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Interview
Marcelo Neri
Director of the Social Policy Center of FGV

THE BRAZILIAN ECONOMY

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Designing a new future

As new technologies accelerate in industrialized countries, Brazil needs a new competitiveness agenda for manufacturing, services, and innovation

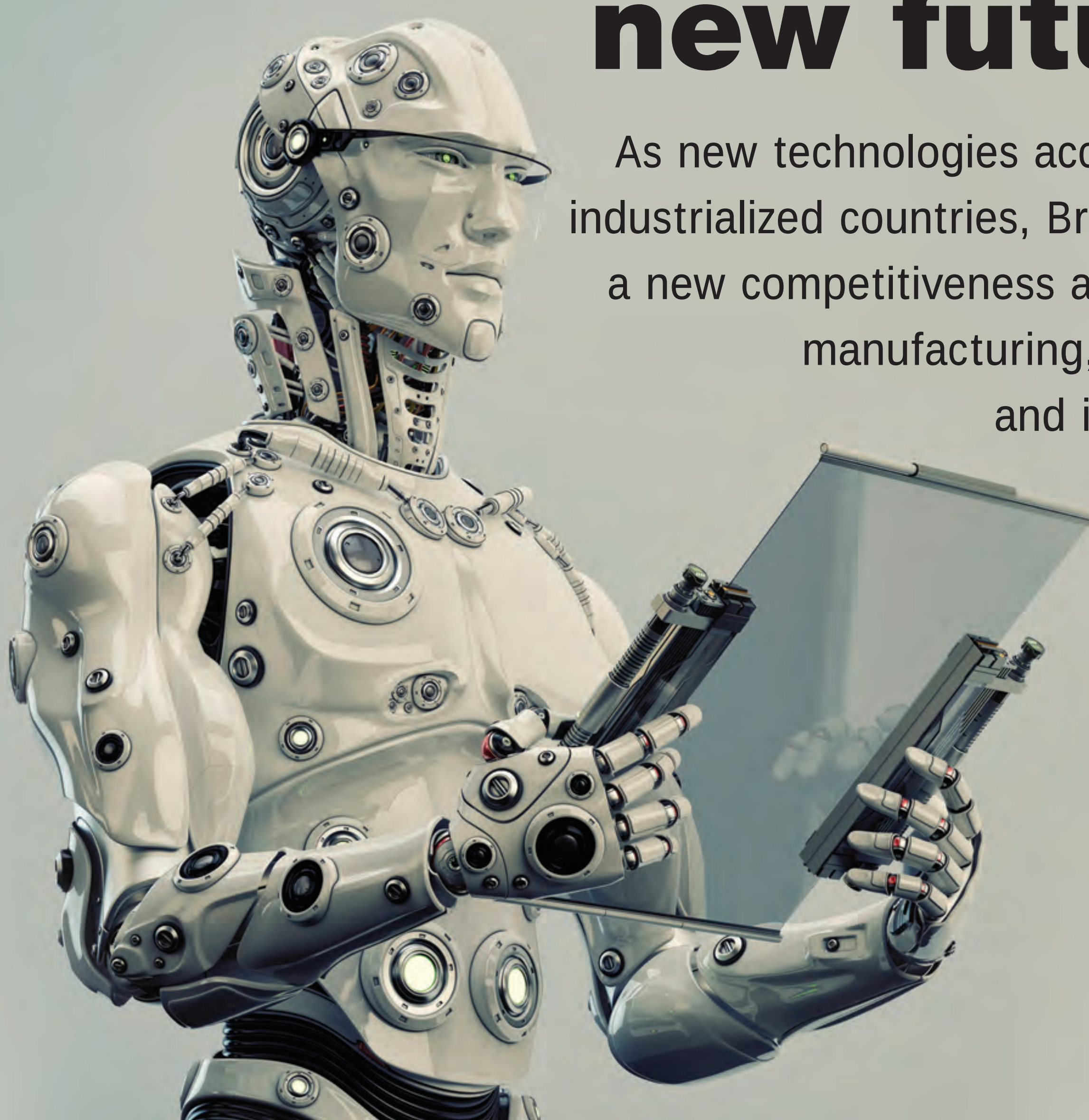

Photo: Saulo Cruz

The threat of a growing inequality

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Solange Monteiro

IN 2015 BRAZIL recorded its first decline in both economic growth and social welfare since 1992, breaking the trend that had kept social welfare rising faster than GDP for more than a decade. According to Marcelo Neri, an active participant in evolution of that trend, the recession threatens the country with growing inequality, and Brazil will not be able to break out of this trap if in making the necessary fiscal adjustment it chooses to cut the program that most efficiently reduces poverty. Neri, former Minister of Strategic Affairs, criticizes the decision to make no nominal adjustment to the Family Grant (Bolsa Família) in order to increase the minimum wage by 11.5%. He emphasizes that Brazil must reintroduce economic and social rationality and move forward in difficult fiscal policy decisions, such as social security reform.

The National Household Survey—the PNAD—has found in recent months a significant increase in the number of unemployed and a drop in the purchasing power of workers. Are we going backwards in terms of reducing inequality?

Despite the economic collapse since 2010 and the explosion of unemployment, informal employment, and inflation, until the end of 2015 the PNAD recorded no fall in workers' incomes. Through the second quarter of 2015, wages had not fallen, and neither had the number of those employed, or their incomes. However, in the third quarter the fall began, and in the fourth quarter it intensified, accompanied by the first rise in income inequality since the turn of the century. Measuring social welfare as average labor income per capita growth adjusted by income inequality,[1] the fourth quarter of 2015 showed a welfare loss of 5.7% in 12 months. It was the first time since 1992 that both economic growth and social welfare fell in the same year. In the 1999 and 2003 crises there had been a significant drop in income, but less inequality had helped to mitigate the social welfare loss. Only since the end of 2015 has the social welfare trend reversed. This new fact makes it clear that we have a social crisis.

Is this the end of the resilience in employment and income that we have seen?

