International
How Brazil and South Korea differ

IBRE Seminar
What's ailing health care in Brazil

Interview
Raul Velloso
Economic consultant



THE BRAZILIAN ECONOMY

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Is INCLUSIVE GROWTH being derailed?

Can Brazil resume growth without compromising its social achievements?

GETULIO VARGAS FOUNDATION

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The BRAZILIAN ECONOMY

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THE BRAZILIAN ECONOMY

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Photo: Fabio Rodrigues Pozzebom Agência Brasil

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ECONOMY

Retail sales rise after two-month decline

Retail sales bounced back in August from big declines in the preceding months, keeping hopes alive that the entire economy will soon start to recover. They rose 1.1% in August from the previous month in seasonally adjusted terms, government statistics agency IBGE said. However, year-on-year, retail sales were down 1.1% from August 2013 due to poor performance in June and July, when Brazil hosted the soccer World Cup and many stores reduced business hours. (October 15)

New jobs and unemployment both fall

New jobs created in September were 123,785, down 41% compared to September 2013, according to the Ministry of Labor. In the year to September, 904,913 new jobs were created, 32% less than in the same period in 2013. (October 15) Meanwhile, unemployment fell slightly, to 4.9% in September, according to the Brazilian Institute of Geography and Statistics (IBGE). Unemployment has been decreasing partly because with fewer jobs being created, fewer people are looking for work. (October 23)

Current account deficit widens in September

The current account deficit widened dramatically in September from US$2.8 billion in September 2013 to US$7.9 billion this year, according to the central bank. Although foreign direct investment is still robust at US$46.2 billion so far this year, it is not enough to eliminate the current account deficit. (October 24)

TRADE

EU files WTO dispute against Brazil

In the largest trade dispute against Brazil in the past 10 years, which may force Brazil to review its entire industrial policy, the European Union has asked the World Trade Organization to judge Brazil's system of tax incentives for the automobile, telecommunications, and fertilizer sectors. The EU alleges that the system is a form of subsidy for local industry. (October 31)

DEFENSE

Embraer unveils new military transport



Photo: Embraer

Emraer KC-390 military transport aircraft.

Brazilian aircraft maker Embraer has unveiled its new KC-390 military transport as it further expands into the global security and defense market. Developing the KC-390, the biggest plane Embraer has produced, cost US$1.9 billion. Embraer's goal is to sell 728 KC-390s in 77 countries, to bring in US$50 billion. The medium-size, twin-engine jet-powered aircraft can transport up to 23 tons of cargo at a maximum cruising speed of 860 kilometers (550 miles) per hour. The plane will back up military, humanitarian, and search-and-rescue missions. (October 21)

Consumer confidence again down

The main consumer-confidence index dropped in October on renewed concerns about inflation and lack of growth, the Getulio Vargas Foundation said. The index hit 101.5 points, down from 103 in September. (October 24)

Inflation slows

Brazil's annual inflation lost momentum in October but was above the official target range (2.5%–6.5%), increasing the risk that the central bank goal will overshoot its 2014 goal for the first time in more than a decade. Consumer prices rose 6.59% in the 12 months through October, easing from 6.75% in September. Consumer prices rose 0.42% in October, compared with 0.57% in September. Smaller increases in food and transportation prices helped bring down inflation, but an announced fuel price increase is likely to drive it up again in November. (November 7)

ECONOMIC POLICY

Government to renegotiate loans to BNDES

The Treasury will renegotiate R$130 billion of loans to the National Development Bank (BNDES), according to Broadcast Agência Estado, to give BNDES more time to start paying the loans off. The renegotiation will increase the bank's cash flow and reduce the need for any new Treasury injection of funds this year. (October 14)

Electricity rates going up

The National Electric Energy Agency has raised electricity rates 17.63% for consumers and an average of 18.20% for industry. The increases reflect the rising cost of production as a devastating drought reduced

the reservoirs of hydroelectric plants, shifting production to more expensive thermal plants. (October 21)

Central bank raises interest rates

Against expectations, the central bank has hiked the policy interest rate by 25 basis points, to 11.25%. The 5-3 votes to raise rates indicate dissent over the decision. The statement released after the meeting said that because "the intensification of relative price adjustments has made the balance of inflation risks less favorable … the Committee considered it appropriate to adjust monetary conditions to ensure, at a lower cost, the likelihood of a more benign outlook for inflation in 2015 and 2016." The bank added that it is now "especially vigilant" for signs that inflation may spread to new parts of the economy. (October 29 and November 6)

Budget deficit widens

In September the budget deficit widened to R$69.4 billion (US$28.4 billion) due to less economic activity, falling revenue, and rising investments. (October 31)

Fuel prices up

State-run oil company Petrobras has raised wholesale gasoline prices by 3% and diesel prices by 5%, the first hike in nearly a year. (November 7)

Administration to reduce public spending

Departing Finance Minister Guido Mantega said the administration is working on a plan to reduce public spending that would among other things reduce subsidies for loans made by Brazil's development bank. Most BNDES funding comes from the National Treasury. Mantega said no tax increases are yet being considered. The goal, he said, is to reduce spending quickly; long-term measures may be discussed later. (November 7)

Rousseff vows to trim budget, curb inflation

In an interview published in several leading newspapers, her first since her re-election on October 26, President Rousseff promised to move to reinvigorate Brazil's economy. "We will reinforce inflation controls and will keep our spending within budget restrictions," she said. Rousseff vowed that all government spending would be put "under a magnifying glass" as her administration seeks places to cut. She also said she would announce her new economy minister after this month's summit of G20 leaders in Australia. (November 7)

POLITICS

Rousseff: Narrow win, broad challenges

President Dilma Rousseff has vowed to reconcile Brazil, reboot the economy, and fight corruption after the most divisive race since the return to democracy in 1985. Rousseff took 51.6% of the vote to 48.4% for pro-business Aécio Neves in a run-off election. In his concession speech, Neves said unifying Brazil was Rousseff's main challenge. After a bitter campaign that split the country between the poor north and the wealthier south, Rousseff picked up enough middle-class votes in the industrialized southeast to cement a fourth straight win for the Workers' Party (PT). When her second term starts on January 1, she must govern a polarized country, win back the confidence of markets and investors, revive a stagnant economy, and tackle corruption. She has promised to listen to voters' demands for change—"This is the top priority of my second term," she said. (October 27)



Photo: Fabio Rodrigues Pozzebom. Agencia Brasil

Reelected President Rousseff has many challenges ahead

DICOM

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Stop? Or go?

WITH THE ELECTION OVER, there is consensus among analysts that the social achievements of reduced poverty and inclusion of millions of Brazilians into the consumer market can only be sustained if the economy grows. The question is, will that happen?

Public finances are clearly in bad shape. Public financing needs shot up from 2.5 % of GDP in 2012 to about 6% in 2014 and in September 2013 total gross public debt hit 62% of GDP.

The president has vowed to fight inflation and curb the public deficit, and departing Finance Minister Mantega has said the government is working on a plan to reduce public spending by, e.g., reducing subsidies to loans made by Brazil's development bank. The central bank has unexpectedly raised interest rates by 0.25 percentage points, and electricity rates and fuel prices have been adjusted. These are encouraging signs that the administration may be serious about tackling Brazil's large economic imbalances.

But there is no consensus on how severe the adjustment must be in order to restart the economy. On November 7, more than 700 economists signed an online manifesto criticizing the idea that fiscal and monetary austerity is the only way to solve Brazil's problems. These economists consider it "essential to keep interest rates low and announce a tax regime committed to the resumption of growth, delaying tightening measures, if necessary, until the economy resumes growth."

The president is convinced that her policies are correct. In an interview after the elections, she said that she would not tighten policies as much as the opposition said and would maintain employment and income. She is likely to make only enough economic adjustments to allow a return to spending on social programs and infrastructure. However, if the government persists with the current policies, Brazil's economic imbalances are likely to worsen. Eventually the administration will have to take even more severe measures to correct the imbalances. We would be back to the stop-and-go policies of the turbulent early 1960s and after the first oil shock in 1974, with disastrous results for the economy—and for Brazilians.

