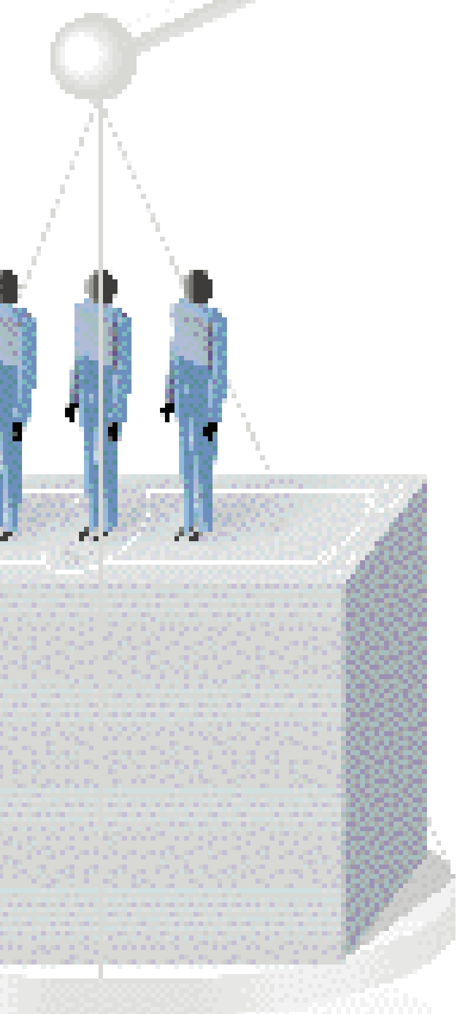
The *Real* Plan, Poverty, and Income Distribution in Brazil

BENEDICT CLEMENTS



Since Brazil's macroeconomic stabilization program was implemented in 1994, the percentage of Brazilians living in poverty has decreased and the distribution of income has registered a small improvement. But poverty and income inequality remain severe.

FOR several decades, Brazil has had one of the most unequal income distributions in the world. From the early 1980s to the early 1990s, the Gini coefficient (a measure of income inequality that ranges from 0 for perfect equality to 1 for absolute inequality) for the per capita income distribution of the economically active population and the Gini coefficient for per capita household income have both been around 0.60. In contrast, the average Gini coefficient from the 1960s to the 1990s was 0.35 and 0.39 in South and East Asia, respectively, and 0.34 in the industrial and high-income developing countries (Chart 1). Income distribution tends to be more unequal in Latin America than in other regions, but in no other Latin American country is the gap between rich and poor as wide as in Brazil—the average Gini coefficient for Argentina, Bolivia, Chile, Colombia, Costa Rica, Mexico, and Panama was 0.42 in the early 1990s.

Income inequality remained high in Brazil in the early 1990s, showing no large improvements. In tandem with low economic growth, this forestalled any reduction in Brazil's poverty rate. The situation seems to have improved sharply, however, since the implementation of Brazil's *Real* Plan in July 1994, which was named for the new currency introduced under the Plan. The macroeconomic stabilization achieved under the Plan has been accompanied by a sizable reduction in poverty because of the rapid income growth experienced by the poor. There has also been a very small decline in income inequality. The next challenge for Brazil is to undertake reforms that will tackle the structural causes of poverty and income inequality.

New policies

The main elements of the *Real* Plan included the introduction of a new currency (the *real*); the deindexation of the economy; an initial freeze of public sector prices; the tightening of monetary policy; and the

