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## **Is there a Brazilian model of development?**

*Are there lessons for countries in Africa?*

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**Abstract:** Brazil's recent growth has been intensely pro-poor, and both poverty and inequality have declined significantly in the last decade. It has been suggested that Brazil's unexpected successes are the outcome of a new model of development. The paper argues that Brazil's unique combination of economic and social policies is at the root of its inclusive growth, but it is poorly understood. An assessment as to whether this combination constitutes a model is perhaps premature, but it is worth considering whether there are any lessons from Brazil's development policies for Sub-Saharan African countries.

**Keywords:** Brazil, inclusive growth, development, poverty

**JEL classification:** O1, O5, I3

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## 1 Introduction

Brazil's ascent to prominence on the international economic stage has been a prolonged affair. Perhaps the most curious feature of Brazil's economic and political development has been an enduring discrepancy between the country's size and obvious potential on the one hand, and its surprisingly low international profile on the other. Whereas the past couple of decades have witnessed an unremitting focus on the rise of the Asian emerging economies, for much of this time far-reaching changes in Brazil appear to have gone largely unremarked by international observers. Compared to the flood of studies dedicated to the rise of China and India, for example, those concerning Brazil have been a tiny trickle. Now, however, the spotlight has begun to turn belatedly towards Brazil.

Since the mid-1990s, despite occasional short-lived crises, Brazil appears to have embarked on a new developmental trajectory in which reasonable growth performance has been combined with an increasingly effective assault on poverty and inequality. The pro-poor character of economic growth in Brazil during the contemporary era stands in marked contrast to the experience of previous boom periods. For example, during the so-called 'miracle years' under military rule between 1967-73, Brazil's growth record, though very impressive by historical standards, could not overshadow the fact that income inequalities were widening and very little progress was being made in tackling entrenched poverty (Baer 2014). Indeed, during this epoch, a combination of rapid industrialization and rural migration cemented in place the urban marginalization and poverty which remain troubling features of contemporary Brazil. This is in sharp contrast to conditions since 2003 in which strong growth has gone hand in hand with a historic reversal of inequality trends. The fact that Brazil appears to be retreating from this unfavourable legacy and not repeating the mistakes of the past is heartening and forms the background to this paper.

Specifically, we set out to address the following question: are there any common features of Brazil's recent rise to economic prominence that collectively might suggest the contours of a new 'Brazilian' model of development? In other words, is something genuinely new at work? Researchers are divided with regard to the correct answer to this question.<sup>1</sup> Some researchers argue that a new development model can be found in the new modalities of state intervention, a determination to tackle inequality and a strategic focus on alleviating bottlenecks to growth. Others reject the view that a new model is in place and argue that Brazil's economic success is explained by the benefits from a commodity price boom allied to a more orthodox macroeconomic policy framework.

In the paper we argue that a unique combination of economic and social policies is primarily responsible for the unexpected success shown by Brazil, and that this combination of policies is poorly understood. There are specific features of the institutions of economic management and investment built after the stabilization plan of 1994 which, together with innovative social policies emerging from municipal activism, set a new course. A renewed consensus or 'social contract' is acutely significant in ensuring the conditions for a positive evolution of these institutions. It ensures economic and social policies work together and reinforce each other. While it is premature to define the dominant features of a new development model in Brazil, the significance of the underlying consensus should be better understood. In addressing these issues we also seek to determine whether the Brazilian experience can yield any useful lessons for the Sub-Saharan Africa (SSA) region, a part of the world which has also reaped benefits from recent commodity price trends.

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<sup>1</sup> See inter alia Baer (2014); Fishlow (2011); Roett (2010).

The paper has four main sections. Section 1 considers the main economic trends and policies which are argued to identify a new development model. Section 2 examines the specificity and contribution of social policy. Section 3 speculates on potential lessons for countries in Africa. A final section concludes.

## **2 A Brazilian new development model?**

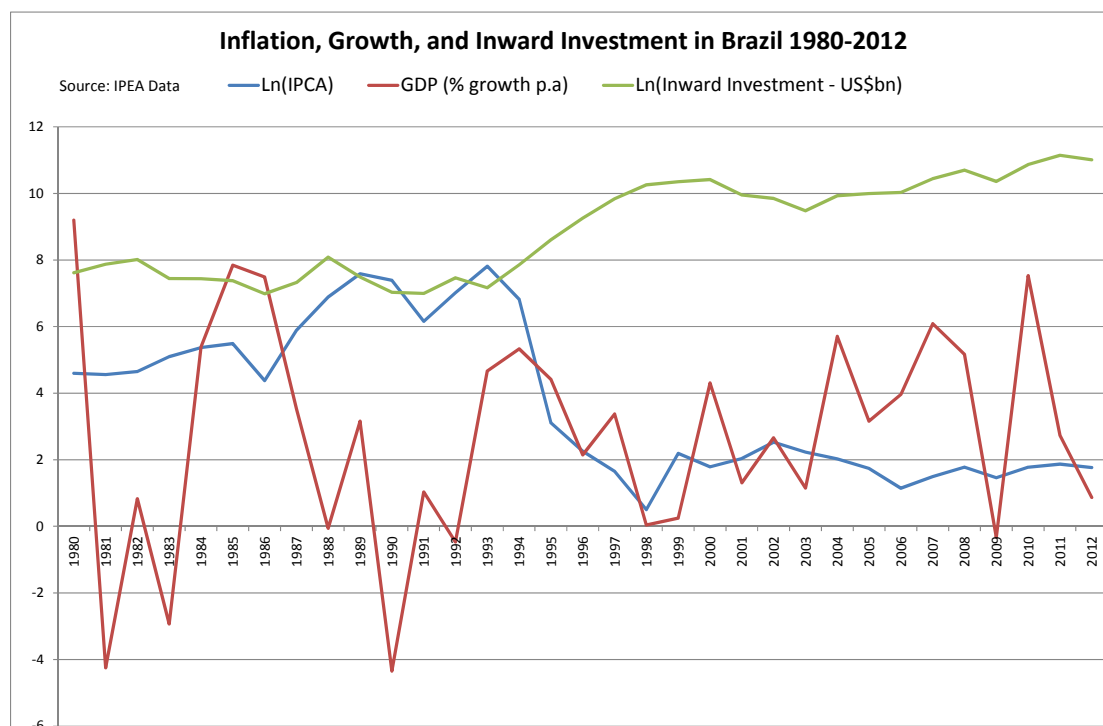
The ascent of the Brazilian economy to global prominence has been one of the most salient features of the international economic landscape of the past 20 years. Having become a byword for economic instability and yawning income inequality during the late 1970s and 1980s, by the end of the last decade Brazil had firmly embarked on a promising trajectory which combined solid—if not spectacular—growth performance with an increasingly favourable track record of addressing ingrained poverty and closing the income gap between rich and poor. In the process, Brazil has drawn increasing international attention, not only as a fruitful location for direct investment but also, potentially, as an example to be emulated by countries seeking to reconcile economic dynamism with poverty alleviation and social justice. Despite a recent dip in GDP growth and the eruption of street demonstrations in the middle of 2013, Brazil continues to make progress in tackling poverty. At the same time, there is very little prospect that the economy will revert to the 1980s-style hyperinflation or begin to accumulate external debt on an unsustainable basis. While a lot remains to be done, not least in the area of structural reform, there is much to applaud. What are the key elements underpinning Brazil's reversal of fortune?

