CDE ROUND TABLE

Number 20 · September 2012

REFLECTING ON BRAZIL'S SUCCESS

How durable? What lessons for South Africa?

Edited proceedings of a Round Table convened by the Centre for Development and Enterprise

The Centre for Development and Enterprise is a leading South African development think tank, focussing on vital national development issues and their relationship to economic growth and democratic consolidation. Through examining South African realities and international experience, CDE formulates practical policy proposals for addressing major social and economic challenges. It has a special interest in the role of business and markets in development.

Series editor: Ann Bernstein

This report summarises the proceedings of a Round Table hosted by CDE in March 2012.
It was written by a team at CDE consisting of Ann Bernstein, Sandy Johnston, Marius Roodt and Stefan Schirmer. Peter Draper was in charge of organising the Round Table and commissioning the research

This document is available from CDE, and can be downloaded from www.cde.org.za.

In Memoriam: Professor Amaury de Souza

This publication is dedicated to Professor Amaury de Souza who died in August 2012 at the age of 69 after a long struggle with cancer. One of Brazil's leading social scientists and an expert on a wide range of Brazilian social and economic issues, Professor de Souza led the Brazilian team of experts to South Africa in March 2012. The Centre for Development and Enterprise worked closely with Professor de Souza over the past two years and benefited greatly from his insights and advice. He will be sorely missed.

The Round Table and this report were funded by the UK Foreign and Commonwealth Office Prosperity Fund. The funders do not necessarily agree with the contents of this publication.

Cover: Embraer presents its new EMBRAER 190 jet (Paulo Whitaker/Courtesy Gallo images).

Published in September 2012 by The Centre for Development and Enterprise
5 Eton Road, Parktown, Johannesburg 2193, South Africa
P O Box 1936, Johannesburg 2000, South Africa
Tel +27 11 482 5140 • Fax +27 11 482 5089 • info@cde.org.za • www.cde.org.za

ISBN: 978-0-9870231-6-2

Contents

Executive Summary *2*

Brazilian Speakers *7*

Participants *8*

Introduction 9

Opening Remarks 9

Economic Growth in Brazil: A glass half-full? 10

Growth of the Brazilian middle-class 16

Poverty reduction in Brazil 19

South African Responses 21

Key Insights 30

Concluding remarks 34

Endnotes *36*

Executive summary

EXECUTIVE SUMMARY

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 8 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 7).* 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.

Executive summary

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.

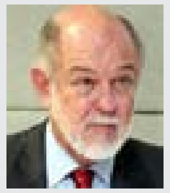
Brazil has many remaining challenges, nonetheless it has notched up some remarkable achievements, many in the past ten to fifteen years. Leadership has been absolutely key to this path to success: from president Cardoso to president Lula and now president Rouseff - each in their own way taking some bold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

BRAZILIAN EXPERTS

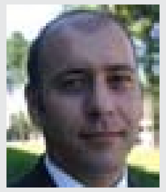
Professor Armando Castelar Pinheiro

Professor Castelar Pinheiro is coordinator of the Brazilian Institute of Economics of the Getulio Vargas Foundation. He is a professor at the Federal University of Rio de Janeiro (UFRJ), a member of the Brazilian Federation of Banks, and was the Head of Economic Department of the Banco Nacional de Desenvolvimento Economico e Social (BNDES), Brazil's largest development bank. He holds degrees in mathematics from the National Institute of Pure and Applied Mathematics, business administration from UFRJ and economics from the University of California, Berkeley.



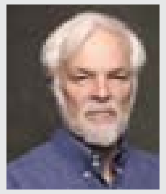
Professor Amaury de Souza

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.



Dr André Portela de Souza

Dr Portela is an associate professor at the Getulio Vargas Foundation. He also works as researcher at the National Council of Scientific and Technological Development. Dr Portela serves as a member of the Committee on the Middle Class, which advises the Presidency of the Federative Republic of Brazil. He has previously served as an adjunct associate professor at Vanderbilt University and a visiting assistant professor at Cornell University. Dr Portela holds degrees from the universities of Cornell and São Paulo.



Professor Claudio de Moura Castro

Professor Castro is the Senior Advisor to the President of Grupo Positivo, an educational outreach organisation based in Curitiba, Brazil. Professor Castro is an economist and holds a Master's degree from Yale University and a Ph.D. in Economics from Vanderbilt University. He has taught at the Catholic University of Rio de Janeiro, the Vargas Foundation, the University of Chicago, the University of Brasilia, the University of Geneva, and the University of Burgundy (Dijon). He was previously the director of the Brazilian Agency for Post-Graduate Education (CAPES), an agency within the Brazilian Ministry of Education. He has also served as the Chief Educational Advisor at the Inter-American Development Bank.

PARTICIPANTS

Michal Baruch, director, Millennium Labour Council

Prof Armando Castelar Pinheiro, economist, Federal University of Rio de Janeiro

Prof Claudio de Moura Castro, senior advisor, Grupo Positivo

Prof Linda Chisholm, special advisor: Minister of Basic Education, Department of Basic Education

Dr Felicity Coughlan, director, The Independent Institute of Education

HE Mr Pedro de Mendonca, His Excellency The Ambassador, Republic of Brazil

Prof Amaury de Souza, fellow, Centro Brasileiro de Relaçõs Internacionais (CEBRI)

Prof André Portela de Souza, associate professor, Getulio Vargas Foundation

Laurie Dippenaar, chairman, FirstRand Ltd; chairman CDE Board

David Faulkner, acting head: Economic Policy, National Treasury

Alan Fine, public affairs manager, AngloGold Ashanti Ltd

Dennis George, general secretary (acting), Federation of Unions of South Africa (FEDUSA)

Prof David Kaplan, professor, University of Cape Town

Prof Peliwe Lolwana, director, College of Education at Wits

Nick Monkhouse, senior official, Politics and Economics Team, British High Commission

Anja Muller-Diebicht, media & communications officer, Federation of Unions of South Africa

Emile Myburgh, attorney, Emile Myburgh Attorneys

Jayendra Naidoo, director, J & J Group

Sipho Pityana, executive chairman, Izingwe Capital (Pty) Ltd

Dr Edwin Ritchken, special projects advisor, Department of Public Enterprises

Mike Spicer, vice president, Business Leadership South Africa

Prof Manuel Thedim, executive director, Institute for the Study of Labour and Society (IETS), Rio de Janeiro

Michael Sachs, chief director, National Treasury

Andile Sangqu, executive director, Xstrata Coal

Prof Stefan Schirmer, associate professor, Wits University

Prof Jeremy Seekings, professor, University of Cape Town

Nicky Weimar, senior economist, Nedbank Group

Ann Bernstein, executive director, CDE

Dr Jeff McCarthy, programme director, CDE

Antony Altbeker, research and project executive, CDE

Peter Draper, programme director, CDE

Marius Roodt, researcher, CDE

Introduction

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 7 and 8 for expert biographies and participant list*).

Brazil's successes in promoting more inclusive economic growth have been widely and deservedly praised. Can other middle income developing countries learn from these achievements in creating jobs and economic opportunities for the poor, reducing inequality and growing the middle class? The experts presentations covered Brazil's economic achievements and challenges, the phenomenal growth of the middle class and the significant reduction of Brazilian poverty levels. South African panellists engaged with the Brazilian experts on how the policies, facts and trends from Brazil could inform South Africans, as this country grapples with similar challenges.

This publication summarises the presentations at the Round Table on Brazil's recent economic and social changes. Professor Armando Castelar Pinheiro outlined Brazil's economic performance. He assessed the factors behind this performance and analysed the sustainability of recent achievements. The late Professor Amoury de Souza outlined the large increase in the Brazilian middle class in the past ten years. He showed how the middle class is defined in Brazil, provided the reasons for middle class growth and assessed the sustainability of these trends. Dr. Andre Portela De Souza focused on the successful reduction of the Brazilian poverty rate, from nearly 23 per cent in 1993 to 8,4 per cent in 2009. The report then presents selected South African responses and the discussion that followed. The final section highlights important ideas and insights for South Africa that emerged from the Round Table presentations and discussion.

Brazil's successes in promoting more inclusive economic growth have been widely praised

Opening Remarks

Ann Bernstein

Executive director, Centre for Development and Enterprise

This is an opportune time for South Africans to engage with Brazilian experts on issues relating to Brazil's achievements, as well as the challenges Brazil continues to confront. The two governments co-operate in the IBSA and BRICS groupings and firms in both countries are conscious of the possibilities of South-South trade and investment.

