

Financial innovations not bad, just misused



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There was a time in Brazil when the finance minister was almost as important as the president, given the autonomy he was granted. Known for his irony, acid humor, and quotable phrases, Antônio Delfim Netto was Minister of Finance between 1967 and 1974, and architect of the “economic miracle” when Brazil grew at rates above 10% a year. He returned as Minister of Agriculture (1979) and shortly thereafter became Minister of Planning. It was he who in 1985 negotiated debt relief with foreign creditors and the International Monetary Fund (IMF). He has also been ambassador to France and was for five consecutive terms federal deputy from São Paulo. Delfim, now 83, here draws a comprehensive picture of the world economy.

The Brazilian Economy — How do you see the changes taking place in the world economy?

Delfim Netto — First, anyone who is not confused is misinformed. We all have a hard time understanding how it was possible to end up in the present situation. Surely, what will come out is a different world, but humankind will continue to seek a social organization that ensures three conditions: productive efficiency; increasing independence and autonomy; and relative equality. The first two goals evolved over time in an almost biological process, but governments have tried to add equality, especially since the Industrial Revolution, by adopting social policies. But it is a highly competitive process, a race that to be fair must allow everyone the same departure point. It is a civilizing process, justice within capitalism.

Today, many complain that the current crisis is a consequence of the welfare state. Nonsense. It is the result of incompetent governments and short-sighted and dysfunctional financial systems, which instead of serving the real sector serve themselves. Financial derivatives can help make the economic system function better

but they can also become weapons of mass destruction, because central banks — and governments — failed to understand them. The current crisis would not have occurred if the Federal Reserve (Fed), the Bank of England, and the European Central Bank knew what they were doing. Letting Lehman Brothers break the way it did showed how myopic they were. Financial innovations are not bad; these were misused. This is changing.

In what way?

The financial sector took over not only the real sector but also political institutions. The Dodd-Frank Act is proof that the financial system has great influence in the U.S. Congress. In a document of 2,200 pages, 140 created new institutions. This is a repetition of the 1929 crisis ... the financial system, once unfettered, always produces the same effects. I often joke that bankers always go back to the scene of the crime. The financial and banking system needed to be saved, but was it necessary to also save the shareholders and managers of the financial system? ... Assisted by his academic advisers, President Obama has protected Wall Street and forgotten Main Street. Shareholders have lost little, financial institution managers came out very rich — and 25 million Americans are unemployed. Honest workers paid the price of the dishonest financial system. These things have to change.

The two main institutions that maintain the capitalist system, the market and the ballot box, will

balance it out: when the market produces major distortions, the ballot corrects it; when the ballot produces major distortions, the market penalizes it. This dialectic will continue. The result will be a market economy, one I would call capitalist, that will probably be better than we have today. It is a civilizing process for which no better alternative has appeared. Slowly we are moving toward institutions more concerned with cooperation, altruism, and concern for the environment. At the same time, there are more restrictions on growth because the earth cannot hold 10 billion people with per capita income of US\$20,000.

In Europe, some national central banks bailed out local financial institutions. However, since the European Central Bank automatically assumes these risks, the whole system is threatened. What does this say for the euro?

The euro was a political decision to establish peace on a continent with a 1,000-year tradition of war. Its civilizing value is extraordinary. Why is Europe in the current predicament? Because the European Economic Community was engaged in self-deception when it said no member could have a fiscal deficit of more than 3% of GDP or a national debt

This crisis is a repetition of 1929, which clearly shows that the financial system, once unfettered, always produces the same effects.

greater than 60% of GDP. The markets and financial institutions, with government complicity, were mistaken. When the rating agencies gave Greek bonds a AA rating, or when the Greek government confounded financial data with accounting tricks, there was no criticism.

Europe is not an optimum currency area, because member country fiscal policies are contradictory. Is the euro worth saving? I believe it will take a while, but there will be an institutional improvement and the [crisis] bill will be paid. Again, the market and the ballot: Over the next 12 or 14 months there will be elections in 24 countries.

No use now to tell the Greeks they spent too much; it is impossible to go back. The only way to produce a surplus is to grow out of it, even if growth is low. These issues are not solved by producing depressions or recessions in indebted countries but by finding mechanisms to ensure at least minimum growth. And there must be debt restructuring. It will take time because you need to strengthen banks' capital so they can absorb the new losses.

Do the serious U.S. fiscal problems pose a threat to its creditors or are U.S. Treasury bonds still the best protection for investors?

The United States has both of the necessary and sufficient conditions for economic growth: innovation and credit. It will grow back faster and more adjusted to the new world.

This shows how rating agencies are not worth anything: When Standard & Poor's reduced the U.S. rating from AAA to AA-plus, there was a race for Treasury bonds. Every week the U.S. places US\$250 billion to US\$300 billion in bonds with 30-day to 30-year terms. They will continue to be placed, at low interest rates. Rating

agencies, not the United States, have lost credibility.

