Towards a more prosperous and inclusive Brazil

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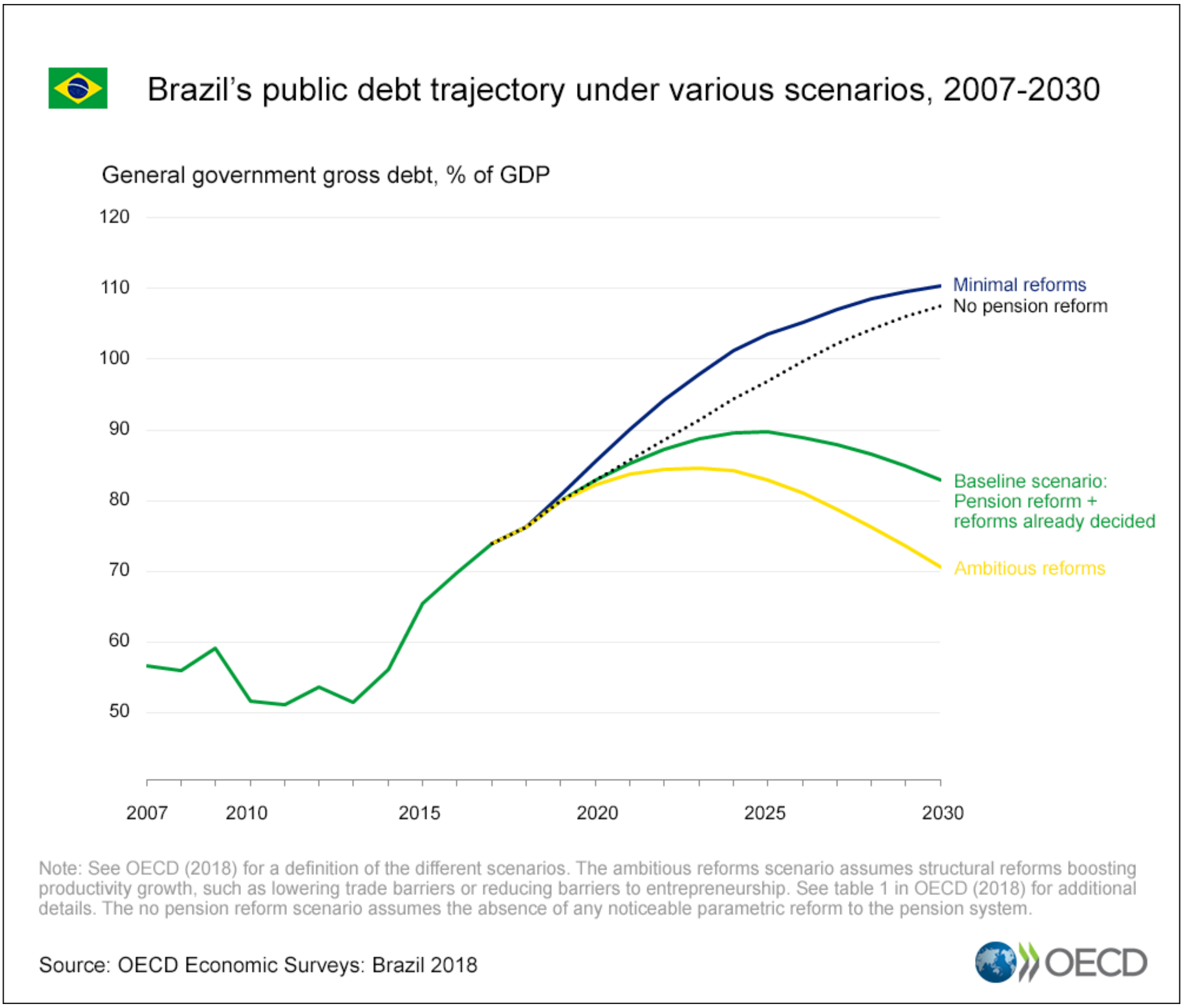
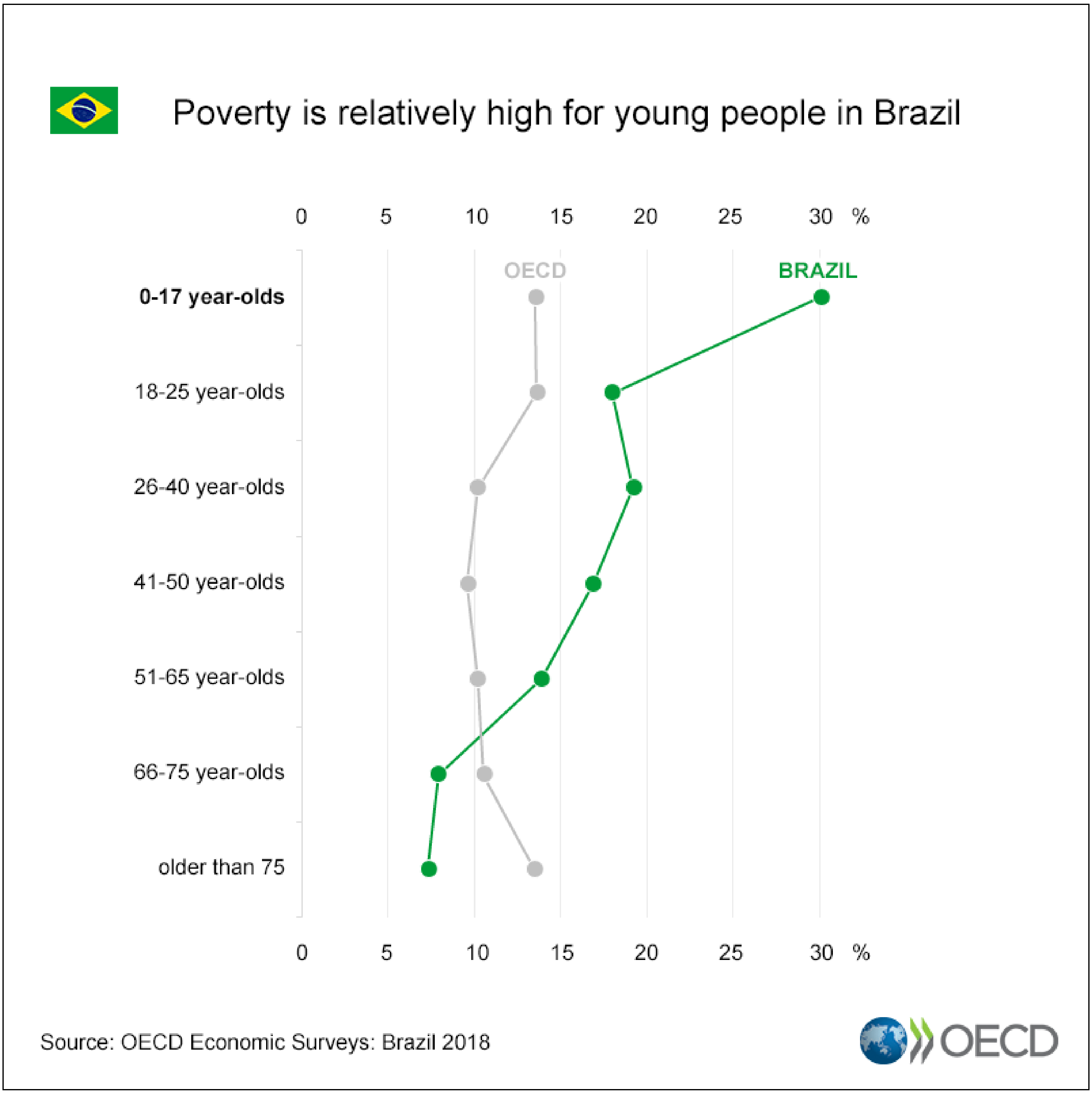
Over the past two decades, strong growth combined with remarkable social progress has made Brazil one of the world's leading economies. However, Brazil remains a highly unequal country, recent corruption allegations have revealed significant challenges in economic governance and the situation of its fiscal accounts is challenging with high and rising public debt (OECD, 2018). This calls for wide-ranging reforms to sustain and continue progress on inclusive growth. The government has started to put in place significant reforms, including a fiscal rule and a financial market reform that aligns directed lending rates with market rates. The long and deep recession is over and growth is projected to accelerate significantly this year. But more needs to be done to improve the living standards of all Brazilians.