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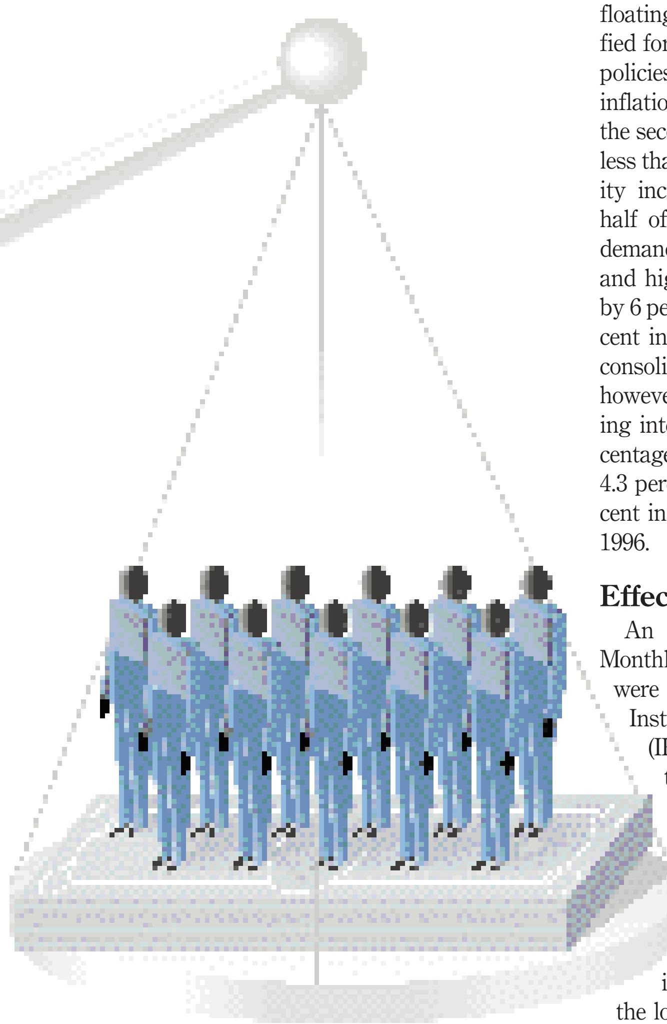
floating of the currency, with a floor specified for its value vis-à-vis the dollar. These policies have enabled Brazil to get monthly inflation rates down from 45 percent during the second quarter of 1994 to an average of less than 1 percent in 1996. Economic activity increased strongly during the second half of 1994, led by a boom in domestic demand that was fueled by lower inflation and higher real wages; the economy grew by 6 percent in 1994, and by 4.2 and 2.9 percent in 1995 and 1996, respectively. Fiscal consolidation has been more problematic, however; the public sector balance excluding interest payments, measured as a percentage of GDP, dropped from a surplus of 4.3 percent in 1994 to a surplus of 0.4 percent in 1995 and a deficit of 0.1 percent in 1996.



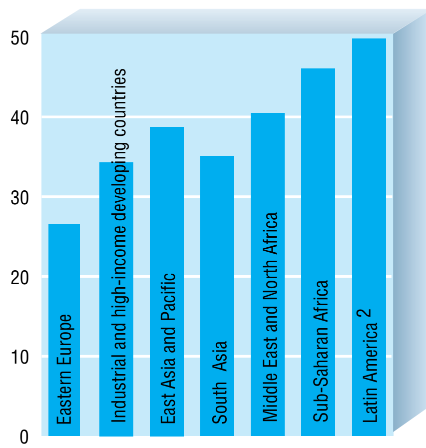
Effect on income distribution

An examination of data from the Monthly Employment Survey (PME) (data were aggregated and assessed by the Institute of Applied Economic Research (IPEA), 1996) for six major metropolitan areas shows that the overall inequality of labor income declined between September 1994 and September 1995, as the income of the lowest 50 percent of workers grew strongly (Chart 2). Over this period, per capita labor income increased by roughly 30 percent for the lowest four deciles of the income distribution, while the top decile's income grew by only 10 percent. The strong income growth of the poorest groups is reflected in a drop in the percentage of Brazilians in these areas living below the poverty line, from a peak of 42 percent in July 1994 to 27 percent in December 1995 (Rocha, 1996).

