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AUSTERITY IS A CHOICE, NOT A NECESSITY:

A PRACTICAL GUIDE TO SIX MYTHS ABOUT PUBLIC FINANCES IN BRAZIL

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Austerity Is a Choice, Not a Necessity: A practical guide to six myths about public finances in Brazil

(Executive summary of Note nº 26). Transforma/Unicamp.

This executive summary accompanies the note "Austerity Is a Choice, Not a Necessity: Six Myths about Public Finances in Brazil," to be published on Friday, November 13, 2026. Prepared in partnership with the Levy Economics Institute of Bard College, it offers a practical guide, grounded in data on the Brazilian economy, for understanding and challenging six widespread myths about public finances and for contributing to the public debate on fiscal austerity.

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I. INTRODUCTION

The note sets out to demystify the dominant narratives about public spending and its limit, offering a data-based analytical framework consistent with a broad agenda capable of confronting the many challenges of contemporary Brazil: low growth of gross domestic product (GDP) and productivity, the climate and environmental crisis, work precarization, excessive inequality and persistent poverty. The financing agenda cuts across every area of the economy and society, and deconstructing common beliefs about public spending is indispensable at a time when rights and social programs may be lost.

Our reading of the problem. Bold proposals that would be good for society and the environment are held back by familiar objections: "it is too costly," "we cannot pay for it," "it would cause inflation," "it would weaken the *real*." Those same beliefs are used to justify cutting important social, economic and sectoral programs. We show, using Brazilian data, that these beliefs are myths.

This summary is a practical guide to understanding and answering six of these myths. Debunking them is necessary to win the public debate and to demand that the federal government respond to the needs of society and the environment. The goal is to present an alternative economic policy, capable of confronting the country's challenges.

HOW TO USE THIS GUIDE

Each myth is addressed briefly here; the detailed analysis is in the full note. Each one follows the same structure:

What they say:

the myth as it is expressed in Brazil.

What the evidence shows:

the fact, in a nutshell.

Numbers to remember:

the figures that support our argument.

Why:

the justification for our view.

How to answer:

a one-sentence reply for a debate, an interview or a message.

What to ask, what to demand:

a question that challenges the claim, and a concrete demand to go with it.

Note: we recognize that the correlations reported here do not establish causality. Still, we think it is useful to present these correlations and other evidence to show that the empirical support the myths take for granted is missing.

THE SIX MYTHS AT A GLANCE

Myth 1: Government cannot spend more than it collects in taxes. The deficit of a currency-issuing government is the private sector's surplus; the federal government spends by crediting bank reserves and does not run out of *reais* (R$). When the government spends more than it collects, the private sector buys government bonds to hold the increase in its wealth in a form that earns interest.

Myth 2: Rising government spending and/or deficits create inflation. There is no positive correlation between growth of government spending or deficits and inflation in Brazil (the correlation between inflation-adjusted spending growth and the Extended National Consumer Price Index (Índice Nacional de Preços ao Consumidor Amplo, IPCA) over 2001–2025, excluding 2020–21, is negative). Rather, inflation peaks were driven by administered prices and the exchange rate.

Myth 3: Rising government spending and/or deficits depreciate the exchange rate. Public spending does not weaken the *real* (R$). The exchange rate of countries like Brazil is determined mainly by the gap between domestic and foreign interest rates, global risk aversion and commodity prices. Spending (public and private) puts pressure on the exchange rate only when a country approaches its external constraint, which is not the case for a country with high international reserves, proportionally low external debt and public debt in its own currency.

Myth 4: Rising government spending and/or deficits raise interest rates and crowd out private investment. Public spending does not crowd out private investment; it pulls it in. The Central Bank of Brazil sets the interest rate according to its monetary policy priorities. Firms invest when demand grows, and public spending is one of the main components of aggregate demand.

Myth 5: Austerity is a technical necessity. Austerity is a choice, not a technical necessity: it did not "fix" the public finances, and it brought recession and mass unemployment. The debt-to-GDP ratio kept rising because of interest, and the so-called deficit problem was not solved.

