# Brazil

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## Abstract

Brazil offers an interesting case study of economic growth which combines both textbook and unorthodox policies. Eighty years of Brazilian history are described in three periods: the first beginning in 1930 with Getúlio Vargas, the second in 1964 with the military coup, and the third in 1985 with the return to civilian rule. Specific attention is paid to the administrations of Collor–Itamar and the Cardoso–Lula, as both periods represented substantial shifts in government priorities. What emerges from this historical analysis is not so much a narrative of development, but a succession of measures intended to solve specific short-term problems, such as: increasing exports, improving the balance of trade, controlling public debt, fighting inflation, enhancing industrial productivity, and reducing poverty and inequality. More than a model of development, the Brazilian experience highlights the importance of government policy, and of the divides between different social classes and regions.

***Keywords:*** Brazil, growth, government policy, Getúlio Dornelles Vargas, Fernando Affonso Collor de Mello, Itamar Augusto Cautiero Franco, Luiz Inácio Lula da Silva, Fernando Henrique Cardoso

## Introduction

Growth is a mystery. Economists have been struggling to unveil the determinants of this process, yet it continues to defy and baffle their insights and theories. Since Solow's pioneering paper (1956), a series of preconditions have been identified that formed the basis for formal models from which the corresponding growth dynamics were assumed to ensue. The myriad of extensions of, and additions to, Solow's original model testify to the power of mathematical modelling, while other theoretical strands, like endogenous growth, have borne out particular families of growth processes. Yet all models leave open the broad question of what determines, causes, or makes for a supportive environment for sustained growth.

The development narrative has produced various attempts at to resolve this fundamental question. Trade, institutions, absence of red tape, a clear regulatory framework, human capital, technology and innovation, industrial policy, enlightened autocratic regimes capable of fostering sustainable investment, a democratic environment for business and entrepreneurship, foreign direct investment, wise mastering of the Dutch disease, a sizeable domestic market, quality education and a thriving middle-class . . . the ideas are almost endless. Ironically, each of these conditions is associated with a particular model, the experiences of a handful of countries at a given point of time. Quite often, there are annoying counter-examples, which make room for the addition of further explanations.

Thus growth remains a mystery, an elusive and seemingly random process, triggered by unique circumstances. Hence country studies are still needed and Brazil offers an interesting case combining both unorthodox and out-of-textbook policies and outcomes, with seemingly reasonable explanations underpinning development during different periods of time. This chapter is a modest attempt to understand the Brazilian dynamics in their entirety, identifying the main features that affect the process of growth and development.

The analysis covers more than eighty years, paying more attention to the period after 1989, from President Collor de Mello to President Lula da Silva. Of course, this latter period cannot be understood without an (inevitably selective) discussion of preceding times, particularly the dynamics of the military regime and the dramatic periods of attempts to control high inflation. Ideally, a detailed economic history would start in the beginning of the twentieth century, when the young Brazilian republic faced the challenge of designing country-wide economic policies. This chapter opens with the beginning of the “modern” period when a shrewd dictator, Getúlio Dornelles Vargas, seized power in 1930. Regulatory measures—related to labor, industry, energy, and infrastructure—moved the economy closer to the spirit of the times, though still far from it. Vargas’ successor, Juscelino Kubitschek de Oliveira, was a pro-growth, charismatic personality who set the country on a path that was ironically continued under the military government, which was precipitated by the temperamental and controversial figure of Jânio da Silva Quadros.

This chapter argues that the personalities of particular Presidents, and the policies they pursued, were critical in shaping Brazil’s development experience. This is not to discount more classical explanations of Brazil’s growth, including factor productivity accounts and the interplay of external and domestic markets. On these issues, the interested reader is encouraged to consult the works of Baer (2008) and Roett (2010) which provide a didactic view of the evolution of the Brazilian economy. In contrast, this chapter identifies forces that shaped the behavior of different Presidents and compounded the struggle for development within Brazilian society that is neither simple nor peaceful. If development is understood as the intentional pursuit of a clear objective, it requires both intention and agency, and these qualities are not easily identified in Brazil. Concentrating on the actions of different Presidents is a way to somehow overcome this difficulty.

The directions of economic policy are described and assessed in general terms, rather than through detailed statistical analysis. Figure 39.1 displays the growth trajectory over time. It should be used as an indication of key periods covered. The chapter opens with a *tour d’horizon* condensing the formative period of 1930–89 within a few pages. Next the five-year period of the Collor–Itamar presidencies are examined more closely as this was a watershed in Brazil's development, clearly marking a break with the past. Subsequently, the Cardoso–Lula presidencies are examined and explained to be the fortuitous product of good luck. The conclusion is deliberately intended to be somewhat off-putting to propose the controversial idea that development as an intentional pursuit is not present in Brazil. This is not a Scandinavian country, and few African and Asian nations share the historical path which has deeply affected Brazil's development process. While there was undoubtedly an evolution in the country's circumstances over time, it requires novel instruments and concepts to be fully understood. What emerges is not so much an intentional, long-term pursuit of development, but rather but a succession of measures intended to solve specific short-term problems, such as: increasing exports, improving the balance of trade, controlling public debt, fighting inflation, enhancing industrial productivity, and reducing poverty and inequality.