As pointed out in IPEA, 1996, the improvement in the relative position of lower-income groups has been even greater than indicated by the above-mentioned figures. First, the data do not reflect the positive impact of lower inflation on real incomes. Given that the poor and lower

Chart 1

Average of Gini coefficients by region, 1960s–1990s [1]



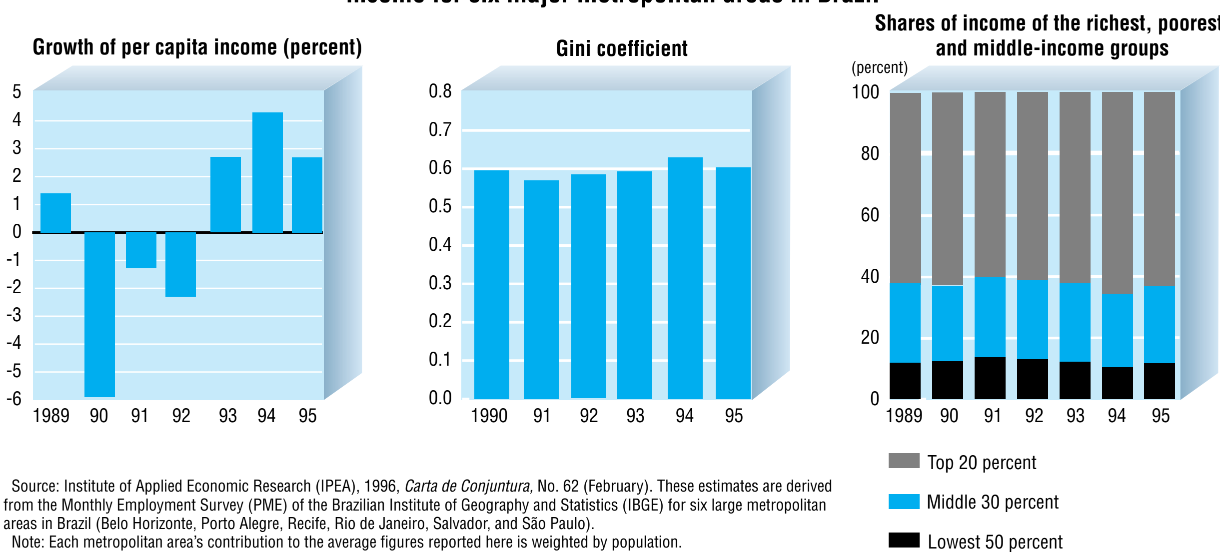
Source: Klaus Deininger and Lyn Squire, 1996, "A New Data Set Measuring Income Inequality," *World Bank Economic Review*, Vol. 10 (September).

[1] Gini coefficients multiplied by 100.

[2] Includes Brazil.

Chart 2

Average per capita income growth and distribution of labor income for six major metropolitan areas in Brazil

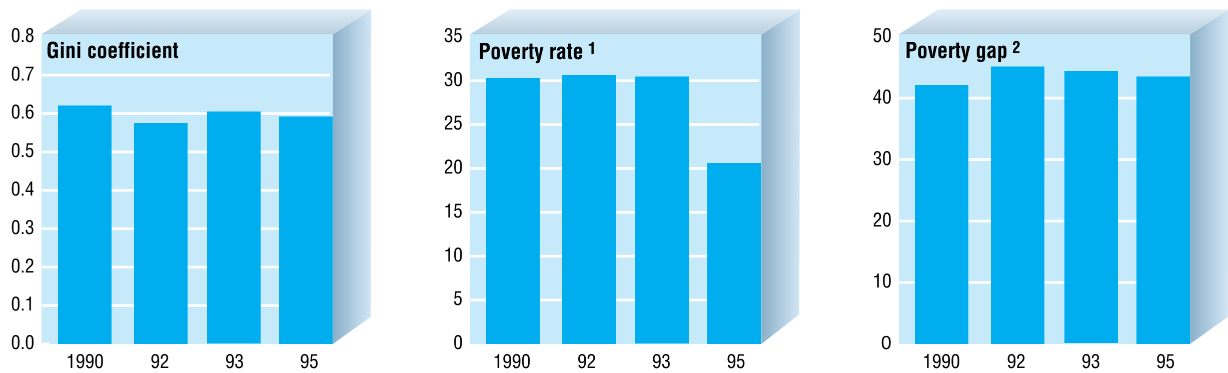


Source: Institute of Applied Economic Research (IPEA), 1996, *Carta de Conjuntura,* No. 62 (February). These estimates are derived from the Monthly Employment Survey (PME) of the Brazilian Institute of Geography and Statistics (IBGE) for six large metropolitan areas in Brazil (Belo Horizonte, Porto Alegre, Recife, Rio de Janeiro, Salvador, and São Paulo).

