

Discussion of the History of Brazil 2

Teresa Ter-Minassian

International Economic Consultant

I would like to thank the organizers of this volume for inviting me to comment on the interesting chapter by Garcia et al. on the fiscal and monetary history of Brazil, 1960–2016.

The chapter covers a long period (more than fifty years) of Brazil's macroeconomic performance, seeking to trace the main causes of its persistently high rates of inflation and the reasons for the failure of various attempts to tame it, until the successful Real Plan of 1994–95. It then discusses how the plan succeeded in achieving sustained disinflation by breaking the inflation inertia due to pervasive indexation mechanisms and ending the prolonged passive stance of monetary policy by strengthening the institutional framework for the conduct of this policy.

I broadly agree with most of the analysis in the chapter; therefore, I will concentrate my remarks on a few areas in which I differ somewhat from it. I will start by noting that, while the Real Plan did indeed represent a major turning point in the conduct of macroeconomic policies in Brazil, it fell short of optimal in a number of respects. The years between its adoption and the end of the century (1995–98) witnessed a significant real appreciation of the exchange rate and related weakening of Brazil's external accounts, a progressive easing of monetary policy, and most importantly, inadequate fiscal adjustment.

Public finances deteriorated significantly during that period, as the growth of real spending, no longer eroded by high inflation, significantly outpaced that of revenues. The primary balance of the consolidated public sector deteriorated significantly, moving into deficit. The overall deficit narrowed initially, reflecting a sharp decline in nominal interest rates, but worsened subsequently, and the public debt rose by nearly 10 percentage points of GDP. To be sure, important structural fiscal reforms were undertaken during those years, including the restructuring of subnational debts and the de-earmarking of a significant portion of revenues (the Fundo de Emergencia Social mentioned in the chapter), but they were insufficient to stem the deterioration in the fiscal accounts.

The substantial weakening of the external accounts, in an international context marked by the Asian and Russian crises, ultimately forced the adoption in early 1999 of a strong adjustment program, supported by large external International Monetary Fund and bilateral official financing. The program included the floating of the real, a substantial tightening of monetary policy and the adoption of inflation targeting, and a range of

revenue-raising and public expenditure containment measures. As a result, the primary balance moved into a significant surplus (around 3 percent of GDP), the nominal deficit was substantially reduced, and the growth of the public debt decelerated. Further, the institutional fiscal architecture was much strengthened by the adoption in 2000 of the Fiscal Responsibility Law.

While the fiscal adjustment was substantial and ushered in a prolonged period of significant primary surpluses, I would argue that it remained inadequate in terms of quality and sustainability. It relied mainly on increases in revenue, partly reflecting the adoption of distortive taxes, such as a financial transactions tax, and partly due to cyclical factors related to the commodity price boom of the first half of the 2000s. Spending continued to rise, reflecting increases in public employment and wages, and especially the growth of entitlement programs, as a result of the failure to adopt needed pension reforms.

The fiscal position started to steadily deteriorate in the aftermath of the global financial crisis, first reflecting strong stimulus measures and then a continued expansionary stance, even as the economy quickly recovered from the crisis. Between 2008 and 2016, the public sector's primary balance went from a surplus of 3.3 percent of GDP to a deficit of 2.5 percent of GDP, and the gross public debt rose to 75 percent of GDP. Furthermore, the deterioration during that period was partly masked by accounting stratagems and one-off operations of various sorts, including the use of financial and nonfinancial state-owned enterprises for quasi-fiscal purposes.

The sustained lack of fiscal adjustment has had a number of costs; in particular, it has necessitated the maintenance of high real interest rates and repeated tightening of credit conditions, with an adverse impact on domestic demand, especially in private investment. The failure to adopt needed structural reforms in taxation, pension systems, public expenditure management, and intergovernmental fiscal relations has also led to a compression of public investments and a further deterioration of the country's already inadequate infrastructure, with adverse effects on productivity and growth.

The roots of Brazil's fiscal malaise are deep and extensive and reflect distributive conflicts that the current political system appears unable to resolve. I would agree with the chapter's conclusion that the fiscal challenge facing the next administration "will have to be tackled, or the Real Plan will pass to history as a long noninflationary interregnum." Let us hope that the new government that took office in early 2019 will be able to muster the political consensus needed to effectively tackle the challenge.