

The Brazilian Economic Crisis

by Mary E. Vignogna
Department of Political Science
Augusta State University
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Brazil, the largest country in Latin America, is larger than the forty-eight contiguous United States. Since its independence from Portugal in 1822, Brazil has never enjoyed any long term political or economic stability. Politically Brazil has been ruled by a sundry of leaders including an emperor (1822-1889), Political machine leaders (1889-1930), a dictator (1930-1943), a constitutional democracy (1943-1964), military authoritarianism (1964-1985), and back to a constitutional democracy (1985-present). There have been several military coups; 1889, 1930, 1937, 1945, and 1964, as well as an impeachment in 1992 (Wynia, 218).

Many of these leader's agendas were to establish themselves as the power base in the country, and then push through their economic policy. Economic growth in the 1950's was attributed to import-substitution, galvanized by increased tariffs and favorable exchange rates. This growth continued through the 1960's with increased foreign, government and private domestic investment. Unfortunately, by 1964, record budget deficits and an annual inflation rate of 52% sidelined the economic growth mobilizing the military to intervene and execute an economic stabilization program (Wynia, 232).

In 1964, the military utilizing civilian economists instituted a program indexing the inflation rate to the exchange rate, interest rates, taxes, incomes, and prices. Eventually, this stabilized and diversified the economy, and increased exports of manufactured goods. During this period Brazil attained an 11% annual growth rate of national products heralding Brazil as an economic miracle in the Latin American region. Although Gary Wynia doubts that the military really created the miracle as much as they used the industrialization base created in the 1950's and 1960's more astutely. The economic boom continued through the early 1970's until the oil crisis increased the cost of imports. The government, in its quest to continue the economic growth, borrowed money from the international market made available by the increased investment of the OPEC nations. By 1979 the Brazilian government borrowed \$40 billion at a floating interest rate. By the end of 1979 interest rates doubled and the government was forced to borrow more money to make past payments, which increased their foreign debt to \$100 billion (Wynia, 234-235).

With the large debt and faltering economy, the middle and upper class started to question the ability of the military to maintain the economic recovery. The military leadership in 1974 decided to prepare for the return of a civilian led democratic government. By 1978, the military created new political parties and restored basic human rights such as freedom of speech, press, movement and habeas corpus. The military leadership did not include the election of a president in the new process, but did hold congressional elections in 1982. However, in 1985, after emplacement of an electoral college, the people of Brazil for the first time since 1964 elected their president.

In 1988, a new constitution was written which Wynia penned "a wish list for every progressive interest in Brazilian society (244)." The constitution guaranteed job security to anyone working for the Civil Service for more than five years, payment of Social Security was based on time of service rather than payment into

the system, proportional retirement benefits were equivalent to the last full year salary and no maximum age requirement was mandated to collect benefits. Probably the most devastating constitutional guarantee is the federal revenue sharing with the states. According to the Constitution, the states are entitled to a percentage of the federal revenues. However the federal government did not relinquish any of its responsibility for project funding. The state governments, instead of distributing this found money among all its citizens, increased their payrolls with unnecessary employees. This left the federal government spending more money than it was actually taking in (Fleischer, 1998).

President Fernando Collor, elected in 1990, tried to impose some administrative reforms, but was impeached in 1992 when a massive corruption scheme was uncovered (Fleischer, 1998). At this point though, Brazil had an inflation rate of 50% per month and the economy was close to collapsing (Weinberger, 1996).

However, in 1993, with the introduction of the Real Plan by Finance Minister Fernando H. Cardoso, there seemed to be a ray of hope in bringing economic stability to Brazil. In 1994, Fernando Cardoso was elected president and was able to bring his plan to reality. Unfortunately, the economic crisis in Asia and Russia has affected the Brazilian recovery. This paper will examine the Real Plan and how it created stability in the Brazilian economy, and the involvement of key groups in Brazil that have supported President Cardoso as well as those who have created road blocks to the success of his plan. This paper will also examine how the Asian crisis sent a ripple of fear through the international investment community leaving Brazil and President Cardoso at the mercy of the IMF and his northern neighbors.