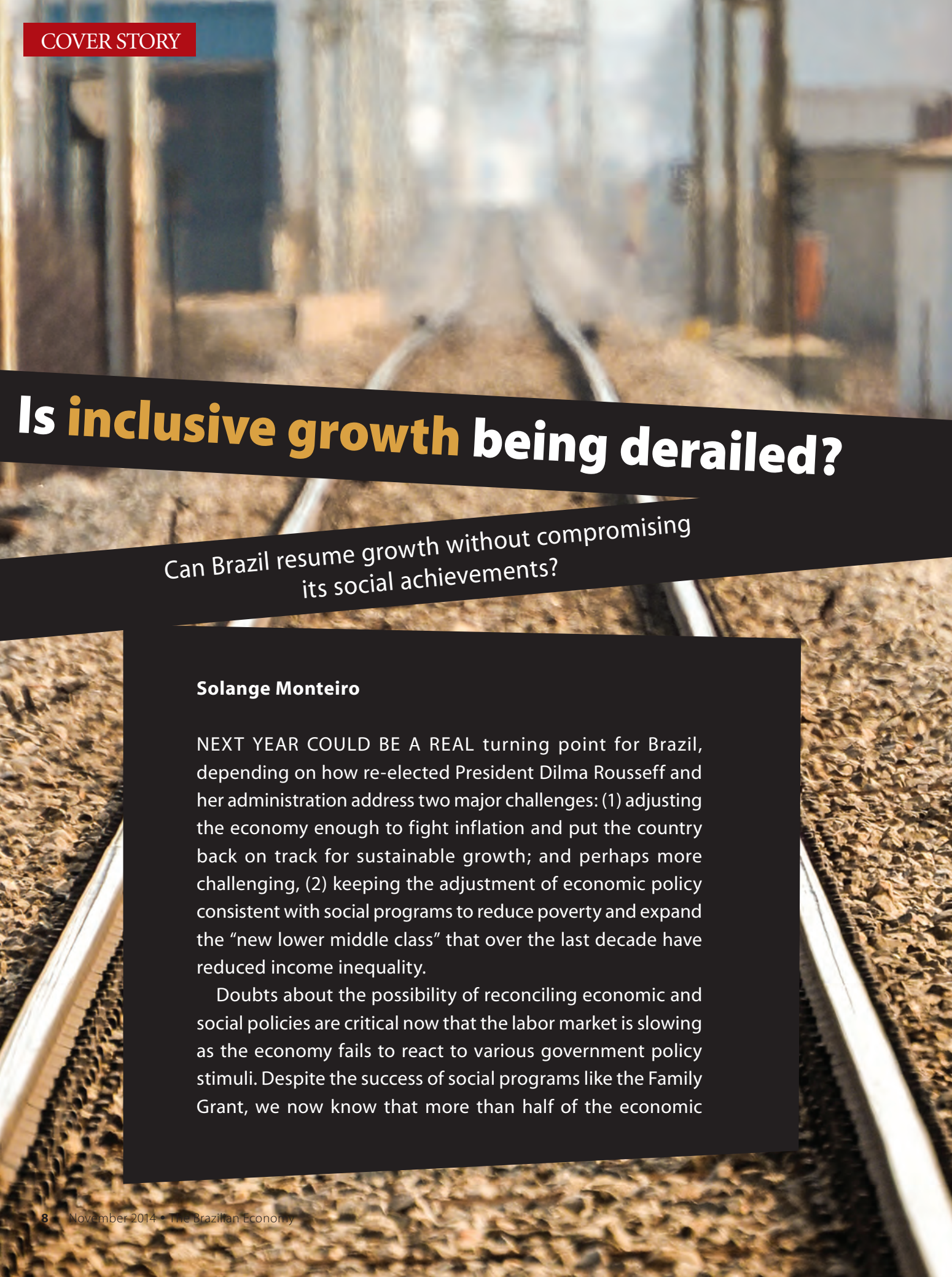
Also, President Rousseff clearly favors government-led growth. However, it will be extremely hard to restart the economy without private investment. The government infrastructure investment program alone is too small to pull the economy out of stagnation.

To restart the economy, the administration must balance adjustment measures, such as eliminating tax exemptions and subsidized loans, with encouragement to the private sector to invest in the economy.

To restart the economy, the administration must balance adjustment measures, such as eliminating tax exemptions and subsidized loans, with encouragement to the private sector to invest in the economy.

To give the private sector confidence, the administration needs to make better governance a priority. The country should not be subjected to every fancy of the markets or every whim of the government of the day. Government credibility must be built on respected institutions and good governance, not on the names of ministers.

As economist Raul Velloso correctly points out in this month's interview, we first need a credible estimate of the federal fiscal situation. To make the budget deficit more transparent and therefore more credible, Brazil needs an independent agency like the U.S. Congressional Budget Office that could help restore the credibility of the country's fiscal accounts. Supported by improvements in the business climate and more independent regulatory agencies, that could pave the way to gradual adjustment of the economy.



Is inclusive growth being derailed?

Can Brazil resume growth without compromising its social achievements?

Solange Monteiro

NEXT YEAR COULD BE A REAL turning point for Brazil, depending on how re-elected President Dilma Rousseff and her administration address two major challenges: (1) adjusting the economy enough to fight inflation and put the country back on track for sustainable growth; and perhaps more challenging, (2) keeping the adjustment of economic policy consistent with social programs to reduce poverty and expand the "new lower middle class" that over the last decade have reduced income inequality.

Doubts about the possibility of reconciling economic and social policies are critical now that the labor market is slowing as the economy fails to react to various government policy stimuli. Despite the success of social programs like the Family Grant, we now know that more than half of the economic

inclusion of poorer Brazilians in the last decade was because they were earning more. Between 2002 and 2012, Brazil's middle class increased by 35 million people, from 38% to 53% of the total population, as per capita family income of R$3,492 rose to R$12,228 at 2012 prices. Thanks mainly to rising real wages, the per capita income of the poorest 10% rose by 7.3% a year—3.5 times the growth recorded for the richest 10%. "The income of rich Brazilians grew like the Swedes, and the income of poor Brazilians like the Chinese," notes Ricardo Paes de Barros, undersecretary of the Strategic Affairs Secretariat (SAE) of the Presidency.

This social transformation, Barros explains, was the result of integrating the poor into the modern economy by reducing informal labor and providing credit. He admits, however, that this social change will be worth little if the Brazilian economy remains stagnant. "Today, the most important social policy for the country is economic policy, because sustaining the economic inclusiveness of the poor depends on solid growth," he says. To achieve solid growth, the economy must become more productive; in recent years growth in productivity has lagged behind wage increases. To encourage productivity Brazil needs an attractive environment for investment, incentives for innovation, and continuous improvement of education so that young people are prepared to meet the demand for more skilled labor and thus earn higher wages.

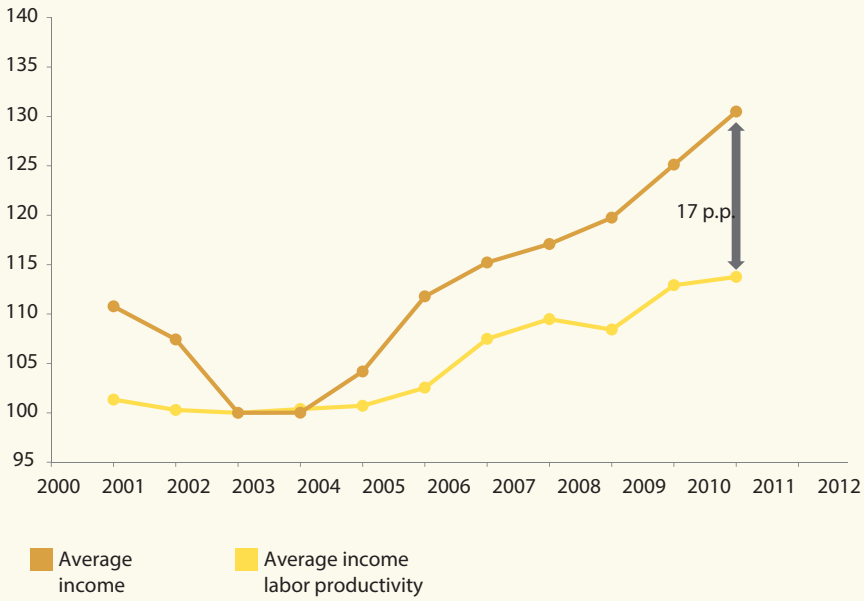
Doubts about the possibility of reconciling economic and social policies are critical now that the labor market is slowing as the economy fails to react to various government policy stimuli.

Between 2002 and 2012
35 million
of Brazilians joined the middle class, which today is **53%** of the population.



Brazil's gap between income and productivity widened in 2001-2011.

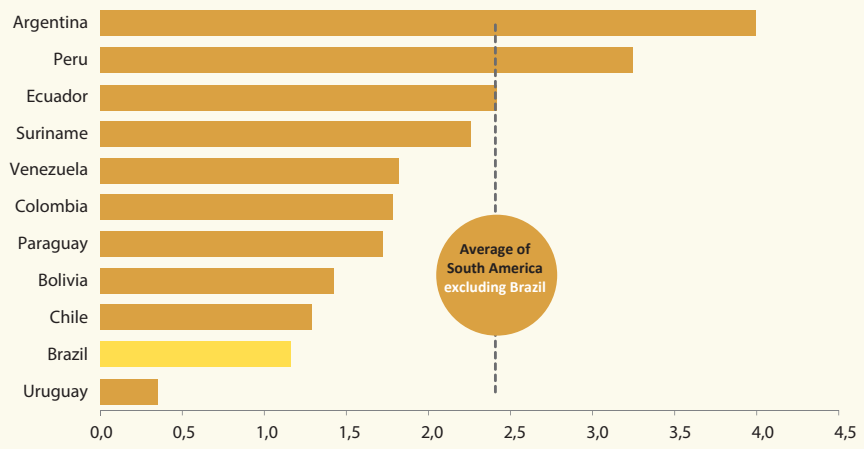
(Indexes 2003 = 100)



Source: Secretary of Strategic Studies of the Presidency.

Growth in Brazil's labor productivity is among the lowest in South America.

(Average 2001-2011)



Source: Secretary of Strategic Studies of the Presidency.

Anemic productivity

Brazilian productivity has not increased significantly since the early 1980s. At that time productivity growth in Brazil was about the same as in South Korea, but today productivity in South Korea is growing four times faster than in Brazil. Between 2001 and 2011, Brazil's productivity rose only slightly more than 1%; the average for all South American countries was 2.4%.

Silvia Matos, Brazilian Institute of Economics (IBRE) researcher, points out that between 2003 and 2012 Brazil's productivity growth was mainly due to the agricultural and finance sectors. As Matos explains, "Agriculture recorded 6.2% productivity growth during this period because its comparative advantage [in terms of natural resources] and the high price of commodities during that the period were a strong incentive to adopt technology" to raise productivity. Financial intermediation and insurance recorded productivity growth of 5.7%. However, services, which are characterized by intensive labor, averaged only 1.7% productivity growth; transport productivity grew 0.6% in the period, and information services productivity actually declined 0.2%.

