

## **Some reflections on Brazil's approach to promoting austerity through a constitutional amendment.**

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My focus is on the question of whether EC-95 accords with Brazil's obligations as a State Party under the International Covenant on Economic, Social and Cultural rights ("Covenant"). Article 2 (1) of the Covenant requires State Parties to take steps "with a view to achieving progressively the full realization of the rights recognized" in the Covenant, and there is a strong presumption of impermissibility of "deliberately retrogressive measures." The UN Committee on Economic, Social and Cultural Rights ("CESCR") has established certain criteria by which to assess whether proposed austerity measures comply with that obligation:

"(a) there was reasonable justification for the action; (b) alternatives were comprehensively examined; (c) there was genuine participation of affected groups in examining the proposed measures and alternatives; (d) the measures were directly or indirectly discriminatory; (e) the measures will have a sustained impact on the realization of the right to social security, an unreasonable impact on acquired social security rights or whether an individual or group is deprived of access to the minimum essential level of social security; and (f) whether there was an independent review of the measures at the national level."<sup>2</sup>

The main thrust of these criteria is that policy responses to economic and fiscal crises do not escape the scrutiny of international human rights law. In making a decision on economic or fiscal reforms to be pursued, States Parties to the Covenant remain obliged to ensure that such a decision does not lead to the denial or infringement of rights guaranteed under the Covenant.<sup>3</sup>

In my view, EC-95 has all the characteristics of a 'deliberately retrogressive measure'. Although I understand that the Government is intent on not presenting EC-95 as a freeze on all federal expenditure for the next 20 years, that is in essence what EC-95 is: current total federal spending levels remain in place for the next 20 years, only to be corrected for inflation. While there is no specific limitation contained in EC-95 on spending on specific budget areas that are of most relevance from the perspective of economic and social rights, such as health care, education and social security, an overall federal spending cap will undoubtedly result in retrogression with regard to the realization of economic and social rights. If the realization of economic and social rights is reliant on public expenditure, and the size of the total public budget is not allowed to grow (except for

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<sup>2</sup> Committee on Economic, Social and Cultural Rights, General Comment No. 19, para. 42.

<sup>3</sup> Ariranga G. Pillay, Chairperson, Committee on Economic, Social and Cultural Rights, Letter to States Parties, 16 May 2012, <http://www2.ohchr.org/english/bodies/cescr/docs/LetterCESCRtoSP16.05.12.pdf>

inflation) for the next 20 years, logic dictates that it is virtually inevitable that the progressive realization of economic and social rights becomes impossible. Only exceptional circumstances, such as a sudden and significant decrease in the size of the population or the complete elimination of the budget for non-social spending (such as military spending) would allow for progressive realization of these rights.

Since there is a strong presumption of impermissibility of “deliberately retrogressive measures” under the Covenant, it is up to the Government to demonstrate why the measure in question (EC-95) is justified. As indicated above, the mere invocation of an economic or fiscal crisis does not set aside the international human rights regime, such economic or fiscal circumstances are only relevant in so far as they may provide a justification for a retrogressive measure. In the case of Brazil, it is clear that the country has been experiencing a severe economic and fiscal crisis and there is no doubt that the Government is fully justified in undertaking measures to address this crisis. My concern is focused on the question of the limits that international human rights law sets on Government measures to counter an economic or fiscal crisis, not on whether a Government may counter such a crisis in the first place, which is without doubt both the prerogative and duty of any Government.

In other words, the question is whether a deliberately retrogressive measure in the form of a 20-year federal spending freeze can be justified by the Government in light of Brazil’s current economic and fiscal crisis as necessary and proportionate. This matter is complicated and deserves a thorough examination. It is not sufficient to make general statements about the need for austerity and the unavailability of alternative measures.

First, as a general matter, it should be noted that research published by the International Monetary Fund on the effects of fiscal consolidation (policies to reduce government debt and deficit) in comparable situations gives cause for significant concern in the current context. This research concludes that “fiscal consolidations typically have the short-run effect of reducing incomes and raising unemployment”.<sup>4</sup> Empirical evidence suggests that cutting budgets during economic recessions may actually increase deficits while deepening and prolonging the recession, worsening unemployment levels and decelerating economic recovery.<sup>5</sup> Information provided by the Government to date does not justify how such likely short-run negative effects would be offset by longer-term benefits, but limits itself to general remarks about the positive impact of EC-95 on growth, inflation and employment.

