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A Few Challenges to Sustainable Growth

As the BRL reaches new lows and the most important states of the country face a tough energy crisis, it may seem odd to talk about sustainable growth. However, sustainable economic growth is the most important goal of economic policy. Therefore, policy makers should always make sure that the short-term measures that deal with the daily crises are not incompatible with the long-term goal.

The Chart displays the growth performance of the Brazilian economy in the last half-century. Until the late seventies, average growth rate was almost 7.5%, with a standard deviation of 3.1%. For the two "lost" decades that followed, namely the 80s and 90s, the average growth rate fell to 2.6%, while the standard-deviation rose to 3.8%. Growth was not only cut to almost a third, but it also became much more volatile. If one wants to consider the welfare effects of economic growth, one should at least consider the decrease of birth rates. By doing so one would improve the overall picture, but not by much. The fact remains that the overall prospect of the Brazilian economy remains gloomy if the conditions for sustainable growth are not met. What conditions are these?

The current energy crisis provides a good example. Sure enough the lack of rain played a decisive role (as the Brazilian energy industry relies 90% on hydroelectric generation), as well as the lack of good regulation and clear rules of the privatization program. Nevertheless, be it public or private, more investment in the energy sector should have been undertaken in the past to prevent the current crisis. And if more investment was required, more saving[1], either domestic or external should have been produced to finance it.

The Table shows the balance between saving and investment during the Real plan. Investment averaged 21.4% of GDP, which was compatible with an average growth rate below 3% per year. To achieve average growth rates of the order of 5%, a much higher investment/GDP would be required. If investment does not pick up, as aggregate demand expands, bottlenecks will show up everywhere, as the current energy crisis reminds us of. How will this increase in investment be financed?

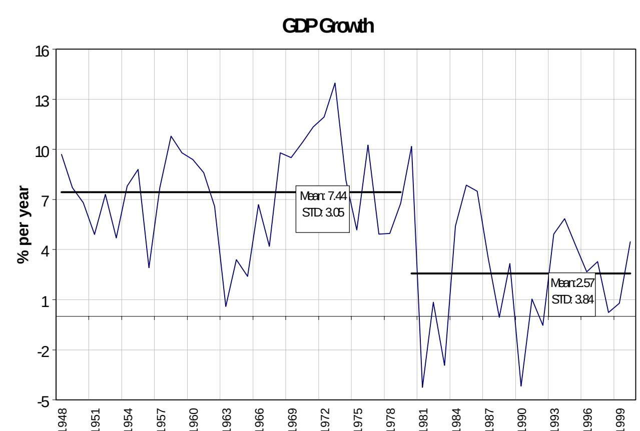
The Table shows us the division of aggregate saving between Gross National Saving (public and private) and External Saving. In the last years (and also 2000) external saving (equal to the current account deficit) amounted to almost 5% of GDP. Even the most optimistic outlook for Brazil would not incorporate a further increase in such figure. Therefore, it is the Domestic Saving that must increase.

Brazil: Macroeconomic Flows and Balances

	1994	1995	1996	1997	1998	1999
			% GDP			
Total Domestic Expenditure	**99.6**	**101.8**	**101.9**	**102.4**	**102**	**101.1**
Consumption	**77.5**	**79.5**	**81**	**80.9**	**80.8**	**80.7**
General Government	17.9	19.6	18.5	18.2	18.8	18.9
Private Sector	59.6	59.9	62.5	62.7	62.1	61.8
Investment	**22.1**	**22.3**	**20.9**	**21.5**	**21.2**	**20.4**
General Government	3.6	2.5	2.3	2.2	2.2	1.7
Private Sector and Public Enterprises*	18.5	19.8	18.6	19.3	19	18.7
Saving	**22.1**	**22.3**	**20.9**	**21.5**	**21.2**	**20.4**
Gross National Saving	21.8	19.7	17.9	17.7	16.9	15.7
External Saving	0.3	2.6	3	3.8	4.3	4.7
GDP at market prices (1994)	**349205**	**363954**	**373630**	**385852**	**386701**	**389756**
Percent change	5.85	4.2	2.7	3.3	0.2	0.8

* Includes changes in stocks

Source: IMF Country Report - Brazil: Selected Issues and Statistics - no. 01/10 - January 11, 2001



[1] Saving is a macroeconomic flow variable, not to be confounded with savings, a stock, that usually means wealth accumulated over time.

To increase private saving is a well-known difficult task. The change from pay-as-you-go to fully funded social security schemes may help a little, but not enough. Therefore, it is the public sector saving that must increase. However, the tax burden in Brazil is above 30% of GDP, a very high figure for a country with a dismal quality of public services. The required reform of the public sector financing – which resulted in primary fiscal surpluses from 99 on - was achieved mainly through new taxes and/or higher tax rates. This not only harms economic efficiency, but also places a serious doubt on the sustainability of the fiscal stance.

Having passed with flying colors on the IMF exams, Brazil now faces a much tougher challenge. If it does not go on with public sector reform—cutting bad expenditures instead of raising distortionary taxes—and with the tax reform, it risks to stall the growth impetus. And this may seriously injure the whole reform program that began with the Real plan.

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