REVISTA
ECONOMIA POLÍTICA
DO DESENVOLVIMENTO

Desafios macroeconômicos para o Brasil do Pós-covid-19

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Resumo O objetivo deste artigo é investigar de forma abrangente os efeitos adversos resultantes da persistente política de taxas de juros elevadas no Brasil ao longo de muitos anos. Esses efeitos têm repercutido diretamente no serviço da dívida pública, trazendo consigo consequências negativas significativas para o bem-estar social. Essa situação é exacerbada pela influência desses fatores sobre o setor produtivo, notadamente a indústria, bem como sobre a infraestrutura física, social e tecnológica do país. A preocupante realidade é que a dívida pública já absorve mais de 50% das despesas públicas, o que exerce um impacto contundente sobre diversos aspectos-chave da sociedade. Portanto, é imperativo que se abra espaço para um debate amplo e informado sobre as implicações de longo prazo das altas taxas de juros e sua influência sobre a gestão da dívida pública. Somente através de uma revisão cuidadosa dessas políticas e uma reformulação estratégica das prioridades financeiras, será possível conduzir o Brasil em direção a um cenário de crescimento econômico sustentável e bem-estar social duradouro.

Palavras-chave Desafios; Juros; Dívida; Brasil.

Macroeconomic challenges for Brazil post-covid-19

Abstract The objective of this article is to comprehensively investigate the adverse effects resulting from the persistent high interest rate policy in Brazil over many years. These effects have directly impacted the servicing of public debt, bringing significant negative consequences to social well-being. This situation is exacerbated by the influence of these factors on the productive sector, notably the industry, as well as on the physical, social, and technological infrastructure of the country. The concerning reality is that public debt already accounts for over 50% of public expenses, which has a pronounced impact on various key aspects of society. Therefore, it is imperative to create space for a broad and informed debate about the long-term implications of high interest rates and their influence on public debt management. Only through careful reconsideration of these policies and a strategic reshaping of financial priorities will it be possible to steer Brazil towards a scenario of sustainable economic growth and lasting social well-being.

Keywords: Challenges; Interest Rates; Debt; Brazil.

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Introduction

The arrival of a new government Always leads to a lot of speculation about the success or otherwise of economic policy. We are living through exactly this moment in Brazil and the financial market is trying to discount its future expectations of asset prices to present value. But we have to separate the uncertainty arising from unexpected economic events, which doesn't seem to be the case, from the reaction to an economic management model assumed by the current government during the presidential campaign and considered to be non-market friendly.

What's the difference?

When it comes to pricing the future, the American economist Paul Samuelson once said that Wall Street had predicted ten of the last six recessions in the USA. The fact that economists only eventually get their predictions right is directly linked to the fact that economics is not, to the frustration of many of my professional colleagues, an exact science, but rather a social and moral one, as Keynes considered. In reality, you can't make macro-dynamic inferences from aggregating the microeconomic decisions of economic agents as if they didn't have divergent interests. This means, in other words, that it is impossible to disregard the political nature of economic policy, the success of which is directly related to the ability to negotiate with the different segments of civil society.

Recently, economist Olivier Blanchard (2022), who is far from being considered a heterodox, was criticized by his peers for stating that inflation is the result of the struggle of economic agents (businessmen and workers) for greater appropriation of the wealth generated in the country. Thus, reducing a phenomenon as complex as inflation to a purely monetary dimension (excess demand over supply) is what has led to Blanchard's own criticism of the macroeconomic “single thought” view of price stabilization: “one instrument (interest rates), one target (inflation)”, which we will deal with later.

As for the financial market's reaction to the new government's proposal for macroeconomic management, in my opinion the main reason for the outcry, the point of disagreement lies in the so-called market-unfriendly view that economic policy should coordinate monetary and fiscal policy instruments with a view to providing stability and sustainability to growth, with social inclusion and income deconcentration. The implementation of such a policy does not meet the interests of the financial market because it affects the structure of wealth distribution, since it alters the tax structure, making it less regressive and requiring interest rates compatible with the return of the productive sectors.

Building such fine tuning between the instruments of macroeconomic policy, in turn, not only takes time, but is only possible with a fiscal framework that involves both the spending side (with a credible and adjustable spending control rule) and the revenue side (based on a tax reform that can reduce the regressive nature of tax distribution in the country). From a monetary point of view, in order for the financial system to be functional (with resources flowing from the financial sphere to the productive sphere of the economy) the basic interest rate cannot remain above the GDP growth rate.

The legacy of the market-friendly macroeconomy has been the drainage of resources from the most dynamic productive sectors, notably industry, to the financial sector. In other words, we have the highest real basic interest rate in the world, at 7.5% p.a., boosting the profitability of banks in Brazil, which explains the presence of four (Santander, Itaú Unibanco, Banco do Brasil and Bradesco) among the ten largest banks in the world in the ranking of return on equity (ROE) of institutions with more than US$ 100 billion in assets, according to a survey by Economatica in December 2021. While the real turnover of Brazilian industry, in turn, fell 22.5% from its peak in August 2013, the share of the manufacturing industry in GDP fell from 15% in 2010 to 11.3% in 2021.

The social repercussions of this economic policy are pronouncedly negative. The average unemployment rate (IPEA), which was 7.4% in 2012, reached 13.5% in 2021. According to IBGE data from the same period, 17.9 million Brazilians were in extreme poverty and 62.5 million in poverty. The Food and Agriculture Organization of the United Nations (FAO) estimates that 61.3 million people in Brazil suffer from some form of food insecurity.

