# Initiative for Policy Dialogue

**Brazil Country Dialogue**
**August 26-29, 2003**

Summary Report

## Introduction

The 1990s in Brazil were characterized by a full range of economic outcomes; from hyperinflation to low inflation (from 1990-1994 average annual inflation was 1724% while from 1997-2000 it was 5.2%); from growth to recession (from 1993-1995 average annual real growth was 5% while in 1998 and 1999 it was .5%); from currency volatility, to stability, to crises. Growth peaked in 1994 at nearly 6%, but this growth was a false start since much of it was based on volatile short-term capital inflows, which did little to stimulate long-term sustainable growth.

Like much of Latin America, Brazil implemented macroeconomic stabilization policies in the mid to late '90s. And, like much of the region, Brazil was able to achieve macro-stability. But the policies put in place did not add to Brazil's growth potential and may have, in some cases, been a force in the retardation of growth.[1] Furthermore, the macroeconomic stability has been threatened by open capital markets, which bring with them the threat of market volatility. The current government in Brazil was elected on a populist platform that promised policies of growth and equitable development. Most of these policies, however, were put on hold as the government implemented more market-friendly policies in the hope of maintaining stability.

While the intellectual debate on this and related issues is well developed in Brazil, IPD was able to bring the topics to the forefront of discussion and enlarge the scope of the debate, as well as offer concrete policy recommendations. There was considerable press coverage of the dialogue, helping to strengthen the arguments of alternative views in the Brazilian public dialogue.

IPD was successful in bringing the issue of accounting and appropriate accounting methods into the discussion. This issue had previously been largely absent from public debate. Alternative accounting frameworks are particularly important in the context of the IMF framework, as the measurement of IMF targets can vary greatly depending on which accounting method is used. During the IPD Country Dialogue Brazil expressed interest in

[1] GDP growth per year: 1998:.2%, 1999: .8%, 2000: 4.3%, 2001 1.4%, 2002: 1.5%, 2003: .7% Estimated data from EIU

putting this topic on the agenda for discussion with the IMF mission in late October 2003, specifically proposing the policy options that IPD brought to the discussion. Since the dialogue Brazil has had discussions with the IMF on changing the accounting standards.[2]

The IMF and the WTO negotiations followed the IPD Country Dialogue, making the timing of the dialogue particularly important in influencing the subsequent discussions. Brazil has since played a major role in the G22 during the WTO negotiations in Cancun. Brazil has become a leader for developing countries by advocating for more equitable trade agreements, especially in the areas of US and European agriculture subsidies – an issue the IPD team spoke on extensively.

The Country Dialogue centered on the issue of enhancing growth and development and on the combination of polices which could put Brazil on a path to sustainable and equitable growth. The main topics discussed were: macroeconomic policy, including accounting and fiscal issues, and the high cost of interest rates in Brazil, trade policy and negotiations, modern industrial policy (using East Asia as an example) and land reform.

## Description of Meetings

IPD was initially invited to Brazil by the Council for Economic and Social Development, created by the Brazilian President, Luiz Ignacio Lula da Silva, as a forum for inclusive policy debate. The goal of the forum is to bring together civil society groups to discuss current national issues. In April 2003 members of IPD's Pension Task Force traveled to Brazil to discuss the issue of pension reform, one of the main topics on which the council was asked to give its opinion to the government. At that time, the IPD team met with members of the government and the Council to discuss issues affecting the proposed pension reform. The IMF, the World Bank, and the government all agree on the need for reform and the necessity to cut costs, but did they not have a clear framework with which to analyze the alternatives and trade-offs of different policies. The IPD team worked with the Council to delineate the goals of the system, and incorporate them into a framework for reform.

The Council then invited IPD to return to Brazil to discuss a broader set of issues on how to stimulate growth. IPD held a series of meetings with the Council, academia, government officials and the private sector. The first set of meetings was held in Brasilia. These meetings were organized by IPD's second partner, UNDP Brazil. The IPD team met with the Central Bank, President Lula's chief of staff, the Minister of Land Reform, the Senate, and ECLAC. In addition the team gave a public conference at ENAP (a University of Public Affairs).

