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THE CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE
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**PROMOTING INSTITUTIONAL REFORMS IN
LATIN AMERICA**

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DAY ONE**

[TRANSCRIPT PREPARED FROM TAPE RECORDINGS.]

MR. DIAS [Interpreted]: I will make all the usual thanks. I would like to thank the organization for the invitation to come here and for the opportunity of enjoying the other sessions since the first presentation this morning, and I will be here tomorrow, too.

I would like to share with you my perplexity in terms of assessing what is happening with two equally important reforms in Brazil. These reforms are the social security reform and the tax reform.

Those who are not familiar with the Brazilian social security, our social security works in the cash flow regime, so it is not actuarial. It is not a matter of funds where I can take out the yield of my fund investments. So this is also all cash. Some pay other receipts in the same month. There are two parallel flows. So in this, it is almost like the fiscal flow. I pay in taxes on the one side, and I have expenses on the other side.

So these are two reforms that have one characteristic in common, and both of them redistribute resources. There are the expenses that benefit some groups in pairs, forget others--anyway--and receive taxes from different groups in the society.

Our social security system also has very clear characteristics of the same type, from whom I receive and to whom I distribute. These are both the public social security and the private social security, or private pension plans.

I think that a case that is extremely rich to be analyzed in terms of large institutional reforms is what happened after 1995. The two discussions are evolving in a very asymmetric way. Everything that happens in Brazil is slow. Changes are slow if they are conducted in a democratic environment. All important reforms that we had, the more radical ones, were all within authoritarian regimes, all of them dictated by the central power, from the creation of income tax and all the rest of the things that we had in Brazil; they were always granted in the moments, the peaking times, of authoritarian processes when they were at the peak of their glory, including the creation of our social security system. This is also part of this process.

But what is it that calls my attention--since 1995, there were several attempts to reform social security. They failed in the beginning of the Fernando Henrique administration; then, a second trial, and at every time we reached a final decision making process at the Congress, some important concept was a barrier to the change of the system, and a new concept that had to be introduced in the system to open a perspective of a different solution was slowly introduced at each of these reforms.

So none of these tests was useless, none of these trials. They always advanced by providing more flexibility to the negotiation

process and finding a new way of exit. If we examine this new change that was approved by the Congress, you give the government the characteristic that it may tax the income of retired people, and therefore, may tax it progressively, the income of retired people, those who have a pension, differently from--well, it may reduce the right to a net amount the person is entitled to provide a universalization of the social security benefit to the entire population.

The pensions were untouchable in the past, and this made the discussion very rigid and prevented progress. Now this principle has become constitutional.

Another criterion that was very well-defined in the three last, more serious attempts at reform are, first, that the right that has been acquired is acquired--we are not going to touch it. The three items that the executive branch brought to the Congress, all of them provided for breaching these rights, and this could not be approved by the Congress. Also, the age of retirement, there was resistance to the first attempt, and now it passed, because you just had to look at what is happening to the population--aging, longevity--so we had to change the date of acquiring these rights. Things have changed this time. So that strong resistance that we had against the process has changed, and now age has been determined at 60 years--60, 65--is it 60--yes.

So resistance in the system was broken. And if you put a few more years there, you can balance the current projection of the social security. We are therefore redistributing those accounts, reducing the privileges of a few that we had in the system, and going in the direction of universalization.

The only thing that is happening--and this may be a good thing--is that not everything is approved at a time. People have a world of ideas on how to solve the problem of social security. We start a comprehensive discussion, and then it is channeled into fundamental points. But what is interesting is that the fact of having discussed this subject for eight, nine years was not in vain.

So in this time, from the viewpoint of principles, what rigid principles that you remove from the Constitution, we reached a lot. Although the numbers are still not satisfactory, we know that the principles were broken.

I think that the basic concepts were, all of them, touched. We are talking about those absurd benefits for the public sector retirement, and we studied the private security, and things will converge. The public sector cannot have these absurd privileges. This has already been removed from the process.

So to a certain extent, I feel optimistic. When we take a look at the tax reform, we are desperate, because we think there is no

solution for Brazil, the country is going to explode, everything will be finished, because we don't see any evolution of this system. I could say that there is an involution. If you look at the last result that is going to be confirmed by Congress, we can say that it went backward; it is worse now than it was. Inconsistencies of the political discourse and the result--nothing like that happens with social security. If you see the discourses, they are the same as the results, appointed by the results.

