Rethinking government's role

Liliana Lavoratti, Rio de Janeiro

In October, the next President to be elected — Dilma Rousseff (Workers' Party [PT]), José Serra (Social Democrats [PSDB]), or Marina Silva (Green Party [PV]) — cannot avoid a basic question: how to improve the Brazilian government? That is because the success of President Luiz Inácio Lula da Silva (PT) will knock on his successor's door. "The spell is going to turn against the wizard. Pressure from the 20 million Brazilians who have climbed the social ladder will increase. The new class will demand more efficiency in public services, especially education and health," predicted Fernando Abrucio, political scientist and coordinator of graduate studies in public administration, the Getulio Vargas Foundation (FGV), during a meeting on "Politics and economics: What to expect from the new government," sponsored by the Brazilian Institute of Economics (IBRE).

At the conference Bernard Appy, former secretary of economic policy for the Finance Ministry (2003-2009) and director of the São Paulo Stock, Mercantile and Futures Exchange, and Mansueto Almeida, researcher in the Directorate of Sectorial Studies of the Institute of Applied Economic Research (IPEA) laid out a path to greater government efficiency. Appy underlined that, "For the current good moment to be converted into widespread development, we need to solve certain structural problems, such as increasing domestic savings rates, managing fiscal policy, and dealing with the competitiveness agenda." Almeida added that another dilemma to be faced by the next administration is how to increase public investment, which today is a meager 1% of GDP, so as to make the infrastructure improvements needed to support yearly growth of 6%.

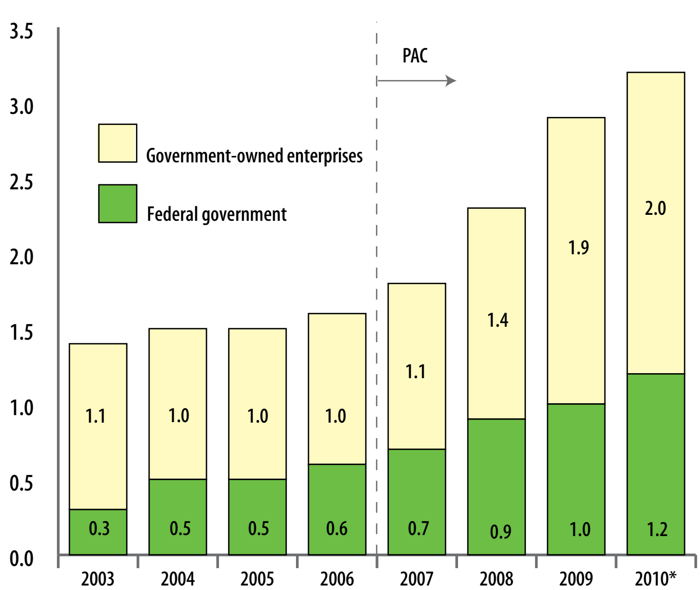
Government idolatry?

Such questions are linked, in one way or another, to the central point of the inevitable debate over the next few years: the role of the government. Maria Celina d'Araujo, professor in the Department of Sociology and Politics of Rio de Janeiro's Catholic University (PUC-RJ), said that "There will be a big difference depending on whether PSDB's plan is put into practice or PT's plan is continued." She believes, unlike liberals who consider that the government is a necessary evil, that today in Brazil there is "government idolatry:" "A new PT government will reinforce the view of the government as a good boss, despite the absence of a movement to defend a minimum government." Abrucio added that

"Since social well-being is higher now than it was 10 years ago and society progresses faster than the government, it might be necessary to change the 'Brazil Government.' The dilemma between privatization and nationalization, for example, makes no sense in the country's new context. Well-being involves more than just economic performance; it encompasses jobs, access to public schools and hospitals, things the electors want in the short term. Today, there is a high level of satisfaction with salaries, low unemployment rates, and inflation control. All this contributes to the popularity of the president and the government. But education and public health are public policies that are still being rated badly."

