Council on Hemispheric Affairs
Director Larry Birns
2501 Calvert Street NW
Suite 401
Washington, DC 20008 USA
T: (202) 223-4975

Temer Clings to Reform Measures and Political Power

By Madeline Asta,
Research Associate at the Council on Hemispheric Affairs

When Michel Temer assumed the presidency in 2016 after the illegitimate impeachment of former President Dilma Rousseff, he immediately focused his attentions on new economic reforms. For the past two years, Brazil's economy has seen negative gross domestic product (GDP) growth, which has thrown the country into a recession -- the worst it has seen in recent history.[i] In an effort to bring the economy out of the recession, Temer has enacted multiple austerity policies aimed at tightening public spending and increasing taxes. However, these policies have been met by public outrage and congressmen have challenged recent tax hikes. While the Brazilian economy has seen GDP and inflation improvement since the beginning of 2017, there has been little tangible improvement in the society. Public services are failing due to lack of funding and the fiscal deficit is at its highest point since 1997.[ii] With the *Congresso Nacional* (National Congress) preoccupied by corruption scandals, there has thus far not been discussion to find effective reforms aimed to reduce the deficit, and Brazilians still suffer from high socioeconomic inequality. As Temer faces corruption allegations of his own, he is only able to hold onto his political power through his promise of economic relief. Even though Congress recently voted to protect Temer from corruption charges, if his policies show signs of weakening, his congressional allies will most likely abandon him should further charges be brought forward. In order to truly improve its current economic, political, and social structure, Brazil needs progressive tax reform and an end to corruption; furthermore, any reform must also be accompanied by effective public expenditure measures and cannot be clouded by excessive political maneuvers.

The Evolution of Austerity Under Temer

Temer's first course of economic action when he became the *de facto* president was passing the PEC 55 amendment in December 2016, which capped increases in public spending at the inflation rate, allowing for no real increase in public spending, for the next twenty years. However, this public spending cap did little to fix Brazil's large fiscal deficit, which has continued to increase in the first six months of 2017 despite the budget cuts.[iii] During these past six months, government tax revenue has fallen by 1.2 percent while government spending has increased by 0.5 percent, adjusted for inflation.[iv] On July 20, Temer used these statistics to justify his latest decision to raise revenue by doubling fuel taxes, announcing a new freeze on public spending, and increasing the payroll tax.[v] Temer froze an additional $5.9 billion Brazilian *Reais* ($1.89 billion USD) in public spending in an effort to match government tax revenue, and the fuel tax -- which was increased from R$0.38 ($0.12 USD) to R$0.41 ($0.25 USD) per liter -- was challenged by congressmen and brought to court, but remains in place.[vi] Temer has implemented tax increases due to the difficulty of passing reforms through congress and his inability to further reduce spending -- as he has already cut public spending to the point that, as of now, most public payments are constitutionally mandatory.[vii] However, raising taxes in a regressive tax system such as Brazil's, where sales and fuel taxes force low-income Brazilians to spend a larger percentage of their income on taxes than high-income citizens, is not a sustainable method of increasing government revenue.

Temer entered office seeking to pass pension, labor, education, and tax reforms, supposedly to restructure and resurrect Brazil's economy.[viii] However, reforms proved difficult to pass through congress, due to their social implications for the lower class and congressional preoccupation with corruption scandals, and Temer moved onto other measures to tackle the country's large fiscal deficit. Prior to Temer's latest economic measures, the 2017 budget had already been cut by R$39 billion ($12.5 billion USD), compared to the 2016 budget.[ix] Nevertheless, this additional reduction still does not seem sufficient to meet the 2017 fiscal deficit target of R$139 billion (USD $44.5 billion).[x] Instead, according to a Finance Ministry economic survey on July 13, the deficit is predicted to only reach R$145.3 billion (USD $46.3 billion) by the end of 2017.[xi] In order to reach the fiscal deficit target, Temer is hoping to pass pension reform; however, the proposed reform has been met with opposition from both congress and the public due to its harmful implications for senior citizens.

