A Second Chance for Brazil and the IMF
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The world is waiting to see how the market will judge Brazil and whether the International Monetary Fund's rescue package, announced over the weekend, will bring the country back from the brink. It would be foolish to try to predict the movements of a global market that has demonstrated a proclivity for excessive pessimism. Yet those who have looked closely at the numbers and the politics are almost unanimous: there is no reason for Brazil to collapse. The United States has every reason to hope that it doesn't.

In recent years, Brazil has created a vibrant democracy with a strong economy. Differences of opinion exist, but on Brazil's key issues a broad consensus prevails, one that includes all the major contenders in the country's presidential election in October.

There is agreement, for instance, on sound fiscal and monetary policies: no one wants to return to the hyperinflation of earlier decades. Brazil's monetary policy has been managed extraordinarily well by Arminio Fraga, president of the central bank, and the analytic resources of his staff match those of central banks in the highly developed countries.

There is also agreement that, while markets are at the center of a successful economy, there is an important role for the state. For example, Brazil's government managed one of the most successful privatizations of telecommunications; it also pushed for stronger competition and regulatory policies. Unlike the United States, which responded to an electricity crisis by letting market forces (and companies like Enron) handle the matter, Brazil took strong action to handle its own electricity crisis at about the same time. As an American, I looked on with envy.

Brazil may be called an emerging market, but it has first-rate financial, educational and research institutions. In S�o Paulo, discussions about economics are as sophisticated as in New York. University seminars in Rio are as lively as those in Cambridge, Mass., or Cambridge, England. Brazil produces one of the finest airplanes in the world, so good that competitors in more industrial countries have tried to raise trade barriers against it.

Brazil has one major weakness: a high level of income inequality. Yet even here, and unlike in many other countries, the problem is recognized. There is consensus across partisan lines that income inequality has to be addressed. All agree education is the key, and the progress that has been made is impressive: 10 years ago, 20 percent of Brazil's school-age children were not attending classes; now only 3 percent don't attend. Similarly, landless farmers present a grave economic and social problem, but there is agreement among the left and right about the need for land reform. Already there is a reform program supported by the World Bank, and it will surely continue. Brazil has likewise faced the AIDS epidemic with resolve. What the government has already done puts it in the global forefront; it has gotten drug companies to allow Brazilian firms to manufacture the critical drugs and provide them to the suffering at relatively low prices.

In short, Brazil has carved out a path for itself that is not based on ideology or simplistic economics. Successfully charting its own course, Brazil has created a broad consensus behind a balanced and democratic market economy.

Critics of the new I.M.F. lending can point to the remarkable record of I.M.F. failures in recent years: Thailand, Indonesia, Korea, Russia, Brazil (1998) and Argentina. Why, they ask, should Brazil in 2002 be any different? There are plenty of reasons. Brazil today, unlike three and a half years ago, has a flexible exchange rate system with an undervalued currency. Argentina had a fixed rate and an overvalued currency. Investors knew it could not be sustained and demanded high interest to compensate: it was only a matter of time before the system cracked. Argentina was able to collect in taxes only 15 percent of gross domestic product; Brazil is able to collect 30 percent of G.D.P. Or consider Russia, which had what Jeffrey Sachs called "the world's worst central bankers." Initiatives by Brazil's central bank to increase openness are a model for central banks throughout the world.

Moreover, unlike in most other I.M.F. packages � which insisted on contractive monetary and fiscal policies that weakened the economy � in this instance the I.M.F. insisted only on the continuation of existing policies, aiming at a primary budget surplus of 3.75 percent. It would have been even better if they had set a cyclically adjusted target, which would be more flexible and therefore have enhanced stability and confidence.

If the markets understand the state of affairs in Brazil, interest rates and exchange rates should adjust to reflect that understanding and, with these adjustments, Brazil should have no difficulty meeting its commitments. That being the case, it would be in the interests of all, no matter what their politics, to see the country's debt commitments fulfilled.

Much is at stake: It was widely thought that the failure of the Argentine rescue would be the final nail in the coffin of the big-bailout strategy. Evidently those who thought so were wrong. But a failure in Brazil would certainly cast further doubt on that strategy and further weaken the credibility of the I.M.F. The Financial Times may have put it only slightly too strongly when suggesting that the I.M.F. had "bet the house" on Brazil. Certainly a failure would give greater credence to the arguments of those, including George Soros and me, who believe there are fundamental flaws in the current global financial architecture. In any case, the continuing instability facing emerging markets around the world � even those with seemingly sound economic policies � should renew the resolve to understand why the global financial system is operating so poorly.

Within Latin America the effects of a failure in Brazil would be profound. Already there is disillusionment throughout the region with the I.M.F. and the so-called market-oriented reforms of the 80's. The question is repeatedly put: if the top students like Argentina and Brazil can fail, what awaits us? Anxieties are reinforced by the data. The growth of the early 90's appears to have been but a brief interlude between the lost decade of the 80's and the lost half decade of the late 90's, in which per capita incomes have declined. Growth for the decade of the 90's as a whole is only slightly greater than half that of the pre-reform period of the 50's, 60's, and 70's. Even when and where there has been growth, the fruits have disproportionately gone to the rich, with many at the bottom actually worse off. Throughout the region, there is a new sense of insecurity.

There is also a heightened sense of resentment at American hypocrisy: free-trade rhetoric combined with increased trade barriers. This question is related to that of I.M.F. policy, which is formed in large part by the United States. It is difficult to deal with a great power that is both schoolmaster and truant. At the very least, it encourages cynicism.

But it may be that the United States' recent experience with erecting steel tariffs indirectly shows a way forward. The Bush administration invoked emergency provisions within World Trade Organization rules to allow for temporary protection of some American steel from competitors abroad. Couldn't there be something similar for countries whose economies run into sudden trouble? If larger markets could open themselves temporarily, along the lines of an emergency bilateral free trade agreement, to a country experiencing great difficulties, the cost could be less than that of a traditional bailout and the impact possibly greater.

In the Americas, certainly, something like emergency tariff reduction would be of enormous political and economic benefit to the whole region � a good-neighbor policy for a new era. And it could help us move away from these battles over international lending and fiscal and monetary policy, battles that have become too frequent and far too costly, for the lender as well as the borrower.