Undoubtedly, we are at a turning point. Since the 2003 recession ended, there has been a mismatch between the growth of GDP per capita, which went up by 29% between 2003 and 2013, and the PNAD data on labor income, which grew about twice as much in the same period. Because of the increase in labor income and the reduction of inequality, social welfare rose three times more than GDP. Since any economics textbook will tell you that the labor market pays for productivity, this mismatch represented a fundamental imbalance. … That mismatch between the growth in labor income and in GDP per capita has widened since 2010. In the first Rousseff administration, GDP per capita decelerated abruptly in response to the end of the commodities boom and growing internal imbalances, yet labor income continued to

[1] To provide a measure of social welfare adjusted by income inequality, Sen Amartaya proposed to multiply the average income by the measure of income inequality, calculated as 1 minus the Gini index. Inequality acts to reduce the average of equitably distributed income.

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grow—by 2014 it was averaging real annual per capita growth of 4.8%. Income inequality actually declined slightly in 2012 and 2013, and then plunged: In 2014, income grew 3.3% and income inequality fell the most in 10 years. Although the economic crisis started in 2011, the start of a new lost decade, the social crisis—the fall in labor income and the rise in income inequality—began only at the end of 2015. Then it arrived in full force.

How can we protect the most vulnerable people in the current crisis?

Today Brazil has a growing inequality trap. On the one hand we have the rising inequality of labor income; on the other we have fiscal tightening. This year the Family Grant Program had zero nominal adjustment even though inflation is already in double digits. And that is the most pro-poor program we have. The Family Grant reduces income inequality by far more than all the other cash transfer social programs. Yet we raised the minimum wage by 11.5%, which is higher than the established rule; that will increase public spending by far more than the Family Grant. It is a machine to generate inequality. Given the need for fiscal

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adjustment, we should protect the Family Grant because it reduces income inequality and has no tangible effect on fiscal adjustment, since it represents only 0.6% of GDP, while pensions account for 12%—20 times more. Funding for the Family Grant has been frozen in nominal terms since May 2014, yet the program is responsible for 20% of the large reduction in inequality that occurred since 2000. We are going backward in terms of income inequality.