The overall budget deficit is close to 8% of GDP driven by rising expenditures. Gross public debt has increased by approximately 20 percentage points of GDP over the last 3 years and stands around 75% of GDP. Implementing the planned fiscal adjustment and achieving fiscal targets is crucial for restoring the credibility of fiscal policy and avoiding a fiscal crisis. A comprehensive social security reform has become the most urgent element of the fiscal adjustment, as much of the worsening of the deficits is due to rising pension spending. A pension reform is also an opportunity to make growth more inclusive through better targeting of benefits. Aligning Brazil's pension rules with those practiced in OECD countries could be done in a way to preserve the purchasing power of pensioners while significantly improving the sustainability of the pension system. For example, in OECD countries people retire on average when they become 66 years old, while the effective retirement age in Brazil is 56 years for men and 53 for women. Establishing a formal minimum retirement age would help, in addition to rethinking the current benefit indexation mechanisms. Without reform, pension expenditure will more than double by 2060 (OECD, 2017), which would lead to unsustainable fiscal dynamics (Figure 1).



Improving the effectiveness of public spending, and in particular public transfers, will also be crucial for further social progress. At present a large and rising share of social benefits is paid to households that are not poor, which reduces their impact on inequality and poverty. Already, poverty is more than three times higher among children and youths than among those aged above 65 (Figure 2). Limiting future increases in those social benefits that do not reach the poor would be a first step. That would instead allow shifting more resources towards transfers that do reach the poor, such as Bolsa Família, which is highly regarded across the world and reaches the poor like hardly any other social programme in Brazil. This would help particularly children and youths. Currently Bolsa Família only represents 0.5% of GDP out of the 15% of GDP that Brazil spends on social transfers (OECD, 2018). There is also scope to reduce transfers to the corporate sector, which have increased markedly over recent years. These transfers, often granted in the form of tax exemptions or subsidised lending, have not been associated with visible improvements in productivity or investment, but they benefitted primarily the more affluent, besides creating fertile ground for corruption and political kick-backs.



Further advances in living standards will also hinge on finding a new inclusive growth strategy, ensuring that the benefits of growth will be broadly shared across the population. Productivity will have to become the principal engine of growth in the future, because the demographic bonus that has supported growth in Brazil is reversing. But raising productivity will require significantly higher investment and trade. Brazil has one of the lowest investment rates among OECD and emerging market economies and it is also less integrated into global trade. Boosting investment and trade would raise productivity, helping Brazilians to access higher wages and living standards.

References:

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