In terms of wealth distribution, according to the BBC, “the poorest 50% own just 0.4% of Brazil's wealth (financial and non-financial assets, such as real estate). (...) The richest 10% in Brazil own almost 80% of the country's private wealth. The concentration of capital is even greater among the ultra-rich, the wealthiest 1% of the population, who owned almost half (48.9%) of the country's wealth in 2021. In the United States, the richest 1% owns 35% of the American fortune”.

The economic and social consequences of this situation of exclusion cannot be ignored when designing development policy for the country. To meet this challenge, we need to deconstruct the narrative that economic policy with social responsibility is harmful to the productive and financial sectors. In fact, with regard to the former, such a policy supports the need for greater coordination between industrial, agricultural, commercial, technological and environmental policies, addressing strategic partnerships between the public and private sectors. As for the banks, both public and private, the system's functionality needs to be restored with a focus on financing the productive sectors at rates that allow investments to be made profitable.

Transitioning from a policy that has been friendly to the interests of the financial market to one that takes into account the well-being of the majority of society will not be easy. But I am convinced that Brazil's prospects for economic, social and environmental development will depend on the success of this transition and that, as the old adage goes, “you can't make an omelette without breaking the eggs”.

Our point here is that Brazil's economic success in the coming years will depend primarily on overcoming the market versus state narrative with social responsibility, which implies greater harmony between fiscal and monetary policies in terms of managing the economy's macroeconomic policies. To this end, it must be made clear that the financial sector is part of the market. In the case of Brazil, financial activities accounted for 6.9% of GDP in 2020 after reaching 8% in 2016, when the selic rate reached 14% p.a. Therefore, economic policy cannot be guided by the narrow interests of financial institutions.

In addition to this introduction, the article is structured in sections that address the following topics. Firstly, the importance of tax reform in ensuring the progressive nature of the tax burden is discussed, as well as the need to establish a new set of fiscal guidelines that preserve the country's ability to invest in physical, social and technological infrastructure. The second section explores how current monetary policy can overestimate the impact of expectations in determining inflation, leading to a harmful vicious circle referred to here as the "monetary trap". The third topic presents the effects of maintaining high interest rates for a long period in Brazil, resulting in a considerable commitment of the fiscal budget due to servicing the public debt, leading to negative consequences for the Brazilian economy, such as stagnation. Finally, the article concludes with some observations by way of conclusions.

2 The tax issue in brazil

Since the result of the presidential election on October 30th, Brazil's fiscal scenario for the coming years has caused a lot of noise in the financial market. The stock market has depreciated, as has the real against the dollar. The main controversy is the removal of the spending ceiling of R$ 198.0 bn over the next four years proposed in the "transition PEC" presented to Congress by the next government's transition team. In the proposal, R$ 157.0 bn would be for the payment of R$ 600.0 for the Bolsa Família, plus R$ 18.0 bn for spending R$ 150.0 for families (for children up to the age of six) and R$ 23.0 bn for investments.

The strange thing is to take as a reference a spending ceiling on which there is consensus among many economists, of different persuasions, that it should be revised because it is completely unfeasible.

Does this mean that I am advocating the absence of a fiscal rule? No. Our position in this debate is that we need a new fiscal framework that not only includes a well-designed spending control rule (fiscal responsibility), subject to adjustments and improvements as suggested in the article by Borges and Gonçalez (2022), but also social inclusion (social responsibility). In addition to an efficient, effective spending rule (i.e. one that avoids the procyclicality of public spending and preserves its countercyclical nature), a tax reform is crucial to remove the current regressive distribution of the tax burden, which penalizes both the low-income population and the productive sector (i.e. one that progressively taxes income and assets and exempts production).

Our aim, however, is to show that, in the debate on the fiscal issue, an important part of the appropriation of the public budget, the financial part, is overlooked and needs to be discussed. In other words, in order to try to reconcile fiscal and social responsibility, it is imperative to politically confront macroeconomic "single thinking" (focused on the primary budget) so that it is possible to make room for a development agenda.

The question you're probably asking yourself right now is: What is this “single thought”? Since the 1990s, the macroeconomic debate in much of the world has been dominated by a kind of macroeconomic “single thought” (known in economic literature as the “New Macroeconomic Consensus”), which is the basis of the famous macroeconomic tripod.

The negative result of this pseudo-consensus was to relegate other economic views to ostracism on the assumption that they lacked theoretical foundation and practical application. The lessons learned from the 2008 financial crisis and the Covid-19 health crisis have highlighted the fragility of this assumption.

In the view of the financial market, sometimes simplistically referred to as the market, growth with price stability depends, in the first instance, on a nominal inflation target and on the real short-term interest rate being based on structural interest rates and the growth of the economy's potential output in the long term, both of which are unobservable variables (Inflation Targeting Regime). Fiscal austerity is another pillar highlighted to keep the debt/GDP ratio falling over time. Finally, the last foundation is the floating exchange rate regime (with free entry and exit of capital).

In short, it is up to macroeconomic policymakers to do their “homework”, based on the mainstream macroeconomic manual (which should be applied to any country regardless of its socio-economic structure), and keep inflation on target, thereby anchoring inflationary expectations. In doing so, even with the advent of temporary exogenous shocks, the level of activity will tend towards its full employment level in the long term. It's the famous “divine coincidence”: Keep inflation on target and the free market will take care of sustaining the economy at its growth potential.