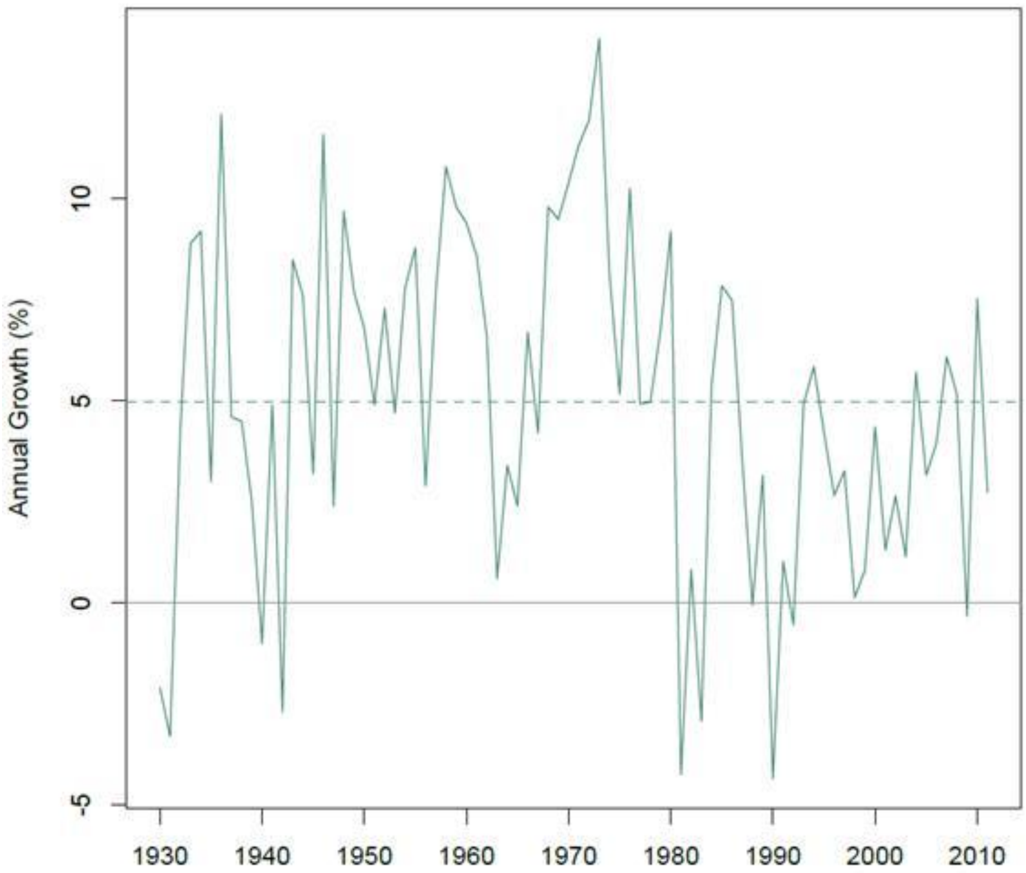


**Figure 39.1: Annual GDP Growth in Brazil (1930-2011)**

# Sixty years of economic policy

## *From Vargas to the military (1930–64)*

The man from Rio Grande do Sul, Brazil's southernmost state, arrived in the capital on horseback and proved to be a savvy politician with a deep knowledge of the fractures dividing Brazilian society. Getúlio Dornelles Vargas was acutely aware of a power struggle between the established elite—largely land barons spread across the country and the emerging bourgeoisie produced by the *paulista* industrial complex—and the new working class created by the same industrialisation spurred by São Paulo. By allotting the former to the *Partido Social Democrático* (PSD), and the latter to the *Partido Trabalhista Brasileiro* (PTB) founded in 1945, Vargas managed quite successfully for most of his rule to pit these groups against each other to achieve a delicate and clever equilibrium which kept him in power.

A rebellious movement saw Vargas installed as a temporary President in November 1930. He was duly elected in 1934, after nearly four years of a "provisional mandate". His government became a dictatorship from 1937. While he was ousted by the military in 1945, he was re-elected in 1951 and closed his career dramatically three years later. In spite of his ability to manipulate the divisions within Brazilian society to his favor, he overlooked the other side of the bourgeoisie, made up of public servants, liberal professionals, and intellectuals largely concentrated in Rio de Janeiro and São Paulo. This segment, which also attracted the middle and upper levels of the military, especially the young, urban, and more cultured generation in the Air Force, found its voice in *União Democrática Nacional* (UDN) and eventually contributed to Vargas' definitive fall from power.

Vargas'[2] economic policy was mostly a compromise between the two groups that supported his administration. For the industrialists, he created a national development bank (*Banco Nacional de Desenvolvimento Econômico, BNDE*) and offered import substitution policy, starting in 1930 and re-emphasised several times during his nineteen years in power. For labor, Vargas offered a minimum wage in 1940, and seminal legislation on labour relations in 1943 in the *Consolidação das Leis do Trabalho*. His nearly intuitive management of the economy was strongly impacted by the Second World War, when the U.S. acting in its strategic interests, forced some key features of modernization, including a major steel smelter Volta Redonda in 1941 with *Companhia Siderúrgica Nacional*, the beginning of motor vehicle manufacturing in 1942 with *Fábrica Nacional de Motores*, and the presence of air force bases in the Northeast.[3] The country became more linked to the Western international production and corresponding developments in services and logistics.

The dictator returned after a six-year interregnum, now duly elected but without a reliable majority in congress. During this second period in power, Vargas' ever present nationalist and populist strains were exacerbated and this time his compromising abilities were not so successful. The former heightened U.S. suspicions towards his government, especially after 1953, when Eisenhower led the Republicans back to the White House. The economy had become strongly dependent on the U.S., which had important investments in the country. Vargas nationalized the energy and oil sectors, creating the state oil monopoly, *Petrobrás* against the interest of the U.S. companies. Through the *Instituto Brasileiro do Café*, Vargas attempted to exert supply management in the vital coffee exports, of which the U.S. was the largest consumer. Starting in 1952, the Vargas government also exercised greater control over, and imposed taxes on, remittances by foreign companies. State intervention in the economy, always present since the early twentieth century, reached new levels.