The demand for greater efficiency in basic government services will be reinforced by another feeling that is growing among Brazilians: the quality of democracy. Abrucio pointed out that "The longest political cycle of Brazilian democracy has been consolidated. Compared to some South American neighbors and other BRICs [the bloc formed by Brazil, Russia, India and China], we are doing well. The question

Brazil: Public investment (% of GDP)



Source: Ministry of Finance.
*Accumulated 12-month trough April 2010.

"In opposition to the idea defended by liberals that the government is a necessary evil, today in Brazil there is 'government idolatry.'"

Maria Celina d'Araujo

is no longer to have democracy or not, but how inclusive it is. It's a new cycle." He believes the main concern now in Brazil's political and electoral game is inequality: "After having controlled inflation and created the conditions for faster economic growth, today the baseline consensus of democracy is to reduce the distance between the rich and the poor."

But how to balance the increase in domestic savings rates, management of a fiscal policy that results in an efficient government and increased investments, implementation of competitiveness measures, and pressure for increased public spending in the social sectors? According to Appy, it all begins with the fact that, in the long term, continuing consumption growth that is greater than GDP growth, such as Brazil has seen since 2005, is not sustainable. "The country's external current account has worsened since 2005. In the short term, this model is not explosive, but long term it is doomed," he warns.

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Fernando Abrucio

Brazil: Tax burden

	% of GDP		Change	
	2004	2008	p.p. of PIB	%
Personal income tax	1.96	2.40	0.44	22.70
Taxes on wage bill	7.99	9.29	1.30	16.30
Corporate income tax	4.23	5.80	1.57	37.00
Sales tax	14.58	15.46	0.88	6.00
Tax on financial transactions	1.63	0.73	-0.90	-55.20
Taxes on estate	1.03	1.23	0.20	19.40
Other	0.81	0.89	0.08	9.90
Total	32.23	35.80	3.57	11.10
Including CPMF*		36.72	4.49	13.90

Source: Brazilian Internal Revenue Service.
*CPMF is a temporary contribution on transfers of values, credit and rights of financial nature.

Savings

Increasing domestic savings is crucial to the expansion of infrastructure investments necessary to maintain economic growth rates of 6% a year. It is almost unanimously believed that domestic savings rates would have to rise from the 14.5% of GDP Brazil recorded in 2009 to at least the 18% seen in 2008, which was the highest level of recent years; and that investment rates, which are presently 19% of GDP, would have to rise to at least 25% so that economic growth does not cause higher inflation. "With low domestic savings, the country will have to finance itself with foreign capital for a long time. This may cause an imbalance in foreign accounts," Appy said.

Appy does not think that the need to adjust the growth model necessarily means there would be a slowdown in current positive trends. "To make these adjustments is not complicated, but it demands changes in how the public finances are managed. And some characteristics of the Brazilian fiscal

National Bank for Economic and Social Development (BNDES) disbursements and Gross Fixed Capital Formation

(Billions of Reais)

	BNDES' disbursements for Capital Formation (a)	BNDES' total disbursements (b)	(a)/ (b) (%)
1995	5.2	7.1	73
1996	5.4	9.7	56
1997	7.5	17.9	42
1998	9.1	19.0	48
1999	8.6	18.1	48
2000	12.0	23.0	52
2001	14.3	25.2	57
2002	15.4	37.4	41
2003	16.0	33.5	48
2004	21.4	39.8	54
2005	23.5	47.0	50
2006	26.3	51.3	51
2007	37.5	64.9	58
2008	48.6	90.9	54
2009	71.4	136.4	52

Source: Mansueto Almeida.

structure bring risks and opportunities to the medium-term growth," he says. The first one is the increase in the tax burden as the economy becomes more formal — from 2004 to 2008, the annual increase averaged 0.9% of GDP — and the structural increase in the tax burden is likely to continue for a long time, at the rate of 0.5% of GDP each year, Appy estimates, adding that "In 20 years, this would add 10 percentage points to GDP, increasing the total tax burden to approximately 45% or 50% of GDP."

"Successmania"

IPEA researcher Almeida sees little room to decrease the public spending-to-GDP ratio: "The government's room has increased, since the market can cope with more spending and a `heterodox` fiscal balance. The 'Successmania' goes against today's logic. But the next government's fiscal management may even improve, since we are reaching the rock bottom," he argues.