In 1993, Finance Minister Fernando Cardoso introduced the Real Plan for fiscal and currency reform. "The main element of the Real Plan included the introduction of a new currency (The Real), deindexation of the economy, an initial freeze of public sector prices, the tightening of monetary policy, and the floating of the currency with a floor specified for its value in relation to the dollar (Clements, 1997)." When Mr. Cardoso was elected president in 1994 he adopted free-market policies, sharply reduced tariffs, stabilized the currency and brought inflation down to under 2% per month (Weinberger, 1996)." Subsequently, the economic indicators showed the best economic recovery in the history of Brazil: food consumption rose 30%, purchase of consumer goods increased, imports increased, the economy grew 4-5% every year since 1993, unemployment dropped to its lowest level and real wages grew from 5% in 1994 to 13% in 1995 (Weinberger, 1996). President Cardoso also began to privatize many of the state owned industries raising many billions of dollars from their sales (Forbes, 1995).

Past economic planning often lacked sound fiscal policy necessary for continued economic success. Mr. Cardoso has included in the Real Plan legislation to amend the 1988 Constitution which single-handedly has crippled the economy. He needs to assure reduction in Social Security payments, rescission of the protections held by the civil service, reduction of required payments to the state governments, and reconstruction of the tax system in order to keep the recovery going (Weinberger, 1996). The implementation of the Real Plan had increased confidence in the Brazilian economy permitting multinational corporations to invest billions of dollars in Brazil (Forbes, 1995). Although many past economic plans have created an initial boost in the economy, Mr. Cardoso's Real Plan has gone beyond the others by including decreases in government spending which is why many Brazilians see the Real Plan as a ray of hope for economic stabilization. The most unusual development in the economic recovery in Brazil under the Real Plan is the inclusion of the poor. No other economic plan ever included this 50% of the population. For several decades prior to 1994, Brazil had the one of the greatest unequal distribution of income in the world. Since the implementation of the Real Plan, poverty has decreased and distribution of income has

improved. As Benedict Clements states in his article "The Real Plan, Poverty and Income Distribution," between 1994 and 1995 the income of the lowest 50% of the workers grew by around 30% whereas the income from the top group grew only 10% (Clements, 1997). An increase in income and a decrease in inflation has created an atmosphere of greater economic prosperity in the lower income group. This has also lent to a rise in improvements in the standard of living among the poor. Clements also states that the number of Brazilians living below the poverty line decreased from 42% to 27% (Clements, 1997). One of the greatest indications that the percentage of those living below the poverty level has decreased is the fact that for the first time in the history of Brazil the minimum wage rose above the basic consumption basket.

The poorest citizens were never a threat to the political leaders because most were illiterate and they could not vote, so they were the forgotten majority (Wynia, 232). The 1988 Constitution enfranchised the illiterate population giving the poor a much needed voice in the way the country is run (Fleischer, 1998). Although the poor have benefited from the implementation of the Real Plan, Mr. Cardoso has gone the extra mile in including reforms in education and rural projects to help the poorest citizens (Weinberger, 1996). Including the poor in the economic recovery, Mr. Cardoso has given them a vested interest in the success of the outcome of the recovery.

The middle class has also thrown their support behind Mr. Cardoso and the Real Plan. Unlike the poor, the middle class has always been included in economic recovery programs. Unfortunately, they are also hurt the most by the high inflation that has accompanied past programs. The middle class has turned almost militant in their support of the Real Plan deeming anything inflationary as antisocial (O'Dougherty, 1999). The middle class are supportive of the free-market economy because it has brought competition and therefore lower prices. Knowing that prices in other countries, especially those in developed nations, are more competitive, the middle class suspect that the national businesses were overprotected and had profit margins that were too high. In the past the middle class were always willing to support the economic plans presented by the president. However, with each failure they have become untrusting of the grossly incompetent government elites, as well as the profiteering business elites (O'Dougherty, 1999). Their support for Mr. Cardoso lies with his willingness to open Brazil to the global economy.

Nevertheless, in a move to gain support from the conservatives in government Mr. Cardoso appointed Francisco Dornelles Minister of Industry and Trade in May 1996. Immediately, Mr. Dornelles imposed quotas on textile imports from Asia, and raised tariffs up to 200%. Mr. Dornelles has been lending a sympathetic ear to those industries hurt most by the open economy. The old elite who grew rich on protectionism are applauding the tariffs and import quotas, but the middle class consumers are so unhappy that Mr. Dornelles is now passing the blame for the higher prices on low-level officials (Economist, 1996).