Second, the Government in this context attempts to present EC-55 as a gradual reform, since it will be in place for 20 years. According to the Government, this 20-year frame prevents it from taking more drastic short-term measures, which would have had a more severe impact on public sector employment and social programs. But this threat of more drastic measures if EC-95 would not have been adopted does not justify EC-95 as such. What is more, it is unclear to what extent a 20-year long federal spending freeze

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<sup>4</sup> Laurence Ball et al., ‘Painful Medicine’, *Finance & Development*, September 2011, p. 21-22.

<sup>5</sup> Jaime Guajardo, Daniel Leigh, and Andrea Pescatori, *Expansionary Austerity: New International Evidence*, IMF Working Paper (2011), <http://www.imf.org/external/pubs/ft/wp/2011/wp11158.pdf>

can be described as ‘gradual’ when it makes it impossible for two decades to adjust federal spending to actual needs.

Third, the Government also maintains that the public expenditure cap was necessary to address a pattern of high income inequality and has referred to unspecified studies that attest that Brazil’s previous fiscal regime contributed to the concentration of income. More specifically, the Government claims that the previous structure of public spending replicated existing income inequalities. In response, I would first like to point out that if it were true that the existing composition of public expenditure contributed to keeping in place existing income inequality, it would be logical to have a discussion about the composition of existing public spending rather than about a 20-year federal spending freeze. A spending cap does not guarantee that public spending will be redirected towards those most in need and thereby address income inequality in Brazil. The unanswered question is why EC-95 would necessarily lead to public spending that is more redistributive to poorer segments of society than before.

Various studies indicate that spending-based fiscal consolidations worsen income inequality more significantly than tax-based consolidations.<sup>6</sup> According to one study, a spending cut of 1 percentage point of GDP was associated with an increase of about 1.5 to 2 percent in the Gini coefficient.<sup>7</sup> Experts’ opinions suggest that progressive taxation and social benefits are crucial components of a fiscal reform package in offsetting the adverse impact of fiscal consolidations on income inequality.<sup>8</sup> It also appears widely acknowledged that in order to foster economic growth and reduce inequality at the same time, it is crucial to have a broad mix of fiscal policy measures to adjust not only expenditure but also revenue, while introducing other structural reforms.<sup>9</sup> The International Monetary Fund has also stated that “...the redistributive role of fiscal policy could be reinforced by greater reliance on wealth and property taxes, more progressive income taxation, removing opportunities for tax avoidance and evasion, better targeting of social benefits while also minimizing efficiency costs, in terms of incentives to work and save.”<sup>10</sup> It is thus doubtful whether EC-95 would have the effect of reducing income inequality by arbitrarily placing a cap on the amount of social spending, which is empirically associated with higher levels of income inequality.<sup>11</sup>

Fourth and finally, I would like to stress that any austerity measure must be “a temporary measure covering only the period of crisis”.<sup>12</sup> Under international human rights law, a derogation from certain rights is permitted only if it is of “an exceptional and

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<sup>6</sup> Jaejoon Woo et al., “Distributional Consequences of Fiscal Consolidation and the Role of Fiscal Policy: What Do the Data Say?”, IMF Working Paper (September 2013), p.3; Pier Carlo Padoan, How to get it right: government balances, growth and income inequality, OECD Yearbook 2013, available at: <http://www.oecd.org/governance/government-balances-growth-and-income-inequality.htm>

<sup>7</sup> Jaejoon Woo et al., p.13.

<sup>8</sup> Ibid., p.3.

<sup>9</sup> Pier Carlo Padoan, supra.

<sup>10</sup> International Monetary Fund (IMF). 2014a. “Fiscal Policy and Income Inequality.” IMF Policy Paper, Washington.

<sup>11</sup> Jaejoon Woo et al., p.16.

<sup>12</sup> Ariranga G. Pillay, 16 May 2012,

temporary nature” and “may only last as long as the life of the nation concerned is threatened”.<sup>13</sup> In this regard, it must be noted that as a constitutional amendment, EC-95 is not a regular law and spans over a period of 20 years. Not only will this tie the hands of future elected governments, this raises questions about its necessity and proportionality. As budget laws are normally approved yearly, a budget cap spanning over 20 years would appear disproportional.

