Notes on the relatively recent Brazilian experience of economic growth with (government-led) income redistribution and the social policies associated with it

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What exactly are we talking about?

- 1 – Average annual GDP growth of 4.3% between 2004 and 2011 (including, therefore the post 2008 crisis years). And 3,8% between 2002 and 2011.
- 2 – Reduction of 10% in the Gini coefficient measure of personal income inequality (from 0,586 in 2002 to 0,527 in 2011- still a very large number.
- 3 - The number of " extremely poor" Brazilians was roughly cut in half in the same period (from close to 18 million with less than US$ 40 a month to 9.5 million people – or close to 5% of the 191 million Brazilians).
- 4 – This seems a decent first approximation of "inclusive growth" to me. More on that later.

Why is this special?

- A former fast-growing country turned economically stagnant for roughly two decades (1981-2001) seems to have come to life once again.
- Average annual GDP growth of 7.5% between 1947-1980 – quite impressive.
- Average annual GDP growth of 2.1% between 1981 and 2002 – not that impressive.
- One of the worst personal income distributions in the planet – had remained relatively stable (and awful) around 0.6 since the middle 1970s (there are no good data for previous decades).
- On the other hand, lots of developing countries did grow fast in the last decade as well (e.g. Colombia, Chile, Turkey , and Russia all had average annual growth rates close to 5%. while Argentina had 7.5% and Uruguay had 6%, not to mention India and China) – and most Latin American countries did so while also improving their income distribution.

Of course, a lot (of institution building) happened during the two lost decades (I)

- (i) return to democratic rule (1985) – Volcker´s tight monetary policy in the early 1980s hurt significantly Brazil, among other heavily indebted countries, and contributed to the fall of the military government;
- (ii) A new Constitution with important welfare state provisions (1988) in a country with not a lot of money to pay for them;
- (iii) a flirt with hyperinflation in the first – institutionally weak – democratic years (1986-1994);
- (iv) price stabilization (1994);
- (v) explicit fiscal surplus and inflation targets (1999);
- (vi) “fiscal responsability law” (2000) made sure the aforementioned fiscal targets were credible.

Of course, a lot (of institution building) happened during the two lost decades(II)

- (vii) a reasonably competent bureaucracy kept improving the ability of the (federal, mostly) government to design and implement better public policies.
- (viii) the government is now able to track the poor, the old and the people with disabilities, know who they are and where they live and can reach them – for example. A "social safety net" of sorts has been put in place.
- (ix) the government is also able to collect taxes and fine tune increases and decreases in tax revenue when necessary (it could increase revenue significantly in crises, for example).
- (x) several exchange rate crises have made perfectly clear the importance of reducing external debt – or, more precisely, reducing dollar denominated debt. In recent years, the so called "original sin" has been, partially at least, forgiven.

But how exactly the resurgence did happen?

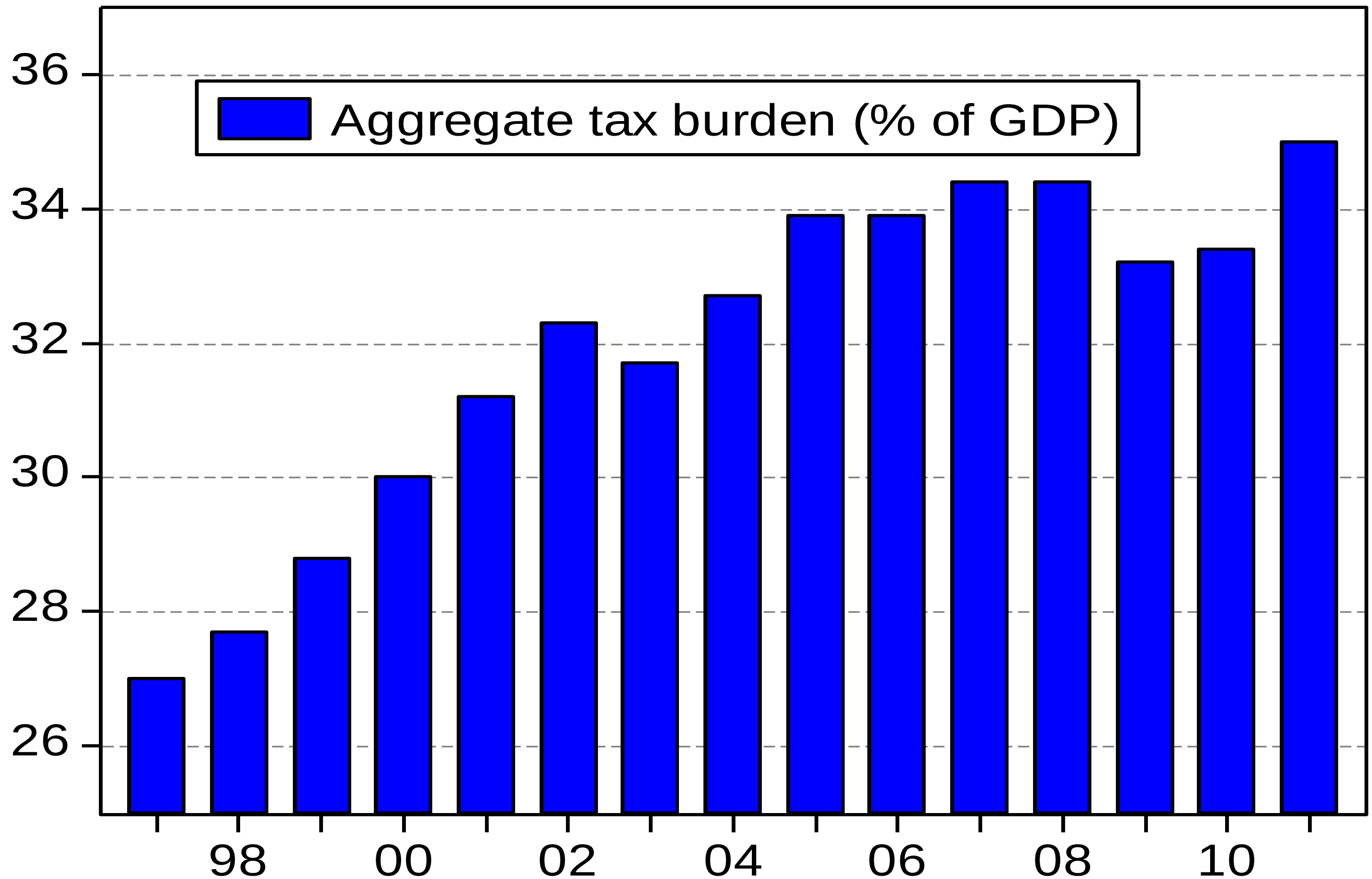
- Like other “emerging economies” Brazil did benefit a lot from both increased global trade since 2002 and higher commodity prices. So private investment went up while the classic “external constraint” to growth was lifted for a while.