CDE has established an international consortium with leading think tanks from Brazil and India. By collaborating with them CDE aims to provide an independent perspective on growth and development from the democratic South, casting greater light on how these three countries seek to achieve sustained and inclusive growth in dynamic, complex, democratic contexts.

Brazil has registered enormous achievements in areas that are critical for South Africa's future. Examples include reducing inequality and fostering a rapidly-growing middle class. However, there is no intention to suggest in this initiative that Brazil represents 'a model' for South Africa. Each country has a very different history, politics, and culture. Nonetheless, the interlinked themes of this Round Table discussion: growth performance, the expansion of the middle class and the fight against poverty and exclusion, are all of enormous importance in both countries; and absolutely central to South Africa's response to its own challenges.

The value of learning from the experience of others does not necessarily mean copying them. It involves learning about other countries as a way of thinking differently about our own possibilities and seeing ourselves in the light of experience in other places.

Economic Growth in Brazil: A glass half-full?

Armando Castelar Pinheiro

Professor, Federal University of Rio de Janeiro

The ability to sustain the good performance of recent years depends on renewed reforms

The first question addressed in this presentation is: What are the reasons for the acceleration in Brazil's growth after 2005? The second question: Is this growth sustainable?

The answers suggest that the Brazilian story is a glass half-full: while there is much to celebrate, there are also risks. More specifically, the ability to sustain the good performance of recent years depends on renewed reforms.

Table 1 below shows that Brazil's general GDP and per capita growth rates have been good over the past five years, comparing favourably with the previous two growth episodes.

Table 1: Growth in GDP and GDP per capita, 1951-2010[1]

	GDP	GDP per capita
1951-1980	7,1%	4,3%
1981-1994	1.9%	-0,1%
1995-2004	2,6%	1,0%
2005-2010	4,2%	3,1%

Source: Prof A Castelar Pinheiro, What Drives Economic Growth in Brazil? Paper commissioned by CDE, 2012

The golden age of Brazilian growth occurred from 1950 through to 1980. GDP growth was 7,1 per cent while per capita GDP growth was 4,3 per cent during this period, when Brazil was one the fastest-growing countries in the world. However, the situation was reversed between 1981 and 1994, when per capita incomes actually fell. The period between1995 and 2004 was a period of stabilisation and consolidation. Reforms, including currency stabilisation, resulted in lower inflation and steady improvements in GDP.

Between 2005 and 2010 the country achieved much more impressive growth rates, including per capita income improvements of 3,1 per cent. Much of this recent phase of growth was demand driven and partly a result of rapid credit expansion. From 2004 to 2011 credit to consumers expanded at an average of 21,8 per cent above inflation, a process that was boosted by large capital inflows and looser monetary and public credit policies. As table 2 shows, domestic demand expanded ahead of GDP, driven by the increasing tendency of consumers to purchase goods on credit.

Table 2: GDP and Domestic Demand Rates

	2001-05	2006-10
GDP	2,8%	4,2%
Domestic demand	1,6%	5,6%

Source: Prof A Castelar Pinheiro, What Drives Economic Growth in Brazil? Paper commissioned by CDE, 2012

This means that the Brazilian economy performed better in terms of generating improvement in the average standard of living than is indicated by GDP figures alone. However credit expansion creates the risk of high inflation and a dependence on capital inflows, which could be disrupted by a new global crisis.

During the period 2002-2011 unemployment rapidly fell from 12 to six per cent and export prices more than doubled in US dollar terms. Import prices also rose, but not as much, so that the terms of trade improved substantially: in 2011 the terms of trade were 35 per cent above their 2005 level. Moreover, because Brazil runs a trade surplus, the simultaneous rise in export and import prices also boosted the trade balance. This helped to foster investment in export-oriented projects, notably in mining, agriculture, and related activities.

During the period 2002-2011 unemployment rapidly fell from 12 to six per cent

Net capital inflows were higher by approximately 15 per cent of GDP than what was necessary to finance the current account deficit. A large portion of these funds helped to boost bank deposits and financing in capital markets, which in turn helped to generate a boom in credit and stock markets. Moreover, the funds were important to sustain the appreciation of the Brazilian real (R$), which was instrumental in keeping inflation down.

Greater tolerance for inflation at the central bank allowed for a rapid rise in domestic demand and in 2008 inflation rose rapidly with signs that the economy was 'overheating'. The global financial crisis removed this problem, as it served to lower both growth and inflationary pressures. Yet inflationary pressures were back by late 2009. Overall, annual inflation averaged 5,6 per cent in 2008-11, well above the central bank target of 4,5 per cent.

The Factors Behind Brazil's Growth Performance

Both rising employment and a substantial increase in labour productivity contributed to the high growth rates of the 1951 to 1980 period. Roughly two-thirds of the rise in productivity stemmed from more capital-intensive production, with the remaining third from the rise in total factor productivity (TFP) growth.

The growth slowdown between 1981 and 1994 followed a sharp decline in labour productivity growth, which became negative. Slower employment growth played only a secondary role in the reduction of GDP growth. The inefficiencies generated by high inflation, excessive regulation and state interference were the critical factors behind the fall in labour productivity, but the much slower pace of capital accumulation was also important. The only compensating factor was the improved rate of human capital expansion.

In the post-reform period (1995-2004), when GDP growth accelerated to an average of 3,1 per cent a year, rising employment rates were the main source of output growth. There were small improvements in total factor productivity (TFP), while the rate at which human capital improved remained constant and capital accumulation decelerated.

In future, given the low rates of unemployment that now prevail, Brazil will have to become more reliant on productivity improvements, either through the more efficient use of capital or through faster rates of capital accumulation.

There is evidence to suggest that the market liberalisation reforms of President Cardoso (1995-2002) contributed to this growth acceleration. Empirical studies show that privatisation greatly improved productivity at former state-owned enterprises, while there is also evidence that trade liberalisation led companies to invest more in modernising plants and improving managerial practices. Greater inflows of foreign direct investment (FDI) probably had a similar effect. Finally, with price stabilisation, companies shifted from a focus on cash management to a much greater emphasis on operational and sales efficiency. There is, however, also evidence that these reforms failed to have a significant effect on investment rates, despite some localised success stories, such as in the telecommunications and railways sectors.

Privatisation greatly improved productivity at former state-owned enterprises

The Challenge of sustaining Brazil's Growth Performance

The generally accepted growth target which Brazil aspires to is five per cent per annum. Achieving this will need substantial investment, increase in savings, and improvements in the business and investment environment. Privatisation improved efficiency and attracted some investment, particularly in telecommunications, railways and ports. However the overall low rate of infrastructure investment since the 1980s and a low rate of savings are major constraints to growth.

Low public investment and an adverse business environment, including a complex and high tax burden, instability of economic, environmental and administrative regulation represent additional and substantial constraints.

BRAZIL'S INFRASTRUCTURE CHALLENGE

Brazil faces a large infrastructure deficit. Roads are the primary method of transportation, but are poorly maintained. The railway system in Brazil is very limited. There are only 27 882 kilometres of tracks in Brazil (excluding urban commuter lines) and this number is in decline as tracks fall out of service. So deficient is the country's existing infrastructure, that many of its big mining, steel and other commodity companies operate their own private rail, road and port facilities. Brazil under-invested in infrastructure for over three decades, and infrastructure investment rates have come up only slowly since 2007. The share of government spending going to new infrastructure is about two per cent of Gross Domestic Product (GDP). Other countries at Brazil's level of development are, on average, spending five per cent of their gross income on infrastructure. China spends 10 per cent. To catch up with a Latin American country like Chile, Brazil needs to double its current expenditure levels for the next twenty years.[2]

To counter this deficit Brazil has launched the Accelerated Growth Programme (*Programa de Aceleração de Crescimento*, PAC), which aims to allocate almost US$800bn to the infrastructure sector between 2008 and 2013. In addition a number of states received loans from the Inter-American Development Bank (IADB) for upgrading roads. In the second quarter of 2010, motorway operator Primav EcoRodovias signed a 30-year concession contract for the Ayrton Senna Carvalho Pinto motorway, at a cost of around US$4bn and US$18bn was allocated for the construction of a high-speed train linking São Paulo and Rio de Janeiro. In August 2012 the Brazilian government announced its largest ever stimulus package to increase private investment into the transport system of roads, rail, and air transportation. The goal is to attract US$66 billion of private investment. The Brazilian Development Bank (*Banco Nacional de Desenvolvimento Econômico e Social*, or BNDES) will provide loans for designated projects. Besides attracting needed investment into Brazil's transport infrastructure, the government hopes that these measures will push the growth rate up to 5 per cent over the next few years.[3]

The main barriers for business are not related to a lack of funding, but to the poor quality of institutions

The table below shows the relative importance of the factors that undermine the business environment in Brazil. The main barriers are not related to a lack of funding, but to the poor quality of institutions: high taxes, complex and restrictive labour and tax regulations, inefficient public bureaucracy. Together with the rise in unit labour costs in recent years – 26 per cent higher in 2011 than in 2005, considering a basket of currencies – these factors hinder the competitiveness of Brazilian firms and discourage investment and productivity improvements. The data in table 3 (Page 14) also highlight the limitations of Brazil's current policy model, based on simultaneous increases in tax revenues and increasing state intervention in the economy. From a list of 15 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between one (most problematic) and five. The proportions in the table below show the responses weighted according to their rankings.