### *Consideration of Alternative Measures*

According to international human rights law, it is up to the Government to show that alternative measures were comprehensively examined and that the proposed measure is necessary and proportionate, in the sense that any other policy, or a failure to act, would be even more detrimental to economic, social and cultural rights.<sup>14</sup> It does not appear that this requirement has been satisfactorily met. There is no evidence that the Government exhaustively considered alternative policy choices and how it determined that EC-95 was a necessary and proportionate measure.

The only alternative policy choice that has been mentioned is an increase in taxation. As I understand the Government’s argument, there was no real possibility of increasing taxation since taxation levels were already ‘at record levels’. But it is unclear if the Government has considered other possible measures which may help address the budget deficit, such as promoting progressivity in the tax system, addressing tax evasion, and reducing the cost of servicing the public debt. According to some reports, combatting tax evasion alone could raise \$80 billion, a much higher figure than the projected fiscal deficit of \$50 billion in 2016.<sup>15</sup> In fact, Brazil’s ability to raise revenue remained weak between 2013 and 2015, and tax revenue fell significantly.<sup>16</sup> Some experts are thus of the view that the Government mischaracterized the economic crisis as a spending crisis when the problem actually lay in the revenue fall, and failed to explore appropriate solutions to the crisis.<sup>17</sup> In studying other alternatives, the government could also consider a wealth tax in the terms of the 1988 Federal Constitution (art. 153, VII: “imposto sobre grandes fortunas”). It is believed that wealth taxes can help in reducing inequality and increasing social mobility. An authority on inequality, Professor Thomas Piketty, suggested raising wealth taxes, including in Brazil<sup>18</sup> while a Brazilian economist suggested the Brazilian State could collect R\$100 billion per year through the wealth tax.<sup>19</sup>

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<sup>13</sup> Human Rights Committee, General Comment No.5, Article 4 (Derogations), paragraph 3.

<sup>14</sup> Ariranga G. Pillay, 16 May 2012; and Committee on Economic, Social and Cultural Rights, General Comment No. 19, para. 42.

<sup>15</sup> Plus 55, “Brazil Loses A Fortune To Tax Evasion” (7 July 2016), <http://plus55.com/brazil-business/news/2016/07/brazil-loses-fortune-tax-evasion>

<sup>16</sup> ECLAC, Fiscal Panorama of Latin America and the Caribbean 2016, [http://repositorio.cepal.org/bitstream/handle/11362/40090/S1600112\\_en.pdf?sequence=1](http://repositorio.cepal.org/bitstream/handle/11362/40090/S1600112_en.pdf?sequence=1), at 36.

<sup>17</sup> See: Economistas auguran aumento de desigualdad social en Brasil (3 November 2016), <http://www.prensa-latina.cu/index.php?o=rn&id=39083&SEO=economistas-auguran-aumento-de-desigualdad-social-en-brasil>

<sup>18</sup> <http://g1.globo.com/economia/noticia/2014/11/imposto-sobre-heranca-deveria-ser-maior-no-brasil-diz-piketty.html>

<sup>19</sup> <http://www.cartacapital.com.br/economia/imposto-sobre-grandes-fortunas-renderia-100-bilhoes-por-ano-1096.html>

The Government has indicated that society had rejected other initiatives to raise taxes, but fails to clarify what these initiatives were and why they were rejected and by whom. It is somewhat unconvincing that the Government proposed EC-95 against the backdrop of very significant protests from large parts of Brazilian society, but then claims that it could not have further explored the possibility of raising taxes because there was pushback from (unspecified parts of) ‘society’.

On the basis of the above, it seems clear that the Government did not fulfill the requirement of international human rights law to give full consideration to all alternative measures and to demonstrate that EC-95 was the most suitable measure in the circumstance to safeguard economic, social and cultural rights of the Brazilian population.

### ***The Impact of the New Fiscal Regime***

The assumption underlying the perceived positive impact of EC-95 is that it would foster sustainable growth, reign in inflation and promote full employment, which would specifically benefit the poor and vulnerable groups. However, these claims, as pointed out above, are very general and lack any reference to specific evidence of the likelihood of this effect. Fiscal consolidations tend to raise unemployment in the short term.<sup>20</sup> A study found that a fiscal contraction of 1 per cent of GDP raises the unemployment rate by almost 0.5 percentage point within two years.<sup>21</sup> Furthermore, fiscal consolidations are likely to hit hardest those who are already suffering the most – the poor and the long-term unemployed.<sup>22</sup> It is inevitable that spending-based consolidations affect lower income groups, as a large portion of their disposable income often comes from public spending and they are more vulnerable to loss of employment.<sup>23</sup> The Government’s assertion that the New Fiscal Regime does not have a discriminatory impact appears untenable in the absence of evidence or information specifically indicating how the distributional impact of EC-95 would be offset by other complementary measures.