Myth 6: There is no alternative to austerity. There is an alternative: the debt-to-GDP ratio depends above all on the gap between the interest rate and the growth rate. The answer therefore lies in lower interest rates, faster GDP growth driven by rising public spending, and fairer taxes, not in cuts to public spending.

SIX NUMBERS THAT DEBUNK THE SIX MYTHS

MYTH 1 • BUDGET CONSTRAINT

~96%

Share of federal public debt owed in Brazilian *reais* (July 2026): the government owes in the currency it issues and cannot run out of *reais*.

MYTH 2 • INFLATION

-0,18

Correlation between inflation-adjusted spending growth and IPCA inflation, 2001–2025, excluding 2020–21: no positive relation.

MYTH 3 • EXCHANGE RATE

-0,46

Negative correlation between government spending growth and the price of the dollar in *reais*, 2001–2025, excluding 2020–21: years of strong spending were years of a stronger Brazilian *real*.

MYTH 4 • CROWDING OUT

+0,39

Positive correlation between inflation-adjusted government spending growth and business investment, 2001–2025, excluding 2020–21: spending pulls investment in.

MYTH 5 • TECHNICAL NECESSITY

+18 points

Between 2015 and 2019, years of spending cuts and of the spending cap, general government gross debt rose from 56.3% to 74.4% of GDP: austerity did not solve the supposed problem of public finances.

MYTH 6 • NO ALTERNATIVE

The debt grows mainly because interest rates are high relative to growth. Fiscal adjustments centered on cutting primary spending have not delivered what they promised. If the debt grows mainly because of interest, why is overly tight monetary policy, which costs about 8% of GDP a year, left out of the debate and outside fiscal rules?

II.I. MYTH 1

Government cannot spend more than it collects in taxes

WHAT THEY SAY

"There is no money."
"The government is like a household: it cannot spend more than it earns."
"Today's debt will be paid by our grandchildren."

WHAT THE EVIDENCE SHOWS

The deficit of a currency-issuing government is the private sector's surplus; the federal government spends by crediting bank reserves and cannot run out of reais (R$).

NUMBERS TO REMEMBER

13% of GDP

Public sector deficit in 2020. That same year, the private sector ran its largest surplus since 1995. Government deficits create private savings.

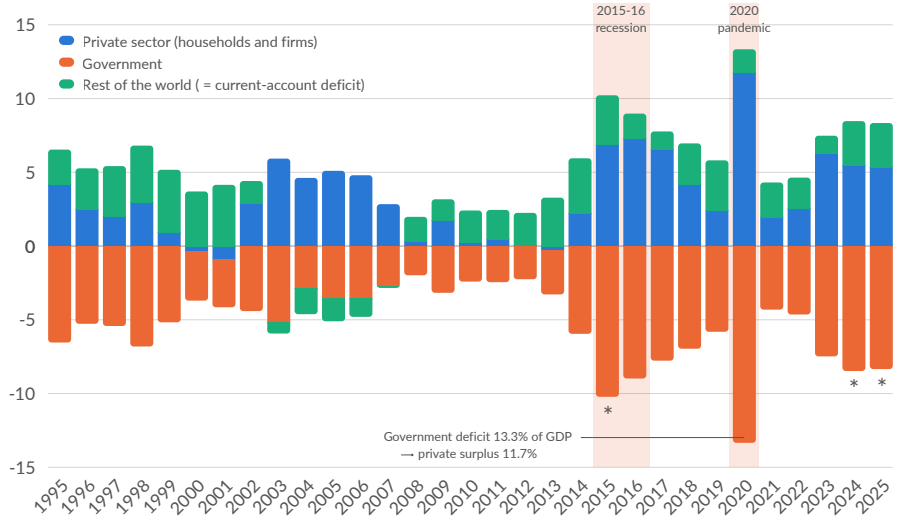
The Brazilian government paid all its commitments even in 2020, with the largest primary (9% of GDP) and nominal (13% of GDP) deficits in decades. Brazil's benchmark interest rate (the Selic) was 2% at the end of 2020. Data also show that even with a government nominal deficit of 13% of GDP, the benchmark interest rate can be as low as 2%.