We see transparency and the consistency between what is in the discourses and in the decisions. The tax reform doesn't do the same thing. The little transparency that we have in the tax issue is also embedded here. Why have these things been approved and other things not been approved?

Let's stop a little bit and take a look at what is happening. I am not going to talk too much about the disasters of 1988 because of the presence of Mailson here, and as he said everything I would say now at that time; I am not going to repeat them--the horrors that were embedded in the political process that led to the constitution of '88.

At a certain point, it loses rationality, and it becomes an agglomerate of Articles in the Constitution that ensure rights that existed in the past to some group in society. And there are other parts that are advances in the constitutional process.

On the fiscal side, let's see what is happening and look--these are absurd paths. In the fiscal process of the 1990s, the central state reacts to what the '88 Constitution had established, that in fact it limited the expenses of the federal government, imposed many transfers to the state governments as a sign of decentralization in public expenditures, and the federal government starts to respond or to react, and it creates taxes--or "contributions," as we call them here--that it doesn't have to share with the other units of the federation of states, trying to accommodate the pressure of expenses from the federal government, including those that happen because of the interventions of the central government in the state governments and the lack of control of some states in their purchases and debt. But they deny it. This is the decentralization line. The political process had made a decision in the decentralization line and the federal government that is discretionary, and it pushed things to the other side.

In the project that is being approved, we are getting to an extreme case of this system. With two contributions that are called "pis" [phonetic] and "cofins" [phonetic] to taxes, we are creating one tax that has an [inaudible] quote of 9.2 percent, that is a high level, and it is going to be charged in a way that we called noncumulative way, so at different stages of production, it is not going to insight in a successive way--it is going to fall once. The law says it is one time, but it is not, because it is going to insight on one level of the production chain at an

[inaudible] quote that will compensate for the multiple incidences we had in the past.

But at the same time, the tax was extended to trade, to the trade activity, so in fact this is not an incidence; it is a tax with a basis that is very similar to the indirect tax that we have, the added value tax that we have.

So after the Constitution, a cycle was finished, and we have a federal government with a tax of 9 percent. Therefore, competing with the basis of the state government with added value taxes at an average of 15 percent. Therefore, we are reaching a limit of the largest part of the Brazilian collection of tax where we are reaching a very high level of taxation, an average [inaudible] quote extremely high on the system when you add up all the taxes, and in a direction that is inconsistent with the discourse and the demand that comes in our democratization process, that there is a distribution of power, there is a distribution of powers between the central government and other governments in the system.

So the level of conflict is increasing, and therefore, the schizophrenia between what we do and what we say is also increasing, and this is converging to an [inaudible] quote that is infeasible in an open economy. You can't charge this set of taxes on the internal market.

Another point I want to discuss in the tax structure regarding the last decisions that were fantastic. Because of interests and ways that were used to write the legislation, when these taxes were created, lawyers and judges decided that this "pis/cofins" [phonetic] could not fall on imports. Everything pointed in the direction that you needed to do that, but the way these taxes were written ended up making it that in practice they were not charged for imports. But our tariffs came from 30, 40 percent, many prohibitions of importing products or discretionary rules for import licenses. We arrived to a system of tariffs with an average [inaudible] quote of 14, 15 percent, and with large sectors of the economy that had [inaudible] quotes of less than 10 percent.

Now, this tax, "pis/cofins" [phonetic], insights from the legal viewpoint, in a clear and undoubted way on imports, so these represent a net addition of 9.2 percent on all import tariffs of the country. It is an incredible increase--70 percent on the average [inaudible] quote for imports.

Another characteristic is why is it that this federal tax was not cumulative. Well, pressure groups were essentially exporters because they were exporting this tax with the product that was exported, and there was no way to get it back from the federal government. Now, when it was written, it became very clear that it generates fiscal credits, and therefore, no exporter will have to pay this tax.

Therefore, if I create an across-the-board tax on all imported products, and I relieve a fiscal burden on all exported products,

according to the theory, I learn this is the same thing as exchange devaluation.

Therefore, we are introducing a nonmarginal change, a large change, that touches the relative prices of the entire economy using this tax. This didn't come up in the discussion except for some analysts who wrote a few articles in newspapers. But nobody cared. Nothing of this has become transparent in our discussions. And the final version is going to be voted on next week. The first was yesterday. This is going to be the last one. It is going to decide the process.

