Strengthening the Middle Class in a New Brazil

By Ricardo Sennes
On the night of March 31, Brazilian President Michel Temer passed a controversial law. It grants Brazilian companies the right to outsource employees for any job and authorizes temporary contracts of up to nine months. For Brazil, this was the start of a revolution in redefining a rigid and costly labor market that offers strong protections to formally employed workers.

But the Brazilian revolution is not limited to labor laws: It includes far-reaching shifts such as upcoming pension reforms and a more outward-facing approach to trade. The goal? Creating a leaner, more efficient model of government. The question now: How can Brazil redesign its state without jeopardizing recent social gains?

It all starts with steady growth. Over the past twenty years, more jobs and higher wages reduced poverty. Now, on the heels of the country’s worst recession ever (8 percent contraction since 2014), Brazil will need to grow an estimated 3 percent per year just to keep its gains intact. Things are slowly getting back on the right track. The Central Bank expects growth rates of 0.5 percent in 2017, and 2.5 percent in 2018. That said, the government will also have to make some tough cuts. Massive public debt leaves little room for spending as in the past.

The present reality was unthinkable just a few years earlier. Today, more than 13 million Brazilians are unemployed. Almost 4 million people who had recently joined the middle class are again living in poverty. Although about 113 million people make up Brazil’s middle class—up 40 percent since 2003—almost 5 million are deemed vulnerable. If a family crisis hits, they lack the resources to provide for themselves. Cutting cost and reforms go hand in hand with strong support for the middle and financially insecure classes.

The phenomenon of the Brazilian middle class—and the example its social policies set for the region—is at a critical junction. Can the country sustain recent gains? What will it take?

In this Spotlight, we argue that the answer to preserving middle class social gains lies in addressing three fundamental areas: more modern and flexible labor market standards; quality of education; and increased access to credit and private insurance.
Brazil is still a very closed economy. Its transformation is urgent and will require more than overcoming the recent crisis. Beyond responding to cycles of growth and recession, Brazil must integrate with the rest of the world and become better capable of responding to global changes ranging from trade to innovation.

Domestic growth stabilized Brazil’s economy for years. But the 2014 recession showed Brazil cannot have sustainable growth without opening its doors to the world. To Brazil, more trade means more inclusion, as it connects more players and industries to new markets. The opportunities are there. As countries in the region move toward integration, regional supply chains could turn into hubs of trade and progress.

As the engine of the Southern Cone, Brazil has the potential to steer the region in a new direction. To do this, Brazil must reconfigure its business culture. It must cast aside old protectionist barriers and embrace global production chains. Brazil’s large domestic market, today restrained by insecurity and recession, should bolster productivity by promoting more open policies and by focusing on innovation. Like it or not, the future of growth in Brazil is tied to its economic engagement with the world.

The future of Brazil — one based on a market economy, democracy, and social justice — hangs on its ability to modernize institutions and increase the country’s competitiveness. Stakes are high. Without change, Brazil risks a quiet isolation that could further impoverish the new middle class.

Brazil’s future growth is tied to its economic engagement with the world.
Brazil’s strict labor laws have enabled a market fraught with expensive hiring practices and low employment diversification. Tax burdens weigh heavily on employees and employers alike. Brazilian companies spend an estimated 120 percent of the salary paid to the employee on taxes, contributions, and fees. Overhead costs are tacked on to long and bureaucratic hiring processes.

To reconfigure this framework, Brazil must relax regulations on employment contracts. The new outsourcing law (Federal Law 13.429, known locally as “Lei da Terceirização”) signed by President Temer in March, as well as the broader discussion on labor law reform, promises to facilitate hiring. Proposed changes include relaxing limits to part-time work; regulating overpay; and legally recognizing decisions reached in negotiations between unions and companies—even when they don’t coincide with the law.

These reforms could reduce unemployment and ease transitions from informal to formal work. There is potential to expand the formal labor market. Alongside economic growth, reforms could boost the domestic market and the country’s average income, both important facilitators of social progress. Likewise, they may guarantee a more even distribution of legal protections and public benefits for every type of employee—not just for those in the formal sector.⁶

However, reforms come with risks. Top of the list is the potential to marginalize workers by reducing the average length of formal positions and reducing benefits. If the new jobs offered to the middle class shift to being temporary or include generalized, reduced rights, the country will have to compensate for income vulnerability. For the middle class, this means increasing access to credit and to private insurance markets and investing in education, as we detail below.