WHY

The Brazilian federal government does not run out of *reais*, because the Brazilian *real* is created through operations between the National Treasury (TN) and the Central Bank of Brazil (BCB). When the government makes a transfer, such as to the Bolsa Família program, pays public servants or buys goods and services from the private sector, the Central Bank debits the Treasury's Single Account and credits the reserves of the recipient's bank. The macroeconomic effect is the same as issuance of money by the federal government. Taxes and bond sales generally come afterwards and replenish the Single Account: they withdraw *reais* from the economy; they do not finance the spending (Serrano and Pimentel 2017; National Treasury 2019). In this way, the government offers the private sector an alternative way to hold its accumulated wealth in a form that earns interest. For the private sector, some return is always better than none, since money pays no nominal interest and loses value when inflation is positive.

Public debt does not need to be "paid off": maturing bonds are rolled over at the rate set by monetary policy. The stock of debt falls only when the government runs a nominal surplus, which reduces the private sector's financial wealth by exactly the same amount. Budget surpluses destroy private financial wealth.

Figure 1 – Sectoral balances, Brazil, % of GDP, 1995–2025



Source: authors' elaboration based on data from the Central Bank of Brazil (public sector borrowing requirement, nominal concept) and, for the current account, from the OECD/IMF via FRED (1995–2014), the Central Bank of Brazil (2015) and the World Bank, WDI (2016–2025).
Notes: *2015: government balance from the Central Bank's public sector borrowing requirement series; current account from the Central Bank's release for 2015 (3.32% of GDP). *2024–2025: government = nominal deficit (BCB); current account from the World Bank's WDI. Private balance = −(government + rest of the world).

HOW TO ANSWER

The federal government cannot run out of the currency it issues. The questions that matter are what the spending is for, who benefits from it, and whether there are workers, machines and energy available to produce the goods and services that public spending buys.

WHAT TO ASK, WHAT TO DEMAND

- If the money has "run out," how does the government pay interest of about 8% of GDP a year?
- Judge each budget item by its results for employment, income and the environment, not by its effect on the deficit.

II.II. MYTH 2

Rising government spending and/or deficits create inflation

WHAT THEY SAY

"Public spending causes inflation."
"More spending means more inflation and higher interest rates."

WHAT THE EVIDENCE SHOWS

There is no positive correlation between spending growth or deficits and inflation in Brazil. The correlation between inflation-adjusted spending growth and the Extended National Consumer Price Index (Índice Nacional de Preços ao Consumidor Amplo, IPCA) over 2001–2025, excluding 2020 and 2021, is −0.18. Inflation peaks, rather, were driven by administered prices and the depreciation of the *real* not by growth of spending or budget deficits.

NUMBERS TO REMEMBER

−0,18

Correlation between inflation-adjusted growth of public spending and inflation over the period analyzed, excluding 2020–21.

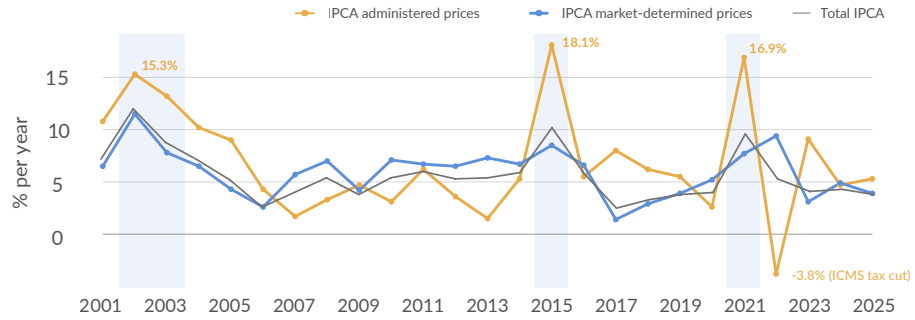
+18,1% and +42%

In 2015, administered prices (energy, fuel, tariffs) rose 18.1%, and the dollar became 42% more expensive in *reais*. Inflation reached 10.7%, even as inflation-adjusted public spending was falling.

