Mexico” *World Development*, 44 (Feb. 2013): 129-141. See also Valeria L. Pero, Gabriela F. Cruz, “A queda da pobreza no Brazil: mudanças no perfil e nos determinantes no início dos anos 2000”, ANPEC Proceedings, 2015.
relative poverty rate twice as big as that for the OECD area (22 percent versus 11 percent), down from 2.7 times as big back in 2000 (27 percent versus 10 percent).

FIGURE 3.1 NEAR HERE

To be sure, this Brazilian “catching up” resulted from a double movement whereby developed economies were increasing their poverty levels whilst Brazil, as well as Latin American (LA) and emerging economies in general, were heading in the opposite direction. Global economic forces were certainly behind this new asymmetry. To mention but one, the rise of “emergent” China, which led the commodity boom, triggered changes that favoured the economic catch-up of commodity exporters in Latin America. The resulting lesser ‘between countries’ inequality (as the income gap between the developed and the developing countries was diminishing) was in this way aligned with a contraction in ‘within countries’ poverty in the less developed areas (where incomes were rising). Still, while in emerging economies GDP growth rates were the underlying driving force, in Latin America redistributive policies were just as important.

Processes of economic growth may differ in terms of the changes they bring in income distribution and their impact on poverty. For example, as mentioned above, growth and inequality cohabited during the ISI era in Brazil, which was nevertheless an important period for the decline of poverty. The heyday of the ISI took place under a military dictatorship that stifled the redistributive claims of sectors of the population not encompassed in the new development strategy. Thus, a central component of the export-oriented industrialization model was a policy of devaluation of the minimum wage, which was later shown to have contributed to an increase in inequality in the 1960s and 1970s. Poverty reduction in this period drew instead on spectacular growth rates and high employment levels, with growth offsetting the rise in inequality in much
the same way as has been happening in China and India more recently. In recent times in Brazil, the relationship between inequality and growth has changed, with both contributing to a decline in poverty.

In fact, while inequality increased in the three decades between the 1960s and the 1980s, despite the growth regime -- high speed, mid speed, and low speed -- in the period, things started to change with the re-democratization that took place in the 1990s, when inequality abated somewhat. Later, in the 2000s, when a centre-left coalition took power, the relationship between growth and inequality became clearly negative, with sizable reductions in the level of income inequality accompanying positive growth rates in the country (see Table 1, below). It was in this period that a diminution of poverty started to relate consistently to lower levels of income inequality, as well as to growth. Incidentally, contemporary inequality studies have increasingly drawn attention to the impact of political variables on the dynamics of both inequality and equalization in advanced economies;\(^4\) and the Brazilian experience seems to broaden the geographical reach of the “political turn” in inequality scholarship. We shall explore key aspects of the centre-left policy agenda in the next section.

TABLE 3.1 NEAR HERE

As regards recent trends in inequality, data from household surveys tracking yearly changes over the 1990s, and the 2000s up to 2014 (graph 2, below), shows a consistent fall in income inequality in the final period, the golden years of redistribution policies. Between 2001 and 2014,

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the Gini index dropped over 13 percent, or 0.07 points, from 0.59 to 0.52.\textsuperscript{5} To give an idea of the significance of this achievement, if we compare these figures with the parallel decennial performances of advanced economies transitioning from peak to minimum levels of inequality in the twentieth century,\textsuperscript{6} we find that Brazil fared much better than did those countries (with the exception of Spain). Again, the recent sizable decline in inequality happened whilst there was mounting inequality in the OECD area and other members of the BRICS, lending support to the social development catch-up hypothesis.\textsuperscript{7} Brazil was on its way to becoming a ‘normal’ country, coming to terms with its inequality problems.

\textbf{FIGURE 3.2 NEAR HERE}

\textsuperscript{5} The decline in inequality as measured by the Gini index is confirmed when other indices, such as the Theils, and income shares of deciles of the distribution, are used as well. In the latter case, the data shows the rate of annual income growth of the lower deciles to be rising more quickly than that of higher ones, for every paired comparison. Cf. Ipeadata.

\textsuperscript{6} Branko Milanovic, \textit{Global Inequality: a new approach for the age of globalization} (Massachusetts: Harvard University Press, 2016), p. 320. The countries reported are the USA, the UK, Italy, Japan, Spain and the Netherlands. See also Sergei Suarez Dillon Soares, “O ritmo na queda da desigualdade no Brasil é aceitável?” \textit{Revista de Economia Política} 30, 3 (Jul.-Sep. 2010): 364-380.

