

# STRATEGIES FOR GROWTH

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## **THE CHANGING ROLE OF THE STATE**



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# BRIEFING ON THE CONFERENCE

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## **STRATEGIES FOR GROWTH: THE CHANGING ROLE OF THE STATE**

In the last of three international conference modules on the topic, public policy specialists gathered in Rio de Janeiro on December 12th and in São Paulo on December 13th to discuss Strategies for Growth: The Changing Role of the State. The two-day conference in Brazil concluded a three-year research initiative led by Columbia University's Center on Global Economic Governance (CGEG), in conjunction with the Columbia Global Centers in Paris, Beijing, and Rio de Janeiro. The project was developed in response to the global financial crisis of the previous decade and the challenges that Europe, East Asia, and Latin America have faced, both individually and collectively, in its aftermath.

The project's inaugural conference in Paris focused on fragmented North-South economic performance in Europe and sought methods for stimulating sustained, widespread growth. In Beijing, discussion surrounded China's slowing growth and its eventual transition from an outward, export-oriented economy towards becoming a service economy with strong domestic consumption.

In Brazil, participants discussed strategies for economic growth in the context of fiscal and structural reform policy, monetary and banking issues, and institutional legitimacy and transparency. In each of the two morning sessions, selected participants were asked to provide brief introductory remarks to initiate broader roundtable discussion. Following a luncheon and keynote speech, the public discussion panels took place throughout the afternoon and attracted large audiences.

Each day of the conference included a keynote lecture with a selected speaker. On

Monday, Maria Silva Bastos Marques, President of the Brazilian National Bank for Economic and Social Development (BNDES) spoke in Rio de Janeiro, and Ilan Goldfajn, President of the Central Bank of Brazil, delivered the lecture in São Paulo on Tuesday.



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## BRAZIL IN CONTEXT

Not long ago, Brazil was the darling of the emerging economies, one of the fastest growing and most attractive markets for international investors. At the outset of 2011, then-president Dilma Rousseff's approval ratings peaked at near 85%, making her one of the world's most popular political leaders. The economy was growing at a quarterly rate of nearly 5% and presalt discoveries were expected to solidify Brazil's position as an economic competitor to Europe and the United States.

Today, Brazil faces record high unemployment, seven consecutive quarters of negative economic growth, and a mere 10 percent approval rating for Michel Temer, Brazil's new president in the wake of President Rousseff's removal from office last August. Temer's administration has indicated it will focus on reducing the country's massive public debt – which hovered around 70 percent of GDP towards the end of 2016 – as well as restoring investor confidence and financial credibility. At the core of Temer's proposed austerity measures is a twenty-year government spending cap and massive reform of the federal pension system. This represents an acute shift from the center-left policies of the previous administration, which greatly expanded social programs aimed at improving access to housing, education, and healthcare.

The conference sought to foster debate and dialogue regarding Brazil's growth strategy in the midst of political and economic turmoil in Brazil.

Conference organizers identified three focus areas for roundtable discussion on economic growth in the Brazilian context:

- Re-examining the Role of the State in Economic Growth in Brazil: Fiscal and Structural Policy Challenges
- Monetary and Banking Issues: Mobilizing Financial Resources to Accelerate Innovation and Growth

- Fostering Growth through Strengthening Institutions: Rebuilding Public Trust in Government in Brazil and Around the World

### **Fiscal and Structural Policy Challenges:**

This first morning session covered the ongoing debates in Brazil on the traditional roles of the state, including budgeting, taxation, fiscal policy institutions, state-owned enterprises and privatization, regulation, productivity and achieving fiscal credibility.

### **Mobilizing Financial Resources to Accelerate Innovation and Growth:**

The second session shifted focus to critical issues involving Central Banks and the financial sector around the world and in Brazil, specifically.

### **Rebuilding Public Trust in Government in Brazil and Around the World:**

The third morning session sought to address the state's loss of credibility in a time of legislative inertia, widespread corruption, and general skepticism towards the government and state institutions in Brazil.

## FISCAL AND STRUCTURAL POLICY CHALLENGES

The first panel examined the historical role of the state in Brazil and the ways in which this historical legacy may be responsible for the present economic and political crisis. Though a myriad of policies, institutions, and external factors were named as root causes, discussion centered around issues of the size, efficiency, and credibility of the state.

**Armando Castelar Pinheiro** of the Brazilian Institute of Economics believes that the present state is dysfunctional due to the state's many incompatible national goals. Structural policy in the 1930s was built around the theory that industrialization requires a strong, central state. In the 1980s, a new set of goals focused on social welfare were added. The state continued to favor industry through subsidies and local content requirements, while at the same time needing to allocate greater resources towards social services. "We need to change the mindset of Brazilians," Castelar argued. "The state cannot be all things at the same time."

Social security and a perverse and complicated tax system were repeatedly identified as two of the greatest drains on government resources. Between its generous policy, a growing ratio of older dependents to the working-age population, and lenient criteria for retirement, total pension expenditures in Brazil are among the highest in the world in terms of GDP. Last year, the International Monetary Fund projected that this ratio would reach 36 percent by 2050, over three times the already burdensome 11 percent the system is responsible for today.

Participants voiced similar sentiments regarding the nation's tax system, which was tabbed as the most time-consuming tax regime in the world in a 2014 study by the World Bank Group, the International Finance Corporation, and PricewaterhouseCoopers. Such obstacles hinder the local business environment and discourage expansion and investment in Brazil. While the need for reform of the tax system is virtually

universally recognized, there is no consensus on what tax reform entails. As **Luiz Villela**, former Trade and Integration Economist at the Inter-American Development Bank, pointed out, tax reform has been a work in progress since the 1980s and Brazil has yet to see any substantive or effective changes. "It's not only a question of burden," he remarked. "The problem is that the system is complicated and inconsistent," citing a series of undertaxed services and overtaxed basic consumption goods.

Uncontrolled government involvement reaches far beyond these social security and taxation issues. The size and inefficiency of the state were repeatedly highlighted as deeprooted failures of the political system that have consequently spread disaster across the nation's economy. It is still hard to understand, however, why and how this was allowed to become such a catastrophic issue for Brazil.

"Our diagnosis in relation to the situation in Brazil becomes clearer each time we discuss it," explained **Ana Carla Abrão**, Secretary of Finance for the State of Goiás. While the system was clearly an unsustainable one, it was a beneficial one that was not easily – or willingly – disrupted: "Everyone had some tax exemption or benefit that made society unwilling to admit that we were going in the wrong direction," said Abrão. "Now we are reconciling with that truth."

