"The government has frightened off entrepreneurs"



Ernane Galvêas

Former Finance Minister, now consultant to the National Commerce Confederation

Cláudio Accioli, Rio de Janeiro

Breach of contracts, disregard for grandfathered rights, legal uncertainty—former finance minister and former central bank governor Ernane Galvêas ascribes the decline of investments that has inhibited Brazil's economic growth to the "excessive burden" of government intervention in the economy. "The government has frightened off private entrepreneurs, both national and foreign," he says. Now economic advisor to the National Commerce Confederation (CNC) and a member of the Board of Getulio Vargas Foundation (FGV), Galvêas also criticizes what he sees as a contradiction: while the Central Bank is charged with containing credit to control inflation, the Treasury does the opposite, expanding the credit operations of state-owned financial institutions. "There are two monetary policies in Brazil."

***The Brazilian Economy*—Recent data for 2012 show that the Brazilian economy continues to struggle to grow. To what do you attribute this situation?**

Ernane Galvêas—The main cause of this worrying loss of drive in the Brazilian economy is the lack of productive investment. Without investment, there is no economic growth. For over 10 years, there has been great concern to redistribute income to reduce social inequalities. However, the government does not have enough money to invest in both social programs and the economy at the same time because it struggles with a permanent fiscal deficit . . . . The emphasis on social programs has led to a neglect of investment. Several quarters of falling investment have produced meager GDP growth. Although it is in crisis, the United States has been growing more than 2% a year; Brazil, which is not in crisis, is growing at less than half that. Recently, the government announced ambitious infrastructure projects of R$486 billion (US$243 billion), but I don't think it has the resources to get them done. Right now, Finance Minister Guido Mantega is doing a road show in New York to demonstrate to foreign investors that Brazil is a fertile field for investments in infrastructure. He will also contact the World Bank and the Inter-American Development Bank to

try to get funding for these projects. But … I have serious doubts that the advertised programs can really happen in 2013 and 2014.

Why is the private sector reluctant to invest in Brazil?

The government has frightened off private entrepreneurs, both national and foreign, with its excessive intervention in the economy. It has disregarded grandfathered rights, broken contracts, and created a climate of legal uncertainty by taking measures that changed transport and energy policy.

The first intervention was disastrous for the oil industry. The government adopted the sharing contract model for oil exploration, effectively making Petrobras responsible for all new oil exploration concessions, since Petrobras has mandatory participation of 30% in all future oil exploration projects. . . . As a result, for five years there have been no new oil well auctions in Brazil, and Petrobras is producing less than it did two years ago. The government has also been controlling Petrobras prices to contain inflation . . . . More or less the same thing has occurred with regard to electricity. By anticipating in 2013 expiration of concession contracts maturing in 2015 and 2017 in an attempt to reduce the rates charged to consumers, the government disrupted the entire system, causing a fall in the stock prices of the large power companies, as with Petrobras, which today are worth less than half what they were worth two or three years ago. The government is now announcing a series of programs that will affect Eletrobras Furnas and other companies, but investors are reluctant to accept the legal uncertainty that shapes the present scenario. Because dissatisfaction and uncertainty affect investments, they affect economic growth.

The main cause of the worrying loss of drive in the Brazilian economy is the lack of productive investment. Without investment, there is no economic growth.

Still, the Brazilian labor market continues buoyant, with very low unemployment. How would you explain this apparent paradox?

It is difficult to explain, especially since industry is not growing. We have the lowest unemployment rate in the history of the country, around 5.5%. … IBRE researchers have suggested that, because of a shortage of qualified professionals, companies are trying to hang on to their best workers and wait for a possible economic recovery rather than incurring the costs of rehiring and training them when there may be more competition for them. However, if you check the statistics, there is considerable volatility in labor markets. … There has been a huge movement between hiring and dismissals, sometimes millions of workers changing sides. The result has for now been a net increase in employment, but volatility is very high.

Is this oscillation also to be seen in commerce?

Commerce grew 9% last year and is expected to grow by about 7% to 7.5% this year . . . . There has been a structural change in the sector, represented by the growth of shopping centers and supermarkets in recent years. It is a new configuration as commerce moves from the streets to shopping malls and super or hypermarkets, which employ a lot of workers. The service sector has also shown significant development, especially production of goods related to technology, globalization, and transmission of scientific knowledge, which does not depend on government policies. Another sector growing fast is tourism—travel, air and land transport, hotels and inns.