How do you think the reform agenda should address the issue of inequality?

Beyond the actuarial disaster of social security, we cannot understand Brazil today without taking into account representative surveys of the views of the population. There is a clear parallel between the economic crisis and the disillusionment of Brazilians with the government. According to the Gallup World Poll, Brazilian satisfaction with public services has been falling since this decade began. Trust in government generally has also fallen. The dissatisfaction reveals itself in increasing tax evasion, by both individuals and legal entities. During the hyperinflation in 1990s we would get rid of money printed by the government, generating the inflationary spiral; now we evade taxes, exacerbating the fiscal crisis.

Brazil had become used to a high rate of revenue, fiscal room for spending that was not sustainable. And we fell into the trap. Brazil has now been hit by fiscal constraints that are not transitory but long term, forcing cuts in public spending. Because it is more difficult to cut other budget items, the government has cut the Family Grant, thus increasing inequality. We have to get out of this vicious cycle and find a virtuous fiscal adjustment.

Is it possible to combine fiscal adjustment with policies that mitigate income inequality?

We must make the fiscal adjustment. If we do not, the social prospects will be even worse, … Given the fiscal fragility, we are surprisingly close to poverty without the protection of formal employment or a social safety net.

You said that, with the crisis, we should assess the social benefit per unit of tax spent, so that we can do more with less. How can this be done?

When I was in the Strategic Affairs Secretariat, we created minimum standards of assessment for federal government programs. Today there is no assessment. We have plenty of data, but we do not evaluate programs. In Central America, for example, smaller countries hire one institution to execute a social program and another to evaluate it. Brazil does not do this. Any government program that survives for a few months becomes a permanent program in the budget. The one exception is the Family Grant, which replaced the Zero Hunger program quickly, in a year. The result is that we are in a difficult fiscal situation but we have no idea what spending to cut—we entered this difficult fiscal situation without a route out. Future generations will pay the bill.

So social security reform is also important for reducing inequality.

Social security reform is absolutely essential. But I see no strategy to deal with it. The social security problems result from excellent news: we are living longer, and I would say better. According to the United Nations *Atlas of Human Development*, every three years in the last two decades we have gained a year of life expectancy. In 2003, the Fountain of Youth survey here revealed that cash transfers to low-income elderly Brazilians improved their health. Now and again we heard criticism of the Family Grant and praise of cash transfer programs for the elderly. How we treat low-income seniors is a good example of Brazil's social policy: it lets a citizen live a miserable life, illiterate, without decent health care, and at the end of their lives, we give them a winning ticket. Yet every dollar spent on the Family Grant program reduces poverty by four times more than increases in social security benefits. It should be a no-brainer. But just like the minimum wage policy, social security reform is taboo.

How do you expect that this year will end in terms of inequality?

Economic stability has been lost, after it was hard-won by the Real Plan in 1994, which ended hyperinflation. We are in a critical situation that points toward chronic crisis, in which families cannot replace what they lose. In general, Brazilians have admirable creativity and flexibility, not losing their minds when

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they lose their jobs, finding informal work or setting up their own businesses. But this flexibility has reached its limit. Right now the most important thing is to reintroduce economic and social rationality — there is no conflict between these things. Brazil is very polarized in terms of ideas and passions, though paradoxically it has never been so integrated in terms of income distribution and education.

Brazilians have the odd ability as a society to produce collective derangements. This is a historic one. And unlike the time of hyperinflation, today there is no possible quick solution. We must work hard, build consensus, and calm things down. We have strayed from the middle path of moderation and conciliation. Economic rationality was thrown out, markets were upset in a superfluous way, and now social policy is going down the drain. We all need to regain emotional balance. Otherwise, with this level of tension there will be no solution.