On May 1, 1954, Vargas doubled the minimum wage, a move still debated by historians and one which raised tension with the opposition during an already clear crisis in governance. He subsequently ended his political career, committing suicide in the Presidential Palace in the early hours of August 24th. Was his suicide an impulsive act of a strong-willed and possessive man who realised that he would never achieve the kind of encompassing control he desired? Or was it the final gesture of a shrewd and meticulous strategist, who clearly saw that he had plunged into a deep and complex mess—political, economic and moral—from which there was no way out, the best solution being to play the martyr for the sake of his beloved people? While historians continue to debate these questions, what is clear is that Vargas' death and his well-crafted "letter to the Brazilian people" had the impact of solidifying support for his policies for the next ten years.

A new equilibrium had been slowly nurtured, the PSD elite leaning towards the intellectual and liberal UDN bourgeoisie. Both parties perceived that a new development model was needed to liberate the economic forces in the post-war period and new world order created under Bretton Woods. At the same time, the parties feared the somewhat haphazard way in which Vargas had tried to increase the share of wages in total output. While the economic record of Vargas' final four years was not bad, the new alliance sought to foster faster growth, setting aside the awkward and obtrusive social pact Vargas had championed.

The man behind this new alliance was Juscelino Kubitschek de Oliveira, an extremely gifted, affable, and charming personality elected in 1955. Kubitschek was to unleash latent productive capacities. He worked with foreign companies to launch the Brazilian car industry to generate new employment, create new industrial linkages, and new sources of tax revenues. A first wave of *maquillas* industrialization delivered goods to the final consumer at very high prices, due to a string of taxes attached to each step of manufacturing. Kubitschek also encouraged foreign investment in the energy, transport, and food sectors. In June 1959, he boldly ended negotiations with the International Monetary Fund (IMF) closing the country to the Fund's resources.

Then, as now, Brazil's large size was a powerful advantage. The open-minded Kubitschek allowed the flourishing of experiments in the Northeast—led by Celso Furtado—and elsewhere in the country, establishing a modest network of fairly diversified production. Even if most of this eventually came to supply the *paulista* industrial core, a domestic market was emerging that supported the success of the import substitution idea. Construction of a new capital city in Brasília had a major Keynesian effect and saw Kubitschek's mandate end with an impressive growth rate and rising life expectancy, albeit these achievements were plagued by escalating public debt, high inflation, and a rising imbalance in external accounts. Industrialization had initiated a rural exodus, feeding a process an uncontrolled urbanization that would last for decades, heightening social inequality in between urban and rural areas.

While Kubitschek had governed successful using the industrial–labor alliance forged by Vargas between the PSD and PTB, these political parties were increasingly at odds by the end of his mandate. Kubitschek was a PSD member, and for some reason PSD–PTB presented themselves as a unified ticket in the 1961 elections. The election resulted in a UDN victory for President Jânio da Silva Quadros, sharing power with PTB Vice-President João (Jango) Goulart, a former Vargas' protégé and Minister of Labor (1952–53). This awkward arrangement testified to the weakness of the post-Vargas social pact, which to a certain extent had persistently attempted to marginalize the still powerful PTB. Although Quadros was intelligent and extremely witty, he was unable to sustain himself as a credible President. He resigned in August of the same year, creating a political crisis. Goulart became the President and, despite strong opposition from the traditional elite, successfully negotiated to hold to power after a complex game of threats and compromises. His tenure was punctuated by strikes and an economic crisis, and ended in a military coup in March 1964 that was widely supported by the urban bourgeoisie and the eventual ascension of the old, conservative elite.

## *Military government (1964–85)*

During the two decades of military rule, the country experienced sustained growth through five presidents, all of which were top generals. Figure 39.1 gives a summary of the growth rates which accounted for what came to be known as "the Brazilian miracle". Cysne (1993) and Skidmore (1988) provide classic discussions of economic policy making during this period. What is less prevalent in the literature is an historical and geopolitical perspective of how military rule in Brazil cannot be dissociated from the U.S. global strategy during the

Cold War. In Latin America, this strategy was upset by the Cuban missile crisis, by widespread agrarian movements from Mexico to Brazil, and by the election of Salvador Allende in Chile.[4] Argentina and Uruguay, key neighboring countries, also experienced a shift to military rule, aided by covert American intervention. In Brazil, the U.S. had been active in the twin crises of the Vargas administrations, in 1945 and 1954. Rural unrest and the ensuing organized social movements had been active since the second half of the Kubitschek mandate, and a source of worry to the Americans. During the post-war period the U.S. cultivated close ties with the Brazilian army, by a variety of means, coupling training and education with several soft power initiatives.

For several reasons, the degree of violence of the Brazilian military dictatorship—apart from the *Bleche Jahren* under Garrastazu Medici (notably 1969–72)—cannot be compared to the ones prevailing in Argentina and Uruguay. This is important because, though the social fabric was damaged, with serious and sad ruptures at certain points, the impact of this disarray on the economy was comparatively small. Growth, even if it fed inequality, contributed to maintaining a degree of social cohesion that in turn helped the economy to function and improve over time.

The military had a clear vision of national development, one which entailed the rise of an autonomous and powerful Brazil. They ruled with the crucial help of a technocratic elite, largely drawn from middle- and upper-class families related to the former PSD and UDN political parties. These were extremely bright people, honest and engaged in the 'big Brazil' pursuit. Urbanization accelerated, rural–urban migration peaked, and the government, in a clear example of its pragmatic approach, inspired by engineering, which created specialized agencies to tackle the problem. At the end of the regime, at least nine conurbations had emerged, nurturing significant portions of a marginalized population that would turn to violence and crime, particularly in Salvador, Recife, Rio de Janeiro and São Paulo. Notwithstanding, there were remarkable developments in infrastructure, notably telecommunications, energy, housing, water, and sanitation. Improvements within the federal public service—including the statistical, internal revenue, and social security systems—were also relevant and welfare-increasing.

