

Taking Action for the World's Poor and Hungry People

关注贫困，行动起来

Beijing, China • October 17–19, 2007

SPEAKER SUMMARY NOTE

Session: Latin America: New Strategies, Actions, and Ways Forward to End Extreme Poverty and Hunger in Main Developing Regions

Speaker: Francisco H.G. Ferreira, Lead Economist, Development Research Group, World Bank, USA

Title: Brazil's Recent Experience with Poverty and Inequality Reduction

Brazil's poverty-reduction record, which had been abysmal during the 1980s, has shown considerable improvement since the early 1990s. Based on a widely-used, income-based monthly poverty line of R\$100 per capita in 2004 prices,¹ Brazil's poverty incidence actually rose (by three percentage points) between 1981 and 1993. Measures more sensitive to the depth and distribution of poverty also record increases over that macro-economically turbulent period.

Between 1993 and 2005, however, the poverty headcount fell from 33% to 20%, a proportional decline of over a third. Although not a match to the performance of faster-growing emerging markets, such as China or Indonesia (at different periods), this change represented a considerable improvement over Brazil's record in the preceding decade. All the more so since this rate of poverty reduction was not exclusively a result of faster economic growth, but also reflected falling income inequality.

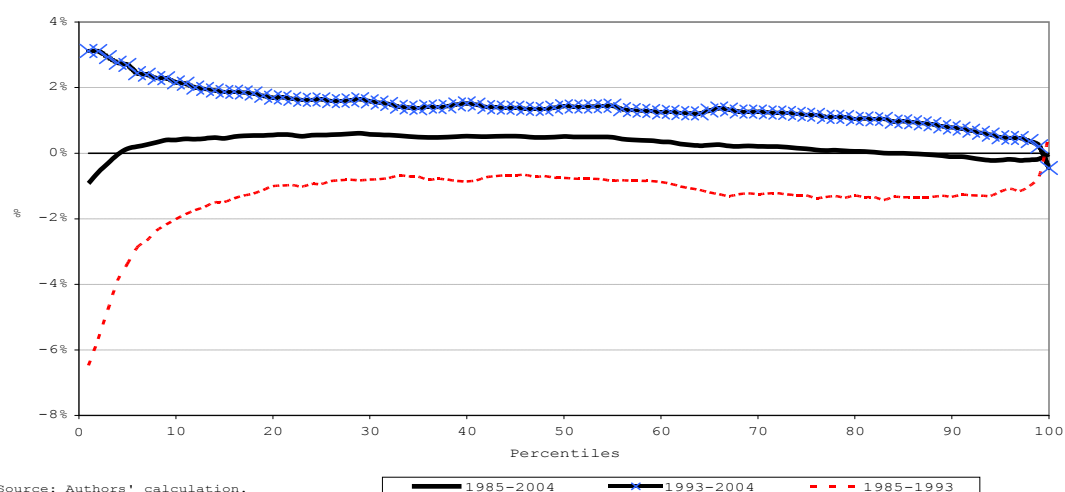
Brazil had long been one of the world's most unequal countries, and its inequality (whether measured by the Gini coefficient or by other indices) had been rather stable over the preceding two decades or so. Between 1993 and 2004, however, the Gini fell from 0.595 to 0.564. The reduction in inequality, which was particularly pronounced at the very bottom of the distribution, contributed some 33% of the decline in poverty incidence (measured by FGT(0)); 45% of the decline in the depth of poverty (measured by FGT(1)); and 50% of the decline in an inequality-adjusted measure of poverty intensity (FGT(2)) over the period.

The combination of a rising mean and falling inequality was particularly welcomed in Brazil, where opinion surveys revealed widespread dissatisfaction with inequality *in itself*, above and beyond its effects in perpetuating poverty. Therefore, the fact that economic growth since 1994 – and more markedly since 2001 – was pro-poor was widely welcomed in Brazilian society. Figure 1 portrays the *growth incidence curve* for Brazil in two different periods: 1985-1993 and 1993-2004: whereas incomes shrank for most percentiles in the first sub-period (and most of all for the poor), they rose across the distribution in the second sub-period (and again, most of all for the poor).