The productivity of services seems to have reached its limit—today its productivity growth

"Today, the most important social policy for the country is economic policy, because sustaining the economic inclusiveness of the poor depends on solid growth."

Ricardo Paes de Barros

is less than 1%. Matos points out that this makes it harder to heighten growth generally because in Brazil services are responsible for 68% of value added and 63% of employment. "The low productivity of services reflects low worker skills," she says. Using the United States as an example, she noted that "when the country moved from an industrial economy to a service economy in the 1990s, there was no decline in productivity. This is the example Brazil should follow," adding that "To raise productivity, either we attract skilled immigrants, or invest in technology. Otherwise, our growth potential will be reduced."

Possible path

In the short term, Matos believes that the necessary economic adjustment will inevitably reduce employment and wages, explaining that "If productivity does increase as a result of innovation and enhanced skilled labor, it will not be possible to completely protect jobs and income without compromising the profitability of companies."

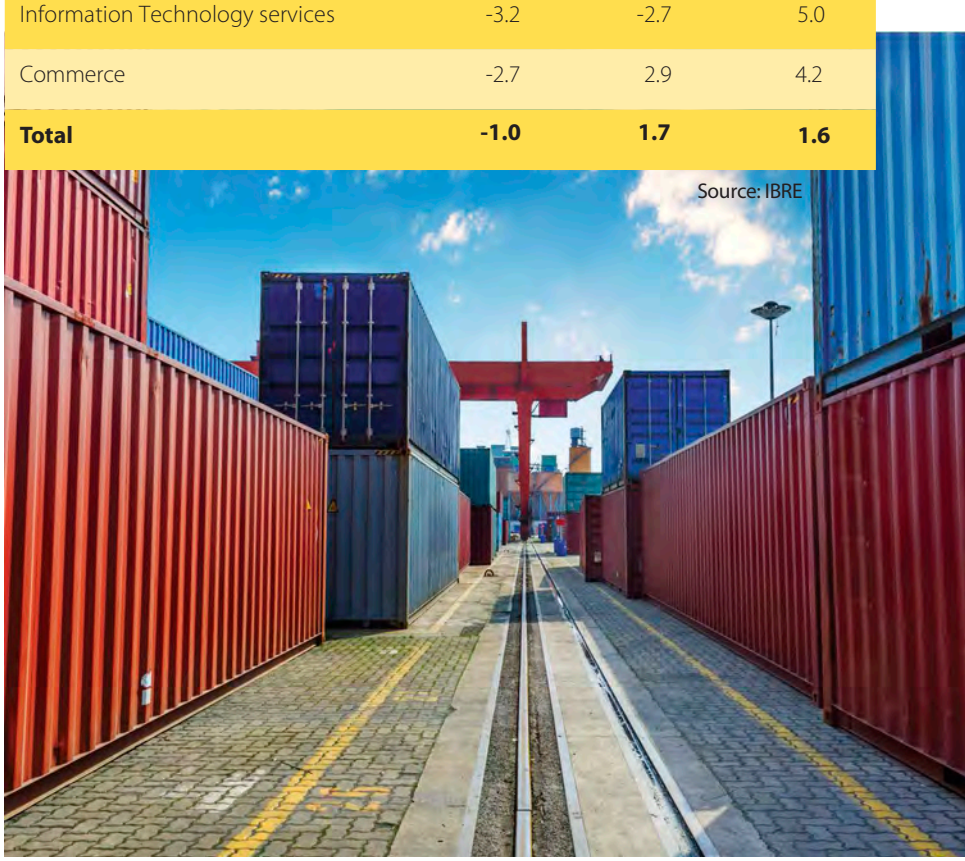
Lack of profitability, incidentally, is the major obstacle that prevents companies from investing in fixed capital, which is essential for increasing productivity. In the past three years, companies operating in Brazil have seen their profits plunge.

Productivity of services in general is low in Brazil.

(% change)

	1995-2003	2003-2009	2009-2012
Transportation, storage and postal	-1.4	1.5	-1.2
Financial services and insurance	-2.2	7.3	2.6
Information Technology services	-3.2	-2.7	5.0
Commerce	-2.7	2.9	4.2
Total	**-1.0**	**1.7**	**1.6**

Source: IBRE



Source: Tooykrub/Shutterstock.com

Today productivity in South Korea is growing four times faster than in Brazil. Between 2001 and 2011, Brazil's productivity rose only slightly more than 1%; the average for all South American countries was 2.4%.



A survey of **700** Brazilian companies shows that return on equity fell from **16.4%** in 2010 to **7,1%** in 2013

A survey of more than 700 non-financial companies showed that their return on equity fell from 16.4% in 2010 to 7.1% in 2013. With less net income to retain, companies have lost a major source of investment financing. Carlos Rocca, director of the Center for the Study of Capital Markets of the Brazilian Institute of Capital Markets, says the main problem has been higher unit labor costs that could not be passed on to the consumer because of competition from cheaper imported products. "Despite the devaluation of the exchange rate, the prices of imported goods in domestic currency increased less than the cost of labor," says Rocca. Moreover, services companies were not able to pass on the higher cost of labor because the government controlled the prices of many services.

Rocca also points out that the rate of return on investment in fixed capital fell from 13.7% in 2010 to 8.1% last year. "In the last two years the rate of return on fixed investment was below the financial cost to companies, which discourages investment in fixed capital," he says. Between 2010 and 2013, companies' investment in fixed capital fell from 9.1% of GDP to 5.8%. "I see little reason for companies to invest in fixed capital until there is a resumption of growth," he concludes.

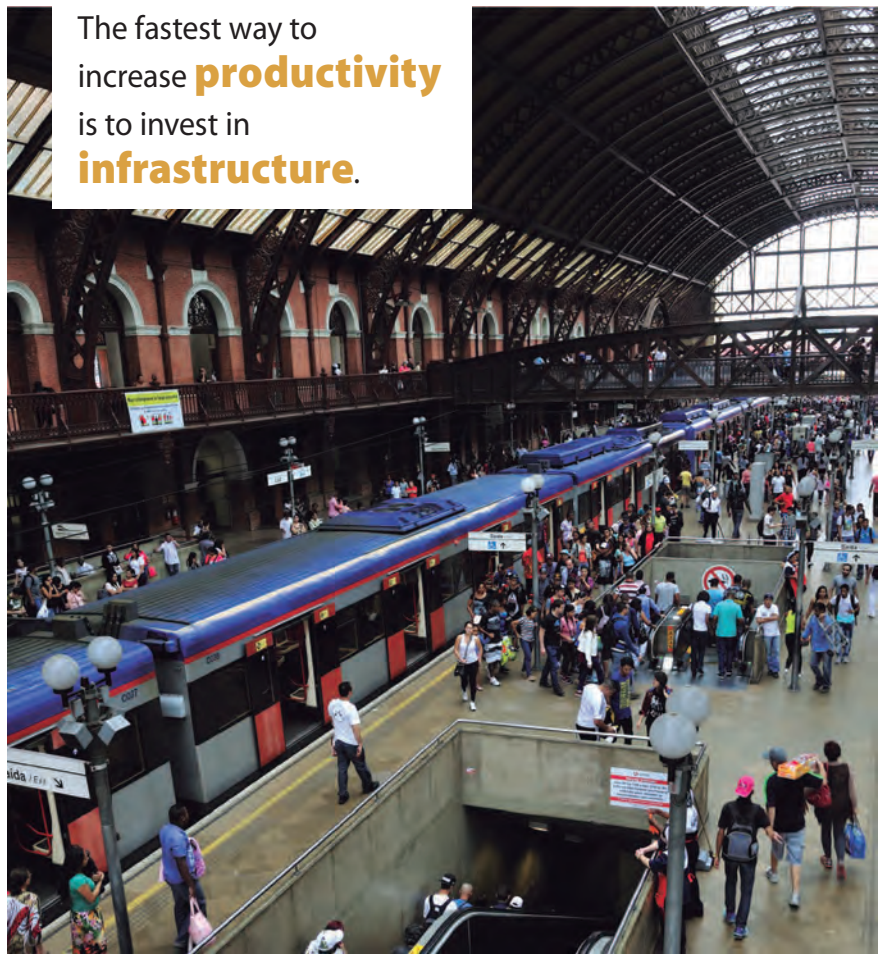
IBRE economist Regis Bonelli believes that the fastest way to generate significant impact on Brazilian productivity is persistent investment in infrastructure. Over time, he says, "These investments could generate a positive demand shock. In the case of transport infrastructure, such investments promote a more dynamic economy." Rocca agrees, but is concerned that because of the fiscal deficit the government does not have the resources to invest in infrastructure. Consequently, he believes, it is necessary "to create all possible conditions to attract private investors" in infrastructure.

"To raise productivity, either we attract skilled immigrants, or invest in technology. Otherwise, our growth potential will be reduced."

Silvia Matos

Matos points out that it is also important to raise productivity in services. "Today policies focus mainly on industry; they do not consider the weight of the service sector in the economy," she says. She sees a great potential to increase productivity particularly in education, health, transport, and trade.

The fastest way to increase **productivity** is to invest in **infrastructure**.



"Despite the devaluation of the exchange rate, the prices of imported goods in domestic currency increased less than the cost of labor."

Carlos Rocca

Why has Brazilian R&D STAGNATED?

Solange Monteiro

FUNDAMENTAL FOR RAISING productivity in general and labor productivity in particular is adopting new technologies. Yet the 2011 Survey on Innovation conducted by government statistics agency IBGE shows that in Brazil spending on research and development (R&D) has been stalled since 2005; in 2011 it accounted for just 0.59% of GDP, compared with 1.83% of GDP in the United States.