Table 3: The most problematic factors for doing business in Brazil

Tax rates	19,3%
Tax regulation	16,6%
Inadequate supply of infrastructure	15,1%
Restrictive labour regulations	12,2%
Inefficient government bureaucracy	10,5%
Inadequately educated workforce	8,6%
Corruption	6,4%
Access to financing	3,3%
Foreign currency regulations	2,6%
Inflation	1,7%
Crime and theft	1,3%
Poor public health	1,0%
Policy instability	1,0%
Government instability/coups	0,2%
Poor work ethic in labour force	0,2%

Source: World Economic Forum Global Competitiveness Report (2011).

The expansion of public credit in Brazil has had a negative impact on the health and transparency of public accounts

State Financing for Growth: The Case of BNDES

The government's reaction to this set of challenges has been to try greater state intervention. Over the past fifteen years BNDES, Brazil's National Development Bank, greatly increased the availability of low-cost financing: increasing disbursements from one per cent of GDP in 1995 to a peak of five per cent of GDP in 2010. At the same time, in 2010/2011 the Bank's base interest rates remained slightly negative in real terms. However, the impact on investment was quite modest: in 2010, the investment rate (19,5 per cent of GDP) was only slightly above that of 1995 (18,3 per cent of GDP).

The strategy has failed for two main reasons. First, a large part of BNDES funds were not used to boost investment, but to save failed companies from bankruptcy as in the cases of Aracruz and Sadia, two large producers of pulp and food products, respectively; to finance mergers, as in the acquisition of Brazil Telecom by Oi; or to finance the expansion of local producers abroad, as in the case of acquisitions of American meat producers by JBS, Brazil's largest food industry multinational. Second, a large portion of investment financing went to companies that could have found finance in capital markets, including Petrobras, the oil state monopolist and Vale, Brazil's largest mining company.

The expansion of public credit in Brazil has had a negative impact on the health and transparency of public accounts. Most of the recent BNDES disbursements were financed by loans from the National Treasury, which involved what amounted to a significant subsidy and has reduced the transparency of fiscal policy. (For a more comprehensive review of BNDES and its role in Brazilian development, see CDE's publication *The Role of Concessionary Finance in Brazil, CDE Insight, June, 2012* available at www.cde.org.za).

The Need for Further Reform

The reform process that Brazil initiated in the 1990s has been important in strengthening the long-term health of the Brazilian economy. Price stabilisation, in 1994, was the most noteworthy reform, but several others are also worth mentioning, such as the significant privatisation and trade liberalisation processes of the 1990s. In the late 1990s and early 2000s, the reform process, which previously had focused more on microeconomic structure and incentives, shifted into improving macroeconomic institutions, with the adoption of a Fiscal Responsibility Law, extensive restructuring of the banking sector, and greater operational independence for the Central Bank. This process continued during President Lula's first term, with a stronger focus on institutional reform in the financial sector, but the enthusiasm for reform diminished greatly in the second half of the decade.

While these reforms have been beneficial, they have not yet gone far enough. Moreover, the fact that other Latin American countries, with different policy models, also improved their economic performance in the same period, suggests that external factors played as great, or even a greater role than reforms in producing Brazil's recent growth successes.

Brazil's current growth performance is therefore unsustainable without reforms that foster a rapid rise in labour productivity through higher investment, a greater emphasis on education quality and more rapid efficiency gains. The limits of the current model are already being tested by the need to bring inflation down, which will tend to keep the economy growing around a more modest 3,5 per cent per annum in the near future. A crisis in China or a return of world liquidity conditions to 2009 levels, although not likely in the next few years, could prove rather challenging to Brazil.

Brazil's current growth performance is unsustainable without reforms that foster a rapid rise in labour productivity

Fiscal consolidation is critical, so as to create room to increase government investment, limit the rise of the tax burden, and allow for a non-inflationary cut in interest rates. This will become increasingly important as social security and health spending rises and savings rates fall.

Infrastructure investment is another critical area in which policies need to change. Privatisation and public-private partnerships are the best means to advance, and the government seems to have recognized this, as signalled by the privatisation of Brazil's largest airports. Yet, the government has generally taken measures that are too little, too late. Moreover, the reforms in the 1990s showed that privatisation without accompanying reforms in regulation, access to financing, and the overall investment climate may have only a limited and localised impact on investment. Government officials have seemingly not learnt this lesson.

The strategy the government has adopted 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.

Another risk that has received insufficient attention is the threat that household indebtedness poses for the health of the banking sector if growth decelerates more sharply and for longer than in 2009. Household debt has risen from 20,2 per cent of disposable income in 2005 to 41,3 per cent in 2011. This rise has been accommodated by a decline in interest rates and the extension of maturities, which translated into a less significant increase in the share of income committed to serving these debts. These borrowing conditions are likely to be reversed if labour market conditions deteriorate and the inflow of foreign capital contracts.

There is also much concern about the loss of competitiveness in Brazilian manufacturing, with the view that Brazil may undergo a severe deindustrialisation process. This stems from three factors: the significant appreciation of the real, which was instrumental in helping to control inflation, but also caused unit labour costs to rise substantially; the poor business environment in Brazil; and the aggressive commercial strategy of China as it attempts to compensate for the decline in exports to Europe and the US with greater exports to emerging economies.

The government has reacted with two instruments. First, it has tried to prevent the real from strengthening too much by aggressively buying foreign exchange in the domestic market and changing regulations concerning exchange rate derivatives. Second, it has applied countervailing duties on some imports, notably, but not only, from China. To some extent, the reluctance of the central bank to raise interest rates to bring inflation down reflects, apart from concerns about growth, the fear that this would further attract foreign capital inflows and strengthen the real. Obviously, this does not explain why fiscal policy has been so expansionist.

Learning the Right Lessons

Although Brazil has not gone as far in reversing the reforms of the 1990s as some of its neighbours, the direction of change is worryingly similar

There is a growing tendency to learn the wrong lessons from Brazil's recent growth experience. The importance of market reforms and macroeconomic discipline has been increasingly downplayed. The reinstatement of trade barriers and the trend towards greater state intervention – or state capitalism, as *The Economist* called it – are evident signs of this.[4] So are the greater tolerance for inflation and the erosion of the transparency of fiscal accounts. Although Brazil has not gone as far in reversing the reforms of the 1990s as some of its neighbours, the direction of change is worryingly similar.

Growth of the Brazilian middle-class

Professor Amaury de Souza
Associate member, CEBRI, Brazil

Definitions and Measurements

'Middle class' can be a treacherous label. Much depends on the criteria of classification and the mixture of economic and social criteria used to construct categories and to place people in them. Traditionally, classes in Brazil have been defined in terms of consumption. The Brazilian Economic Classification Criterion has become the standard instrument for this. It stratifies people according to their possessions and consumption patterns, such as a car, television, radio, washing machine, number of bathrooms in the house, whether a maid is employed, and the household head's education level. Respondents are placed into five economic consumption classes, labelled from A to E. Category A is upper middle class. The next three categories (B-D) are the middle class proper, the lower or new middle class, and the working class. Those in category E are defined as poor.[5]

My presentation uses instead an absolute income-based definition developed by the Centre for Social Policies of the Getulio Vargas Foundation in Rio de Janeiro, which correlates well with education and household consumption patterns.[6] The monthly household income threshold for each of the classes is as follows:

Table 4: Income Classification Criteria

Class	Income category	Population share (2011)
A – Upper	US$3 723 and above	A + B = 11,7%
B – Middle	US$2 855 to US$3 723	
C – Lower middle/new	US$662 to US$2 855	55%
D – Working	US$415 to US$662	20,4%
E – Poor	US$415 or less	12,8%

Source: Prof A de Souza, Brazil's New Middle-Class: Challenges and Lessons, paper commissioned by CDE, 2012

The Rise of the 'New' Middle Class

Roughly the equivalent of South Africa's entire population changed their income status

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.[7] While many of those who recently achieved middle class status remain clustered at the lower end of the middle class spectrum, this still means that roughly the equivalent of South Africa's entire population changed their income status during this relatively short period. At the same time the population share of the poorer classes has shrunk: in 2003, categories D and E accounted for 96,2 million people (54,8 per cent) but by 2011, their total was 63,6 million (33,2 per cent). The biggest decrease was at the bottom of the economic pyramid: from 49,3 million (34,9 per cent) in 2003 to 24,7 million (12,8 per cent) in 2011.