The second set of meetings and the open forum were held in Sao Paulo. The forum was co-organized as a full-day major public dialogue with the Council for Social and Economic Development and *VALOR Economico* (a Brazilian newspaper). This event was

[2] See the The Financial Times, "Brazil seeks more spending leeway", April 26, 2004 and "Brazil seeks IMF deal on public investments", July 27, 2004

attended by over 400 people, received considerable coverage in the media, and led to increased public awareness of the issues discussed. The IPD team also participated in the Council's monthly meeting, met with members of the private sector, academia and the governor and mayor of Sao Paulo.

## Overview of the main topics of discussion

### *Macroeconomic environment and policy*

President Lula's market-friendly polices were implemented to calm the international capital markets and avoid possible capital outflows. PT supporters, however, are dismayed at the lack of progress in social programs and in growth and development.
During the Council meeting, some of the members of the Council addressed issues of stabilization and growth, questioning the lack of growth on Brazil's end and calling for higher savings to ease dependence on foreign capital.

The IPD team emphasized that overly high interest rates and an overvalued exchange rate used to reduce inflation will retard growth. The IPD team stressed that stabilization is not enough for growth. Much economic theory has confused ends with means. The long term goal of economic policy is sustainable growth and higher living standards. Inflation should be viewed as an intermediate variable, not an end goal in itself. Reducing inflation from hyperinflation levels, as Brazil did in the early 90s, is generally good for growth, since hyperinflation has a high cost associated with it. However, the cost of relatively low inflation is low, while the costs of *fighting* low inflation, in terms of lost growth, can be high.

However, as the IPD team discussed heterodox policies alternatives, it seemed clear that the political situation in Brazil is such that these policies may not be easily implemented. The fear of consequences of not following market-friendly policies is too great.

### *Fiscal Management*

Over the past several years Brazil has retained primary surpluses. As part of the 2003 IMF agreement, Brazil has agreed to maintain a surplus of 3.75%.

Given its low savings rate and high level of public debt, Brazil needs to increase savings in order to repay its debt. Maintaining a high primary surplus is one way to do this. In addition, those who support a high primary surplus hope that it will send a positive signal to the market, with a tight fiscal policy providing the framework for reduced risk premium and the inflow of capital.

The Minister of Finance, for example, argued the risk premium in Brazil is highly correlated with the primary surplus. Marcos Lisboa, Secretary for Economic Policy, argued that if the primary surplus falls then interest rates would rise, thereby forcing the government to cut expenses to maintain the high surplus.

On the other side of the debate, a high primary surplus signifies lower expenditures on much-needed social programs. In fact, Brazil has achieved its primary surplus by cutting expenses, not by increasing tax revenues. The social programs are particularly important, given the political platform on which President Lula was elected.

*Accounting issues*

The IPD team was critical of the IMF's counter-cyclical policy recommendations of tightening fiscal policy during a recession to maintain a primary surplus, and addressed the need to employ expansionary policies during a downturn.

However, given the political realities one emphasis of the analysis was on how to increase the ability to use fiscal policy within the IMF framework. The IPD team focused on the way the fiscal statements are accounted. In Brazil, unlike in Europe or the US, loans taken out by state owned companies are consolidated into the state balance sheet. This policy negatively affects state owned enterprises that incur debt as part of an investment strategy, because the liabilities are not weighed vs. the assets. The IPD team pointed out that investors and the IMF should be looking at both the assets and the liabilities of the state owned enterprises in order make better-educated investment decisions. The current accounting method shows a higher government fiscal deficit due to interest payments on the debt owed by state owned firms, and a lower primary surplus.

This important policy recommendation was well covered by the press and well received by government officials. Brazil has put this and other topics on the agenda for discussion with the upcoming IMF mission in late October 2003. The government plans on discussing issues such as accounting, specifically proposing the policy options that IPD brought to the discussion.