WHY

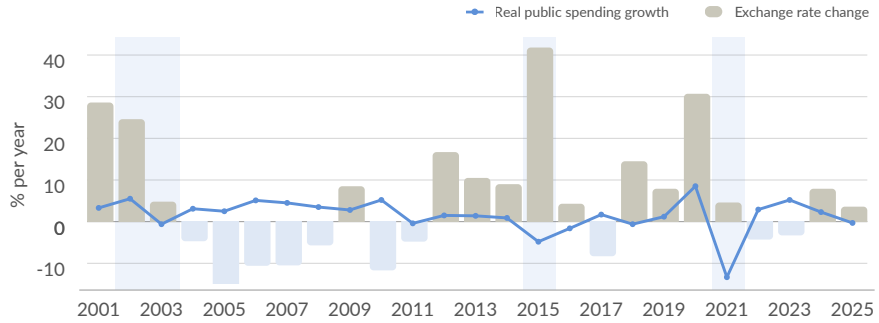
In Brazil, inflation is mainly cost inflation. The years of highest inflation (2002–2003, 2015 and 2021) were years of exchange-rate shocks and large increases in administered prices, such as fuel and electricity, not years of fast spending growth. Contract indexation, makes these cost shocks persist. Raising interest rates and cutting spending does not reverse these causes: austerity only lowers demand and employment.

Figure 2 – Inflation: market and administered prices, Brazil, 2001–2025 (% per year)



Source: authors' elaboration based on IBGE (Extended National Consumer Price Index – IPCA) and BCB (SGS 4449, 11428).
Note: annual changes compounded from the monthly series. Shaded areas: 2002–2003, 2015 and 2021, the years of highest inflation, driven by administered prices and the rise of the dollar. In 2022, the fall in administered prices reflects the cut in the ICMS (the state-level value-added tax) on fuel and energy.

Figure 3 – Inflation-adjusted growth of public spending and change in the exchange rate (R$/US$), Brazil, 2001–2025 (% per year)



Source: authors' elaboration based on BCB (SGS 3694), National Treasury, MGI and IBGE (IPCA, to deflate spending).
Note: annual changes. Positive values of the exchange rate indicate depreciation of the real (a rise in the dollar). Shaded areas: 2002–2003, 2015 and 2021. Correlation of −0.46 between the two series, excluding 2020 and 2021.

HOW TO ANSWER

In 2015, inflation reached 10.7% while public spending was falling. It came from energy and fuel prices and from a dollar 42% more expensive in *reais*, not from spending.

WHAT TO ASK, WHAT TO DEMAND

- In which year was inflation caused by excessive public spending, and what is the evidence?
- Fight inflation at its sources: exchange-rate volatility, administered prices and indexation.

II.III. MYTH 3

Rising government spending and/or deficits depreciate the exchange rate

WHAT THEY SAY

"Out-of-control spending sinks the Brazilian real."
"Brazilian real sinks against the US dollar because of fiscal risk."

WHAT THE EVIDENCE SHOWS

The growth of public spending (and of fiscal indebtedness indicators) bears no necessary relation to the exchange rate. The exchange rate is determined mainly in financial markets: it depends on the gap between domestic and foreign interest rates, adjusted by a risk premium that mainly reflects international liquidity and global risk aversion. That is why the Brazilian *real* rises and falls together with the currencies of other emerging economies with very different fiscal situations, and follows US interest rates, commodity prices, not the public deficit. Spending (public and private) weighs on the exchange rate only if the economy approaches its external constraint, that is, when there is not enough foreign currency to pay for imports and external commitments. With high reserves, a modest external deficit and public debt almost entirely in *reais*, that is not Brazil's situation.

NUMBERS TO REMEMBER

–0,46

Correlation between spending growth and the price of the dollar in *reais*, 2001–2025, excluding 2020–21: years of strong spending were, in general, years of a stronger Brazilian *real*.