For **José Alexandre Scheinkman**, a professor of economics at Columbia University, the broader lack of efficiency and productivity is the core issue: "The real problem in Brazil is that our growth has been dismal," he argued. "And the reason that this happens is because our total factor productivity has lagged compared to advanced economies." Though he acknowledged shortcomings of the education system and capital accumulation as contributing to Brazil's meager growth in recent years, Scheinkman asserted that total factor productivity is what separates the countries that have been able to 'catch up' from those that have not.

**Otaviano Canuto**, Executive Director at the World Bank Group, suggested the government be forced to control its spending through swift and resolute fiscal policies. A tightening of government spending regulations should improve cost-effectiveness of public spending, in addition to regaining public trust in the system. Canuto also called for the state to eliminate the many rent-seeking incentives that cause the political system to favor poor allocation of resources. The view that public funds are inefficiently allocated is not an uncommon one; citizen dissatisfaction with quality and cost of public services, particularly mass transport, has been at the core of country-wide protests since 2013.

While many participants sought immediate, large-scale changes, others remained skeptical regarding drastic measures, such as President Temer's plan to freeze public spending. Columbia University professor **Thomas Trebat** referred to the spending ceiling as "shock therapy," advising Brazil to "focus on short-term measures with an immediate impact rather than miracle solutions." **Marcio Holland** of the School of Economics at Fundação Getúlio Vargas (FGV) shared this sentiment, believing the spending cap to be a reactionary measure that will be ineffective absent any institutional reform.

The desire for such reform is felt at all levels of government. In the municipal elections held in October 2016, the leftist Workers Party (PT) lost half its mayors, a shift fueled in large part by anger towards the party. Many see the PT as responsible for the economic fate Brazil has met, as well as for the Petrobras oil corruption scandal that cost has billions in bribes and lost efficiency. For many, the impeachment of President Rousseff was the first step in expunging widespread corruption from Brazil's political system. Even so, the quickly shifting political matrix – and the questionable conditions under which President Rousseff was impeached – has left the state with little legitimacy.

**Daniela Campello**, professor at the School of Public and Business Administration (EBAPE) at FGV, warned participants of the fragile state Brazilian citizens now face and the heightened need for democratic processes: "If you

say, 'It's going to be this way or we see disaster,' it's a very undemocratic system." Citizens are eager to see change and eager to see reform, she argued, but that reform process must involve them. In reference to the spending cap, she stated, "Those who will be most affected by [it] are not represented by the political system," but instead "excluded from the process that most affects them."

**Andrés Velasco** of Columbia University asked participants to consider how the political and fiscal situations are intertwined: "What are the failures of the political system that created the failures of the fiscal system? One has to think about political reform as a way of solving the fiscal problem." It would seem that the political aspect of reform has already begun, starting with the succession of Michel Temer as president. Temer has identified fiscal responsibility as a fundamental principle of his administration but has yet to disclose details of his planned pension system overhaul. Although the spending cap alone will not be able to restore fiscal balance, it is hoped that the cap will help lead to a recovery of business confidence and Brazil's investment grade credit rating.

## MOBILIZING FINANCIAL RESOURCES TO ACCELERATE INNOVATION AND GROWTH

Brazil exhibits a low level of financial intermediation, both in terms of quantity and quality. Moving forward, it will be critical for the state to reconsider the role of public banks, which presently account for nearly 60% of the total credit market. Their tendency to drive up interest rates weighs heavily on an already deficient system and makes investment infeasible. Public banks are also heavily subsidized by the federal government, representing a major burden on the budget.

Privatization and concessions opened up key infrastructure sectors to private investment in the 1990s, but failed to draw the needed private investment to compensate for reduced public sector investment. **Edmar de Almeida** of the Federal University of Rio de Janeiro (UFRJ) discussed this issue in his brief, stating “We are losing all of the tools that the state had to promote infrastructure and investment in Brazil.” In today’s world, the relationship between state owned companies and the state is no longer legitimate, with companies such as Eletrobras and Petrobras “just trying to survive.” In this new scenario, the role of the government remains unclear, but the new government will need to find methods for encouraging both private investment and public investment.

**Thomas Trebat** remains hopeful that public-private partnerships will fill in the gap. This would be particularly critical for investment in infrastructure, in which Brazil lags behind comparator countries. Part of the solution, it seems, will be driving greater levels of competition in the financial sector in Brazil. **Rodrigo Reis Soares**, professor of Brazilian public policy at Columbia University, believes it is not enough to expand credit, as much of the expansion and subsidized loans are given to long-existing companies, rather than creating new companies and increasing competitiveness. Moreover, the

private sector remains extremely inefficient, and “invests more in institutional relations with the government than in developing new technology and creating new markets.”

**Shang-Jin Wei**, professor of Chinese Business and Economy at Columbia University drew comparisons between Brazil and China, inviting participants to identify their relative strengths and weaknesses from which to learn. According to Professor Wei, China is more effective in facilitating market entry and competition than Brazil: “In China, most of the growth comes, not from making existing firms bigger, but via dynamic new firms coming in.” He does, however, consider Brazil more successful at encouraging innovation and private sector investment. Despite the fact that private firms in China exhibit much higher levels of innovation, the government in China continues to provide direct subsidies to public enterprises. Professor Wei encouraged Brazil to seek productivity and efficiency by encouraging both domestic private involvement and facilitating international investment and trade.

Brazil remains a very closed economy in terms of exports and access to foreign markets, a legacy left by its history of ideological protectionism. Too many times has Brazil missed new economic opportunities because, as **José Scheinkman** explained, “We were waiting for the [oil drilling] platforms to be produced and available in Brazil,” drawing on the technology as an example. “Effective protection is different from protection.”

As Brazil’s domestic markets continue to stall, the need for robust international trade policy grows stronger. **Debora Revoltella**, Director of the Economics Department at the European Investment Bank, recommended developing a comprehensive global industrial policy with the support of other nations, drawing on France’s



experience in nuclear energy production. “One side is creating rules,” she said, “and the other side is creating financial incentives for the private sector.”

**Leonardo Pereira**, President of the Securities and Exchange Commission of Brazil (CVM), believes the creation of rules alone will be a significant incentive for private sector investment. Until these are established, though, an insufficient financial system will continue to suffocate investment: “We can have lower interest rates, strong willingness for people to come to the market, but we will be in trouble sooner or later again if we don’t have the basics resolved.” Rectifying the financial sector is fundamental to generating investor interest, trust, and confidence in Brazilian markets. “How can we have a company that generates a billion dollars in revenue per year, but doesn’t have a basic control framework in place?” Pereira stated that a set of “basic ground rules of corporate governance” need to be implemented before Brazil will be considered a credible and attractive market for investment.