Government spending costs are estimated to account to R$284.5 billion this year, the second largest expenditure of the Brazilian government, behind social security payments.[xii] Before debt payments, pensions account for almost half of government expenditures, and in 2016, social security spending totaled 8.1 percent of GDP, and is set to reach 17.2 percent of GDP by 2060.[xiii] Temer sees pension reform as the most efficient way to cut back the country's fiscal deficit, but economic reforms need congressional approval before they can be adopted. Congress is currently debating a pension reform bill that seeks to raise the retirement age from 54 to 65 for men and 62 for women.[xiv] While congressional debate has been stalled due to *Operação Lava Jato* (Operation Car Wash) investigations, citizens have organized large protests and strikes to show their disapproval of the bill. In April, prison guards stormed a congressional committee room and workers organized a nationwide austerity strike.[xv] In a survey conducted by *Datafolha* in May 2017, 71 percent of voters opposed the reform bill.[xvi] Temer sees reform as an alternative to massive tax increases, but voters do not share this same viewpoint. Despite Temer's efforts, Brazil's fiscal deficit is targeted to remain high throughout the year, and as Temer continues to impose austerity policies, Brazilians are forced to live on fewer and fewer public resources.

Reshuffling of Public Funds

With Temer's tight economic policies, public service departments have seen their funding significantly decrease. As a result, Brazil's federal police (*Polícia Federal*, PF) was forced to limit air rescue services, cease issuing passports, and refrain from paying many employees.[xvii] Faced with the stark economic realities his policies have created, Temer announced on July 27 that he would divert R$2.2 billion (USD $700 million) that were initially intended for infrastructure projects to public services – air traffic control, civil defense, and the *Polícia Federal*.[xviii] Gil Castello Blanco, founder of Brazilian non-governmental organization *Contas Abertas*, asserted that the recent money diversion demonstrates that the current economic structure has made it "almost impossible" to bring economic growth through investment alone.[xix] When pursuing his economic goals, Temer saw public services as an outlet for budget cuts, primarily due to the focus of the last two leftist administrations on providing support for the nation's poorest. However, the reduced funding has forced many public services to stop functioning, impeding efforts for national economic growth and public improvement.

Economic Recovery

Despite the hardships still felt by many Brazilians, the country's economy is still predicted to grow at 0.3 percent this year, according to the International Monetary Fund (IMF).[xx] This growth comes after two years of economic contraction, and can be largely credited to Temer's restrictive economic measures; however, this does not mean that Brazil's economy is back on track. GDP growth is not the only measure of development and doubt exists that these policies will be sustainable throughout the year; therefore, any further economic or social recovery will be slow and weak. According to the Organization for Economic Cooperation and Development (OECD), should Temer's policies hold, unemployment is not expected to decline until the end of the year and even then will decline sluggishly.[xxi] So far in 2017, inflation has decreased significantly and is predicted to fall 4.5 percent below the target rate.[xxii] However, this decrease is largely due to a decrease in demand for goods and services, as Brazilians have cut back on their consumption due to the severity of the recent recession.[xxiii] In order to truly improve the economy, Temer must focus on increasing consumer consumption again, but this will be difficult to achieve while pursuing his strict economic policies.

The Future of Brazil's Economy

Looking solely at GDP growth and inflation rates, Brazil's economy may have improved since Temer assumed the presidency, but inequality and public discontent remain high. As the fiscal deficit remains high and the reduction target seems unattainable, more cuts are possible in the future. Conservative government officials largely support the cuts and are using their political authority to pursue personal agendas. Torquato Jardim, Brazil's Justice Minister, sees the budget cuts as an excuse for the *Polícia Federal* to restructure their operations and adapt to lower funds.[xxiv] Furthermore, Jardim has used Temer's handling of the fiscal crisis as an opportunity to call for the dissolution of *Operação Lava Jato*'s task force.[xxv] However, Jardim acted without consulting the *Polícia Federal* and discussing how best to modify the department's spending. Dyogo Henrique de Oliveira, Minister of Planning, declared all departments will need to lower spending, but he made one exception for healthcare.[xxvi] Brazil's government is unified on the issue of fixing the economy and cutting government spending, but there is large disagreement regarding where best to cut back.

As Brazil's political stability continues to be tested with corruption scandals, congressmen remain behind Temer hoping that his policies and reforms succeed in improving the economy. On August 2, Congress voted to reject corruption charges made against Temer, but support for the *de facto* president remains contingent on economic progress.[xxvii] Congressman Eduardo Cury, the vice-president of the *Partido da Social Democracia Brasileira* (PSDB) – the largest party in the governing conservative coalition – stated, "our commitment at this point is only to back the reforms. If we see that they are not advancing, then we should quickly look for an alternative government."[xxviii] To the government and his few supporters, Temer "represents reform and a return to a normal economy."[xxix] Therefore, despite the accusations of corruption, Temer remains in power due to the support he has from congress and legislators fears of being indicted themselves. Should his economic policies fail to bring the desired outcome, his legislative support will desert him, as more corruption charges are likely to come forward in the future. Nevertheless, in the chance of his indictment, no ideal replacement exists for Temer at this time, as corruption allegations have filled congress and no qualified candidates have stepped up to fill the position until the 2018 elections.