The government system was highly centralized and pursued central planning systematically, with the federation of states often existing more in rhetoric than practice. The budgetary process was significantly improved, and management of federal institutions of was greatly modernized. The economic model was based on a constant and generous inflow of foreign capital, giving way to what came to be known as the "pharaonic" civil works, such as the

Itaipú Dam, which greatly contributed to the external debt. Growth, outstanding in many years, was achieved with high inflation, taxes, and by running deficits. The exchange rate was managed accordingly, meaning that the U.S. dollar was constantly appreciating, and dollar bills—hidden below the mattress—became a form of savings.

**Table 39.1: Growth in Urbanisation, 1960-1980**

| | 1960 | | | 1980 | | |
|---|---|---|---|---|---|---|
| | Total* | Urban (%) | Rural (%) | Total* | Urban (%) | Rural (%) |
| Brazil | 70,070 | 44.7 | 55.3 | 119,003 | 67.6 | 32.4 |
| North | 2,562 | 37.4 | 62.6 | 5,880 | 51.6 | 48.4 |
| Northeast | 22,182 | 33.9 | 66.1 | 34,812 | 50.5 | 49.5 |
| Centre | 2,943 | 34.2 | 65.8 | 7,545 | 67.8 | 32.2 |
| Southeast | 30,631 | 57.0 | 43.0 | 51,734 | 82.8 | 17.2 |
| South | 11,753 | 37.1 | 62.9 | 19,031 | 62.4 | 37.6 |

Source: 1960 and 1980 Population Census; *Instituto Brasileiro de Geografia e Estatística* (IBGE).

* Total population in 1000s.

## *Sarney's economy (1985–89)*

José de Ribamar Ferreira de Araújo Costa Sarney, until then a representative of the class of political chieftains from the northern states—in his case, the borderline Amazonian state of

Maranhão—was undoubtedly the luckiest politician of his generation. Vice-president to a President-elect who fell mortally ill just hours prior to the inauguration, Sarney became the first civilian leader in two decades. The military had released their hold on power for several reasons: an exhaustion of both their mystique and socio-economic capabilities, the renaissance of opposition parties, and rising demands from the excluded. Yet above all there was failure of the economic model, with inflation sweeping the middle-class that had originally guaranteed support to the regime. Between 1980 and 1982, annual inflation averaged around 100 percent, and in the three subsequent years it rose to above 200 percent. Thus Sarney received an economy that, while still booming, was plagued by problems.

Sarney was a master of compromise and formed alliances in any conceivable direction and with any existing group that might fulfil his constant goal of political survival. He soon realized that inflation was a monster that threatened to swallow his office and career: not only was it hurting the middle class, but it contributed to serious and ever-rising inequality. Power had returned to the liberal-conservative elite of the old Vargas period, yet Sarney was obliged to make a gesture to the lower classes and the segments of society kept out of power during the past two decades. He was forced to continually arbitrate among the old elite (including land barons), the labor class, and the São Paulo entrepreneurs and associated *intelligentsia*.

All kept a restive eye on the security and military community, who had just recently left the government.

Sarney decided to rely on a group of economists based at the Catholic University at Rio de Janeiro, who had been actively debating the dynamics of inflation. They were creative, linked to the mainstream of economy theory, with good connections in the U.S. and beyond. These economists were palatable to the different forces around the Sarney administration and came to play an important part in his government. The story of this somewhat funny marriage, and its series of inflation-abating plans, has been well-covered in the literature. Most were short-lived, quick fixes that gave the government a brief respite to design the next experiment. Brazilian society docilely endured a succession of plans, always hopeful that the most recent one would prove successful.

As a political figure, José Sarney became one of the most intriguing examples of political acumen in the recent Brazilian history. Yet in 1987, the government was obliged to default, unable to pay the interest on its external debt. Disarray was evident and, at the end of Sarney's mandate, annual inflation exceeded 1,700 percent. The fiscal monster had won.

## *Setting the stage*

A few salient points arise from these three time periods, spanning sixty years of economic development. First, there was the constant of state intervention in the economy, despite brief spells of a more market-oriented conduct. The usually centralized character of the federal government, be it out of fear of overly strong regional opposition forces, or as a means to deal with the considerable size of a relatively unpopulated space, helps explain this *dirigiste* style. Within this reality, regional disparities were blatant. The Northern society, still following the class structure of the sugar cane economy, was more resilient to economic transformation. It is no wonder that the revolution that brought Vargas to power was triggered by the South and Southeast of the country. The brief, more innovative spell for the Northeast, under Kubitschek with Celso Furtado at *Sudene*, and the road and highway network built during the military era, were not enough to fully engage sizeable regions of the country in the industrialization of the South and create a more balanced economy through greater connectivity.

Second, industrialization took place throughout this period[5], but the incentives for innovation and the creation or adaptation of new technologies were diffuse or non-existent. Within an economy strongly dependent on the export of a single export (coffee), at least until the

Kubitschek era, there were further barriers to altering income distribution whether at the regional or national level. Some importation of technology did take place, but never reached the desired levels. Export dependency on the U.S. during the post-war period, further complicated to the development project.

Third, since the late 1940s, inflation started to slowly creep into the array of problems. During his second term, Vargas—like Argentina's Juan Domingo Perón[6]—perceived inflation and distribution as the key conflicts that needed to be solved. Very broadly, inflation is the result of poor macroeconomic management. The exchange rate management associated with a single export commodity, combined with import substitution policy and the leniency towards inflationary growth adopted by Kubitschek and the military, compounded the original inflationary sin. Support to the banking system, which quickly learned how to extract formidable rents from the process, became one of the key pillars to its persistence. Inflation had become out of control, and some form of rupture was needed.