\textsuperscript{7} Increasing inequality in developed countries has been associated with concentration of market income growing at a faster pace than the increase in governamental redistribution (Organization for Economic Co-operation and Development, \textit{Growing Unequal? Income Distribution and Poverty in OECD Countries} (Paris: OECD Publishing, 2008). Among the multiple factors pushing market income inequality upward, fundamentally tied to globalization and technological change, are labour market deregulation and reductions in progressive taxation (See OECD, \textit{In it together: why less inequality benefits all} (Paris: OECD Publishing, 2015); Piketty, \textit{Capital in the Twenty-first Century}; Milanovic, \textit{Global Inequality}. In the case of emerging economies such as India and China, inequality has seemingly been fueled by market reforms, which have delivered rapid economic growth and urbanization in the context of agrarian economies, à la Kuznets.
The shift of millions of families out of poverty fuelled the idea that a robust new middle class was emerging in the country; but this assessment was over-optimistic. More sober analyses would show that conditions such as occupations at the lower end of the labour market (e.g. informal or manual jobs), economic insecurity (lack of property and savings) and consumption patterns (similar to those enjoyed by the poor) placed most of those who escaped material deprivation in the category of “strugglers”, not yet among the economically secure members of the middle class. 8 Moreover, as consumption taxes weighed heavily in the country’s tax burden (51 percent in 2014), their impact on the final income of the poor, who spend their earnings chiefly in consumption items, was far from negligible: a decomposition exercise found that consumption taxes increased the proportion of the poor to levels above those of market income poverty. 9 This is a sign of the country’s obstinate “abnormality” as far as taxation goes: in a group of 26 countries, Brazil stands out for its high reliance on regressive consumption taxes and, together with Hungary, its minimal use of progressive income taxes (graph 3 below).

FIGURE 3.3 NEAR HERE

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9 See Nora Lustig, Carola Pessino and John Scott, “The impact of taxes and social spending on inequality and poverty in Argentina, Bolivia, Brazil, Mexico, Peru and Uruguay: an overview”, working paper no. 13, Commitment to Equity, 2013.
Expansion of good quality social services and changes in the tax system are among the missing interventions that might have mitigated this situation -- a point we return to in section 4. However, even considering that the depth of the experiment could have been more profound, and its stability more firmly rooted, the golden years in Brazil delivered unequivocal, as well as historically rare, social progress as measured on poverty and income inequality yardsticks.

<h1>Driving forces shaping inequality reduction</h1>

In trying to disentangle the factors shaping income equalization in Brazil, studies have converged on lower wage inequality as the main driver of the changes and, secondarily, redistributive government transfers to the poor.\textsuperscript{10} This result might convey the idea that pure market developments did much of the trick. However, detailed analysis of the data uncovers public policies playing decisive redistributive roles in both the labour and non-labour incomes of Brazilian households.

To begin with, labour market policies, such as the statutory minimum wage and its adjustment rules, were key to countering wage concentration. In particular, the policy of valorization of the minimum wage, meant to recover its living-wage level after decades of devaluation, delivered

yearly adjustment indices in excess of inflation rates. Complementing the new minimum wage regulation were a series of institutional and legislative initiatives that facilitated formalization of the workforce, and these were reinforced by the addition of effective oversight of, and functioning of, the labour justice system. These measures helped raise levels of compliance with the minimum wage (20 percent of non-compliance, down from 25.9 percent in 2002) and effective formalization (64 percent, up from 47.3 percent in 2002). The combined impact of these interventions on wage concentration, well documented in the literature, was substantial. Moreover, it was to be expected that contributions to the social security system stemming from this new wave of formalization would translate in the future into lower income inequality, as more and more people gained access to public pensions. Finally, the long-term (however slow)

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11 Actually, minimum wage valorization started in 1995, but it was during the Workers Party (PT) era, starting in 2004, that it became a governamental policy. As from 2007, adjustment should amount to the inflation rate for the previous year plus GDP growth rates for the previous two years.

