Tax and the social contract in Brazil

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Internationally, debates on tax in Brazil often focus on its refusal to adopt OECD transfer pricing guidelines, but the country's domestic arrangements also offer a fascinating window on its impressive development progress.

Over the last ten years Brazil has lifted an estimated 40 million people out of poverty, while reducing inequality by around 12%. Since the mid-1990s, the country has undergone a transformation – and tax, redistribution and the social contract have played a pivotal role.

Brazil managed a remarkable 7% increase in tax revenue as a percentage of GDP between 1995 and 2010, a rise from 26.9% in 1995 to 34% in 2010. We wanted to understand how this had come about and what other developing countries could learn from it.

The big rise in Brazil's revenue base is not the result of any significant change in tax codes or administration. Economic growth has played its part, but unlike many African countries, which are struggling to convert the proceeds of growth into increased revenues, Brazil has capitalised on comprehensive tax reforms undertaken in the 1960s. Brazil adopted a modern tax code, became the first country to introduce VAT and revamped its tax administration.

This legacy of these reforms was a broader tax base, which has helped to stabilise the economy and critically, to establish the technical skills and capabilities needed to manage a large tax system. The downside has been the evolution of an extremely complex and in many ways, inefficient approach to tax collection, not helped by the federal structure of the country.

The incidence of taxation across society is relatively neutral, with the progressivity of direct taxes neutralised by the regressivity of indirect taxes. Despite growing calls for a simpler, more progressive system, successive governments have converged on the view that redistributive objectives are best secured via spending, not taxation.

Economic growth and the rise of the tax/GDP ratio in Brazil have enabled successive governments to expand inclusive social policies without the need to reallocate resources from existing programmes and therefore avoid damaging conflict. The flourishing of social assistance programmes in Brazil has been made possible by increasing tax revenues. The internationally feted Bolsa Familia anti-poverty transfer programme was able to expand from covering 6.5 million households in 2004 to 14 million in 2013. Other less known programmes such as Brazil's two social pensions reach over 10 million people (with a budget twice that of Bolsa Familia's). Both poverty and inequality levels have fallen sharply as a result.

The political commitment to expanding redistribution throughout society has its roots in Brazil's transition from dictatorship to democracy. The early years of civilian rule saw a strong consensus form around the need to tackle the “social debt” created under military rule. The incorporation of previously disenfranchised ‘illiterates’ into political life created a large constituency for redistribution.

Indeed, the higher rates of tax paid by large companies and the assertive approach to transfer pricing are a reflection of the priority Brazil places on raising and redistributing revenues to its poorest citizens, over the desires of business.

As Brazil’s economy has slowed over the last few years, the ability of the government to continue to expand investment in social policies has been severely curtailed. Members of the emerging middle classes have been described as increasingly having a ‘dissatisfied customer’ relationship with the state; they are not content with the quality of public services they receive for the tax contribution they make.

With a forthcoming presidential vote, Brazil is now facing a critical juncture. The high level of taxation, the increasing politicisation of the issue and the pressures for better quality in public services are straining the previous consensus. This may result in less corruption and better services in exchange for tolerating high taxes, but the final outcome is far from certain.

- Read the full research paper: Taxation, redistribution and the social contract in Brazil.

IRIBA is a DFID funded research programme, based at the University of Manchester. It brings together an international team of researchers, examining how lessons from Brazil's development experience can be used by African countries.

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