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HIDALGO: Brazil´s complacency problem

Economy is cruising, but bureaucratic red tape acts a brake

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As Brazilians head to the polls on Sunday, they may be forgiven for feeling complacent. After all, the economy is growing, poverty is falling, the historical gross income inequalities have been somewhat reduced, and Brazil is finally seen by many as a rising global economic power. It is not surprising, then, that Brazilians seem inclined to vote for continuity by electing Dilma Rousseff - President Lula da Silva's anointed successor - as president.

Yet, if Brazil's economy is to live up to these high expectations, both at home and abroad, it needs a fair dose of change in the form of free-market reforms.

After many years of economic stagnation and hyperinflation, Brazil enjoyed in the last decade a welcome period of stability and growth. In the four years prior to 2009 (the year in which the economy contracted by 0.2 percent due to the global slowdown) growth averaged a healthy 4.6 percent per annum. This year the economy is expected to grow by almost 8 percent.

Brazil's newfound stability is based on the reforms implemented during the previous administration of Fernando Henrique Cardoso (1995-2003), which brought down inflation, and the competent macroeconomic stewardship of the Lula years. However, most of Brazil's growth has been fueled by the high prices and strong demand for Brazilian commodities. A rise in public spending has also played a role in recent years.

Even with these favorable external factors, Brazil's economic performance is far from stellar and its growth rate lags behind those of China and India, or even other economies in the region. In the last decade, 10 Latin American countries enjoyed higher growth rates than Brazil. As UCLA economist Sebastian Edwards points out, "the vast majority of indicators analyzed show a major gap between Brazil's current conditions and those of countries and regions that have been successful."

A recent survey by the Pew Research Center shows a puzzling picture of Brazilian attitudes toward the economy, in which satisfaction with current policies mixes with a growing favorable view of free markets. On the one hand, the population is largely content with the way things are going: 62 percent say that the economy is in good shape and three-quarters of Brazilians think the economy will improve in the next year. This leads us to the second interesting finding of Pew's survey of Brazilian attitudes towards the economy: A vast majority (75 percent) of Brazilians supports a free-market economy, even though it could lead to more income inequality. The same number thinks that large foreign companies have a good influence in Brazil. This is all the more surprising in a country where economic liberalism has long been viewed with skepticism.

Nonetheless, there is an important disparity between what Brazilians view favorably and their reality. The 2010 Economic Freedom of the World report, recently published by the Fraser Institute, shows Brazil in the 102nd position among 141 economies studied. It is the fifth-least-free economy in Latin America. If Brazilians really do want policies that would sustain the economic growth of recent years, they should support a comprehensive program of free market reforms.

In particular, Brazil must tackle high and complicated taxes that stifle entrepreneurship. According to the World Bank's Doing Business report, a Brazilian businessman spends 2,600 hours every year figuring out his taxes (versus 194 hours in the mostly developed OECD countries). He also pays 69 percent of his profits in taxes (versus 44.5 percent in rich nations). In its latest Global Competitiveness report, the World Economic Forum ranks tax regulations and tax rates as "the most problematic factors for doing business" in Brazil, actually leaving the country at the bottom of the ranking of the 139 economies studied in the "extent and effect of taxation" indicator. Overall, tax revenue in 2009 represented 35 percent of Gross Domestic Product, compared to 25 percent in the United States.

Red tape and inflexible labor markets also constitute major hindrances to greater productivity. Starting a business takes four months of bureaucratic procedures, compared to the 13 days it takes in the developed world. Brazil has some of the most rigid labor laws in Latin America, a region notorious for its inflexible labor markets. Painful taxes, rigidity of employment and an overwhelming bureaucracy are responsible for an informal sector that accounts for more than 50 percent of Brazil's total workforce. Trade barriers remain particularly high, especially on industrial goods. There is also ample room for reform in this area.

Unfortunately none of the major presidential contenders talks about the need for change. If anything, Ms. Rousseff seems fonder of government intervention than Mr. da Silva. And Brazilians don't seem to care, either. They are largely happy with the direction - and pace - in which their country is headed. This is understandable since their current stability and prosperity sharply contrasts with the economic turmoil and stagnation of the past. Nonetheless, Brazil's aspirations of becoming an economic global powerhouse can only be fulfilled only if it overcomes its complacency on needed reforms and becomes a full fledged market economy.

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