Unfinished business

THE 1994 REAL PLAN not only stabilized the national currency, it stimulated an impressive and politically difficult series of structural and institutional reforms under President Fernando Henrique Cardoso (1995–2002): The federal government refinanced state and municipal debts through bilateral agreements; the social security system got a new face; a constitutional amendment in 1998 raised the retirement age for new public employees to 60 years for men and 55 years for women and led to changes in how the pension benefits of private workers were calculated; state-owned enterprises were privatized; many banks were closed or restructured; and the Fiscal Responsibility Law was approved.

In a remarkable political U-turn, leftist President Luis Inácio "Lula" da Silva (2003–2010) stuck with the policy framework of the Real Plan, though apart from introducing an income tax on pensions of retired public employees, reforms virtually came to a halt. Nevertheless, the Lula administration enjoyed enviable international and domestic conditions for introducing pro-growth and poverty reduction policies. However, consumption-led growth eventually proved to depend too much on external financing, making Brazil's trade less competitive.

Since 2011 with a less favorable international outlook and the exhaustion of consumption-led growth, the economy has stagnated and the external current account has deteriorated steeply. Dilma Rousseff's administration (2011–2014) correctly identified many of the structural constraints on the Brazilian economy—high interest rates, high energy prices, low fixed investment... but its attempts to correct them by government-led growth has so far had at best mixed results.

Since the Real Plan was introduced, no administration has yet addressed the crux of the matter: government consumption has exploded, and so has the tax burden on Brazilians. Two decades ago, total public spending—federal, state, and municipal—was 25% of Brazilian GDP, already higher than in countries with similar per capita incomes. Today, government eats up 40% of GDP—about the same as Europe, but certainly without the same quality of public services. In 2013, while nominal GDP rose by just 8%, public spending shot up almost twice as fast, by 15%.

No doubt Brazil has been more successful than other emerging countries in social integration and reducing inequalities, but that success has come at the cost of lower investment and growth. As former Finance Minister Delfim Netto points out, we urgently need a better balance between income distribution and pro-growth policies.

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To avoid stalling the economy further, in 2015 the next president must curb the gargantuan government appetite. Growth in current public spending must be held below growth in nominal GDP. A solid ceiling for spending growth needs to be complemented with a reduction in budget rigidities, less earmarking of revenues for specific expenditures, and more transparency in spending, tax benefits and subsidies.

Obviously, that will be politically difficult. Vested interests will arise in all directions. But as the precedent of the Real Plan itself makes clear, major reforms are possible in Brazil even under extremely difficult conditions. Many of the reforms put in place by the Cardoso administration required negotiation of constitutional amendments that at the time were also considered politically impossible. We can only hope that political leaders do not validate the opinion of Brazilian anthropologist and folklorist Câmara Cascudo, who famously said, "Brazil has no problems. Only delayed solutions."