Without social security reform, the constitutional spending ceiling could be disastrous

Aloisio Araujo
Professor and researcher, the Getulio Vargas Foundation Graduate School of Economics (EPGE) and the Applied Mathematics Institute (IMPA)

Solange Monteiro
WHEN IT COMES TO CONTAINING public debt and placing the country on a sustainable growth path, Professor Aloisio Araujo, the only Brazilian economist elected to the U.S. National Academy of Science, has a clear idea of the role the government should play in the economy. He agrees with President Michel Temer’s strategy of making privatization a priority and setting a ceiling for public expenditure—as long as it is accompanied by social security reform—but argues for retaining constitutional mandates on spending for health and education. He believes that making education spending more efficient should not be done through budget cuts: “We have to rebalance government finances and ensure funding for health, education, science and technology, through two fronts: social security reform and reducing the role of government as operator of state-owned companies, which are vulnerable to political manipulation.”

Nobel Prize winners Erik Maskin and Robert Lucas participated in the meeting of the Association for Public Economic Theory (PET) at FGV in July. What were their views on the current state of the Brazilian economy?
Since the discussions focused on economics, most of the presentations did not address Brazil’s problems directly. But some things clearly applied: Lucas, for example, stressed the importance of education. This is relevant for Brazil today: in
the crisis we are living with, a large fiscal adjustment is necessary, but we must remember that investments in education should be preserved. The Chicago School, in which Lucas participates, was the first to recognize the importance of education in human capital theory, which explained the Industrial Revolution as the product of family concerns to raise more educated children.

Meetings like that in July help because they not only discuss our problems, but bring in scholars who are at the research frontier to meet our students and researchers. I have devoted much of my career to training doctoral students ... because I believe that a great country like Brazil should not focus only on the daily public policy debate. It is also necessary to prepare people to dialogue with those at the research frontier and think more deeply about our problems. In several countries, especially the United States, there is more sophistication in the public policy debate, and that is what we should replicate here.

How can the economic policy debate in Brazil be improved?

I think it will take a little bit of everything. Brazil started late and that has been costly. When I arrived at EPG in 1983 after teaching in the United States, I dealt with two issues that today are considered banal. The first is that education is important for economic growth, and the other is the connection of inflation to fiscal policy, so that curbing inflation requires containing public spending. These issues, which are obvious, took too long for society to understand, and that has had its price. The recent fiscal relapse shows the lack of maturity of Brazilian society.... With more sophisticated models we can continue debating to refine [economic policy]. We still have much more to do because, first, the knowledge frontier keeps expanding. Second, as we approach the frontier, we have to deal with the specifics of Brazil’s problems.... I hope the government understands the importance of sustained funding for research.

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You mentioned the need for a debate on fiscal adjustment. Do you approve of the constitutional amendment to limit public spending that President Michel Temer has proposed?

I would like this constitutional amendment if it were accompanied by social security reform, phased in rapidly. Without reform, we will have to cut essential spending, which could be disastrous. The govern-
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The proposed constitutional amendment to cap public spending is a heroic measure, in the midst of a profound crisis, in a country without an investment grade rating, but it will only make sense if there is social security reform. For example, we need to equalize the retirement age of rural and urban workers immediately, of men and women immediately; this will allow savings to ensure that there are resources for the sectors I have mentioned.

It has been found that spending on education is not efficient or sustainable, and that public spending on higher education benefits the wealthy. Do you agree that we need to review education policies? Spending on higher education is a big problem; we have improved it and reduced the gap between what is spent on higher and on basic education ... but we still need to cut excesses and ensure that educational institutions and students meet minimum qualifications. Anyway, we are heading in the right direction.