### *Interest Rates*

Brazil has seen little growth in recent years. The IPD team suggested that some of this stagnation could be attributed to the high real interest rates in Brazil. High interest rates do not create a favorable environment for investment, and they attract short-term capital flows as opposed to long-term investment into the country. Interest rates (Selic) in Brazil at the time of the dialogue were 22%. Real rates were estimated to be between 10-12%.. IPD asserted the importance of lowering interest rates to restart growth. There was discussion about this issue with members of the private sector as well as the public sector. Interest rates had already started coming down slowly before the dialogue, and by November 2004, rates had fallen to 19%[3]

[3] Economist.com, Economist Intelligence Unit, Country Forecast, November 10, 2003

The Central Bank defended its position of a tight monetary policy, and suggested that high interest rates are partly a result of people's reluctance to lend to the government due to past economic turmoil, Brazil's history of default, and the current risk of a default on sovereign debt. The fear of inflation also keeps interest rates high. The government echoed the Central Bank in asserting that high interest rates have kept inflation down. The Central Bank pointed out, that Brazil did grow even given the high interest rates.

On the other hand, Brazil has experienced low to negative inflation rates throughout 2003,[4] while growth, though positive, has been extremely low by historical standards [refer to earlier footnote.] The IPD team again stressed the importance of not confusing ends and means. Low inflation and stability should be a tool used to achieve the real goal of long-term sustainable growth, rather than an end goal in itself.

Members of the private sector (in particular entrepreneurs) echoed IPD's adamancy regarding the retardation of growth as a result of high interest rates. The private sector called for the government's help in creating a proper environment for credit, as well increasing micro-credit and altering the bankruptcy law. The private sector believes that this will have an effect in bringing down the interest rates. These issues are discussed in more detail below.

In discussion with the Central Bank, the IPD team suggested that there are additional heterodox tools that can be used to fight inflation, which do not have as great an impact on growth. For example, inflation puts can be included in government bonds. If inflation rate exceeds a certain level (the strike), investors can sell the bond back to the government at a preset price. In this way investors can hedge against inflation. In addition, the government will make a commitment to lower inflation, which can influence inflation expectations and lower the inflation rate without needing to resort to such high interest rates. This recommendation was made in response to the Central Banks' adamant stance on maintaining high interest rates.

Exacerbating the effect of high real rates, the spread between borrowing and lending rates is extremely wide[5]. Some have attributed the spread, in part, to the lack of competitiveness in the banking sector. There is an issue of low supply of credit in the market, which enables the banks to set higher than equilibrium rates due to low competition.

The financial sector, however, pointed to an IMF study that shows that Brazilian private banks are indeed competitive. This study showed that only public banks are not competitive. However, others, who maintained that the banks operate as an oligopoly, disputed this study.

[4] National Consumer Price Index % change in 2003
Jan - 2.47, Feb.-1.46, Mar.- 1.37, May - .99, Jun. –0.06, Jul. –0.04, Aug. - 0.18, Sep. - .82
Source: Brazil Central Bank

[5] August 31.3%, September 30.6%, Agencia Estado Brazil

Members of the banking sector attributed the wide spread, in part, to poor bankruptcy laws. In addition, they pointed to tax on those who borrow money, which the borrower must pay at the minimum rate of .38% and up to 1.5% of the amount of the transaction. Moreover, banks have compulsory deposits at the Central Bank and pay what the private banks deem as overly high tax rates.

While the banking sector points to poor bankruptcy laws as the primary reason for the large spread, there is some evidence that the sector has been slow to push for new laws. There is little incentive for the financial sector to push for change. The government maintains seniority in bankruptcies. Since most bankrupt companies have huge tax liabilities, banks do not often pursue bankruptcies in the courts. Since the banks are making a large profit, even with the inefficient bankruptcy laws, there has been no push for new laws.[6]

The IPD team proposed the option of a new law, but members of the banking sector argued that a new bankruptcy law will not solve the problem of the borrowing tax or the high risks associated lending. For example, even with laws in place, judges are reluctant to repossess homes and throw the homeowners out on the street, making mortgage lending extremely risky.

