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REFLECTING ON BRAZIL'S SUCCESS

How durable? What lessons for South Africa?

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Brazilian policies, from conditional cash transfers to concessionary finance, have been put forward as models that South Africa should copy. This is a potentially perilous way to learn from Brazil's development successes. The factors behind Brazil's achievements are complex, rooted within a particular context and not always clearly understood. There are enough differences between Brazil and South Africa to ensure that simply transferring a set of policies from one country to another is unlikely to work.

Nevertheless, there are good reasons why Brazil is of particular interest to South Africans. Like South Africa, it is a middle income democracy confronting the challenges of inequality and poverty. Comparing the two countries can shed new light on South Africa's situation, raising novel questions, new ideas and possible approaches that can be adapted to our development strategies.

In March 2012, the Centre for Development and Enterprise (CDE) hosted leading Brazilian experts from São Paulo and Rio de Janeiro for a Round Table discussion with an invited audience of South African business leaders, senior government officials, labour representatives, diplomats and academics. *(See Page 10 for a list of participants at the workshop)*.

The expert presentations covered Brazil's economic achievements and challenges and the factors behind both the rapid expansion of the middle class and the impressive reduction of poverty levels. *(See bios of the Brazilian experts on page 9)*. South African panellists engaged with the Brazilian presenters on how the policies, facts and trends from Brazil could inform South Africans, as the two countries grapple with similar challenges.

This short summary starts by highlighting the pertinent facts and issues raised by the Brazilians. It then outlines the key insights that emerged from the workshop and concludes with reflections on what South Africa could learn from Brazil's recent development successes.

Economic Growth in Brazil: A glass half-full?

Economic achievements

After experiencing high rates of growth in the three decades before 1980, the situation was reversed between 1981 and 1994, when per capita incomes actually fell. The period between 1995 and 2004 was one of stabilisation and consolidation. Reforms, including currency stabilisation, resulted in lower inflation and steady improvements in GDP. Between 2005 and 2010 the country achieved more impressive growth rates. The GDP growth rate was 4,2 per cent, while per capita growth was 3,1 per cent. As a result unemployment fell from 12 to 6 per cent. Export prices more than doubled in US dollar terms during this period, which helped to foster investment in export-oriented projects, notably in mining, agriculture and related activities. This growth performance was important in reducing Brazilian poverty and in modernising the economy.

The need for further reform

There is evidence to suggest that the reforms initiated by President Cardoso (1995-2002) laid some of the groundwork for the growth achieved in subsequent years. Empirical studies show that privatisation greatly improved productivity at former state-owned enterprises. There is also evidence that trade liberalisation led companies to invest more in modernising plants and improving managerial practices. The reforms failed, however, to dramatically improve the investment rate, despite some localised success stories, such as in the telecommunications and railways sectors.

The generally accepted growth target which Brazil aspires to is 5 per cent per annum. Achieving this will need

substantial investment, increase in savings, and improvements in the business and investment environment. While the initial reforms of the 1990s put Brazil in a good position to take advantage of positive external factors after 2002, further reforms to improve the business climate and improve Brazil's infrastructure were not pursued vigorously enough during this period. As a result, the economy performed relatively well, as did other Latin American countries that also took advantage of these external opportunities. However, if Brazil hopes to sustain its current growth performance once international conditions become less favourable, the country needs to create the type of business environment that will foster higher investment and more rapid productivity gains.

Learning the right lessons

The strategy the Brazilian government has adopted to reach the five per cent target favours increasing state intervention as the means to eliminate bottlenecks to growth. These include giving a more prominent role to state-owned enterprises and interfering more directly in the business decisions of private firms. These measures are likely to reduce, rather than expand, output growth.

The Rise of the 'New' Middle Class

The lower or new middle class has grown by nearly 40 million people in the past ten years and the whole middle class has grown by about 49 million people during the past 15 years. This means that roughly the equivalent of South Africa's entire population changed their income status during this relatively short period.