The reforms of the 1990s played a key role in this growth, including the opening up of the Brazilian economy to world trade, which allowed global competition to help create a dynamic, more modern economy.

Monetary stabilisation was also important in helping people move out of poverty, as was improved education. Brazil now has 99 per cent enrolment at the elementary school level. The quality of education has also improved, which has allowed some young people from poor backgrounds to move into skilled jobs and higher income categories. In addition, between 2003 and 2008, labour income increased by 20 per cent in real terms, while unemployment fell from 12,4 per cent in 2003 to 6,0 per cent in 2011.

Labour income represents roughly 76 per cent of household income, with little variation across the income distribution.[8] 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 like the *Bolsa Familia*, a monthly stipend for poor families, granted on condition that children are in school and taken to public health clinics regularly.[9]

Credit expansion has also played a role, although in terms of international comparisons credit still makes up only a small proportion of GDP in Brazil. In South Africa overall credit was consistently above 100 per cent of GDP during the first decade of the century. By comparison in Brazil the rate of credit as a proportion of GDP has hovered at around 50 per cent for most of the first decade of this century.[10]

The government's policy of increasing the minimum wage has also helped move people into the middle class. The national minimum wage went up 35 per cent in real terms between 2001 and 2007. 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.[11]

All of this means that 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.[12]

Sustainability?

The rising middle class is much more vulnerable to economic downturns

The main challenge for the new middle class is sustainability. One important question is whether this middle-class growth has just been an episode linked to very favourable global circumstances or whether it is based on internal, self-sustaining dynamics.

The new middle class owes its rise to the expansion of the economy and employment in the formal sector. Many of those who have taken advantage of these opportunities are in a vulnerable position because they have a limited amount of education, few skills, and limited access to social contacts and organisations. The new middle class does not always have stable sources of income, equity, or productive assets. Neither is it rich in the social capital that comes with participation in a wide network of personal contacts and connections with firms, voluntary organisations, and the government. Ultimately, what defines and sustains middle class status are good jobs with stable income and health and retirement benefits.[13]

Struggling to maintain itself, the rising middle class is much more vulnerable to economic downturns. For many, it means working hard and fighting for success, frequently in unfavourable conditions. Hence to emulate the consumption patterns of the traditional middle class carries the risk that misfortune – be it a bad debt, an economic crisis or unemployment - forces the household to slip back into poverty.[14]

One factor that threatens the sustainability of the new middle class is the increasing debt burden, since interest payments now equal nearly 20 per cent of disposable income for some consumers. The concern is that domestic demand has been the prime driving force of growth in Brazil. If consumers can no longer meet their debt obligations then this engine of growth will be seriously damaged.

Research shows that members of the new middle-class are the ones under the most pressure. In 2010, some 61 per cent of people in this class were forced to cut their spending in the month prior to the survey and 46 per cent had to delay instalment payments on consumer goods. More than 30 per cent of the new middle class had to work extra hours to pay debts, and went deeper into debt to service existing debts.

The very high Brazilian tax liability of about 36 per cent of GDP also falls heavily on the middle class.[15] Brazil collects more in tax than Canada, the United States, and many European countries. The growth in current government expenditure has been more than double the growth of GDP in the past 10 years. Government productive investment is at an all-time low, while taxes are at an all-time high.

This latter fact poses intriguing challenges for the future and for the succeeding generation of the new middle class. 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

Dr André Portela de Souza
Associate professor, Getulio Vargas Foundation

Higher labour income was the most important factor in overall income improvements experienced by everyone above the lowest income decile

In 1990, about 22 per cent of people in Brazil fell into the category of extreme poverty, measured as an income of less than US$2 a day. Between 1993 and 1995 the proportion dropped from nearly 23 per cent to 17,3 per cent, due largely to the currency stabilisation plan, which brought hyperinflation under control. The proportion then remained stable until 2003, when rapid improvements took off. By 2009, only 8,4 per cent of the population remained in extreme poverty. This meant that Brazil achieved its Millennium Development Goal (MDG) for poverty (an extreme poverty rate of 11 per cent) in 2006, nine years early.

Between 2001 and 2009, per capita household income of the poorest 10 per cent in the population increased by about seven per cent per annum while growth in household per capita income for the richest 10 per cent was less than two per cent per year. As a result inequality began to decline in 1999 and continued on a steady downward trend. Despite the substantial decline of inequality in Brazil, the Gini coefficient, the standard measure of inequality, remains high at 0,53. In 2001 Brazil had a Gini score of 0,6, the highest in the world, indicating that there is progress yet to be made.

Between 2000 and 2009 the most important factor raising the income of the poorest 10 per cent was increase in non-labour income per adult (including government transfers). This accounted for 50 per cent of the overall increase in incomes. Increases in labour income were, however 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.

Non-labour income improvements can largely be attributed to the government's three major income transfer programmes:

- **BPC/LOAS** - A government pension transferred to Brazilians older than 64 or to those who are disabled and cannot work
- **Aposentadoria Rural** - A special pension amounting to the minimum wage for elderly people living in rural areas
- **Bolsa Familia** - a conditional cash transfer programme.

In 2009 government transfers to the elderly and disabled reached about 3,5 million people, costing 0,6 per cent of Brazil's GDP.[16] The rural beneficiary scheme for the elderly, which goes to ex-farm workers and subsistence farmers, reaches about 8,1 million people and in 2009 cost 1,7 per cent of Brazil's GDP.[17]

Bolsa Familia provides cash transfers to poor families on the condition that their children attend school and go to clinics. Unlike the other two programmes, *Bolsa Familia* benefits children and young families. The value of the *Bolsa Familia* transfer is relatively low (around one fifth and one seventh of the minimum wage), but the number of people receiving this transfer is much higher than the two pension programmes. In 2009 the number of families benefitting from *Bolsa Familia* was about 13 million, which equated to over 40 million individuals. The number of people receiving the two old age pensions is probably about 12 million. However, 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).[18]

Bolsa Familia provides cash transfers to poor families on the condition that their children attend school and go to clinics

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

A second reason for improved labour incomes is 'productive inclusion', the expansion of economic opportunities for poor Brazilians. It is likely that the economic opportunities that poor people have accessed since 2003 include increases in production and productivity achieved by small family farmers, small family businesses taking advantage of opportunities in the provision of commerce and services, increases in demand for labour as a result of economic growth and investments made possible through microcredit programmes.

Unfortunately, there are no systematic studies to evaluate which particular programmes or interventions helped the poor the most. However, it is clear that, while public transfers were helpful in reducing extreme poverty, particularly among the poorest 10 per cent, above this level the per capita income of the poor grew by an impressive 5 per cent per year due to increases in their work-related income.

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.

BRAZIL SEM MISÉRIA

In June 2011, President Dilma Rousseff launched an antipoverty programme known as *Brasil Sem Miséria* (Brazil Without Poverty). The ambitious goal of the programme is to eliminate extreme poverty in Brazil by 2014. The programme will increase the transfer payments already provided by *Bolsa Familia*. It will also provide credit, technical assistance and skills training. It aims to increase poor people's access to health care, housing, and sanitation. The programme is especially focused on the Northeast Region of Brazil, which is the most impoverished region of the country. The programme intends also to ensure that the poor are in a better position to access both government services and economic opportunities. To achieve this the programme aims to ensure that the poor have proper documents, become literate, are healthier and have access to day-care facilities.[19]

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.

Ultimately, it does not matter for a poor worker whether his productive inclusion was facilitated by the public or the private sector. What matters to this person is that a sufficient amount of high quality productive opportunities exist (that there are exit doors out of poverty) and that he or she has had full access to them.