The IPD team advised Brazil to expand credit to micro borrowers, as the expansion of micro enterprises is an important facet of growth and equitable development. Increased competition through reduced barriers to entry into credit market will greatly reduce the spread.

### *Capital Controls*

Even though the current government was elected on a platform that promised policies of growth, once elected it felt that it had to shift its focus shifted towards policies to maintain market stability, to avoid an economic crisis.

Professor Stiglitz raised the issue of using selective capital market regulations to reduce market volatility and safeguard the Brazilian economy from the shocks associated with capital flight or excessive capital inflows, while giving the government room to pursue growth-oriented policies. In the past, for example, Brazil regulated these inflows. These regulations were lifted and the current government is not seeking to reinstall them.

Professors from various universities asserted that it is impossible to re-impose capital controls, citing reasons that such controls would lead to a soaring of the exchange rate and capital flight. The IPD team put forth the view that capital controls can contain volatility associated with international capital flows. Brazil has been forced into counter cyclical policies because of its high debt burdens and open capital markets, and capital account regulations could be used to give the government additional degrees of freedom.

[6] This point was raised by Aloisio Araujo during a meeting of IPD's Bankruptcy Task Force on Septmeber 24th, 2003.

Capital controls can reduce the pro-cyclical nature of capital markets and buffer Brazil from devastating shocks.

Prof. Stiglitz pointed to the boom in Latin America, which was based on unsustainable short-term capital. He pointed to the fact that a country cannot build factories with capital that can leave overnight. This argument was well taken by the members of the Council, but again the Council commented on political economy issues that may impede Brazil from imposing any sort of controls. The current government has promoted social development policies, yet has been fearful of appearing unfriendly to markets. These policies do not always complement each other, and in the case of capital market controls, the Brazilian government fears the world financial markets would react unfavorably to such a policy. The IPD team also pointed out that there are different forms of capital controls, such as those that control inflows, rather than outflows, and Chile was cited as an example of a country that has been successfully able to implement capital controls on inflow and has not experience capital flight.

***Trade***

The Country Dialogue took place during a pivotal time, shortly before the WTO negotiations in Cancun. The trade imbalance between rich and poor countries was brought up both by the IPD team and members of the Brazilian government. While there was consensus on the negative effect of this imbalance, the IPD team was able to help the public discussion of the issue. Trade negotiations and current imbalances were covered extensively by the Brazilian press, as was Prof. Stiglitz' support for stronger negotiation tactics.

The IPD team stressed the importance of strong trade negotiations during public lectures and the IPD talk to the Brazilian Congress. The IPD team mentioned factors such as non-tariff barriers and unbalanced industrial policy as factors that contribute to the imbalance between rich and poor countries. Professor Stiglitz stressed, "A bad agreement is worse than no agreement." The statement rung true at the recent round of WTO negotiations at Cancun, where Brazil was an influential leader in the G22 group. Brazil has long pushed for lower agricultural subsidies to European and US farmers and a removal of the barriers to agricultural trade. It is now in a prominent leadership position to continue to negotiate more aggressively.

The Central Bank addressed China's accession to the WTO and the effects it has had on the Mexican economy, as well as its possible negative effects on the Brazilian economy despite Brazil's positive trade with China. The IPD team agreed with the Central Bank that reorienting their trade towards China is a good way to confront the situation. They advised Brazil to start thinking more broadly about what niches Brazil can engage in, in conjunction with appropriate industrial policies in the short run. The IPD team also pointed out that monetary policy is a big determinant in filling these niches; high interest rates affect access to capital and result in lower investment, making it more difficult to compete.

