The Fiscal Adjustment and the Goat

The true necessity and the lie of what is possible

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Legend has it that, back in the days of communism, a family of 11 people lived in a tiny apartment equipped with one single bathroom. The family head, living on this situation of shortage, decided to complain with the Comrade who promised a solution to this predicament: he sent a goat to live with the family – that loved to stay in the living room. Obviously, what was a really bad situation became the hell, and therefore the family head came back to the Comrade begging the removal of the animal from the apartment. Some days later the Comrade asked to remove the goat and called the family head to know about how things were going, and he was said: "now that the goat was removed from the living room, it is better". Since the new economic team of the Interim President Michel Temer assumed power, we saw the target of the fiscal *deficit* of 2016 soar to dizzying R$ 170 billion, and in the last weeks the estimates for 2017 rose to R$ 200 billion. Finally, the government has admitted that R$ 139 billion is a more realistic target for 2017: it is our real-life version of "the goat out of the living room"!

Few economists have yet failed to accept that the fiscal adjustment is the cornerstone of our financial health and of a recovering sustainable economic growth. Also, few are those who cannot see the fiscal irresponsibility of these last years, although these do not appear to be as numerous as those who set aside the transparency and the level of accountability that rules the composing fiscal *surplus/deficit* accounts. Therefore, extending credit that a competent economic team, such as the current one deserves (team whose premises of the recovery of economic growth are based exactly on the fiscal adjustment), we assume the new estimate to be true. However, only six months ago no economist nor consulting firm, not even the most pessimists, would dare to present a *deficit* of R$ 170 billion for 2016, given the troubling contrast with the figures discussed at that time. Could it really be that projecting revenues and expenditure in this segment, with tens of economic thesis awarded around the globe about how to estimate government revenue and countless methodologies developed to quantify expenditure, is such a daunting challenge that no one could predict this number? Was it then a total surprise? Or is that a general collusion within the previous administration in such a way as to "hide" the reality of existing facts? Or, prior to this, is the current economic team misidentifying and wrongfully mapping out the numbers? Or, finally, is the necessity of gradual adjustment added to a weak political situation "concealing" the truth? It does not matter; the benefit of the doubt is given to the current economic team, but a breakdown of expenditure and a clear identification of how the revenues will be achieved are expected to be further detailed.

In this sense, in order to understand the rational management of public accounts, the new government will have to go public as regards its long-term perspectives, however difficult and imprecise it could be (but defining those targets and guidelines to achieve them is essential at this moment). Actually, it is not so hard, since members of the economic team have already done it once, partaking in previous administrations, now it is of necessity to achieve the alignment of techniques with politics and with what is possible. Thus, we need that the politics, as the art of the possible, lines up to what in fact the country needs, and is able to attain. Not because of luxury or insensitive audacity where additional contingencies promote the opposite of the oath taken by economists, *"… the promotion of the nation's social and economic welfare…"*, but that the certainty that not correcting the present imbalances today will lead to heavy burdens tomorrow – a reality we

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are ourselves living. The institutional setback called the New Macroeconomic Matrix charges its price today, and reverting this situation means recognizing that we have spent resources unavailable to us, and that, therefore, we need to review the entire arrangement. The adjustment will come one way or another, sooner or later, in a direct or indirect manner – a stubborn inflation does not let us lie.

As we do not live isolated from the world and as we are in desperate need of external savings, solving or not the fiscal conundrum impacts directly the appetite of foreign investors for Brazil. And those investors rely greatly on the concept by which risk-rating agencies evaluate us, being the main solvency indicator of a country (among others) the ratio of Gross Debt/GDP. The irresponsibility of the previous government has led us to lose the Investment Grade, which sacred away foreign investors. Thus an important source of funds was suppressed, and whose return is not only uncertain but it is conditioned on this adjustment restoring the *status* of good payers again.

Getting back to being a country with Investment Grade must to be our main goal. To achieve this objective several actions are required, although the fiscal adjustment is the first and most important step. From this standpoint, the targets of R$ 170 billion for 2016 and, especially, of R$ 139 billion for 2017 are far from helpful. More than this, the target of 2017 does not seem to match the government-sponsored hypothesis of a 1,2% GDP growth rate in 2017. Our estimates point to a *deficit* of approximately R$ 128 billion (without greater efforts to cut back), resting on the projection of a negative GDP growth of 1,3%. In other words, someone is really wrong – either that or the databases applicable to the projections are erroneously available.

When all is said and done all of it matters very little, since it will not be the lie of the possible to be done, but the truth of the urgent necessity that will seal our future. Honest projections about the Gross Debt/GDP ratio lead us to unimaginable 90% in following years, demanding a *surplus* of 4% to at least bring the referred ratio to stability. Mathematically speaking, there is no mystery: reduce the expenses, increase the revenues and have a rising GDP – facing this issue is the real problem, and the first measure must be to drastically reduce spending. Risk-rating agencies will not pay a blind eye to those forecasts and our *rating* will not be unscathed by them. The alternative is to act, and act intensively now – surprise everyone with measures that do not leave doubts about the effort on short, medium and long terms. Everybody knows about the limits to managing the federal budget – we delegate to the brilliant minds of the new economic team the task of coming up with new ideas (despite the participation of the Minister of Planning, which has integrated the teams under Mantega and Nelson Barbosa - the brief - whose past seems incompatible with the current adjustment). More than political ability, we need the courage, vision and detachment of a truly statesman to get the country back on tracks.

The financial markets and the Brazilian society are extending the benefit of the doubt to the new team, although this truce has limits; these latter range from the transparency of its acts and the pragmatism of its actions to the effective impact onto the heart of the problem and on the economy. What is the matter then? This “honeymoon” is unlikely to last long, as society is growing weary while knowing this adjustment will compulsorily extend to the long run, that being the reason why an immediate long-term plan is due. It may be a suicide the attempt at coordinating this process with a better political moment. It is impossible to simply remove the goat from the living room. We must find a better way to live.

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