### ***Access to Health and Education***

The Government has indicated that EC-95 places no specific cap on expenditures on health care and education, and that it does not alter or replace the constitutional requirements to keep the minimum expenditure on health at 13.7 per cent of the net federal revenue and on education at 18 per cent of the federal tax revenue. It furthermore suggests that EC-95 may in fact prevent a decrease in spending on health care and education, as it no longer hinges on the level of federal revenue, which significantly fluctuates according to the economic conditions. As explained by the Government,

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<sup>20</sup> Laurence Ball et al., ‘Painful Medicine’, Finance & Development, September 2011, p. 22.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

<sup>23</sup> Jaejoon Woo et al., “Distributional Consequences of Fiscal Consolidation and the Role of Fiscal Policy: What Do the Data Say?”, IMF Working Paper (September 2013), p.18.

however, the effect of EC-95 is that the minimum floor for health and education expenditures will be adjusted only according to inflation. This means that there will be no real growth in education and health care expenditures over the next twenty years, even if the federal revenue grows.

The bottom line is that because of the federal spending cap, health and education budgets can only be increased at the expense of other public expenditure. This should furthermore be set against the backdrop of growing demand for these social services in light of population growth and other factors as well the gaps in coverage that already existed before EC-95. It has been estimated that EC-95 would have the impact of reducing health expenditure by R\$433 billion over the next 20 years (representing a 25 per cent reduction) and education expenditure by more than R\$45 billion by 2025, which is particularly worrisome considering Brazil's growing and ageing population.

There is concern that EC-95 will make the goals and strategies of the National Education Plan unfeasible. Because there will be no real growth in education expenditures, goal number 20 of the Plan (which states that the country should reach an investment equivalent to 10% of GDP in education)<sup>24</sup> will not be achieved, as the budget devoted to education remains subject to the inflation adjustment. Because EC-95 reduces planned investments, it puts other issues related to education at risk.<sup>25</sup> In particular, it threatens the maintenance and development fund focused on primary and secondary education (Law 11.494/2007) and the allocation of oil resources for education and health (Law 12.858/2013).

These laws and the National Education Plan in particular, result from years of negotiations and debates between the government and Brazilian civil society. They are demonstrations of the will of the Brazilian people, and therefore should not be ignored. The protection of the right to education is not only a commitment undertaken by the Brazilian government to the international community. It is first and foremost a commitment to its citizens, who should participate in the discussion of measures which will directly affect them. Public hearings, however, were not held to facilitate a debate on PEC 241/PEC 55.

The Government has stated that EC-95 will only apply to public expenditure at the federal level, thus leaving untouched expenditure of the state and local governments which account for 66 per cent of all public health expenditure. However, this assertion appears contrary to Brazil's obligation under the Covenant to "move as expeditiously and

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<sup>24</sup> Campanha Nacional pelo Direito a Educaçao. 2014. *Privatization of education and rights violations in Brazil: notes for the Committee on the Rights of the Child*. [http://www.right-to-education.org/sites/right-to-education.org/files/resource-attachments/ACAO\\_Privatization%20Violates\\_the\\_Right\\_to\\_Education\\_2014\\_en.pdf](http://www.right-to-education.org/sites/right-to-education.org/files/resource-attachments/ACAO_Privatization%20Violates_the_Right_to_Education_2014_en.pdf)

<sup>25</sup> Campanha Nacional pelo Direito à Educação. 2016. *Urgent warning: Recent announcements on privatizations, the extinction of education programs and the proposed amendment to the constitution (PEC) 241/2016 put in risk the fulfilment of the right to education in Brazil*. [http://campanha.org.br/wp-content/uploads/2016/09/UrgentWarning\\_final.1.pdf](http://campanha.org.br/wp-content/uploads/2016/09/UrgentWarning_final.1.pdf)

effectively as possible” towards the full realization of the Covenant’s rights.<sup>26</sup> Even in times of severe resources constraints, State Parties to the Covenant are required to take necessary steps “to the maximum of its available resources” to achieve that goal.<sup>27</sup> Abrogating this responsibility and delegating it entirely to the state and local governments without providing additional resources to achieve the goal seem incompatible with the fundamental intent and spirit, or *raison d’être* of the Covenant. What is more, the Government’s reply does not take into account the very real possibility that local and state governments in Brazil are not able or willing to cover the gaps in education and health spending that are caused by the federal spending freeze the Government has imposed via EC-95.