12 A detailed description of these initiatives may be found in Javier Alejo, Guillermo Cruces and Cecilia Parada, “Desigualdad e informalidad en América Latina: el caso del Brasil”, in Desigualdad e informalidad: un análisis de cinco experiencias latinoamericanas, ed. Verónica Amarante and Rodrigo Arim, Libros de la CEPAL, No. 133 (Santiago de Chile: Comisión Económica para América Latina y el Caribe (CEPAL), 2015): 129-162.


expansion of schooling, most of it publicly provided, paid off. Wage differentials linked to the levels of educational attainment of the labour force, historically among the highest in the world, began to shrink.¹⁵ Taken together, these policies were integral to what became known as pre-distribution intervention, for they potentially affected income distribution even before the actual encounter of employees and employers in the labour market.

Unsurprisingly, classic redistribution interventions such as cash transfers played an inequality-reducing role as well, through the “non-labour income” channel. Both the coverage and the level of benefits expanded markedly in the period. For example, social assistance benefits such as the 2003 *bolsa familia* (a conditional cash transfer targeted at the poor) extended eligibility beyond the early 2001 *bolsa escola* to include poor families without children, practically doubling the latter’s coverage; and non-contributory pensions such as the *benefício da prestação continuada* for the elderly and disabled poor soared, on account of more inclusive eligibility rules.

As we explain below, thanks to the 1988 constitution, the influence of the minimum wage valorization policy was felt through the entire process of income equalization, affecting labour and non-labour incomes alike. To begin with, the 1988 constitution set the parameters for a universalist welfare state in the country. It broadened the then-existing social protection system, previously limited to workers who contributed to the social insurance fund, and mandated public provision of universal social services, including health care, previously guaranteed only to insured workers or (via assistance) to the poor. So, following the constitution’s enactment, a raft of new social entitlements were established, having as a consequence the doubling of the level of

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¹⁵ Lustig, Lopez Calva and Ortiz Juarez, “Declining inequality in Latin America in the 2000s”.
social spending as a proportion of GDP, from 10 percent to 20 percent, within a couple of years.\textsuperscript{16} While some of the new spending went on the creation from scratch of a national health service (the SUS), most of it went on social security benefits, notably, pensions and social assistance.

A distinctive feature of the new constitutional parameters in relation to social benefits in cash was their pegging to the minimum wage: none could be established at a nominal level below it. As the constitution also determined that the minimum wage be fixed at an amount compatible with a living wage, the minimum underwent successive adjustments from 1995 on. The reason for these was, as we have seen, that it had been systematically undervalued since the 1960s. These changes impacted strongly on income distribution. In the end, valorization of the minimum wage turned out to be the most important single factor in the decline of income inequality in Brazil -- accounting for 72 percent of the decline between 1995 and 2013, and 64 percent, between 1995 and 2014, according to a decomposition exercise.\textsuperscript{17}

\textsuperscript{16} In real terms, spending tripled from 1988 to 2008 -- most of the increment occurring in the initial period (1988-1990) and final period (2004-2009). Cf. Celia Lessa Kerstenetzky, \textit{O Estado de Bem-Estar Social na Idade da Razão} (Rio de Janeiro: Elsevier, 2012): p. 295. The rhythm outpaced that of advanced economies when they were constituting their welfare states in the twentieth century. Note, however, that inequality did not decline in the aftermath of the enactment of the constitution and explosion of social spending as the country was struggling with the debt crisis and hyperinflation. The international context was far from favourable to the Brazilian economy in the 1990s. To this must be added policy choices that generated social problems of their own, such as high levels of unemployment and informality in the labour market.

\textsuperscript{17} See Alessandra Scaloni Brito, “\textit{O papel do salário mínimo na redução da desigualdade na distribuição de renda no Brasil entre 1995 e 2013}”, Doctoral thesis, Economics, Universidade Federal Fluminense, Niterói, 2015, p. 125;
Various factors combined to produce this favourable outcome. First, the valorization per se was substantial, and has been particularly so over the last decade, when it has become an upfront policy pursued by the incumbent centre-left coalition, and has reached over 72 percent (112 percent if we take the last two decades). Not surprisingly, this has had a bearing on the labour market, directly affecting minimum wage earners (15-20 percent of the employed). However, for reasons previously mentioned, it also affected non-labour incomes such as basic pensions and social assistance benefits. In fact, the strongest redistributive impact came through the latter channel, and basic pensions, which accounted for the majority of pensions in the public system (60 percent) were responsible for most of the effect. Overall, as minimum wage recipients of either labour or non-labour incomes are concentrated in households in the bottom half of the per capita income distribution, the income gains distributed through minimum wage adjustments were unambiguously redistributive.