Industry, which accounts for over 70% of business R&D, is the focus of government programs to stimulate innovation. Paulo Mol, director of innovation of the National Confederation of Industries (CNI), believes that such programs have improved. He says, "The success of initiatives such as the Inova Empresa—the innovation program established in 2013 with funding of US$13 billion to support companies working on innovative projects—and the Brazilian Agency for Industrial Research and Innovation have made it possible to undertake more complex projects."

"The success of initiatives such as the Inova Empresa and the Brazilian Agency for Industrial Research and Innovation have made it possible to undertake more complex projects."

Paulo Mol

He and other experts point out, however, that government support for innovation is still procyclical. "Today," Mol says, "we have a policy that offers incentives to companies when the economy is doing well, which is just when the private sector would be willing to invest." He adds that "One of the concerns is that the large Brazilian fiscal deficits force budget cuts on grants that finance complex long-term innovation projects."

Mol cites as another problematic example the Good Law of 2004, which authorizes tax rebates for expenses incurred for innovation. The problem is that in periods when companies do not have profits, they cannot benefit from the law. "We should create a tax credit so that expenditures could be recovered

over two or four years," he argues. That would allow companies to continue to invest in innovation regardless of economic conditions.

The barrier of protectionism

According to Mauricio Canêdo Pinheiro, IBRE researcher, a major barrier to adoption of new technologies is excessive protection of the domestic market. "With a relatively closed economy and a guaranteed market, there is no incentive to invest in technology and innovation," he says. "No multinational company will transfer its best technology to another country if that is not essential to increase its market share and profits," he adds. The lack of openness in the Brazilian economy is reflected in the low level of imports of production components. Diversification of the supply of inputs would help raise productivity and competitiveness, Pinheiro says, noting that "In 2011, only 13.5% of the intermediate inputs of Brazilian manufacturing were imported, while the United States imported 20% and Mexico 30%.,"

Carlos Arruda, manager of the Center for Innovation and Entrepreneurship at the Dom Cabral Foundation, believes that the technological gap is the result of a business culture in which innovation is a low priority. Arruda explains that "Because companies are dominated by a short-term view, they do not develop products with higher added-value. Their pursuit of lower sunk costs turns them away from developing new products and expanding markets." In a Don Cabral Foundation survey, he found that "most of the entrepreneurs said their strategy was to remain in the same market, reducing costs and increasing efficiency."

On the one hand, industry's concern with productivity gains has led some firms to reduce

"Because companies are dominated by a short-term view, they do not develop products with higher added-value. Their pursuit of lower sunk costs turns them away from developing new products and expanding markets."

Carlos Arruda

deficiencies that affect their supply chain as a whole. "Examples include Embraer, which has a training program for suppliers, and Massey Ferguson, which has invested in improving the performance of providers of after-sales services for the company," Arruda says. On the other hand, the culture of seeking efficiency gains helps to accentuate the negative view among international corporations established in Brazil that do not to identify the country as a potential hub for R&D. "Apart from segments such as ethanol and agribusiness, which are well-regarded internationally, the prevailing image is that Brazil has no universities that are internationally recognized and exports few products with higher-added value," he says. International corporations view Brazil only as a market for selling their products rather than as a potential center for R&D. He concludes that "Brazilian leaders have to work to place Brazil more prominently in the strategic plans of these international corporations."

Can Brazilians be educated out of POVERTY?

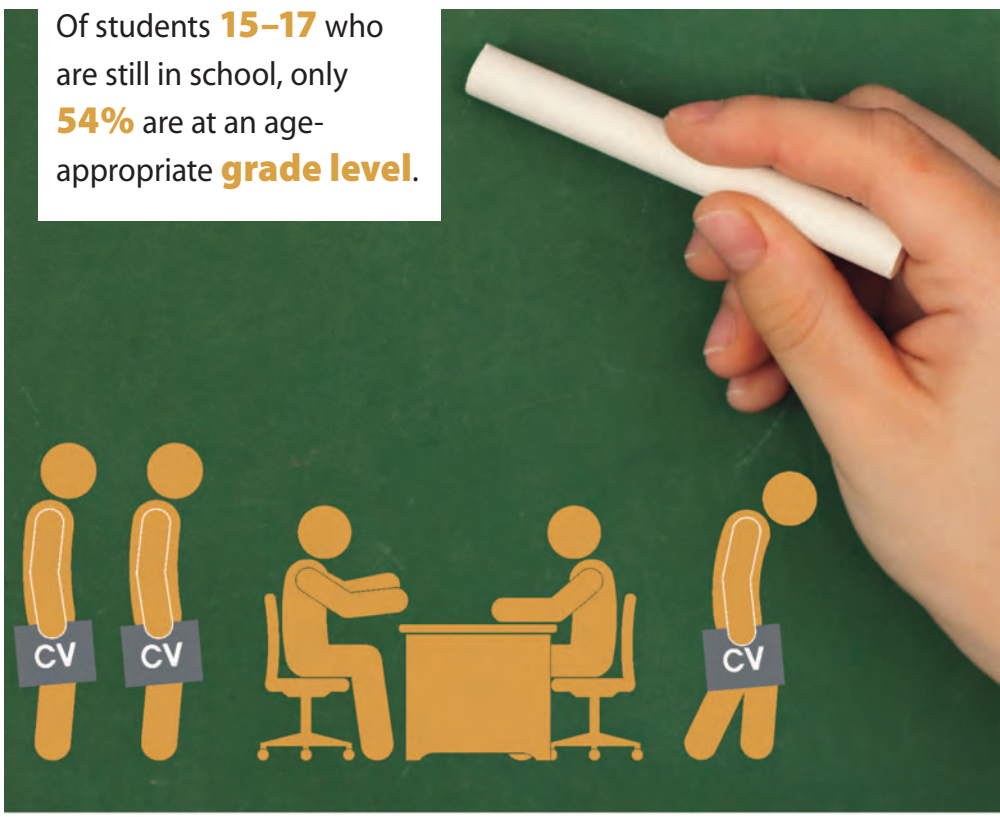
Solange Monteiro

OF ALL THE POLICIES to ensure inclusive growth in Brazil, improvement in education is the most essential. The increase in school enrollment that occurred in the last two decades has already brought significant gains for the Brazilian economy. Fernando de Holanda Barbosa Filho and Rodrigo Leandro de Moura, Brazilian Institute of Economics researchers, estimate that between 2002 and 2012 workers being more educated reduced informal work by 45%.

However, the country has failed to keep on improving education. According to Leandro de Moura, "From 1990 to 2000, schooling of the population grew 42% to 6.4 years of study; from 2000 to 2010, years of schooling rose only by 17%, to 7.5 years."

Ricardo Paes de Barros, undersecretary of strategic affairs for the Presidency, says the lack of motivation to gain more education has many aspects; for example, recently it has been more difficult for the poor to find jobs. Today, less-educated people face a very different job market than in the last decade, when they had above-average income increases.

Of students **15–17** who are still in school, only **54%** are at an age-appropriate **grade level**.



From 2001 to 2011, wages of unskilled workers grew by about 40%, compared to 15% for the average-skilled and 5% for the highly-skilled. "Today," he says, "the Brazilian job market is not able to absorb workers with little education."

The greatest challenge is to overcome functional illiteracy, which affects about 18% of the population and is considered one of the reasons that young low-income adults drop their studies. Raquel Alvez Pereira, supervisor of CETEP Ipanema, a technical school maintained by the Rio de Janeiro Department of Science and Technology, is thoroughly familiar with the problem. CETEP offers free continuing education courses in IT networks, languages for tourism services, and administrative assistance. Initially it was targeted to about 11,000 residents of low-income areas, but "enrollment of this population has been no more than 30%," Pereira says; the others enrolling are people who work near the school. However, "though enrollment often surpasses the 2,500 spaces we have available, only 1,500 at most actually complete a course," she says. Along the way many students stumble on their own lack of preparation and quit. Pereira points out that "It is difficult, for example, to explain the use of an Excel spreadsheet to those who have difficulty with the four basic math operations." The school does have classes in Portuguese and math for students who need them.



Rio de Janeiro
Photo: Marchello74/Shutterstock.com

In Brazil, **85%** of the richest students finish high school but only **28%** of the poorest, for a national average of **58%**.



Squandered bonus

School dropout is even more worrying when those dropping out are younger, 15–17 years. In this age group, school dropouts reach 20%—1.5 million youngsters. "For any country that aspires to be developed in the near future, this age group should be studying like crazy,

"Today, the Brazilian job market is not able to absorb workers with little education."

Ricardo Paes de Barros

full-time," says Paes de Barros. He believes the country is at risk of wasting its demographic bonus. Between 2003 and 2023, he estimates, the share of Brazilians aged 15–29 years will be at its peak of about 50 million. "Due to dropouts, Brazil will have the largest workforce of all time with an educational deficit that is difficult to fix; this will create a group of adults who may not be incorporated into the modern economy. This is very serious." The National Education Plan (PNE) set the goal of 100% school attendance for this age group by 2016, which now seems a Herculean challenge.

There are other education deficiencies. Of students 15–17 who are still in school, only 54% are at an age-appropriate grade level. The PNE goal is for 85% to be at an age-appropriate level by 2024. At 3.7 in 2013 the Index of Basic Education Development (IDEB) had not budged since 2011;

Between 2003 and 2023, the share of Brazilians aged **15–29 years** will be at its peak of about **50 million**.



Rio de Janeiro

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the Ministry of Education target was 3.9 (out of a high of 10). Furthermore, an Inter-American Development Bank study published in June revealed that, in Brazil, 85% of the richest students finish high school but only 28% of the poorest, for a national average of 58%.