## The Collor–Itamar period: true transition

The period is worthy of distinction as it included two radical turns in the tiring sequence of inflation plans and a presidential impeachment unique in Brazilian history, entirely within democratic rules and less than ten years after the military had lost power. Fernando Affonso Collor de Mello represents, in a rather awkward way, the earthquake that was needed to change the course of economic policy. As with any earthquake, it caused excessive damage, and eventually amounted to further waste of precious time, resources, and confidence. But the bold shudder in macroeconomic management, trade and industrial policies, and government intervention in the economy awakened the old conservative alliance and part of the progressive forces needed to renew domestic policy.

Soon after Collor's inauguration in March 1990, he unleashed a previously inconceivable assault against inflation. Beside consistent measures to reduce the public debt, and a frontal attack on indexing of wages and other payments, the Collor Plan enforced a generalized confiscation of monetary assets held by citizens in the Brazilian financial system. As mentioned above, the sociology of the Brazilian people, with regards to their relationship with authority, and economic policy in particular, over the past four decades deserves to be thoroughly studied. The amazingly peaceful reaction on behalf of the population—despite several individual tragedies—to this most abusive, illegal, and unfair measure can only be explained by the fatigue experienced after a decade of growing and uncontrolled inflation and misguided attempts to address such during the Sarney administration.

The population absorbed in the best possible way the confiscation and the sudden, drastic reduction in their income. Meanwhile President Collor, sometimes in an apocalyptic way, abolished old structures and all sorts of bureaucratic barriers. Most of his initiatives proved useful, including the liberalization of trade and reduction of tariffs with the General Agreement on Tariffs and Trade, drastic reduction of red tape for imports, closure of federal agencies and institutes that had become the core of *cartorial* activities (a Portuguese word denoting crony capitalism involving specific groups within the private sector and a few bureaucrats who control strategic decisions in key institutions). Collor de Mello also streamlined the public sector, encouraged privatization of services, and cut of subsidies to protected industries. He was young, assertive, bold, and in a hurry, but without a clear destination.

The speed of the reforms and a generalized lack of confidence following the drastic confiscation, soon led to an exaggerated emphasis on reducing the public debt. Faithful to the Brazilian tradition of excessive reliance on public spending—enhanced during the military period and the Sarney years—the economy entered a brutal recession aggravated by fear of a return to inflation. Indeed, growth was minimal following the disarray introduced by the Collor Plan which made it impossible to stabilize prices. By the end of January 1991, inflation was back and a renewed Collor II plan was produced. But the year was dominated by the turmoil in the President's political trajectory, triggered by accusations from his own brother. Collor de Mello was impeached in October and, to avoid further complications, he resigned in December, opening the way for his Vice-President, Itamar Augusto Cautiero Franco.

In spite of an adverse political climate, Collor de Mello managed to successfully convene the UN Conference on the Environment and Development (UNCED) which produced key conventions on biodiversity and climate change, as well as the Agenda 21 roadmap for sustainable development. The conference set Brazil as a focal actor in the environmental debate, something the country has yet to use to its full advantage.

A shrewd and cautious politician, Franco spent the year establishing his base and probing the latitude of his government. He named Senator Fernando Henrique Cardoso as Minister of External Relations in 1992, and then as Minister of Finance in 1993. Cardoso acknowledged Collor de Mello's achievements in restructuring of the economy, and pursued many of the same measures, including privatization, albeit with a more moderate and gentle style. Cardoso also retreated somewhat from trade liberalization and, with the help of key figures from the Sarney plans, crafted a new scheme for controlling inflation. The credibility enjoyed by Itamar Franco and the support he personally gave to all phases of the operation were decisive. Launched in July 1994, Cardoso's *Plano Real* (Real Plan) saw the creation of a new currency and a clear transition away from the old one. Neither prices nor wages were frozen. New measures regarding the public debt were seriously enforced. Privatizations received a further boost, and consumption was indirectly restrained. The new currency was accompanied by an artificially high exchange rate (parity with the U.S. dollar), with a very narrow band for flotation, and excessively high interest rates to maintain the international attractiveness of the new currency.

What explains the success of the *Plano Real*? One explanation is generalized weariness, even from the financial institutions that had extracted considerable rents from high inflation. A learning process undoubtedly had taken place among the pundits who had concocted so many previous failed attempts. And the world and Brazil had changed: inflation had become a serious nuisance to the elites, even more than to the population writ large. The success of *Plano Real* gave Cardoso two mandates as President, after the end of the Itamar period. He would pursue his reforms and correctly perceived the several measures still needed, but would become a hostage to the instruments that guaranteed the success of his Plan. Growth would be timid.

**Table 39.2: Annual rate of inflation in Brazil**

| | | |
|---|---|---|
| The last two years of General J. B. Figueiredo | | |
| 1983 | 210.99 | Inflation peaks at the end |
| 1984 | 223.81 | of the military regime |
| Mr. Sarney's five years mandate | | |
| 1985 | 235.11 | Inflation continues to escalate |
| 1986 | 65.03 | 'Cruzado' Plan and 'Cruzado' Plan II |
| 1987 | 415.83 | Bresser Plan |
| 1988 | 1,037.56 | Inflation defeats Mr. Sarney |
| 1989 | 1,782.89 | Summer Plan |
| The Collor de Mello–Itamar Franco transition | | |
| 1990 | 1,476.71 | Collor de Mello's confiscation |
| 1991 | 480.23 | Broad contraction; inflation still high |
| 1992 | 1,157.84 | Collor de Mello is withdrawn |
| 1993 | 2,708.17 | Itamar Franco's first year |
| 1994 | 1,093.89 | *Plano Real* |

Source: *Instituto Brasileiro de Geografia e Estatística* (IBGE).