- Moreover, and this is crucial, the aggregate tax burden increased significantly. This allowed both a significant reduction in government debt and a significant increase in government transfers to the old, people with disabilities, and the poor.

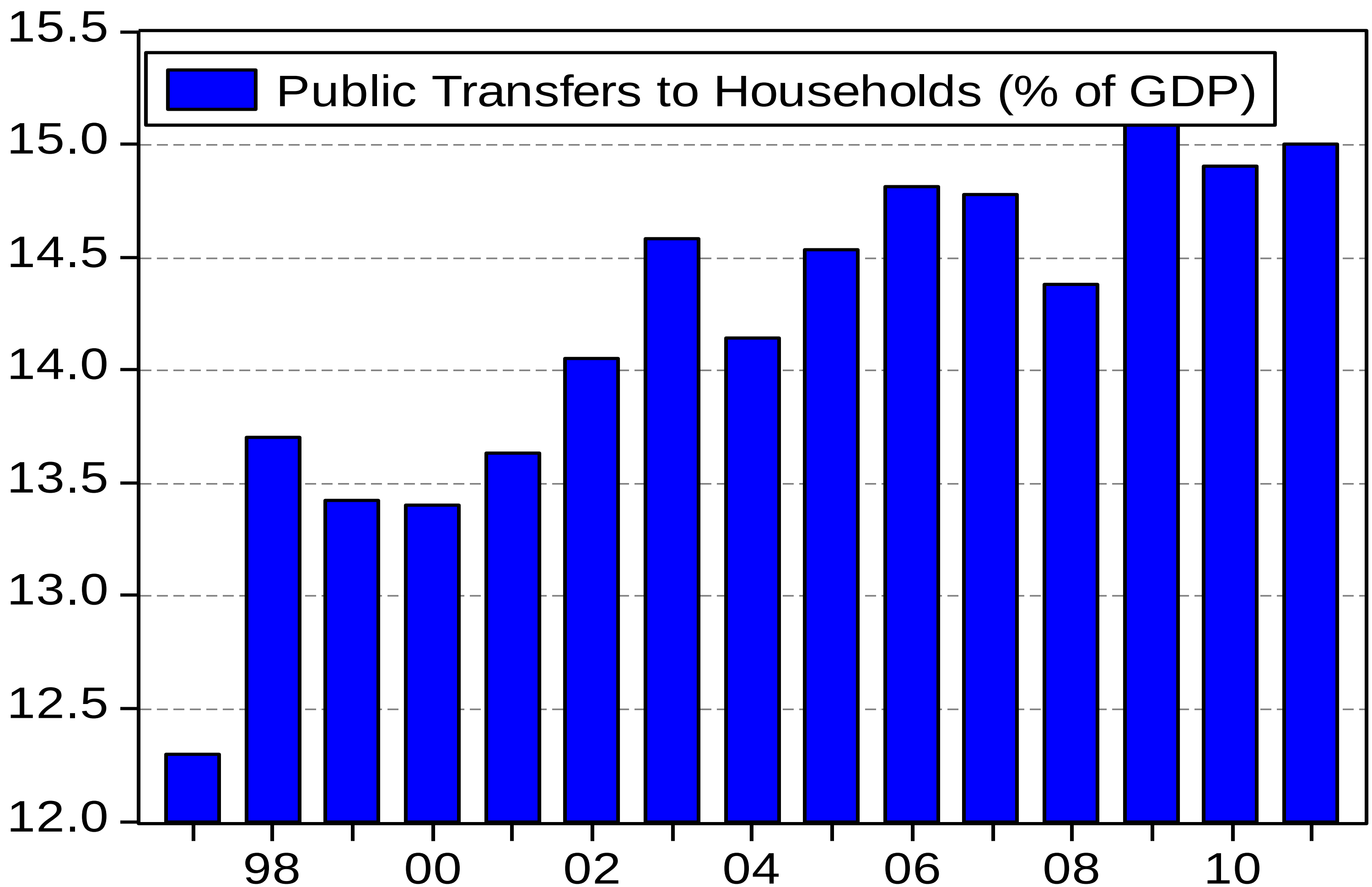
- Additionally, financial inovations allowed the expansion of credit – especially (but not limited) to the people receiving government transfers (whose ability to pay was clear).

- The combined effect of these measures brought millions of people to the marketplace – and that, in turn, generated even more investment. A virtuous cycle of growth -income redistribution-more growth was put in place.

Of course, without money, it is kind of difficult...



