How Brazil should respond to the crisis

A new book analyzes the impact of the recession on Brazil and shows that the best way to overcome is to maintain austerity in public spending and control inflation.

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Nobody doubts that Brazil is more prepared than many countries to face the global crisis. With currency reserves of almost US$200 billion, a large and sound internal market, and relatively little dependence on exports, the country could be one of those least affected by the world crisis. But despite the favorable situation and the optimism of the government and many analysts about the future performance of our economy, Brazil will still be severely affected by the slowdown in rich countries.

Most economists bet, with support from the World Bank and the International Monetary Fund (IMF), that Brazil will grow up to 1.5% in 2009 compared to 5.6% in 2008. The latest report released by the Economist Intelligence Unit, the economic research arm of the respected British magazine, was gloomier. It said that Brazil could even suffer a slight drop in gross domestic product (GDP), the sum of all goods and services produced in the country every year. “This will happen despite the fiscal stimulus and monetary loosening measures adopted by the government,” it said.

In this context, How to respond to the crisis? Economic policies for Brazil offers a valuable contribution to the Brazilian economic debate. Edited by economists Ilan Goldfajn, former director of economic policy of the central bank of Brazil, and Edmar Bacha, one of the architects of the Real Plan (1994), the book assembles lucid analysis of the crisis from 22 first-rate economists, many of whom have worked for the government. They do not limit themselves to diagnosis of the crisis. They also try to point out alternatives to reduce its impact and promote resumption of sustained economic growth.

Most authors are members of the Institute for Economic Policy Studies, Casa das Garças, based in Rio de Janeiro. The institute, which has historical links with the Brazilian Social Democracy Party (PSDB) and Fernando Henrique Cardoso's government, promotes academic studies and debates on the economic policy of the country. The participants consist of former finance minister Pedro Malan; former governors and directors of the central bank like Arminio Fraga, Gustavo Franco, Francisco Lopes, Alkimar Moura, and Benny Parnes; and bankers like John Cesar Tourinho, executive director of the Safra Bank. “Our idea was to share with the public the thoughts we have been discussing about the crisis,” says Bacha. “Everyone believes the reaction to the crisis may not only affect the immediate future of the country but also shape the Brazilian economy over the next decades,” says Goldfajn.

There is a consensus in the book around the idea that the impact of the crisis in the national economy will be deeper and more prolonged than many have imagined. Nobody believes that the external “tsunami” will become a “ripple” here, as president Luiz Inácio Lula da Silva predicted late last year. There seems also a consensus that the government, despite its optimism, has so far adopted a proactive stance and acted in a reasonable way in combating the crisis.

Most of the authors, however, say the government is not doing something essential: managing
public finances carefully. If possible, the ideal would be to carry out social security reform and abort the swelling number of government employees. This would make room, say these experts, to reduce the interest rate and expand credit without creating inflationary pressures. This course would be much more sustainable in the long run than promoting tax exemptions and other measures, as was done in the automobile sector at the end of 2008. Any reduction in interest rates would also help reduce the large government payments to roll over the public debt. Reducing the interest rate would have a negative effect only if implemented artificially, for political reasons, and if doing so put at risk the attainment of inflation targets.

Although the public accounts are relatively controlled, it is believed that the government’s room for maneuver in this area is very small. Compared with other countries, Brazilian public debt still represents 35.8% of GDP, which is high by international standards. It is feared that excessive release of resources by the government to stimulate the economy might exacerbate the public deficit. “The government has greatly increased spending on personnel in recent years, counting on future tax revenues that will not occur,” says Bacha. “Now, with the prospect of a fall or very low growth in revenue in 2009, the blanket has turned out to be short.”

In the opening chapter, “Where we want to get?” Malan criticizes the use of the ideas of economist John Maynard Keynes, who advocated increasing public spending to stimulate the economy in periods of recession in all circumstances. Malan says that in Brazil, the hiring of a large number of public employees, increases in public salaries, large current expenditures, and a permanent increase in purchases of goods by the government began to be regarded, mistakenly, as if they represented the best of Keynes’s teachings. “The defeat of Antonio Palocci (former finance minister) and Paul Bernardo (planning minister) by the rest of the government was bad for the country,” Malan says. “If the winners (Guido Mantega, finance minister, and Dilma Rousseff, President’s chief of cabinet) are able to sell the country the idea of increasing expenditure as an answer to the current crisis, we are on a collision course with our desire to be seen by ourselves and the rest of the world as a reliable country.”

According to Malan, the best way to ensure a healthy economy is to keep fiscal policy austere. “The widespread desire for lower real interest rates would be more easily achieved with a policy marked by fiscal austerity and the pursuit of efficiency in the management of scarce public resources,” he says. “The central question today is to contain the expansion of current public spending. This is the only way, since it is not possible to increase the tax burden or allow the return of inflation as a mechanism for financing the government, add much to the debt, or further reduce public investment, today less than 2% of GDP.”

Another concern, according to several authors, is the use of federal banks to expand credit so as to avoid a significant fall in economic activity. This has happened previously and ended up compromising the performance of banks, which in turn forced the government to invest billions to cover bank losses caused by bad loans granted for political reasons without meeting technical criteria. “Contrary to what is seen abroad, the Brazilian banking system is well capitalized and provisioned (to cover potential losses in credit),” said Arminio Fraga. “If banks do not take the lead and keep financing growing fast, it is because they fear losing money with the reduction of capacity of debtors to pay in a crisis.”

This book is, of course, not a light read. The authors often look into details of the economy that are almost solely of interest of technicians. But in general the book can help form a critical opinion on the proposals implemented by the government to combat the crisis. At a time when there is almost unanimity around solutions that involve more government spending to resume economic activity, a book like this brings light. It should be compulsory reading for those, whether or not they are trained in economics, who seek a broader vision of Brazilian reality and the impact of the global crisis on the country.

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