### **2.1 The stabilization plan: building consensus**

Without doubt, the critical turning point in Brazil's economic return to form came two decades ago with the elaboration and implementation of a complex stabilization plan, the *Plano Real* (Real Plan). Introduced under the Minister of Finance and later President, Fernando Henrique Cardoso between 1993 and 1994 the plan combined both heterodox and orthodox macroeconomic elements (Amann and Baer 2000). The challenge faced by policy makers at the time was substantial: inflation was running on an annualized basis at more than 1000 per cent while the economy had suffered huge contractions in output at the start of the decade in the wake of a failed stabilization plan implemented by President Collor de Melo. The Real Plan differed from its failed predecessors in that it was introduced gradually and cleverly employed a pegged exchange rate. Allied with trade liberalization this maintained an external check on domestic price formation. Prior to the Real Plan, a key challenge in containing inflation stemmed from the fact that the economy, which had employed an inward orientated industrialization strategy, was effectively insulated from the potentially moderating influence of import prices on the general price level.

Since the implementation of the Real Plan, by contrast, a comparatively solid national currency, combined with unprecedented openness to imports has, albeit with periodically unfavourable consequences for the trade balance, proved highly effective in backstopping price stability. It is interesting to note that unlike its predecessors, the Real has managed to maintain respectable external valuation, despite the abandonment of a formal currency peg at the end of the 1990s and its replacement with an inflation targeting framework which envisaged no specified target band for the exchange rate (Averberg 2002).

Figure 1: Inflation, growth and inward investment in Brazil, 1980-2012



Source: IPEA data.

Accompanying the introduction of a new and pegged currency, the Real, policy makers added a firmly orthodox plank to their counter-inflationary strategy by setting targets for the fiscal balance. The strategy here combined more effective limits on public spending with limited reform of the taxation system. In regard to the latter, despite continuing inefficiencies,<sup>2</sup> the tax raising powers of the various levels of government have proven impressive by emerging market economy standards, accounting for over 30 per cent of GDP (Bernardi et al. 2007). As growth accelerated following stabilization it has consequently proven possible for the federal government to combine fiscal rectitude with a rise in spending on social programmes such as the celebrated *Bolsa Família*, a theme which will be examined more thoroughly in the next section.

The clever technical design of the stabilization programme aside, one of the key reasons for its enduring success has to do with the manner in which it has been possible to secure a broad political consensus in its favour across political party divides, business, trade unions and civil society (Roett 2010). The greatest political challenge of the early years of the programme was to overcome resistance to the abolition of income indexation in the formal sector. That this was successfully achieved reflects two factors; first, a collective recognition of the exhaustion of the previous model which had effectively ‘locked in’ hyperinflation and, second, the politically adept, consultative and inclusive approaches of the Franco and Cardoso administrations. The fact that indexation could be progressively abolished before the Real Plan had had time to demonstrate a sustained track record on tackling inflation is, it is possible to argue, one of the most significant and lasting political achievements since the return to civilian rule in 1985.

The depth of the ‘buy-in’ across the political spectrum was revealed once more, following the election of the Workers’ Party (PT) President Lula in 2002. Both Lula and his successor, Dilma Rousseff, have retained in place the core elements of the Real Plan minus, of course, its exchange

<sup>2</sup> Not least the continuing prevalence of cascading indirect taxes, a long-term target of reform.

rate peg component (which had been abandoned under the Social Democratic administration of President Cardoso). The continuity of macroeconomic policy over the past decade has proven effective, not only in containing inflation, but also in providing a relatively predictable platform for both domestic and foreign investors. This, in turn, has served to underpin the more favourable growth record of recent years.

## **2.2 Complementary microeconomic policy**

While the shift in the macroeconomic policy framework has received widespread attention (if not acclamation) in the literature, changes in the microeconomic policy set are equally noteworthy. As already indicated, prior to the 1990s, Brazil had adhered to an inward orientated industrialization policy commonly known as import substitution industrialization. This had involved the application of significant tariff and non-tariff barrier protection for large swathes of the industrial sector together with a primary role for the state as direct producer in such key sectors as public utilities, mining, petrochemicals, steel and transportation (Bulmer-Thomas 2003).

The first half of the 1990s saw an extensive, though not complete, dismantling of this apparatus through a combination of privatization (the world's largest such programme), market liberalization, trade reform and investment liberalization (Baer 2014). As a consequence, barriers to trade and investment fell drastically and, also encouraged by developments in the macroeconomic sphere, foreign direct investment surged. The microeconomic reform agenda has had a number of consequences including modest, though not spectacular gains in productivity and competitiveness, a marked increase in foreign participation in certain sectors (especially public utilities) and some thinning out of the domestic industrial sector (with an accompanying rise in the prominence of the more 'traditional' agriculture and mining sectors).

As in the case of the macroeconomic stabilization programme, the degree of collective 'buy-in' to this reform agenda has been surprisingly high, notwithstanding the controversy surrounding some of the privatizations (Molano 1997). To the surprise of many sceptical investors, the PT administrations of the post-2002 period have not significantly pushed back on privatization, market liberalization, or trade reform and appear committed to promoting Brazil as a competitive player in the global economy. This stands in marked contrast to the policies of statist nationalism now promoted in Argentina and Venezuela, for example. This is not to say that the current administration is an enthusiastic exponent of neoliberal market reform, however. Despite the changes of the last 20 years, elements of the *ancien régime* of import substitution have been re-instituted, not least in relation to protection and managed trade in the automotive sector and the elaboration of local content requirements for the fast-expanding offshore oil production and exploration sector (Tordo 2011: 89).

Of a significantly less high profile nature, the current administration is a firm proponent of activist industrial policy and the use of directed credit (much of it from the BNDES development bank) to build industrial and technological capacity in non-traditional sectors. This reflects an anxiety, whose roots can be traced back to the days of Prebisch and Singer at the Economic Commission for Latin America, that Brazil is too reliant on the export of commodities and natural resources-based products. The supposed centrality of the commodities sector to the Brazil's recent economic success is the issue to which this paper now turns.

## **2.3 How significant is the global commodity boom?**

Brazil, like many Latin American economies, has long been profoundly affected by international commodity price cycles. In the nineteenth and early twentieth centuries Brazil enjoyed periods of boom and bust as the international demand for key agricultural and mineral exports such as coffee,

cotton, rubber and precious metals waxed and waned. The industrialization programme which ran between the 1930s and the 1980s was explicitly designed to address the external vulnerabilities which commodity export dependence supposedly created (Baer 2014). However, despite the substantial structural changes to which the Brazilian economy was subjected, its fortunes could never be entirely divorced from events in the global commodities market. It is interesting to note that the economy's lowest ebb in the post-war period, the 1980s, coincided with a vertiginous slump in commodities prices. Conversely, even a cursory examination of data for the more recent and successful era reveals a strong association between a sharp recovery in commodity prices and a resurgence in growth.

Examining the growth output relationship in more detail, it becomes obvious that the sharp uptick in global demand for commodities has been one of the principal drivers in Brazil's economic resurgence. In one area in particular, exports, the trends are especially apparent. The sharp rise in exports since the beginning of the 2000s has strongly contributed to GDP growth and has helped to keep the trade imbalances from widening,<sup>3</sup> consequently contributing towards a reduced need to take on external debt. A combination of solid trade balance performance allied to capital inflows dominated by direct rather than portfolio inflows means that Brazil has been able to grow in a manner consistent with a sustainable evolution of the external accounts. Such a situation stands in sharp contrast to the debt with the growth strategy of the 1970s and the endemic current account crises of the 1980s and early 1990s.