But where did the money go? (1)



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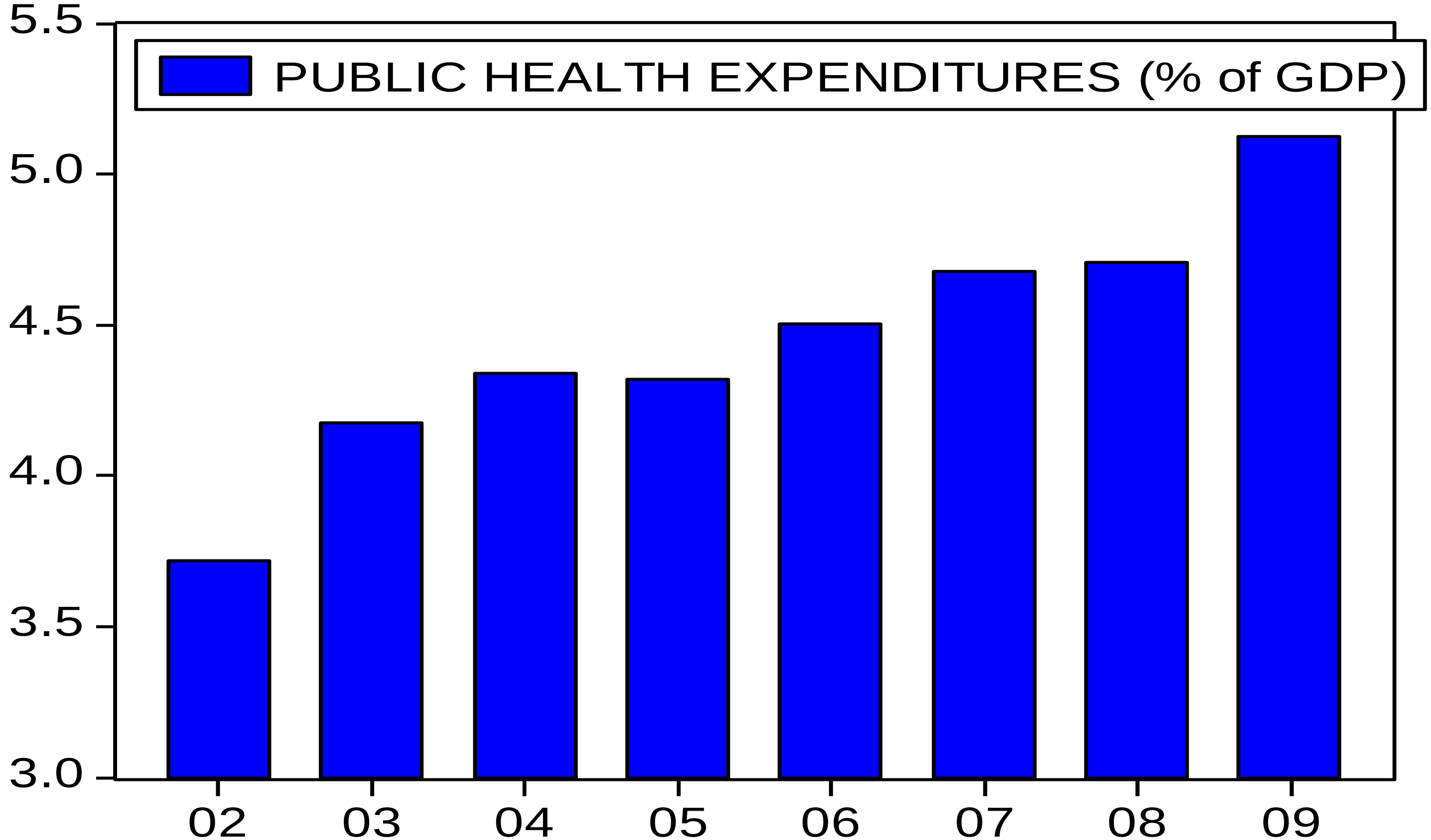

