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Sustainability of Social Protection in the SADC:
Economic Returns, Political Will and Fiscal Space
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**How Brazil has cut its Inequality through Fiscal Policy:
redistributive role of social protection,
main trends and challenges for fiscal sustainability**

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What exactly are we talking about?

Historical background:

- 1960s and 1970s: Former fast-growth country with increasing inequality during the military regime.
- 1980s and 1990s: Country returns to democracy and faces economic stagnation with stability in a high level of income inequality. One of the highest in the planet.
- 2000s: Inequality starts to fall as growth accelerated again during the commodities boom. Rare combination of democracy, decreasing inequality and economic growth.
- 2010s: Great depression following the international crisis finally hits Brazil. Deceleration of growth and fiscal sustainability issues start to impose limits for the process of reducing inequalities (more on that later).

Figura : GDP per capita and Gini Index

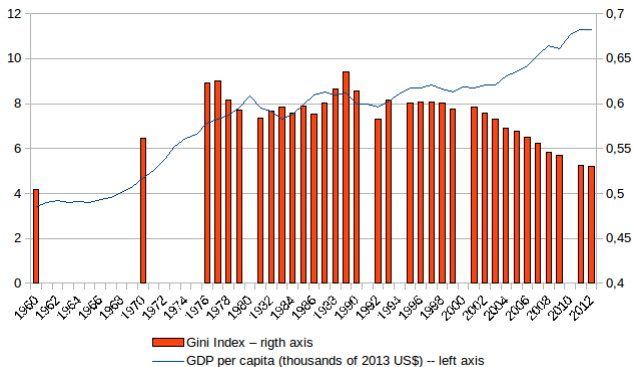


Figura : GDP per capita growth (constant 2005 US\$)

Countries	1960-1970		1970-1980		1980-1990		1990-1995		1995-2000		2000-2005		2005-2010		2010-2014	
	Rate	Rank	Rate	Rank	Rate	Rank	Rate	Rank	Rate	Rank	Rate	Rank	Rate	Rank	Rate	Rank
Argentina	2,3%	17	1,3%	28	-3,0%	35	5,1%	7	1,4%	30	0,9%	40	4,6%	9	2,0%	27
Brazil	3,2%	12	5,9%	3	-0,4%	28	1,5%	20	0,6%	36	1,4%	35	3,4%	20	1,2%	36
China	1,8%	21	4,3%	7	7,7%	2	11,0%	1	7,6%	2	9,1%	1	10,7%	1	7,5%	1
Colombia	2,2%	18	3,1%	14	1,4%	21	2,3%	12	-0,3%	39	2,2%	28	3,3%	23	4,0%	11
India	1,8%	20	0,7%	31	3,2%	6	3,0%	10	4,1%	6	5,0%	7	6,7%	3	5,2%	4
Iraq	-	-	8,6%	1	2,0%	19	-10,7%	44	13,2%	1	-2,2%	46	3,1%	25	2,8%	19
Japan	7,9%	1	3,3%	13	4,0%	5	1,1%	28	0,6%	35	1,0%	36	0,3%	40	0,9%	38
Kenya	1,1%	25	4,1%	10	0,3%	24	-1,5%	37	-0,4%	40	1,0%	38	2,3%	29	2,6%	20
Korea, Rep.	5,9%	3	7,2%	2	8,4%	1	6,8%	3	4,3%	5	4,2%	10	3,6%	18	2,5%	21
Russian Federation	-	-	-	-	-	-	-9,1%	43	1,9%	25	6,6%	5	3,6%	17	1,8%	29
South Africa	3,5%	10	1,1%	30	-0,9%	30	-1,3%	35	0,4%	37	2,3%	27	1,7%	33	0,7%	39
Sudan	-1,2%	30	0,3%	32	-0,5%	29	1,9%	17	3,0%	12	3,4%	16	4,2%	14	4,6%	6
Uganda	-	-	-	-	-	-	3,6%	8	2,9%	13	3,2%	19	4,5%	10	2,0%	26
World	3,4%	-	1,9%	-	1,4%	-	0,6%	-	2,0%	-	1,6%	-	1,0%	-	1,3%	-

How did the consolidation of the social protection happen?

The transition to the democracy in the late 1980s and the attendant extension of the suffrage led to a reconfiguration of the social contract that was encapsulated in the Constitution of 1988.