## The Cardoso–Lula period

Spanning sixteen years of continuity in many areas, the Cardoso-Lula era is at first sight a perfect example for those who place institutions and the role of government as the key engines of growth. Blessed by the victory over inflation, and with the knowledge gained in the Itamar government, Cardoso easily won his first presidential mandate. He was eager to give the country a modern outlook, suitable to a globalized world where the benefits of growth should accrue to everyone. His mandates were characterized by his personal charm and capacity to form alliances with actual or potential opponents, coupled with his own critical reassessment of the rapid pace of the Collor-led reforms. Shrewd and open to the world, he aimed to hitch the country to the bandwagon of the European Union, rather than to the U.S. model, notwithstanding his good relations with President Clinton.

Luiz Inácio Lula da Silva was an exceptionally gifted negotiator who cannot be classified as a true leftist. He came to power after three courageous, but failed, attempts at the presidential elections. With a strong intuition and fast intellect, he had the ability to perceive the nearly optimal path leading to the results he wanted. Rather than a being the leader of an abstract, but largely unknown mass called the "Brazilian people", he was truly a legitimate leader thanks both to his personal qualities and the formidable, Stalinist-like machine built by his *Partido dos Trabalhadores* (PT). Lula represented the "other Brazil," the opposite dimension of that part of the nation represented by Cardoso. The auspicious, almost wonderful irony, is that Brazil needed both.

Cardoso pushed for basic structural reforms, regulatory frameworks, privatizations, and trade liberalizations; not always to the full, nor in the most desirable way, but nearly all successful. He made the country and its economy more modern. Lula, in a certain way, did the opposite. Suspicious of regulatory agencies and frameworks, cautious in his approach to privatization, he concentrated on the dire social inequalities plaguing Brazil. Through massive, bold, and well-managed social programs, he showed Brazilians and the world that inequality could be reduced at a fast pace and better living conditions for the poor were obtainable for those who held power. A less unjust Brazil emerged from his rule.

However, a thin thread ties together these two Presidents, avoiding an otherwise drastic fracture which could have taken place, in spite of the democratic transition of power in 2003. This stability is largely a credit to Lula. The change of power—an expression that few times had been as meaningful in Brazilian history—occurred through a transparent, democratic process, amidst great uncertainty and relatively high tension among the financial markets and the middle and upper classes. The economy had not fared well during Cardoso's final two years. Argentina's economy had collapsed between December 2001 and February 2002, and many feared that Brazil would be next, that Lula would be the pilot of a sinking ship. Instead, to everyone's surprise, the new President maintained the monetary policy of his predecessor. He displayed a new, but not radically new, rhetoric and incorporated into his economic staff a wise combination of experts with proved technical credentials and, more importantly, conservative tendencies. Lula thus aborted a looming crisis, the country resumed its daily life, and Brazil achieved eighteen years of democratic and economic continuity, something it dearly needed. The conditions for a new era had been set.

## Four Mandates

### *Cardoso (1995–98, 1999–2002)*

Surfing on the success of *Plano Real*, Cardoso started his first mandate with a strong liberal drive which aimed to open the economy to market forces. He abolished the state monopolies in oil, telecommunications, gas, and shipping. The mining company *Vale do Rio Doce* was privatized along with a number of state-owned enterprises. Cardoso further liberalized trade and declared the country open to foreign investment. However, these steps were not without their costs. Inflation was under control thanks to an overvalued exchange rate that progressively became unsustainable, coupled with high interest rates, responsible for attracting a sizeable portion of speculative capital. Moreover, these market opening measures were, in overall terms, more timid than those introduced by Collor, as Cardoso struck sophisticated compromises with the old elites, notably with the manufacturing sector.

The sudden drop in the inflation rents extracted by the banks, which were at around four percent of GDP before the *Plano Real*, obliged the government to create a special program in 1995 known as *Programa de Estímulo à Reestruturação e ao Fortalecimento do Sistema Financeiro Nacional* (PROER). This program rescued several financial institutions, avoiding a serious collapse of the system. The volume of PROER operations amounted to roughly three percent of GDP during 1995–97. The programme was strongly criticised by opposition parties and many segments of the society (Maia 2003), however the resulting streamlining of the financial sector, along with prudential measures enforced by the Central Bank, would later prove useful during the 2008 financial crisis. The outcome of Cardoso's first mandate was a timid growth rate and signs of a looming recession by 1998.

Unable to resist the temptation of a second mandate, Cardoso employed considerable personal energy in enlarging the spectrum of political commitments in order to change the legislation forbidding the re-election of the President. In spite of the modest performance indicators, the modernization drive and the control of inflation rewarded him with a second term. In 1999, soon after his inauguration, the situation in the foreign account was close to untenable and pressure on the Brazilian real (R$) was high. The stubborn conduct of the Central Bank, evident since the second half of his first mandate, now underwent an internal leadership conflict, threatening to ignite a crisis. An ill-timed, and delayed, devaluation of the Brazilian currency cost the reserves over forty billion U.S. dollars. The President eventually acted and replaced the Central Bank administrators, putting Arminio Fraga Neto into the top position.