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What about the recovery of industry?

The share of Brazilian industry in GDP has declined for a number of reasons, including loss of a significant portion of the foreign market. … High interest rates, an appreciating exchange rate, a lack of credit, and poor infrastructure have done much to weaken industry. … Brazilian industry works with an advanced level of technology, similar to North American or European levels. But it has suffered from the economic constraints and, of course, intense international competition, especially from China. The Chinese have taken markets aggressively, at first catching everyone off guard. They took many markets from Brazil [and have] penetrated Brazil's domestic markets, selling textiles, footwear, toys, and manufactures of all kinds. Brazilian industry has really been squeezed, although today, I believe, it has stabilized.

In this scenario of low growth, is inflation over 6% a year worrying?

What is the nature of inflation in Brazil today? Is it driven by demand, supply, wages, government spending? Without a correct diagnosis, it is difficult to talk about measures to fight it . . . . I believe inflation will tend to remain above 6% because of the budget deficit and wage policy. Wages are being adjusted in real terms by more than inflation, and this is clearly itself inflationary. At the same time, we have an expansion of credit that is incompatible with a low inflation rate. Credit grew 19% in 2011 and 16% in 2012. With credit expanding at these rates, how can inflation be 4.5%? Add to this situation the Brazil cost, which not only weighs a lot but has risen, particularly in the transport sector. And there arises a curious contradiction: if there is inflation, we must fight it with fiscal policy but even more so with monetary policy. But what monetary policy? … There are two monetary policies in Brazil. The Central Bank is trying to contain credit to avoid creating demand

inflation. Meanwhile, the government, through the Treasury, does exactly the opposite, expanding the credit operations of state-owned banks and stimulating borrowing from abroad.

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As a former central bank governor, do you think the Central Bank should act more firmly to control inflation?

Of all Brazilian institutions, the Central Bank is best prepared to respond to changes in the economy. But the Central Bank is still government, and cannot deviate from the government's goals. Lowering the policy interest rate was a very important decision. But it was not a Central Bank decision. Until 2009, there was great resistance to reducing the policy interest rate . . .. Later, President Rousseff ordered lower interest rates . . . . Today, many economists are advocating a rise in interest rates to contain inflation [but that] would stir up inflationary expectations . . . .The policy interest rate is in the right place at 7.25%. The key to controlling inflation is to correct the fiscal deficit, the wage policy and that excessive expansion of credit.

What is the outlook for the international economy in 2013?

That is completely dependent on China. Its entry into the world market in 1990 boosted demand and prices of manufactured goods, raw materials, food, and fuel. … At first, it brought huge benefits for all emerging countries and oil producers. Now the picture has changed because China is itself a major producer of heavy equipment for industry, oil rigs, and ships as well as information technology and communications. The World Trade Organization and the Organization for Economic Cooperation and Development expect international trade to grow about 2% this year and next, [and] China accounts for most of the expansion. I have the impression that China will no longer be able to grow 10% or 11% a year, but 7% growth should be enough to sustain the volume of Brazil-China trade.

What about the United States and the Eurozone?

The United States is slowly recovering . . . . If it develops shale gas faster and becomes self-sufficient in fuel, we will witness the beginning of a revolution whose consequences we cannot yet assess. That could frustrate Brazil's plans to export to the U.S. the deep sea oil it produces.

The main problems for the Eurozone are the fiscal deficit, companies' lack of confidence to invest, and high unemployment. Average unemployment is about 16%, including France, Germany, Belgium, and Holland. In countries like Portugal, Spain, Greece, and Italy, it reaches 26%. It's a desperate situation: you need to invest, but

the government has no resources and the companies have no confidence; without investment, there are no jobs and no consumption. It can become chronic. Many people think that Europe's problem will take several years to resolve.

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Back in Brazil, do you believe that 2013 will be better than 2012?

A little better, mainly because of the expected expansion in agriculture, which does not employ a lot of workers but creates demand for tractors, trucks, fuel, etc. . . . Some of the government's infrastructure projects may take off, generating better growth prospects for 2013 and 2014. It is also good to remember that we are entering an election period, during which the government traditionally spends more on travel, advertising, and projects . . . . The economy will improve, but there won't be a growth explosion.

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