Other reasons: the social contract has not yet changed, the active role played by public banks — especially the National Bank for Economic and Social Development (BNDES) — will probably continue, and there are few, if any, cost-benefit analyses being made by Brazil.

Still, according to Almeida, the growth pattern for public spending has held steady since 1999: increase in income distribution fueled by actual growth of the minimum wage. Meanwhile, federal public investment has not gone over 1% of GDP since 1999.

The figures clarify this situation: from 1999 to 2009, the government's total spending (excluding interest payments) rose 4 percentage points (from 14% to 18% of GDP). Of the total growth, 3 percentage points (70% of the total) are attributable to increased spending by the Social Security (INSS) and other social agencies. Education and health spending have also increased since 1999. The total cost of the Unified Health System (SUS), for example, jumped from R$11 billion to R$35 billion, almost doubling its share in GDP.

"The PT government sees the increase in public spending as normal," Almeida

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stressed. The Ministry of Finance adopted the concepts of net tax burden and net public spending (excluding income transfers and social expenditure) in order to evaluate public income distribution results. "The assumption behind this is that public spending does not grow because society is being benefited," he added. The result is a "more-of-the-same" scenario. "In general, Dilma Rousseff will maintain this situation. But, as to José Serra, I have doubts. The opposition criticizes the size of the government, but won't say how it would cut expenses. The rhetoric of the elites is dubious: businessmen criticize the tax burden and at the same time welcome the increase in resources for the Investment Sustainability Program of BNDES, which offers interest rates subsidized by the National Treasury," Almeida pointed out.

He believes that the demand for BNDES resources to finance exports, infrastructure, and purchase of machines and equipment will increase because of pre-salt oil exploration. He also raised some concerns: "The principal candidates running for president defend the industrial policies. The nontransparent relationship between the National Treasury and public banks may worsen. For example, the terms of the most recent loan the Treasury granted to BNDES are not known; neither are the terms of Banco do Brasil`s capitalization by the Sovereign Fund."

Certainties and Doubts

In a tough race polarized by two candidates, the presidential elections raise questions about what will be changed, maintained, or reinforced by the next government. "The approach to dealing with problems that still have to be resolved may give rise to alternative courses of action by the presidential hopefuls," says the economist Regis Bonelli of the Brazilian Institute of Economics (IBRE) of FGV. Bonelli commented on the following themes:

■ **The new role of the government** — "The answer to the 2008 crisis involved an arsenal of anti-cyclical measures that turned out to be very effective. A group of analysts affirms that some were already in place, or ready to be, despite the crisis. This points to a trend inside the current government to expand the role of the government in the economy, not only concerning public spending but also in financing and regulation of economic activity. In this sense, several questions may be raised: how would the attitudes of both candidates on this question differ? Should we expect a future government more focused on regulation? Or would it be more involved with providing credit, goods, and services? In other words, should we expect a more regulating or a more providing government? And what would be the role of the regulatory agencies?"

■ **Infrastructure bottlenecks** — "Inadequate infrastructure continues to limit growth and the limitations tend to become more pronounced as economic activity grows. The lack of adequate management, especially, has been blamed for the poor performance of infrastructure projects carried out by the public sector. To what extent is that true and how would a new administration deal with complex problems of administrative continuity caused by a change in government? And what is the future of concessions and public-private partnerships?"

■ **Institutions and economic policies** — "The pace of the fiscal adjustment and the subsequent transition to a domestic benchmark interest rate compatible with international interest rates have been very slow, and inflation has been more resilient than expected. At the height of the subprime crisis, as the world experienced a generalized deflationary crisis, the change in the broad consumer price index (IPCA) was never less than 3.5% a year. What will be the position of the candidates regarding the fiscal costs of the policy that guarantees monetary stability? Are there risks of default or restructuring of domestic public debt?"

■ **Social programs** — "Part of the success of the outgoing federal administration is due to a variety of social programs. It would be interesting to evaluate the possibilities of increasing, reducing the importance, or even eliminating some of them, especially considering that a large part of poverty reduction recorded in the past years was mainly due to the labor market, not income distribution."

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