As for the efficiency of spending, it is certainly something we can improve through program evaluation and cost-benefit analysis—which is not done much in the Brazilian public sector in general. Early childhood education is essential because that is the point in a child’s life when the expenditure is most productive. The quality of the National Program for Access to Technical Education and Employment (Pronatec), for example, is doubtful. I prefer the idea of a program in

ment is saying it will make a complete reform, but assuming the worst case scenario, where it is politically very difficult to carry out reform that would mean steep spending cuts, including, for example, cuts in education and health spending, where we still need much investment. In early childhood education, only 20 to 30% of poor children have access to education. Many high schools do not have labs or gymnasiums, and the children spend little time in school. In the health sector, the problems are similar. The waiting time for treatment of cancer or heart diseases, which determines the survival of a patient, is now long. We have to spend more on education and health because they are essential. I also consider spending on science and technology to be essential because without them there is no future. There have been many cuts in this area, we seek more efficiency with few resources, but it’s hard. ... We must ensure spending that give good results for Brazil.
partnership with the private sector, which knows what the market needs, rather than just opening a technical course financed by the government.

But it is not only in Brazil that there is waste in spending on education, and we should not cut spending on education only because we spend badly. That would be the worst of all worlds. I do not know if it is true that having fewer resources will make spending more efficient; we may end up cutting what is easier and not where there is more waste. … I have a deep distrust of public sector efficiency and its ability to evaluate teachers because there is an immediate reaction from people that interferes with the efficient allocation of resources. You have to be careful with this kind of criticism, because it can lead to very bad economic policies.

**Do you support retaining the mandatory spending on education and health as required by the Constitution?**

I think that the spending mandate was a good decision. At first I was afraid, but then we saw that the Human Development Index has improved as education opportunities expanded. There are much better systems [for allocating resources to education and health], but without the spending mandate the balance of political forces could be very bad [and unfavorable to the poor]. I understand that it is harder to carry out fiscal adjustment when spending is mandatory. But suppose the economist wants to solve the fiscal adjustment problem and because elections are coming the politician chooses not to reform social security because that is politically less costly. Rather than seeking for culprits, we should focus more on what we spend and we should not have spent, as on the growth of government and the creation of state-owned enterprises.

**You have always supported privatization and concessions to increase efficiency and economic growth. Today this issue is back on the policy agenda, but more to generate cash flow to contain the federal budget deficit. Could that pose risks to privatization and concessions?**

Privatizations serve not only to ensure efficiency and economic growth, especially in a difficult fiscal situation, but also to contain corruption. It is difficult for society to supervise a bloated government
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and understand whether public funds are being well applied. But it is important to design privatization well. Often the result is an auction that is not competitive and a price for services that is not appropriate, so that renegotiation becomes necessary, as in the case of airport concessions.... Mexico privatized phone services by selling its phone service monopoly, which was bad; it resulted in very expensive phone services. We did not do the same, though the auctions of our telecommunications, for example, were far from competitive. In that case, technological advances have reduced the cost of phone services, but in other sectors, such as ports, we need to think about how auctions are designed.

Privatization is a big task because there have been so many recent changes. When the economy was relatively better, the government could demand a lot of investment in return. Today, however, government needs more cash flow because of the fiscal situation, and ... it needs to sell concessions to the highest bidder.

Does this imply less commitment to future investment?

We need to get some private sector commitment to investment, but not so much as was required in the past. We have to be realistic. Of course it is good to have low fares and large investments, and even subsidize private investors, if necessary. Currently, however, the fiscal situation is very difficult.

But I think we can have a balance. I have advocated for privatization of sanitation companies, which could serve as a counterpart for renegotiation of state debts. In this case, for example, you have to demand from private investors the expansion of sanitation for all people. Sanitation is something that affects everyone and, in relative terms, Brazil is much farther behind in sanitation than in other sectors. We already have a successful example where the federal government promoted privatization of state banks in exchange for restructuring state debt in the 1990s. For sanitation it would be the same. ...

So we have to rebalance government finances and ensure funding for health, education, science and technology, through two fronts: social security reform and reducing the role of government as operator of state-owned companies, which are vulnerable to political manipulation.