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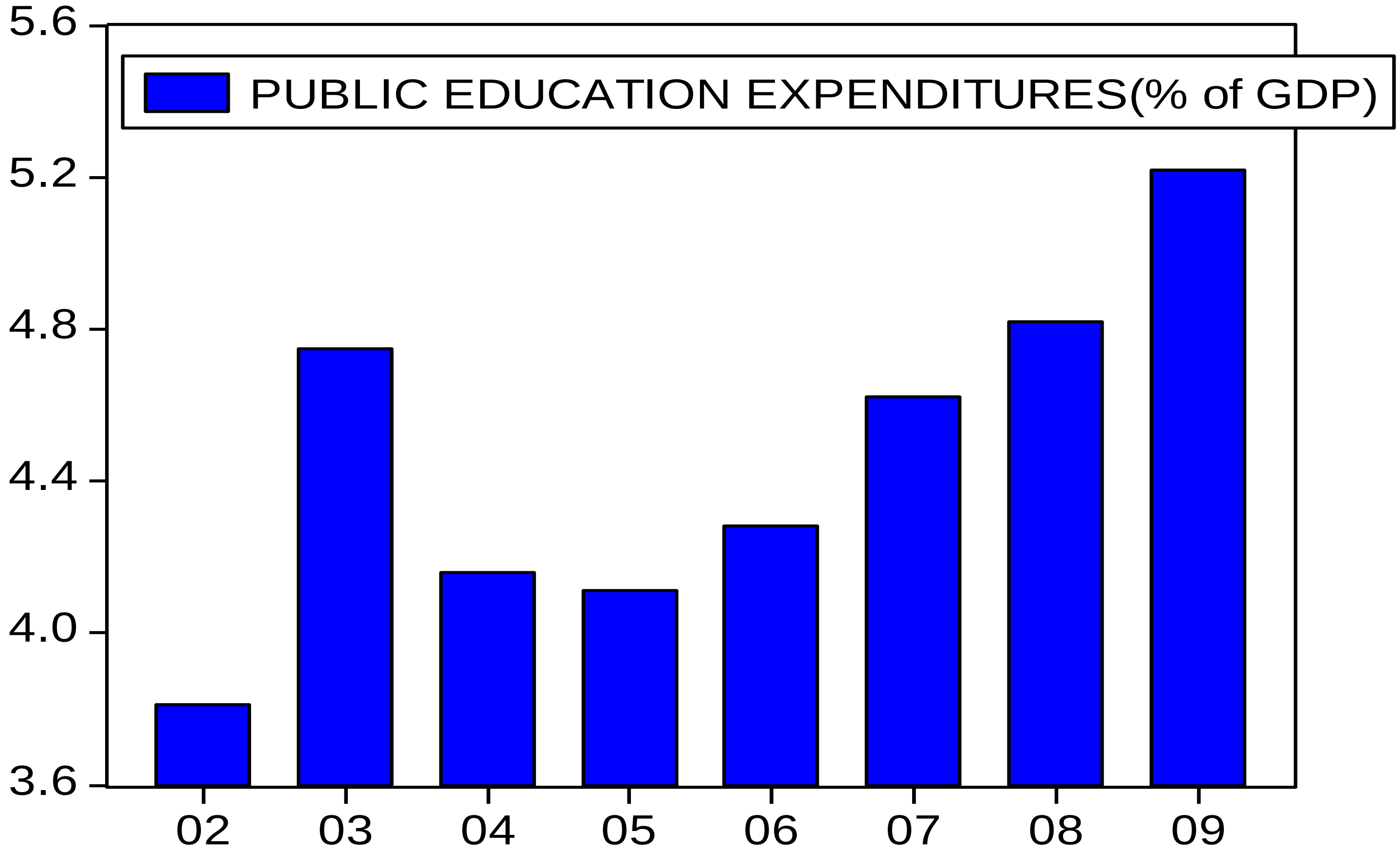

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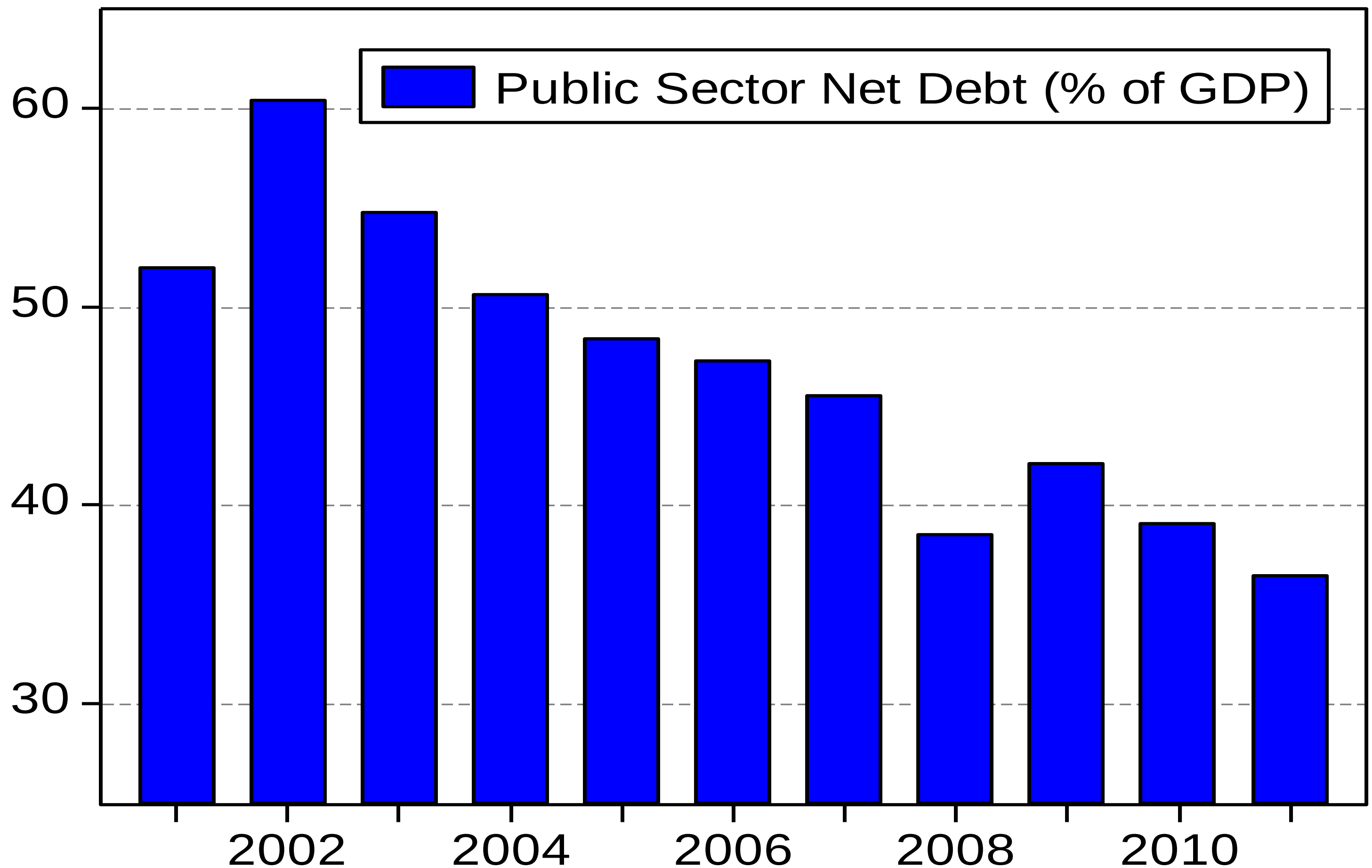


A first summary

- From a macroeconomic perspective the recent Brazilian “inclusive growth” experience can be seem as the result of (i) good external environment (relaxation of the external constraint); (ii) increased (and better targeted) government transfers and consumption expenditures; (iii) increases in the availability of credit to the poor; and (iv) larger “fiscal space” (and domestic saving) provided by increases in the tax burden (and despite the increase in consumption of the poor) .
- This seem to me a good first approximation of the “main drivers” of Brazil´s “inclusive growth strategy”.

