

Rousseff Needs to Tackle Brazil Cost

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Former president **Luiz Inácio Lula da Silva** used to say that Brazil has two structural problems: inequality and the *Custo Brasil* (the cost of getting things done in Brazil). Since then the battle against poverty has been partly won. Unfortunately, the fight against *Custo Brasil* has suffered continuous defeats. The re-elected **Dilma Rousseff** needs to address this national problem.

Brazil has been able to successfully combat its greatest stigma: being one of the most unequal societies on earth. Since 2002 the left-leaning *Partido dos Trabalhadores* governments of Lula and Rousseff have reduced chronic poverty by three quarters. The Lula years were particularly impressive. Poverty was reduced by half, which means that in only eight years Brazil achieved what the experts of the UN millennium poverty reduction goals expected would take 25 years.

While inequality reached its peak in the 1990s, by 2010 Brazil achieved its lowest Gini coefficient (a measurement of inequality) since the 1960s. Unsurprisingly there is a strong consensus in favor of the 14 government-sponsored poverty reduction schemes (such as *Bolsa Familia*). They have helped to create a new middle class. Households earning between 2,000 and 8,500 *reais* (respectively US\$830 and US\$3.500) –when added to the upper classes– now represent a total mass of 140 million consumption-prone citizens out of Brazil's population of 200 million.

Main pillars of growth

Due to this structural shift, and the provision of easier credit – thanks to improved macroeconomic management and favourable investor confidence during the **Fernando Henrique Cardoso** and Lula years – household consumption has exceeded the 60 percent of GDP threshold (it was 63 percent in 2013) and has become, alongside the export of commodities, one of the main pillars of Brazilian growth. The question, however, is how long this can last.

We are not in 2010, when Brazil's growth was 7.5 percent of GDP (the highest in 25 years). The tide is changing. China is importing less commodities. To maintain growth in the run-up to the elections, Rousseff's government increased its budget deficit. This generated inflationary pressure. The central bank wanted to tighten, but the government leaned against it to underpin consumption levels. This in turn has made inflation rise further (to 6.75 percent, above the 6.5 percent upper limit set by the central bank).

The possible outcome of this downward spiral has been rehearsed before. International investors start losing confidence in Brazil, they withdraw their money and the *real* sinks. This is a windfall for Brazilian exporters, but if the currency is too weak, inflation is likely to accelerate, the central bank will eventually need to tighten, the economy will tank and unemployment will rise. True, this time the situation is different because Brazil has US\$375 billion in foreign reserves. But still, it is difficult to tame the market herd once it is in full gallop.

Tackling Custo Brasil

To avoid this Rousseff needs to tackle the other stigma burdening her country: **the *Custo Brasil*, the obstacles that Brazilians and foreigners alike need to overcome to do business and pursue daily life.** The concept is both routinely mentioned by international investors and has become part of the vocabulary of the average Brazilian.

Brazilians are fed up with the state of public services and infrastructure in their country. It is often said that life for Brazilians has markedly improved *da porta para dentro* (indoors). Most households now have washing machines, TVs and computers, but once the average Brazilian steps outside his front door (*da porta para fora*) life is very tough.

If Brazilians go a step further, and travel overseas (*do país para fora*), life becomes even harder because they realize that public transport and infrastructure is better abroad than at home. This is not only the case in the US and Europe (traditional destinations for middle-class Brazilians) but also in the new emerging markets such as China, Chile and Mexico.

The value of infrastructure stock in Brazil is 16 percent of GDP. In India (also a country with infrastructure problems) it is 58 percent, while in China it is 76 percent. The effects of infrastructural bottlenecks are striking. In Brazil it costs more than US\$2,000 to import or export a container. In China the cost is around US\$500 and in Chile US\$800.

Rousseff at a crossroads

Custo Brasil not only refers to poor infrastructure. It is also related to the Brazilian economy's other ills: excessive bureaucracy and red tape, corruption, an over-complicated tax system, an inefficient judiciary, the excessive cartelization of the economy, an absence of global value chains, the average Brazilian worker's very low productivity and a poor education system, unable to produce highly-skilled labor. In total Brazil invests less than 18 percent of GDP compared with the 23 percent regional average.

Many believe Rousseff is now at a crossroads. Either she continues to stimulate consumption or she addresses the economy's supply-side problems. In principle, a combination of both would be the best option, although finding the right balance is never easy. There is the temptation to follow the current trajectory until it is exhausted. This would be a mistake. Rousseff needs to show that she is serious about winning the battle against *Custo Brasil*. Not only because it is what big business and international investors demand, but more importantly because it would be the average Brazilian who would stand to benefit the most.