Public policies must make workers aware of the available opportunities

Any assistance is important to help build a country without extreme poverty. The larger the contributions made by the public and private sectors, as well as by the world economy, the better. The most important aspect is to obtain support from all sectors and, as a result, achieve the highest reduction in poverty.

South African Responses

Lumkile Mondi

Chief economist, Industrial Development Corporation

The Brazilian story is very similar to that of South Africa. The policy of import substitution and nationalisation which Brazil followed in the 1960s had its counterpart in South Africa at the same time. Other economic similarities are apparent in later periods, especially in the 1980s and early 1990s. Faced by poverty and inequality, politicians in both countries have been inspired by the 'Third Way'. This is an economic policy deployed by centre-left politicians to use conservative macro-economic and fiscal policies to stimulate economic growth, using the proceeds of growth to finance redistributive social policies.

This strategy of using macro-economic stability and a conservative fiscal policy to grow the country's economy worked successfully under the previous government of Thabo Mbeki. During this time, the South African state believed that true open economic policies would produce a surplus, and this surplus could be used to fund infrastructure. However when South Africa began to seriously look at expanding infrastructure again in the mid-2000s, the economy was struck by the financial crisis of 2008. This has led South Africans to look for new ways to make the economy grow in the post-crisis world and may have influenced the shift towards state capitalism under Zuma.

Unlike Brazil, South Africa is a huge exporter of skills. In the past fifteen years South Africa has lost very many highly-skilled citizens to the so-called 'brain drain'. In 2006 it was estimated that at least 800 000 white South Africans had emigrated in the period between 1995 and 2005.[20] In that same year the Department of Labour released a report showing that there were 12 000 South African doctors and 13 000 South African nurses working in countries that were members of the Organisation for Economic Co-operation and Development (OECD).[21] The skills vacuum that now exists will affect the Zuma government's policy of state capitalism and the use of state-owned enterprises as engines of growth. South Africa does not have the required skills to facilitate the expansion of industrial and infrastructural capacity.

Professor David Kaplan

Professor of Business and Government Relations, University of Cape Town

Income growth of the poorest half of the Brazilian population has been nearly six times greater than that of the traditional middle-classes

Countries are never directly comparable, but if there is one country that is the most comparable to South Africa it would be Brazil. What can South Africa learn from Brazil's recent economic performance?

The macro-stability that was created in the Cardoso years underpinned the strong economic growth that Brazil experienced. This in combination with favourable terms of trade resulting from high mineral and agricultural prices, led to large capital inflows. This resulted in an appreciation of the real, high consumer spending, cheaper imports, and lower inflation because the real was strong. It is a rising tide that lifts all boats.

South Africa had all that, and everything was in place. The country had a sound macroeconomic policy and there were capital inflows. The difference is that South Africa lost out on the commodity boom. When commodity prices rose, Brazil increased its output – South Africa did not. So, although South Africa had favourable terms of trade, the country's investments and what the country produced remained static in volume terms. The South African government interfered with property rights and did not get the country's infrastructure right, which retarded economic growth. If we had kept property rights strong and improved our transport networks, South Africa would have experienced the same boom as Brazil. There is nothing magical in the Brazil experience. South Africa did not focus on some of the essentials, but we can still recreate the environment that Brazil had just before its economic boom. Property rights will have to be protected in the correct way such as to give security to investors, and infrastructure will need to be improved. To the South African government's credit it is improving infrastructure. In fact, it is Brazil that is not spending enough on its infrastructure. This may lead to real problems for Brazil in the future.

Economic growth in Brazil got people into employment. Most of the employment has been in non-tradable sectors like construction, retail, and trade, rather than manufacturing. Nevertheless, the critical issue is to get people into employment. Once people are working, their chance of staying in employment later will improve, and they will become more productive over time. South Africa has lost out on this, and it will take us a long time to make up the deficit.

Brazil and South Africa face similar challenges in creating productive jobs for semi-skilled and unskilled people. If a country's terms of trade are improving a construction boom tends to follow and retail trade and other non-tradable activities will increase, creating jobs in these areas. Without these developments it is difficult to create unskilled jobs. Neither Brazil's nor South Africa's unskilled and semi-skilled labourers are internationally competitive. South Africa and Brazil have to look for ways to lower the real cost of labour, through new forms of employment contracts and different ways of negotiating wages as well as enhancing productivity. That is the only way that employment will be increased for unskilled and semi-skilled people in the traded sectors.

South Africa has problems with a restrictive labour market, but Brazil's labour market situation is even worse. What Brazil demonstrated was that, even with a poorly-functioning labour market, if a commodities boom is taken advantage of, employment can still be created.

One advantage that South Africa has is our highly-developed and efficient financial sector. Small firms in South Africa borrow at rates of only one or two per cent more than big corporations like Anglo American. South Africa does not need concessionary finance because the financial system we have generally works well. Brazil has a greater need for concessionary finance because of very high real rates of interest. But even in Brazil concessionary finance has created a number of unforeseen challenges and has not successfully raised the rate of investment. There is no rationale for South Africa to adopt a concessionary finance policy.

Neither Brazil's nor South Africa's unskilled and semi-skilled labourers are internationally competitive

The final point is with regard to science and technology. Brazilians have had great success exploiting their raw materials, but have also succeeded in applying science and technology, particularly in agriculture (see Box on EMBRAPA). South Africa has looked to space and nanotechnology, rather than the areas where there is already considerable local capacity, such as in agriculture and mining. Brazil used to have a similar ratio of receipts from technology as compared to payments for technology that South Africa had. Now South Africa's ratio of payments as opposed to receipts is 30:1 while Brazil's is 7:1. Brazil has also outstripped South Africa in the number of patents registered. In 2010 Brazil registered 254 patents at the US Patents Office. The number for South Africa in that year was144. Pre-1998 South Africa registered 2091 patents at the US Patent Office, while Brazil registered 836 patents.[22]

Brazil has also produced large numbers of skilled people and then invested in research and development (R&D). South Africa 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. South Africa cannot move ahead without addressing the skills constraint.

It is important that we grasp how important the role of macroeconomic policies and market reform have been in Brazil's growth story

EMBRAPA AND THE EXPANSION OF BRAZILIAN AGRICULTURE

The *Empresa Brasileira de Pesquisa Agropecuária* (Brazilian Agricultural Research Corporation), known by its Portuguese acronym, EMBRAPA, is a state-owned company which concentrates on pure and applied research in agriculture. It is affiliated with the Brazilian Ministry of Agriculture.

EMBRAPA was established in 1973 and is headquartered in the Brazilian capital, Brasilia. It has over 8 000 employees of which more than 2 000 are researchers. Of those one quarter have master's degrees, while nearly three quarters have PhDs. It has an annual budget of about US$1 billion.

Brazil used to be a net food importer. Now 80 per cent of what Brazil produces is consumed domestically, while the rest is exported. The increase in Brazil's farm production has been stunning. Between 1996 and 2006 the total value of the country's crops rose from US$11,4 billion to US$53,6 billion or 365 per cent. Brazil increased its beef exports tenfold in a decade, overtaking Australia as the world's largest exporter. It has the world's largest cattle herd after India's. It is also the world's largest exporter of poultry, sugar cane and ethanol. Since 1990 its soya bean output has risen from barely 15 million tons to over 60 million. Brazil accounts for about a third of world soya bean exports, second only to America. In 1994 Brazil's soya bean exports were one-seventh of America's; now they are six-sevenths. Moreover, Brazil supplies a quarter of the world's soya bean trade on just 6 per cent of the country's arable land.

Most of Brazil's agriculture revolution has been due to the opening up of the *cerrado*. This is a vast tropical savannah-type ecosystem in Brazil's interior, accounting for some 21 per cent of the country's total land area. It was always viewed as land that was unsuitable for agriculture, due to high levels of acidity in the soil, as well as a lack of nutrients. EMBRAPA did four things which opened up the *cerrado* to modern agriculture:

- They poured large quantities of lime into the soil of the region in order to reduce the levels of acidity. Scientists from EMBRAPA also bred *rhizobium* for use in the *cerrado*. *Rhizobium* is a type of bacteria which, when used in agricultural applications, reduces the need for fertilisers in soil.
- They brought a type of African grass, called *brachiaria* to Brazil. Through crossbreeding, a variety called *braquiarinha* was developed, which produced 20 – 25 tonnes per grass feed per hectare, a much greater yield than that of the native *cerrado* grasses. This allowed large areas of the *cerrado* to be turned to pasture, allowing the expansion of Brazil's beef herds.
- They pioneered a new farming technique called the 'no-till' method. Soil is not ploughed or harvested at ground level. Plants are harvested high on the stalk, and what is left of the plant is allowed to rot in the soil. The following year's crop is then directly planted into this 'compost'.
- They developed soybeans as a tropical crop. Soybeans grow best in temperate climes, and are native to south-east Asia. Using the technique of crossbreeding, EMBRAPA created a soybean which was capable of growing in tropical regions. Varieties of soybeans that grow faster were also developed, allowing farmers to have full harvests in a year, further increasing the yield.[23]

Michael Spicer

Vice-President, Business Leadership South Africa

The Brazilian presenters' conclusions should have strong resonance for South Africans. It is important that we grasp how important the role of macroeconomic policies and market reform have been in Brazil's growth story.