Fraga Neto is largely responsible for the success of the Cardoso's second mandate. The President, unfortunately, had his hands tied by the compromises he had to make to assure his re-election and now showed a more discreet, even hesitant, economic leadership. Public debt returned to less orthodox levels, unemployment increased, and Cardoso was unwilling or unable to pursue much needed reforms. In contrast, Fraga Neto's cool manner and clever implementation of inflation targeting ensured the consistent macroeconomic management of this period, at the price of high interest rates. Apart from the smart Central Bank policies, perhaps the greatest accomplishment of the Cardoso's second mandate was the Fiscal Responsibility Legislation (*Lei de Responsabilidade Fisca)* in 2000, which established clear and well-designed guidelines for the managing public funds at all levels of the federation. It is correctly considered a major step in improving public administration in Brazil. In February 2002, the long awaited crisis in Argentina took a dramatic final turn, with the dismantling of the Currency Board and the peso to U.S. dollar parity that had amazingly endured for a decade. Uncertainty prevailed in the financial markets and spirits heightened with the possibility of a Lula victory in the November elections. Volatility was pervasive and Fraga Neto again excelled in his ability to keep the macroeconomic framework under control. As a result, Cardoso's departure from government was low key.

## *Lula da Silva (2003–06, 2007–10)*

Lula started amid great tension and uncertainty regarding the path of the economy. He retained Fraga Neto for a time, eventually appointing Henrique Meirelles, a former banker and conservative, to the Central Bank. As noted above, Lula's economic staff included moderates and technocrats that helped calm markets and reverse expectations. This allowed the President the latitude needed to concentrate on the social policies that would become the imprint of his government.

It is debatable who designed the *Bolsa Familia* and *Fome Zero* programs, the former originating at the very end of Cardoso's period. What matters is Lula's leadership in emphasizing the social agenda: changing the rules of the game and placing government machinery at the service of poverty alleviation and social improvement nation-wide. This was something that had never taken place in Brazil. It is not that the governing elites had been oblivious to the ever spreading social ills, but it tended to enter the official narrative as an afterthought, to be addressed through the spill-overs of policies to grow the economy in general. This was an approach that targeted at most 65% of Brazil's population, thus leaving the remaining 35% as hungry outcasts. Even Cardoso, a sociologist with serious social concerns, largely overlooked the dire conditions of at least one-third of the country.

On the domestic front, this is the essence of Lula's contribution. Everything gravitated around a core mission of poverty reduction: from measures to make credit available to the poor, to improved access to health care. At the same time, both *Bolsa Familia* and *Fome Zero* were improved, expanded, and became increasingly efficient. A conservative macroeconomic policy, secured by Meirelles' credentials at the Central Bank, and the maintenance of excessively high interest rates, assured a stable environment for the government and the support from the ruling financial class.

On the international front, Lula's fine perception and emotional intelligence established an image of a confident Brazil that was active, serious, and successful in addressing its critical problem of stark inequality coupled with absolute poverty. Lula realised that his victory—a union leader from the bottom of society with modest education—represented an achievement for Western democracy and an acceptable face for capitalism. He conspicuously employed this engaging, symbolic image, aided by an innovative and competent Foreign Minister.[7] Brazil became a model experiment: the BRIC member without nuclear weapons and the country which was acting quickly to change its pattern of social injustice. Brazilians could take pride in their country's standing on the world stage.

Lula's disproportionate emphasis on the social agenda, of course, had its toll. The regulatory framework for public services and infrastructure was neglected. The country's capital stock (ports, airports, highways) was ignored with a serious impact in subsequent years. Few of the Cardoso's incomplete reforms progressed. At the same time, the macroeconomic instruments whose origin lay in the *Plano Real* were showing signs of exhaustion. In spite of achieving growth, interest rates were still abusive and the exchange rate was moderately overvalued.

During Lula's second mandate, he successfully coped with the international financial crisis, thanks to the sound macroeconomic management in place for more than ten years, the healthy status of the banking sector, and the lucky counter-cyclical moment the country was living in when the crisis struck. Lula's optimism, bold statements, and confident reassurances played a role as well, countering accusations of vapid rhetoric and wishful optimism by the opposition. Lula also continued to boost foreign policy, giving special weight to relations with the

African continent. However, corruption, ingrained in Brazil since at least Vargas, did not decrease under Lula's rule. Hopes that the federal administration would become impeccable were soon abandoned. Perhaps worse, nominations were tightly controlled by the political party, and unqualified affiliates were appointed to many important technical positions.

Apart from the inflationary peak, a superficial analysis of growth during the two decades of military and sixteen years of civilian rule might suggest that performance during the military years; but many more dimensions are at stake. Stability was a major achievement during the Cardoso–Lula years, but volatility is still high in both eras. The country was still far from a mature economy.

## Development to nowhere, change everywhere

In the introduction to this volume, the editors suggest that "consensus on what constitutes development, and how to best pursue it, may well be a thing of the past." One might go further and argue that development does not exist at all, and that the whole concept needs to be rephrased. The Brazilian experiment, briefly outlined in these pages, supports this argument, and brings a new perspective to how we might think about development. What can be learned from the eighty years of Brazilian history?

First, growth versus distribution is a false dichotomy. If one places too much emphasis on one side, a high price is paid for having overlooked the other. Vargas and Lula seemed to have perceived this. Vargas, as happens to nearly all dictators, even shrewd ones, tried to accommodate the different forces within his own personal schemes, which lacked a democratic framework, and eventually lost credibility among a large fraction of the elite. Meanwhile Lula was obliged to play a fireman in addressing social inequity, tipping the scale to the distribution side of “development management”. Kubitschek and Cardoso cannot be fully blamed for neglecting income distribution, but they certainly pushed the scales more in favour of growth. The irony is that Kubitschek really achieved growth, while Cardoso had a poor record on this indicator. Meanwhile, during the mandates of both presidents, the social problems plaguing Brazilian society remained largely unresolved.