Table 1: Sector composition (HS2) of exports and revealed comparative advantage

Type	Value 1996-98	Value 2006-8	Value 2009-11	Share 1996-98	Share 2006-8	Share 2009-11	RCA 1996-98	RCA 2006-8	RCA 2009-11
01-05 Animal	4,410	32,901	39,885	3.0	6.8	6.7	1.2	3.9	3.6
06-15 Vegetable	16,599	48,544	72,620	11.3	10.1	12.3	3.2	3.6	3.9
16-24 Foodstuffs	25,252	55,745	81,520	17.1	11.6	13.8	5.0	4.2	4.5
25-27 Minerals	9,930	84,498	149,408	6.7	17.5	25.2	0.9	1.0	1.4
28-38 Chemicals	8,520	23,882	30,363	5.8	5.0	5.1	0.7	0.6	0.5
39-40 Plastic / rubber	4,534	14,084	16,323	3.1	2.9	2.8	0.7	0.7	0.6
41-43 Hides, skins	2,259	6,338	5,237	1.5	1.3	0.9	1.6	2.1	1.5
44-49 Wood	9,387	23,675	24,382	6.4	4.9	4.1	1.5	1.8	1.6
50-63 Textiles, clothing	3,663	6,797	6,999	2.5	1.4	1.2	0.4	0.3	0.3
64-67 Footwear	4,634	6,045	4,611	3.1	1.3	0.8	2.7	1.7	1.0
68-70 Stone/glass	2,008	5,959	4,800	1.4	1.2	0.8	1.1	1.3	0.9
71-83 Metals	19,887	55,069	51,345	13.5	11.4	8.7	1.4	1.1	0.9
84-85 Machinery/electr icity	18,092	53,929	48,398	12.3	11.2	8.2	0.4	0.4	0.3
86-89 Transportation	15,794	57,263	49,711	10.7	11.9	8.4	0.9	1.2	0.9
90-97 Miscellaneous	2,522	6,761	6,639	1.7	1.4	1.1	0.3	0.2	0.2

Source: World Integrated Trade Solution.

Source: Reproduced from Canuto et al. (2013).

To critics of Brazil's recent economic performance, its success is overly dependent on favourable commodity price trends, which once reversed, will drag the economy back into recession. Fears here were underscored in mid-2013 by the implosion of Elke Batista's<sup>4</sup> energy and commodities empire. There is some broader basis for these anxieties: it is certainly the case that over the past

<sup>3</sup> In fact, for a number of years since 2003 Brazil has generated a healthy trade surplus.

<sup>4</sup> Once Brazil's richest man.

two decades, Brazilian exports have increasingly focused on natural resources-based products. At the same time, exports of higher value-added industrial products and services have failed to take off to the same extent (Canuto et. al. 2013: 4). Table 1 indicates that an important measure of competitiveness, Real Comparative Advantage, rose quite sharply for minerals between the late 1990s and 2009-11 whereas for the major manufacturing sectors—machinery, electrical equipment and transportation equipment—the indicator declined or remained static. However, the argument that Brazil’s recent success is just the latest example of a soon-to-expire commodities-driven boom needs to be examined a little more critically. There are a number of arguments which need to be taken on board here.

First, in contrast to its past experiences, Brazil has moved up the value chain as a commodities exporter, increasingly adding value and technological input, changing the qualitative nature of the products exported. Thus, for example, the export of new strains of higher quality soya, added value coated steel or even just in-time frozen chickens for the US fast food industry suggests strong product differentiation and genuine competitive edges being gained in distribution and logistics. In this sense it is increasingly difficult to argue that Brazil’s integration with the global economy—even in the field of commodities—is simply based on low valued added and low price. Second, given global population trends and continuing expansion of demand from Asia, it is far from obvious that the world stands on the brink of a commodities price slump of the variety that occurred in the mid-1980s. Third, Brazil’s newly acquired self-reliance in hydrocarbon fuels production means that its external accounts, the trade balance in particular, are far less vulnerable to a sudden decline in exports than was the case in the 1980s. Fourth, while it is undoubtedly true that Brazil’s export growth has been driven strongly by commodities, other key strengths remain in the industrial and even services exports. For example, in transportation equipment, especially aircraft, Brazil has become one of the world’s leading exporters while it is developing an increasing profile in software exports and technical services such as construction and project management. Technological capabilities in the manufacturing sector have continued to receive funding support from policy makers who, themselves, are very cognizant of the need to diversify and upgrade the productive base (Amann and Figueiredo 2012).

Finally and perhaps most obviously, reducing the Brazilian ‘success story’ to a simple commodities play ignores other sources of demand in the economy which have been unlocked by the process of economic stabilization described earlier. As will be made clear in the next section, one of the dividends of macroeconomic stabilization and pro-poor policies in general (whether conditional cash transfer programmes or otherwise) has been to unleash a fresh source of domestic demand as the real incomes of people lower down, the inter-personal income distribution have risen as inflation has fallen and real incomes have risen. In this sense, limited parallels can be drawn with the case of China where internal demand is increasingly moving to centre stage at the relative expense of its external counterpart.

## **2.4 Consensus: Key to success**

Thus far the key elements of the Brazilian economic model (if that is what it is) have been argued to comprise macroeconomic stabilization, cautious microeconomic reform and an adept leveraging of the opportunities presented by a surge in global commodities demand. All of these elements could not have been facilitated without the forging of a broad consensus across the political spectrum, key actors in business, the labour movement and civil society. In our concluding section, we argue that achieving this consensus and ensuring positive engagement with the reform programme, while being critical elements to success, may be the hardest to secure in practice. Before leaving this section, however, it is important to set out the challenges that Brazil still needs to grasp if its comparatively favourable recent track record is to be sustained into the future.



While by its own lights the Brazilian economy has performed favourably over the past two decades, it is clear that by comparison with other major emerging economies, notably China and India, its growth rate has been sluggish. It is also the case that compared with such economies, the sources of Brazil's export growth have proven more concentrated and its technological dynamism arguably less marked. Of course, this does not negate the fact that Brazil has achieved technological excellence—and export success—in some advanced sectors. Still, the central problem which has continued to afflict Brazil is that despite extensive market reform exposure to global trade and investment flows since the early 1990s, the supply-side responsiveness and flexibility of its economy have remained stunted. Part of the issue here concerns inadequate investment in physical infrastructure especially in the transportation and energy sectors. According to Frischtak (2008: 310), spending on infrastructure by both the private and public sector actually declined from 3.32 per cent of GDP to just 2.18 per cent of GDP between 2001 and 2008-10. The reasons for this are complex and are partly connected with planning rigidities, the slow pace of the legal system, the high cost of financial intermediation and lack of domestic technical and managerial capacity in some areas. The authorities have embarked on a multi-billion Real programme, the *PAC*, to address infrastructural bottlenecks but progress has been frustratingly slow.

In addition to the question of physical infrastructure lies the issue of bottlenecks created by human capital deficiencies. A legacy of entrenched inequality, poverty, and deficits in education means that the Brazilian workforce is characterized by acute skill shortages. This presents huge challenges when the objective is to engage in systemic processes of industrial and technological upgrading and may be one reason why exports have failed to diversify (in strong contrast to what can be observed in relation to post-1991 India). The final major challenge centres on the competitive disadvantages imposed on business and entrepreneurship by costly bureaucratic procedures, a slow and unpredictable judiciary and an over-extended state. Such issues have been collectively termed the *Custo Brasil* and continue to exercise a baleful influence despite extensive lobbying from business groups.