Labour income represents roughly 76 per cent of household income, with little variation across income groups. This leaves 24 per cent of income which is derived from a number of different sources, including government transfers such as pensions and conditional cash transfers. It is likely that improved employment opportunities have made the biggest contribution to getting Brazilians into middle class income categories.

The income share of the new middle class and the poor has risen rapidly at the expense of the richest 10 per cent. Between 2000 and 2009 the accumulated rate of real per capita income growth of the richest 10 per cent was only 10 per cent. By comparison, the real per capita income of the poorest 50 per cent grew by 68 per cent. The Brazilian poor have experienced Chinese growth rates of 6.8 per cent per year over the past ten years. The income growth of the poorest half of the Brazilian population has been nearly six times greater than that of the traditional middle-classes.

Sustainability

'Middle class' can be a treacherous label. A very large proportion of this new middle class (+/- 80 per cent) is concentrated in the borderline "low middle class" category and faces the danger of falling back into poverty under adverse economic circumstances. One factor that enhances this threat is the increasing debt burden, since interest payments now equal nearly 20 per cent of disposable income for some consumers.

The very high Brazilian tax liability of about 36 per cent of GDP falls heavily on the middle class, which poses intriguing challenges for the future. The new middle class feels increasingly excluded from public services and benefits, which are focused on the poorest, and nurtures deep aversion to the combination of high taxes and the need to pay for quality private services – such as education, health, and safety – that theoretically the government should provide.

Poverty reduction in Brazil

In 1990, some 34,5 million people, or 22 per cent of the people in Brazil, fell into the category of extreme poverty, measured as an income of less than US$2 a day. By 2009, only 8,4 per cent (or about 15 million people) remained in extreme poverty. Partly as a result of this considerable progress, inequality has also fallen. Brazil's Gini coeffecient fell from 0,6 in 2001 to 0,53 in 2011.

Between 2000 and 2009 non-labour income (including government transfers) was slightly more important than labour income in raising the income of the poorest 10 per cent. Non-labour income improvements can largely be attributed to income transfer programmes such as *Bolsa Familia*. This programme provides cash transfers to poor families on the condition that their children attend school and go to health clinics. The value of the *Bolsa Familia* transfer is relatively low but the number of people receiving it is high. The annual expenditure on *Bolsa Familia* was only R$10 billion in 2009, equivalent to about US$5 billion at the time (0,4 per cent of GDP). The number of families benefitting from *Bolsa Familia* was about 13 million, which equated to over 40 million individuals.

Increases in labour income were close behind in importance. Labour income accounted for nearly 40 per cent of the income improvements achieved by the poorest 10 per cent. Higher labour income was also the most important factor in overall income improvements experienced by everyone above the lowest income decile.

The central role played by higher labour incomes can be attributed to two main factors. Firstly, Brazilians, particularly young people, are now more educated with even the very poor receiving some form of schooling. This translates into improvements in productivity, which generates higher wages.

A second reason for improved labour incomes is the expansion of economic opportunities for poor Brazilians. Poor people have accessed a wide range of opportunities. Small family farmers have achieved increases in production and productivity. Family businesses have taken advantage of opportunities in the provision of commerce and services. Poor people have benefitted from increases in labour demand while others have made new investments financed by microcredit programmes. Many of these new 'productive inclusion' opportunities have come about as a direct result of the economic growth that Brazil has achieved over the past fifteen years.

It is in recognition of this that productive inclusion is an increasingly important guiding concept in Brazil's efforts to sustain the momentum of poverty reduction – for instance in the government's *Brasil Sem Miséria* (Brazil Without Poverty) plan, launched in mid-2011.

The public sector can contribute to creating and improving productive opportunities for low-income workers. The main focus of public policies should be to make workers aware of available opportunities, offer them the possibility of acquiring the necessary skills and remove barriers that may prevent them from benefiting from these opportunities. Cash transfer programmes, food and transportation subsidies can enable workers to use new skills productively.