Second, public funds play an important role. This is especially so in young capitalist economies. The key issue is how to moderate, target, and measure their use. Brazil clearly “progressed” during periods of substantial public investment, unfortunately often uncontrolled, and given the size of the country, a constant flow is needed even if only for replacement purposes. The mystery is how to combine such contributions with the active participation of private investors. The duality—alleviated, but not solved, by the privatization—of an overstretched public sector together with unused capacity in the private sector has been pointed out by some as a persistent Brazilian problem.[8]

Third, stability matters. This point may partially answer the previous question of what can one learn from Brazil's history albeit in a rather conservative way. The much praised virtues of stability—political, macroeconomic, and regulatory—coupled with credibility gained through consistent behavior by government, increased global credibility and attracted a diversified group of agents to participate, together with the government, in the "pursuit of development." The Cardoso–Lula sequence is a good example of this. The miracle years, under the military, even if more imperfect and partial, share something of this logic.

Fourth, social classes—and the divides between them—are essential for understanding a large country with a diversified society, such as Brazil. Without entering into a simplistic Marxist analysis of the Brazilian phenomenon, it is clear that the development narrative of these eighty years is a narrative of class struggle; a strong and violent struggle in the way the top elites defend their privileges and position, notwithstanding the docile behaviour of the Brazilian people. Those who held power, even the generals-presidents of the military decades, did perceived this, but few were successful at navigating around and through class struggle. Vargas, Kubitschek, and Lula demonstrated a deeper understanding of the contradictions, and achieved, in different ways and with varying degrees of success, reasonably constructive pacts between classes. Lula was perhaps the most successful, but lacked a broader and better technical staff. This aspect of the Brazilian experience is perhaps the most relevant for understanding other large countries with complex societies, such as India, Indonesia, and China.

This chapter overlooks the question of culture and education, but a couple of points might be made here by way of explanation. It is almost a cliché to say that education plays a key role in development with social progress (see Langoni 1973). What matter more is something beyond formal education and that encompasses broader aspects of culture. It is not that formal education, whether in natural sciences or humanities, is not vital for innovation and an improved society, but rather it is neither necessary nor sufficient. During the decades covered, Brazil did not excel in its education policies, but was extremely innovative in agribusiness and particular industries, such as manufacturing mid-sized aircraft. Naturally, education played a role in this, whether through the scientific staff of the state agricultural research company, EMBRAPA, or the top engineering institute funded by the Air Force, where EMBRAER started. But a clever mixture of Ricardo's and Smith's advantages, coupled with broader cultural traits of the agrarian sector and the military, created favourable conditions for innovation.

The country is also extremely creative in music, now a powerful industry and world brand. Brazil is also well-known for the peaceful and surprisingly efficient management of colossal popular events, such as the Rio Carnival, a reputation which likely contributed to Brazil winning the right to host the 2014 FIFA World Cup and the 2016 Summer Olympics. These are activities reasonably distant from the classic understanding of formal education, yet they matter tremendously in a narrative of development in Brazil. In contrast, Brazil has so far missed the opportunity to become a model for sustainable development. While natural resources are abundant, the country lacks technical skills required for their management. Since Collor de Mello hosted UNCED in 1992, Brazil has tried to find a path toward sustainable development, and Brazilian diplomacy has played a constructive role in the international arena, often thanks to its superior matchmaker abilities. But the nation does not yet fully qualify as a model of sustainability.

The four considerations above unavoidably bring to attention to the regional differences within the country. Often it is almost silly to speak of ‘Brazil’ as a single entity, given the multiple realities encompassed by the name. Over the twentieth century, having occupied a vast land, new territorial tensions emerged, coupled with varied geographic patterns of development. This obliges any analyst to be careful in making broad statements about a country that is discovering and asserting, in increasingly affirmative and modern ways, its multiple regional identities.

In synthesis, what has the *sturm und drang* of these eighty years led to? Is there a trend or tendency to be discovered in the kind of economy and social structure that has emerged? Rather than continuity, the succession of policies and measures described above speaks to several staggering efforts to solve specific problems, and orient the economy to partial, ultimately short-term targets, including increasing exports, improving the balance of trade, controlling public debt, fighting inflation, enhancing industrial productivity, and reducing poverty and inequality. Yet development and an encompassing social project are nowhere to be found. This does not mean that accomplishments and change, sometimes substantial, have not taken place. However, taking into account historical context, is Brazilian society fairer in 2011 than it was in 1931? Very likely, yes, but proving this is not easy.

Brazil is now a democratic capitalist society, but this statement is as vague as saying that China is a socialist republic undergoing a capitalist experiment. Only sound and specific knowledge of procedures, proceedings, cultural traits, structural assets, shortcomings, and of the daily functioning of institutions and the varied economic agents, can shed light on such omnibus statements. Change took place everywhere during these eighty years. If, like in physics, dynamics is what matters, the overall direction is probably positive. But the situation is more complex: explanations need simultaneously a broader and deeper view. And this is what makes study of Brazil so attractive.

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[1] The author is indebted to Timothy Hobson for his invaluable assistance.
[2] Throughout the text, the name of the President is used interchangeably to refer to the historical facts and dealings of the personas well as for the policies, measures, or appraisals related to his or her respective mandate.
[3] On U.S. military presence in Brazil, see Conn and Fairchild (1989: 302–30).
[4] It is also interesting to point out the anti-U.S. incidents in the Panama Canal in 1964, which eventually led to the handing of canal to local authorities in 2000; as well as a wave of protests in Asian countries, including the Philippines and Vietnam.
[5] A comprehensive account of such is found in Malan et al. (1977).
[6] The two dictators—Vargas in Brazil and Perón in Argentina—reflect distinct contexts, but is nonetheless a common comparison. Both undoubtedly shared certain sensitivities, including a desire to increase the portion of GDP dedicated to wages.
[7] Lula's Foreign Minister, Ambassador Celso Amorim, was ranked among the 100 Global Thinkers for 2010, by *Foreign Policy* magazine.
[8] Ignácio Rangel (1914–94) was one of the pioneers of this interpretation.