

## A Critical Review of Brazil's Recent Economic Policies

by Alfredo Saad-Filho, Department of Development Studies, SOAS

### Introduction

Hundreds of thousands of middle-class protesters took to the streets in Brazil on 15 March 2015 in an organised upsurge of protest against the federal administration led by President Dilma Rousseff of the Workers' Party (*Partido dos Trabalhadores*, PT). Similar smaller demonstrations took place across the country on 12 April 2015. These demonstrations have erupted in the political vacuum created by the increasing paralysis of Rousseff's administration, which stems, in large part, from Brazil's worsening economic conditions.

These difficulties have been compounded by aggressive media reporting of the *Lava Jato* corruption scandal, which has badly damaged the government's credibility. This scandal stems from the supposed channelling of vast sums of money from a network of firms to assorted individuals and political parties through the state-owned oil company *Petrobras*.

This Development Viewpoint (DV) attempts to trace these political difficulties in Brazil to the economic policies implemented by the PT administrations of both Luís Inácio Lula da Silva (2003-06 and 2007-10) and Dilma Rousseff (2011-14 and 2015-present). These administrations had delivered, for a time, significant gains in growth, employment and social equity, but they have been hampered by both recent global stagnation and the consequences of their own economic policy choices.

In particular, this DV reviews the extent to which the PT administrations have had to maintain conservative macroeconomic policies. Such policies have come to be known as the 'Policy Tripod' and encompass a standard conventional package of 1) inflation targeting and central bank independence, 2) free capital movements and floating exchange rates and 3) tight fiscal policies.

### Lula's First Administration

Lula, the founder of the PT, was elected President in 2002 based on support from a coalition of various forces, most of which supported more expansionary and distributive economic policies.

But these aspirations were limited not only by the imperative of managing an unwieldy political coalition, but also, immediately, by Lula's 'Letter to the Brazilian People', issued just weeks before the election. In this communication he felt compelled to commit his government to the conventional economic policies of the Policy Tripod, largely in order to contain the outflow of hot money during the election campaign and avoid an exchange rate crisis in case he was elected.

Lula's power was also limited by a Congress that was highly fragmented across more than a dozen raucous and unreliable parties. The PT has never elected more than 15% of the Deputies and Senators for the Brazilian Congress, and the seats held by both the party and its close allies have never exceeded one-third of the total.

The first Lula administration introduced moderate redistributive policies, including the formalisation of labour, rising minimum wages and new social transfer programmes. But broader social and economic gains were limited by the government's determination to secure 'market credibility' through the continued implementation of the Policy Tripod.

The ensuing tight macroeconomic policies constrained transfers, public investment and industrial restructuring and supported the overvaluation of Brazil's currency. These economic weaknesses were disguised but not resolved by the global commodity boom that was gaining momentum in the background.

This boom helped raise Brazil's exports from around US\$70 billion in 2003 to US\$200 billion five years later. Tax revenues and aggregate demand rose in tandem, allowing the government to raise social transfers by 172% in real terms between 1995 and 2010, and boost real minimum wages by 72% between 2005 and 2012.

During these years there was also a modest expansion of infrastructure, the promotion of selected industries (especially those where competitive advantages could be easily achieved, such as large-scale agriculture, mining, oil, food processing and construction), and rapid increases in employment in low-wage and low-productivity services. However, modest GDP growth rates in the initial years of the first Lula administration constrained the implementation of more expansionary economic policies (see Table).

### Brazil's Economic Trends 2003-2013

Economic Variable	2003-2006	2007-2010	2011-2013
Real GDP Growth (%)	3.5	4.6	2.1
Inflation Rate (%)	8.1	4.8	6.1
Current Account/GDP (%)	1.3	-1.3	-3.1*

Sources: Ipea data base; IMF database for inflation.

\*Average includes 2014

Lula's government was also damaged politically in 2005 by the *Mensalão* scandal, in which the government was accused, without clear evidence, of paying a monthly stipend to Deputies and Senators in order to secure their support. Despite this political setback and uneven economic progress, Lula was easily re-elected for a second term.

### Lula's Second Administration

During Lula's second administration, the resources made available by the global commodity boom led to the adoption of more expansive economic policies, including bolder industrial and fiscal policies, higher public-sector and SOE investment, and stronger redistributive programmes.

In the meantime, Lula was able to balance the demands of rival social groups by the judicious distribution of public resources through state investment, development funds, wages, social benefits and improved labour laws. The economy picked up speed, with real GDP growth rising from an average of 3.5% per year during his first administration to 4.6% under his second. Also, the inflation rate dropped from 8.1% to 4.8%. Tax revenue, investment, employment and incomes increased in a virtuous circle.