Despite the recent show of support from Congress by rejecting Temer's corruption charges, his political immunity remains weak -- especially if new corruption charges emerge or his economic policies do not give desired results. Brazil's economy is recovering after two years of a recession, but the recovery is weak and at risk of reversal if public services remain unfunded and the fiscal deficit is not addressed. Furthermore, the current political instability in Brazil, caused by sweeping charges of corruption, creates economic uncertainty. Brazil needs a budget reform that aims to reorient social spending to be more efficient, not limiting it at the expense of Brazilians' wellbeing. The most effective reform could come from a tax reform, to create a progressive system that does not force poor Brazilians to spend larger percentages of their income on taxes than wealthy citizens. Furthermore, many Brazilians rely on government expenditures for cash transfers, education, and healthcare. If Temer makes further moves against these services, there will be massive public response that will likely threaten both his political legitimacy as well as any semblance of economic progress made by the *de facto* president.

By Madeline Asta,

Research Associate at the Council on Hemispheric Affairs

Additional editorial support provided by Aline Piva, Research Fellow and Head of Brazil Unit, Liliana Muscarella Research Fellow, and Sheldon Birkett and Martina Gugliemone, Research Associates at the Council on Hemispheric Affairs

[i] Cascione, Silvio. "Brazil's worst-ever recession unexpectedly deepens in late 2016" *Reuters*. March 7, 2017. http://www.reuters.com/article/us-brazil-economy-gdp-idUSKBN16E1EL

[ii] LatinNews Daily. "Brazil posts record high fiscal deficit" *latinnews.com*. July 27, 2017. https://www.latinnews.com/component/k2/item/72979.html?full=true&period=July%202017&archive=3&cat_id=808294:pensions-crisis-intensifies-in-el-salvador

[iii] Ibid.

[iv] Ibid.

[v] Ibid.

[vi] LatinNews Daily. "Brazil raises taxes and slashes spending in austerity drive" *latinnews.com*. July 27, 2017.
https://www.latinnews.com/component/k2/item/72910.html?period=July%202017&archive=3&Itemid=6&cat_id=808213:brazil-raises-taxes-and-slashes-spending-in-austerity-drive&Itemid=6

[vii] LatinNews Daily. "Brazil posts record high fiscal deficit"

[viii] Leahy, Joe. "Temer stays tough on Brazil economic reforms" *Financial Times*. February 2, 2017/ https://www.ft.com/content/9d8a1286-e805-11e6-893c-082c54a7f539

[ix] LatinNews Daily. "Brazil raises taxes and slashes spending in austerity drive"

[x] LatinNews Daily. "Brazil posts record high fiscal deficit"

[xi] Ibid.

[xii] Boadle, Anthony. "Brazil plans federal workers' buyout to cut deficit" *Reuters*. July 24, 2017. https://www.reuters.com/article/brazil-economy-budget-idUSL1N1KF1RP

[xiii] Marcello, Maria Carolina. "Brazil pension reform clears hurdle, faces tough approval path" *Reuters*. May 3, 2017. http://www.reuters.com/article/us-brazil-politics-pensions-idUSKBN17Z1RF

[xiv] Ibid.

[xv] Ibid.

[xvi] Ibid.

[xvii] LatinNews Daily. "Brazil moves to revive public services following budget cuts" *latinnews.com*. July 28, 2017.
https://latinnews.com/component/k2/item/72998.html?full=true&period=July%202017&archive=3&cat_id=808320:venezuela-on-edge-ahead-of-constituent-assembly-election

[xviii] Ibid.

[xix] Ibid.

[xx] LatinNews Daily. "Brazil posts record high fiscal deficit"

[xxi] "Brazil - Economic forecast summary (June 2017)" *OECD*. 2017. http://www.oecd.org/eco/outlook/brazil-economic-forecast-summary.htm

[xxii] Ibid.

[xxiii] Ibid.

[xxiv] LatinNews Daily. "Brazil moves to revive public services following budget cuts"

[xxv] Ibid.

[xxvi] Ibid.

---

xxvii Boadle, Anthony. “Brazil’s Temer wins Congressional votes to block graft charge” *Reuters*. August 1, 2017. https://www.reuters.com/article/us-brazil-corruption-temer-idUSKBN1AI09B

xxviii Boadle, Anthony and Alonso Soto. “Rosier economy, lack of replacement give Brazil’s Temer a breather” *Reuters*. May 31, 2017. http://www.reuters.com/article/us-brazil-politics-temer-idUSKBN18R2C2

xxix Ibid.