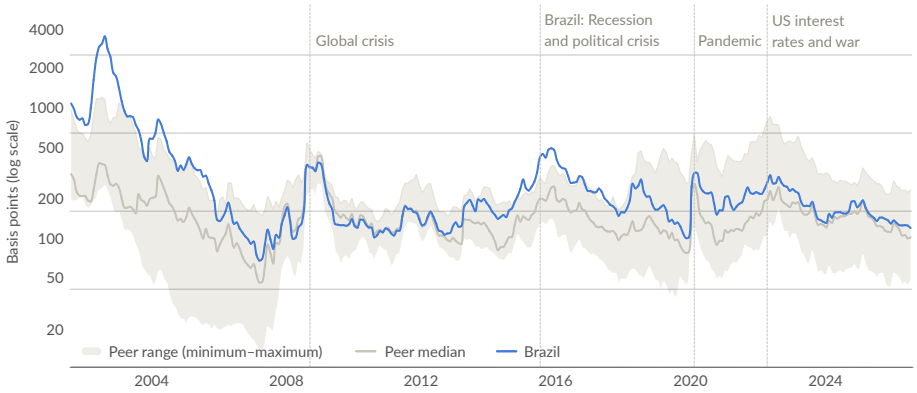
0,88

Correlation between monthly changes in Brazil's country risk (5-year Credit Default Swaps, CDS) and those of the median of six emerging economies (South Africa, Chile, Colombia, Mexico, Peru and Turkey), October 2003–September 2026: Brazil's country risk rises and falls with that of its peers, whatever the fiscal situation of each.

WHY

Exchange rates are determined mainly in asset markets, not in trade in goods. What moves Brazil's exchange rate is global risk appetite, interest rates abroad and the prices of what Brazil exports; Brazil's country risk moves together with that of other emerging economies (Aidar and Braga 2019).

Figure 4 – Country risk of Brazil and other emerging economies: 5-year sovereign Credit Default Swaps, October 2001–September 2026 (basis points, monthly average, log scale)



Source: authors' elaboration based on JP Morgan 5-year sovereign Credit Default Swap data.
Notes: Brazil's country risk rises and falls together with that of other emerging economies. Peers: South Africa, Chile, Colombia, Mexico, Peru and Turkey. Since October 2003, monthly changes in Brazil's CDS have had a correlation of 0.88 with the median of its peers, and a common factor explains 82% of the joint variation of the seven countries.

HOW TO ANSWER

When US interest rates rise or global risk appetite falls, the Brazilian *real* depreciates together with the currencies of other emerging economies, whatever the deficit of each. Cutting spending does not change that.

WHAT TO ASK, WHAT TO DEMAND

- Why cut social programs in response to movements of the Brazilian *real* against the dollar that are explained mainly by external factors?
- Protect the external position and reduce exchange-rate volatility through regulation, instead of cutting spending in the name of "fiscal risk."

II.IV. MYTH 4

Rising government spending and/or deficits raise interest rates and crowd out private investment

WHAT THEY SAY

"The State competes with firms for savings."
"Public spending crowds out private investment."
"Deficits push up interest rates."

WHAT THE EVIDENCE SHOWS

Public spending does not crowd out private investment; it pulls it in. The Central Bank sets the interest rate according to the priorities of the monetary policy, not according to the deficit. Firms invest when demand grows.

NUMBERS TO REMEMBER

0,5% vs –3,9%

Average annual growth of public spending and of business investment in 2015–2019: when government spending stalled, investment fell.

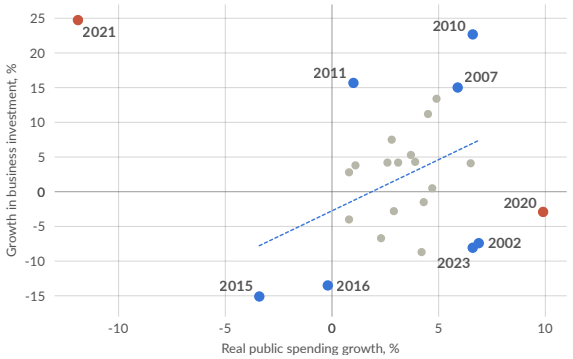
0,34

Correlation between the inflation-adjusted central bank benchmark interest rate and the primary surplus, 2003–2025, excluding 2020–21: larger primary surpluses came with higher interest rates.