As a consequence the redistributive pressures escalated towards fiscal decentralization and extend social rights. Reacting to a long period of authoritarianism, centralized power and income concentration.

The 1988 Constitution provides the institutional framework of the Social Security Budget. Establishing or foreseeing:

- Wide range of social benefits for those with illness or disability, for the elderly (rural and urban) and unemployment insurance.
- Prevision of universal health care and social assistance (and also universal basic education).
- Social contributions to finance social security system. With special conditions and wide range of economic bases (social securities on payrolls, consumption, corporate income etc).
- Minimum wage as a reference to fix social benefits.

How did the consolidation of the social protection happen?

Social rights were gradually accessed. Leading to rapid expansion of social expenditure.

But there are additional issues:

- Mid-1990s: Targeting transfers to the poor became increasingly important. Initially there were several programs (bolsa escola, bolsa alimentação, auxílio gás etc).
- Unification of the conditional cash transfer programs and faster growth (Bolsa Familia, 2004).
- Policy of raising the minimum wage in took place in the mid-1990s. And accelerated significantly during the Center-left Workers Party (2003-2015) presidential mandates.
- Explicit rule for the minimum wage indexation related to the GDP growth rate (2006).
- Public provision of education and health care services were reoriented towards basic areas.

How did the consolidation of the social protection happen?

Of course, a lot of learn by doing and institutional building happened:

- Strengthen of fiscal and monetary institutions. After a flirt with hyperinflation in the first – institutionally weak – democratic years. Price stabilization (1994), new macroeconomic regime with fiscal surplus and inflation targets (1999) and Fiscal responsibility law (2000).
- Reasonably competent bureaucracy kept improving the ability of the government to design and implement better public policies and also to collect a large volume of taxes.
- Including a cultural change on practices of beneficiaries from social protection.

Figura : Social benefits from central government (as % of the GDP)

Benefits	1998	2002	2006	2010	2011	2012	2013	2014
Retired worker and auxiliary beneficiaries	5,15%	5,79%	6,87%	6,56%	6,43%	6,72%	6,92%	7,14%
Assistance for poor elderly and disabled	0,27%	0,34%	0,48%	0,57%	0,57%	0,62%	0,65%	0,70%
Unemployment insurance	0,44%	0,48%	0,61%	0,77%	0,78%	0,82%	0,86%	0,98%
Conditional cash transfers (Bolsa Família)	0,00%	0,13%	0,32%	0,35%	0,38%	0,45%	0,47%	0,47%
Total	5,86%	6,74%	8,28%	8,24%	8,16%	8,61%	8,89%	9,29%

Figura : Number of beneficiaries.

Year	Retired worker and auxiliary beneficiaries	Assistance for poor elderly and disabled	Unemployment insurance	Total
2004	20.506.649	2.629.196	5.008.168	28.144.013
2005	21.149.560	2.792.638	5.582.395	29.524.593
2006	21.644.885	2.940.141	6.058.355	30.643.381
2007	22.066.263	3.096.566	6.525.294	31.688.123
2008	22.776.205	3.311.827	7.215.675	33.303.707
2009	23.534.497	3.504.080	7.911.598	34.950.175
2010	24.426.882	3.703.505	8.117.808	36.248.195
2011	25.176.323	3.863.503	8.515.204	37.555.030
2012	26.032.855	3.999.462	8.779.654	38.811.971
2013	27.009.011	4.165.956	9.114.189	40.289.156
2014	27.818.973	4.310.448	9.060.184	41.189.605
Growth per year	3,1%	5,0%	6,1%	3,9%

Figura : Indicators of the labour market

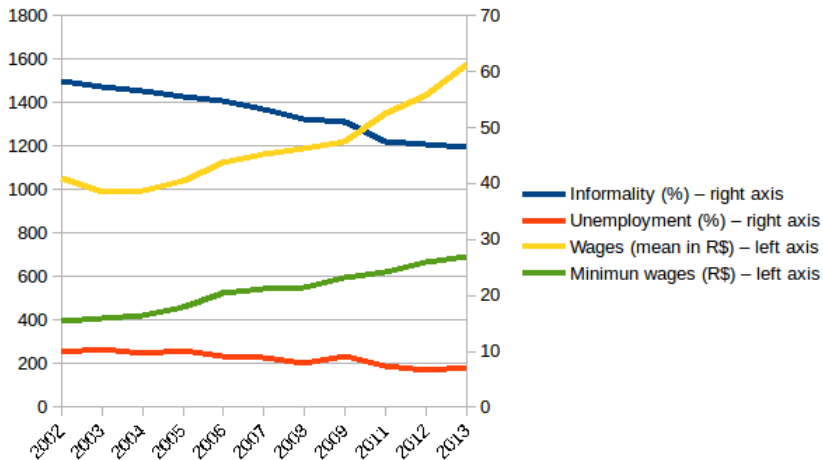


Figura : Tax burden and public transfers (as % of GDP)

