International Policy Centre for Inclusive Growth

The International Policy Centre for Inclusive Growth is jointly supported by the United Nations Development Programme and the Government of Brazil.

One pager No. 221

October, 2013

Fiscal Equity: Distributional Impacts of Taxation and Social Spending in Brazil

by Fernando Gaiger Silveira, IPEA; Fernando Rezende, EBAPE/FGV; Jose Roberto Afonso, IBRE/FGV and Jhonatan Ferreira, SAS Institute Brazil

A behavioural analysis of the distributional impacts of tax policy and public spending shows that the Brazilian tax system has remained quite regressive, and, as an innovation, there have been gains, some quite significant, in the progressivity of social spending. While, in 2003, the progressivity of social spending moderately compensated for the regressivity of the tax system, in 2009, with the increase in social spending and the deepening of its progressivity, its distributional effects have overcome the concentrating impact of collection.

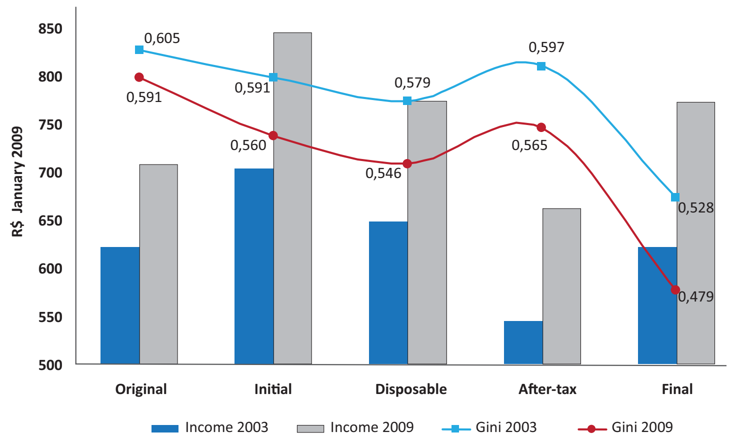
The regressivity of the Brazilian tax system— that is, the excessive burden that taxes have on the income of the poor and the intermediate income strata of the population— is due to indirect taxes or, more specifically, their magnitude. Such regressivity in indirect taxation does not clash with the international reality, but the burden of indirect taxes in tax collection enhances its income concentration effect. In turn, the progressivity of direct taxation is relatively high; however, the distributional effect is attenuated by the small burden that these taxes place on income. As such, the regressivity of the tax system in Brazil is not so much a result of the progressivity and regressivity of direct and indirect taxes, respectively, but of how important each of these types of taxes is for income. Between 2003 and 2009, the tax burden on families did not increase, while there was a significant drop in income inequality— resulting from the social spending component of the country's fiscal policy.

The areas placed under these dynamics — of greater amounts spent and higher progressivity — include the national social security regime (Instituto Nacional do Seguro Social, INSS), public education and health and social welfare, especially the Bolsa Família programme. Even the highly-regressive income 'stratum'— public employee retirement and other pensions — boasted a distributional effect of income, as there has been a decline in its income share and a decrease in the degree of regressivity.

The dynamics of the progressivity/regressivity of spending can be seen in the figure, in which the bars show the average per capita household incomes in the different income stages, according to state intervention: (i) original income, which considers all revenue, except benefits received by households; (ii) initial income, which considers the original income plus benefits; (iii) disposable income, which is initial income minus direct taxes; and (iv) after-tax income, which is disposable income minus indirect taxes. Finally, when we add the monetary value of benefits-in-kind — public health and education — we arrive at (v) the final income.

There was a reduction in income inequality with the provision of social security welfare benefits and the incidence of direct taxes. This reduction is partially reversed through the incidence of indirect taxes, because of the regressive nature and size of these taxes. Social spending on education and health, however, lead to a very significant decrease in inequality.

Behaviour of the Gini Index in the Total, Original, Initial, Disposable and Final Incomes — Brazil, 2002–2003 and 2008–2009
(per capita monthly incomes, 2009 amounts, R$)



Source: POF/IBGE micro-data. Creation: Ipea.

Comparing the Gini indices for the 2003 and 2009 original income levels, there is a relatively smooth decline in distribution inequality. This change becomes more pronounced when looking at initial income— the Gini index dropped 5.0 per cent in 2009, compared to a decline of only 1.7 per cent in original income. This difference was only slightly altered when considering direct and indirect taxation; however, it grows substantially when public spending on education and health is added. In 2009, the Gini index for final income was 9.6 per cent lower than in 2003, which is almost double the drop in inequality achieved through social security and assistance policies. Therefore, it is clear that the progress made in 2009 is due to social policies and not to changes in the tax structure.

Results show that, if there is one new component in fiscal policy, it is the increased importance of social spending in conjunction with a deeper progressive profile. As such, the increased criticism of the tax burden is rather surprising—and is reflected in initiatives such as the *Impostômetro* (tax meter), the number of work days needed to pay taxes and no-tax day — seeing as how the most significant changes were not in the amount of taxes but, rather, their destination. Given this situation, it seems that this is not a reaction to the size of the burden but to the changes in the tax spending profile.

Reference:

Gaiger F. S. et al. (2013). 'Fiscal Equity: Distributional Impacts of Taxation and Social Spending in Brazil', *IPC-IG Working Paper No. 115*, Brasilia, International Policy Centre for Inclusive Growth.

This work was supported by CNPq.

International Policy Centre for Inclusive Growth (IPC - IG)
United Nations Development Programme
SBS, Quadra 1, Bloco J, Ed. BNDES, 13º andar
70076-900 Brasilia, DF - Brazil

E-mail: ipc@ipc-undp.org ▪ URL: www.ipc-undp.org
Telephone: +55 61 2105 5000