WHY

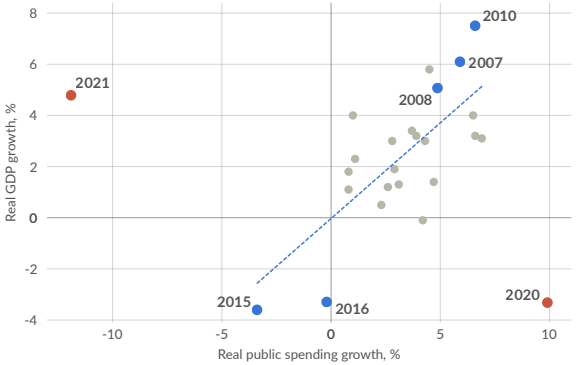
Firms expand capacity when they expect to sell more. Public spending is an autonomous source of demand: when it grows, sales, income, employment and investment grow with it. Over 2001–2025, excluding 2020–21, the correlation between inflation-adjusted spending growth and business investment is positive (0.39); the correlation between inflation-adjusted spending growth and GDP growth is positive as well (0.73).
The interest rate is set by the Central Bank, which reacts to inflation and the exchange rate, not to the size of the deficit.

Figure 5 – Growth of public spending and business investment, Brazil, 2001–2025



Source: authors' elaboration based on IBGE (National Accounts), National Treasury and the Ministry of Management and Innovation in Public Services (MGI); volume indices from the breakdown of gross fixed capital formation (GFCF).
Notes: public spending pulls business investment in rather than crowding it out. Correlation of 0.39 between inflation-adjusted growth of public spending and growth of business investment, excluding 2020–2021 (in red in the chart).

Figure 6 – Growth of public spending and GDP, Brazil, 2001–2025



Source: authors' elaboration based on IBGE (National Accounts), National Treasury and the Ministry of Management and Innovation in Public Services (MGI).
Notes: public spending and GDP growth move together. Correlation of 0.73 between inflation-adjusted growth of public spending and real GDP growth, excluding 2020 and 2021 (in red in the chart).

HOW TO ANSWER

When austerity cut public spending, private investment did not take its place: it fell too. When public spending grows, it stimulates GDP growth, and investment tends to grow along with them.

WHAT TO ASK, WHAT TO DEMAND

- If deficits raise interest rates, why were inflation-adjusted interest rates highest (8% to 13% a year in 2003–2006) precisely when the public sector ran its largest primary surpluses?
- Plan public investment as a driver of private investment, not as a residual of fiscal targets.

II.V. MYTH 5

Austerity is a technical necessity

WHAT THEY SAY

"It is a bitter but necessary medicine."
"The spending cap will bring back confidence and growth."

WHAT THE EVIDENCE SHOWS

Austerity is a choice, not a technical necessity: it did not solve the supposed problem of public finances; it brought recession, increased inequality and caused mass unemployment, while the debt-to-GDP ratio kept rising because of the cost of interest and slow GDP growth.

NUMBERS TO REMEMBER

56,3% → 74,4%

General government gross debt (% of GDP) in 2015 and 2019: up 18 points over five years of spending cuts.

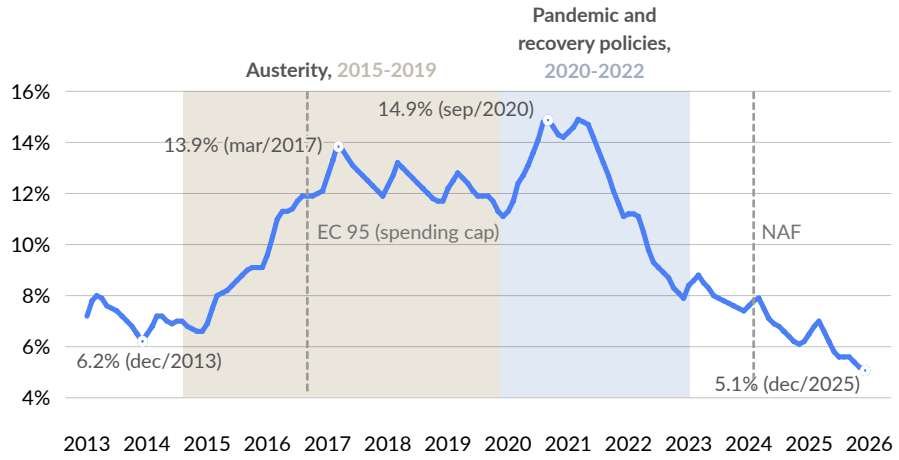
6 years

Unemployment never below 11.1%, from April 2016 to March 2022.