The new government under President Michel Temer seems eager to restructure Brazil’s insular economy strategy and expand international trade. This is likely to be met with substantial resistance, though, as the country’s ‘local-content’ industrial policies have long favored a set of powerful companies and industries in Brazil. Temer will depend on political support from legislators – as well as his constituents – if he is to make substantial changes to these policies.

## REBUILDING PUBLIC TRUST IN GOVERNMENT IN BRAZIL AND AROUND THE WORLD

Between the ongoing Petrobras investigation, the impeachment of President Rousseff, and calls for the impeachment of her predecessor, the state's reputation has taken a hit, both within Brazil and around the world.

But it's not just Brazil, says **Paul Lagunes** – “Corruption thrives in Latin America,” drawing on a recent scandal in Mexico in which President Enrique Peña Nieto was revealed to be living in a house built by a favored government contractor. “Brazil's challenges are disguised as education and health issues,” he explained, “but it really comes down to corruption.” He urged participants to look to Costa Rica and Peru as countries that have reduced corruption using democratic measures.

Lagunes also applauded citizen engagement in the nation's fight against corruption: “Brazilians are confronting corruption in a deliberate manner,” he said, citing the many demonstrations taking place across the country. “Brazil gets the prosecutorial sides of things right, which is more than can be said for others in the region.”

**Eduardo Pontual**, professor of economics at UFRJ, argued that more needs to be done following this process – “You put people in jail and then what?” Pontual called for followup to the prosecution system. In addition to eliminating corrupt politicians, the state must try to understand why corruption is able to thrive and what structural deficiencies feed it. It is not enough to remove corrupt politicians in a system that lends itself to corruption. As **Daniela Campello** explained, the problem may not be specific to people but to the system structure: “If the institutions are OK, but people within the institutions are not, maybe we should take a look at the selection process.”

Clientelism and patronage politics have a long history in Brazil, and combatting them will be a long and quite possibly perilous road.

**Edmar de Almeida** discussed the turmoil created within society when politicians are being prosecuted. “There is substantial institutional risk during the cleaning process,” he said. This uncertainty also deters investment interest and trade relations. Moreover, the true extent of corruption is unknown, making it difficult to know where to start and how to proceed.

**Cristiane Alkmin**, commissioner of the Administrative Council for Economic Defense (CADE), called the situation in Brazil “an economic, political, and ethical crisis,” but she believes that many simple fixes would have collectively have a powerful impact. She identified how stronger institutional relationships with ministries and municipalities would mitigate anticompetitiveness schemes, improve the regulatory framework, and redesign procurement processes. **Ciro Biderman**, an economics professor at FGV, also called for the redesign of procurement. He discussed the impact of innovation and the sharing economy, citing start-ups like Uber. These new technologies challenge Brazil's traditional regulatory structures. “Uber is a very important disruptive technology in Brazil, but it must be regulated,” he explained, adding, “However, our system of regulation is not the way to go.”

These and other structural changes discussed will require a great deal of both political consensus and support. Between party fracturing and charges of fraud pointed at many of Brazil's most prominent politicians, it will be difficult for President Temer to garner the support needed to rebuild the nation's political economy. Much of this support will need to come from politicians, but as Ana Carla Abrão pointed out, it starts with the people: “Change is possible when society backs the government – you can't move forward without the support of the people.”

## KEYNOTE LECTURES

### MARIA SILVIA BASTOS MARQUES

President, Brazilian National Development Bank

In her lecture, Maria Silva Bastos Marques focused on concessions, privatization, and the role of the National Development Bank in improving infrastructure in Brazil. Despite the many political and economic obstacles facing the country, Bastos applauded Brazil's resilience in trying times: "Few countries would be able to survive the turmoil Brazil has experienced over the last few years," she stated.

Bastos's lecture identified the main drivers to growth recovery and how BNDES would contribute to national growth. New guidelines under BNDES will include expanding access to credit, strengthening governance within capital markets, improving total factor productivity, and unlocking private sector investment. Central to BNDES's growth strategy is improving the nation's infrastructure; in particular, Bastos spoke to the need for infrastructural advances in relation to the environment, urban mobility, and energy. Bastos encouraged attendees to remain optimistic for 2017, pointing to positive growth expectations and the strides that have already been made towards a controlled level of inflation.



Photo: Maria Eduarda Vaz

### ILAN GOLDFAJN

Governor, Central Bank of Brazil

Ilan Goldfajn opened his keynote lecture with a diagnosis of Brazil's economic struggle, discussing the impact of boom-and-bust cycles and the state's failure to accommodate these fluctuations. Goldfajn explained that in times of growth, government salaries in Brazil were increasing beyond what their counterparts in developing countries would be. As investment fell and debt rose in the bust period, the government failed to adjust expenditures. "How can [GDP] increase while employment is falling? It was an unsustainable system," he said.

Goldfajn also discussed how fallen confidence domestically and internationally has affected and continues to affect the Brazilian economy. In spite of the many reforms needed, he believes that the new government is willing and able to steer Brazil's recovery, stating, "There are sufficient resources to repair the system."



Photo: Everton Juliano/Christian Parente

# POLICY BRIEFS

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## THE BRAZILIAN PRODUCTIVITY ANEMIA

Brazil has been suffering from “anemic productivity growth”. This is a major challenge because in the long run, sustained productivity increases are necessary to underpin inclusive economic growth. Without them, increases in real labor earnings tend to conflict with global competitiveness; collecting taxes in order to fund government expenditures on infrastructure and social policies becomes a heavy burden; returns to private investment becomes harder to achieve; and ultimately citizens will have less access to high-quality goods and services at affordable prices. The focus on urgent fiscal reforms adopted by the new government— public spending cap, social security reform (Canuto, 2016) – must be accompanied by action on the productivity front.

Brazil’s recent social and economic progress was achieved without major productivity growth. Both minimum and average wages rose a lot faster than labor productivity, and employment moved toward sectors with few opportunities for productivity growth. According to estimates reported in World Bank (2016a), Brazil’s Total Factor Productivity (TFP) increased at an annual rate of 0.3% from 2002 to 2014 – and only 0.4% p.a. during the roaring years from 2002 to 2010. Two-thirds of Brazil’s GDP increase can be accounted for by higher quantity and quality of labor being incorporated in the economy. Only 10% can be attributed to TFP gains.

Demographic trends – a growing working-



**Otaviano Canuto** is the executive director at the Board of the International Monetary Fund (IMF) for Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor Leste and Trinidad and Tobago. Mr. Canuto has previously served as vice president, executive director and senior adviser on BRICS economies at the World Bank, as well as vice president at the Inter-American Development Bank. He has also served at the Government of Brazil where he was state secretary for international affairs at the ministry of finance.

age population - leading to labor force growth were responsible for 1.1 percentage points to annual GDP growth in 2002-2010, while increases in labor force participation, especially among women - (Agenor and Canuto, 2013) (Canuto, 2013) - contributed about 0.6 percentage points. Better access to education accounted for about 0.7 percentage points of average growth in the same period. Since the investments-to-GDP ratio remained at or below 20%, it is not surprising that growth in the capital stock contributed only about 0.9 percentage points to growth on average. In labor productivity, which includes the gains from capital deepening as well as TFP, Brazil lagged behind most of its peers over the period.