For a South African this rings loud bells, because this country has been through a period of macro-stabilisation and has had orthodox and sound macro polices. In addition, policymakers in South Africa were generally reformers and liberalisers from the late 1990s up until about 2004. However that period now feels like the distant past. South Africa has since entered the era of state capitalism, looser macro policies – or at least arguments for those – and a very strong emphasis on industrial policy. The lessons that countries around the world – including Brazil – learned in the 1970s and 1980s regarding the perils of state intervention are now just a distant memory and the importance of market reform and macroeconomic prudence to Brazil is not always understood by those that look there for inspiration.

It is important to remember that Brazil and South Africa, while sharing some similarities, also have important differences. One material difference is that South Africa has a market of 50 million people while Brazil has a market of nearly 200 million. The absence of successful regional integration in southern Africa is thus an enormous constraint on the growth of the economy. There has been increased rhetoric in support of greater regional integration, but at a practical level that has not happened.

South Africa has performed poorly in making the best use of the endowments it has and finds it difficult to learn from the successes of others. Part of the reason for this is that the legacy of the past looms large in South Africa. Questions of race unduly influence economic thinking and planning, leading to a skewed priority on redistribution rather than on wealth creation. Land reform is a prime example of this. Land reform is motivated by politics not by the need to increase agricultural efficiency which takes a back seat.

There are also differences between the way South Africa and Brazil act pragmatically. In Brazil, pragmatism is defined as resorting to the rhetoric of state capitalism while being prepared to practice privatisation. By contrast, privatisation is absolutely off the table in South Africa. The most that could happen in South Africa is port concessions, or having railway-line users provide the capital to build the line and receive reduced tariffs in return. However, even these policy suggestions are highly contested. The irony is that Brazil has sold off one of its airports to a company which is not only South African, but also a state enterprise. This is the Airports Company of South Africa (ACSA), which won a joint venture concession to overhaul and manage Brazil's busiest airport, Guarulhos in São Paulo.[24] However, ACSA built a new airport in Durban, South Africa, that was not really needed, at such a high cost that the fees now charged at this airport are driving private-sector, low-cost airlines out of the market.[25]

South Africa has a market of 50 million people while Brazil has a market of nearly 200 million

Pragmatism – or if you prefer, realism – may have prevailed in South Africa over the threat of mine nationalisation, but only after much damage had been done to investor confidence. South Africa has failed to fully benefit from its vast mining resources because the mineral rights systems are inefficient and prone to corruption, all this is against a constant undertone of ideological hostility to all large-scale business and the property rights that underpin enterprise. While this may not be government policy, it is sufficiently well-grounded in the ANC Alliance to suggest to the prudent investor that one day it may well be. All of this has affected the country's mining industry negatively. As it stands, the price for not nationalising the mines will be a large number of new taxes levied on the mining industry. This will introduce new constraints into the business of running mining companies. At the same time, the government has been saying, in somewhat contradictory terms, that the expansion of the country's mining industry is to be one of the lynchpins of future South African growth.

Jeremy Seekings

Professor, political studies and sociology, University of Cape Town

Brazil has managed to lift people out of extreme poverty into semi-poverty while at the same time lifting working-class people into the middle-class. If one looks at these two processes, there are both differences and similarities between Brazil and South Africa.

Brazil has managed to reduce poverty significantly over the last decade and a half. The evidence indicating this is quite consistent, with the numbers and proportion of people living in poverty having decreased over the last ten to fifteen years. This has been due to a mixture of well-targeted cash transfer programmes and a rise in labour income through the expansion of employment. South Africa has managed one of these two things, which is the significant increase in cash transfers to the poor. These are also relatively more generous than their Brazilian equivalents. However, South Africa has had no significant decrease in its unemployment rate and no increase in the rate of labour earnings of people in the poorest 40 per cent of the population over the past ten years. Another issue is that there has been a collapse in private welfare provision in South Africa. The system of remittances, which was closely linked to the system of migrant labour, has a negligible effect on poverty in this country today. Poverty may have diminished in South Africa over the past ten years, but poverty rates are not significantly lower than they were in 1994.

South Africa has had no significant decrease in its unemployment rate and no increase in the rate of labour earnings of people in the poorest 40 per cent of the population

There are two obvious differences between South Africa and Brazil which explain Brazil's success in reducing poverty. The first is with regard to schooling. The South African government spends large amounts of money on education but the value of this education, especially for poorer children, is negligible, even zero. Despite official statistics to the contrary, South Africa clearly has people between the ages of 16 and 18 that are functionally illiterate. Brazil's schools are far from good, but they seem to do a better job in equipping young people with the basic competencies needed in the labour market.

The second difference between Brazil and South Africa is that the demand for unskilled and semi-skilled labour in South Africa has virtually collapsed. This can partly be attributed to the relatively restrictive labour legislation which South Africa has. In addition, unskilled and semi-skilled labour has priced itself out of the market. One can see this playing itself out in KwaZulu-Natal. This is a province which has historically been a low-wage region and it formerly had a significant, labour-intensive clothing industry, especially in and around Ladysmith and Newcastle. However, over the past six years, minimum wages have doubled in real terms for the clothing industry in these areas (admittedly from a low base). The wage differential between low-wage and high-wage areas around the country has been greatly reduced. This has resulted in massive job destruction in the clothing industry - the only remaining labour-intensive manufacturing sector. Now there is almost no demand for unskilled and low-skilled labour in South Africa in the formal private sector, and the informal sector is very small. This is an area where Brazil and South Africa differ. Brazil has managed to ensure that there is demand for low-skilled work.

Part of this is due to historical factors. South Africa has institutionally and culturally been a high-wage economy. European immigrants who came to South Africa generally came from North-west Europe, which was a high-wage region. Conversely, the majority of immigrants who settled in Brazil came from Southern Europe, which generally had lower average wages than North-west Europe. Brazil has institutionally and culturally been used to lower wages than those that South Africa feels comfortable with.

Jayendra Naidoo

Executive Chairman, J&J Group

In 1994, South Africa's income distribution was the second worst in the world. Brazil's was the worst. Since then Brazil's position has improved, and South Africa is now probably the most unequal society in the world. Despite the programmes instituted to redistribute income, South African inequality levels have worsened since 1994.[26]

A critical difference between Brazil and South Africa appears to be a sense of common purpose amongst the Brazilian people. This contrasts with South Africa's context of hostile compromise which produces at best half-hearted policy and at worst policy paralysis. There is something in the Brazilian policy dialogue that is positive. South Africans should think hard about what we learn from that. We need to find a way to move from our inflexible hostile compromise towards the type of national consensus that will get things moving.

Brazil also appears to have more effective institutions. Their policy decisions lead to actions; they get things done by implementing policies in an effective way. It does not matter how good a country's policies are, if the right institutional arrangements are not in place to get practical results the best leaders and best policies will not make a difference to a country's success.

General Discussion

Brazil proves that a growing manufacturing sector is not always necessary to generate increased employment

Job Creation in Brazil

The issue that interested South Africans the most was how Brazil created so many low-skill jobs compared to South Africa, despite the similarities between them, including the existence of relatively onerous labour legislation in Brazil?

Professor Amaury de Souza explained that the low economic growth and lack of employment that Brazil experienced in the 1980s forced many people into low-productivity jobs in the informal sector. The entry of people into the informal, low productivity economy was further exacerbated by the lack of a social security net at the time. Further, state-owned enterprises employed large numbers of people in low productivity positions. Brazil's recovery in the 1990s and 2000s has, furthermore, been concentrated in labour intensive sectors like construction. Brazil proves that a growing manufacturing sector is not always necessary to generate increased employment.