So there is a huge movement in the process without the corresponding discussion. The principle that we can see after these changes in the tax system is the opposite of the spirit that we see in all political discourses in other positions of the dominant political parties, so other people are deciding about this, and they do not talk about it. They are not being called to say what is happening, what decisions they are making. Since I can presume that the entire Congress is made up of a group of ignorant people who don't understand anything about what they are deciding upon, obviously, this is not the case, but the discourse is different. We are going in the direction of hypocrisy in this fiscal discussion, extreme level of hypocrisy of saying many things and at a certain level, other types of things are negotiated, or some set of results is imposed with no discussion along the process, completely of what happened in the social security reform. There, the discourses, the principles, the advances, are consistent and coherent. Political positions are clear. Resistances are also clear. Public officers tried to go into strike and were not able to do it, so they could no longer impose their position on the Congress' decision. But they did try it. They called everybody for a strike, but it didn't bother those--it didn't disbalance the discussion, it did not reach the public opinion or the majority of representatives. And the process changed.

And why is it that in the tax reform in a country that has a tax structure that is part of our very bad income distribution, a country where this tax structure contributes significantly to the bad income distribution that we have, why does it happen in this country?

To give you another example on the part of the production sectors of the chains where I work mostly, can you imagine what is going to happen to the cost of food next year? Our agricultural industry in agribusiness is notoriously the most competitive part of the Brazilian economy. We produce, we export primary products, and we also export manufacturing products in the agrifood chain. We are the major exporter of pulp in the world. We process wood in energy. We use these resource fantastically. You produce fuel from agriculture, and they have market prices, competitive prices, in this process.

So we are the only country in the world that produces a significant volume of fuel for cars at competitive prices compared to oil.

So if I perform that change in the import tax, and if I make the change in the net result of products exported, the industry that will have to change relative prices is the agricultural industry. There is no question about it--prices go up, profitability of exporters increases, and the domestic market will be punished because it is going to have to pay all the tax burden. Imported products have a higher import [inaudible] quote. Bread [inaudible] will have to go up at least 10 percent; otherwise, how can we import wheat at a higher tariff and produce bread in this system? And the entire export agriculture in Brazil, that is huge, sophisticated, responds very rapidly to any stimulus, gained a premium of over 16 percent in the export [inaudible] quote.

And whatever I sell domestically will be taxed at least 9 percent of its end value. It is a huge fiscal burden. Or, the worst of the explanations--everybody will continue to make believe that there is no fiscal revision in Brazil. Everybody will make believe that there is no fiscal corruption, that there is no fantastic fiscal corruption that protects levels of fiscal revision that are unbelievable in some production chains; in others, there is no such thing. This is a very asymmetric process. There is no symmetry when you compare one region of the country to the other, one process to the other. This is clearly a process of clandestine agreements that define these types of situations.

So we are making believe that all of it will continue to exist with no transparency at all, because during this last year when we discussed this measure, no one made the calculations in putting an estimate of fiscal revision that we have today in how much I would have to change [inaudible] quotes to try to avoid fiscal revision to remain at the same level it is today. No authority that participates in this process, no production class authority, touched this point, with the exception of a recent article by former Minister Del Finato [phonetic] in the newspapers, and very likely in a very cryptographic language, that only the initiates could understand what he meant.

Therefore, in a certain way, he perceived that he had to be very careful when he mentioned this, because this is not accepted in the system that prevails of the interests and games that we have in the system.

So my question is why do we have these types of situations? What are the actors that are playing this game? What is the level of authority they have to conduct this discussion? How can they end a decision-making process that reflects circumstances that are completely different, one that contributes to chaos, to incredible confusion in the future--it is going to be much more difficult to negotiate a tax reform after the decisions that have been made now--and another cycle of decisions in the case of social security that are clearly going in the direction of a solution; they are clearly pointing out that the negotiation spaces are becoming more and more flexible, and there is more and more possibility of solving the problem in the medium term. And in the tax reform, we are going to see a huge confusion, a shock,

and a change that is not going to be negotiated, because there will be no way of negotiation and articulation to produce a solution to this problem.

I think I have finished.
[Applause.]