"The Brazilian educational goal—which we are not meeting—is to reach the level of OECD countries with a 15-year delay," Paes de Barros says. "We already have in several cities schools in underprivileged communities that meet the current goal of the OECD, in which students attend school at age-appropriate grade levels. That means we know how to do it. We just need to know how to disseminate best practices and create appropriate incentives."

Joining forces

Alejandra Velasco, general coordinator of the movement All for Education, says, "We should begin [by improving] the quality of basic education, which currently frustrates students and leads them to dislike school." She points out that basic education was the center of attention in Sobral city in Ceará state, where half the population is poor. The city carried out an illiteracy eradication program based on assessment of student performance, teachers' training, and incentives to teachers to meet set goals. It has already achieved the 2021 IDEB goal of 6.1 points. Ceará state provides Sobral with resources to pay bonuses to the best-performing teachers. In 2007, the Sobral program was extended to all of Ceará state. It has also inspired the creation of a federal program, National Literacy at the Proper Age.

Fernando Veloso, IBRE researcher, underscores the importance in successful cases of coordinating efforts at different levels of government to improve management. "This is particularly important in the case of small municipalities that cannot obtain resources because they are not able to develop high-quality educational projects," he says.

"It is difficult to explain the use of an Excel spreadsheet to those who have difficulty with the four basic math operations."

Raquel Alvez Pereira

Velasco advocates a system of transfers and subsidies for schools and teachers in poor areas. "Since more remote schools generally do not have enough equipment or a decent library, they are unlikely to attract the best teachers. In the end, those who accept the positions are generally younger teachers with little experience, who are already thinking about a future transfer," she says.

Experts support the expansion of vocational education in high schools —Brazil accounts for less than half of the vocational enrollment of Chile —as well as more flexible curricula. "Today high school education is too rigid," Veloso says. "In successful countries there is a broader offering of subjects to accommodate a variety of interests and attract the attention of the young."

Velasco points out, however, that decisions need to be made faster, noting that "The National Education Plan took about four years to be approved." Paes de Barros agrees: "We are far behind. We must do everything possible to accelerate progress in education."

How Brazil's taxes affect the poor

The Brazilian tax system does little, if anything, to reduce income inequality.

Solange Monteiro

BRAZIL'S HIGH TAX BURDEN is in the news every day. In theory, high taxes are necessary to pay for cash transfers aimed at reducing income inequality. However, these transfers have been less efficient than expected: it is estimated that less than one-third of the transfers actually reach the relatively poor. The remainder is the "tax-welfare churn": what the government takes from a taxpayer with one hand it gives with the other to the same taxpayer.

"Brazil has today the same Gini coefficient [which measures the concentration of income] as in 1960, 0.53, yet the tax burden is 17% of GDP. This means that today, although we mobilize more than twice the resources, we maintain the same degree of inequality," says Rozane Bezerra de Siqueira, economist at the Federal University of Pernambuco.

"Brazil has today the same Gini coefficient as in 1960, 0.53, yet the tax burden is 17% of GDP. This means that today we mobilize more than twice the resources yet maintain the same degree of inequality."

Rozane Bezerra de Siqueira

Siqueira compared the impact on household income at different stages of cash transfers (Family Grant, family wage, salary bonuses, unemployment insurance, and benefits to the elderly and disabled); direct taxes (income taxation of individuals and social security contributions); and indirect taxes (taxes on goods and services less subsidies). She found that social transfers reduce income inequality measured by the Gini by 6 percentage points; direct taxes reduce inequality further by 2 points; but indirect taxes increase inequality by 3 points. In sum, the impact of taxes on inequality is just 5 points. "In the UK, consumption taxes also increase inequality, by 4 percentage points, but the weight of transfers is higher, and total impact on inequality is 14 percentage points. In the European Union, transfers and taxes reduce inequality by 20 percentage points," she says.

Nora Lustig, professor at Tulane University in the U.S., is director of the Commitment to Equity

Project, which is analyzing the impact of taxes, transfers, and other public spending on inequality and poverty in 32 countries. She believes the most troubling issue in Brazil is the weight of indirect taxes on the basic consumer basket. "The taxes on consumption nullify the effect of cash transfers on poverty reduction," she says.

Nevertheless, Lustig says, Brazil still redistributes more income than the Latin American average, through such nonmonetary transfers as free health and education services. Among emerging nations, only South Africa surpasses Brazil. But even with massive transfers, she says, Brazil remains one of the most unequal countries in the world.

Simple and clear

Because indirect taxes are regressive, they are often mentioned as a candidate for reform to increase the redistributive impact of the tax system. Siqueira, however, emphasizes that "indirect taxes account for a large part of the tax collection, 48%. To reduce indirect taxes would require increasing tax income [in other ways], which does not sound feasible." Nor does she support tax exemption policies. "It is a difficult alternative for a complex tax system as Brazil's, with different tax rates and tax collection systems, which also has ripple effects," she says. She believes that the priority should be a broad tax reform that would create a value-added tax (VAT) with just a few rates, in order to bring simplicity and transparency to the system.

Since such a major change in the tax system is not feasible in the short term, Siqueira suggests a move to a more progressive tax system. José Roberto Afonso, IBRE researcher, recommends more selective indirect taxation. "The Constitution provides that the ICMS and IPI have different rates for essential goods," he notes. "The problem is that the IPI was practically abolished and the ICMS is distorted by the tax war between Brazilian states. Most of the products involved in this war are not consumed by the poor."

"The taxes on consumption nullify the effect of cash transfers on poverty reduction."

Nora Lustig

Afonso advocates a tax on assets as a way to reduce the burden of regressive taxes. He says the collection of property tax has lost ground to other taxes, such as those on services, which also burden the poor. He explains that "Mayors generally avoid unpopular increases in property taxes because they are already collecting a lot from the tax on services, which is a tax that people pay without noticing. What we do not say is that the property tax is fairer than the tax on services because properties of low value are exempt."

There are other important issues that need to be evaluated. The first is the quality of public spending. "There is a huge lack of knowledge, and interest about who spends and how," Afonso says. The second is the need to reform the pension system. Today, 15% of GDP goes to public assistance transfers and 11% to pensions. Siqueira believes that part of these funds should be directed to other purposes to achieve a larger redistributive effect, pointing out that "Investing in infrastructure contributes to sustainable growth."

Photo: Cristiano Costa



The elusive reforms

Raul Velloso

Economic consultant

Solange Monteiro

THE INTENSE EXPECTATIONS that await re-elected President Rousseff's announcement of her economic team stem from the desire of markets to know how the president plans to put the country on a path to sustainable growth. Former Secretary of Economic Affairs of the Ministry of Planning Raul Velloso has been skeptical about the president's initial statements, which were replete with ambiguous words like 'change' and 'dialogue.' A close observer of the government, Velloso—an economic consultant since he left his government post in 1991—is particularly concerned about Brazil's fiscal situation. Here he analyzes how Rousseff's first administration managed the economy, emphasizes the need for a credible estimate of the federal fiscal situation, and advocates changing fiscal policy from stimulating consumption to promoting fixed investment. "Everything indicates that the government thinks it can push the situation to its limit. But if the opposition is arming to fight its proposals, we will have daily clashes as in the election campaign," he said.

***The Brazilian Economy*—With the economy still stagnant, what do you think the second Rousseff administration priorities should be to restore the confidence business lost in 2014?**

Raul Velloso—A serious problem is the looming fiscal crisis, which was asleep waiting for the election outcome. Now the crisis must be confronted. First, we need a credible estimate of the government's fiscal situation. It is difficult to suggest things unless we believe that a change in policy is possible—something that I personally do not believe. If we look at what has happened with revenue and expenditure recently, we

see that the fiscal situation has deteriorated, and now the crisis is imminent. … The Lula administration was in a very comfortable fiscal situation, because from 2004 to 2008 both revenue and expenditure grew at the same high rates, which preserved the fiscal surplus inherited from the Cardoso administration and reduced the debt-to-GDP ratio. After 2009 revenues fell but spending kept growing at 9%. The Lula administration decided to continue the fiscal stimulus and let public spending grow, arguing that restraining it would accentuate the recession.

Could we have phased out the fiscal stimulus?

At that moment, perhaps the government should have explained what it would do. One alternative was for it to hold down expenditure and wait for revenues to recover after economic growth resumed. … The government ignored the issue and kept public spending growing. As a result, the budget surplus fell and markets began to get restless, but the government instead initiated a program of tax cuts that has been reducing revenues ever since. Eventually, public spending declined, but not because the government took concrete measures to control expenses. In the 12 months through August, public spending growth slowed to 7% because part of the spending is pegged to the minimum wage, and adjustments to it have slowed with GDP growth. Meanwhile, revenues, excluding extraordinary revenues, grew by only 1%. … I think President Rousseff first has to say what she will do to turn this situation around, [so we can see] whether the government will be able to change current economic policy.

How would you describe current economic policy?

Current policy is mainly based on three pillars. First is expanding consumption at any cost, especially more public spending on transfers and expansion of credit. Second is protecting industry to compensate for losses from wages rising above productivity and competition from imported goods. Last is tariff populism: the government wants the private sector to invest in infrastructure, despite low returns, and to charge the lowest imaginable tariffs.

"If we look at what has happened with revenue and expenditure recently, we see that the fiscal situation has deteriorated. Now the crisis is imminent."

After the election, the president said she had been re-elected to make big changes and would seek to advance fiscal responsibility. Would that be a positive sign?