Brazil historically had a large number of low-skilled, poorly educated workers, and a small number of highly-educated, highly-skilled workers. Every extra year of school was then associated with a ten to fifteen per cent wage increase. With the opening up of the Brazilian economy in the 1990s, the demand for unskilled workers increased. At the same time, new technologies biased towards skilled workers were introduced, which resulted in wage differentials remaining relatively static. The rehabilitation of the Brazilian education system then saw a general improvement in Brazilian schooling, which increased the supply of skilled workers. This was followed by the growth of the construction and services industries, 'all of which resulted in a demand shift in favour of relatively low-skilled Brazilians'.

If labour legislation in Brazil were to be reformed the attractiveness of Brazil to foreign firms would increase exponentially

Professor de Souza added that unions have monopoly power in Brazil. For example, all metal workers in the city of São Paulo are required to be members of a certain union. There are requirements like this for all occupations in all Brazilian cities. Most of the country's unions are funded by payroll taxes. Consequently, the number of workers voluntarily associated with unions is quite small. Labour legislation in Brazil deals with all the minutiae of interactions between workers and management. This over-regulation has led to the growth of the informal sector, with many enterprises remaining informal so that they can escape the excessive labour and tax regulations. If labour legislation in Brazil were to be reformed the attractiveness of Brazil to foreign firms would increase exponentially.

However, it is relatively easy to fire workers. There is a severance fund in Brazil to which individuals and employers contribute. When a worker is fired employers are obligated to pay a fine to the value of 40 per cent of the individual worker's total contribution to the fund. However, any worker who has been fired, even though he has received a settlement from his employer, is entitled to take his employer to the labour court. He is entitled to that for a period of five years from the date of dismissal. This creates legal uncertainty for employers. Current legislation also provides six months fully-paid maternity leave, and some policy makers want to extend this provision to fathers.

Professor Andre Portela de Souza added that payroll taxes and mandatory benefits greatly increase the cost of labour in Brazil. These payroll taxes are used to finance social security, the union and BNDES. For every real a company paid to a worker, he claimed, another 1,8 to 2,2 reals were paid in mandatory benefits and taxes.

Does South Africa have a high wage culture compared to Brazil?

Following up on a suggestion made by Professor Jeremy Seekings, a participant wondered whether Brazil did traditionally have a culture that encouraged the creation of low wage jobs. Professor Amaury de Souza answered that it is true that Brazil has had a low-wage culture, but Brazilians are becoming less interested in low-wage occupations, with the exception of the service industry, 'and there are now many foreigners to be found in Brazilian low-wage jobs, particularly in the construction sector'.

Mike Spicer pointed out that South Africa's high-wage culture is further exacerbated by an immigration policy that restricts skilled immigration, which is made even worse by the behaviour of many professional associations, which act like guilds and restrict entry into various professions. 'At the same time, a large section of our skills base is effectively exported,' he added.

Investment Patterns in the Two Countries

Participants wondered which factors influenced the different investment patterns in Brazil and South Africa. Professor David Kaplan pointed out that Brazilian investment tends to be labour-intensive because of the high cost of capital. As a result, firms would rather economise through employing low-cost labour. In South Africa the cost of capital is comparatively low, and many firms, despite investment incentives from the government, are funded through retained earnings. This, coupled with 'the hassle factor' of employing people in our legal and regulatory environment, has resulted in capital intensive economic growth in South Africa.

Professor Armando Castelar Pinheiro said that investment rates in Brazil are still too low. Brazil does not have an investor-friendly environment. A particular problem is the onerous tax regulations, which differ between the various states. 'The shortage and low quality of infrastructure is another problem,' he added.

A Striking Contrast

Jayendra Naidoo observed that - based on the presentations -in Brazil the public sector is often considered the benchmark for excellence. In South Africa, by contrast, the private sector is almost always automatically considered as better than the public sector.

Final Session

Professor Amaury de Souza
Fellow, CEBRI

Brazilian investment tends to be labour-intensive because of the high cost of capital

Brazil and South Africa have been increasingly looking to China. In many ways this is a healthy change of perspective. Generally, the two countries have previously looked to the West and Europe. One result of this tendency to draw on Western models was the adoption of a welfare state at an early stage of their development, before the two countries had developed the resources to support that kind of system. As a result Brazil confronts a major challenge now. Too much is being spent on social security. People are also retiring too early, when they could work for another 20 to 25 years.

Brazil is also spending too much on the civil service. Brazilian civil servants retire with full pay. There is proposed legislation to stop that, but only for the new entrants into the civil service. The country will still have to foot the bill for current civil servants, which will amount to about US$35 billion per year for the next forty years.

This idea that Brazil and South Africa should be miniature European countries also influenced labour legislation. Our countries imported everything that the International Labour Organisation (ILO) bureaucracy had to offer. Our governments signed all the ILO treaties.

That is why positive development can come from shifting our gaze towards China. We should not retrench people and strip labour or pensioners of their rights, but we should understand how China made the best of the few resources that they have.

China has embraced the notion of innovation. We have been led to believe that only one kind of innovation is worth our while – what the literature calls 'disruptive innovations'. These types of innovations completely transform an industry and introduce wholly new services or products. This kind of innovation is rare. Someone like Steve Jobs comes along every 300 years or so. China has understood this. Much of Brazil's R&D research still goes into funding university research in the hope that pure science will generate a novel insight, which more practical minds will transform into technological applications. This is an out-dated way of going about creating science and technology.

What China is doing is finding innovation in every single step of the production process. There is innovation in better marketing, better logistics, and a shift from individual to collective design processes. All of this counts. A good example of this type of innovation can be found in EMBRAPA, the Brazilian agricultural concern. Its greatest success has been with the growing of soy beans. Soy beans are a temperate climate species. This kind of climate does not really exist in Brazil, so the soy beans had to be adapted through genetic adaptation. Now soy beans are being planted in the arid regions of Brazil. There is a joke that soon Brazilians will be planting soy beans on rocks thanks to genetic engineering. This is a prime example of innovation 'bearing fruit'.

South Africans should not forget that the post-1994 transition is one of the major feats of political engineering and negotiation in history. The fact that the homelands have disappeared and everyone is now a citizen is a major political achievement. Brazil and South Africa share that experience. Brazil had a transition from military rule to democracy. Admittedly the rule of the Brazilian military was never as bad as Apartheid, but Brazil also made that transition through peaceful negotiations and a great deal of political engineering, similar to what happened in South Africa. Both countries deserve more patience and understanding while they seek to get things right.

Ann Bernstein
Executive Director, CDE

Brazil has shown that it is possible to begin winning the war on poverty and inequality

One of the most important lessons of the discussion at this workshop is that Brazil has shown that it is possible to begin winning the war on poverty and inequality. In South Africa the challenges that the country faces often seem overwhelming. However Brazil – which is a much bigger country – has got a number of things right. There is a pragmatism that seems to be at work in Brazil and which is in contrast to the 'hostile compromise' that we see in South Africa. In Brazil – through the terms of several presidents now – there is agreement on the broad thrust of where Brazil is going, which is absolutely vital. Brazil has shown that it can be done, and the results have been dramatic. The decrease in poverty rates in Brazil is inspiring and the lifting of 30 to 40 million people into the lower middle class is phenomenal.

Within this Brazilian pragmatism there have been some big ideas, from sending Brazilian students to study at leading universities overseas every year for the past quarter century to the major innovations in agriculture that Brazil has developed and is now exporting to Africa. These, and the many additional ideas discussed at this workshop, contain insights that South Africans should reflect on. The challenge is to turn 'good ideas' that have worked in Brazil, into appropriate and effective policies within the South African context.

Key Insights

In reflecting on the workshop discussion we will now summarize the key findings and draw out some insights and implications of importance to South Africans.

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.

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. Nevertheless, some of the Brazilian achievements discussed at CDE's workshop that could serve as a source of inspiration for South Africans include the following:

- Brazil has lowered poverty levels to single digit figures (from 23 per cent to 8 per cent) in less than two decades from 1990 to 2009.
- 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.
- 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 exporter.
- Poor people's living standards and prospects have been raised mainly through the expansion of 'productive inclusion' in the economy. Rather than depending on others for welfare indefinitely, a growing number of poor Brazilians are now in a position to contribute to the on-going growth of the Brazilian economy.
- 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.

It is important not to exaggerate Brazil's achievements

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, 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 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.

Related to these issues, 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 $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 2 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 has under-invested in infrastructure for decades

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: '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.

The Brazilian state remains a large and important actor

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 government's 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.