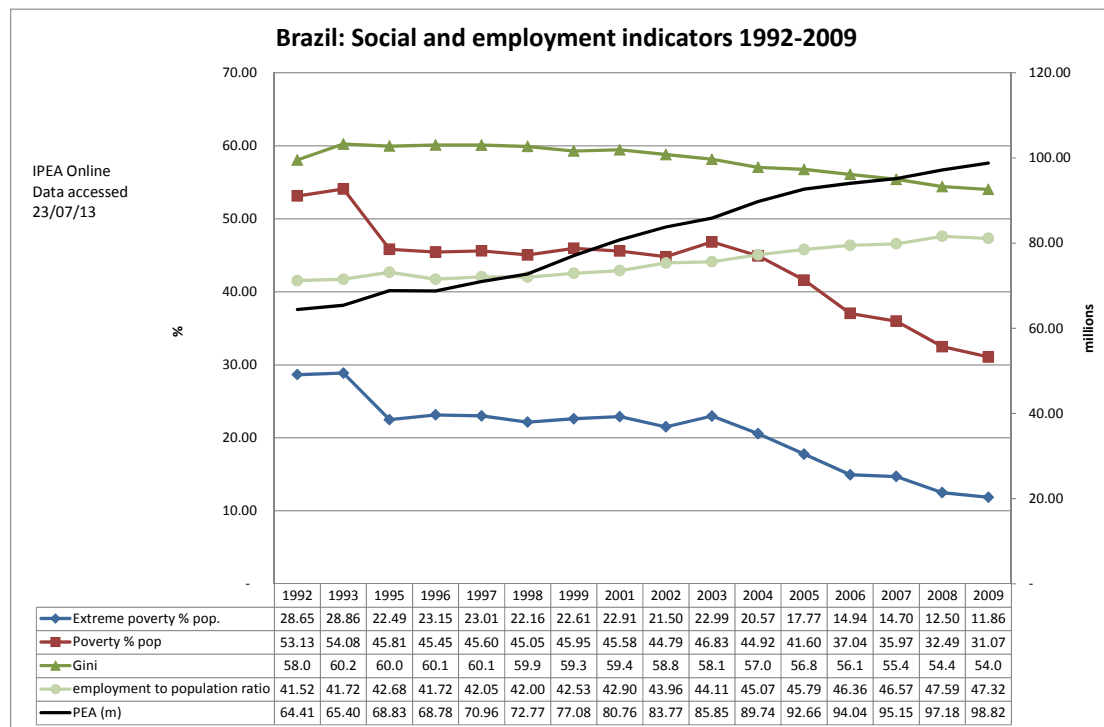
### **3 The role of social policy in Brazil's model**

The attention to social policy has been a highly distinctive feature of government policy in Brazil in the last two decades. Comprising transfers-in-kind, as in education and healthcare, and transfers in cash, as in social insurance and social assistance, social policy is an essential component of a 'Brazilian model'. The 1988 Constitution led to activism on social policy, with a focus on raising living standards among the worst off groups and regions in Brazil. It directly led to education and healthcare reforms and to the emergence of social assistance programmes like *Bolsa Escola* and *Bolsa Família* that focused on groups in extreme poverty. A quarter of a century since the new Constitution, the combination of economic growth and social policy initiatives has proved successful in reducing poverty, inequality, and social exclusion. Figure 2 shows trends in inequality, poverty and employment. It is the specific configuration of economic and social policies achieved in Brazil since the return to democracy, and the political consensus that underpins them, that can make the strongest claim to constituting a distinctive Brazilian model.

Following the end of twenty years of dictatorship, the discussions around the new 1988 Constitution shaped the emergence of a new social contract in Brazil, with a raft of social rights to education, health and social protection now firmly established. The half decade leading to the Plan Real in 1994 was dominated by hyperinflation and macroeconomic instability and provided a challenging environment in which to embed the aims of the Constitution in new policies and institutions. The Unified Health System began to be implemented in 1990 against the grain of President Collor de Melo's liberal economic policies promoting budgetary contraction. The implementation of the Rural Social Insurance in 1993 aimed at including rural informal workers

within the existing Social Insurance Fund was easier as it involved reforming an existing programme introduced by the dictatorship.

Figure 2: Brazil: Social and employment indicators, 1992-2009



Source: Authors' calculations based on IPEA data.

From the mid-1990s, and against a context of macroeconomic stabilization brought in by President Henrique Cardoso in 1995, health and education reforms deepened. The Unified Health System and the new Family Health Programme established in 1994 pushed forward with extending health provision to lower income groups. A programme providing financing and technical support to upgrade basic education, the FUNDEF (*Fundo de Manutenção e Desenvolvimento do Ensino Fundamental*) was introduced in 1994 raising education expenditure per student and in the process redistributing resources from better-off states and municipalities to poorer ones. In 1996, a non-contributory pension, the *Benefício de Prestação Continuada*, was introduced to provide transfers to poorer older people and people with disabilities. It constituted a break with past social protection in that it eschewed the ever dominant contributory principle as the eligibility rule and replaced it with a competing citizenship principle. In 1995, municipal activism led to the emergence of guaranteed income programmes focused reducing child labour (PETI) and extreme household poverty (*Bolsa Escola*). These programmes combine regular income supplements for households in extreme poverty with conditions ensuring human development investment, principally children's school attendance and primary healthcare utilization. Direct transfer programmes expanded rapidly among municipalities before becoming federal programmes in 2001.

The Lula administrations (2003-11) pressed forward with social assistance programmes, consolidating all federal guaranteed income programmes into *Bolsa Família* while at the same time expanding the target population to 13 million households. *Bolsa Família* quickly became the government's flagship programme and the centrepiece of the newly established Ministry of Social Development (*Ministerio de Desenvolvimento Social*) tasked with addressing poverty and social exclusion. A new formula for the indexing of minimum wages to the sum of changes in the consumer price index and real GDP growth, agreed in tripartite fashion, ensured significant gains in the value of minimum wages in real terms, around 10 per cent per year in the second Lula

administration ( Ferreira de Souza 2011). In Brazil, minimum wages provide a floor for labour earnings in formal employment and a benchmark for wage settlements of informal workers (the lighthouse effect). In addition, minimum social insurance pensions and non-contributory pensions are indexed to the minimum wage. A single policy lever can ensure the gains from growth are distributed to lower-income groups (Saboia 2009). It also enables the government to reach the majority of low-income and vulnerable groups, with *Bolsa Família* reaching the remainder.

This section is not aimed at providing a detailed account of social policy developments in Brazil,<sup>5</sup> but to underline instead its significance for the Brazilian model. There is a lively debate on the extent to which social policy has evolved in line with the orientation of the 1988 Constitution (Jaccoud et al. 2009; Mesquita et al. 2010); on whether the reforms have been successful in changing the structure of social policy in Brazil (Hunter and Sugiyama 2009); and on the extent of the challenges that remain (de Castro 2011). The role of social policy within the Brazilian model is apparent in three important areas: fiscal inclusion, productive capacity and demand management.