Which Social Policies? A closer look at the Brazilian Public Transfers (1)

(i) Before we take a look at the transfers, it is important to notice that Brazil is a country of roughly 193 million in which public health care is freely available for all (even if often lacking in quality), and close to 50 million people have access to public (elementary, middle, high and college) education free of charge. The country spends roughly 10% of its GDP with its public education and health systems.

(ii) Turning now our attention to the transfers themselves, we begin by noting that almost 26 million Brazilians receive (close to 6.6% of GDP in) benefits from the general – contributory – social insurance program. Close to 16 million of these benefits amount to exactly 1 monthly minimum wage.

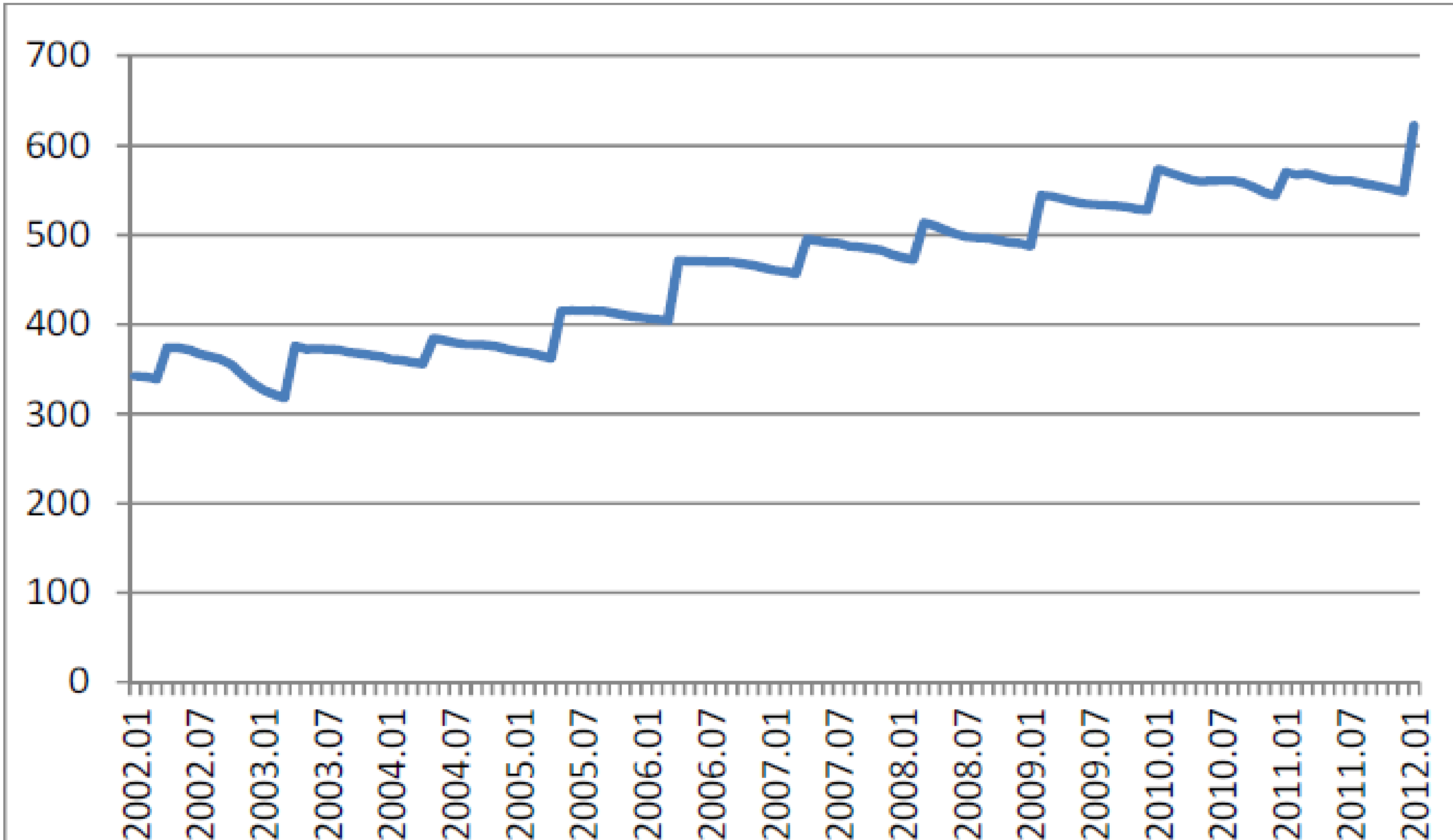
(iii) Other 4 million poor Brazilians (who are 65 or older and/or with disabilities) receive from the government monthly stipends of exactly 1 minimum wage even without having had to contribute for them. This costs the country around 0.6% of GDP;

(iv) And then there is the famous “Bolsa Familia”, Brazil´s largest cash transfer program (which alone is responsible for close to 1/3 of the total reduction in personal income inequality) affecting 13 million households and around 40 million people. Its “bang for the buck” is undeniable, for it costs only 0.4% of GDP – for the value of the average benefit is close to one fifth of the minimum wage.