What factors may account for this substantial reversal of fortunes in 1994? As always in the field of income distribution analysis, a number of overlapping factors play a role. We emphasize four. First, 1994 was the year of macroeconomic stabilization, when the successful *Plano Real* reduced annual inflation from 2269% in 1993 to 24% in 1995. Inflation fell further to 4.3% in 1997. Inflation taxes money holdings, which represent a larger proportion of the wealth of the poor than of the rich, since better-off households have superior access to financial markets, including to inflation-proof assets. Inflation also introduced considerable noise into the signals provided by the price mechanism, making long-term investment decisions riskier, and thus contributing to economic stagnation. There seems little doubt that the restoration of relative price stability was a necessary condition for Brazil to resume growth, and most of the evidence suggests that it contributed to declining inequality as well.

¹ At nominal exchange rates, this line corresponded to U\$34.48 per month in September 2004.

Figure 8: Growth Incidence Curves for Brazil



Second, earlier progress in expanding school enrollment and discouraging early evasion led to a substantial rise in the average years of schooling in Brazil's labor force during the 1990s. This expansion in skills began to contribute to reduced inequality in labor earnings, both directly and through a reduction in the skill premium, reflecting a rise the supply of skills, relative to demand. While this victory of education over skill-biased technological change (as Jan Tinbergen might have seen it) has beneficial implications for inequality, they may also be seen as indicative of a persistent lack of dynamism in the Brazilian economy.

Third, Brazil's trade liberalization episode (1988-1995), during which average nominal tariffs fell from 43.4% to 13.9%, also contributed to a decline in wage inequality. Unlike in many other developing countries that liberalized in the 1990s, Brazil's pre-existing pattern of protection was biased in favor of skilled workers. Tariff reductions did therefore have the wage effects predicted by the Stolper-Samuelson theorem. There is some evidence that this reallocation of workers and activities across industries contributed to an increase in the elasticity of poverty-reduction with respect to growth in the tradable goods sectors, particularly agriculture. Agricultural growth, in turn, was partly responsible for a significant reduction in income disparities between urban and rural areas.

Finally, since the restoration of democracy and the 1988 constitution, Brazil social security and social assistance expenditures have increased dramatically. While some of the growth in pension outlays has been regressive (particularly in the highly subsidized public sector scheme), some initiatives have been exceptionally progressive. Non-contributory retirement and disability pensions to all agricultural workers, in particular, extended benefits to the elderly in some of the most underprivileged areas and occupations in the country. Since 1994, a rising real value of the minimum wage (to which basic pensions are indexed) has further enhanced the poverty-reducing impact of these benefits.

On the social assistance side, the last couple of years saw the massive scaling up of the country's pre-existing conditional cash transfer program (Bolsa Escola), into a better-integrated, better-funded, and much larger program, known as Bolsa Familia. This now reaches 11 million households, or around 45 million individuals – nearly 1 in 5 Brazilians. Transfer amounts are relatively small, but the program appears to be very well targeted, which ensures that contributions do reach those who need them the most. While the jury is still out on whether the conditional transfers have real impacts in learning outcomes for the children who benefit, there is now little doubt that the immediate effect of the cash on the livelihoods of recipient families is substantial.

All in all, Brazil's recent experience suggests that economic growth remains the key driver of poverty

reduction – even in Latin America. But in unequal societies like Brazil's it is clearly possible to attain faster growth while simultaneously reducing income disparities, both through eliminating market distortions (like trade barriers) and by direct income redistribution (like Bolsa Familia). Reductions in inequality are often valued for their own sake, but they also considerably enhance the poverty-reduction power of economic growth.

This note has drawn on the following papers:

Ferreira, F., P. Leite and J. Litchfield (forthcoming): "The Rise and Fall of Brazilian Inequality: 1981-2004", *Macroeconomic Dynamics*.

Ferreira, F., P. Leite and M. Ravallion (2007): "Why has Brazil's Economic Growth Not had More Impact on Poverty?" World Bank Research Department. Unpublished.

Ferreira, F. P. Leite and M. Wai-Poi (2007): "Trade Liberalization, Employment Flows and Wage Inequality in Brazil", World Bank Policy Research Working Paper #4108.