WHY

Cutting public spending reduces demand, income and tax revenue itself. No amount of "confidence" makes up for a lack of demand. The 2015–2016 recession lasted 33 months, the longest in the country's history, and GDP per capita only surpassed its 2013 level in 2024.
The spending cap (Teto de gatos) squeezed health, education and public investment, but left out interest payments and coexisted with billions in tax breaks for powerful sectors. That selectivity shows that austerity decides who is protected and who pays the bill.

Figure 7 – Unemployment rate, Brazil, %, 2013–2025



Source: authors' elaboration based on IBGE, Continuous National Household Sample Survey (PNAD Contínua; SIDRA, table 6381).
Notes: unemployment went from 6.2% (December 2013) to 13.9% (March 2017) and peaked at 14.9% (September 2020). Unemployment rate, %, PNAD Contínua (rolling quarter, monthly series).

HOW TO ANSWER

Austerity promised confidence and growth. It began in 2015, with a broad program of cuts to public investment, and was intensified by the adoption of the spending cap in 2016. It ended up delivering the longest economic crisis in the country's history, from 2015 to 2022, when GDP returned to its 2014 level. Austerity also resulted in six years of mass unemployment, and more public debt, not less.

WHAT TO ASK, WHAT TO DEMAND

- Why did the spending cap limit spending on health, education and investment, but not interest payments or tax breaks?
- Put the distribution of the adjustment, who gains and who loses, at the center of the budget debate.

II.VI. MYTH 6

There is no alternative to austerity

WHAT THEY SAY

"There is no alternative."
"A new adjustment is needed to stabilize the debt."

WHAT THE EVIDENCE SHOWS

There is an alternative: a rising debt-to-GDP ratio is driven by high interest rates and slow GDP growth, not by primary spending. The answer therefore lies in lower interest rates, faster growth and fairer taxes, not in cuts to public spending.

TO REMEMBER

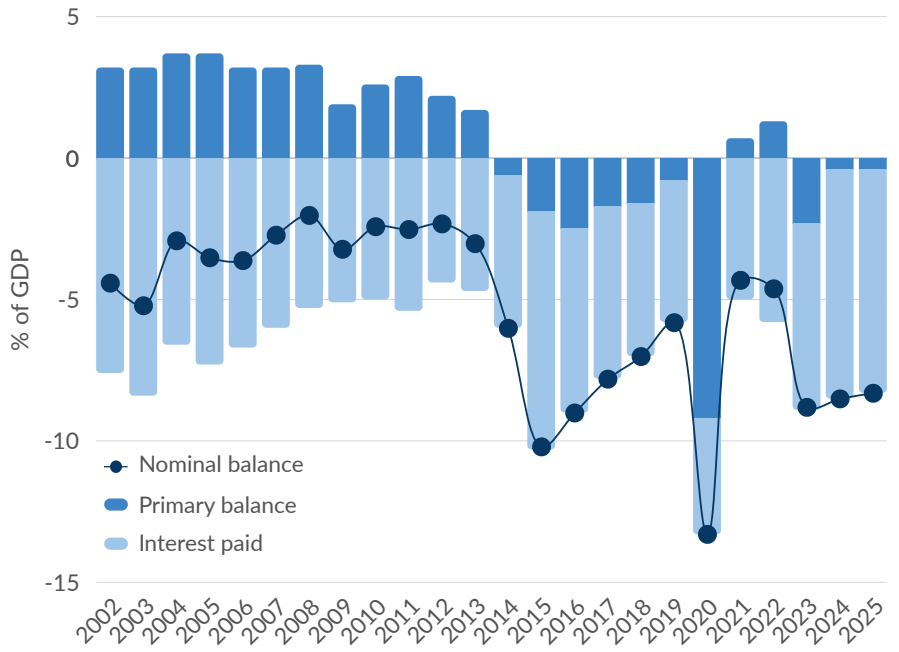
In Brazil, more is spent on government interest payments than on health or education.