### 3.1 Fiscal inclusion

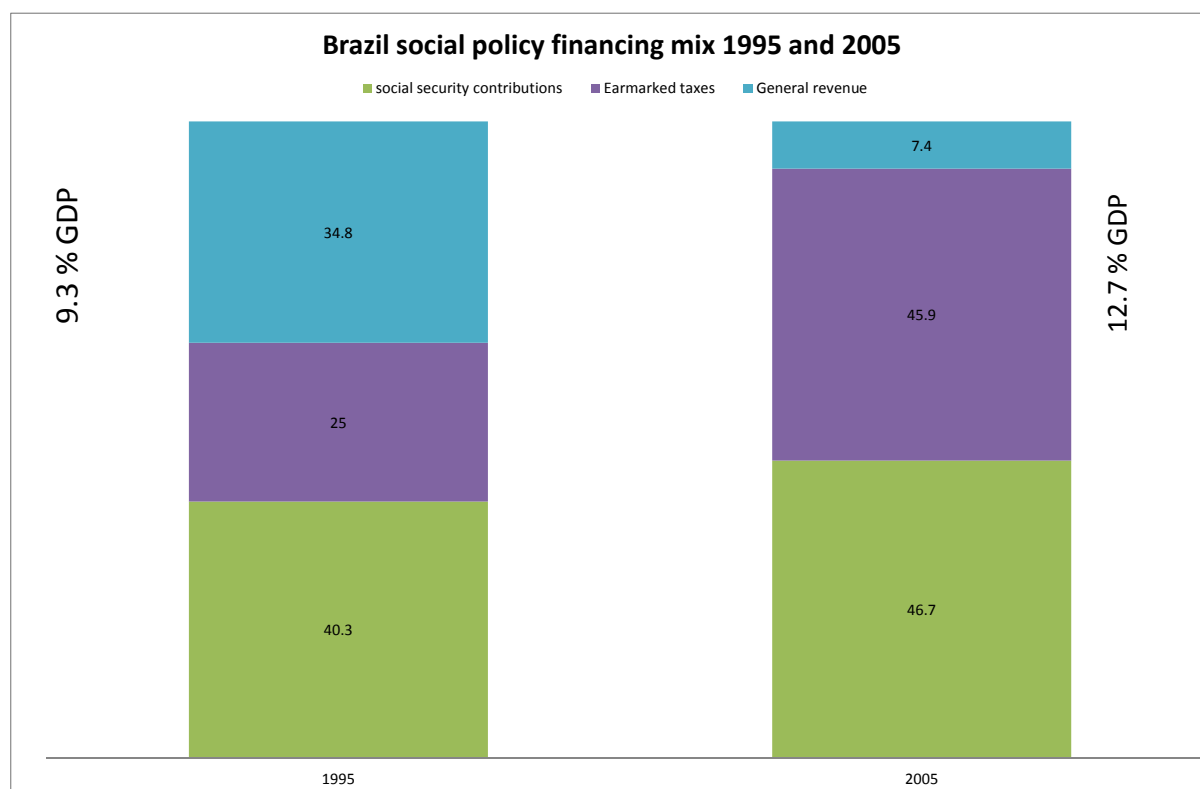
Research on social policy commonly focuses on the scope and effectiveness of government policies, the design of programmes and their institutional frameworks, and the impact on households. In studying the Brazilian social policy over the last two decades, it is essential to begin with their financing. In low- and middle-income countries wishing to expand the scope of their social policies, the issue how this expansion is to be financed has primacy. Proponents of social policy often highlight their likely impact on the beneficiary population, on poverty and inequality for example; while opponents will stress the impact on public spending and taxation. Raising revenue can be costly in terms of the impact of taxation on incentives, as captured by the marginal cost of public funds. In the context of Brazil, the trade-offs have been fully recognized and measured but due to several factors, including among them the complexity of existing institutions and their distributional effects, financing the expansion of social policy has been relatively unproblematic.

As noted above, the implementation of the expanded set of social rights in the 1988 Constitution encountered severe financing barriers arising from adverse macroeconomic conditions. To address this constraint, policy makers constructed a social security budget in which funds were earmarked to finance social expenditures. For this purpose, two specific taxes were introduced in 1997, the CPMF (a tax on financial transactions) and the Cofins (a tax on sales contributing to finance social insurance) with a ten-year time window. This involved a shift in the financing of social policy from reliance on social security contributions and general tax revenues, to a more diversified funding mix. Figure 3 shows the shift in financing between 1995 and 2005. In that period, social expenditure rose from 9.3 to 12.7 per cent of GDP, a significant increase in resources given that GDP increased in the same period by about 10 per cent (IPEA 2005). Social expenditure therefore managed both an absolute and a relative increase in its share of resources (de Castro et al. 2008).

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<sup>5</sup> For earlier accounts see ( Paes de Barros and de Carvalho 2003; Camargo 2004).

Figure 3: Brazil's social policy financing mix, 1995 and 2005

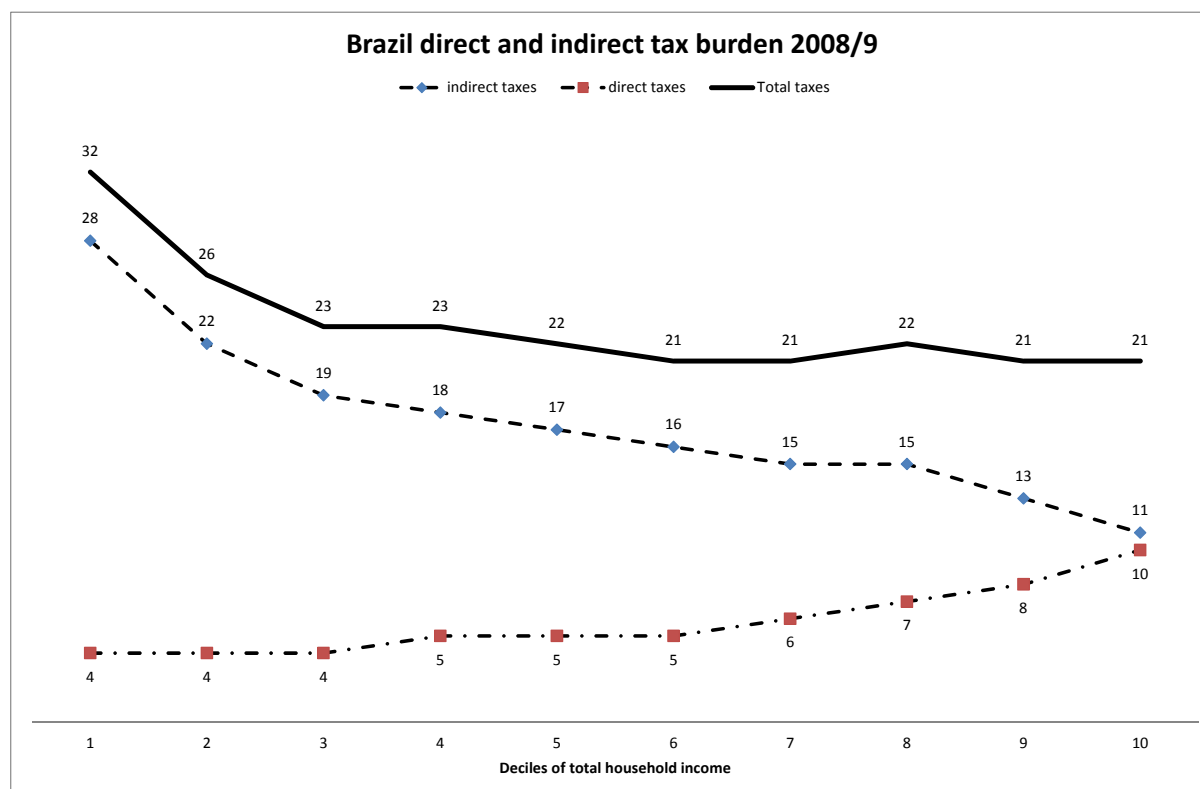


Source: de Castro et al. (2008).

