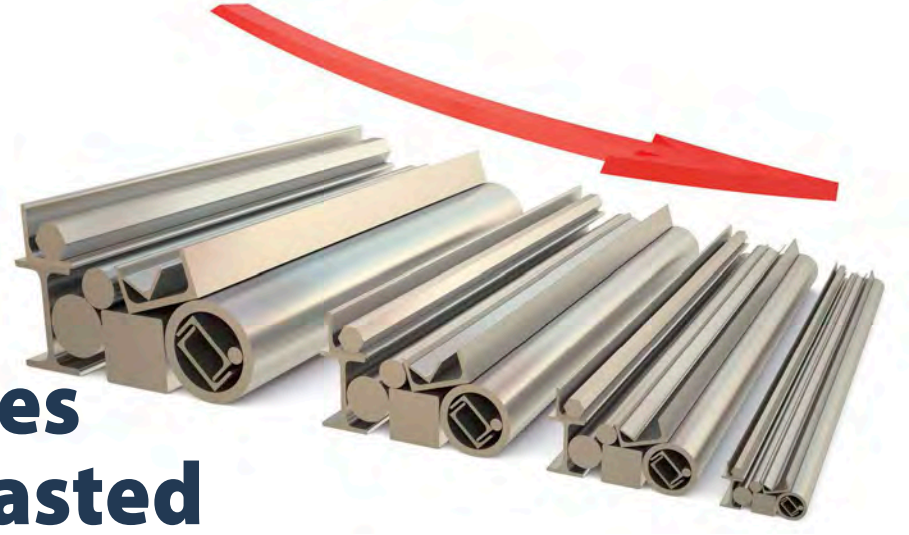


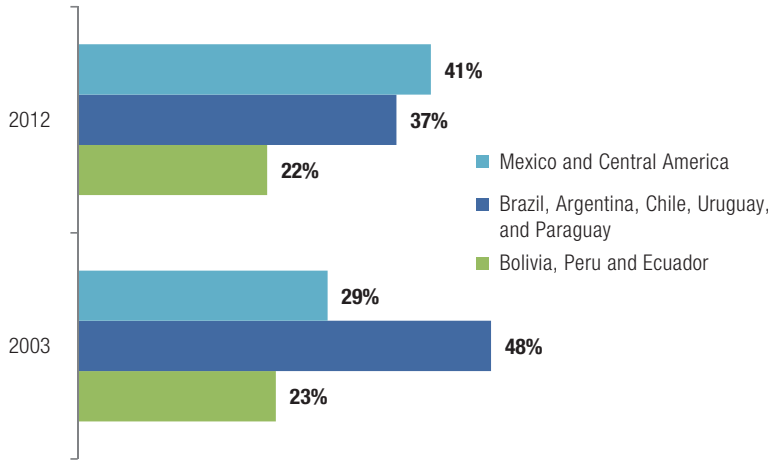
The commodities boom: A wasted windfall

Solange Monteiro

THE END OF HIGH COMMODITIES prices not only affects Brazil's economic growth but also threatens the social gains made in the last decade. Armando Castelar, IBRE coordinator of applied economics, points out that the commodities boom made a major contribution to reducing inequality in Brazil: it helped to raise tax revenues enough to carry out income transfer and social security policies and led to exchange rate appreciation, which although a detriment to exporters benefitted most sectors not related with foreign trade. The appreciation especially benefited the labor-intensive service sector, creating more jobs and pushing up wages. "During this period," Castelar explains, "it was possible to stimulate domestic demand and the resulting imports because the large volume of commodities exports minimized the impact on inflation and the external trade balance. From 2004 to 2011, Brazilian growth was concentrated in such sectors as construction, commerce, and financial intermediation, which employed a large number of unskilled workers."

With the end of the commodities boom, the situation has been reversed. To balance the external current balance deficit, it will be necessary to devalue the exchange rate, which implies a less favorable environment for service sectors to hire. Castelar points out that "With the end of the commodities windfall, income growth will depend on heightened productivity. If Brazil does nothing to raise productivity, there is no way to prevent the deterioration of social indicators."

The share of population living below the poverty line (less US$4 per day) fell significantly in Latin America in the last decade.



Source: World Bank.

This problem is not unique to Brazil. All Latin American commodities-exporting countries have used the proceeds over the past decade to address poverty and income inequality. World Bank data shows that Brazil, Argentina, Chile, Uruguay, and Paraguay all reduced poverty by 11 percentage points between 2003 and 2012, and Bolivia, Colombia, and Ecuador had a less dramatic but perceptible reduction in poverty. In Mexico and Central America, which are more focused on manufacturing exports, over the same period poverty went up by 12 percentage points. The Gini coefficient, which measures income inequality, has also evolved positively for most commodity-exporting countries. The Gini indicator for Brazil declined from 56.8 in 1990 to 50.1 in 2011 (the lower the number, the lower income inequality), for Chile from 51.8 to 48.5, and for Peru, from 52.7 to 46.9. In all these cases, labor income was a major factor: 70% of poverty reduction in Latin America, according to the World Bank, was due to improvement in wages. A study by Nora Lustig estimates that labor income accounted for 45% of the decrease in inequality, followed by cash transfers (14%) and a demographic increase in the number of people of working age (12%) .

The productivity problem

Sustaining social achievements now that the commodity export boom has ended will depend on how each country used its commodities windfall. "Countries that have low inflation and no external current account deficit will not need to raise interest rates and will fare better," says Castelar, citing the cases of Chile, Colombia, and Peru. Things will be more difficult for Brazil, which has a large current account deficit of 4.2% of GDP. It must deal with both exchange rate depreciation and lower growth in China. Based on the DXY index, which measures how the dollar performs against a basket of currencies, and the likely trajectory of Chinese growth, Castelar estimates that in 2015 prices for Brazilian exports will fall by at least 10%, noting that "This means lower prices for non-tradable goods and services, which will reduce labor income."

"If Brazil does nothing to raise productivity, there is no way to prevent the deterioration of social indicators."

Armando Castelar

The outlook for GDP growth is not encouraging either. For the five-year period 2014–18 the Central Bank is estimating average annual increases of just 1%. "If this projection is confirmed and labor productivity continues on the same path as in recent years, an 0. 6% average, the margin left to expand employment will be only 0.4%–not enough to accommodate the growth of the economically active population, which is currently 1.4% a year," Castelar says. The result, he suggests, could be an annual 1 percentage point increase in the unemployment rate.

Mitigating the decline in income and employment will depend primarily on increasing investment and productivity. Unlike such countries as Chile and the United States, Brazil's productivity has been virtually stagnant. "Even China has reduced poverty by putting more productive people in the labor market, while we did almost nothing [to raise productivity]," Castelar says, mentioning the slow progress in upgrading infrastructure. He argues for a more progressive tax system and more care for quality in public spending as complementary policies to support Brazilian workers' incomes. "We have to make public spending more efficient. Part of the social cash transfers today go to people who are not really poor. That must be corrected," he concludes.