For the lower-income population, the answer lies with prioritizing effective social policies proven to increase development and reduce inequality, such as the Bolsa Família cash-transfer program.⁷ The federal government must discontinue policies with dubious social and economic returns. It must also dismantle the mechanisms through which corporations siphon off public funds. Many costly public subsidies have failed to produce viable economic results. This includes certain subsidies to the automotive sector and some wasted innovation benefits. Programs should have clear goals. Those proven to be ineffective should be redirected, leaving funds available to social policies that focus exclusively on the financially insecure classes.

If done well, labor reform could decrease unemployment and facilitate the transition from informal to formal work.
Brazilian education has improved dramatically. Today, we see higher enrollment rates and more investments. That said, challenges remain: Quality of education is low, and gaps between private and public education are apparent.

Much more can be done at every stage. While the need for a broader range of competencies is bigger than ever, Brazil has failed to ensure even the most basic education in reading and mathematics. In 2015, 44 percent of Brazilian students were “low achievers” on OECD Programme for International Student Assessment (PISA) reading, science and math tests. Only 14 percent of Argentinians and 23 percent of Chileans fell in the same category. In reading and math, Brazilians scored far below the OECD average, as well as lower than test-takers from countries in the region such as Colombia, Mexico, Argentina, Costa Rica, Uruguay, and Chile.

Forward movement on education requires embracing new teaching methods. A huge arsenal of technological solutions are at our disposal: information technology tools for science and math studies, e-learning platforms for languages, and many other mechanisms. If used strategically and on a wide scale, these tools could generate significant impact, particularly in rural schools, and in places experiencing a shortage of teachers and other education professionals.

In a more fluid job-market, a given for the new Brazil, the quality of public and private education plays an even more important role. Workers will need to be better prepared to transition among different jobs. This will require adapting quickly to career changes and to the new labor market, which will only be possible if Brazilians are offered a broader set of language and technological skills.
Proposed limits for retirement and social safety nets will increase society’s reliance on private-sector solutions. This is especially true for the middle class. These new models range from private social security systems and insurance, to private pensions and retirement strategies. The middle class must also be treated like an investor, for whom access to credit is paramount to investing in the future.

The trend moving forward includes restricting social welfare programs to those at the bottom of the social pyramid. For retirement benefits, for example, governments would guarantee a monthly income of approximately $1,100 (R$3,500) for the private sector and up to $1,600 (R$5,000) for public servants. Those interested in a higher income would look for private plans.

Today, the middle class needs more than the Brazilian market can offer. They need life insurance plans that cover parents until their children turn 25 (when contributions become private pensions), protect small business partners in case of another partner’s death, and provide for self-employed professionals who must survive the ups and downs of the market. The public sector cannot directly make available these benefits, putting the burden on the private sector to respond with new programs. Still, the government should enact the right public policies and regulatory incentives, such as lower taxes and fees. More financing from banks and public funds would also facilitate the development of this private insurance market.

Going forward, every member of the middle class should be considered an investor. An investor needs more access to credit. But a lack of financing opportunities makes it particularly difficult for small investors from the middle class. In fact, the country suffers from an overconcentrated credit market: Four banks hold almost 80 percent of the entire market, according to the Central Bank of Brazil. Lower access to credit increases credit costs in the form of higher interest rates imposed on customers. Ultimately, long-term credit lines depend entirely on public banks, which cater mostly to large entrepreneurs.

The Brazilian middle class cannot sustain itself in the long-run if current realities don’t change. The credit market needs to be much more open and flexible. It must combine opportunities from public and private institutions and encourage expansion of capital and venture capital markets. Implementing these changes will set Brazil on the right path forward.

Brazil is not alone in its challenges—every major global democracy will need to address similar problems sooner or later. Relying on protectionist policies ahead of the inevitable labor force transformations will not ultimately save jobs. Eventually, economies will need to adapt to a more flexible and uncertain scenario where entrepreneurship plays a pivotal role. In this new world, the public sector will be tasked with preparing its citizens to integrate into new economies and providing better means of survival to those at the bottom of the social pyramid. Brazil is already undergoing its transformation. Now is the time to discuss how this transformation can move the country toward the future it needs and deserves.
STRENGTHENING THE MIDDLE CLASS IN A NEW BRAZIL

Endnotes


4 The Brazilian middle class includes those who earn between four and ten times the minimal wage (of R$ 950, or USD 305), according to the Brazilian Institute of Geography and Statistics - IBGE


6 In Brazil, formal workers are registered with government agencies and have jobs officially listed by employers on their employee ID card. They are subject to labor laws and entitled to its labor rights.


The Atlantic Council is a nonpartisan organization that promotes constructive US leadership and engagement in international affairs based on the central role of the Atlantic community in meeting today’s global challenges.

1030 15th Street, NW, 12th Floor, Washington, DC  20005