In a comparison with the internationally acclaimed *bolsa familia* programme, a particularly redistributive cash transfer that complements the incomes of eligible poor families and is not included in the constitution (and thus may deliver benefit values that fall well short of the

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and Brito, Foguel and Kerstenetzky, “Minimum wage valorization policy and the decline in income inequality in Brazil between 1995 and 2014”.

minimum wage), boosting the minimum wage has proved to be much the stronger measure: from 2006 to 2011, the latter had an impact four times as great as the former.\textsuperscript{19}

It should be noted that many of the achievements of the period took place in the context of a positive growth rate. Yet it is also noteworthy that formal employment (stimulated by public policies) grew at a faster pace than the GDP -- a situation Brazil had not experienced either in its fast-growing or its moderate-growing past.\textsuperscript{20} It is also remarkable that, through the minimum wage policy, economic growth was able to deliver more balanced distributive results -- a rather unfamiliar experience in the country’s history. Moreover, redistributive policies taken as a whole increased the disposable income of poor, vulnerable and low middle-class households, and ultimately promoted growth itself.

In this regard, it is estimated that 75 million Brazilians, roughly 40 percent of the population, are directly affected by the value of the MW (because they live in households with at least one recipient of a minimum-wage-indexed income),\textsuperscript{21} while 50 million live in households where beneficiaries of the \textit{bolsa família} programme also live. That this massive income (re)distribution stimulated consumption is anything but surprising: in fact, over the last decade, domestic

\begin{footnotesize}
\begin{enumerate}
\item Brito, “O papel do salário mínimo na redução da desigualdade na distribuição de renda no Brasil entre 1995 e 2013”. The number of people involved and the level of benefits -- in the case of the minimum wage, many more people, much higher benefit levels -- account for the difference.
\item Nor have India or China, which have seen a growth in informal jobs instead.
\end{enumerate}
\end{footnotesize}
consumption was the component of aggregate demand that led growth rates in the country, well above commodity exports. So, (re)distribution both benefited from and contributed to economic prosperity.

Top incomes (or inequality, according to Piketty)

In the wake of the publication of Thomas Piketty’s *Capital in the Twenty-First Century*, new information on, and analyses of, the distributive question in Brazil have emerged, this time drawing on income-tax-returns data. This recent work reveals a quite different picture to the one we have seen earlier, in the section above.

In fact, as well as a huge concentration of income at the top, the data reveals a stabilizing of, or even a slight worsening of, inequality when this is measured in relation to the income share of the one percent richest (from 2006 to 2012) -- which starkly contrasts with the declining inequality suggested by various indices based on household-survey data. The diverging perspectives may be explained by the fact that, while tax returns are a good source of

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22 And, of course, it is unacceptable to quip that this move stimulated consumerism, as these sections of the population are historically deprived of access to basic consumption items, not to mention durables. See Celia Lessa Kerstenetzky, “Consumo social e crescimento redistributivo: Notas para se pensar um modelo de crescimento para o Brasil”, *Revista de Economia Política* 36, 1 (Jan.-Mar. 2016): 29-45.

23 Piketty’s book could not include data on Brazil because the internal revenue service (the Receita Federal do Brasil, RFB) would not disclose it, alleging secrecy concerns. But following publication of Piketty’s book, the RFB started to publish special tabulations of tax returns and a plethora of new research followed suit.

information on the incomes of the rich and very rich, household surveys better capture the incomes of lower parts of the income distribution. Considering both databases, the complete picture discloses two “countries”: one with intense tectonic movements up to the 90th percentile of the income distribution; the other, practically immobile, starting at that high level and climbing up to the last percentile and even higher (the 0.1 percent or the 0.01 percent richest, and so on).

The figures for the “immovable” landscape, taken on their own, are disturbing. The shares of the five percent, one percent, and 0.1 percent richest inhabitants amount, respectively, to 50 percent, 25 percent and 10 percent of the national income: in other words, they are 10 times, 25 times and 100 times as much as the proportion of the population represented by these people. But an important immediate consequence of this is that income concentration as a whole seems to emanate chiefly from the concentration at the top. For example, according to one study\(^\text{25}\) which draws on both household surveys (PNAD) and tax returns, if the incomes of the richest 5 percent of the population were removed from the calculation, the Gini coefficient would shrink by about 40 percent; whereas the removal of lower incomes, those below the 25th percentile, would decrease it by no more than 10 percent.\(^\text{26}\) These facts and estimations forcefully indicate the

\(^{25}\) Own calculation based on data in Medeiros and Souza, “A estabilidade da desigualdade no Brasil entre 2006 e 2012”.