### ***Industrial Policy***

The 1970s was a period of high growth in Brazil, especially when compared to the growth rates of the 1990s[7]. In the 1970s the Brazilian government implemented an industrial policy, while in the 1990s the government adopted a more "hands off" approach, relying on the markets for growth. There is a growing view that the growth in the '70s was in large part due to the government's use of industrial policy.

The IPD team gave examples from Brazil in the 1970s, as well as other countries' similar experiences, as a reason for Brazil to pursue a more aggressive, modern, industrial policy today. The IPD team assessed that a there needs to be a bigger role for the government in the context of development, pointing out that Brazil is neglecting education and technological advances.

On the other hand, members of the private sector argued that much of the success in the 1970s was due to other factors, such as a less public sector debt. They pointed to corruption and inefficiencies in past use of industrial policies. While acknowledging the possibility of corruption and inefficiency, the IPD team maintained the need to learn from both the failures and successes of the past and focus on new ways of promoting education, technology, finance and marketing.

There are two types of industrial policy subsidies in Brazil. The first is the traditional BNDES subsidy, in which government funds are allocated to different companies, chosen by BNDES. The financial sector displayed displeasure with this type of subsidy, stating that BNDES needs to give incentives for people to choose their own investments, and not leave the choice of investments to the discretion of the bank. The second type of subsidy is made through private banks. The government, through BNDES, advises the private banks who they should lend to. The borrower does not pay for the subsidy, and in effect, the private banks lend at a subsidized rate.

Professor Dosi of the IPD team stressed the need for additional industrial policy and agreed that, while there may be no room for picking winners, there is room for industrial policy in Brazil. Some of the discussions were centered on issues where Brazil can have a comparative advantage, such as the pharmaceutical industry. Brazil, due to its large size, has an important domestic market. The Brazilian government has been working on an industrial policy action plan, which will be released later this year. IPD is working closely with the Council on these issues and the Council is collaborating with the government on the policy action plan.

IPD brought up issues of poor quality in Brazil and how to address the problem. Our partner institution, ECLAC, pointed out that while exports boomed in the 60s, 70s and

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[7] GDP % change - 1970: 8.8%, 1971: 11.3%, 1972: 12.1%, 1973: 14%, 1974: 9%, 1975: 5.2%, 1976: 9.8%, 1977: 4.6%
Source: UNSD Common Database

80s, they fell substantially in the 90s, and even the 60% devaluation was not enough to bring a rise to exports. There is clearly a problem of low competition in Brazil, which drives down the quality of goods. There is outdated capacity, a lack of low-price and high quality inputs, and excess domestic demand compared to export demand. Professor Dosi also pointed to the asymmetric tax system, where exports but not imports pay taxes, and the taxes are not reimbursed when goods are exported. This drives more industries to produce for the domestic market, which due to low competition produces lower quality goods. The two factors are combined to lower export orientation.

The Vice President of BNDES spoke on issues of state intervention during the VALOR conference. He argued that the state should protect innovation. He said that BNDES is committed to providing new funds for small and medium sized enterprises (SMEs), but that SMEs have not been requesting the funds. BNDES also pointed out that while it is a development bank, it needs more public funds to allow for greater investment in development projects. The IPD team commented on the need for a greater role of BNDES in stimulating an environment suitable for enterprise, innovation, and investment. BNDES needs to redefine its role as a development bank and promote new frontiers.

For example, currently neither Brazilian firms nor the government make significant investments in R&D, even though, as pointed out by Prof. Stiglitz, the return on investment in R&D is three times the return on education. This under-investment results in low productivity for high value added sectors, and contributes to the poor quality of Brazilian goods. Brazil therefore exports products with less valued added and is not able to successfully meet domestic demand with quality products.

One of the areas where the government has taken an active role is in the Amazon Free Trade Zone in Manaus. The Manaus free trade zone was developed in collaboration with BNDES, the development bank, to develop the Amazon region. The free trade zone was originally not planned as an area with exporting priorities. Rather the goal was for long-term development of the region. However, the area is now a semi-maquiladora region, which has brought employment, but done little else in the way of development. ECLAC, one of IPD's partners, asserts that if the free trade zone were to disappear there would be nothing left in the area. Manaus is an example of a region that, given more investment in R&D, could produce more value-added products and possibly backward linkages, while developing the zone. While there is no move to close the zone, without further development and targeted polices the proposed development of the region will not occur.