I do not see it that way. The fiscal irresponsibility that has been around for some years is the result of the current policy and the lack of GDP growth. Everything indicates that the government thinks it can push the situation to its limit. But … we will likely have a daily clash as in the election campaign: When the president suggests a change, the opposition will raise questions. Today we already see markets going wild. Soon the turmoil may reach inflation, interest rates, further economic slowdown, further worsening of the fiscal situation, and downgrading by international rating agencies. There are great expectations for policy changes. If there are none, the government will be bombarded.

"President Rousseff first has to say what she will do to turn this situation around, [so we can see] whether the government will be able to change current economic policy."

Does the recovery of investment depend on these changes?

In general, entrepreneurs wonder whether the current policy is sustainable, whether consumption growth is sustainable. Today the consensus is that it is not. This is already a barrier to higher investment. …

Moreover, the natural tendency of a policy to promote consumption is to make service prices rise relative to industrial prices, which attracts investments in services at the expense of the industrial sector. … In recent years service prices grew by 9% and industry prices by 2–3%. No wonder industry is shrinking. That's why the Rousseff administration began granting tax exemptions and other measures to support industry. Actually, the government is taking resources from the economy to give to industry, even though it is shrinking. … The government does not see that its goals are in conflict. It cannot at the same time achieve low tariffs and large-scale private investment. That just won't happen.

Some people argue that the Brazilian social contract endorsed in the 1988 Constitution promotes transfers to low-income households, reducing savings to finance investment and promote growth. Do you agree?

I have a different view: It's easy to say a social contract was made, but it has never actually been spelled out and approved by actors who are well informed about its implications. This policy, what they call the social contract and I call a public spending growth policy, was not well understood by anyone. A policy of public spending growth leads to economic stagnation and large tax increases. No one who was involved in the Constitutional Reform of 1988—and I was involved in it intensely—was able to evaluate at the time how it would affect economic growth and the tax burden. I do not know if the people who voted for the Constitution Reform would have done so if they knew the consequences. I have done a study with colleagues showing that public spending on pensions, social assistance, and personnel now accounts for 73% of total public expenditure—nearly the entire budget—and almost nobody realizes that. If we do not reform, our projections indicate that public spending will double by 2040 as a percentage of GDP. That would require an unimaginable tax hike.

But if public spending is determined by the Constitution, any president would have little room to cut spending without effective constitutional reform?

It is complicated because you have to create a political environment to make it possible to discuss these issues, show [what will happen] to society, and create the conditions to do the reforms. I do not know if a government that has just been re-elected with a small margin of votes would be able to do something. … Given the situation, the only way for the country to grow is to attract foreign savings. We have many dilemmas, and maybe that's the biggest. But we

cannot regard the social contract as immutable. … I believe we should approach the problem as follows: a constitutional change was made that seemed good at the time, it certainly had positive effects, but no one had carefully estimated the consequences and therefore we need to reopen the discussion.

What changes should be made to reduce the tax burden?

Currently the only thing that government officials are discussing in private is how to raise taxes to continue increasing public spending. The environment has become very unfavorable for the discussion of tax reform, because the government is pressing in the opposite direction. Workers' Party leaders often blame the opposition for blocking higher social spending … . In reality, recent governments like to address the fiscal problems by creating new taxes, which conflicts with the idea of tax reform. … When we discuss tax reform, changes are always subject to finding a way not to lose revenue, and then it is difficult to carry out reform.

The Brazilian social security system is criticized because of its high fiscal cost for a still young country. What changes should be done?

President Fernando Henrique Cardoso's reform was an attempt to get closer to the ideal social security system in which benefits are paid for with contributions. After that, social security reform virtually stopped. Today, we see instead a counter-reformation. In a recent study we found that implementing various reform proposals would prevent social security spending from growing by 2040. Instead of doubling as a percentage of GDP, it would remain constant. We have reform proposals. Only political will is lacking. If we start reforming [social security] now, we will not see the results until after 2040 because it takes time. … Another benefit introduced in the Constitution is the special pensions, whose approval was not vetoed. … The Courts are granting these pensions even though they are not yet regulated. All this increases public spending.

"The government wants the private sector to invest in infrastructure, despite low returns, and to charge the lowest imaginable tariffs."

Do you think Brazil can grow without abandoning social inclusion?

I think so, because important factors for social inclusion, however trivial it may be, are economic stability and economic growth. Without them, you end up generating an economic crisis that will eventually reduce the incomes of the poor. Today, the country is growing between zero and 1%. Inflation is already above the target ceiling. If we continue like this, all social inclusion achievements will eventually be lost—especially because the transfers are not necessarily going to the poorest. This is a discussion that is also absent from the debate. We only speak of the Family Grant program, but it is small compared to what I have called the big payroll. For example, to what extent do increases in the minimum wage help the poor? There are studies that indicate they do not.

How Brazil and South Korea differ

In the 1970s the economies of Brazil and South Korea were similar; today they are very different. What did Korea do to become so much richer?

Thais Thimoteo



IF TODAY SOUTH KOREA is recognized for economic policies that in a few decades turned it into a rich economy, the reasons go beyond an efficient industrial policy anchored in long-term strategies and programs of incentives and benefits that had well-defined expiration dates. Complementary policies also contributed to South Korean economic success: massive investments in infrastructure and education, improvements in the business environment, relative inflation control, and organization of public finances. This combination makes it easier to understand why the South Korean economy has grown rapidly while Brazil's growth is disappointing.

Until the 1970s both countries had similar per capita income. Both were poor. And at the end of that decade, the global oil price shock hit both countries. The difference lies in how each dealt with the shock. "The question now is why Brazil did not grow much in 40 years and South Korea did," says Mauricio Canêdo Pinheiro, researcher at the Brazilian Institute of Economics. He believes the difference lies in industrial policy and the policies that complemented it.

"It was the success of both types of policy that led South Korea to reach per capita income three times greater than that of Brazil," Pinheiro says. "Some analysts believe that South Korea has grown mainly due to industrial policy. Others credit … other policies. I think it was a combination of the two." South Korea's per capita income in dollars, adjusted by the purchasing power of the population (PPP) went from US$1,074 in 1960 all the way to US$27,522 in 2011. Meanwhile, Brazil's went up from US$1,982 only to US$9,300.

South Korea also made major strides in education. Schooling of South Koreans older than 15 rose from 4.2 years in 1960 to 12 in 2010; over the same period in Brazil schooling went up from 2.5 years to 7.9. "Brazil has improved economically and has tried to catch up, especially in educational levels, but we lost more than 30 years," Pinheiro says. "Education access and quality were stagnant in the 1970s and 1980s. We thought that leveraging industry, education would come along and that did not happen."

The infrastructure differences between the two nations are even greater. According to the World Economic Forum's 2013–14 report Brazil's performance in improving the ports, railways, roads, and airports that are fundamental for industry is similar to the poorest countries. South Korea performs among the richest. "Brazil is a middle-income country, but it is at the same level of infrastructure as low-income countries," Pinheiro says, adding, "Until we change this situation, Brazil cannot grow."

"Brazil is a middle-income country, but it is at the same level of infrastructure as low-income countries. Until we change this situation, Brazil cannot grow."

Mauricio Canêdo Pinheiro

The lessons

Trade liberalization—gradually removing protections of the domestic industry from import completion—is also important to make domestic industry competitive and build up a resilient economy. Because South Korea has provided subsidized credit to selected sectors and fiscal incentives to its industry, and protected its domestic market as it was opening up gradually, at a glance Korean industrial policy seem similar to Brazil's current policies. However, there is a fundamental difference: South Korea set definite expiration dates for protection and incentive programs, which functioned to avoid turning the economy into an autarchy that was neither productive not competitive. "The great move of South Korea's industrial policy was to set expiration dates. There was planning. If it was important for a particular industrial sector to develop, the government would help it, so later it could go on its own. When we compare the degree of market opening in Brazil and South Korea (measured by the sum of imports and exports as a proportion of GDP), we realize that Brazil's has stayed the same since the 1960s," Pinheiro says.

Industrial policy should take into account long-term development. However, "The difficult task is to raise competiveness gradually," Pinheiro warns. "We cannot open the domestic market overnight because that will harm Brazilian industry, which does not have adequate infrastructure, skilled labor, and a favorable business environment to compete with foreign products. The challenge is to continue addressing these shortcomings, and at the same time open the economy gradually to international markets."



Chico Santos

A RECENT STUDY MOVES forward the debate about the shortage of skilled labor in the Brazilian economy and the immigrant labor option for solving the problem. The authors—economists Sergio Werlang, former director of the central bank and now professor at the Brazilian School of Economics and Finance (EPGE) of the Getulio Vargas Foundation, and Everton Santos and Marina Gontijo, both EPGE doctoral students[1]—estimated the effects that attracting a massive number of immigrants would have on Brazil's labor market and gross domestic product (GDP).

Considering Brazil's demographic trajectory, the debate on immigrant labor is urgent, but Fernando de Holanda Barbosa Filho, researcher at the Brazilian Institute of Economics (IBRE), doubts whether Brazil would be able to attract enough foreigners who have the professional profile the labor market requires.

In less than 30 years, the Brazilian population is projected to start declining. Government statistics agency IBGE estimates that starting in 2042, when the population (estimated today at 202 million) will reach 228 million, there will be fewer births than deaths. By 2060 there will be 10 million fewer Brazilians than in 2042. According to Ana Amélia Camarano, researcher at the Institute for Applied Economic Research (IPEA), both the total and the economically active population may decline even earlier, in 2035.