\(^{26}\) Drawing on this combined database, another study, using the \(J\)-divergence index (which adds up the Theils \(T\) and \(L\)), calculated that the participation of the top 10 percent accounted for 67 percent, while that of the one percent accounted for 50 percent of total household inequality. Cf. Marcos Hecksher, Pedro Luis do Nascimento Silva and Carlos Henrique Leite Corseuil, *Preponderância dos ricos na desigualdade de renda no Brasil (1981-2016)*, slides, colour (Rio de Janeiro: Seminário de Metodologia do Instituto Brasileiro de Geografia e Estatística, IBGE, 2016).
importance of paying attention to top incomes in devising policies aimed at a meaningful degree of income equalization.

Yet, redistributive policies that were implemented in Brazil during the “golden decade” hardly affected the relative position of top incomes. The income shares of those at the top are impervious to modest, albeit successive, minimum wage adjustments and the gradual expansion of educational opportunities. Taking education, for example, a recent study did not find any statistically significant relationship between schooling and the concentration of income at the top: the rich in Brazil are not rich because they have received more education. Top income shares seem instead particularly sensitive to progressive taxation -- that much is suggested by the post-war record of distributive achievements in the now advanced economies, a topic extensively discussed in Piketty’s 2014 book.

Interestingly enough, post-war Brazil seems to provide additional evidence of this connection, as data revealed by recent research has disclosed. Progressive taxation in the country dates back to 1922-1924, but the period from 1945 to 1964, between the two authoritarian regimes, saw an unusual amount of tinkering with elevated marginal income tax rates. These jumped to 45 percent in 1945 from a low 25 percent in the previous year, and later peaked at 65 percent on the

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eve of the 1964 military coup. Over these two decades the basic rate incurred by lower incomes never passed 5 percent and even plunged to zero in the beginning of the 1960s. Not surprisingly, by the end of the period, the share of the one percent had plummeted to below 10 percent from well over 30 percent in the previous years. Other contributory factors might have been the unprecedented successive adjustments of the minimum wage, which amounted to a three-fold valorization in the 10 years from 1950 to 1960 (just for comparison, the recent two-decade valorization totaled just over 100 percent). As mentioned, with the military coup, the minimum wage would undergo its strongest contraction, while marginal income taxes would never regain the 65 percent level of the early sixties.

It comes as something of a shock that, with re-democratization, under the José Sarney government in 1989, the marginal tax rate declined from 45 percent (in 1988, the year of the enactment of the current constitution) to 25 percent, and the basic rate increased to 15 percent, implying a thorough paradigm shift in the financing of the state. After that time, the marginal rate would never pass 27.5 percent, even though the basic rate later dropped to 7.5 percent under the second Lula administration, in 2007.

At this point, as we try to connect advances and setbacks, a compelling hypothesis comes to mind: the social pact behind the 1988 “Citizen Constitution” (as the constitution is usually called in the country), while endorsing the expansion of social spending, failed to support this with the necessary redistributive funding. In fact, thereafter, financing of the state as a whole, and social expenditure in particular, would rely either on inflation (up to 1994) or disproportionately on regressive consumption taxes (and regressive public debt), a feature that would distinguish Brazil
within the large group of developed and emerging economies in which it would henceforth be included.

<h1> Bets that were not placed </h1>

Throughout the world, the share of aggregate income accruing to the richest one percent has been growing;\textsuperscript{30} Brazil is only leading the way. Worrisome as this seems -- if we bear in mind the disproportional influence of the very rich on the political system and thus on decision-making concerning opportunities for wealth-hoarding and wealth-protection -- it also suggests resources for redistribution still untapped. Yet, in Brazil, progressive taxation has been a cause without sponsors in the political system. Not even parties on the political left have pushed for an effective shift in the progressivity of the tax system.

