What Brazil and China can learn from each other

Experts from Brazil and China discuss challenges to growth for both countries.

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IN THE LAST DECADE, BRAZIL AND CHINA have drawn worldwide attention: China because it has become the second largest economy on the planet, and Brazil thanks to its exports of agricultural commodities and minerals and its booming domestic market. But both countries still require reforms if they are to sustain their growth. The challenge is to consolidate the opening of their markets while also securing a balanced social safety net to reduce inequality.

But the challenges for each country are different. While Brazil strives to increase domestic savings and overcome historical structural bottlenecks, China needs to slow investments and increase the share of domestic consumption in GDP. While China races against time to fix deficits in its social safety net as its population ages, Brazil needs to balance its extensive social safety net with curbing government spending and easing the tax burden. “It is as if Brazil were to take lessons on capitalism from China, and China had to learn something from Brazil about socialism, such as social inclusion and social benefits, but without overdoing it,” said Roberto Abdenur, CEO of Brazilian Institute for Ethics in Competition (ETCO) and former Brazilian ambassador to China.

This was the heart of the debate as Chinese and Brazilian experts gathered at two seminars late November in Rio de Janeiro. The event to celebrate publication of The Middle Income
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“we need a government that is more a service provider, which has regulatory functions rather than direct intervention. That means reducing the complexity of the rules, the tax system, and the consequent legal uncertainty.”

IBRE economist Lia Valls emphasized the need to restart reforms so that Brazil can break out of the middle-income trap—the loss of economic dynamism after a period of strong growth because of the country’s difficulty in transitioning beyond its current development policy. “For Brazil,” she said, “it is fundamental to improve productivity—which involves improving education quality and investing in innovation—to transition to a new stage of development that is no longer based on an import substitution policy.” She added that is also necessary to strive for a more open economy and to diversify markets and exports.

For China, Zheng Bingweng, director of Trap: Visions of Brazil and China marked the first anniversary of the research partnership between the Brazilian Institute of Economics of Getulio Vargas Foundation (IBRE-FGV) and the Institute of Latin American Studies of the Academy of Social Sciences of China (ILAS-CASS).

THE STATE AND THE ECONOMY

Chinese experts stressed the directive issued at the Third Plenary Session of the 18th Central Committee of the Chinese Communist Party held a few days before the seminar, which favors greater private sector participation in the economy over the next decade. They believe it is important to reverse the recent expansion of state control. “Especially since the 2008 financial crisis, the government has intervened [in the economy] significantly, boosting monopolistic activities,” said Liu Xiaoxuan, ILAS–CASS researcher. Liu stressed the intensification of government control of land and capital markets and the rent-seeking activities that prioritize gains from monopolistic activity, deforming the productive structure. “Much of the government investment of 4 trillion yuan in 2008 ended up in the housing market, creating a bubble; the increased costs of the housing market caused costs to rise in other sectors, creating huge inflationary pressure that is difficult to manage,” she stressed.

During the 2008 financial crisis, Brazil experienced a similar dynamic, IBRE researcher Fernando Veloso pointed out: “The debate we now see in China about reducing monopolies and opening the economy began in Brazil in the 1990s and is still not finished.” Putting the brakes on reform is maintaining—and sometimes intensifying—economic protectionism, which has negatively affected the business environment. Today, Veloso said,
ILAS-CASS, argued that the foundations of the new stage of reforms should give priority to such critical points as reducing government intervention in how economic resources are allocated, streamlining bureaucracy, restructuring government, creating small and medium-size banks, letting the market determine interest rates, protecting patents, and moving more economic activity, which today is concentrated on the coasts, to the countryside.

Among the challenges the world’s second largest economy faces, Zhao Shengxuan, ILAS-CASS vice president, highlighted the need to promote innovation and improve income distribution. He explained, “We pursue the goal of doubling the income of the country by 2020. To achieve it within a harmonious and stable society, we have to eliminate the contradictions present in such key sectors as housing, employment, and education, and embrace development as a path. This is the strategy that will define the future of China.”

SOCIAL ISSUES
Establishing a social safety net that reduces inequality is a complex task for China because its population is aging and there are serious imbalances. In the last decade, while Brazil put up a good fight against inequality, in China inequality worsened significantly. “In Brazil, the reduction in inequality resulted mainly from a growing labor market, the policy of raising the minimum wage, and income transfers,” said Fernando de Holanda Barbosa Filho, IBRE researcher. Marcelo Neri, president of the Institute of Applied Economic Research (IPEA), pointed out that the income of the poorest Brazilians grew 120% in the last decade while the incomes of the richest went up only 26%. “Even so,” Barbosa added, “like China, Brazil is still a very unequal country.”

For the Chinese, lack of a more developed social safety net is risky because the advantage of a large untapped potential for urbanization—China is only 51% urbanized compared to Brazil’s 84%—also carries the risk of intensifying social imbalances. A major reason is that there are still in place remnants of the old planned economy, such as the hukou system of controlling geographical mobility. Guo Cunhai, ILAS-CASS researcher, said that, although it has become more flexible since the economy has begun to open up, hukou still represents an immense disadvantage for peasants migrating to cities, where they do not have access to health, education, and housing.

The Chinese hope that in the next decade,
urbanization will boost GDP, which so far has been driven mainly by investment and exports. “Among the factors that may contribute to this is the reform of the tax system, which began in Beijing and Shanghai; it is relieving the tax burden on the service sector and stimulating the creation of jobs there,” said ILAS-Cass researcher, Xie Wenzhe. However, his colleague Fang Lianquan believes that the country needs to address not just migration but also informality and access to public services. “This is still a great challenge that combines an aging population with a retirement system that also records low levels of benefits and coverage,” she said. “We have observed with interest the United States and Brazil. Our concern is the sustainability of social benefit costs. Will we be able to fund programs?” She pointed out that Brazil’s public spending on education, health, social security, and housing today represents 27% of GDP compared to China’s 14%.

The experts noted that Brazil needs to address the cost of the social safety net and social security so that it does not jeopardize the country’s growth. Fabio Giambiagi, economist at the National Bank for Economic and Social Development, pointed out that the fiscal impact of social security benefits is becoming increasingly serious partly because of the policy of indexing social benefits to a minimum wage that is regularly raised. Today, social security pensions linked to the minimum wage explain 26% of the reduction in inequality, but Valls emphasized that “social safety net excesses can influence the country’s business environment, since a high tax burden [to pay for benefits] undermines domestic savings, which, in turn, limits investment.” She noted that between 1990 and 2005 the Brazil tax burden rose from 25% to 35% of GDP.

Despite the success of Brazil’s social programs, Barbosa advocated for review of some policies. “Raising the minimum wage has a high fiscal cost and no longer addresses poverty,” he said. “Today, expanding the minimum wage by 10% would cost R$3 billion, but only R$100 million would reach the poorest,” he said. “In contrast, the Family Grant benefit is about 20% of the minimum wage, is better focused on the poor, and has a lower tax cost of only R$13 million for each R$1 increase in benefit.” Barbosa also questioned whether changing current social programs would be desirable, arguing that “we should focus more on improving teaching and specific regional policies. Because regional inequality in Brazil is large, reducing it could give better results at lower cost.”