The macroeconomic “single thought” narrative has come under a lot of criticism, especially in developed countries, since the 2008 financial crisis. The first criticism concerns central banks (CBs) using the basic interest rate (in Brazil's case, the Selic) as the only instrument to stabilize prices, even if the nature of inflation is not one of demand. So far, most CBs have been resilient to this criticism, despite the fact that supply shocks are the main cause of inflation in most cases (notably those caused by Covid-19).

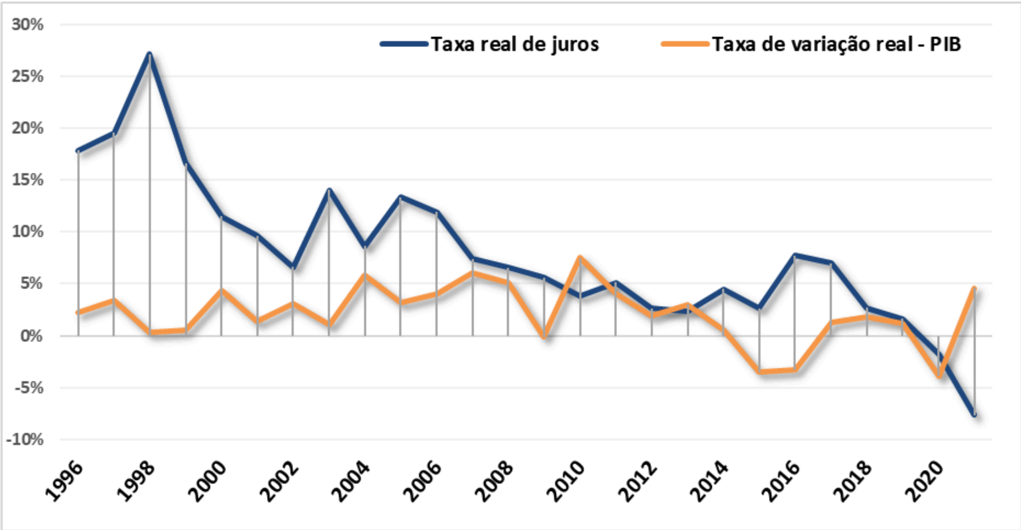
From the fiscal point of view, the criticism is that the macroeconomic "single thought" is based on the controversial hypothesis of "expansionary fiscal contraction" whose effect over time would be to reduce country risk, leading to lower interest rates and increased private investment. The problem with this hypothesis is that it disregards the importance of the fiscal multipliers of public spending on the economy's income, the relevance of which was once again highlighted in the global economic crisis caused by Covid-19.

Notably, in the Brazilian case, there is no denying that without tax transfers to families, companies and states, outside the spending ceiling, the Brazilian economy could have shrunk by 8% of GDP in 2020, according to the IMF. Furthermore, in addition to neutralizing the counter-cyclical nature of fiscal policy, since it freezes real spending for twenty years, Brazil's fiscal austerity policy disregards the level of regressivity of the tax burden, on the revenue side, and an extremely relevant part, as will be shown below, of public expenditure, on the financial expenditure side. Let's look at the data.

The main distortion caused by macroeconomic "single-mindedness" in the Brazilian economy, from our point of view, can be seen in Graph 1. In other words, despite the primary surpluses, notably under the Lula government, and the labor and pension reforms under the Temer government, from 1996 to 2021 only in two years (2010 and 2021) was the economy's real growth rate above the real interest rate. There is no debt that can remain on a downward trajectory in relation to GDP with such financial dysfunction, which has continued since the FHC government.

The consequences for the Brazilian economy are average GDP growth rates close to zero and negative GDP per capita growth rates from 2011 to 2020, 0.2% and -0.6% respectively, the second lost decade since the 1980s.

Graph 1. Real interest rate and real GDP growth rate



Source: Silva Santos (2022).

The data in Graph 2 clearly shows the legacy of the “single-minded” macroeconomic management model. Comparing the last year of Lula's administration with the penultimate year of Bolsonaro's, it can be seen that the resources earmarked for the public debt represent the largest share of paid expenditure in the federal budget, i.e. 45.3% and 50.9% respectively. Not only was there an increase in the financial share of the pie in the period under review, but it was to the detriment of resources earmarked for productive investments and the payment of personnel and social charges, the latter always being placed as the villain of the fiscal imbalance in the narrative of the financial market.