Note: Each metropolitan area's contribution to the average figures reported here is weighted by population.

Chart 3

Poverty in Brazil and the distribution of income from all sources



Source: Gini coefficients calculated by the Brazilian Institute of Geography and Statistics (IBGE) on the basis of its National Household Survey (PNAD). The coefficient measures the distribution of income from all sources for individuals over 10 years old with income. Poverty rate and poverty gap data, derived from the PNAD data, are from Rocha, 1997.

[1] Percentage of the population below the poverty line, based on number of persons living in households with per capita incomes below the poverty threshold.

[2] Percentage difference in per capita incomes of those below the poverty line and poverty line per capita income.

middle class have limited access to mechanisms to protect themselves from the adverse effects of inflation on consumption (e.g., interest-bearing checking accounts and purchases of goods on credit), when inflation rates drop, these groups enjoy a larger percentage increase in their real incomes than upper-income groups. A one-time increase in the real incomes of lower-income groups of at least 9 percent between June 1994 and September 1995 can be attributed to reduced inflation. Second, the small increment by which the low-income consumer price index (CPI) increased (1.9 percent from July 1994 through September 1995, compared with 34 percent for the overall CPI) made a further contribution to improvements in the living standards of poor Brazilians. This reflects the fact that food prices, which rose only slightly during this period, account for more than 78 percent of the low-income CPI.

The asymmetric gains from the *Real* Plan are also evident in data on income increases in the formal and informal sectors. Formal sector employees saw their monthly average real incomes go up 18.7 percent between 1994 and December 1995, while workers in the informal sector enjoyed an increase of 38.4 percent. One reason lower-income groups seem to have benefited more than other groups from the *Real* Plan is that relative prices for nontradables have gone up, fueled by strong growth in the nonfinancial services sector, compared with industry. This sector employs many unskilled workers. Data on income gains by level of education also show that income growth for groups with less education has been greater than for other groups.

Recent data on changes in the distribution of income from all sources for all of Brazil also demonstrate that macroeconomic stabilization has been accompanied by greater equality, although the improvement has been very small. Gini coefficients for the distribution of all incomes fell to 0.59 in 1995, from 0.60 in 1993 (Chart 3); except for 1992, this was the lowest Gini coefficient of the 10-year period from 1986 to 1995. The poverty rate has been significantly reduced, from 30.4 percent of the population in 1993 to 20.6 percent in 1995. Furthermore, the severity of poverty was also slightly reduced, as the gap between the average per capita income of those below the poverty line and the per capita income that defines the poverty line (the "poverty gap") narrowed.

One aspect of the *Real* Plan that benefited middle- and upper-income groups more than the poor was the temporary freezing of public sector prices. Despite an initial upward adjustment of prices, real prices for gasoline, telecommunications, electricity, and other public sector goods and services between July 1994 and September 1995 were substantially below their previous 12-month average. Many of these goods and services are consumed predominantly by families in the top decile—families with incomes more than 10 times the minimum wage of September 1993. For example, this group consumes 94 percent of all gasoline and telecommunication services and 65 percent of all electricity purchased in Brazil. Prices for a number of public services and products were increased substantially in late 1995 and early 1996; as a result, real electricity prices were higher in the first three quarters of 1996 than before the *Real* Plan. However, in real terms, prices for telecommunications services and gasoline remain below pre-Plan levels.

Conclusion

The *Real* Plan has been associated with declines in poverty and income inequality, demonstrating that macroeconomic stabilization can benefit the poor. However, the results suggest that there are limits to how much macroeconomic stabilization can improve the distribution of income, given the small changes in the Gini coefficients for the distribution of labor income between 1994 and 1995 and all incomes between 1993 and 1995. Income inequality in Brazil remains high by international standards and is rooted in structural causes, such as inequality in educational attainment and land ownership. Moreover, a number of government policies, including education policies, appear to have contributed to the high degree of inequality. To achieve substantial improvements, Brazil will need to address these root causes of income inequality. F&D

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