It is now widely accepted that a systematic increase in Brazil’s labor productivity and TFP will be needed if the growth-with-

social-inclusion that prevailed in the 2000s is to return. But how can Brazil come up with these productivity improvements?

One obvious source of productivity gains is infrastructure. In addition to being a source of gross fixed capital formation, sustainable investments in infrastructure would alleviate bottlenecks that became increasingly tight as the economy expanded:

*“For at least the past two decades, investment in infrastructure in Brazil has been below the rate of natural depreciation. The rate of infrastructure investment needed simply to offset depreciation has been estimated to be of the order of 3 percent of GDP (...). In Brazil, total investment in infrastructure has been less than 2.5 percent of GDP annually at least since 2000.” (World Bank 2016a, p.74)*

As illustrated in the World Bank report, substantial negative effects in terms of wasted resources – labor time, misallocation of resources, product loss etc. – are derived from the insufficient investment in infrastructure and the bad state of energy supply and connectivity (transport, logistics, and ICT). Reducing the waste of resources through more and better investments in those areas would result not only in direct productivity gains, but would also induce private investment in other sectors.

Additionally, horizontal productivity gains could be achieved in the private sector by improving Brazil’s business environment. The Doing Business Report, prepared annually by the World Bank for 189 countries, has indicated year after year how a typical Brazilian company is obliged to spend human and material resources on activities that do not generate value because of the difficulties and costs associated with starting a business, registering a property, getting credit, paying taxes, and enforcing contracts (World Bank, 2016b). The negative consequences for productivity are three-fold: it subtracts productivity at both enterprise and macroeconomic levels; it stifles competition as it raises barriers to entry and to the contestability of markets, especially for smaller firms that are unable to dilute the costs of doing business through scales; and it stimulates informality.

The Brazilian business environment

is especially unfriendly to investments and technological learning obtained through foreign trade. Transaction costs and difficulties to access technologies, equipment, and supplies from abroad limit innovation, productivity increases, and competitiveness. Investments in logistics infrastructure would help, but an evaluation of the costs of the complex structure of tariff and non-tariff barriers – like local-content requirements - embedded in trade protectionism is also needed. Brazil has become an unusually closed economy as measured by trade penetration and the opportunity cost of failing to open its economy has risen dramatically in the recent past (Canuto, Fleischhaker, and Schellekens, 2015) (Canuto, 2015). Not by chance, foreign direct investment is mostly aimed at accessing Brazil’s large domestic market, rather than seeking efficiency in production (World Bank, 2016a, p.89-92).

Access to finance is another aspect of the Brazilian business environment limiting productivity growth. Finance for long-term projects and for small-and-medium enterprises is limited – except for a small group of preferred enterprises with access to government subsidized credit.

In most of its dimensions, Brazil’s business environment not only takes a toll in terms of waste in the use of resources, but also does not create incentives toward innovative, technology-adaptive, productivity-enhancing firm behavior. Lack of competition is part of the problem:

*“Compared to other emerging markets, Brazil has a wider dispersion of productivity levels across firms and a larger number of low-productivity firms. (...) Large gains could be made in aggregate TFP if physical and human capital were reallocated in a way that allowed more-productive firms to grow and the least-productive ones to shrink or exit. High firm dispersion in Brazil suggests market and policy failures that create an uneven playing field for firms, negatively affecting the entry and expansion of more-efficient firms and the exit of less-efficient ones.” (World Bank, 2016a, p.73-74)*

The window of opportunity opened by the on-going corruption scandals shall be used to upgrade governance in the interface between public and private sectors, with many gains such as: improved rule of law and corporate governance,

resulting in lower risk perceptions; improved competition and market discipline in key sectors, particularly those bidding for public projects; and cutting out wide-spread kickbacks will reduce both public overspending and the notorious Brazil cost (“Custo Brasil”) born by the private sector (Canuto, George and Fleischhaker, 2016).

Besides infrastructure investments and addressing the business environment, a third obvious source of systematic productivity gains would come from better and more accessible continuing education and skill acquisition by workers. Despite improvements in quantity and quality of education over the last 10 years, there remains the legacy of a long history of educational neglect with respect to large swaths of the population that accompanied the non-inclusive nature of Brazil’s economic progress over the previous century.

Even as Brazil achieved upper-middle-income status and captured higher positions on some global value chains, such as technology-intensive agriculture, sophisticated deep-sea oil drilling, and the aircraft industry, a substantial share of the population remained mired in poverty. With inadequate education, poor health conditions, and a lack of on-the-job training preventing many workers from increasing their productivity, Brazil’s potential economic growth has been compromised. Provided that the country manages to return to a comprehensive poverty-reduction path which includes improved access to health care, financial services, and education Brazil’s overall productivity could improve in the coming years.

Problems go beyond supply and access to education in general terms. There is an overlap with the problematic Brazilian business environment: Brazil is a country where, compared to its peers in levels of per-capita income, private companies invest less in training their employees. Disincentives embedded in current tax and labor laws are part of the reasons for this underperformance. In fact, current labor regulations discourage longer tenures, more hiring, and higher productivity of workers (World Bank, 2016a, p. 107-108).

Anemic productivity growth means that over the last 15 years, labor productivity in manufacturing declined, stagnated in services

and moved up substantially only in agriculture. The bulk of employment growth happened in relatively low-productivity services, with job creation in manufacturing in turn held primarily to low-productivity activities. As argued by Agenor, Canuto, and Jelenic (2012) and (2014), overcoming “middle income traps” is associated with virtuous cycles of productivity growth. This includes changes in the jobs structure which are possible only with appropriate infrastructure, access to finance, and an enabling business environment. Brazil has been falling far short in these dimensions.

Therefore, the Brazilian economy shall benefit a lot from losing the waste caused by its lagging infrastructure and the unhealthy aspects of its business environment as components of a treatment of its “productivity anemia”. In addition to the fiscal regime change currently implemented by the government – including a constitutionally mandated public spending cap already approved by congress and a bill on pension reform - the government has also obtained - or is seeking - congressional approval for other reforms with potential positive effects on investments and productivity. As of the moment this text is written: a full agenda of microeconomic reforms dependent on action by the Executive has been announced; Petrobras has been freed from the obligation to invest in all pre-salt fields; a review of local-content policies is being under way; a reform of the regulatory agencies law is likely to entail an improvement to their governance and budget independence; prevalence of negotiation over labor legislation has been confirmed by the Judiciary; and simplification of two taxes with heavy impact on Brazil’s cost of doing business is expected to be subject to discussion in 2017. The government has also launched a first package of new infrastructure concessions.