The faster economic growth experienced by the Brazilian economy expanded the social security budget, especially through an increase in the value and quantity of social insurance contributions, but also through the amounts collected from earmarked taxes. These conditions enabled a rapid increase in social expenditure, in absolute and relative terms. Debates leading to the renewal of the earmarked taxes in 2007 raised concerns around the financial sustainability of the expansion of social assistance (Kerstenetzky 2009). In any event, parliament's failure to renew the CPMF in 2007 and the impact of the 2008 financial crisis have not undermined the financing of social expenditure. A proposal for tax reform introduced in parliament in 2007 includes a consolidation of taxes earmarked for social expenditure into a federal consumption tax that could ensure adequate financing into the future.

The complexity of the Brazilian tax system makes it particularly hard to reform, but its inertia over the last two decades has led to a significant increase in the tax burden from 28 per cent of GDP in 1995 to around 35 per cent of GDP in 2008, a level not dissimilar from southern European countries. However, the distribution of the tax burden and the contribution of social expenditure to reducing inequality are very different. Figure 4 shows the share of household income contributed in direct and indirect taxes grouped by deciles of gross income.

Figure 4: Brazil direct and indirect tax burden, 2008/9



Source: de Castro (2011).

As the Figure demonstrates, the tax burden for households in Brazil is almost neutral in its distributive effects. In fact, the tax burden of the poorest households is highest due to the regressivity of indirect taxes. The earmarking of tax revenues to support social policies has a strong justification on distributional grounds. The distributional effects of social policy are central to the extent to which the government can influence poverty and inequality.

### 3.2 Productive capacity

A strong focus of social policy innovations in Brazil is on improving the productive capacity of the target population, especially disadvantaged groups. The linkages from social policy to health and education are obvious, as the main objective of reforms has been to improve provision and reduce the large disparities in access to services across states, municipalities and socioeconomic groups. Improvements in education feed directly through to the skills and productivity of the labour force, while improvements in healthcare can help extend productive lives. Ferreira de Souza (2011) notes that illiteracy rates fell among 15-24 year olds from 7.1 per cent in 1995 to 1.9 per cent; while the proportion of the economically active population with completed primary (secondary) education increased from 34.5 (20.7) per cent to 61.7 (44.1) per cent in the same period. As a result the Gini index of years of schooling for the economically active population dropped from 0.413 to 0.288. These indicators show large improvements, but disparities in provision have attenuated rather than disappeared.

The conditional transfer programmes are focused on improvements in the schooling, health and nutrition of children. In fact, *Bolsa Escola* and PETI were designed specifically with the objective of facilitating improvements in the productive capacity of children in households in extreme poverty (Camargo 2004). The evidence from impact evaluations show that they are effective in

reaching disadvantaged groups, suggesting further improvements in the productive capacity of younger cohorts (de Brauw et al. 2012). Improvements in schooling have also been observed for transfer programmes without an explicit focus on children (de Carvalho 2008a; Ponczek 2011). Conditional transfer programmes have the advantage that they engage education and health agencies to ensure that supply infrastructure is improved to meet the additional demand.

A common concern with income transfer programmes focused on low-income and disadvantaged groups is the potential effect that the additional income and eligibility conditions might have on the labour supply of beneficiaries (Moffitt 2002). This issue has been studied extensively in Brazil and elsewhere in Latin America. On the whole, the findings emerging from these studies suggest that labour supply effects from transfer programmes are muted (Cortez and Camargo 2007; de Carvalho 2008b; Foguel and Paes de Barros 2008; Ribas and Soares 2011). Conditional income transfer programmes can be effective in reducing child labour, especially where this is an explicit objective of the programme as in PETI (Yap et al. 2002). Non-contributory pension programmes also produce reductions in the labour supply of older beneficiaries, even where eligibility conditions lack a work test. As regards the labour supply of adults, the studies find marginal effects on the hours of work and insignificant effects (both positive and negative) on labour force participation. The interesting point about Brazil is the fact that labour force participation rates among the population targeted by income transfer programmes are no lower than participation rates among the population as a whole (de Castro et al. 2010). The concern is less with adverse labour supply effects, than with the fact that income transfer programmes might compensate for low incomes and precarious employment, and therefore reduce incentives for upgrading jobs. Income transfer programmes help stabilize consumption among vulnerable households and therefore support economic inclusion in less than ideal conditions.

The recent orientation of social policy—especially education, health and social assistance—towards encouraging the productive capacity and economic inclusion of disadvantaged groups has contributed to supporting pro-poor economic growth. The combined effects of growth and social policy have ensured that in Brazil the rate of income growth among the poorest deciles has been significantly larger than for the richest. The growth incidence curves which looked like an inverted ‘U’ for the 1980s and early 1990s (Ferreira et al. 2010), changed to a ‘L’ in the 2000s with income growth at around 7 per cent for the lowest decile and just above 3 per cent for the highest decile. The income growth for the lowest quintile was driven by improvements in employment and the rise in the minimum wage, but with an important contribution from income transfers. Table 2 shows a decomposition of the changes in per capita household income for the 2003 to 2009 period. The decomposition focuses on three main factors: (i) increases in work-related income; (ii) increases in the number of adults in the household; and (iii) increases in social assistance transfers. The figures show that all three factors contributed to the growth of incomes among poor households in Brazil.

The ‘productivist’ approach characterizing social policy in Brazil will be reinforced with a new integrated policy framework under *Brasil sem Miséria* which aims explicitly to support employment and economic inclusion (Paes de Barros et al. 2011).

Table 2: Income growth among bottom quintile is explained by a mix of growth, demographics, and redistribution

	2003	2009
Increase in work-related income per adult	R\$87	R\$123
Increase in the number of adults per household	55%	58%
Increase in non-work related income per adult	R\$25	R\$49

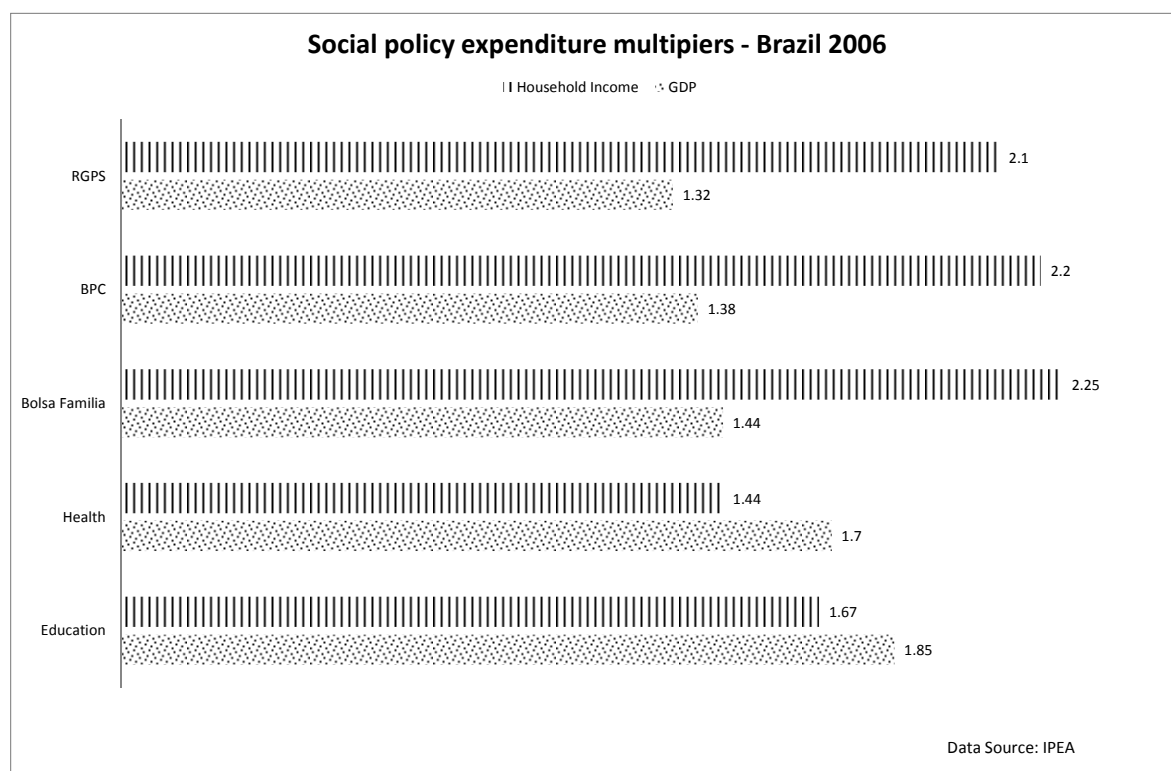
Source: Authors’ calculations based on Paes de Barros et al. (2011).

