Tax Reform, Income Distribution and Poverty in Brazil: An Applied General Equilibrium Analysis
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Tributary reform is a recurring subject of discussion in Brazil. In the last twelve years the debate on this theme has intensified due to growing evidence of the inefficiency of the Brazilian tax system, especially its indirect tax system. The Brazilian public has increasingly accepted the need for broad fiscal reform, yet there is no general agreement on how it should be done.

The high number of taxes and large differences in tax rates create distortions by favouring sectors with fewer taxes and lower tax rates. In addition, the cumulative nature of these taxes imply that sectors with more intermediate steps in the production process (such as food processing) pay more taxes, with obvious implications for welfare. This issue is of urgent importance for the poor.

To analyze the problem, a group of Brazilian researchers simulated the impacts on poverty of three different indirect tax reforms; a reduction in indirect taxes on; i) the main household consumption goods; ii) the main agricultural inputs; iii) all products in a specific region, São Paulo state.

The reduction in indirect taxes on food emerges as the most promising in terms of poverty alleviation. Due to the importance of food processing in the Brazilian economy, this is also the policy that generates the largest positive effect on economic activity, which reinforces the benefits in terms of poverty and inequality.

The cost of this kind of policy, however, raises doubts about its feasibility. Indeed, the tax revenue loss is too high, when compared to the actual direct transfer policies underway in Brazil. This result remains even if one considers that the administrative costs (and inefficiencies) of the transfer policies are not included in the calculations.

Another important point to be noted here is that it would be hard to get a general agreement among states to implement these policies, since the tax revenue loss would be unevenly spread across them. The poorer states would lose proportionally more than the richer states, given the smaller share of manufacturing in their total production.