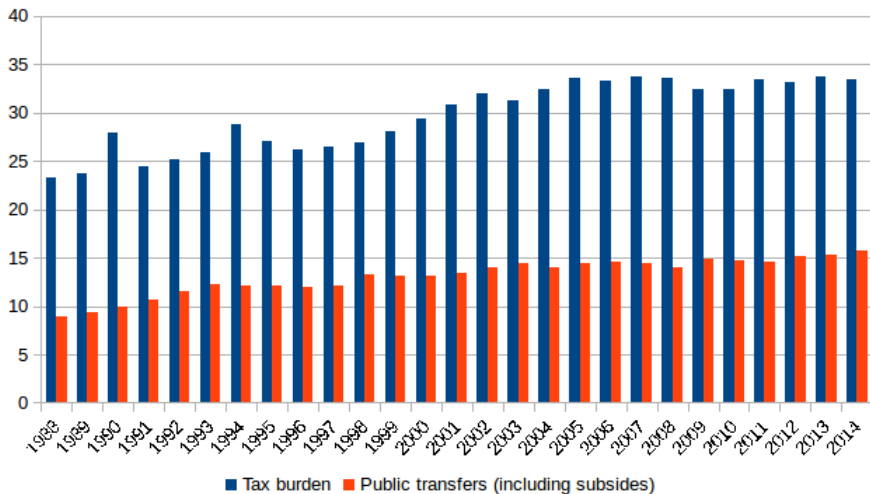
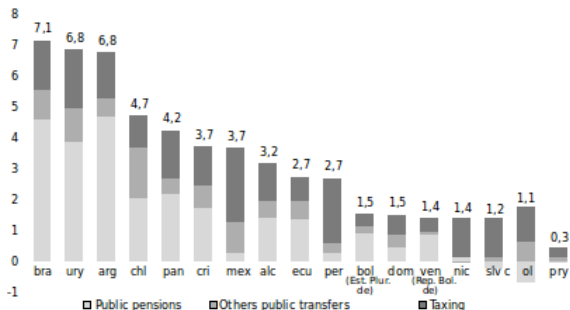


Figura : Redistributive impact of fiscal policy in Latin American countries.
(Percentage of the Gini Index)



What lies behind the inclusive pattern of growth during the 2000s?

Like other emerging economies Brazil did benefit a lot from both increased global trade since 2002 and higher commodity prices. So the **external constraint to growth was lifted** for a while.

Social benefits were important to reduce income inequalities. But it is not the main driver. Wages and salaries respond from 50% to 85% of the fall in the Gini Index. While social benefits indexed to the minimum wage are estimated in 39% and Bolsa Familia 7%. Of course, results are quite different for poverty as 80% of the Bolsa Familia goes to families below the poverty line.

Links between social protection and labour market were crucial. Economic conjuncture (acceleration of employment growth) and institutional factors worked together increasing bargaining power of employees.

Additionally, financial innovations allowed the **expansion of credit** – especially (but not limited) to the people receiving social benefits.

What lies behind the inclusive pattern of growth during the 2000s?

The combined effect of these measures brought millions of people to the marketplace – increasing both consumption and investment.

Even more importantly, the number of poor Brazilians reduced significantly – poverty was cut by more than half (61,8 to 28,7 million people) during 2003-2013; and extremely poverty even more (26,2 to 10,5 million people).