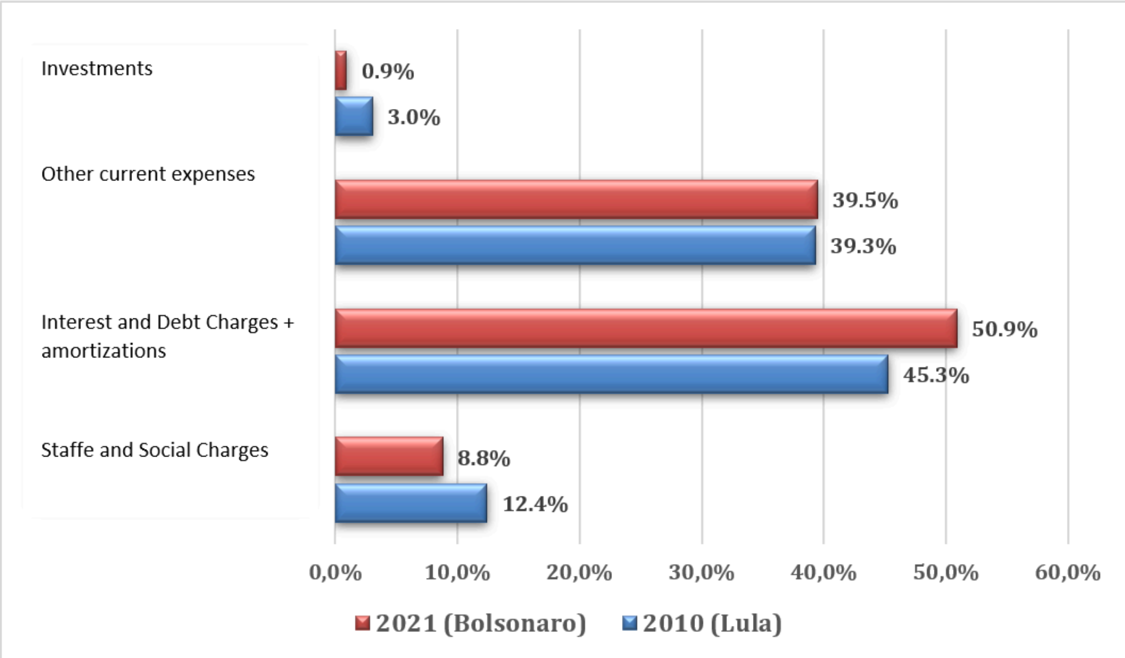
To give you an idea of the appropriation of the public budget by the financial sector, based on the latest data from 2022 on total spending, education, health, citizenship and science and technology represent 24.9% of what was paid in interest and charges plus debt amortization.

This figure is very similar to the one observed in 2010 (24.7%), which shows that the problem lies in the macroeconomic management model of the “single mindset”, regardless of the ideological differences between governments.

In the financial market's narrative, the debt stock is made up of a multitude of small savers who buy bonds through Treasury Direct.

According to data from the National Treasury, in October 2022 the Treasury Direct stock reached R$ 101.23 billion, while the Federal Public Debt reached R$ 4.64 trillion. In other words, 2.12% represents the percentage of financial wealth grabbed by a myriad of savers (around 2.1 million active investors), with the remaining 97.8% in the hands of financial institutions (28.1%), non-resident investors (9.8%), pension and investment funds (62%).

Graph 2. Share (%) of expenditure in the Federal Budget Executed (paid) in 2010 and 2021.



Source: Own elaboration with data from Siop/Secretary of Planning of the Federal Government, 2023

It is therefore necessary to bear in mind the importance of social policies in a country where, according to the IBGE, in 2021 approximately three out of every ten Brazilians lived below the poverty line and one in extreme poverty. That's 62.5 million living in conditions of social exclusion. Faced with such a bleak context, it's impossible to put more than 50% of the government's financial expenditure out of the account in order to try to combine fiscal and social responsibility. Without confronting the macroeconomic "single thought" trap, there is no way to implement an economic and social development agenda with environmental sustainability. In Brazil, except at times when autonomous public spending is injected into the economy, rent-seeking has only generated "chicken flights".

Monetary trap

In recent times, there has been a lot of controversy over the maintenance of the Selic rate (the basic interest rate determined by the Central Bank) at 13.75% p.a., giving Brazil first place on the podium of the highest real interest rates in the world, at 7% p.a.

Among the theories that seek to substantiate this unpromising title for the growth of our economy, there are the explanations given by economists who believe that inflation is determined by the expectations of rational economic agents who are able to identify any deviations of monetary policy from what they consider to be proper macroeconomic management and thus anticipate its effects over time on the prices of goods, services and assets. At the other end of the spectrum are heterodox economists who see inflation primarily as the result of disputes between different social classes over income distribution and minimize the effects of expectations.

Controversies aside, the view adopted by Central Banks around the world is one that associates the success of monetary policy in stabilizing prices with its credibility and also its ability to anchor economic agents' inflation expectations over time. The main instrument used by Central Banks since the end of the last century is the basic interest rate, whatever the factors behind the acceleration (deceleration) of inflation.

In a recent article (2023), André Nassif makes an assessment of the mistakes made by the Central Bank in giving excessive weight to expectations in determining the inflation rate. The following passage touches on the point we intend to explore here: “This short-sighted view of monetary policy has led the Central Bank to make repeated mistakes, the consequences of which have been the dilapidation of a considerable stock of physical and human capital that is unlikely to be recovered in the medium term”.