As mentioned above, soon after the enactment of the constitution, marginal income tax rates fell 20 percentage points and the funding of the state turned instead to regressive contributions and consumption taxes. The marginal tax rate now prevailing, 27.5 per cent, is still well below international standards. The regional average in Latin America hovers around 31 percent, while the OECD average reaches over 42 percent. Of course, this limits the decline in inequality that is currently obtained through income tax. The latter reduces the Gini index by 4.9 percent in Uruguay and 6 percent in the OCED area, but only by 2.8 percent in Brazil.\textsuperscript{31}

\textsuperscript{30} See Piketty, *Capital in the Twenty-First Century*, and Atkinson, *Inequality: what can be done?*

Beyond this minimising of income tax, in 1995, a new law exempted distributed profits and dividends from taxation -- a tax advantage that remains to the present day, distinguishing Brazil (and Estonia) as an authentic innovator in tax collection. This huge loophole, the alleged rationale for which is the avoidance of double-taxation (profits would otherwise be taxed at both company and individual levels) and the deterrence of investment, places Brazil among the countries with the lowest total tax rates on profits (28.3 percent against 51 percent in the OECD area, 57.6 percent in the US, 40 percent in Chile and 42 percent in Mexico) and thus the highest retention rate (71.7 percent) in the developed and emerging worlds taken together. And yet, while “double-taxation” is in this case merely a question of allocating total rates among different entities (persons and companies), the preferential treatment given to profits did not lead to additional investment in the country.

Why is taxation on capital income and progressive taxation in general so important? Tentatively, we suggest “equity” reasons, which encompass both “pre-distribution” and “post-distribution” of market income. Reduction of inequality of wealth is one expected effect of taxation on capital income, an effect that comes into operation even before market income is generated (pre-distribution). The very fact that taxes on rents, profits and dividends exist imposes a reduction on the expected net return on wealth invested, and thus on the market value of assets -- like real estate, land, financial assets and production capital -- that generate these income flows. Moreover, an equalizing effect on labour incomes might also be expected as a result of progressive rates on top-incomes, as these tend to discourage the negotiation of very high salaries. Piketty reports that both rising asset values and the high wages of, say, hedge fund

\[32 \text{ Ibid.}\]
managers and CEOs are contemporary phenomena that underscore the explosion of inequalities the world over, and he compellingly associates these inflated gains with retrenchment of tax progressivity in the OECD area.

Turning to post-distribution reasons, one usual effect of tax progressivity on the distribution of disposable income is that it renders the latter less unequal than the primary distribution of market income. Also, progressive taxation is an important source of funds for financing the provision of public social goods and building up something of a social bequest (a proposal put forth recently by Anthony Atkinson), given the high income concentration at the top of the primary distribution. Moreover, the very financing of the state in a context of fiscal strain, though not only under this circumstance, might benefit from the substitution of progressive taxes for public debt (thus averting increasing interest rates as well as inequalities therefrom) and income taxes for consumption taxes (thus mitigating social problems such as impoverishment).

Testifying to the fruitfulness of increasing tax progressivity in Brazil, simulations show significant positive variation in public revenues and negative variation of the Gini coefficient associated with different scenarios of increased progressivity, none of which is very radical. The stronger scenario considered in the exercise, based on the withdrawal of exemptions for profits and dividends and the imposition of a top income tax rate of just 35 percent (below that prevailing in liberal Chile and the USA), already suggests the collection of an additional amount representing around one third of the current fiscal deficit, and a reduction of the Gini coefficient

33 Atkinson, Inequality: what can be done?

34 Cf. Gobetti and Orair, “Tributação e distribuição da renda no Brasil”.
in excess of 4.3 percent. But the gap is certainly wider than that: property taxes are negligible, especially on rural property; bequests and donations are very undertaxed; and there is no taxation on wealth at all. The Brazilian tax system is a haven for the rich and the very rich.

The other area that did not advance significantly was the provision of public social services. Education and health care spending progressed very slowly, certainly more slowly than social security and the spending that would be required to deliver constitutionally mandated social rights. The SUS (the Brazilian National Health Service) is still an unmet promise, as over 50 percent of Brazilians’ health care expenditure comes out of their own pockets. As for education, the country is still failing to cover needs at pre-primary, secondary and tertiary levels. Educational inequities between poorer and richer as well as between blacks and whites are still blatant. Quality of education is a major concern, especially in the public system below college level. In the PISA, a ranking based on an international proficiency exam sponsored by the OECD and applied to 15-year-old students in 60 countries, Brazil, the seventh world economy, has featured in the very lowest positions ever since the exam’s inception, without significant improvement in the last decade. Under-funding is a key problem: per capita spending at all schooling levels is markedly substandard. There is, by now, a plethora of academic and non-academic material documenting these sad facts about education in the country.  