### ***Public Consultations and Popular Participation***

Genuine participation of affected groups in examining the proposed retrogressive measure is one of the critical criteria in determining whether such a measure is compatible with States’ obligations under the Covenant.

While the Government points to support from the IMF and international investors for EC-95, that does not take away the procedural concern with EC-95 that it locks-in policy choices for any future Government for the next 20 years. In light of these concerns, it seemed appropriate in the earlier communication to make reference to the way in which the current Government had assumed power. Such a reference neither questions the legitimacy of the Government nor the legality of the procedure by which it assumed power. It merely points to the fact that the present Government came into office after the impeachment of the previous President and has not been able to obtain a specific mandate from the electorate for its program of fiscal consolidation, which runs contrary to the platform on which the Government had been elected. That context would seem to make it all the more important for the process leading to the adoption of PEC 55/2016 to comply with the requirements of the Covenant, requirements which underline specifically the importance of consultation. This becomes all the more important given that PEC 55/2016 is not a regular law or regulation that can be repealed by a successive government, but a change of the Constitution that will potentially tie the hands of future elected governments for a period of two decades.

While the Government points to public consultation in the run-up to the adoption of EC-95, there are several reasons to question the extent of broad public support for this measure. It has been reported that there was no public information campaign about the proposed amendment in a simple language easily understood by the public and the ways in which it was presented was too technical and complex for laypersons to understand the content and impact of the amendment.<sup>28</sup> According to one survey, 43 per cent of Brazilians were not aware of the proposed EC-95. According to a survey conducted in

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<sup>26</sup> Committee on Economic, Social and Cultural Rights, General comment No. 3: The nature of States parties’ obligations (art. 2, para. 1, of the Covenant), para. 9.

<sup>27</sup> *Ibid.*, para. 10.

<sup>28</sup> Alternativa à 'perversidade' da PEC 55 busca equilíbrio fiscal, justiça tributária e crescimento (9 November 2016), <http://www.redebrasilatual.com.br/economia/2016/11/alternativa-a-perversidade-busca-equilibrio-fiscal-justica-tributaria-e-crescimento-8405.html>

December 2016, 60 per cent of the respondents said that they were against EC-95 and 67 per cent believed that it would bring more losses than benefits to the poorest segment of the society.<sup>29</sup>

It also appears that engagement with civil society was rather limited and did not include a wide range of different civil society organizations and groups. According to my information, debates on EC-95 mostly took place in Congress and there was limited scope for civil society to be involved in discussions or debates on the matter. While the Government has indicated that technical experts from the Ministry of Finance engaged in discussions with independent experts and civil society organizations, it has been reported that they did not necessarily contribute to a greater understanding of the proposed amendment and an informed debate, as they often repeated technical information available on the Ministry of Finance website<sup>30</sup> and discussed the benefits and effects of the proposed amendment in technical terms. In some cases, such technical experts were reportedly not even present at the public hearings.<sup>31</sup>

A final indicator of the limited level of genuine consultation with and participation by civil society and the public is the exceedingly short period of time within which an important constitutional amendment of this nature was adopted. Many Brazilians have expressed concerns that the Government did not allow sufficient time for the amendment to be thoroughly debated by all stakeholders and to carry out a proper impact assessment of the amendment.

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<sup>29</sup> Maioria é contra aprovação da PEC 55 (13 December 2016), <http://datafolha.folha.uol.com.br/opiniaopublica/2016/12/1840963-maioria-e-contra-aprovacao-da-pec-55.shtml>

<sup>30</sup> <http://www.fazenda.gov.br/novo-regime-fiscal/pec-241/perguntas-e-respostas>

<sup>31</sup> For example, at a public hearing of experts before the Committee on Economic Affairs, no representative from the Ministry of Finance was reportedly present, despite having been invited to the hearing. PEC do Teto deve aumentar desigualdade social, dizem economistas (3 November 2016), <http://agenciabrasil.ebc.com.br/economia/noticia/2016-11/pec-deve-aumentar-deigualdade-e-impact-politicas-sociais-dizem>