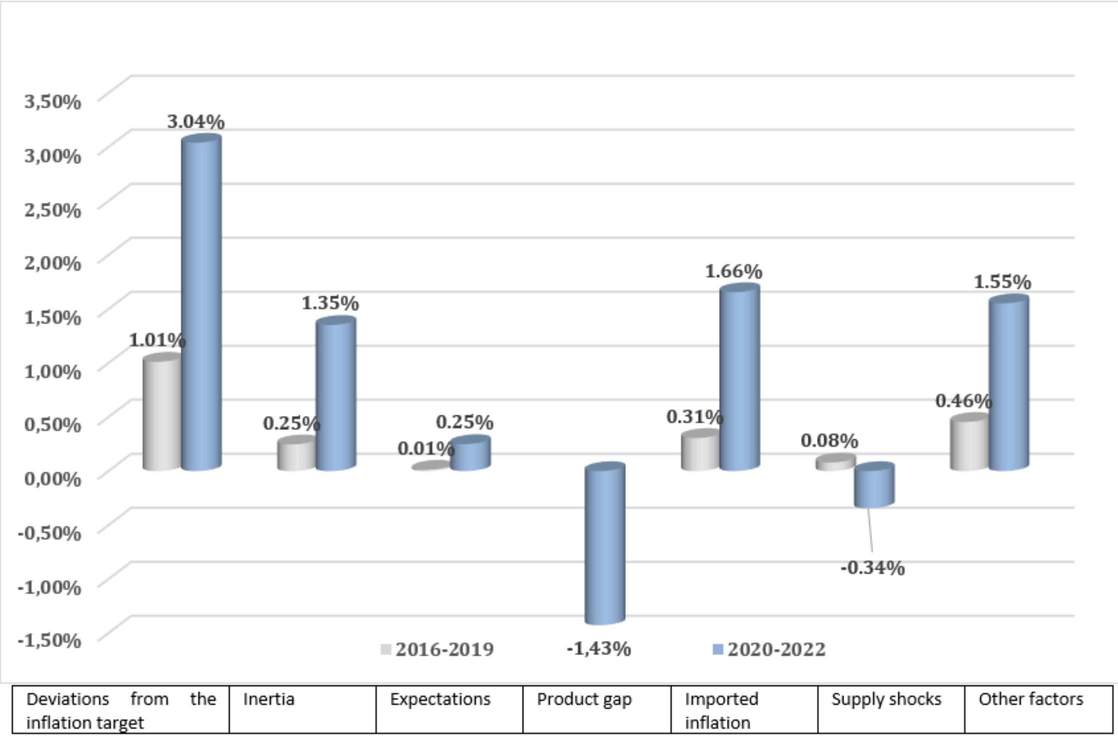
Using the BCB's own data, we will show that Brazilian inflation since 2016 has been determined to a large extent by shocks of different kinds and not directly by expectations, and that its resilience is due to the relative indexation of prices. Monetarists, like the BCB, recognize the limited nature of the high interest rate policy to combat this type of inflation. However, they advocate raising interest rates to avoid the secondary effects of shocks spreading and discouraging the inflationary expectations of economic agents.

The “short-sightedness” of monetary policy pointed out by André Nassif has led to what we call the monetary trap. In other words, a vicious circle in which high interest rates over time structurally restrict the economy's growth potential (the estimated capacity of the economy to grow without putting pressure on the inflation rate), quickly transforming demand stimuli into inflationary pressures that are responded to with further interest rate increases.

The justification given by the BCB for maintaining high basic real interest rates in Brazil, above the GDP growth rate, with the exception of 2010, 2013 and 2020 (Graph 1), is to avoid unanchoring economic agents' inflation expectations at the center of the target. But what is the direct influence of economic agents' expectations on the composition of the inflation rate in Brazil?

Since 2016, the BCB has adopted a new methodology for estimating the composition of Brazilian inflation, pointing out the factors that explain the deviations of inflation from the target. Graph 3 shows the factors that led to the average deviation of inflation from the center of the target (divided into the 2016-2019 and 2020-2022 periods, since it was only from 2020 onwards that the BCB began to estimate the influence of the Output Gap on the decomposition of inflation).

Graph 3. Breakdown of the average deviation of the inflation rate (IPCA) from the center of the target



Source: Own elaboration, 2023.

From Reading the data, four aspects stand out. The first is that, in the two periods under analysis, inflation expectations, at leasst directly, were responsible for the smallest part of the explanation for the average deviations of inflation from the target. This aspect is crucial because it shows, at first glance, the fragility of the narrative that Brazilian inflation is determined by the expectations of rational economic agents. It is important to note that from 2020 to 2022, average inflation remained well above the center of the target, and even then, expectations had little influence.

In both periods, the relevance of the shocks caused by imported inflation and other factors in explaining the average deviations of inflation from the target is clear. In the specific case of the second period, these factors reflected the virulence of the Covid-19 effect on international supply chains, with impacts on commodity prices and exchange rates, as well as the logistical problems arising from imbalances between global supply and demand. From the point of view of supply shocks, what contributed to reducing the deviation was the improvement in reservoirs from April 2022, which led to a reduction in electricity tariff flags, and temporary tax relief measures involving fuel, electricity and telecommunications.

The still considerable weight of inertia as an explanatory factor for deviations of inflation from the target in Brazil is worrying, not only because it makes inflation resilient to the downturn, but also because it increases the propagation effect of shocks despite the high interest rate policy, as has been widely documented in the economic literature, especially in the Brazilian case, which deals with inertial inflation.

The last factor to highlight is the importance of the negative output gap (idle capacity), which has helped to offset the inflationary effects of shocks and inertia. The idleness of the Brazilian economy, regardless of discussions involving the effectiveness of the methodologies used to estimate the output gap, has remained high since 2016. According to IPEA estimates, from the first quarter of 2016 to the second quarter of 2020 the average output gap was -3.8%. Post-Covid-19, the negative output gap was, according to FGV estimates, on a downward trajectory that was interrupted by the rapid rise in the Selic rate in the period. In its recent Inflation Report, the BCB itself projects a rate of -1.7% for the fourth quarter of 2023.