Universal public provision of quality social services has never been a policy priority in Brazil. And yet the reasons why such services should be prioritised abound. Social needs in these areas

are overwhelming -- a fact that had already attracted the attention of the representatives drafting the 1988 constitution, who included public provision of these services among social citizenship rights. Insofar as funding was not adequately tackled -- the need for progressive financing in particular -- the commitment turned out to be more for effect than effective. But services, beyond social needs and rights, are also critical in view of their distributive and productive effects and, of course, their political-economy underpinnings.

To begin with, welfare states that rely heavily on service provision are the most redistributive ones.\textsuperscript{36} Education and health services affect people’s well-being and agency generally speaking, but also, in more instrumental ways, their productive capacity, helping to sever the often-rigid connection between social origin and social destiny. Also, public provision of these services substantially affects employment and income generation, so much so that, in countries where provision is universal, public sector employment reaches over 30 per cent of the total.\textsuperscript{37} In addition, employment in the public sector helps improve the average terms and conditions of employment as a whole, because public sector jobs tend to be regular, pay well and display a rather restrained wage distribution. (There is evidence that this is also the case for Brazil, where public employment is nonetheless meagre, 12 percent of total employment, and less than 6 percent is the share of jobs in public education and health care proper.)\textsuperscript{38} So, the more public employment features in a country’s labour market, the smoother the distributive features thereof.


\textsuperscript{38}Kerstenetzky and Machado, “Labour market development in Brazil”.
A second tier of social service provision is the so-called care services (elderly care and early childhood education and care, or ECEC) and long-term active labour market policies of training and retraining. These interventions are multifunctional, and are crucial if the country is to respond to new social risks stemming from an ageing of the population, women’s economic participation, and rapidly changing labour markets, spurred on by new technologies and the knowledge economy. The whole package of quality external care services and childhood development policies, together with policies for the upskilling of the workforce, has been termed “redistributive-and-efficient” for its contribution both to productivity and equality. These policies integrate the basic tool box of contemporary “social investment” policies.39

Again, the well-known potential of public provision of quality services notwithstanding, recent Brazilian experiments in social progress have not broken any new ground in these areas.

Moreover, also from a political-economy perspective, a policy that assigns priority to the expansion of public social services has important consequences, and this signals another missed opportunity in Brazil. To begin with, income gains connected with the redistributive growth experiment, which lifted poor families to the status of lower middle class, might have been reinforced by gains in well-being resulting from access to quality public services. By freeing those families from buying market services, public provision might also have assisted the birth of

discretionary (i.e. beyond basic needs) income that might have turned into a source of economic security, if accumulated in savings or property. On the contrary, research has shown that a significant proportion of new entrants into the ranks of the lower middle classes have opted instead to buy health insurance and private education for their children\(^\text{40}\) -- very likely on the grounds of lack of trust in the extant public provision -- from which they have anyway been withdrawing in the current crisis. Expansion of quality services might have reinforced their political defences, this time by creating a broad social coalition of roughly satisfied users including the middle classes. The history of robust welfare states in advanced economies is littered with episodes of cross-class coalitions supporting public provision of social services. As it turned out, the latter were key to the very shaping of a large-scale middle class in those countries.

<h1>Concluding remarks</h1>

It cannot be denied that Brazil witnessed a substantial process of redistribution over the 2000s, a unique decade in which there was an appreciable evening out of the country’s economic inequality. This mainly resulted from the expansion of social protection entitlement and benefits, as well as labour market regulation, where a policy of minimum wage valorization, in tandem with effective enforcement, stood out in a context of win-win economic growth. The resulting decline in inequality basically reflected a rising floor, though the shrinking of education premiums also impacted on somewhat higher sections of the income distribution (but not the

Of course, the process still has a long way to go, as income distribution remains highly concentrated by international standards, even leaving aside the very rich (if they are taken out of the calculation, Brazil is now the thirteenth most unequal country in the world\textsuperscript{41}): further expansion and equalization of educational opportunity and entitlement to public benefits, as well as further labour market policies, are among the missing initiatives.