There definitely is now a strong perception among Brazilian stakeholders that, in order to return its economy to a path of growth-with-social-inclusion, the role of the state in Brazil has to be reconfigured so as to support systematic increases in Brazil’s labor and total factor productivity.

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## FISCAL DOMINANCE AND INSTITUTIONS IN BRAZIL

### Introduction

Brazil is again faced with dramatic political and economic problems in upcoming years. Far from the rise in confidence that greeted Michel Temer when he initially succeeded Dilma, the recent past is rapidly repeating itself. Both Ministers Joaquim Levy and Henrique Meirelles projected more immediate and better economic results. Alas, turn arounds take longer, especially when the initial difficulties are under estimated. In the next two sections, I will briefly analyze the fiscal and institutional limitations confronting the regime. There is a brief conclusion.

### Fiscal Dominance

Fiscal dominance can be defined as a context in which monetary policy loses its capacity to serve virtually alone as a regulator of the domestic economy. A large fiscal deficit increases the need for government debt -admitted or not- and ultimately, by relying upon excessive monetary and credit supply to insure domestic absorption, increases inflation. In the absence of adequate domestic investment, growth slows although consumption remains strong. At some point, the economy moves into disequilibrium, with need to control prices and offer expanding incentives to industry, while at the same time increasing imports.

This circumstance prevailed for several years in the both the first and second Dilma

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administrations. By delaying payment for expenditures, *restos a pagar* and utilizing a Sovereign Wealth Fund created in the time of high commodity prices, Dilma (and her continuing Finance Minister Mantega) managed to maintain modest expansion prior to re-election in 2014. After that, it was a year of attempted fiscal restraint by Joaquim Levy that ended with his resignation and a declining economy. Thereafter came Nelson Barbosa, with a final attempt to modify policies away from the New Economic Matrix he had introduced at the beginning of Dilma's government that had seen rising fiscal deficits, control of prices, declining real interest rates, and slowing expansion.

This explanation of a lack of fiscal control has been accepted as central to policies undertaken by Henrique Meirelles, the current Finance Minister. His proposed twenty year constraint on government expenditures, limiting

them to the rate of inflation, will take effect next year. Unfortunately, the details show a rapidly rising increase in government indebtedness, with a return to a primary surplus only 5 or 6 years in the future. Moreover, since some 90% of federal outlays are obligatory, that leaves little room for government investment to drive the economy forward by undertaking larger contributions to badly needed infrastructure expenditure, and promoting the creation of combined public-private (including foreign) investment projects. Government already spends much too much subsidizing consumption, and too little on productive capital formation.

That recognition has sparked a second major commitment, alteration of the social security system, seeking to eliminate the growing deficit, now amounting to 3.5% of GDP. Such a revision characterized both the Cardoso and Lula governments, and was indicated among the revisions necessary mentioned by Dilma in her Inaugurals. The reasons are simple: a changing age distribution with overly generous annual adjustments. Here there is expectation of greater problems in the Congress -who wishes to vote for restrictions to a program popular among recipients and whose real effect will only appear over an extended future time period. The consequence of this measure is substantially for new retirees. Gains in reduced public deficits are thus delayed.

In sum, the ability to deal with both of these problems within a short period somehow require return to high rates of growth of the past. That was the beauty of the Commodity Boom years. Remember as well that petroleum prices of \$150 are unlikely to recur, even with the current attempt of OPEC to put a higher floor on their level.

In the absence of such a magical resolution, the options become more difficult. Making matters worse, these problems recur at the state and municipal levels. A federalist system involves the necessity of close and productive cooperation, something that proves most difficult when resources are scarce. Then centralization creates conflict.

Can Brazil's evolving institutions help to push these challenges to a positive outcome?

## **Institutions**

What has been clear is an evolving strength of civil authority and socio-economic management within Brazil over the last 30 years. On the economic side, there is the continuity of the real, commitment to much lower rates of inflation, greater engagement in world markets, and rising and positive participation of the financial sector and the Central Bank. On the social side, there has been the expansion and better integration of the Bolsa Familia in dealing with the bottom income group, a significant rise in the lower middle class, and even significant reduction in overall inequality. Even within the health and education areas, there has been advance -not merely in the level of outlays but also in their quality.

But above all, and especially most recently, there has been an active participation of the Judiciary in this process. This goes beyond the ability to expose the corruption in Petrobras and other agencies. It extends to important prior decisions in virtually all areas, and most recently has produced open conflict with the Congress. In turn, the Executive Branch has displayed a reduced ability to play its former dominant role within Brazil, creating greater scope for Congressional and Judicial participation.

One can note as well greater popular participation as a factor of influence, and especially the roles of the press, radio and television, and the computer in dramatically widening the flow of information within the country. Lava Jato has become a major matter as a consequence. Now even the President and the Congress are unable to take actions without an immediate reaction, as was seen in the effort to curtail efforts to constrain further operations of the Federal Police and Ministro Publico beyond what already has been accomplished.

The real issue is how to assure continuity and effective integration of these three branches of governance into the future. Now, everything is short-term; the long term becomes anything over a month. The present constitutional provision for election to the Camara, changes in the role of private finance of political parties, has always been discussed. But the pressure of the moment inhibits coherent response. It is hardly an accident that Brazil has evolved into a system

of more than 30 political parties: now there is no necessity for anything requiring cooperation and consolidation. That is not the global prominence Brazil has always sought.

Evolution within this sphere requires a capability to cooperate rather than compete. It requires all three of the branches to define their authority, and stay within its limits. It is more than writing a set of new rules. These are needed, to be sure. But everyone is now more fully aware of the importance of compliance with them, rather than finding some indirect way to accomplish the desires of a few: whether they be entrepreneurs, labor union leaders, NGO's, etc.

### **Final Thoughts**

There is a new world out there. Globalization was a significant force in defining economic expansion and political cooperation for many years. Now it seems in tatters. The US has Trump; the EU is faltering; Japan has continuously failed to achieve its objectives and is directly challenged by China. How Brazil defines itself over the next few years will have international as well as domestic consequence.