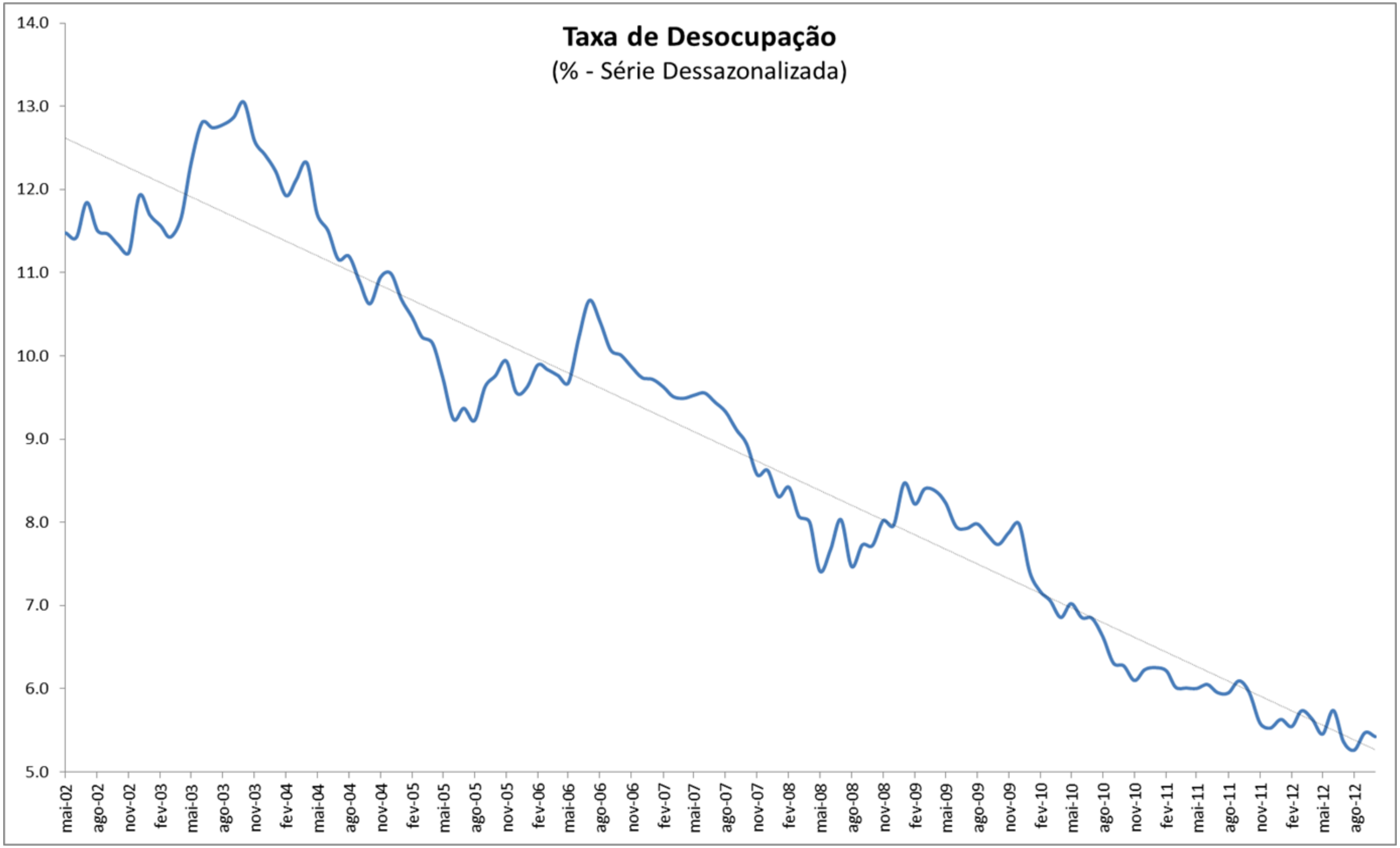
Which Social Policies? A closer look to Brazilian Public Transfers (2)

- Let us not forget the close to 3.5 million Brazilian public servants who retired or died and generated pensions – for the country spends more than 4% of its GDP with them (yep, this is 10 times more than it spends with Bolsa Familia).
- And, of course, the 8 million people who receive (close to 0.6% of GDP every year) unemployment benefits and the 17 million people employed in the formal labor market and receiving low wages, who receive an extra minimum wage from the government (add 0.25% of GDP to the bill)
- It is now easy to understand the crucial importance of the minimum wage in the Brazilian growth strategy. Not only it affects the labor markets but also affects several key public transfers – increasing private income.