With the gradual decline in population growth, which was rising 2.99% a year in 1960 but dropped to 1.17% in 2000–10, a lower birth rate; and increased life expectancy, the Brazilian population is aging more rapidly, and Brazil will soon see the end of the "demographic dividend," when more people enter the labor market than leave the economically active population. According to IBGE, in 2000 Brazilians 14 years old and younger represented 30% of the population and Brazilians older than 60 years represented only 8%. In 2014, youths are 24% of the population and seniors 11%. IBGE forecasts that by 2028 there will be more elderly than youths.

An aging population and fewer young people entering the labor market is an issue that is worrying economists and demographers, because of the

[1] Sergio Werlang, Éverton Santos, and Marina Gontijo, "Equilibrium in the Labor Market in Brazil—Short-Term Effect of Immigration Policies." Rio de Janeiro: EPGE, FGV, 2014.

effects on not only Social Security but also on the labor market. Right now Brazil has full employment, with unemployment at 4.9% in September, according to IBGE, yet GDP growth is close to zero.

Harder to grow

"With the active population growing less and less because of low growth in the population as a whole, it will become more difficult for the economy to grow," Barbosa Filho says. He believes that given current demographic trends alternatives to raise economic growth will be difficult to put in place in the medium term; increasing fixed investment, for

The number of immigrants in Brazil is very low—only 0.3% of the population, according to the United Nations, compared to 20.7% in Canada, 14.3% in the U.S., and 13.8% in Spain.



Foreigners in Brazil

2000 and 2010



Country	2000	2010
Portugal	213,202	137,972
Japan	70,932	49,058
Paraguay	28,821	39,251
Bolivia	20,387	38,815
Italy	55,031	37,165
Spain	43,603	30,735
Argentina	27,531	29,066
Uruguay	24,739	24,048
United States	13,947	23,512
China	10,301	19,396
Germany	19,555	16,241
Chile	17,131	15,432
Peru	10,813	15,019
Lebanon	16,090	12,336
France	8,381	9,559
South Korea	n.a.	8,577
Colombia	4,159	6,850
Angola	6,339	6,444
United Kingdom	4,034	4,947
Poland	7,458	3,482

Source: IBGE.

instance, is constrained by Brazil's low savings. Raising productivity also depends on long-term factors, such as raising education levels in Brazil. The domestic supply of labor could be enhanced by keeping older people in the labor market longer, or by stimulating female participation in the labor market, but that will also take time.

Attracting immigrants, who helped to solve similar problems in Canada and Australia, emerges as one possible alternative. Werlang, Santos, and Gontijo note that since solving part of the labor shortage by investing in education can only be done in the long term, and ask if in the short term a more open immigration policy could help without increasing Brazilian unemployment or reducing wages significantly. They found that the number of immigrants in Brazil is very low—only 0.3% of the population, according to the United Nations, compared to 20.7% in Canada, 14.3% in the U.S., and 13.8% in Spain.

In Brazil, the largest contingent of immigrants are those over 65, who constitute 1.2% of all residents of Brazil aged 65 or over. Gontijo suggests that they reflect the migrations caused by World War II, which ended in 1945. In other countries most immigrants are in the age groups most in demand in the labor market. Immigrants account for 29.8% of the population aged 35–39 years in Canada, 25.4% of that age group in the U.S., and 23.5% of residents aged 30–34 in Spain.

Using data from the Organization for Economic Cooperation and Development (OECD), the study found that in general immigrants are more educated than citizens. In Australia, 25.8% of immigrants have higher education compared with 20% of citizens. In Canada, 38% of immigrants and 31.5% of natives have more education. In Spain, the educated constitute 21.1% of immigrants and 18% of natives, in Mexico, 34.8% of immigrants and 12.8% of natives. In Brazil, data on immigrant education are not available, but only 8% of natives are that well educated.

How would immigration affect the labor market?

The study authors projected various scenarios. If immigrants have the same characteristics as the local population average and they all get jobs, unemployment would fall because immigrants are meeting the demand for labor, and wages would also fall because the labor supply increases. For example, if immigrants increase the working population by 0.5% (about 750,000 workers) average salaries would drop by 3.3%, unemployment would fall 0.03 percentage points, the employed population would grow by 0.93%, and GDP would grow by an additional 0.47%.

Alternatively, if immigrants have more education than the local population average, wages would fall less because demand for more skilled labor is high. In that case, with an annual increase of 0.5% in the working population, wages would fall by only 2.6%.

Gontijo stressed that the number of immigrants into Brazil today is negligible. The study did not discuss policies to attract immigrants. She suggested looking at Canadian and Australian immigration policies, which prioritize higher education. She also recognized that a massive arrival of immigrants could also bring negative externalities, such as worsening traffic in cities.

Brazil's immigration legislation should reduce red tape to increase transparency, speed up and reduce the costs of immigration processes, and ultimately encourage foreigners to come to Brazil.

Paulo Abrão

A limit on development

National Secretary of Justice Paulo Abrão believes that Brazil should enter the international competition for skilled labor; the first step in that direction would be to revise the Statute on Foreigners. "Current law is an obstacle to immigration as a development factor," Abrão said. He is one of 11 authors of a draft law submitted at the end of August to the Ministry of Justice to replace the current law. The draft has earned strong support from national and international bodies concerned with the rights of migrants.

Meanwhile, there are two other projects in the National Congress to change immigration law: Bill No. 5655/2009, authored by the Executive Branch, which since 2012 has been in the Committee on Foreign Relations and National Defense Chamber of Representatives, and Bill No. 288/2013, proposed by Senator Aloysio Nunes.

The expert draft on which Abrão worked proposes creation of a National Immigration Authority (ANM) under the president to centralize the immigration processes that today are scattered among the ministries of Justice, Labor, and Foreign Affairs.

Secretary Abrão believes that Brazil's immigration legislation should reduce red tape to increase transparency, speed up and reduce the costs of immigration processes, and ultimately encourage foreigners to come to Brazil. Also, it should grant work permits to immigrants seeking employment for specific terms of six months to a year. Today, immigrants can apply for work permits only if they already have a job offer.

IPEA's Camarano doubts a new immigration policy would attract foreign labor. "First," she argues, "the work force is aging in most of the world… . Soon there will no longer be workers to attract." She is also concerned about how mass immigration would affect Brazilian culture. In her opinion, Brazil should be seeking domestic alternatives to a smaller labor force. One might be incentives to keep the elderly in the labor market, since Brazilian law does not prevent those retired from continuing to work.

IBGE researcher Marden Campos also does not believe that large numbers of immigrants can be attracted to solve Brazil's labor shortage. Based on recent immigration history, he says, "I see no indication that this will happen." He points out that from 2005 to 2010 268,000 people entered Brazil, but 65.5% of them were returning Brazilians.

From 2000 to 2010, the immigrant and naturalized population shrank in both relative and absolute terms. As a proportion of total population it fell from 0.40% to 0.31%, and in absolute numbers from 683,800 to 592,600. Portuguese (the largest number), Italian, Japanese, and Spanish immigrants declined, and the numbers of U.S. citizens, Paraguayans, Argentines, and Bolivians increased.

Visa statistics from the National Immigration Council of the Ministry of Labor show that from 2011 to June 2014, 13,539 work permits were granted—12,270 permanent and 1,269 temporary. Of those, 9,000 were granted to Haitians, part of the diaspora caused by the earthquake that devastated their country in January 2010.



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What's ailing health care in Brazil

Thais Thimoteo

IMPROVING HEALTH SERVICES is the top concern of Brazilians, followed by quality education and safety. *Portraits of Brazilian Society—Issues and Priorities for 2014*, a study conducted by the National Confederation of Industry (CNI) and the Brazilian Institute of Public Opinion and Statistics (IBOPE), shows that 49% of Brazilians want the government to pay more attention to health services.

Experts point out four factors that make the Brazilian health care system dysfunctional: (1) The business model for managing and financing hospitals is profoundly fragmented, divided among federal, state, and municipal agencies and complex public, private, and nonprofit organizations. (2) Administrative costs are high as a percent of total spending. (3) Brazilians tend to seek medical care from hospitals rather than physicians in general practice, who are ideally the starting point for medical care. And (4) health care in Brazil is focused much more on emergency care and disease treatment than on preventive care and care of such chronic conditions as diabetes, alcoholism, smoking-related illnesses, and obesity.

In October in Rio de Janeiro, the Brazilian Institute of Economics (IBRE) of the Getulio Vargas Foundation sponsored a seminar to discuss possible solutions for Brazil's health crisis, *Governance and Management of Public Hospitals in Brazil*. "The 1988 Constitution established our Public Unified Health System (SUS), which inherited all the problems of the previous health care system. Our arrangement is contrary to the model other

countries have developed for universal access to health care. Reform is needed. But the challenge is how to simplify the complex federal, state, and municipal structure," said Mônica Viegas, associate professor, the Federal University of Minas Gerais state. She believes that the best model is health care networks—integrated programs and services to efficiently deliver comprehensive care—but it requires a clear assignment of responsibilities, and the only way to get that is through the federal government. She said, "To reform the health care system, we need to address the fragmented management of the system," adding "Greater integration with the private health care system is also fundamental."

