

3% TO 5% GROWTH

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The artificial increase in wages and consumption will lead to the substitution of foreign for domestic savings

Between 1995 and 2004, Brazilian economy was growing at an approximate rate of 3% per annum - which led conventional economists to say that 3.5% was the "potential GDP" - that is, the maximum growth rate that Brazil could experience without a return of inflation. From 2005 to 2008, however, this rate jumped to nearly 5% and, after the repercussions of the global crisis in 2009, shall grow by a bit more than 5% in 2010. Given its human, technological, and institutional resources, and given its still cheap workforce and the possibility of copying or buying technology at a relatively low price, Brazil would be able to grow, as the other three BRICs, by more than 7% per annum. But how to explain the leap from 3% to 5%?

In order to understand it we must consider that the economic development depends on the existence of internal and external demand. It also depends on factors on the supply side, but the fact is that Brazil has innovative entrepreneurs, competent managers and technicians, a national system of innovation, a financial system and better institutions than would be expected with the countrys per capita income. The developments bottleneck is not, therefore, on the supply side, but on the demand side. For growth to exist, it is essential that entrepreneurs have demand, that is, good investment opportunities, credit, and that they invest, thus increasing savings.

Between 2003 and 2005, it was the external demand that supported the leap in Brazilian development. It was a depreciated exchange rate, that started from R\$ 3.95 in December 2002, as well as a huge increase in the price of commodities exported from Brazil. Unattended, however, the exchange rate gradually appreciated again, and the industry lacked incentives to invest in the production of export goods. Yet, as of 2006 the internal demand replaced the external demand as a development factor, and industrial investment was once again stimulated. It didn't grow based on public deficit, which was kept under control, but based on two healthy distributive measures (the increase in the minimum wage, and the increase in the expenditure with family allowances) which effectively made up for the structural tendency of wages to grow less than productivity. And also based on a dangerous financial measure: the "crédito consignado" [*a loan whose installments are deducted from the paycheck*], that is, a greater household indebtedness, which may create problems in the future. Through those three policies, internal demand replaced the external one, entrepreneurs continued to have lucrative investment opportunities, and investment and savings rates increased.

Can we, therefore, at last celebrate Brazilian return to sustained economic development? Unfortunately not. And not only because the "crédito consignado" is dangerous. But also and particularly because the exchange rate is again appreciating and Brazil is back to the current account deficit. As a result, it "will grow with foreign savings", conventional economists argue. Big mistake. When a nation spends more than it collects and goes into current account deficit, what we have is exchange rate populism sanctified by orthodoxy. Instead of an increase in investments, what will happen again is the artificial increase in wages and consumption, and, thus, the substitution of foreign for domestic savings. And, once again, Brazilians will be haunted by the prospect of instability and financial crisis.