Figura : Regional distribution of GDP

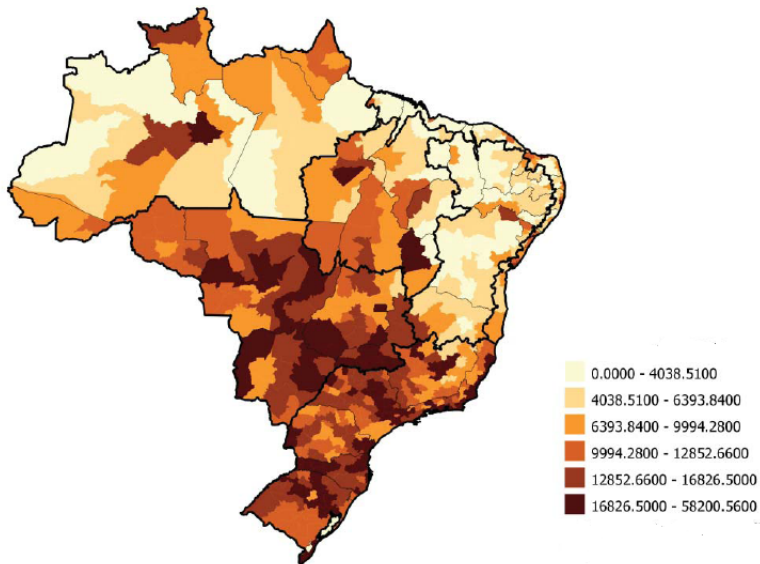


Figura : Transfers beneficiaries Em participação (%) no PIB.

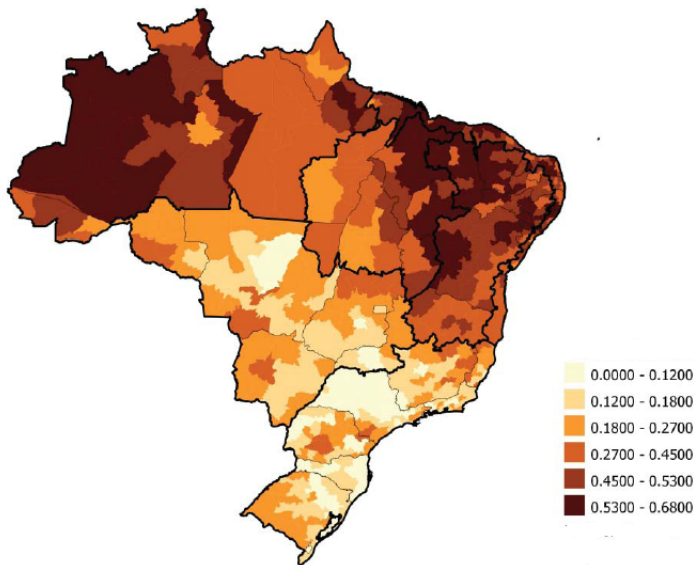
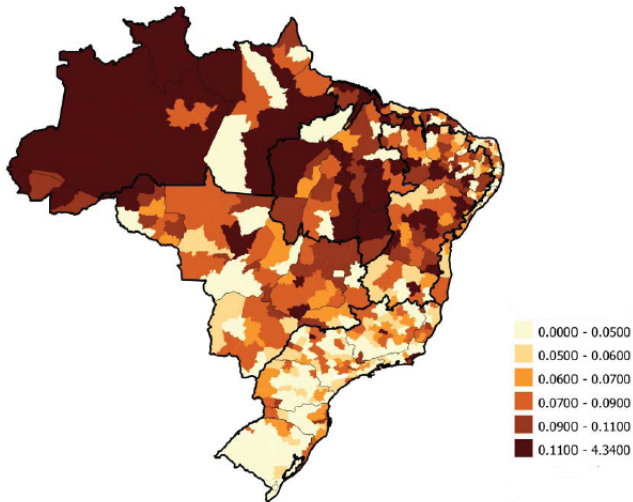


Figura : Formal employment growth



A first summary

From a macroeconomic perspective the inclusive growth in Brazil during the 2000s can be seen as the result of:

- 1 Good external environment (relaxation of the external constraint).
- 2 Consolidation of social protection and increasing redistributive spending.
- 3 Greater availability of credit to consumption.
- 4 Change in the fiscal regime to an expansionary phase, allowing not only the acceleration of social benefits but also the growth of other types of expenditures (mainly public investments).
- 5 Larger fiscal space provided by the performance of revenues due to high labour market dynamism and formalization (mainly social contributions). Spending was accommodated without fiscal deficits and even a decreasing public debt.