The economic dynamics in Brazil were sufficiently strong to support bolder expansionary policies in the wake of the global crisis in 2008, leading to the country's rapid recovery in 2009-10. By the end of his second administration in 2010, Lula's approval rates reached 90%.

Yet, these successes were limited by both faltering external factors and the conservative policies still embraced by Lula's administration. The government was also unable to diversify exports and raise the technological content of manufacturing production, leading to a decline in the manufacturing share of exports from 55% in the early 2000s to less than 40% in 2014, and an ensuing average current account deficit of -1.3% of GDP during this second term.

Brazil created 21 million jobs in the 2000s, in contrast to only 11 million in the 1990s, but the former were mostly precarious, poorly paid and unskilled, both on average and in comparison with those in the 1990s. In contrast, 4.5 million 'middle class' jobs (paying over five times the minimum wage) disappeared during the 2000s. Urban services were relatively neglected and there was notable underinvestment in economic infrastructure.

### Rousseff's First Administration

Dilma Rousseff, who was Lula's Chief of Staff, was elected as his successor in 2010. During her first administration (2011-2014), macroeconomic policies became, initially, nominally more progressive, but the Policy Tripod framework still exerted significant influence. Interest rates did fall, fiscal policy became increasingly expansionary and new investment programmes were introduced.

The government intervened in an increasing number of sectors to reduce costs and expand infrastructure, and BNDES (Brazil's large development bank) financed a growing portfolio of loans. Some capital controls were introduced, and the government expanded its social programmes in order to dramatically reduce extreme poverty. The strategic goal was to shift the engine of growth away from a faltering external sector and towards domestic investment and consumption.

But continuing global stagnation tightened up Brazil's fiscal and balance of payments constraints, and quantitative easing in the USA contributed to destabilising the *real* and other developing country currencies. Continuing global uncertainty along with concerted domestic critiques of unnecessary economic 'interventionism' by the Rousseff administration limited private investment.

Brazil's prospects worsened further as China's economy cooled and thus global commodity prices began to fall. During her first administration the current account balance as a ratio to GDP had an average deficit of 3.1%. The country's public finances deteriorated, and annual inflation rose above 6% on average (see Table).

Government perceptions that its economic strategy was not working and that the external environment was unlikely to improve led to policy zigzags. In the second half of the administration, Rousseff's economic team increasingly abandoned expansionary macroeconomic policies and reverted to the essentials of the Policy Tripod. Fiscal austerity returned, slowly at first, and a low inflation target became an increasingly important constraint on economic policies.

Soon Rousseff's administration had to confront not only a worsening economy but also mounting political turmoil. The media ratcheted up its pressure on the administration and started scaremongering about an 'economic disaster'. The government's base of support weakened and it encountered increasing difficulties in passing new legislation.

### Rousseff's Second Administration

Dilma Rousseff was re-elected in 2014 by the narrowest margin in recent Brazilian history. In the first weeks of her second administration, she faced converging crises leading to the virtual collapse of the two axes of PT rule: its progressive economic model and the political alliances supporting its administration. The government's earlier unwillingness to do away with the policies of the Policy Tripod, continuing global stagnation and the inadequacies of the country's industrial policies fed the overvaluation of Brazil's currency and led both to deindustrialisation and a wider current account deficit.

These constraints effectively eliminated the scope for greater redistribution and rising economic growth. The growth of GDP already hovers around 0% during early 2015. Insufficient investment in urban infrastructure in earlier years has led to a pronounced deterioration in service provision, symbolised by a crisis in transport in 2013 and dire water scarcity in 2014-15.

Rousseff's response to these crises has been to invite a representative of Brazil's largest private bank to become the new Minister of Finance, and charge him with the implementation of a more conventionally 'credible' adjustment programme. The government's weaknesses and its recent adoption, effectively, of the economic programme of its conservative opposition have triggered an escalating political crisis.

In addition, another massive corruption scandal, based on the *Lava Jato* operation, has captured public attention. Extensive media coverage has led to further deterioration in the government's credibility and helped stoke a mass opposition movement demanding the 'end of corruption'.

The Rousseff administration now appears to be stymied in implementing any further progressive economic policies. Economic growth, the improved distribution of income, employment gains and the expansion of infrastructure remain important goals in Brazil. But the current administration appears unable, in the current situation, to regain the political momentum that would enable it to work towards achieving them.