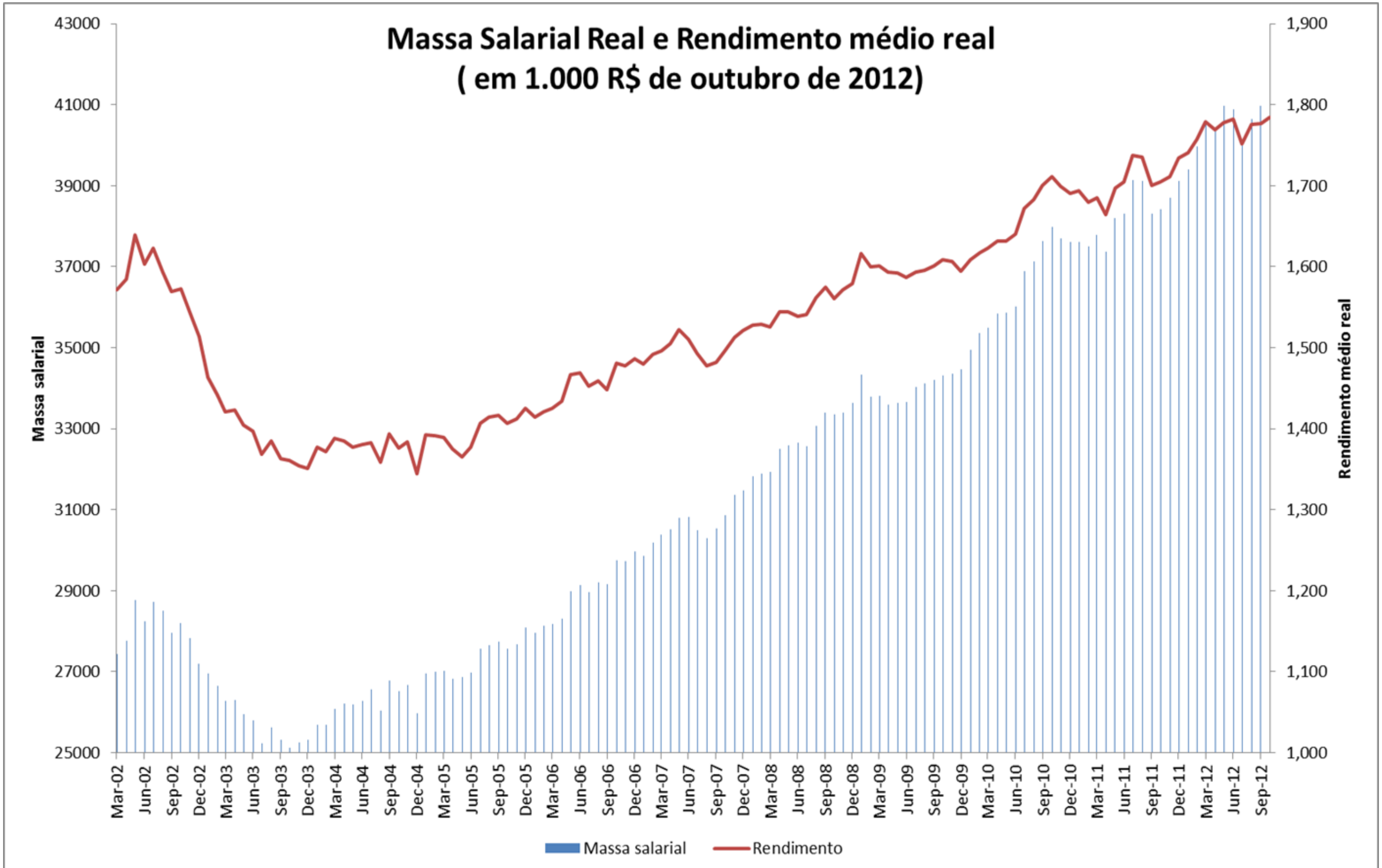
Which Social Policies? (3) The minimum wage (in real terms)



Which Social Policies? (4) Increases in the minimum wage did not prevent (quite on the contrary!) a brilliant labor market performance



Which Social Policies? (5) More on the brilliant labor market performance



Some more facts and a hypothesis about the brilliant labor market performance (1)

- The data is clear that a few sectors have driven the increase in jobs – i.e. (i) public administration, (ii) financial services, (iii) water, electricty and gas, (iv) real estate and rentals, (v) construction, (vi) transportation, storage, and mailing services, (vii) retail; and (viii) oil.
- Together, these sectors respond for close to 85% of the total increase in the labor income tax revenue between 2009 and 2004. And for close to 70% of the increase in the total wage bill in the same period

Some more facts and a hypothesis about the brilliant labor market performance (2)

- It is important to notice that a large part of the increase in taxes happened in payroll taxes – and that the labor market dynamics is the main reason for that. And that another large share of the increases in taxes happened on income taxes – and again the labor market (and increased profits) are to blame.
- The hypothesis is that this pattern of job growth is endogenous to the inclusive growth strategy – given the increases in the size of the government and public services associated with it, as well as the demand impact of the much higher wages.

The impact of government transfers on personal income distribution and poverty: A summary (1)

(i) The data show clearly that government transfers in Brazil improve personal income distribution and help to reduce poverty – and are, therefore, key to associate the adjective inclusive to the noum “growth”.

(ii) The data show clearly that the impact of cash transfers programs – like (mostly) Bolsa Familia and the public transfers to persons with disabilities and senior citizens – is particularly large.

(iii) The data is clear also that the general social insurance program does improve income distribution (not as much as the previous transfers, but still) , while pensions of public servants don´t

The impact of government transfers on personal income distribution and poverty: A summary (2)

(iv) The data is clear also that the general social insurance program costs a lot of money – and that its size is fundamentally determined by the size of the minimum wage. So increases in the minimum wage have a smaller “bang for the buck” than increases in cash transfers

(v) But the data is unclear –you need a theory for that – on the impact of the minimum wage on the labor market. And that is crucial, for the data is clear that labor incomes are the main drivers of the reduction on inequality

But shouldn´t all this mean a reduction in the saving rate of the economy?(1) Well, no.