Great depression after the financial international crisis finally hits Brazil in 2011

The favourable scenario changed as some of the drivers of inclusive growth are gone:

- 1 External sector bonanza was over – the efforts to keep high growth based on domestic demand became associated to deficits in the current account balance (or, in other words, it required more external saving – and debt).
- 2 Banks started to act more cautiously and restrict credit expansion.
- 3 Expansionary fiscal policy changed its composition towards tax cut and subsidies as a tool to stimulate private investments. Private sector took a very pessimistic view of the future, and did not responded to the stimulus.
- 4 Economic depression had a direct effect on decelerating revenues growth. As expenditures remained on the previous growth trend, fiscal results gradually deteriorated. In 2014 the public sector had primary deficits for the first time in 16 years and increasing public debt.

Social spending remained as the only one of the drivers of inclusive growth. It is not a standalone.

Figura : Growth rate of federal spending and revenues (annual mean)

	1999-2002	2003-2006	2007-2010	2011-2014
Total revenues	6,5%	4,8%	3,6%	2,2%
Total spending	3,9%	5,2%	4,9%	4,2%
Social benefits	5,9%	9,0%	4,4%	5,2%
Wages and salaries	4,4%	1,3%	4,0%	0,2%
Goods and services	1,7%	2,4%	5,0%	5,4%
Investments	0,5%	-3,0%	21,4%	-0,5%
Subsidies	-9,8%	20,7%	-7,8%	26,4%
GDP	2,3%	3,5%	4,5%	2,1%

Figura : Public debt (as % of GDP)

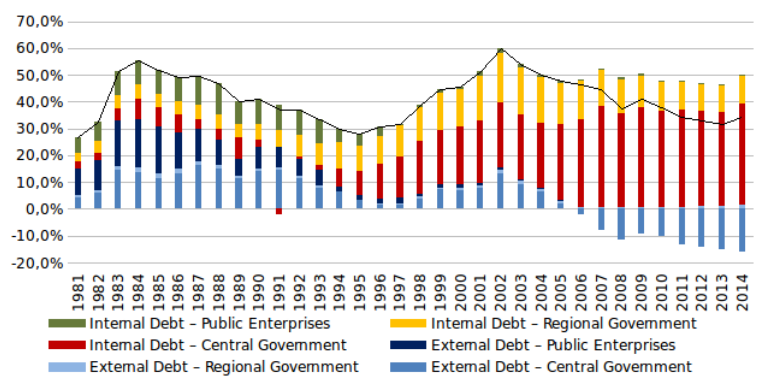


Figura : **Primary surplus** (as % of GDP)

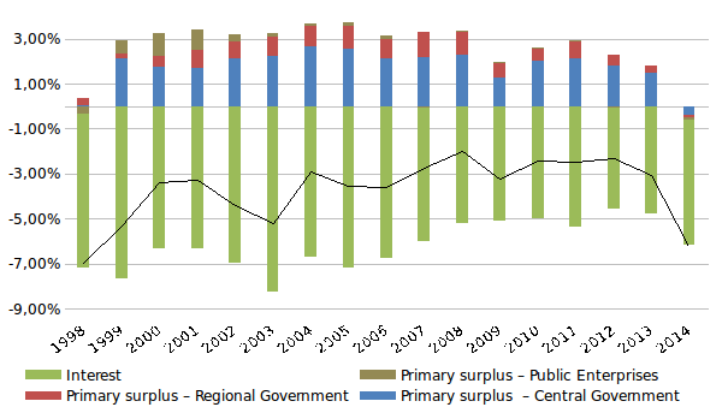
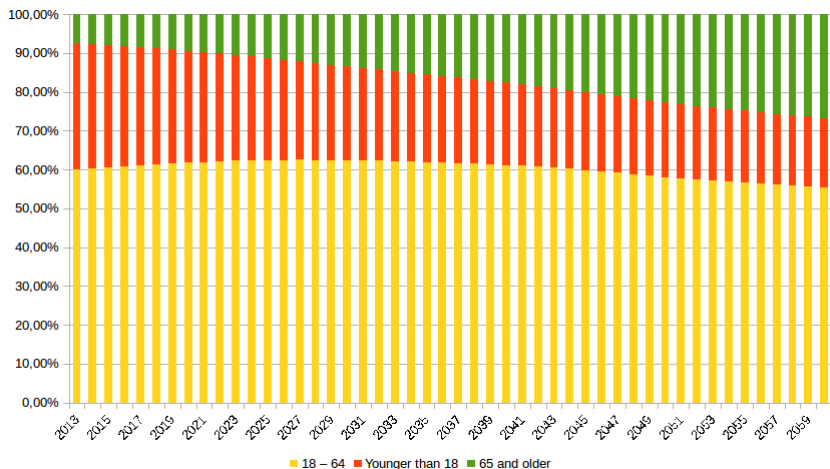


Figura : Growth rate of federal spending and revenues (annual mean)



How sustainable is the strategy?

