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Pro- and Anti-Market Reforms in Democratic Brazil

Armando Castelar Pinheiro

Regis Bonelli

Samuel de Abreu Pessôa

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Pro- and Anti-Market Reforms in Democratic Brazil

armando castelar pinheiro, regis bonelli,
and samuel de abreu pessoa

This chapter is motivated by a riddle: why, after implementing so many reforms over the last quarter century, has Brazil fared so poorly at accelerating economic growth? There are two possible answers. The first is that the reforms were well chosen and well targeted but faced serious obstacles in meeting the growth objective. They may have been poorly implemented or incomplete, perhaps because of problems of design (poor sequencing or lack of complementary reforms, for instance), or because they were sidetracked by problems not initially foreseen or that emerged during, or were even caused by, the reform process itself. This explanation fits the facts in Brazil's case: the process of market-oriented reform did face implementation problems, for example in the regulation of infrastructure, and it does remain incomplete in several areas, from education to judicial reform.

The other explanation hinges on the reforms themselves: although pursued forcefully, they may have targeted the wrong foundations, failing to address those that were actually constraining growth. This may have occurred, for instance, if the reforms were selected to foster goals other than accelerating growth. This description, too, fits the Brazilian case, not so much because the reforms as a whole

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aimed at the wrong foundations, but rather because several of the reforms were more concerned with distribution than with growth, while others did seek to foster growth but did not do so in a market-oriented way. More important, the reforms that pursued these other goals were not neutral with respect to growth but actually compromised the foundations for growth. In short, even as policymakers were, with one hand, fighting inflation, opening the economy, eliminating restrictions on business practices, and privatizing, with the other hand they were actively pursuing what we call anti-market reforms: changes in legal norms and policies that discouraged investment and productivity growth. These reforms seriously weakened the link between market-oriented reform and growth. As a result, the reforms as a whole, while reducing the burden of regulation, at the same time enhanced the role of the state in directly allocating resources, by expanding public expenditure, and weakened property rights.

One can point to several examples of this parallel reform agenda. The 1988 constitution sought to enhance political competition and equality of opportunity, but it also contained some clearly nationalist and statist provisions: it established public monopolies in telecommunications, oil, and the distribution of natural gas; created barriers to foreign ownership in mining and electricity; and reduced contract flexibility in labor markets. In addition, the stabilization plans of the 1980s and 1990s relied on price freezes that breached financial contracts and, in the case of the 1990 plan, blatantly disregarded property rights. More recently, a large primary fiscal surplus contributed to stabilizing the public debt-GDP ratio, but it coexisted with a huge expansion in taxes and current expenditure. Income transfer programs helped spread the benefits of growth, but these were structured in such a way that they discouraged participation in the social security system. A more independent judiciary increased protection against arbitrary government decisions, but, by pursuing distributive goals rather than imposing the rule of law, judges have often weakened contract and property rights.

We regard the expansion in public expenditure, the change in its composition (a decline in public investment and a rise in current outlays), and the concomitant increase in the tax burden as the most harmful of Brazil's anti-market reforms, because of the consequences for macroeconomic stability. Looking forward, priority should be given to a fiscal reform aimed at reducing current expenditure and the tax burden, while creating the fiscal space needed for an increase in public infrastructure investment. Implementation of such a reform will require overcoming political barriers of various sorts. Part of the rise in current public spending stemmed from new obligations enshrined in the 1988 constitution or created in the following years, which were perceived as necessary for securing citizenship rights and the stability of democratic institutions. The new constitution also ended twenty years of fiscal centralism, eventually causing a major expansion in state and municipal revenue and fiscal spending that will be hard to reverse, given that political support for spending reduction is weak.

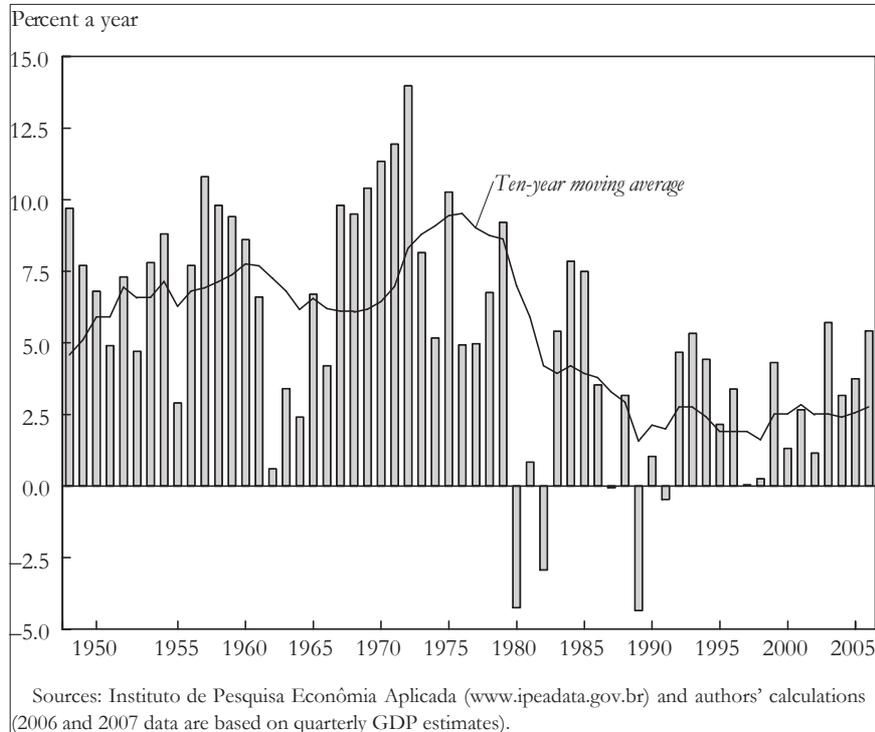
This chapter discusses the Brazilian reform riddle and identifies the reforms that we see as having the greatest potential to enhance future growth, while highlighting the role of politics in explaining past outcomes and shaping the new reform program. We begin by reviewing the main stylized facts of Brazil's recent growth performance. We then discuss the recent history of reforms, the way they affected the foundations for growth, and the issues of reform selection and incompleteness. Next, taking a more forward-looking approach, we analyze the reforms that we believe have the greatest promise of positively impacting the foundations for growth in Brazil. The chapter ends with some brief concluding remarks.

Some Stylized Facts on Growth and Inclusion in Brazil

Growth and Productivity

After five decades of strong performance, Brazil's GDP growth rate plunged in the early 1980s; in the quarter century since then, average growth rates have yet to return to their previous levels. Figure 1 shows that since the late 1980s, long-term real GDP growth (as measured by a ten-year moving average) has stayed around 2.5 percent a year, roughly a third of its 1950–80 average. With population continuing to grow rapidly, growth in income per capita has been just a little over

Figure 1. *Growth of GDP, 1948–2007*



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