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What Explains the Decline in Brazil's Inequality?

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The economics profession has long debated whether there is a trade-off between growth and equity. Countries that pursued inequality-reducing strategies have been warned that growth will be affected, and hence that poverty increases. The harbingers of doom advocated a growth-focused strategy. Their assumption was that the income of the poor rises in direct proportion to economic growth. The truth is more like this: economies with more equal income distribution are likely to achieve higher rates of poverty reduction than very unequal countries. In this One Pager we consider if this is the case in Brazil.

Inequality in Brazil, as measured by the Gini coefficient, fell from 0.59 in 2001 to 0.53 in 2007. Much remains unknown about why inequality has fallen, but two sets of known causes stand out. The first consists of improvements in education. In the early and mid 1990s, for example, the workforce gained more equal access to education. This is because of universal admission to primary schooling and lower repetition rates.

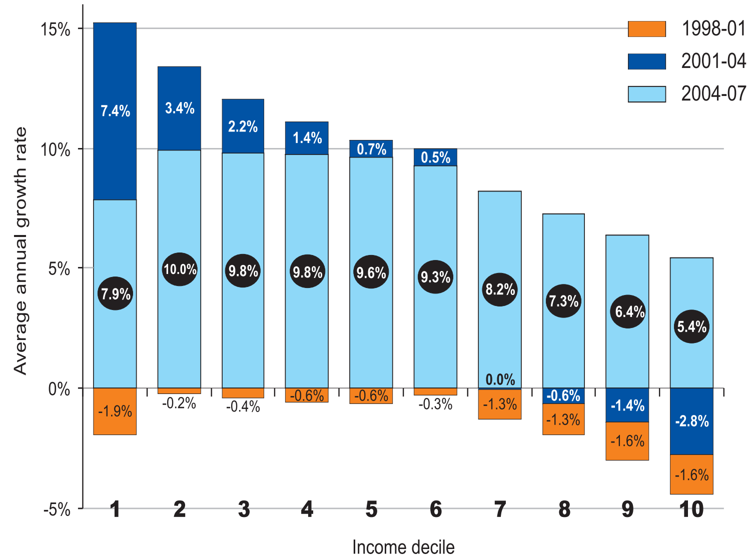
In conjunction with other demographic trends, such as a decline in family size and improvements in family dependency ratios, access to education helped reduce inequality. We estimate that the impact of improved access to education on primary income distribution was 0.2 Gini points per year from 1995 onwards.

The second set of factors that reduce inequality are direct cash transfers from the state to families and individuals. These transfers improve secondary income distribution. For instance, a rise in the minimum wage leads to an increase in various transfers, such as the lowest level of the contributory pension system, partially contributory rural pensions, and non-contributory income substitution for those who are unable to work and who live in poor families. At the same time, conditional cash transfers, such as *Bolsa Família*, deliver substantial amounts directly to the poorest families. Together, these changes lead to reductions in inequality of another 0.2 Gini points per year.

These two well-documented causes of inequality reduction explain about two-thirds of the fall in the Gini coefficient since 2001 (see Veras et al., 2006). For the remaining third the evidence is somewhat unclear, but we can plainly see knock-on effects of better income distribution. As the figure shows, the income of the bottom six deciles in Brazil has been rising since 2001, while the income of the top four deciles has risen only since 2004. For the period 2001–2007, the bottom six deciles, which account for only 18 per cent of income, accounted for 40 per cent of total income growth.

These numbers cannot be explained solely by education policy, demographic trends or social protection.

Average Annual Growth Rate in Per Capita Incomes By Deciles for Three Periods between 1998 and 2007



Source: National Household Sample Surveys (PNAD).

Structuralists have long argued that under-consumption could be tackled through egalitarian income distribution. This in turn would trigger efficient capacity utilisation and encourage new investments. We can safely argue that well designed and targeted social policies stimulate aggregate demand and consumption. The transmission mechanism is straightforward. A virtuous cycle of increases in the income of poorer families, together with wage growth, has enlarged the domestic market. Greater consumption of mass-market goods has led to growing labour demand for these same families, spurring further increases in their income and purchasing power. For instance, unemployment fell by 22 per cent between 2004 and 2007.

Brazil still has a high level of inequality and progress in being made towards lowering it. It is too early to say with certainty, but one reason why the financial and economic crisis did not hit Brazil as hard as other countries may be the growing domestic market and changes in the structure of demand created in the last decade. These, in turn were spurred by this virtuous pattern of improved income distribution.

Reference:

Veras, F., S. Soares, M. Medeiros and R. Osorio (2006). Cash Transfer Programmes in Brazil: Impacts on Inequality and Poverty. Working Paper # 21. IPC-IG.

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