### 3.3 Growth multipliers

The growth in social expenditure in Brazil and the particular institutional form in which the additional resources were allocated are likely to have a direct effect on growth through their effect on demand. Estimates of the multipliers applying to government expenditure suggest that the focus on disadvantaged groups in the expansion of social policy had sizeable effects on economic growth. IPEA has estimated that the GDP multiplier of social expenditure taken as a whole was of the order of 1.37 in the mid-2000s, while the social expenditure multiplier in household income growth rates was higher at 1.85 (IPEA 2010).<sup>6</sup> Figure 5 shows the estimated multipliers by type of expenditure.

Disaggregating the growth multipliers by type of social expenditure shows that expenditures on services, especially health and education, show higher GDP multipliers than household income multipliers, whereas social protection expenditures show higher multipliers for household income growth than for GDP. This is explained in large part by the methodology employed to yield these estimates. Expenditure on basic services has a more immediate effect on capital accumulation than expenditure on social protection transfers. Expenditure on social assistance transfers, as expected, shows the highest estimates for household income growth, an additional 1 percentage of GDP allocated to *Bolsa Familia* transfers raises household income by 2.2 percentage points.

Figure 5: Brazil: Social policy expenditure multipliers, 2006



Source: IPEA data.

The main conclusions emerging from this discussion point to the fact that the expansion of social policy in Brazil is likely to have generated net positive effects on economic growth, in addition to

<sup>6</sup> The multipliers were estimated on a 2006 SAM for Brazil.

contributing to the reduction in poverty and inequality.<sup>7</sup> The programmes and institutions delivering social policy have been an essential component of the Brazilian model. The growth in social expenditures, in absolute and relative terms, enabled innovative policies to be implemented. It also facilitated far-reaching institutional change, as the reforms in health, education, and the creation of the Ministry of Social Development, attest. The orientation of social policy towards low-income and disadvantaged groups not only enabled these groups to benefit from growth, but also consolidated public and political support for social policy innovations.

It is important to take note of the factors that could restrict the effectiveness of these policies in the medium term. It is highly unlikely that the growth in government revenues will continue into the medium term. The wave of demonstrations in Brazil in May/June 2014 signal firm limits to the government's revenue raising capacity. The growth in resources for social policy during the last decade and a half allowed the government to make policy changes without affecting existing beneficiaries of social policy, especially civil servants and formal sector workers in social insurance schemes, and tertiary education. There are strong reasons to believe that continuing with the current orientation of social policy will give rise to conflict over budgetary allocations. The financing requirement of the public social insurance fund catering for 2.5 million civil servants is about the same as the financing requirement of social transfers under *Bolsa Família* and the two non-contributory pension programmes which reach about 20 million households. Budgetary restrictions will necessarily involve tough political choices.

#### **4 Are there lessons for countries in Africa?**

There is growing interest in identifying whether there are any lessons from Brazil's economic success for other developing countries, and particularly countries in Africa which are also benefiting from sustained growth. A new research programme led by the authors will attempt to draw out these lessons in some detail.<sup>8</sup> Here we can only sketch preliminary lessons emerging from the research carried out to date on Brazil. The key lessons for Africa would appear to be as follows:

- The forging of a cross-cutting national consensus necessary to push through and sustain difficult and potentially socially disruptive reform programmes such the Real Plan. This requires policy makers and politicians to ensure that relevant groups across society buy into the reform agenda through a sense of collective ownership. This fundamental lesson is often acknowledged in development plans in developing countries, but it is seldom adhered to in the design and adoption of policies.
- The paper underlines the general point that a political consensus is central to the success of policies, but it also suggests that the specific combination of economic and social policies in Brazil merits close scrutiny in this context. In Brazil's case, economic and social policies mutually reinforce each other. Policies that facilitate growth with employment reduce poverty and create fiscal space for innovative policies that reinforce growth and political support. An implication from this point is that a single focus on policies directed at maximizing growth; or alternatively a single focus on redistributive policies, unlikely proves to be successful. Brazil's experience suggests that maximizing growth and reducing poverty and inequality must have approximate roughly equal standing.

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<sup>7</sup> The Appendix provides a simple model for assessing the effects of social policy changes on growth.

<sup>8</sup> The DFID-funded research programme, which started in September 2013, will run for three years (see [www.brazil4africa.org](http://www.brazil4africa.org)).



- The consensus around the stabilization plan has endured through several changes in ruling coalitions. Coalition politics ensure a critical mass of support, and prevent the emergence of particularistic policies dominant in Brazil before the 1990s.
- The presence and legitimacy of administrative and taxation capacity necessary to raise revenues from a natural resources ‘boom’ and to deploy them in the national developmental interest are important foundational components of an effective strategy to achieve growth and equity. In the case of Brazil, the socially useful appropriation and application of resources, mainly through earmarked taxation, have facilitated the alleviation of poverty through conditional cash transfer programmes and, to an increasing extent, through accelerated spending on education.
- Brazil shows the effectiveness of exploiting underlying natural comparative advantages in agricultural and minerals sectors as a platform to move up the value chain and to add value to base commodities through technological and managerial/logistics innovation. Significant examples of this are provided in the offshore oil exploration and production sector and in Brazil’s export-intensive agribusiness sector.
- Social policy in Brazil evolved from a focus on pensions and older groups to increasingly ‘productivist’ social policies with a strong focus on human development, and specifically human capital accumulation. It will be important for countries in Africa with a younger demographic profile to prioritize human development. Brazil shows that a ‘productivist’ orientation for social policy does not delay significant outcome gains in terms of poverty and inequality.
- The fact that Brazil’s growth rate remains constrained by supply-side inelasticities stemming from under-investment in education and infrastructure, shows the scale of the ambition needed for policies in these areas. Both the Lula and Rousseff administrations have striven to address the infrastructural issues highlighted here through the Growth Acceleration Programme, the *PAC*. However, due to financial and regulatory constraints, progress has been comparatively slow particularly in the fields of transportation and electricity infrastructure.
- Examining the lessons for African from Brazil’s economic and social policy also point to significant gains from south-to-south policy engagement.

