The Brazilian Economy—What can we make of the current discontent?

**Delfim Netto**—The transformations and dislocations of the world economy have brought about this [popular] movement that we are living with. . . . The [people] want to show that government priorities are not the priorities that society wanted, but society’s priorities do not fit within Brazil’s GDP.

It has never been so important to show society that there are physical limitations. Concrete and steel can be used for building either a soccer stadium or metro transportation, but not both, because production factors are limited . . . Economic growth can only be attained by raising labor productivity. And that depends not only on the education and health of workers but also the amount of capital that each worker has. Productivity can only grow with investment. As Brazil’s total production is growing very little, investment must be done either by replacing private or government consumption, or by increasing the external current account deficit. . . . Any attempt to violate this limit will produce more inflation, more confusion, and a larger current account deficit.

To address popular demands would require unpopular policy adjustments to change the current growth model. Will this prove costly to the government?

First, let’s reject this idea that the apocalypse is around the corner. True, the government fiscal position is not comfortable, but the nominal budget deficit is only 3% of GDP, and
interest payments on public debt are 5%. Could be a little less, a little better, but there is no great fiscal disorder. The nominal budget deficit has been declining since the Real Plan [stabilized inflation in 1994]. However, [the government] has done a lot of accounting alchemy. In fiscal matters, we have to forget all the sophistications and go back to basics—understand, for instance, that deficits and public debt are closely connected. … Gross Brazilian public debt is much higher than what is recorded, and net public debt [used by the government as a fiscal indicator] no longer makes sense. [Large gross public debt] has significantly reduced the room for fiscal policy. This is not a disgrace; it does not mean that we will explode soon. It just means that we cannot regard debt as current revenue.

Analysts point out that the budget primary surplus is falling and inflation is rising because the government has exhausted its options for stimulating growth. Do you agree?

Of course we have nasty inflation of 6%, but … it has never been much smaller than it is today. Ten years ago inflation was high—but the real interest rate then was 10% per year and today it is 1.5%. Earning an honest living today is much harder.

Among the factors that used to help mitigate inflation were the large export revenues from commodities that pay for imports of consumer goods. However, commodities prices are falling. Does this concern you?

Rising prices for commodities exports definitely helped to contain inflation . . . .

Agribusiness will suffer greatly. Its income will fall and the infrastructure inefficiencies will show up … it will take years to resolve the issues that affect agribusiness logistics.

The government fiscal position is not comfortable, but the nominal budget deficit is only 3% of GDP, and interest payments on public debt are 5%. Could be a little less, a little better, but there is no great fiscal disarray.
cies will show up. Rates of return will be lower because it will take years to resolve the issues that affect agribusiness logistics. Not only will commodities prices fall, but agribusiness income will grow less than GDP. Thus profits will decline. At the same time, we have destroyed the industrial export sector. I believe that in the next four to five years the critical problem for Brazil will be financing the external current account deficit.

Will exchange rate depreciation help the export sector?
Exchange rate depreciation will not stimulate exports much because external demand is weak. But it should have an important role in import substitution. It is not conceivable that Brazil does not produce more electric irons and blenders. It has nothing to do with low Brazilian productivity. It has been demonstrated that the Brazilian factory worker is as productive as the Chinese worker. The differences are outside the factory. This idea that Chinese is very efficient is true, but at the expense of huge subsidies and other types of social organization of labor relations. Brazil was the only country in the world that believed China was a market economy, and our industry has paid a dear price for it.

How will the Brazilian economy be affected by the positive signs of economic recovery in the United States and China’s slowdown?
The consequences are all negative. The U.S. is still the place to which we export our industrial products. China’s slowing down will certainly bring down prices for Brazil’s commodities. Rising U.S. interest rates will redirect capital flows back to the U.S., which will worsen Brazil’s external current account deficit and reduce external financing. We will have to use our international reserves. Brazil’s exchange rate will eventually adjust—depreciation is inevitable. This adjustment would take about two and a half years. Exchange rate depreciation has much less effect on inflation than you might think. Our problem is that we cannot continue borrowing to support the exchange rate. The freedom of the Brazilian economy has decreased markedly.

Would you say the government has been hyperactive?
Hyperactivity in the right direction is very good. In this case, what happened was a wrong answer. Everything was fine in the streets. It was going in a civilizing direction. The answer of government and Congress, in my opinion, was schizophrenic. Congress voted on 10 things that had been pending for 14 years — and all wrong. The government itself has not really tried to understand what was happening. There is no use advertising US$25 billion for urban transportation without knowing how it will be financed. The problem for education and health in Brazil is not lack of resources, but it is a matter of administration. No use saying that [the government] will allocate 10% for health, 10% for education, subsidize fuel. All this

Bank customers that borrowed in dollars but do not export will find it difficult to pay their debts. This, in my opinion, is the most delicate aspect for the future.

The port concessions are absolutely correct, but how they are being done is producing too much friction.
In the next four to five years the critical problem for Brazil will be financing the external current account deficit . . . exchange rate depreciation is inevitable.

Even with the need for so many adjustments, do you think the government is moving in the right direction?
Yes. The renewal of electric power concessions, for example, was correct. It did not violate the contract, though it could have been done in a different way.

[The government] could have waited for current contracts to expire, and energy prices would have declined much more . . . . The port concessions are also absolutely correct, but how they are being done is producing too much friction . . . Policies are in the right direction and will produce results in two to four years, but in the short term the friction they are producing is enormous.

The discrediting of the government economic team is being reflected in the popularity ratings of the president. Those in the government know that everything is more difficult than those on the outside think . . . Since 2009 there has indeed been fiscal laxity . . . We have to calculate the public deficit and debt correctly. The numbers will be depressing, but knowing the actual numbers is the first step to correcting them. I insist: we can no longer turn loans into income; loans are not the same as revenues.

With commodities prices falling, we are heading for a trade balance deficit. Although currently that deficit is only 3.5% of GDP, that amounts to a projected deficit of US$75 billion for this year that will have to be financed.