Eliane Gianotti, director, Department of Regulation, Evaluation and Control Systems, Ministry of Health, agreed that integration of the entities involved (managers, patients, and regulators) and definition of their functions is essential to overcome the fragmentation. But she believes management responsibilities should be shared and not so concentrated in the federal government: "It is the role of the federal administration to set macro guidelines to encourage creation of health care networks and to propose policies that address management fragmentation." She pointed out that those familiar with the day-to-day life of people providing health care services are the ones who

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Mônica Viegas

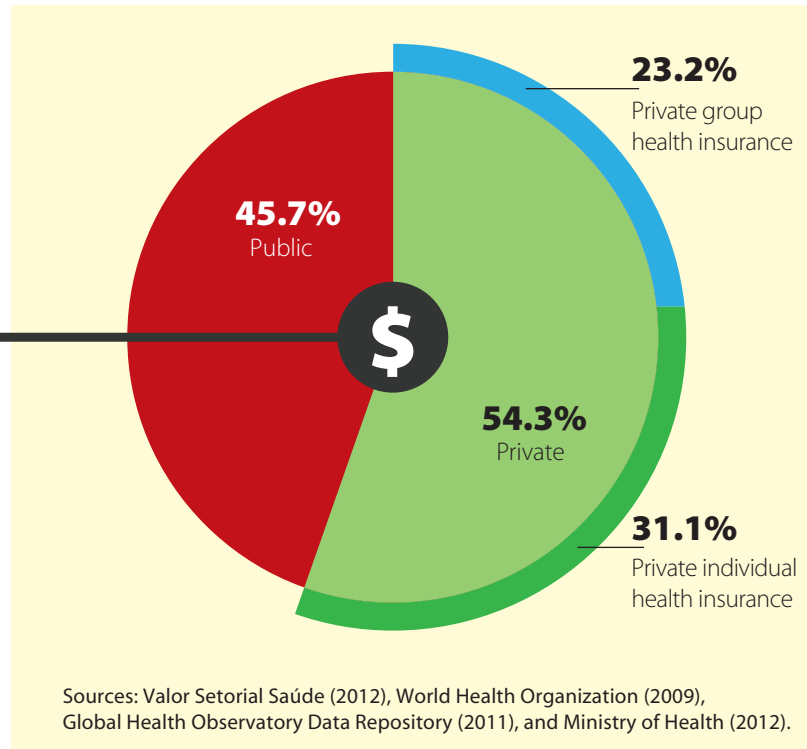


Spending little on health

Brazil spent on health services R$2,384.83 per capita in 2011 compared to the average of OECD countries of R$7,597.75 in the same year.

Source: OECD Health Data (2013).

Brazil's health spending



Sources: Valor Setorial Saúde (2012), World Health Organization (2009), Global Health Observatory Data Repository (2011), and Ministry of Health (2012).

"Hospitals have idle physical and human resources, and lack standardized clinical procedures and management, which prevents them from reducing costs and improving efficiency."

Bernard Couttolenc

know the patients better and are better able to predict situations of greater vulnerability and risk.

Where the money goes

In 2013, the Court of Audit (TCU) analyzed the Brazilian health care system and identified major flaws. Deep regional inequalities were detected. Large cities average 4.56 doctors per thousand inhabitants, for example, compared to only 1.11 in the countryside. The study also looked at 116 public hospitals, which account for nearly 27,600 beds (8.6% of total public beds in Brazil). Among other deficiencies, the TCU found that in 64% of these hospitals emergency rooms are operating far above capacity. Also alarming is that in 81% of hospitals the biggest problem is the shortage of professional staff, and in 63% employees are often absent. This situation seems to reflect management problems rather than a lack of resources. In 2011, the World Health Organization found that Brazil spent 8.9% of GDP on health, compared with 7.9% in Argentina, 5% in Bolivia, 7.1 % in Chile, 6.5% in Colombia, 8.6% in Uruguay, 8.0% in Paraguay, and 5.1% in China. Marcelo Chaves, TCU Secretary of Health Inspection, pointed out the difficulty of auditing government spending on health because responsibilities are so decentralized: "Increasingly the Ministry of Health is not directly managing health system resources, which are mostly being transferred to municipalities. We need to establish



a plan with state and municipality Audit Courts so we can have a more complete view of health care costs."

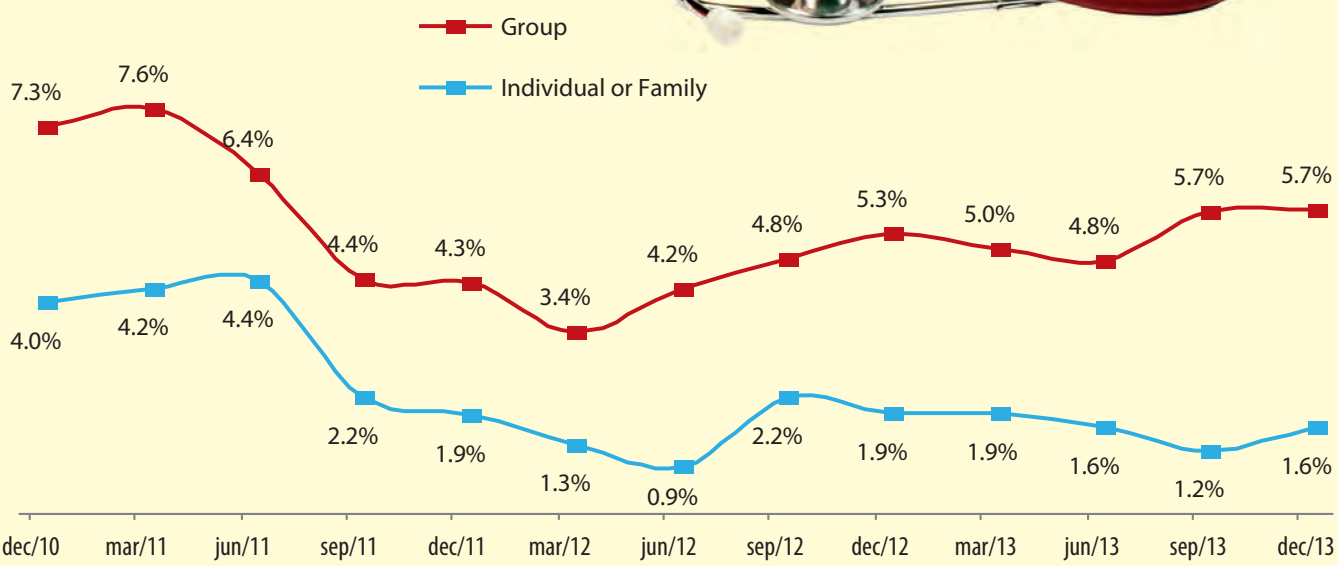
Public hospitals consume about 67% of total spending on health services according to a study of Bernard Couttolenc, director of the Performa Institute, and Gerard La Forgia, World Bank lead health specialist. Couttolenc believes that "You can do three times more with the resources that are available," which is why he considers it very important to monitor hospital performance. "Hospitals have idle physical and human resources, and lack standardized clinical procedures and management, which prevents them from reducing costs and improving efficiency," he said. "Brazilian public hospitals use twice as many employees per occupied bed than the U.S. or European countries. We hear managers complaining that the biggest problem in public hospitals today is the shortage of personnel. Looking at the data, we find there is something wrong in this story."

"The current disease situation requires an integrated system that operates continuously, rather than occasionally, and proactively promotes prevention, cure, and rehabilitation."

Eugênio Vilaça



Private health insurance is expanding.
(% growth)



Source: Ministry of Health

What people die from

Public health consultant Eugênio Vilaça, told at the seminar, "To understand management of the health sector, we have to consider what people die from, and what incapacitates them. Brazil has a triple disease burden: 66% of the diseases are chronic, 23% are infectious and maternal and prenatal causes, and 10% have external causes, such as pollution and violence." Vilaça explained that these diseases are being addressed incorrectly because the model for health care evolved in the mid-1950s, when acute conditions prevailed. In fragmented health care systems, he added, primary care physicians do not speak with specialists, and hospitals are organized according to hierarchy. They are reactive, responding only when the patient seeks care, and services are paid by the procedure, not by results. In his opinion, "These systems are a universal failure in the management of chronic conditions."

To turn around this situation, analysts agreed, Brazil needs to turn to health care networks. Vilaça emphasized that networks can improve outcomes for chronic conditions, reduce referrals to specialists and hospitals, increase the efficiency of health care systems, produce better services at lower cost, and increase customer satisfaction. "The current disease situation requires an integrated system that operates continuously, rather than occasionally, and proactively promotes prevention, cure, and rehabilitation—a system no longer centered on the doctor but [calling on] a multi-professional team," he said.

What has been changing

The public-private balance: Although hospital-centered health care persists, since the early 2000s there have been some changes. For instance, there are fewer private hospitals and more public hospitals, according to the 2009 National Registry of Health Facilities of the Brazilian Institute of Geography and Statistics (IBGE). World Bank economist André Médici explained that this change is related to efficiency: Small private hospitals have closed because they are less efficient and get less financial support. In general, however, the productivity of Brazilian hospitals is very low. According to the 2014 National Registry of Health Facilities, 58% of hospitals had less than 50 beds and only 20% have more than 100 beds. Médici commented that "public hospitals are so inefficient that 90% of them could cease to exist. Hospitals should be large enough to operate [efficiently]. This is complicated because the SUS has to meet small town demand, creating inefficient hospitals with occupancy rates of less than 30%."

Private health insurance: Encouraged by the rise of the new middle class, the supply of health insurance significantly increased between 2012 and 2013, according to the National Health Agency (ANS). Last year, 25% of the population was insured: 50 million had health insurance and 21 million dental plans. Most are covered by corporate group health insurance plans; individual health policies make up less than 20% of total health insurance. However, despite its growth, health insurance profitability has deteriorated. In 2013, revenue from private health insurance increased by 9.5% to R$108 billion over 2012, but expenditures have risen rapidly: for every R$100 in revenue, R$83 goes to pay hospitals, clinics, and medical and laboratory services. "Although the market is growing, profitability is declining. In 2013, the average was 7.1%, the worst result since 2009, when it was 12.9%," ANS director Leandro Fonseca da Silva pointed out.