Investment will drive the economy

Nelson Barbosa

Professor of economics, São Paulo School of Economics, Getulio Vargas Foundation, and former executive secretary of the Ministry of Finance

Fernando Dantas, ***Rio de Janeiro***

Nelson Barbosa, who earned a Ph.D. in economics from the New School for Social Research in New York and now teaches, held several positions in the Lula and Rousseff administrations. Barbosa analyzes what has happened in the Brazilian economy in recent years, especially during the Rousseff administration, and its prospects for the future. He believes that, driven by investment, Brazil can grow faster, to about 3.5-4.5%.

The Brazilian Economy**—Has economic policy changed under President Rousseff?**

Nelson Barbosa**—**Economic policy continues to follow the same institutional framework as before: an inflation target, a fiscal target, and floating exchange rates. However, in recent years the policy has had to be adapted to a new national and international context. At the beginning of the Rousseff government, the Brazilian *real* was extremely appreciated, and the government took measures to discourage further appreciation. This is not an exchange rate target; it is simply a way of trying to regulate currency volatility so that neither appreciation nor depreciation is excessive. This policy is compatible with the floating exchange rate. When the opposite happened—when the prospect of the end of U.S. expansionary monetary policy contributed to devaluation of the *real*—the government acted to prevent excessive devaluation.

What about the changes in fiscal policy?

The target is still the primary budget surplus target, with flexibility . . . . As economic growth slowed down not only in Brazil but also globally, the government in effect reduced the budget surplus target and will do so again this year, and probably next year as well. But even with a smaller primary surplus than in the recent past, net public debt continues to fall and gross public debt is stable. Fiscal policy was contractionary in 2011, I think everyone agrees, and yet it was in 2011 that inflation reached 6.5%. Despite the slowdown in growth from 7.5% to 2.7%, inflation accelerated because it was not necessarily associated with aggregate demand, and it was affected by some supply shocks.

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However, fiscal policy turned expansionary after 2011. Why?

Because the slowdown of 2011 continued in 2012, it is natural that fiscal policy became more expansionary because the minimum wage and the Grant went up, which meant that public spending did not fall in the same proportion as revenues. It is not possible or reasonable to ask for fiscal policy to tighten when GDP growth slows to less than 1%. In fact, fiscal policy should try to stabilize growth.

How about inflation?

The inflation target should be pursued primarily by using monetary policy measures, which is what the central bank has been doing recently by increasing its policy interest rate. This will eventually bring inflation down to the center of the target range. I think that by the end of next year or early 2015, Brazil will have inflation closer to 4.5%—if there is no adverse impact from the rest of the world. The policies of recent years have successfully increased employment and raised wages, and that pushed up the price of services. By 2010, most of the increase in services prices had been offset by a fall in other prices. What has happened in recent years is that other prices behaved less favorably to contain inflation. This pushed inflation up, which is a concern. It is important to bring inflation back to the target.

How do you see gross debt, which is a current concern?

Gross debt in Brazil has grown in recent years for two reasons: The first was the accumulation of reserves—the central bank has to sterilize its purchases of foreign exchange by issuing bonds. This has a high fiscal cost, but the increase in international reserves was necessary to reduce Brazil's vulnerability to external shocks. A country that has reserves has

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room for a more flexible economic policy. It's expensive insurance, but it's necessary. It made possible counter-cyclical policy in 2008 and 2009, and today as well. Reserve accumulation accounts for more than half of the increase in gross debt in recent years. The second part is loans to the public banks, such as the National Bank for Economic and Social Development (BNDES), in 2009 and 2010. That was how Brazil increased credit when private banks reduced it. The Treasury lent funds to the BNDES, which in turn lent them primarily to finance working capital for small businesses, investments in machinery and equipment, and infrastructure.

Lower growth reduces government tax revenues. At the same time, the government has kept up its income transfer program.

The Treasury policy of lending to BNDES is a major target of criticism.

The policy has been successful in fighting the crisis and it achieved its goals, but there is no need for it to continue in the same volume as in the past. As I said, this policy has a high fiscal cost: the government borrows at 10%, and the BNDES lends at 5%. The challenge now is to gradually begin reducing these incentives. That cannot happen immediately, because many investments still depend on the performance of these banks, but there is no need to lend as much as in the past. Actually, each year, government loans to BNDES have been lower than in the previous year, and that will gradually reduce the cost of debt. The problem of public debt today is not a solvency issue, because there is no doubt that Brazil has the capacity to pay—especially because some of the debt is in local currency, solvency is not a big problem. It's more a matter of cost.

Why has the growth of the Brazilian economy slackened during the Rousseff administration?

On the demand side, policy tightening in 2011 slowed growth in an unfavorable international scenario, which caused a decline in our exports. So it is possible to explain most of the slowdown in terms of lower aggregate demand. Internally, there was a slowdown in investment . . . and there was also reorganization of the government's investment policy, with less emphasis on public works, and the decision to grant the private sector more concessions. This caused a temporary drop in the volume of investment. Finally, private banks reduced their lending, which hit consumption.

How can demand recover?

The economy may grow faster driven by investment. The government is doing all it can to increase its investments with concessions . . . which may boost growth. On the other hand, the world outlook does not suggest that our exports will recover quickly, so growth will be somewhat slower than in the past. But from the point of view of demand, a range of 3.5% to 4.5% is possible.

How about the supply side?

On the supply side, the challenge is to sustain growth without stimulating inflation. The big change is that we now have full employment, so there is no room for the unemployment rate to fall. That means growth now must come mainly from increased productivity. And once again it is necessary to increase investment, because increasing the amount of capital per worker increases productivity.

How do you see economic growth this year and next?

Economists generally are expecting 2.5% in 2013 and the same next year, though the government expects a little more in 2014—a goal of 4% is in the 2014 budget, though economists talk about a figure above 3%. I think what happens will depend on two factors whose direction we cannot predict. The first is the strength of the recovery of the world economy. The second, on the domestic side, will depend on the success of the current policy of increasing investment, especially investment through concessions . . . . This can create a climate of greater confidence, leading the private sector to resume its investments. . . . If successful, that may be the deciding factor for Brazil to grow more than 3%.