There was also a discussion surrounding the limits of the WTO and industrial policy. The IPD team raised questions regarding possible polices given the constraints of the WTO and the degrees of freedom Brazil experiences in dealing with such polices. ECLAC suggested policies of regional integration, which are not against WTO rules —an innovation law to generate closer ties between universities and enterprises. The IPD team suggested that there are loopholes in the WTO agreement, especially regarding Intellectual Property Rights, of which developing countries should take advantage. On the issue of Intellectual Property, Brazil has placed little emphasis on the patent office.

Brazil now has a European type model, but is bearing pressure to adapt to an American standard. The IPD team mentioned that Brazil might, in fact, want to have an inefficient patent office, which as a policy would allow Brazil to follow more competitive policies, while still remaining within WTO regulations.

During the meeting with the Council for Economic and Social Development and the VALOR conference The IPD team used Korea as an example of a country that followed a successful industrial policy. Korea's policy of sectoral targeting and discretionary industrial policy was key to its success. The IPD team pointed to the differences between Latin America and East Asia, and specifically to Korea; the East Asian countries have a higher number of qualified engineers and scientists, higher years of schooling and privately financed R&D. These differences, along with the high rate of savings and the increased competitiveness in the East Asian economies, propelled East Asia onto a road to development that Latin America has not experienced. While the IPD team stressed that Korea cannot be copied due to both the savings rate in Korea and the alliance and social structures of the Brazilian society, there are lessons to be taken from the Korean experience, particularly in the area of education and garnering a more skilled workforce.

Growth will be achieved by producing better and cheaper products to sell abroad and at home. IPD recommended strengthening the generic pharmaceutical industry, a joining of BNDES with the private sector to enter into high opportunity markets and challenging the Intellectual Property Rights protection. The Press covered IPD's push for greater Industrial Policy extensively. The Council for Economic and Social Development has requested further consultation on this topic and possible case studies, which will be presented to the office of the presidency.

***Education***

Brazil invests heavily in the public universities. There is a problem, however, because public universities are mainly accessible to students who have completed a private high-school education, and are more prepared to pass the rigorous examination necessary for entry.

Both the private sector and the public sector officials commented on the need for improvement and investment in education. Sergio Werlang of Bank Itau suggested that the government should democratize public education, since they do not want to privatize public universities. Investing further into primary education and increasing the quality of teaching at this level can achieve this. He also advised (during his speech at the VALOR conference) not investing in programs that offer a lower rate of return than education.

Albert Fishlow of the IPD team also emphasized the need for improvement in the quality of education, emphasizing that quality and not only quantity is important. He advocated for transfers (fellowships) for the poor to attend private high schools. This would allow the poorer members of the population access to the public universities. Giovanni Dosi of the IPD team spoke extensively on the need to increase education in terms of Industrial

Policy. He cited Korea as an example where the highly skilled work force was a determinate factor in the success development and growth.

### *Land Reform*

In the South and the Southeast, Brazil has a long history of advance. However, in the semi-arid Northeast region, families are poorer. Many people do not have access to land, and the fast mechanization of farming has harmed the small farmer. The landless families have formed a strong political movement (the MST) and are important supporters of the PT. The political movement has gained tremendous momentum staging rallies in the capital with heavy press coverage.

While the budget for land reform is low, the government needs to find a way to address the movement especially due to their strong political and social influence. 27, 000 Brazilian landowners control 178 million hectares[8] of land; the Gini coefficient is extremely high at 60.70[9]; and 22% of the population lives under the national poverty line[10]. The PT party was elected on a platform of social inclusion and income equality; the government is looking towards land reform as a solution to these inequalities.