## 5 Conclusions

There is a growing interest in Brazil’s success in combining economic growth with large reductions in poverty and inequality. Interest has gone hand in hand with a more prominent role for Brazil in the global economy and institutions. Is there a Brazilian model of development other developing countries could emulate? The paper has argued that Brazil has implemented distinctive economic and social policies since the early 1990s which set a new course for its economy and society. It is perhaps too early to say whether these policies constitute a new developmental model.

What is distinctive about Brazil is the fact that a renewed social contract or political consensus, beginning with the stabilization plan in 1993/94, has created the conditions for a unique combination of economic and social policies to emerge and evolve in ways which reinforce favourable outcomes. The paper has reviewed the main economic and social policies and pointed to their grounding in this consensus.

The global commodity boom has contributed to the growth of the Brazilian economy, but it is unlikely to explain the large improvement in economic and social indicators. The complexity of Brazil's tax system makes it particularly difficult to reform. The introduction of new taxes on financial transactions and sales to support an extension of social policy in the early 1990s generated, in the context of high growth, a large expansion in fiscal space. Social expenditures grew in both absolute and relative terms, enabling inclusive and innovative social policies to expand without adversely affecting existing constituencies. The productivist orientation of new social policies supported growth.

In terms of economic reforms, the period since the start of the 1990s has seen the unfolding of a programme of market and trade liberalization. These supply-side reforms have served to open up the economy and are largely responsible for the surge in inward investment which Brazil has experienced. While the result has been greater economic flexibility, there is no doubt that microeconomic reforms are still a work in progress; there remain substantial bottlenecks, not least in relation to transport and energy infrastructure. Productivity growth in Brazil has also lagged behind that of other major emerging economies despite economic liberalization.

Still, these concerns aside, the specific combination of economic and social policy at the core of Brazil's success merits close attention by other developing countries, and African countries in particular.

## Appendix: A basic framework integrating economic and social policy

As argued in the paper, a distinctive feature of the emerging Brazilian model since the mid-1990s has been the particular combination of economic policy (financial stabilization, export promotion, fiscal expansion) and social policy (education and health reforms, expansion of social transfers, minimum wage upgrade). Social policy was fully integrated as a core component of the model, as opposed to the complementary, and compensatory, role it enjoyed in previous periods.

A simple model, adapted from Tomassi (2010) could help to pinpoint the distinctive role of social policy in Brazil. He considers the optimal role of social policy in a two sector economy. One sector, we could call it low-tech, exports to highly competitive markets where competition is primarily on prices and therefore costs. The other sector, referred to as high-tech, competes in the world economy on the basis of product quality and innovation.<sup>9</sup> Social policy consists of institutions and programmes which have costs  $C$  and benefits  $B$  for the two sectors. The costs are the same for the two sectors and consist of mandatory contributions to the government to finance social policy and additional labour costs, for example additional costs associated with employment regulation. Denoting mandatory contributions as  $t$  and additional labour costs as  $w$ , they are assumed to be an increasing function of social expenditure  $S$ , as in:

$$t = t(S) \text{ and } w = w(S) \quad (1)$$

The benefits  $B$  are dependent on social expenditure  $S$ , and the type of institutions tasked with implementing social policy. The type-of-institutions variable is intended to highlight the implications of the institutional environment to the economy. It is not just to do with the effectiveness of institutional processes, but also with their fit and public support. Both the varieties of capitalism and the welfare regime literatures study the distinct institutions observed for high-income countries, even within Europe. The influence of the type of institutions could help explain why OECD countries fail to show a direct correlation between levels of social expenditure on the one hand and growth or welfare outcomes on the other. Benefits for low- and high-tech sectors are assumed to depend positively on social expenditure  $S$  and positively or negatively with institutions  $W$ , as in:

$$B_k = B_k(S, W) \quad , \text{ where } k=L, H \quad (2)$$

In Acemoglu et al.'s (2006) endogenous growth model, the rate of growth  $A$  in the economy is made to depend on the productivity of the low- and high-tech sectors. Productivity in the low-tech sector is assumed to depend on the rate of adoption of established technology  $l < 1$ , which itself denotes competitive advantage. Productivity in the high-tech sector depends on innovation skills  $h > 1$ .

Incorporating the effects of social policy on the productivity of low- and high-tech sectors yields:

$$\begin{aligned} l &= l(B_L, t, w) = l(S, W) \\ h &= h(B_H, t, w) = h(S, W) \end{aligned} \quad (3)$$

The impact of social policy on growth, including a term  $\alpha$  to take account of the degree of competition in low-tech export sector, can be set as:

$$A = \alpha l + h = \alpha l(S, W) + h(S, W) \quad (4)$$

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<sup>9</sup> Tomassi (2010) grounds his model on an endogenous growth model presented by Acemoglu et al. (2006).

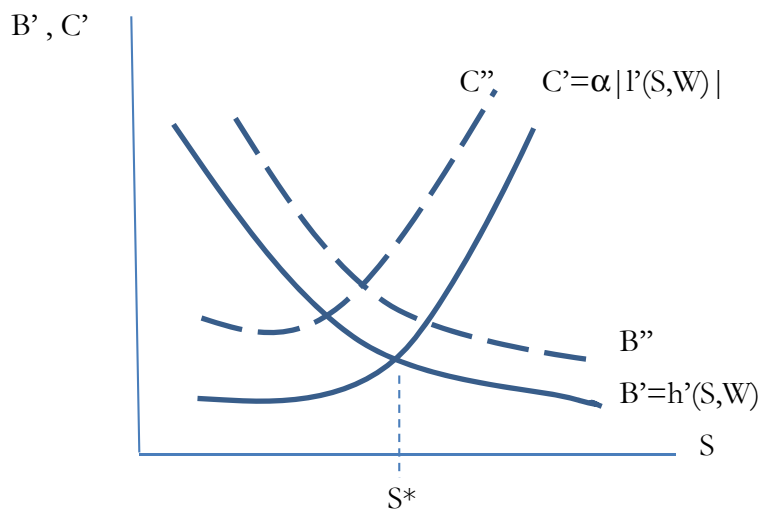
Tomassi (2010) assumes, in the context of high-income countries and globalization that the costs of social policy are more damaging for the low-tech sector which competes on prices and therefore production costs. He also assumes that the benefits from social policy are greater for the high-tech sector, for example in terms of reducing the potential losses from risky innovations and preventing a brain drain to countries with institutions providing greater security. Maximizing (4) with respect to social expenditure  $S$  yields first order conditions as follows:

$$\alpha l'(S,W) + h'(S,W) = 0 \tag{5}$$

$$\alpha |l'(S,W)| = h'(S,W) \tag{6}$$

Appendix Figure A1 below depicts these relationships:

Appendix Figure A1: Optimal social expenditure level consistent with growth maximization



Source: Authors' elaboration.

The figure also shows the effect of changes in the costs and benefits. Changes in competition in low-tech global markets ( $\alpha$ ) as in  $C''$  in the figure can work to increase or decrease the costs of social policy and therefore shift the optimal level of social expenditure. Greater effectiveness of social policy will enhance its benefits for a given level of social expenditure, as in  $B''$  in t Appendix Figure A1.

Changes in social expenditure  $S$  and institutions  $W$  are rarely straightforward and can involve complex and protracted political processes. Changes in  $S$  involve changes in the financing base for social policy. Changes in  $W$  are difficult to effect where existing interest groups have incentives to veto or attenuate reforms or where path dependence is strong.

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