In his article, André Nassif didactically defines the Taylor rule as “a reaction function in which the short-term interest rate (our Selic) increases when observed inflation and/or inflation expectations exceed the target pursued by the Central Bank and actual GDP is higher than its potential (the output gap)”. From what has been discussed above, it is possible to deduce that, in the period from 2016 to 2022, the deviations of Brazilian inflation above the target set by the National Monetary Council (CMN) have been explained primarily by shocks to input prices (commodities, foreign exchange, industrial components, droughts, etc.), propagated by the relative level of price indexation (administered prices). On the other hand, the negative output gap has prevented further deviation from the target, while expectations have played a minor role in directly explaining such deviations.

Therefore, not even Taylor's rule seems to explain the high interest rate policy adopted by the Central Bank in recent times, either because of its lack of effectiveness in relation to supply shocks and indexation, or because it doesn't lead to excess demand (positive output gap), or because of the dubious relevance of inflationary expectations.

In short, the high interest rate policy adopted by the BCB for a long time has trapped the Brazilian economy in a trajectory that combines “dilapidation of a considerable stock of physical and human capital” (i.e. a reduction in growth potential), with estimates for long-term real interest rates of 4% to 6% p.a. and bold inflation targets of 3% p.a.

The pernicious effect of the monetary trap produced by the BCB, if not tackled, is to increasingly limit the economy's demand impulses (responsible for generating employment and income). The pernicious effect of the monetary trap produced by the BCB, if not tackled, is to increasingly limit, in the name of price "stability", the economy's demand impulses (responsible for generating employment and income) to satisfy the growing restrictions of our productive structure.

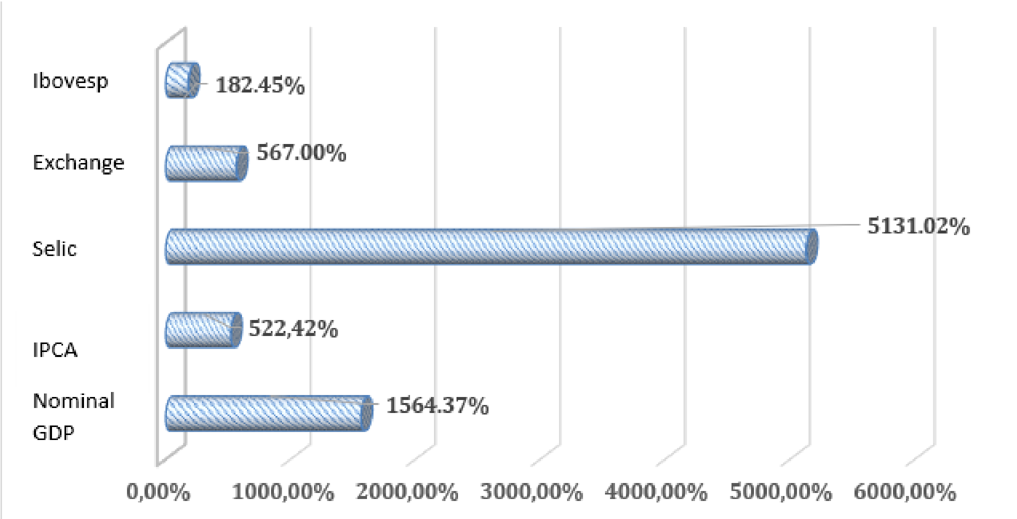
But the above doesn't give a satisfactory answer as to why interest rates are so high in Brazil.

Interest rates in Brazil

In Brazil, since the implementation of the Inflation Targeting Regime (IMR) around twenty-two years ago, the interest rate used by the Central Bank to coordinate inflationary expectations has been a cause of concern for economists outside the financial market. The central question is to understand why the Selic rate is so extraordinarily high in the country. We don't intend to provide a definitive answer to this riddle, since there are already renowned economists, such as André Lara Resende and Luiz Gonzaga Belluzo, investigating the intricacies of Brazilian monetary policy. We will therefore content ourselves with shedding light on its impact on Brazilian society.

In the Brazilian context, there is a central problem related to the persistently high levels of the Selic rate. These levels are often observed, even when inadequate, especially in the face of inflation episodes caused by supply shocks. This situation results in a process of distancing of the Selic's accumulated percentages, which stand out significantly in relation to the IPCA rate, nominal GDP and other assets over time, as clearly shown in graph 4.

Graph 4. Accumulated rates of different assets, IPCA and nominal GDP in Brazil from 1995 to 2022



Source: Own elaboration with data Anbima and Central Bank of Brazil – BCB,2023.

Even though the RMI has been adopted in Brazil since 1999, as a monetary policy rule that uses the Selic rate as an instrument to keep inflation at the center of the target, the following question is pertinent (taking 1995 as a reference): Why was a 5,131.0% increase in the basic rate necessary to combat inflation of 522.42% in the period under analysis? In this scenario, those who have invested over the last twenty-seven years in the real sector of the economy represented by GDP or in companies (Ibovespa), or even in dollars, have obtained markedly lower results compared to those who have bet on the Selic.

It is difficult to conceive that such a disparity can be attributed exclusively to the unanchored inflationary expectations of economic agents or to “populist” interference in monetary management. Some would argue that if the Monetary Authority were independent throughout the period, the 'inflationary risk premium' in cases of 'populist' governments coming to power would be lower, resulting in lower interest rates to coordinate inflation expectations. However, this hypothesis is controversial, considering that the Central Bank already has independence today and yet the Selic rate has only now, in a decision that divided the Monetary Policy Committee (COPOM), fallen 50 basis points to 13.25%, despite the accumulated inflation rate over the last twelve months having fallen from 11.9% in June 2022 to 3.2% in the same period in 2023.