After extreme repression during the military regime the middle class has found its voice. Also this latest recovery has increased the number of people included in the middle class who are enjoying the privileges of middle class consumerism. Since the middle class and the poor have benefited from better economic conditions in Brazil, there is a possibility that Mr. Cardoso can fuse these two groups into a coalition to fight against the old elites that have create road blocks to the continued economic success of the Real Plan.

The Real Plan stabilized the economy, but in order to bring real economic stability Mr. Cardoso needs to assure passage of the amendments to the 1988 Constitution. Mr. Cardoso was smart enough to separate the Plan into two groups because he knew the currency reforms would make it through the legislative body virtually intact, but the fiscal reforms would be more difficult. There have been reforms to social security basing benefits on age and amounts contributed rather than on years of service (Weinberger,

1998). Any reform to the government pension plan will affect the legislators, so they have been hard-pressed to see the benefit of cutting their own pensions. The amendment includes a cap on the ability to collect two or more pensions or double and triple dipping which would directly affect 141 deputies, not including their spouses and family members (Fleischer, 1998). Unfortunately, the investment community has looked at the inability of Mr. Cardoso to persuade Congress to change the Constitution. When the Asian crisis hit there was a cry to devalue the Real believed to be overvalued 20%. Cardoso refused to do so because he was hoping that continued investment and continuing the effort to get Congress to pass the austerity package would allow him to keep the Real propped up. However, after the fall of the Russian economy in August 1998, nervous investors started pulling money out of Brazil. Hard currency reserves in August and September plummeted \$25 billion (Hart, 1998). With a \$58 billion budget deficit the austerity measures need to be put into place in order to make investors more confident in the Brazilian economy.

Mr. Cardoso has raised interest rates to 50% in order to keep investors' money in the country (Economist, 1999). Until late 1998 he was able to defend the Real because the IMF came in with a \$41.5 billion relief package (Hart, 1998). This however did not stop the fleeing of foreign investments. Consequently, in January 1999, Brazil widened the band that the Real can be traded on the international market causing a devaluation of 8%.

Brazil's economic recovery is in real trouble. The rise in interest rates has hurt the Brazilian people with mortgages and small business loans. The fear of a return to higher inflation has caused people to hold on to the money they have. This has caused a drop in consumerism and the loss of many jobs (unemployment rate is 10%).

Another indication that there is trouble within the boundaries of Brazil is the debt moratorium declared by seven state governors. Although the states receive a percentage of the federal revenues, the state governors have borrowed money to pay for infrastructure projects from the federal government. These seven governors were sworn into office on January 1, 1999 and inherited the old debts and some new ones. Because of the crisis and austerity budget imposed on Brazil these governors blame Mr. Cardoso and the IMF for their problems. Their answer in order to solve their problem is to not pay their debt. They have approached Mr. Cardoso with the possibility of renegotiating the debt, but that may not be possible says Finance Minister, Pedro Malan (Economist, 1999).

The Real Plan has not been the savior of the Brazilian economy. Unfortunately, it could have been. The elites are extremely strong and have always been the ones in the power positions in Brazil. One can look at the budget deficits and high inflationary periods in Brazil as the reason why Brazil has never had long term economic stability, but this economic crisis is deeper than that. One needs to look below the surface to see that there has never been fierce nationalism in Brazil. The elites will do what is necessary to fill their own pockets and let everyone else fend for themselves. This is so prevalent in the large gap in income among the population, but especially in the refusal of the Chamber of Deputies to pass the austerity measures for economic success. However because the initial success of the Real Plan included so many in the lower and middle class the elite may have to deal with a possible uprising that may just jump-start the economy and bring foreign investment back into the mix. Something needs to be done in Brazil because so many economies depend on its success. Canada and the United States depend on Brazil as a market for their good. More importantly though Latin America depends on Brazil being successful so that their economies stay afloat. Mr. Cardoso needs to find away to instill in the elitist group that what is good for the country will eventually be good for them. Until then, Brazil will limp along as the weak link in the world

economy.

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