From 2002 to 2025, interest payments averaged 6.11% of GDP; in 2024–2025, 8% of GDP. Health spending, by contrast, averaged 4.2% of GDP between 2010 and 2024, and education spending 4.86%.

WHY

What drives the debt-to-GDP ratio is the gap between the inflation-adjusted interest rate on the debt (r) and inflation-adjusted GDP growth (g). With debt close to 78% of GDP, each point of difference between r and g adds about 0.8 point to the ratio every year, even with balanced primary accounts.
Austerity does not reverse the rise in the debt-to-GDP ratio: it lowers g and leaves monetary policy free to keep r high by maintaining very low inflation targets. That is what happened in 2015–2019: less growth, more debt.

Figure 8 – Interest paid, nominal balance and primary balance (% of GDP), Brazil, 2002–2025



Source: authors' elaboration based on Central Bank of Brazil data (BCB-DSTAT): primary and nominal balance of the consolidated public sector. Interest paid = primary balance − nominal balance.

HOW TO ANSWER

The debt grows mainly because of high interest rates, not because of spending or the primary deficit. Cutting spending lowers growth and can worsen the debt-to-GDP ratio.

WHAT TO ASK, WHAT TO DEMAND

- If the debt grows mainly because of interest, why is excessively tight monetary policy, which costs about 8% of GDP a year, left out of the debate and outside every fiscal rule?
- See "The agenda we need" on the next page.

III. THE AGENDA WE NEED

There is no single possible policy. There are choices, with winners and losers, and democratic debate should be about them. The note points to four:

1. Bring down the interest bill. High interest rates come from Central Bank decisions, not from budget deficits. Brazil needs to revisit the inflation target and the assumptions of the inflation-targeting regime itself, and to tackle the actual sources of inflation: exchange-rate volatility, administered prices and indexation.

2. Shift any adjustment to the revenue side. Give continuity to the progressive tax reform and review tax expenditures, tax exemptions and subsidies that rarely face the scrutiny applied to direct spending. Tax those least likely to cut their own consumption: high-income and high-wealth individuals.

3. Adopt a spending rule for growth, employment and distribution. Make the growth rate of public spending the policy variable, determined by GDP growth, employment and distribution goals.

4. Protect what works. The public health system (Sistema Único de Saúde, SUS), public education, social security, science and public investment are not a "burden": they strengthen the economy, public services and social protection.

IV. GLOSSARY

***Real* (R$):** Brazil's currency, issued by the federal government through the Central Bank.

Real (adjective): adjusted for inflation, as in "real growth" or "real interest rate."

Depreciation of the Brazilian *real*: a rise in the price of the US dollar in *reais*. *That is*, the real (R$) buys fewer dollars.

Primary balance: the government's revenue minus its spending, not counting interest on the public debt.

Nominal balance: the government's revenue minus all its spending, including interest on the public debt.

Treasury Single Account: the National Treasury's account at the Central Bank, through which all federal payments and receipts pass.

Selic: Brazil's benchmark interest rate, set by the Central Bank's Monetary Policy Committee (*Comitê de Política Monetária*, Copom).

Tax expenditure: revenue the government gives up through tax breaks, exemptions and subsidies; economically equivalent to spending.

EC 95 (spending cap): Constitutional Amendment 95/2016, which froze federal primary spending in real terms for twenty years.

NAF: the New Fiscal Framework (Novo Arcabouço Fiscal, Complementary Law 200/2023), which replaced the cap and allows limited real growth in spending.

r – g: the gap between the inflation-adjusted interest rate on the debt and inflation-adjusted GDP growth; the main driver of the debt-to-GDP ratio.

Read the full note: *"Austerity Is a Choice, Not a Necessity: Six Myths about Public Finances in Brazil," Transforma, Unicamp, November 13, 2026.*

V. REFERENCES

The full note

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