Therefore, explaining the resistance to the fall in the Selic rate solely on the basis of the behavior of the IPCA is a narrative that is notoriously difficult to sustain.

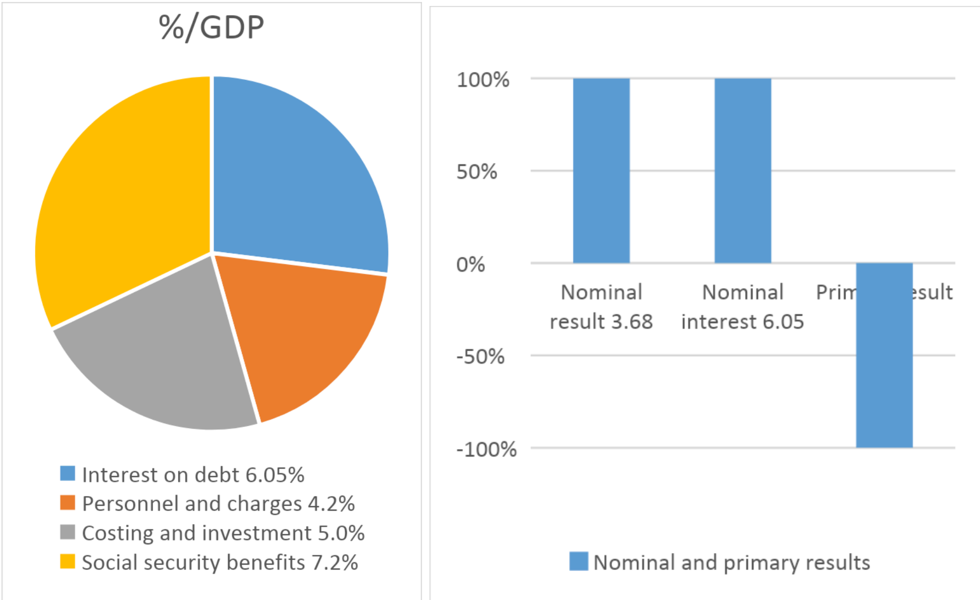
Another explanation attributed by economists faithful to the 'single-minded macroeconomics', as pointed out above, for the inflationary risk and the explosive accumulation of the Selic rate in the period under analysis, is related to 'fiscal irresponsibility'. According to these economists, especially those in the financial market, this fiscal irresponsibility makes it very difficult for the Monetary Authority to act in the search for price stability by increasing public spending and the public debt. Over the last twenty years, however, the data has called into question the thesis of 'fiscal populism' as the great villain and responsible for the Selic rate being at surreal levels. So let's look at the arguments that support this other perspective.

On average, interest has accounted for a significant portion of the Gross Domestic Product (GDP), falling only slightly short of social security spending and well above personnel, costing and investment spending, as shown in Graph 5. Compared to primary spending, which over this period amounted to 17.7% of GDP, interest represents more than a third. This is a considerable percentage of interest expenditure, apparently justified in the name of price stability threatened by fiscal irresponsibility.

This is also because, based on Graph 5, it is clear that, for most of the last two decades, a primary surplus was achieved which resulted in an average of - 2.4%, and the nominal deficit was not lower due to the significant share of interest on GDP. These figures refute the idea of a lack of fiscal responsibility, especially for the period between 2002 and 2013, when there was a primary surplus in every year.

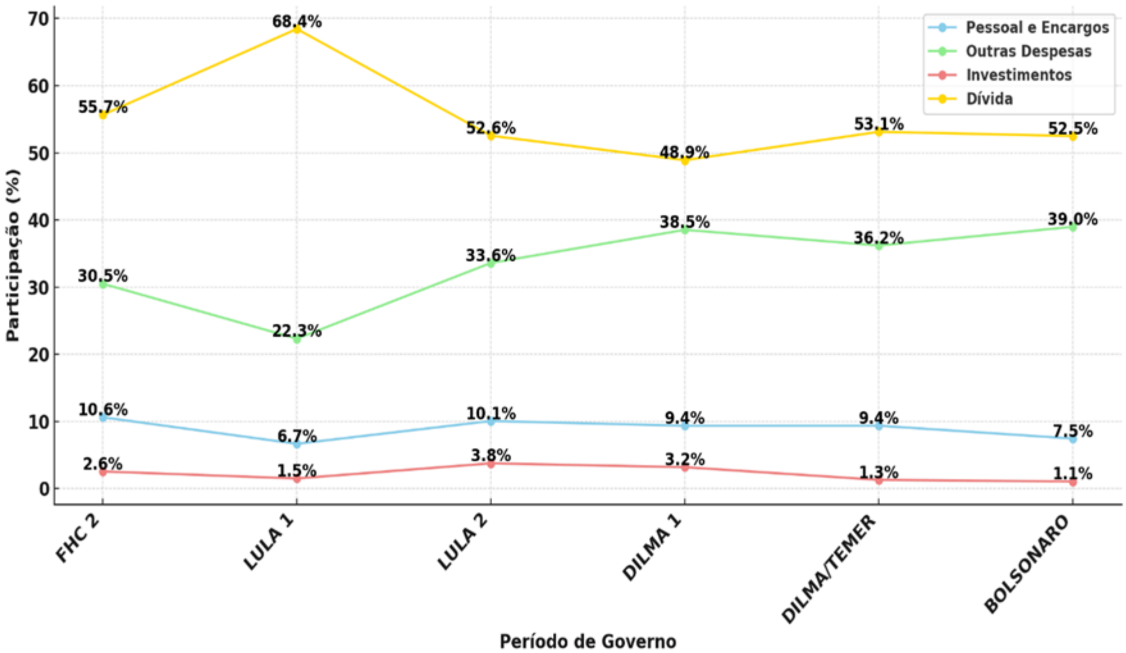
Debt servicing, including interest and amortization, has maintained its leading role in public spending over the last two decades, absorbing more than 50% of federal budget spending. There was a brief exception during Dilma's first administration, but even then, debt servicing continued to represent a significant portion of the budget, according to the data in Graph 6. On the other hand, public investment, which is responsible for driving private investment, performed poorly. After improving under Lula and in Dilma's first term, public investment fell dramatically to just 1.1% under Bolsonaro.