State driven policies like BNDES' concessionary finance programme were not successful in raising the rate of investment. 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. (See CDE's recent publication *The Role of Concessionary Finance in Brazil, CDE Insight, June, 2012*, available at www.cde.org.za.).

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.

By taking advantage of growth opportunities, Brazil got its people into employment

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.

There are no simple 'models' that South Africa can import from Brazil

Endnotes

1. Data from the Institute for Applied Economic Research (IPEA), the Brazilian Institute of Geography and Statistics (IBGE), and Barro, Robert and Jong-Wha Lee, A New Data Set of Educational Attainment in the World, 1950-2010. NBER Working Paper No. 15902, April 2010.
2. OECD economic surveys, Brazil, October 2011; "Brazil Unveils Plan to Boost Rail and Road Investment," 16 August 2012, Reuters, http://in.reuters.com/article/2012/08/15/brazil-economy-idINL2E8JF3D320120815
3. Read more: http://community.nasdaq.com/News/2012-08/will-increased-stimulus-for-brazilian-transport-infrastructure-be-sufficient.aspx?storyid=166298#ixzz24Nkjv2vr
4. "The rise of state capitalism," The Economist, 21 January 2012, available online at: http://www.economist.com/node/21543160
5. The so-called Brazilian Criterion was developed by Brazilian Association of Market Research. The weights assigned to its components are estimated from a Mincerian equation, using the log of total family income.
6. See Marcelo Côrtes Neri. A Nova Classe Média: O Lado Brilhante dos Pobres, Rio de Janeiro: Fundação Getúlio Vargas, Centro de Políticas Sociais, 2010.
7. This new middle class is also sometimes defined in relative terms as being above the 50% poorest and below the 10% richest.
8. Marcelo Côrtes Neri. Desigualdade de Renda na Década, Rio de Janeiro, Fundação Getúlio Vargas, Centro de Políticas Sociais, 2011, p. 43.
9. "Brazil's Bolsa Familia: How to get children out of jobs and into school," The Economist, 29 June 2010, available online at: http://www.economist.com/node/16690887
10. World Bank, Domestic credit to private sector, http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS, accessed 16 July 2012.
11. See Ricardo Paes de Barros, Mirela de Carvalho, Samuel Franco and Rosane Mendonça. "Markets, the State and the Dynamics of Inequality: The Case of Brazil" in Luis Felipe Lopez-Calva and Nora Lustig (editors) Declining Inequality in Latin America: A Decade of Progress? Washington, D.C.:Brookings Institution Press, 2010, pp. 134-174.
12. See Marcelo Côrtes Neri. A Nova Classe Média: O Lado Brilhante dos Pobres, Rio de Janeiro: Fundação Getúlio Vargas, Centro de Políticas Sociais, 2010.
13. See Abhijit V Banerjee and Esther Duflo. "What Is Middle Class about the Middle Classes around the World?" Journal of Economic Perspectives, 22 (2), 2008, p. 26.
14. Martin Ravallion, "The Developing World's Bulging (but Vulnerable) Middle Class", Washington, DC: The World Bank, Policy Research Working Paper 4816, January 2009.
15. "The Brazil backlash," The Economist, 19 May 2012, available online at: http://www.economist.com/node/21555583
16. Prof A Portela de Souza, Exit doors, productive inclusion and extreme poverty eradication in Brazil, Paper commissioned by CDE, 2012
17. Ibid.
18. Ibid.
19. http://www.unhcr.org/refworld/country,BRA,4fcc953a27,0.html
20. F Cronje, and M Macfarlane, Fast Facts, August-September 2006, South African Institute of Race Relations
21. M Breier, The shortage of medical doctors in South Africa, March 2008, research commissioned by the Department of Labour.
22. World Bank, Patent applications, residents, http://data.worldbank.org/indicator/IP.PAT.RESD?page=6, accessed 25 May 2012.
23. http://www.embrapa.br/english/; P. Cremaq, The miracle of the Cerrado: Brazil has revolutionised its own farms. can it do the same for others? Economist, 26th August 2010.
24. H Lazenby, "Acsa consortium awarded R70 billion Brazil airport contract, "Engineering News, 8 February 2012. Available online at: http://www.engineeringnews.co.za/article/acsa-consortium-awarded-r70bn-brazil-airport-contract-2012-02-08
25. A Hlongwane and M Savides, "Airport charges rocket," Independent Online, 29 May 2011. Available online at: http://www.iol.co.za/news/south-africa/kwazulu-natal/airport-charges-rocket-1.1075351
26. World Bank, GINI index, http://data.worldbank.org/indicator/SI.POV.GINI?page=3, accessed 24 July 2012. World Bank, GINI index, http://data.worldbank.org/indicator/SI.POV.GINI?page=3, accessed 24 July 2012. M Leibbrandt and A Finn, CDE Insight, Inequality in South Africa and Brazil: Can we trust the numbers? July 2012, Centre for Development and Enterprise
27. "No longer bottom of the class," The Economist, 9th December 2010; CDE, Schooling reform is possible: Lessons for South Africa from international experience , CDE Round Table, September 2011
28. David Sterman, Forget China And America -- These Nations Dominate In The 'Economic Olympics', August 09, 2012, http://www.investinganswers.com
29. The top emerging economies of the world, http://www.incrediblediary.com/top-ten-emerging-economies-in-the-world
30. Stuart Grudgings, Surge in Investment Reshapes China Brazil Ties, 10 August 2010, http://www.reuters.com/article/2010/08/10/us-brazil-china-idUSTRE67947R20100810; China Invests Heavily in Brazil, 10 July 2010, www.washingtonpost.com
31. https://www.adr.com/Markets/GlobalNewsStory?docID=1-DN20120815010667-5SC90R4N8APTBNUVU7TA0ASU9J
32. http://siteresources.worldbank.org/INTEXPCOMNET/Resources/ICA_Brazil_2005.pdf
33. Ezra Klein, "Brazil facts," August 7, 2012, www.washingtonpost.com
34. Ibid
35. http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG
36. C Weigand and M Grosh, Levels and Patterns of Safety Net Spending in Developing and Transition Countries, World Bank SP Discussion Paper No.0817, 2008. This report pegged Brazilian welfare payments at under 2 per cent of GDP and South Africa's at over 4 per cent. The Brazilian figure, may, however, have ignored the income redistribution that takes place through the Brazilian pension system.

Previous publications in this series

Special Ecnonomic Zones: Lessons for South Africa from international evidence and local experience
CDE Round Table no 19, June 2012

Schooling reform is possible: Lessons for South Africa from international experience
CDE Round Table no 18, September 2011

Jobs for young people: Is a wage subsidy a good idea?
CDE Round Table no 17, August 2011

A nation's health in crisis: International experience and public-private collaboration
CDE Round Table no 16, November 2010

Poverty and inequality: Facts, trends, and hard choices
CDE Round Table no 15, August 2010

Water: A looming crisis?
CDE Round Table no 14, April 2010

South Africa's Public Service: Learning from success
CDE Round Table no 13, November 2009

Managing migration in South Africa's national interest: Lessons from international experience
CDE Round Table no 12, October 2009

Accelerating growth in tough times
CDE Round Table no 11, March 2009

South Africa's electricity crisis: How did we get here? And how do we put things right?
CDE Round Table no 10, July 2008

Farmers' voices: Practical perspectives on land reform and agricultural development
CDE Round Table no 9, February 2008

Going for growth: Are AsgiSA and JIPSA bold enough?
CDE Round Table no 8, March 2007

Local government in South Africa: Priorities for action
CDE Round Table no 7, September 2003

Why is South Africa failing to get the growth and jobs that it needs?
CDE Round Table no 6, March 2001

Local government reform: What's happening and who is in charge?
CDE Round Table no 5, November 2000

The future of South African universities: What role for business? Part Two
CDE Round Table no 4, September 2000

The 1996 Census: Key findings, problem areas, issues
CDE Round Table no 3, August 1999

The future of South African universities: What role for business? Part One
CDE Round Table no 2, July 1998

Getting into gear: The assumptions and implications of the macro-economic strategy
CDE Round Table no 1, April 1997

CDE
CENTRE FOR DEVELOPMENT AND ENTERPRISE
Informing South African Policy

5 Eton Road, Parktown, Johannesburg, South Africa
P O Box 1936, Johannesburg 2000, South Africa
Tel 27 11 482 5140 • Fax 27 11 482 5089
info@cde.org.za • www.cde.org.za

This CDE Round Table was funded by
the UK Foreign and Commonwealth Office Prosperity Fund

British
High Commission
Pretoria