Key Insights

Achievements

Brazil's solid growth performance of the past eight years, its ability to raise more than 40 million people into middle-class income categories and the lowering of poverty levels from 23 per cent to 8 per cent in less than two decades should serve as a source of inspiration for South Africans. Additional Brazilian achievements discussed at the workshop include the following:

- Although education levels remain low in Brazil, there have been significant improvements in the quality of schooling during the last 12 years. As a result of introducing incentives for teachers, professionalisation, and a focus on student performance, the country has moved steadily away from being 'bottom of world class'.
- A productive partnership has been established between the Brazilian state-owned agricultural company EMBRAPA and thousands of entrepreneurial commercial farmers. Consequently, Brazilian agriculture has grown rapidly. For example, since 1990 Brazil's soya bean output rose from barely 15 million tons to over 60 million in 2010, an increase of 300 per cent, making it the world's second largest producer and exporter.
- Through the presidencies of Cardoso and Lula (two terms each) and now the presidency of Dilma Rousseff, Brazilian leaders have displayed a purposeful pragmatism towards promoting economic growth and modernising the Brazilian economy. These goals appear to be widely shared by diverging social groups and they cut across divisions between interest groups and between political parties.

These are among the promising signs that have led commentators to rank Brazil as one of the best performing economies in the world. Many of these achievements have implications for South Africa's policy challenges.

However, it is important not to exaggerate Brazil's achievements and remember that gains achieved in good years can be reversed under the current difficult global circumstances. To gain a balanced perspective of the Brazilian situation we also need to understand the many challenges that Brazil still needs to overcome.

Challenges

At 4,2 per cent per annum, Brazil's economic growth rate between 2005 and 2010 was solid rather than spectacular, and the economy remains vulnerable to shifts in the global economy. Domestic reforms have, furthermore, not gone far enough to create the type of environment for doing business that is required to raise the rate of investment.

Brazil's growing dependence on China to whom it exported goods worth US$7,9 billion in the first quarter of 2012, is noteworthy. China became Brazil's biggest trading partner in 2010. In the same year Chinese investment in Brazil topped US$20 billion and China moved towards becoming the country with the largest investments in Brazil. The result is that Brazil needs Chinese markets to sustain its prosperity.

This reliance on China's prosperity is risky and gives China leverage. An example of how China uses its market power to influence other countries' trading policies comes from neighbouring Argentina. In 2010 China refused to buy a drop of soy oil from Argentina after that country imposed tariffs on Chinese shoes.

Infrastructure is a serious challenge. Brazil has under-invested in infrastructure for decades. Currently, Brazil invests two per cent of GDP into infrastructure compared to China's 10 per cent, and many private companies in Brazil have to build their own roads and ports. To catch up with a Latin American country like Chile, Brazil needs to double its current expenditure levels for the next twenty years.

Brazil's tax burden is equal to 36 per cent of GDP, one of the highest in the developing world. Government spending, at 40 per cent of GDP, is also among the highest in the developing world. The public sector's share of the economy climbed from 25 per cent of GDP in the early 1990s to close to 35 per cent in 2005 - 10 percentage points of GDP in 12 years. Since at least 2005, Brazilian firms have consistently identified the tax burden as the main obstacle to the growth of their businesses. Brazilians are unhappy with the high rate of taxation and they also complain about the quality of services they receive from government. As Professor De Souza put it at the workshop: "government productive investment is at an all-time low, while taxes are at an all-time high".

Brazilian growth has been driven by better terms of trade for its raw materials and by absorbing a growing proportion of its population into the work force. In the long run, however, growth will only be sustained if the economy becomes more productive. Between 1980 and 2008, Brazil's productivity grew at an annual rate of about 0,2 per cent. China, by contrast, grew at an annual rate of 4 per cent.

Implications for South Africa

In the light of the insights derived from reflecting on Brazil's strengths and on-going challenges, the following implications for improving South Africa's development prospects are worth careful consideration.

