The economic team’s credibility gap

Rousseff’s economic team lacks the balance and credibility of previous administrations. As domestic economic indicators falter and with political uncertainties, this may well undermine the effectiveness of the administration’s policies.

João Augusto de Castro Neves, Washington D.C.

Asking how the global financial meltdown of 2008–2009 would impact the Brazilian economy, former president Lula compared the negative externalities to small ripples that would wash ashore safely. At the time that actually seemed to be the case, and Brazil rebounded from the crisis easily. But now, amid faltering domestic economic indicators and political uncertainties, the persistent turbulence of global markets is calling into question the resilience of the Brazilian economy.

As risky as they may seem, inflationary pressures, extreme fluctuations of the currency, and pressure from congressional allies to increase spending are recurrent features in Brazil’s public policy landscape. For nearly 10 years, the federal government has responded unwaveringly to these challenges with a combination of fiscal responsibility, monetary tightening ... and a significant dose of political maneuvering. Regardless of the changes they faced in the international environment, the Cardoso administration (1995–2002) and the Lula administration (2003–2010) followed roughly the same recipe for sound economic policies.

Although it is still early to tell whether the Rousseff administration will deal similarly with the economy, clouds of uncertainty are massing on the horizon. The most recent cause for concern was the Central Bank’s decision to lower interest rates. Since inflation is expected to exceed the ceiling for this year’s target range — and probably for 2012 as well — many political and economic observers considered the decision to be a conscious attempt by the administration to reach a new economic policy mix, one that gives priority to economic growth over inflation. This perception was enhanced by the fact that the monetary loosening was accompanied by only a very limited promise of government fiscal restraint in the near future.

Beyond faltering economic indicators and the policy choices, the cast of characters in President Rousseff’s economic team is another source of uncertainty. So far, the apparent shift in the economic policy mix has been interpreted as an indication of undue
political influence over monetary decision-making. Although Brazil’s Central Bank has enjoyed a reasonable degree of autonomy for the past decade or so, this independence is not written in stone. The Central Bank is not legally independent; it can only operate with autonomy if it has conscious political support from the president.

To demonstrate the federal government’s commitment to economic stability, Cardoso and Lula adopted similar political strategies. Despite considerable pressure for more economic growth coming from political circles and the industrial sector, the two attempted to shield the monetary authorities from political influence. Though he had to find room in his cabinet for more expansionist groups and ideas (creating, for example, the Ministry of Industrial Development),

Beyond faltering economic indicators and the policy choices, the cast of characters in President Rousseff’s economic team is another source of uncertainty.
Cardoso was always careful to show political support for unpopular measures taken by his finance minister and Central Bank governors. Similarly, Lula sought to counterbalance his lack of responsible economic credentials by anointing as the government’s main economic interlocutors Antonio Palocci as Minister of Finance and later Henrique Meirelles, a former private banker, as Central Bank governor. Having the right amount of political savvy, the Palocci-Meirelles team became the anchor of economic stability for Brazil.

Even though President Rousseff inherited the economic policy framework and the political blueprint of her two predecessors, her economic team seems at this point to be projecting less credibility. Certainly some responsibility for this lies in a more murky and therefore challenging international economic environment. A lagging U.S. economy and the specter of sovereign debt defaults and banking crises haunting Europe, for example, highlight the ineffectiveness of the policy tools the main economies have been using. The lack of global economic coordination seems to be causing negative externalities (such as a currency war) for an emerging country like Brazil, which has limited resources to respond.

But another source of uncertainty seems to be rooted within the Rousseff administration. When picking economic advisors, President Rousseff decided to keep from the Lula administration players who were notorious for more state-centric approaches, such as Guido Mantega at the Ministry of Finance. It is true that for the Central Bank she opted for Alexandre Tombini, who has recognized technical expertise, but he has much less political viability as a credible counterweight to Mantega.

The president could quite easily compensate for this handicap by a show of direct political support for the Central Bank. Rousseff’s low-profile style of governing, however, has prevented this.

Without interlocutors who combine political girth with discernable market-friendly credentials, Rousseff’s economic team lacks the political savvy and technical balance shown in previous administrations. In a domestic environment where politics has significant impact on economic policy decision-making, this situation will most likely trigger even more speculation … and instability.