ISSUE BRIEF
No. 5063 | MAY 12, 2020
CENTER FOR INTERNATIONAL TRADE AND ECONOMICS

Has Brazil Turned the Corner Toward Greater Economic Freedom?

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KEY TAKEAWAYS

There is new hope that Brazil may be poised for an economic upturn that could transform it into an economic power commensurate with its size and natural resources.

Making that leap, however, will require sustained progress on the package of reforms introduced by the Bolsonaro government when it took office in 2019.

Brazilians should embrace free-market reforms, including reform of its tax code, reducing government spending, and accelerating much-needed privatizations.

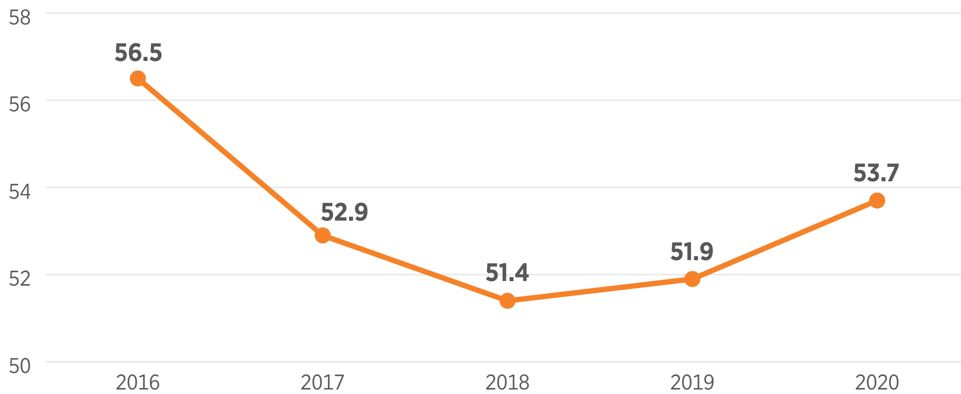
The Heritage Foundation's recently released 2020 edition of the *Index of Economic Freedom*[1] offers some hope that Brazil, after years of poor performance, may be poised for an upturn that could let it emerge as an economic power commensurate with its size and generous endowment of natural resources. The country's score on the *Index*, which rates 12 categories of economic freedom, rose 1.8 points this year on the *Index's* zero-to-100 scale, mostly due to improvements in government integrity and investment freedom.

Although Brazil's overall score remains well below regional and world averages, the upturn marks an encouraging turnaround after 15 years of steadily declining *Index* scores. It means that Brazilians can begin to hope—cautiously—that their economy may remain on an upward trajectory and, eventually, escape the *Index*'s "mostly unfree" category, where it has languished since 2007.

CHART 1

Economic Freedom in Brazil: Mostly Unfree

HERITAGE FOUNDATION'S *INDEX OF ECONOMIC FREEDOM* SCORE



SOURCE: Terry Miller, Anthony B. Kim, and James M. Roberts, *2020 Index of Economic Freedom* (Washington, DC: The Heritage Foundation, 2020), http://www.heritage.org/index.

IB5063 heritage.org

Making that leap, however, will require sustained progress on the package of reforms introduced by the Bolsonaro government when it took office in 2019. One major reform—of the country's pension system—was passed by the Brazilian congress in 2019; it should greatly improve future government spending scores in the *Index*, as would approval by the congress of a comprehensive tax reform package in 2020.

Of course, there is a large caveat that must be acknowledged, and that is that progress toward greater economic freedom in Brazil—and, indeed, throughout the world—will inevitably be set back by the cost of recovery from the coronavirus pandemic. In that regard, Brazil may face a steeper challenge than some neighboring countries, due to its government's incompetence and lack of seriousness in confronting the crisis to date.

Assuming the country does quickly overcome the economic damage from the health crisis, continued progress in economic freedom would contribute to conditions to support a higher rate of economic growth in the future.

Background

When the left-wing Workers' Party (PT) rose to power in 2003, Brazil ranked 72nd of 177 countries in the *Index of Economic Freedom*, with an overall score of 62. By the time the *2017 Index* was published, the country had suffered its worst economic crisis in 100 years and the scandal-ridden administration of PT President Dilma Rousseff had been removed from office. Part of Rousseff's legacy was an *Index* ranking of 140th in the world (of 180 countries), with a score of 52.9 (7.1 points below the world average). In 2018, Brazil's *Index* performance was even worse: 51.4 points, in 153rd place.

That steady decline in *Index* scores moderated somewhat during the abbreviated administration of Rousseff's successor, interim President Michel Temer, a moderate who sought to implement free-market policies and who left office at the end of 2018. His main legacy was the approval of a spending cap that should help to reduce public debt in the long run.

Now, under the administration of center-right President Jair Bolsonaro and his economic advisors—led by Finance Minister Paulo Guedes (a University of Chicago–trained economist)—Brazil's improved score in the *2020 Index* finally gives Brazilians reason for optimism. As a result of the improved score, Brazil also climbed six positions in the *Index* rankings, to 144th place.