## HOW TO TAKE ADVANTAGE OF A GOOD CRISIS: MOVING BEYOND BRAZILIAN CRISIS TO IMPROVE EFFICIENCY

### Executive Summary

Just last year Brazilian government spending has reached the astonishing amount of 20% of the country's gross domestic product (GDP), almost twice as much as two decades ago, with gross government debt going to the astronomical 70.5% of GDP, according to figures of November 2016, from 57.2% of GDP, in December 2014. This increase is a clear indicator of the potential catastrophic scenario Brazil has in the next decade and demonstrate how urgent are the structural reforms. The call for major changes in spending, fiscal, labor, and pension system in the works today demand political legitimacy and a major public consensus to face Brazil's major challenge: defining its priorities.

As our policy recommendation, we defend an agenda of structural reforms with pragmatic and realistic plans and a timeline focused on improving efficiency. There is a huge avenue for increasing in output by adopting measures related to efficiencies and qualities, given the current capital and labor stocks, which we shall present in this paper.

### Context

In current times, it is hard to forget the words of Raimundo Faoro, Brazilian historian and sociologist -who had great influence over Brazilian economic and political thought, especially in the 1960ies and on-, and whose quotes echo with



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the current crisis of our economic and political system. According to him, capitalism in Brazil has systematically been implemented as an attachment, some type of appendix of the State, which, in turn, has contaminated itself by its need to be the perpetrator of all forces, to the point of containing “the germ of economic suicide.”<sup>1</sup>

Faoro’s words become more dramatic today as we look at system of privileges and incentives created by the state that have turned itself into an unmanageable force. Special tax regimes to most industrial sectors, regional subsidies, huge banking margins -as we have the highest short term interest rate worldwide in a concentrated banking system-, combined with an unrealistic federal public higher education and health system for wealthy families, differentiated social security, and so. The Brazilian state is known for trying to accommodate a variety of needs, without clearly providing an efficient services to theones who rely on it.

Aditionally, Brazilian State is manifested itself in many state-owned companies -actually and surprinsingly, we don’t know how many<sup>2</sup>-; spread in different economic sectors, from energy to banking - many of them poorly managed and under political parties influence. Some of them have provoked a passionate debate on the role of the State in the economic development, as the case of the BNDES (Brazilian Development Bank). Others, as the case of Petrobras, was sunk in scandals of corruption, and also in the abuse of its main stakeholder.

Ultimately, according to several well-known international indicators, such as “doing business”, by The World Bank, and “quality of infrastructure”, by The Economic Forum, the entrepreneurial potential of Brazil strives and survives despite all odds. With the insane fiscal structure of multiple tax regimes simultaneously operating, companies need to run in over cautious measures to adjust the business to the Brazilian “fiscal madhouse.”

Finally, the past one and half decade of Labor Party policies have worsened the situation in the expense of the good, the bad and the ugly intentions of an outdated economic model implemented. The boom of commodities and the consumption driven model imbued the state with the populist sense of omnipotence which

created a bubble of prosperity that has given the lower and middle classes a false impression that everything was going well, despite the unreal growth of public spending and increasing federal and state debt. The corruption scandals that broke right after the ellections in 2014 and led to a serious political crisis - culminating with the removal of Dilma’s presidency - coincided with the collapse of this economic model.

The unrealistic level of responsibility the state has gained has compromised its own capacity to sustain itself in the long run, making government’s future uncertain. More seriously, without political legitimacy or capacity, political leaders of today have in their hands the power to advance structural reforms and set the priorities for the state or accommodate another set of priviledges to the expense of the public good. Should we believe they are capable of doing the right thing, this opportunity calls for compromise and long term views that put the country and the majority of people at first.

## Proposal

Our policy recommendation relies on a sustainable and long term agenda of structural reforms. There is no shortcut not even a miracle in the path of growth. Brazilian economy and society have been changing rapidly without suffering changes in its structure of incentives. We are a potentially rich country with poor structure of incentive to save and invest long term. The result is a productivity growth stagnated.

However, there is a huge avenue of increasing in output by adopting measures related to efficiencies and qualities, given the current capital and labor stocks.

As a matter of illustration, let’s take a very simplified and exogenous Solow growth model. First, we assume that firms produce according to a Cobb-Douglas production function as the following:  $Y_t = AK_t^\alpha N_t^{1-\alpha}$ , where  $Y_t$  is the output in time  $t$ ,  $K_t$  is the capital stock in time  $t$ , and  $N_t$  is the labor supply in time  $t$ , and  $A$  is a constant (produtivity). Regardeless issues of lack of realism, this model attempt to explain long-run economic growth through capital accumulation, labor growth and increasing in produtivity.

For our purpose here, let’s look inside the  $A$ . As widely known, produtivity ( $A$ ) can

increase alongside education improvements. In principle, the residual in this equation, called Solow residual<sup>3</sup>, can be attributed to differences in production technology, differences in the scale of operation, differences in operating efficiency, and differences in the operating environment in which production occurs<sup>4</sup>.

According to Coelli (2005)<sup>5</sup>, “a natural measure of performance is a productivity ratio: the ratio of outputs to inputs, where larger values of this ratio is associated with better performance.” However, a better performance occurs also alongside with optimization in allocation of resources and better business environment. That is, efficiency as well as technology and education foster growth, given the capital and labor stocks. Brazil has a huge space to grow based on increasing in efficiencies through structural reforms that can improve output growth, given its stock of capital and labor. It is a sort of privilege of its stage of development.

Thus, economic and political reforms, alongside with investment in education and in infrastructure, are like low hanging fruits to be reap shortly. Besides a new fiscal regime and the social security reform it includes: political, labor, tax, government administration including a comprehensive program of privatization, independence in the central bank and an independent fiscal authority, microeconomic reforms to leave the business environment friendly to long term investments, trade openness, international financial integration, and so on.

Brazil could benefit to grow faster in a sustainable path through incentives for efficiency and quality. Another model for the state and its relationship with the private sector indicates a path towards long-run sustainable growth. Our recommendations are far from liberal and naïve ideas of the state mainly because of the colossal lack of efficiency of the Brazilian economy.

## Conclusion

There is no shortcut nor a miracle to put the economy back on track. Brazilian society has to come to terms with its set of priorities to face the consequences of its choices for a system that can provide adequate services with

quality. Creating an appropriate structure of incentives to save and invest in the long term should result in steady productivity growth in an extended period of time. To reverse the current scenario, the state needs to position itself and choose the strategic areas to invest, taking into consideration the demographic changes in the past 50 years and looking ahead into the needs of its citizen in the future.

As Rahm Emanuel – the famous chief of staff for Obama administration coined the famous sentence for the late 2000s: “You never want a serious crisis to go to waste”. This seems to be the silver lining approach in the current Brazilian context: the ongoing crisis provides the opportunity for the country to do things that you could not before. The economic agenda needs to tackle the situation, a medium-term spending-cut based fiscal consolidation program rather than the short-term tax hikes based fiscal adjustment, having in mind the other reforms<sup>6</sup>. A comprehensive and bold social security reform proposal aligned with the one currently being discussed in the Congress that establishes realistic parameters for the next generations.