The action undertaken, it is worth reiterating, was far from trivial and should not be summarized as the mere introduction of residual safety nets to alleviate poverty (e.g. the \textit{bolsa família} programme): the minimum wage policy proved to be the chief redistributive tool, as it cut across a significant section of the Brazilian population. For lack of an accepted category to classify the experiment, we suggest “(re)distributive growth”, implying that public action through labour market regulation and transfers were key to the onset of a more socially balanced growth process, steered by domestic consumption. The minimum wage management, due to its affecting both labour and non-labour incomes, did most of the trick -- and performed as a sort of guaranteed social wage.

However, in spite of the espousal of expansionist social policy, funding was not tackled in a redistributive way as (non-contributory) social policy continued to be financed by regressive taxation, relying disproportionately on poor and low middle-class tax payers’ money. Moreover, as rich people do not pay their fair share in taxes -- indeed, far from it -- a potentially huge

reservoir of resources for redistribution and the financing of badly needed social goods remains unexploited.

Alas, this seems to have been the “political economy” of the changes.

In fact, the “original sin” may be traced back to the 1988 constitution: anecdotal evidence as well as simple inference both indicate that social spending cum regressive financing was the cross-class social pact underscoring the Citizen Constitution. Representatives drafting the law were certainly aware of costs and benefits: on the one hand, indirect taxes are not easily perceived as the foe of equality; on the other, it is easier to build consensus around economic growth than progressive taxation in the search for additional resources for social spending. One should also consider that in Brazil, since the old-days of import substitution industrialization, the favourite strategy for all kinds of top-down “modernization” has been conservatism: an alliance with the incumbent elites that would largely accommodate their interests in exchange for modest social advances. Be that as it may, not even the left has been a champion of directing structural changes in the tax system towards more progressivity and thus international normality. The recent redistributive episode missed that opportunity as the governmental coalition favoured redistribution policies that left unscathed the relative and absolute positions of the wealthiest. More resources for education and other services would of necessity translate into more taxation of those at the top, but this alternative was not on the table.

Compounding the redistribution deadlock are the economic and political crises of recent years. The sad end of the PT era, when policy errors and corruption scandals ended up by
contaminating people’s perception of what a left agenda was about, and largely discredited it, was succeeded by an even bleaker time of austerity and unfulfilled expectations regarding the consolidation of a welfare state in Brazil.

Thus, in 2014, the international crisis finally reached the country and, in conjunction with what proved to be wrong economic policy wagers, delineated a context of tighter fiscal management. Political circumstances added to the already unpropitious economic scenario, only contributing to plunging the country into the worst recession in a century and also bringing out a thorough reversal of the government agenda. Among these circumstances are popular outrage with the Dilma Rousseff administration’s austerity proposals, presented shortly after the president’s re-election on a frankly expansionist agenda; large-scale corruption scandals involving the PT’s officials and their efforts to buy a supportive parliamentary coalition; and tireless and effective political exploitation of these facts by the political opposition, including systematic blocking of any government legislative initiative to handle the fiscal crisis -- all culminating with the impeachment of President Rousseff. The seeming political void was immediately filled by a conservative coalition, led by the former vice-president, which took advantage of the unique opportunity to advance (backed by a perfunctory parliamentary majority) an austerity and “fiscalist” project that would hardly gain the favour of the electorate were the latter to be consulted. Incidentally, the new ruling elite is widely perceived to be corrupt. PMDB, the new incumbent and PT’s former senior coalition partner, is enmeshed in the biggest bribery scheme ever to be reported in the country, the very same that damaged the PT’s reputation.
As a disturbing sign of the new times, fiscal adjustment, which should be no more than a short-term remedy to address an emergency situation, and in any case one that policy-makers prescribe with heavy hearts, is about to enter the Brazilian constitution in the form of a proposed freezing of fiscal spending in real terms for a 20-year period -- another distinctly Brazilian invention.\textsuperscript{42} The minimum wage valorization policy, as well as the linking of benefits to the minimum wage, are among the likely victims. Mimicking Ulysses, who ordered that he be tied to a pole whilst hearing the sirens, Brazilian politicians are choosing to tie their own hands: only there will be no sirens to be heard.

The long-term fiscal freeze seems to be the \emph{pièce de resistance} in the development strategy concocted by the current political incumbents. Sadly, inequality is again off the radar in Brazil.

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