Brazilians have focused their energies on utilising the resources at their disposal. They have exported their minerals, expanded employment and made productive use of their land. The technologies they develop serve to complement these efforts. Brazil, in other words, has played to its strengths.

In South Africa, by contrast, we often create new barriers in areas where we have potential. Mining and agriculture are good examples. At the same time we aspire to develop sectors where we have little capacity, such as jewellery manufacturing and nanotechnology. Rather than building on South Africa's strengths, too often we play to our weaknesses.

Related to this lesson is the importance of taking advantage of global economic opportunities. Brazil took better advantage of the global commodity boom than South Africa. If South Africa had followed Brazil's example, growth would have been higher, unemployment would have been lower, and poverty and inequality levels would have fallen. A rising tide does lift all boats, a phenomenon that was starting to emerge in South Africa during the brief period of higher growth from 2005-2008.

The Brazilian state remains a large and important actor within the Brazilian economy. And it is important to acknowledge the areas where the state has played a pivotal role in transforming the economy. Chief among these is the state-owned agricultural agency EMBRAPA. By establishing a productive partnership with large commercial farmers, EMBRAPA has revolutionised Brazilian agriculture.

A critical component of EMBRAPA's success is the vital importance of Brazil's impressive skills base. EMBRAPA employs around 6 000 people with PhDs. Brazil produced large numbers of skilled people and then invested in research and development (R&D). South Africa on the other hand has often invested in R&D without having the necessary skills to take advantage of the technology generated by such activities. If South Africa wants to grow its economy it needs skills; the country cannot move ahead without addressing the skills constraint.

In other areas state driven policies have been less impressive .The large Brazilian development bank BNDES' concessionary finance programme has not been successful in raising the rate of investment in Brazil. The programme has rather acted to crowd out smaller firms, and has ended up with tax payers subsidising the largest firms who can get capital anywhere they want. South Africa does not need concessionary finance because the financial system we have generally works well. Small firms in South Africa borrow at rates of only one or two per cent more than big corporations. There appears to be no rationale for South Africa to adopt a concessionary finance policy. *(See CDE's recent publication, The Role of Concessionary Finance in Brazil, CDE Insight, June, 2012, available at www.cde.org.za.)*

Brazil's fight against poverty reveals that welfare grants can be helpful, but only if they are accompanied by an expansion of economic opportunities accessible to the poor and they constitute a small part of the national budget. Coupled with an innovative approach to welfare, Brazilians have focused on what they call, 'productive inclusion' - developing the economy to create income generating opportunities for poorer and less skilled people.

The Brazilian policy of increasing the minimum wage has also increased the income of the poor. The national minimum wage went up 35 per cent in real terms between 2001 and 2007 and many social security payments – those made to the elderly and the disabled for example – are linked to the minimum wage. When the minimum wage goes up social security grants are raised by the equivalent amount. There is, however, a growing sense that this policy has reached its limits due to the mounting fiscal burden. It is also possible that these rising wages will place constraints on employment.

South Africa's welfare programmes constitute slightly more than four per cent of GDP, which places it amongst the most generous of all developing countries. Despite these high, increasingly unsustainable payments, the very large numbers of poor people in South Africa remain trapped without much hope. With very poor education and a capital intensive economy the vast majority cannot access wage or other income earning opportunities. They therefore remain dependent on the state indefinitely and are unable to find a durable path out of poverty.

South Africa is haunted by its past. Brazil appears to be much more focused on building a better future. Despite on-going debates and differences about policies, Brazilians seem to have developed a common purpose and pragmatism that is sadly lacking in too many arenas in South Africa today.

It is important that South Africans do not learn the wrong lessons from Brazil's many and impressive successes. Rather than buying into the hype surrounding 'state capitalism' we should be careful about downplaying the role that market reforms, macroeconomic discipline and global competition played in creating a dynamic, more modern economy. Brazil's success has been underpinned by the privatisation and macro-economic stability introduced by President Cardoso's reforms in the 1990s. Excessive government regulation, the scale and complexity of the tax regime, the unaffordability of the minimum wage link to pension nexus and the growing size of the public sector are frequently cited as obstacles undermining the sustainability, efficiency and on-going modernisation of the Brazilian economy.