And why is the American economy not working? Families are consuming less because they are using their resources to pay debts and they are not sure whether they will have jobs. Corporations with US\$2 trillion in cash do not invest because they have no expectation of demand. Banks, which have US\$1.5 trillion in excess reserves, do not lend because they have doubts about the other banks. An economy lives on expectations. When no one has confidence, everyone is drowning in liquidity.

If Obama wins in 2012, he might possibly win majorities in the House and Senate and could implement his program, right or wrong. If a Republican is elected, it could be a great tragedy because they are locked in a retrograde ideological process. Obama did everything by the book: increased liquidity, gave money to states for public works, etc. He has

created all the conditions for the economy to work but failed to co-opt the private sector, to whom he dispensed very harsh treatment at the beginning of his administration. And society has rejected him. But the United States has both the necessary and sufficient conditions for economic growth: innovation and credit. It will grow back faster and more adjusted to the new world.

You mentioned elections as a remedy for economic distortions. But the latest revolution in the world economy was caused by a country with little sympathy for elections and until recently for capitalism. How would you decipher the enigma of China?

There's no enigma. China is actually a projection of the United States, the result of a strategic U.S. political act. When Mao Tse-Tung and Stalin quarreled and China moved away from Russia, the U.S. seized the moment to give China a big chance: "open special economic areas that I bring my capital and open my market for you." To get an idea of the symbiosis, currently 35% to 40% of Chinese exports come from U.S. companies based in China. Why has the U.S. Congress never declared that China is not a market economy? Because it would be forced to raise the tariffs on goods from China as high as the general appreciation of the yuan.

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China did a wonderful job, but now it is starting to show signs of the 30-year sin: it is abundantly evident that China needs to profoundly change the axis of production from the export to the domestic market. It is an extremely difficult transition. China's 12th Five Year Plan is hugely optimistic, based on very unlikely assumptions, such as a large increase in total factor productivity. We live in a time when the productivity of capital and demographic trends are down.

What is Brazil's weight in the BRICS group?

The comparison [with the other BRICS] has helped us demonstrate the dramatic improvement in the Brazilian situation. Of course there are sins, but it is also clear that the government is making efforts to address Brazil's fundamental problems, for example, carrying out a long-term fiscal balance program and tackling public sector pensions and control of personnel expenses. There is a perception that you need to make room for increasing domestic savings. Critics say this is just posturing to force the Central Bank to lower interest rates. This year the government will spend R\$190 billion on interest on public debt. Who with common sense can imagine that Brazil needs a real interest rate of 8% a year? My hope is that the new fiscal policy allows the central bank to reduce

the real interest rate to about 2.5% to 3% over the next four years. Many people will have to earn an honest living.

Our reliance on exports of commodities has been much criticized. But when world economic growth falls, demand for agricultural commodities tends to be less affected. Could they be a competitive advantage for Brazil?

There is no contradiction in taking advantage of the [commodities] boom. Remember that Brazil went broke twice, in 1998 and 2002; today, we have US\$350 billion in international reserves. We took advantage of the expansion of the world. We have become a creditor country.

But we were better competitors then than we are today. We have the highest gross tax burden among countries with our level of income and the highest interest rate and the most appreciated exchange rate in the world. When someone calls for general equilibrium models, that is completely crazy, because the general equilibrium theory has nothing to do with the world.

Emerging countries have managed to combine high rates of economic growth with stability, but some, like Brazil, face rising inflation. How do you promote growth with low inflation?

It takes a credible, feasible long-term fiscal policy and higher public saving. For Brazil

to grow 4.5% to 5% a year, the domestic savings rate should be about 22% of GDP. We need to convince Brazilians that there is a tradeoff: more income distribution today means less growth for our children. As for inflation, it is a global problem and Brazil depends on imports, so there is no reason to think that Brazil could meet its target. There are also other factors. In the service sector, for example, there is a mismatch between demand and supply structures. This cannot be corrected by the interest rate but only with a policy of educating labor.

How would you assess Workers Party (PT) government, especially Rousseff's first few months?

The election of Lula consolidated democracy in Brazil. In the first election when I said I would vote for him, my people were very annoyed. This test was necessary. Lula proved to be a great president. So did Cardoso. Even Collor made an important contribution to opening the economy. What matters is that Brazil has been improving all this time. Lula addressed an important aspect of the Constitution of 1988: increased opportunities for the people, which are linked to the equal starting point I mentioned. He did a very good job, took advantage of what the world offered. I see President Rousseff as a technocrat who reads the same books that we read, studies reports, and is not fooled by bells and whistles. She represents very important continuity. ■

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