Table 4: Investment and saving in 2002-2011 (as a % of GDP)

Years	HH Cons.	Gov. Cons.	Total Cons.	Invest (Gross fixed capital formation)	Total Invest.	Domestic Saving	Ext Saving.	Net income received from abroad	Net Exports	Net External Liabilities
2002	61.72%	20.57%	82.29%	16.39%	16.20%	14.69%	1.51%	-3.54%	1.51%	-55.10%
2003	61.93%	19.39%	81.32%	15.28%	15.77%	15.95%	-0.18%	-3.26%	2.91%	-46.30%
2004	59.78%	19.23%	79.01%	16.10%	17.12%	18.47%	-1.36%	-3.04%	3.88%	-40.68%
2005	60.27%	19.91%	80.19%	15.94%	16.21%	17.35%	-1.14%	-2.89%	3.61%	-34.50%
2006	60.30%	20.04%	80.34%	16.43%	16.76%	17.58%	-0.83%	-2.49%	2.90%	-33.27%
2007	59.90%	20.26%	80.15%	17.44%	18.33%	18.08%	0.25%	-2.09%	1.52%	-35.96%
2008	58.93%	20.19%	79.12%	19.11%	20.69%	18.78%	1.92%	-2.40%	0.19%	-21.83%
2009	61.11%	21.21%	82.32%	18.07%	17.84%	15.91%	1.93%	-2.02%	-0.16%	-32.28%
2010	59.64%	21.15%	80.79%	19.46%	20.24%	17.53%	2.71%	-1.83%	-1.03%	-39.19%
2011	60.33%	20.68%	81.01%	19.28%	19.73%	17.22%	2.51%	-1.91%	-0.73%	-33.98%

Source: IBGE and Central Bank of Brazil.

But shouldn´t all this mean a reduction in the saving rate of the economy?(2) Well, no.

- Domestic saving is the sum of government´s, (financial and non-financial) firms´, and households´ saving. It therefore can go up even if the latter goes down, given increases in the other three components.
- This is precisely what happened in Brazil in the last decade. Investment (mostly) and domestic saving went up – even if households´ saving went down.

But shouldn´t all this mean a reduction in the saving rate of the economy?(3) Well, no.

Table 5: Composition of national disposable income and domestic saving

	Household disposable Income (% GDP)	Household Saving (% GDP)	Non financial firms disposable income (% GDP)	Non financial firms saving (% GDP)	Financial firms disposable income (% GDP)	Financial firms saving (% GDP)	Govt. disposable income (% GDP)	Govt. saving (% GDP)
2002	66.20%	5.86%	8.89%	8.89%	5.15%	4.41%	16.73%	-4.48%
2003	65.94%	5.72%	11.30%	11.30%	3.51%	2.46%	16.52%	-3.53%
2004	63.52%	5.37%	12.57%	12.57%	2.86%	1.92%	18.53%	-1.39%
2005	63.32%	4.65%	11.15%	11.15%	3.73%	2.81%	19.33%	-1.26%
2006	63.43%	4.85%	11.50%	11.50%	5.09%	4.04%	17.91%	-2.80%
2007	63.18%	4.68%	10.92%	10.92%	6.40%	5.39%	17.72%	-2.91%
2008	61.93%	4.63%	11.84%	11.84%	4.14%	3.04%	19.98%	-0.74%
2009	64.55%	4.69%	10.63%	10.63%	3.45%	2.71%	19.59%	-2.12%

But there are problems, of course (I): A closer look at the composition of the tax burden

- The composition of the tax burden also can be improved considerably.

(1) Close to half of it consists of consumption taxes – which are regressive;

(2) Personal income taxation – which is progressive – is very small in Brazil (2,2% of GDP – against an OECD average of 9% of GDP).

(3) Property taxes are also quite small (only 1,3% of GDP – against an OECD average of 2%)

But there are problems, of course (II)

Public expenditure is still poorly targeted in Brazil

(1) The country spends more with interest payments on public debt (5,5% of GDP) than on public education or health services;
(2) A lot of what is spent on public goods go to the higher income groups
(3) Moreover, the quality of the public education and health services is poor. More and better investment in human capital would be highly desirable.

But there are problems, of course (III)

Table 2 – Composition of Brazilian exports (% of total)

Year	End-use categories						Degree of elaboration		
	Consumption durables	Consumption non durables	Consumption (total)	Intermediary goods	Capital goods	Oil	Basic	Manufactured	Semi-manufactured
1974	2.36%	15.22%	17.58%	76.62%	3.22%	1.66%	57.57%	28.46%	11.57%
1984	3.85%	21.66%	25.51%	63.30%	4.22%	6.98%	32.24%	56.03%	10.64%
1994	4.55%	16.93%	21.49%	67.45%	9.06%	2.00%	25.39%	57.32%	15.83%
2004	5.94%	16.87%	22.81%	59.11%	13.02%	5.06%	29.51%	54.96%	13.89%
2005	5.90%	16.87%	22.77%	57.53%	13.10%	6.60%	29.30%	55.14%	13.47%
2006	5.28%	16.21%	21.49%	57.76%	11.91%	8.83%	29.23%	54.44%	14.17%
2007	4.66%	16.71%	21.37%	57.30%	12.17%	9.16%	32.12%	52.25%	13.57%
2008	3.88%	16.60%	20.49%	57.36%	11.54%	10.61%	36.89%	46.82%	13.68%
2009	3.45%	16.98%	20.43%	61.01%	8.78%	9.78%	40.50%	44.02%	13.40%
2010	3.39%	15.20%	18.58%	63.08%	8.02%	10.31%	44.58%	39.40%	13.97%
2011	2.68%	13.84%	16.52%	64.92%	7.54%	11.02%	47.83%	36.05%	14.07%

Source: IPEA

A final summary

- Even better targeted transfers would be welcome
- More hard work in providing better public education and health services is needed
- Marginal changes in the composition of the tax burden also seem appropriate
- Long term macroeconomic stability seems to be a pre-requisite to any sustainable economic growth path (inclusive or not).
- All these things appear to be decisive for a succesful long term inclusive growth strategy.
- But there is no doubt that government transfers and expenditures were the key drivers of the whole process