All in all, reaching consensus over the measures to be taken require rationality and commitment from politicians and the public understanding that the current structure is broken and calls for a rational and realistic new one. A new system where the state can indeed provide public services as rights, not privileges in a democratic, efficient and universal way.

## Notes

<sup>1</sup> Faoro, R. (1958). This text appears only in its original edition from 1958. In its second edition, in 1974, the author expressed differently this phenomenon but kept the same point.

<sup>2</sup> Our initial research indicates around 500 state-owned companies belonging to the federal administration (about 154 companies), to the states (about 230 companies) and the remaining belonging to municipalities.



<sup>3</sup> See Romer, D. 2012. *Advanced Macroeconomics*. McGrawHill, p9-17. The Solow residual describes productivity growth over the time. Robert Solow defined rising productivity as rising output with constant capital and labor input. It is a “residual” because it is the part of growth that cannot be explained through capital accumulation or increased labor.

<sup>4</sup> As defined by the US Department of Labor’s Bureau of Labor Statistics.

<sup>5</sup> Coelli, T. et al. 2005. *An introduction to efficiency and productivity analysis*. Springer.

<sup>6</sup> However, in a “crony-capitalism state” as the Brazilian one, privileges were still being distributed as civil servants were awarded with high increases in their earnings.

## PUBLIC SECTOR CORRUPTION IN REGIONAL PERSPECTIVE<sup>1</sup>

Some of our earliest records of corruption in Latin America come from a secret eighteenth-century report (Juan and de Ulloa 2011 [1749]). The report provides a detailed account of corruption in the territory we know today as Peru and Ecuador. It describes how viceroys sold public offices; members of the judiciary auctioned off verdicts; and customs officials allowed merchants to import goods at reduced tax rates. Strikingly, much of the corruption detailed in the historical report is similar to the corruption we observe today. The implications of this last statement are as profound as they are troubling: the spread of electoral democracy, the implementation of market-oriented reforms, and the adoption of transparency legislation have failed to reverse historical patterns. Corruption stubbornly thrives in Latin America.

Studying corruption is difficult. The corrupt have an obvious interest in concealing their illegal ventures. Still, by looking at the available data we find that corruption is perceived at much higher levels in Latin America than in wealthier, OECD-member countries (Jarquín and Molina 2016 12). This fact alone is unsurprising. What is more surprising is that according to victimization surveys only between ten and twenty percent of Latin American residents admit to having firsthand experience with corruption (Riaño, Hodess and Evans 2009 7; Zechmeister 2014 144). Those surveyed are probably hesitant to



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speak openly about the unsavory, for researchers assure us that Latin American countries are among the most burdened by corruption in the world (Morris and Blake 2009 2).

Fortunately, a small number of Latin American countries—among them, Uruguay and Costa Rica—have made notable progress in the fight against corruption (Buquet and Piñeiro 2015; Wilson and Villarreal Fernández 2015), but the same cannot be said about most of the neighborhood. Corruption indicators in the region have remained relatively unchanged over time (Rehren 2009 50). More than seventy percent of Latin Americans perceive public officials in their respective countries to be corrupt (Lagos 2001 & 2003 in Rehren 2009 47). Thus, taken at face value, victimization data on corruption is misleading: corruption is anything but a marginal problem.

For additional evidence on the extent to which corruption affects the region, we can look to some of the recent scandals. In Mexico, President Enrique Peña Nieto and his family were living in a luxurious home built and owned by Grupo Higa, a construction conglomerate that had obtained major contracts from the government (Redacción AN 2014). Chile, the country that often tops Latin America's performance indicators, witnessed its own case of conflict of interest. President Michelle Bachelet's son was accused of using political connections to obtain a ten-million-dollar bank loan (Reuters 2015). The loan was granted a day after Ms. Bachelet was reelected (Romero 2015). In Guatemala, a UN-backed agency played a pivotal role in uncovering a multi-million-dollar customs fraud case involving President Otto Pérez Molina (Goldman 2015). Pérez Molina resigned and so joined the growing list of Latin American presidents who, since 1990, have been removed from office prematurely because of corruption. The list includes Carlos Andrés Pérez of Venezuela, Fernando Collor de Mello of Brazil, and Alberto Fujimori of Peru (Naím 2005; Pérez-Liñán 2007).

A discussion about failed presidencies inevitably brings us to recent events in Brazil. The Lava Jato scandal surrounding Petrobras, the state oil company, hit Brazil while another prominent scandal was still fresh in people's memories. Mensalão was a corruption scheme that unfolded during former President Luiz Inácio Lula da Silva's first term in office. Coalition parties were given large, clandestine payments each month to support the Workers Party (The Economist 2013b). News about the scheme broke in 2005 when a congressman publicly accused the Workers Party of bribing political allies (Staff 2013a). The Supreme Court took up the case and the trial began in mid-2012 (Bodart 2013).

In the interim, the Workers Party won two more presidential elections—one of which placed Dilma Rousseff, a trained economist and close ally of Lula's, at the head of Brazil's highest political office.

Rousseff began her presidency by firing a series of high-level officials because of corruption (Forero 2011). However, the axe-wielding did not matter much by June 20, 2013. On that day, over

a million protestors took to the streets (Watts 2013). What had started as a small demonstration against a nominal increase of bus fares in São Paulo grew dramatically. Protesters called for an end to corruption and expressed anger at the billions spent on new stadiums for the 2014 World Cup rather than on public services. Then, in the presidential election of 2014, another form of protest emerged: Rousseff was reelected, but only by the narrowest margin of victory in modern Brazilian history (The Economist 2014a). It is in this political context that the Lava Jato affair unfolded.

According to allegations, the Lava Jato scheme involved skimming a fraction of the value of Petrobras's contracts between 2004 and 2014 in order to fund personal and party accounts (Leahy 2014). Over two billion dollars appear to have been paid in bribes (Editorial Board 2016). To this day, more than one hundred individuals, including thirteen senators, twenty-two federal deputies, and two governors are under investigation (Casas-Zamora and Carter 2016). In the midst of this scandal and a shrinking economy, Brazil's legislature voted to approve Rousseff's impeachment on account of unrelated financial improprieties (Beauchamp 2016; Jacobs 2016).

Even if sixty percent of the lawmakers who voted for the impeachment were facing serious charges of their own (Romero and Sreeharsha 2016), the evidence shows that Brazil's law enforcement authorities have reacted forcefully to corruption. To date, authorities have made nearly two hundred arrests and over one hundred convictions (Pearson 2016). Among those sent to jail is the ex-CEO of Latin America's largest construction group (Dickerson, Magalhaes and Lewis 2016).