The Reform-Minded Bolsonaro Administration

From the day it took office, the Bolsonaro administration has emphasized the importance of reducing government spending, deregulating markets, and shrinking Brazil's gigantic bureaucracy—so bloated that it sank Brazil to 124th place (of 190 countries) in the 2019 edition of the World Bank's *Doing Business Survey*.[2]

In its first year in office, aided by a newly elected congress with many reform-minded members, the government was able to pass massive reforms to Brazil's unsustainably costly pension system. That step was vital if the country hopes to balance its budget in the long run.[3] The new legislation is expected to save federal and state budgets Brazilian real (R$) 855 billion (approximately U.S. $170 billion) over the next 10 years.[4] The consensus among Brazilian economists is that, absent such a reform, public finances would have collapsed within a few years.

Another victory for the new administration in its first year was the passing of the Law of Economic Freedom, a package of measures that made it easier for entrepreneurs to create and operate a business.[5] Among other things, it speeds up the process to obtain a business license and reduces the amount of paperwork necessary to fulfill certain governmental regulations.

More recently, in a successful effort led by Bolsonaro's Minister of Justice Sergio Moro, the congress approved an aggressive anticrime legislative package. Moro is a former judge who played a key role in Operation Car Wash, arguably the largest and most successful anti-corruption task force in Brazilian history.

The legislation will make it easier for prosecutors to crack down earlier on corruption, a plague that has been holding back economic growth for decades in Brazil. The new law also increases prison time for serious crimes. Overall, the Bolsonaro administration's tough-on-crime policy has produced some encouraging results, with homicides down by 19 percent in 2019, after a 10 percent drop in the last year of the Temer administration.[6] That progress is likely to have a positive impact on economic freedom as well, given the economic and social costs of rampant violence in some major Brazilian cities.

The Brazilian congress also approved other free-market measures, such as one which opened the commercial aviation market to foreign companies and allowed for the privatization of basic sanitation services. These are encouraging signs: After more than a decade of left-wing policies and a steady decline in its economic freedom score, Brazil is clearly moving in the opposite direction.

It has been the case for many years that Brazil—the fourth-largest democracy in the world and one of the globe's top 10 economies—should have done much better economically than it did. Hopefully, the *2020 Index* results indicate a turning point for South America's most important economy.

Still, in addition to the urgent need to handle the current health crisis, there are many other obstacles to overcome before Brazil is finally able to join the ranks of the world's economically freer countries.

Recommendations for the Brazilian Government

In order to continue the move toward greater economic freedom, the Brazilian government should implement several major economic reforms that have been postponed by past administrations, such as:

- **Reforming Brazil's tax code.** Tax reform should be the number one priority for Brazil. Although Brazil maintains tax rates on a par with developed European countries, such as Germany and France, its vast bureaucracy delivers poor-quality public services. The current, inscrutably complex web of city, state, and federal tax legislation is hurting small businesses the most. Those problems need to be addressed in the comprehensive tax reform bill that the Bolsonaro administration intends to submit to the congress this year.

- **Reducing government spending.** This should also be a high priority, since this is by far the worst indicator for Brazil in the *Index of Economic Freedom* (a score of only 4.6 of 100). The excessive spending is driven by the inefficiency of the public sector, which, in turn, is fueled by the lack of accountability, the absence of incentives for good performance, and de facto lifetime tenure for public employees. In this context, legislators should pay special attention to the high cost of the Brazilian judiciary. A study by the University of Rio Grande do Sul[7] concluded that the country's annual judiciary costs amount to 1.4 percent of gross domestic product. That is multiple times higher than comparable numbers in the United States (0.13 percent), Chile (0.22 percent), and Portugal (0.28 percent).

- **Accelerating privatizations.** According to *Forbes*, in 2018, Brazil had more state-owned enterprises (418) than any Organization for Economic Co-operation member country—it is "Latin America's China."[8] The creation by Bolsonaro of the position of "Secretary of Destatization" to lead the privatization drive was a refreshing novelty brought by the new president; still, the administration needs to better articulate the goal to privatize state-owned entities, such as Eletrobras (the electricity company) and Correios (equivalent to the U.S. Postal Service). The successful privatization of these budget-busting giants would have an immediate positive impact on public finance and help the country to reduce its sovereign debt. A secondary effect would be the reduction of opportunities for corruption.

Conclusion

To maintain the momentum of its pro-market agenda, the Bolsonaro administration must build a governing majority in the extremely fragmented congress where more than 40 political parties are represented. The main Brazilian political parties barely control 10 percent of the seats. This lack of political stability may harm the country's capacity to adopt measures to advance economic freedom.

Brazil's current conservative government has strong ties to the Trump Administration. That is an opportunity that should not be wasted. The two countries are giants in the Western Hemisphere and share a natural affinity that should be the basis for a long-term alliance.

In a time of a pandemic that has turned a spotlight on America's dependence on Chinese products, a free trade agreement with Brazil could be beneficial to both sides. A secondary effect of that kind of cooperation would be a more intense promotion of free-market policies elsewhere in South America, a region that has too often been vulnerable to collectivist ideologies. During the Workers' Party years, the Brazilian government funded projects in Cuba, Venezuela, and Bolivia. Today, the largest country and market democracy in South America is in a position to assist neighboring countries that face anti-democratic threats.

Brazil still has a long journey ahead, and the crisis caused by the novel coronavirus will likely delay achievement of short-term policy goals and foment political and social instability. Still, if it adopts forward-looking and transparent policies that take advantage of its natural position as a major player on the South American continent, Brazil could finally begin to realize its economic potential.

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Endnotes

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