Graph 5. Average share of expenditure in GDP (%/GDP) and nominal and primary results – 2002 to 2022.



Source: Own elaboration with data FGV Fiscal Observatory and BCB, 2022.

Graph 6. Share (%) of total federal government expenditure



Source: Own elaboration with data https://www1.siop.planejamento.gov.br/, 2023.

When we look at the average share of spending on public security, social assistance, health and education over the last two decades, we see the following percentages: 2.28%, 0.38%, 3.36% and 2.65%, respectively. In contrast, spending on social security accounted for 17.36%, while interest on the debt reached an alarming 14.06%.

During this period, four changes were made to the social security rules, but social spending remained practically stagnant, close to the average. These figures allow us to conclude that we were not facing a fiscal meltdown, nor was there any justification for maintaining such high interest rates.

The other side of the coin of such a prolonged period with the basic interest rate at a high level is a low average GDP growth rate for a developing country, of 2.25% pa. From a sectoral point of view, industry, which is responsible for spreading technological progress and innovation to other sectors, as well as allowing for greater diversification and complexity in the country's productive capacity, recorded a mediocre growth rate of 1.4% p.a.

Given the data presented, a pressing question arises that deserves reflection: Is “fiscal irresponsibility” responsible for the persistence of high interest rates in Brazil, or are the latter, which exceed the alarming average of 14% of GDP, really responsible for stifling the country's ability to progress with social inclusion and improving the well-being of society as a whole?

In my opinion, the most appropriate approach to tackling this controversial issue is to adopt macroeconomic management that combines monetary and fiscal policies, with a view to economic development with social responsibility and environmental sustainability. In this sense, both the tax reform and the new fiscal framework currently being discussed in Congress allow us to move beyond the previous logic, which subordinated fiscal policy to monetary policy, based on the outdated premise of “divine coincidence”.

However, this approach was discredited during the 2008 financial crisis.

In a model favorable to development, it is essential to keep the real basic interest rate below the GDP growth rate. In addition, it is necessary to restructure the tax burden to exempt production and make it progressive in relation to income and assets. Another important point is the regulation of public spending through control rules that guarantee investment in physical, social and technological infrastructure. These measures are fundamental to creating a balanced and favorable macroeconomic scenario, because with the real basic interest rate below the GDP growth rate, the economic environment becomes more attractive for productive investments. In addition, the restructuring of the tax burden, by exempting production and making it progressive in relation to income and assets, stimulates sustainable growth and reduces social inequalities.

In order to implement this new approach, it is of the utmost importance that the Central Bank of Brazil fully aligns itself with this logic and with the objective of fostering the country's economic development. Otherwise, the debt/GDP ratio, due to disproportionately high interest rates, will continue to threaten the possibility of a promising future for the Brazilian population.

3 Conclusion

In the post-Covid-19 scenario, Brazil faces a significant challenge in relation to its public debt. Debt spending, consisting of interest and amortization, has consumed a substantial portion of public spending.

This dynamic severely limits the government's ability to invest in critical areas such as health, education, infrastructure and social development. The high proportion of the budget dedicated to debt servicing, to the detriment of other expenses, highlights a framework of fiscal restriction that could compromise the country's ability to promote social welfare and sustainable economic development.

At the same time, Brazil has one of the highest interest rates in the world, which has several consequences. Firstly, the high interest rate increases the cost of public debt, making debt servicing an even bigger part of government spending. This creates a vicious circle, where the high cost of the debt perpetuates the need to allocate a large part of the budget to interest and amortization payments.

In addition, high interest rates make credit more expensive for companies and consumers. This discourages productive investment and consumption, which are crucial factors for economic recovery. At the same time, high interest rates can make Brazil attractive for short-term investments focused on fixed income, to the detriment of long-term investments in productive sectors of the economy. This scenario can contribute to financial market volatility and does not necessarily translate into benefits for the real economy.

Finally, it is important to note that high interest rates tend to benefit holders of public debt securities and financial investors, while making credit more expensive for the general population. This can accentuate social inequality in the country, since the richest tend to benefit more from high interest rates than the low-income population.

In this context, we conclude that it is imperative for Brazil to find a way to manage and eventually reduce its public debt in a sustainable way.

This will probably involve a combination of sustained economic growth, structural reforms and prudent fiscal policies. In addition, a reassessment of monetary policy, aimed at lower and sustainable interest rates, could be an essential part of the solution, as it could relieve pressure on the public budget and foster investment and economic growth.

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