Growth trend of social benefits should perpetuate into the future, not only due to demographic challenges, but specially with a bad performance of the economy. Projections for the next decade point to rises that varies from 0,4% to 2,8% of the GDP, depending on new legislations or economic growth scenarios.

Fiscal policy changed its orientation in the year 2015 towards fiscal adjustment. Evaluation of the Social Protection is being reduced to an issue of short term fiscal sustainability.

The conventional argument is that public spending has been stagnant in key areas and there is not much room for further cuts (administrative, personal expenditures, investments). Social spending became the main target for a structural fiscal adjustment.

Together with a conservative reform agenda of the social protection framework. It goes from revisions of social benefits and indexation rule of the minimum wage, and up to a more substantial revision of the 1988 Constitution that is the foundation of the welfare state in Brazil.

How sustainable is the strategy?

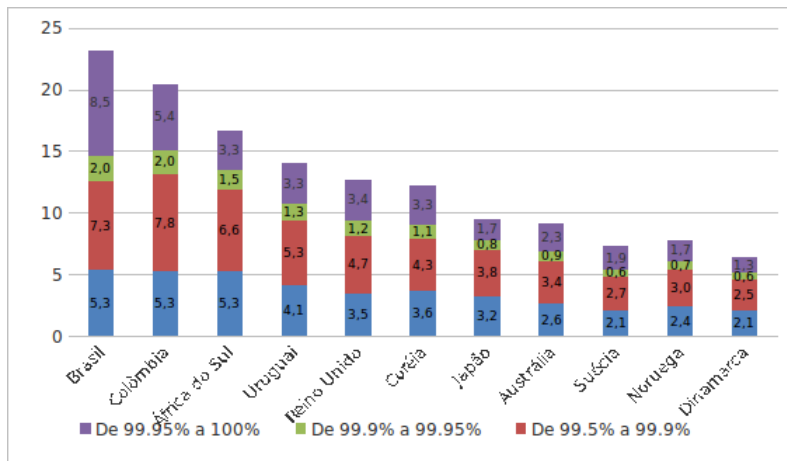
Fortunately, expenditures and taxing can get much better than what they are now in terms of equity and efficiency. Without need of a substantial revision of social protection or threatening the inclusive growth.

Brazilian public debt is in a low level from a comparative and historical perspective, and has changed to a better composition.

In a medium term there are important policy gaps to be filled:

- Public expenditure still poorly targeted in Brazil (high interest payments on public debt and public servants retirements, accumulation of social benefits, subsidies, tax exemptions) and also there is a margin for efficiency gains (quality of the public education and health services is poor). **Some improvements in terms of targeting and efficiency are needed even among social spending.**
- Tax structure is highly complex, inefficient and regressive in Brazil. Actually these aspects deteriorated since the 1980s as consequence of the proliferation of taxes covering a common tax base. **A reform towards a progressive tax system is a way to combine efficiency and equity.** It simultaneously reduce pressures on redistributive spending and provide fiscal space.

Figura : Top 1% concentration



A final summary and policy implications

Brazilian experience shows that the linkages of several drivers – including the consolidation of the social protection and more specifically the growth of redistributive spending – determinate inclusive growth.

The favourable scenario changed as some of the drivers are gone since the Great depression. Fiscal sustainability issues raised in this new context and costs of the welfare state tend to be higher with rising unemployment.

Of course, long term macroeconomic stability seems to be a requisite to any sustainable economic growth path (inclusive or not). But revisions of social protection must be cautious to do no treat an inclusive agenda. Fortunately, there is margin for improvements on spending and taxing.

Until now tax policy received very little attention. The puzzle is that since 1980s policy makers and political actors have converged into the notion that redistribution is to be achieved primarily via social spending not taxation. There was a pragmatic option for a tax system with high capacity to extract revenues. Without efficiency or redistributive considerations in mind. This situation can be reversed.

MUITO OBRIGADO!

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