The MST is demanding high-speed land reform and is threatening to re-seize land (as was their practice in past years). The government however, must also bow to the landowners, whose agribusiness represents 15% of GDP. The Ministry of Land Reform and the PT maintain that land reform is a pillar of the administration's policies, but point out that they do not have the finances to buy and redistribute as much land as necessary for those policies to succeed. The private sector asserts that the reform is not being dealt with well by the government, especially in regards to the regulating agencies. Currently the budget to settle the 60,000 landless families is 300 million Reals, while the necessary funds are equal to 1.2 billion Reals.

The IPD team met with the Minister of Land Reform, Miguel Rosetto. Rosetto and discussed the current criteria for land reform. Important issues for the Minister are small households schemes that will result in a more equitable land model, a policy of social inclusion, regional and local development, and the preservation of income in communities. The reform will include the following guidelines:

1. Short-term credit lines for investment in rural property and a simplified process to obtain the credit.
2. A national technical assistance program for farmers.
3. An income guarantee through insurance for small farmers.

The administration currently does allow for a transfer of large, unproductive estates to small farmers. However, the accounting method used has made this policy expensive and difficult for the government enact this policy. In the current policy, large landowners are

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[8] From Alternatives, Action and Communication Network for International Development
[9] from www.humandevelopment.bu.edu
[10] according to World Bank Data (2000) and WB poverty definition

paid through land bonds, at market rates. At the same time, the government makes mortgage loans to help fund small farmers. The government bond is counted as a liability on the country's balance sheet raising the country's debt ratios, but the asset (i.e. the mortgage) is not counted. The IPD team suggested that the current accounting is unfair, and that the government should separate this payment from the general accounting. The IPD team stressed that the asset transfer is not inflationary, and therefore should not be included as part of the fiscal accounting. IPD urged the Brazilian government to negotiate accordingly with the IMF on this issue.

The IPD team suggested policies to aid in the land reform process. A tax policy may affect market price by reducing the cost of acquisition land. A tax on unproductive land can also be imposed which will provide an incentive to sell land at below market prices. The Minister of Land Reform pointed out that this tax exists and has not proved successful. IPD suggested a program by which each landowner values the unproductive land himself. If the landowner places a low value to avoid taxes, the selling price will be below market rate, however if the landowner places a higher value on the land and the corresponding taxes will be high.

### *The World Economy and its effect on Brazil*

The final area of discussion was on the IPD's view of the world economy, and its effect on Brazil. In meeting with the Central Bank, Professor Stiglitz gave an analysis of US economic policy and possible scenarios and the effect that may have on the world economy. Professor Stiglitz was pessimistic in his overview of the US economy. In his view US interest rates would have to rise. He cited the fall of the housing market caused by rising interest rates, th``e huge US trade deficit, huge fiscal deficit and low savings as reasons for his pessimistic view. Professor Stiglitz explained the rise in interest rates by pointing out the change in net demands on the part of the US. Real interest rates would have to be higher due to a turnaround for demand for savings by 2% of world GDP. Stiglitz also asserted that medium-term interest rates would rise due to the increased risk premium brought on by the fiscal mismanagement of the US, which will be paid by emerging markets. Stiglitz painted four possible scenarios of the US economy:

1. Likely scenario: (with a 20% probability of a more dramatic event). The downturn of the US economy will be moderate.
2. Doomsday scenario: In terms of the exchange rate, two forces will move in opposite directions. While large deficits undermine confidence, the US will also have to borrow to finance deficit, this will pour money into the US economy and cause the currency to appreciate.
3. Negative scenario: The crisis in the Middle East will move money from Middle Eastern countries out of the US. The huge Asian reserves in the US will be moved within East Asia. The hostility in Europe will also drive investors to move money out of the US. All of these political movements will cause the US currency to crash.

4. The most likely scenario: The US dollar will appreciate, as the US needs to fund its deficit. This will work against the world trade regime as US trade balance worsens, with the US becoming more protectionist as a result.