In summary, there is strong evidence that Brazil gets the prosecutorial aspect of corruption control right. However, the fight must not rely solely on jailing those who violate the law. The country's legislators also need to work to limit the extreme political fragmentation observed today. Brazil has over two-dozen parties, and members of Congress are constantly renegotiating their political loyalties. From Fernando Collor de Mello to Luiz Inacio Lula da Silva, the rules of the game have provided an incentive for presidents to apply questionable tactics in order to sustain governing coalitions. But this needs to stop. Brazil needs

long-term solutions to the corruption problem. President Temer has raised the possibility of reforms that would limit political fragmentation (Mello & Spektor 2016 109). Instead of seeking to grant themselves immunity from prosecution (Reuters 2016), Brazilian legislators should pass the political reforms that actually serve the country's needs.

## Notes

<sup>1</sup> Portions of this policy brief were published as part of the following article: Lagunes, Paul. "What Peru's New President Can Learn from Brazil's Fight against Corruption." *The Conversation* July 26. 2016. [To view the article visit: <http://bit.ly/2amVadF>]

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## BRAZIL: THE CHALLENGE OF PRODUCTIVITY

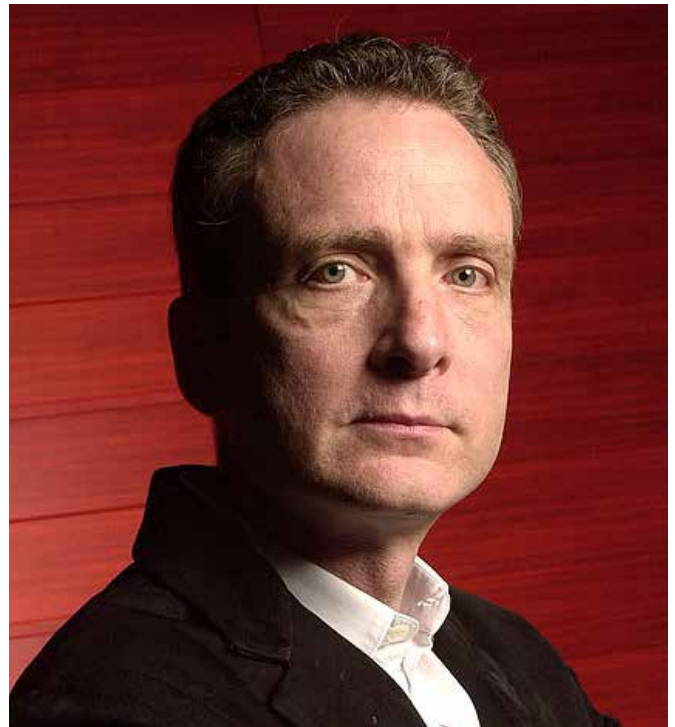
For three and one half decades, the growth of the Brazilian economy has been disappointing. Although Brazil's capital formation and educational improvements have not been brilliant, the main reason for the low growth has been the dismal performance of (total factor) productivity – the measure of how much a country produces in goods and services with a fixed amount of factors of production, capital and labor.

Whereas productivity in China, Korea, Taiwan or India is growing much faster than US productivity, helping to narrow the difference in output per worker vis-à-vis the developed world, Brazilian productivity relative to the US's fell 20% since 1990.

It is impossible to imagine Brazil growing fast for a considerable period, unless we tackle the problems that depress the country's productivity growth.

**Some good news:** While growth of productivity has been mediocre overall, there are sectors, such as financial intermediation or agriculture, in which productivity grew fast. In contrast, growth of productivity in manufacturing in Brazil has been a dismal failure.

**Agribusiness:** In 1960 Brazil imported 30% of its food consumption. The country was a net importer of poultry, meat and cereals. Agriculture was highly regulated. A government license was needed to import a bushel of wheat or to export a pound of sugar. The reduction of



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barriers to trade and the lessening of government controls over production and exports of agricultural products were crucial for the revolution in Brazilian agribusiness. However, even earlier, in 1973 the government created Embrapa, charged with generating R&D for the Brazilian agricultural and livestock industries. Among Embrapa's many achievements were technological advances that allowed Brazilian farmers to occupy the Cerrado, a formerly degraded region that nowadays accounts for nearly 50% of Brazil's grain production.<sup>1</sup>

Embrapa's R&D and the deregulation of the 1990s created the conditions for the migration of producers to new areas and for an increase in scale of operations. The performance of Brazilian agriculture since then has been spectacular. In 1990-2009, the increase of productivity of



agriculture in Brazil was 160% of the increase in productivity in agriculture in the US.

**Improving productivity:** Although productivity is an aggregate measure, individual firms engender productivity growth. A productivity agenda should aim at facilitating the entry and growth of the more efficient firms and the exit of less efficient competitors. The evidence shows that this churning is responsible for an important share of productivity growth in the US<sup>2</sup>. Unfortunately this mechanism seems to be much less operative in Brazil, allowing too many small and inefficient firms to survive and depress average productivity. One of the reasons less efficient firms survive is that the tax system favors small firms. The current myriad of taxes that are paid in the supply chain (IPI, ICMS, Pis, Cofins, ISS) should be replaced by a value-added tax with a single tax rate for all firms. More generally, Brazil's complicate legal system, including labor law, and the role of the state in providing credit subsidies and tax-exemptions, favors producers with good connections instead of efficient firms.

Brazil's abysmal infrastructure depresses productivity in many sectors. The country needs to implement new regulation to attract private players to produce infrastructure services. Using firm-level data, Lisboa, Menezes and Schoor (2010) document that the relatively limited lessening of trade barriers in 1990s resulted in productivity gains for Brazilian firms because it gave them better access to inputs and capital goods. Further reduction in tariffs and non-tariff barriers would allow Brazilian firms to use better inputs and capital goods to improve productivity.

Many Brazilian programs to incentivize R&D have not shown effectiveness. However the international experience and Brazil's own Embrapa show that well designed government programs to produce or promote R&D have enormous effects in productivity.

The success in agriculture, a sector that still suffers from a difficult legal environment, barriers to imports of inputs and an inadequate infrastructure, shows that even limited progress in creating conditions to improve productivity can do much good.

## Notes

<sup>1</sup> Vieira and Fishlow (to appear) provide an excellent history of the agricultural revolution in Brazil.

<sup>2</sup> See Foster, Haltwanger and Krizan (2001).

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# INTERVIEW SERIES

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## ABOUT

During the conference, we have organized a series of interviews produced by Canal UmBrasil. This project aimed to bring a series of foreign and Brazilian scholars to discuss the role played by the Brazilian state, how its policies and the current political crisis have affected and will affect the developments in Brazil's economy.

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