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November 23, 2020

Statement by Mr. Bhalla and Mr. Singh on Brazil
(Preliminary)
Executive Board Meeting
November 25, 2020

1. We thank the staff for an informative and analytical set of papers and Mr. Bevilaqua for his insightful Buff statement. We broadly agree with the staff appraisal.

2. The economy of Brazil was already slowing down before the Covid-19 crisis hit. Underlying the weak growth performance during the last decade were stagnating productivity growth and low investment. However, **several key structural reforms proposed by the authorities would help bring the economy back to a sustainable growth path** viz., stabilizing pension spending, legislations to control government spending, improving tax efficiency, decentralization of fiscal resources, and legislation to give the Central Bank *de jure* independence. These measures have considerably improved Brazil's fiscal outlook and precipitated a fall in the sovereign risk premium. Despite risks and uncertainties, it is encouraging to note that the signs of a rebound in economic activity are visible in Q3.

3. **Brazil's social protection programme during Covid-19 has been one of the most impressive and swift among the EMEs.** The Emergency Aid (EA) proved crucial in supporting the livelihoods of informal workers and poor households, lifting the income of an estimated 23 million individuals (10 percent of the total population) above the extreme poverty line. The employment retention schemes helped protect formal jobs. The EA rolled out in April that covered around one-third of the population, more than compensated the (temporary) negative impact of the pandemic on poverty and income inequality.

4. The Staff assessment suggests that a drawdown of household savings accumulated during 2020 and employment support will smooth consumption during the first quarter of 2021. The surge in household savings seems to be a widespread phenomenon across many countries. **We would like to understand the nature of savings, whether these**

are precautionary and common in countries that do not have adequate social safety nets? Second, the output gap closes over the medium-term by 2024. **While many countries are exhibiting a prolonged period of the negative output gap, it would be interesting to understand how the closure of the output gap compares with the GFC and whether the prolonged negative output gap could be because of limited fiscal policy space over the medium-term to spur aggregate demand?**

5. Brazil currently faces a very steep local currency yield curve, highlighting market concerns over fiscal sustainability as the public debt to GDP ratio reaches 100 percent. Regarding debt sustainability, as suggested by the staff, an important element in reforming the subnational fiscal framework is to sustain the provision of core public services. The report suggests that states and municipalities have been struggling with high debt and liquidity pressures and some of the largest states have already defaulted on part of their debt and are running payment arrears, which may need greater attention. Addressing this may be critical to avoid the adverse expectations of further federal bailouts, which may vitiate the already high debt burden going forward.

6. We welcome the authorities' proposal to unify PIS and COFINS into a single federal VAT. The authorities may continue to work in the direction of harmonizing the fragmented federal and subnational tax regimes to lower the cost of tax compliance. **We understand that enhancing taxpayer compliance under the VAT is a common challenge across EMEs.**

7. Indeed, the authorities accept that structural reforms are critical to ensure medium-term consolidation. It is encouraging to note that changes in labor market regulation are currently being considered to reduce labor costs and improve the ease of doing business. On the fiscal front, the staff analysis shows that backloading fiscal consolidation may cause a loss of market confidence, and a spike in interest rates, and a rise in the debt-GDP ratio. **Given the dilemma between limited fiscal space and the risk inherent in shaper withdrawal of fiscal support leading to a prolonged slowdown, what could be the best course for the fiscal policy going forward?**

8. We fully concur with the concerns of the central bank that there are potential trade-offs related to further cuts, and the need for a cautious stance to give the financial system time to adapt to the unprecedented level of the policy rate. We expect that the reform agenda focusing on a big push to privatization, further opening up of international trade, reform to simplify taxation and improve efficiency, will all prepare a stronger ground for the takeoff to a higher growth path.

9. With these comments, we wish Brazil and its people every success in their future endeavors.