The Brazilian development model: Australia rather than China

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Recently, the view that low domestic savings is a structural feature of the Brazilian economy has been prominent in the study of conditions for development. One important question is the extent to which the low rate of savings is due to the welfare network built up since Brazil was democratized in the early 1980s.

According to World Bank data, between 1995 and 2004 domestic savings in Brazil averaged 18% of GDP; the average for 134 economies was 21%, with a median of 20%; and the average for Asian countries in the last 15 years was about 35%, compared to 20% for Latin America. Even compared to OECD countries, with a rate of 23% in that period, Latin America saves much less. Thus, Brazil's low savings may be part of a more general Latin American phenomenon.

Savings and growth

Moreover, national savings have not reacted much to the acceleration of economic growth, although elsewhere in the world savings are usually positively associated with growth. From 2001 to 2004, a period of low growth in Brazil, the savings rate increased from 14% of GDP to 18%, yet when growth accelerated dramatically from 2004 to 2008, savings actually dropped, from 18% to 17.5%. In the third quarter of 2008, just before the international crisis put the brakes on the Brazilian economy, the investment rate reached 20% of GDP, for a savings rate of 17.8%. In other words, the use of external savings (the current account deficit) rose to 3% of GDP.

As discussed in the IBRE Letter in this issue, high public spending on the social safety net set up after democratization in the early 1980s explains the low level of savings. Because of broadened eligibility and increases in the real value of social security benefits — foremost among these the policy of raising the minimum wage — savings have not reacted to economic growth. While the savings rate in Brazil has always been low, the generosity of the social safety net is a relatively recent phenomenon.

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Savings and demographics

Studies using data for several countries have identified several factors that determine how much each country saves. In particular, at different times in history, demographics may explain periods of high and low savings. Indeed, throughout the 1970s Brazilian society was at the height of a population boom. Population growth between 1955 and 1975 was about 3% a year. This high rate of growth meant that the working age population (PIA) was relatively small. Countries with many children, like aging societies, tend to save less.

After democratization, Brazil greatly increased access to health, basic education, and pensions. The build-up of the huge social safety net (huge in terms of Brazilian per capita income) has offset the trend of higher savings as a function of demographic change.

Since the mid-1970s, Brazil has no longer been a young society. The proportion of people 25 to 64 years in the total population increased from 44% in 1970 to 63% in 2010, and is projected to reach 65% in 2025. Thereafter, the growth of the elderly population will more than offset growth in the number of children, so PIA as a fraction of the total population will again decline.

Another measure used is the ratio between the PIA and the inactive population (mainly children and elderly). This ratio hit a low of 1.2 in 1965. From 1965 through 2000, it grew rapidly, reaching 1.8, where it is expected to remain until 2035. This is what demographers call the demographic bonus. Thus, the savings rate in Brazil should have been very high since the 1970s. Apparently, the build-up of the huge social safety net (huge in terms of Brazilian per capita income) has more than offset the trend of higher savings as a function of demographic change.

After democratization, Brazil greatly increased access to health, basic education, and pensions. Moreover, most post-secondary education is free in public universities, or is indirectly funded by the state. Although the quality of health and basic education is poor, public spending on them as a share of GDP is high by international standards. Raising the quality thus will depend more on improving management than on increasing resources.

Social generosity

International comparisons show clearly how generous the national pension system is. Brazil spends 12% of GDP on social security, including pensions, death benefits, and permanent disability benefits. A simple regression analysis of World Bank social security data for a total of 113 countries, taking into account Brazil's demographics, suggests that rather than 12%, Brazil should have spent only 3%. In contrast, the countries of East Asia under spent in pensions by 6.1 % (Japan), 3.8%, (Singapore), 3.5% (South Korea), and 1.2% China.

A dissimilar comparison

Many think it useful to look to China, the society that to some extent can be considered the opposite of Brazil in its very high savings. In the 1990s the Chinese savings rate was 35%–40% of GDP and in 2006 it reached an unimaginable 50%. Of the 50%, 22.5% was household savings,

22.5% enterprise savings, and 5% public savings. The rise in China's savings in the last decade was mainly because households had to provide for their own health and education as well as buy homes. The public social spending figures in China speak for themselves: The public sector spends 3% of GDP on education, 1% on health, and 2% on social security! So China is spending only 6% of GDP while Brazil is spending 21% (12% on social security, 5% on education, and 4% on health).

The high household savings in China and the low household savings in Brazil reflect to a large extent differences in their social safety nets. The enterprise savings gap is much smaller. While Chinese households save approximately 22.5% of GDP and Brazilian households only 5%, Chinese enterprises save 22.5% and Brazilian ones 15%. The high savings rate of Chinese enterprises is associated with a high rate of profit, which in turn reflects China's notoriously low salaries, compared to worker productivity. China labor market institutions would be incompatible with Brazil's democratic institutions, such as the right to go on strike and to organize unions.

A similar comparison

A country that saves little needs foreign savings to finance the difference between its savings and its investment rate. With savings of 18% of GDP and the need to invest 23% of GDP to achieve sustainable annual growth of 5.5%, Brazil will need to use foreign savings comprising 5% of GDP — and indeed, it is possible to absorb that amount of foreign savings; Australia demonstrates that relatively high external current account deficits can be sustained for long periods so long as certain conditions are met:

1. Adopting a floating exchange rate, with mechanisms for automatic correction of external imbalances;
2. Maintaining fiscal balance;
3. Having net external liabilities in the form of equity — foreign direct investment or stock market inflows — or denominated in domestic currency; and
4. Ensuring sound institutions and regulation that will attract foreign capital to supplement domestic savings.

Rather than comparing itself with China, Brazil should therefore look to Australia, which has democratic and market institutions that are much more similar to Brazil's.

An economy that adopts this pattern of external financing is not likely to suffer sudden stops in capital flows. Exchange rate changes cushion rather than amplify external shocks. Rather than comparing itself with China, then, Brazil should look to Australia, which has democratic and market institutions that are much more similar to Brazil's.