The shortsightedness of economic policy packages

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The succession of demand stimulation "packages" may even bring momentary relief but they jeopardize sustained growth.

Primum non nocere (first, do no harm) is a basic principle of medical ethics, according to which a doctor should assess, before recommending any course of action, whether it will be more detrimental to the patient's health than doing nothing at all. This lesson can be applied to various other areas, including economics. Unfortunately, it has not been afforded the attention it deserves in the conduction of recent Brazilian economic policy. The economy's sharper deceleration has led to the adoption of a succession of increasingly pathetic economic stimulus packages.

These packages are based on the same diagnosis: a lack of demand. And prescribe ever larger doses of the same medicine: credit subsidies and tax breaks, always focused on a few products and sectors which are chosen according to obscure criteria. Policymakers have also often resorted to the creation of barriers to imports of products that compete with sectors with the strongest lobbies in Brasilia, notably the auto industry.

It is true the Brazilian economy is currently experiencing a patch of weaker demand and it is the function of economic policy to smooth out the business cycle, as far as possible. However, the rare and brief moments of lack of demand are far from being the most significant threat to the performance of the Brazilian economy. On the contrary, it is the difficulties on the supply side that constitute the structural bottlenecks that have been hampering economic growth for many years. And it is often the case that, instead of removing supply restrictions and helping to increase the economy's productivity,demand stimulus packages, in fact, represent an increase in the Brazil cost for sectors that do not benefit from government measures.

Recent economic policies are looking increasingly like those that existed in the pre-Real (1994) period when rules underwent frequent changes. This approach is diametrically opposed to the precepts of modern economic theory, which has increasingly emphasized the importance of maintaining incentives that favor economic growth and prosperity. Incentives can only work if they are based on rules and institutions that remain stable over time. The instability caused by a succession of packages hinders investment and growth.

Instead of making efforts to reduce costs and invest to increase productivity, a rational entrepreneur who faces difficulties will soon realize that it is more profitable to join a lobby group to obtain rents in Brasilia or Chile Avenue (Headquarters of the Brazilian National Development Bank, BNDES). It comes as no surprise that this is what has, in fact, been happening.

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I confess that even I find it tiresome to have to repeat the argument that the structural reforms (social security, tax, labor) should once again become a priority. But not even the modest bill of law aimed at limiting the real growth of the public sector payroll has been put before Congress, with the lower house representative, who is the rapporteur, alleging that he will not do so until the President affirms that passing the measure is indeed a priority.

It is increasingly evident that economic policy lacks a coherent long-term view. For example, when justifying the measures of the recent package, the Development Minister declared that "*the government is combining structural measures, such as the systematic reduction of interest rates, with conjunctural measures….*" (Valor Econômico, 05/23/2012, pg. A3). This declaration contains two falsehoods. First of all because it attributes the reduction of interest rates to a supposed government agenda of structural measures, when, if one is to believe the declarations made by President Dilma and the president of the Central Bank (CB), interest rate management should be the CB's autonomous responsibility. Secondly, and more importantly, because changes in interest rates are, by definition, anti-cyclical and constitute, thus, conjunctural measures. Structural measures would be those that allowed the CB to reduce rates without putting the control of inflation at risk, such as a real fiscal adjustment to restrict the expansion of current expenditures and stimulate public investment. But the government does not seem to be interested in these kinds of measures, or is unable to promote them.

As a friend said the other day, the current economic strategy looks increasingly like that of the stand-in chess player: "Just move the pieces forward, because chess is only luck"!