Concluding remarks

If we compare Brazil and South Africa's average growth rates for the period 1992 to 2011, it is evident that Brazil's growth was only slightly better than South Africa's (3,2 per cent compared to 2,9). Why then has the country notched up so many areas of achievement?

Among a number of factors, Brazil took better advantage than South Africa of 'commodity boom' opportunities in the years before the financial crisis. The contraction they experienced in 2009 was less severe than ours, and their recovery in 2010, when they achieved a growth rate of 7,5 per cent, was much more impressive than South Africa's 2,9 per cent. Their remarkable success in agriculture has helped many small farmers become productive enterprises. The country's high level of urbanization has opened doors of opportunity to many more citizens. By taking advantage of growth opportunities, Brazil got its people into employment, and through education reform ensured that wages rose for better educated workers.

It was the subsequent increase in labour incomes that played by far the most significant role in bringing down both poverty and inequality levels. Brazil probably re-distributes a smaller portion of its income than South Africa. The *Bolsa Familia* programme has helped the very poor in Brazil, but it constitutes only 0,4 per cent of Brazilian GDP, and the simultaneous expansion of 'productive inclusion' economic opportunities have leveraged this support into something more durable for poor Brazilians.

There are many policy lessons to learn from reflecting on the experience of Brazil – a large and diverse country.

Some issues stand out for South Africans – play to the country's strengths and build on the expertise and skills you have already; take advantage of the growth opportunities relevant for your country within the global economy and become an effective global competitor; improve the quality of education through leadership, vision and fundamental reform based on teacher performance; and translate these gains into wage and other income earning opportunities for the poor and the unemployed; find ways to maximize the number of skilled people in the society; encourage urbanization and access to new opportunities; and use state resources to enable people to help themselves. Perhaps most importantly get the country on a path to growth and employment that political leaders across party divides agree on so that the direction of economic reform and social policy is sustained over a long period.

The Brazilian story demonstrates that it is possible to change the prospects of tens of millions of poor people, bring down unemployment, significantly reduce poverty and start to turn the tide on inequality. This can be done in a reasonably short period. And it can be done without fixing everything in a society simultaneously.

Brazil has many remaining challenges, nonetheless it has notched up some remarkable achievements, many in the past ten to fifteen years. Leadership has been absolutely key to this path to success: from president Cardoso to president Lula and now president Rouseff - each in their own way taking some bold and foundational decisions to help the country move forward.

There are no simple 'models' that South Africa can import from Brazil – a completely different country that operates at a scale and in an economic and skills context that is completely different from that of South Africa's. Nonetheless, this developing world democracy has been able to make progress in some of the important areas South Africa must improve if we are to succeed. We need to learn the right lessons from their experience and then adapt these for our particular circumstances.

This is an executive summary of CDE Round Table no 20, REFLECTING ON BRAZIL'S SUCCESS: How durable? What lessons for South Africa? (September 2012). The full-length publication is available from CDE, and can also be downloaded from www.cde.org.za.

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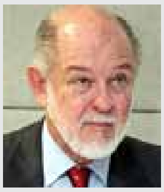

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The late Professor de Souza was a senior researcher at the Instituto de Estudos Econômicos, Sociais e Políticos (Institute for Economic, Social, and Political Studies) in São Paulo. He was a fellow at the Woodrow Wilson International Centre for Scholars, visiting professor and research associate at the University of California, and member of the board of the Roper Centre for Public Opinion Research at the University of Connecticut. He was also a senior partner at MCM Associated Consultants, an analysis company focussing on applied economics and policy analysis.

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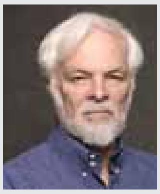

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