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BRAZIL: A COURSE OUTLINE

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BRAZIL

The following case study of Brazil is designed to address both political stability/instability issues and North-South political economy issues.

With regard to stability, Brazil in effect presents several case studies. As with most other third world countries, Brazil's early attempt at democracy broke down -- for reasons typical of democratic breakdowns throughout the Third World. Democracy was replaced by a military regime which achieved outstanding successes -- to an extent that made Brazil a model for numerous other countries, particularly after the alternative models of Chile, Cuba and Peru became clear economic failures. However, since the mid-1970s, Brazil has again been showing instability, this time an instability characteristic of many Third World military regimes under pressure by democratic and egalitarian forces. Finally, there is reasonable ground for speculation that the successor regime, whatever form it takes, will also prove to be a transitional one.

With regard to the world political economy, Brazil has played several roles. First, as noted, Brazil has become a model for some other Third World countries, particularly in Latin America ; Brazil has been the right wing military model that worked, in contrast with the communist model, the socialist/populist model, and the left wing military models (Cuba, Chile, Peru) that didn't work. On the other hand, for its critics Brazil represents a model of a different kind -- a model of everything wrong with the right-wing, export-oriented, U.S.-favored approach to development. The critics assert that its repressive politics, its extraordinary income inequality, and its debt problems represent the logical outcome of this kind of growth path, and that the apparent successes will now be overwhelmed by political instability and economic stagnation or collapse.

There are two other senses in which Brazil is a model. It is a symbol of the debt crisis of the Third World today, holding $70 billion out of the total Third World debt of $400 billion. Brazil's debt is a major issue for the world monetary system, because it represents more than half the total capitalization of the world's major international banks.

Finally, Brazil is a useful model to contrast with South Korea. The South Koreans have also followed a right-wing, military-dominated, U.S.-oriented, export-driven economic model (see the material in the Korean case study folder), but have combined it with extremely egalitarian education, organization-building, and income redistribution programs, and have chosen to build their economy around labor-intensive manufacturing rather than mining and heavy industry. Unlike Brazil, South Korea has avoided the pattern of excessive borrowing to finance huge state firms whose primary purpose is to compete with multinational enterprises in capital-intensive industries. The result is an extremely egalitarian, more flexible, less debt-ridden economy. Thus, it would appear that Brazil's problems result not so much from its emphasis on an open, export-driven, U.S.-associated economy than from its choice of a capital-intensive development strategy and of a nationalistic drive to compete with multinational corporations with huge state firms -- as well as from a crucial reversion to import substitution which actually caused the explosion of its debt after 1973.

<u>The Instability of Brazilian Democracy, 1961-'64</u>

During the 1950s Brazil expeienced what appeared to be a period of stable democracy, accompanied by quite respectable rates of economic growth: about 7 percent per annum. However, a number of sources of instability came together at the beginning of the 1960s:

--The growth could not fully hide continuing problems of unemployment, inequality and inflation;

--The import substitution industrialization programs ran out of steam and growth rates declined drastically;

--The legacies of vast projects like the building of Brasilia included hyperinflation;

--Democratic political institutions were exceedingly weak;

--Government administrative institutions were weakened by patronage appointments and corruption, and the role of those institutions was weakened by the electoral politics of their political masters;

--Democratic government in fact meant rule by a conservative coalition.

--The accidental rise to power of a populist/leftist president greatly exacerbated all the above problems and in addition led the armed forces to fear that Goulart would dismember the officer corps.

Reading: Alfred Stepan, <u>The Military in Politics: Changing Patterns in Brazil</u>

It is important to underline the extent to which such problems are characteristic of democracies in Third World countries. Governments in the Third World usually suffer from severe institutional weakness, and electoral patronage frequently exacerbates these problems. Democracy facilitates the organization of strong pressure groups, which press on weak governments and obtain concessions which lead to massive inflation. Democracy in Third World countries usually means rule by a coalition of conservative groups: powerful landlords, protected traditional industrialists, an entrenched civil service, and sometimes (as in Mexico) a labor union elite which protects its own high-wage interests at the expense of mass unemployment. These groups successfully oppose land reforms and other egalitarian measures which would help the tenant farmers, the unemployed, unskilled labor, and ethnic minorities. Finally, Third World democracies are usually vulnerable to populist demagoguery which espouses inward-looking policies which are less likely to lead to growth and universal employment.

This is not to say, of course, that democracy is alone in these vulnerabilities. Traditional despotisms, civilian or military, can be far worse. But increasingly many Third World regimes look to technocratic, disciplined, institutionalized, modernizing military regimes as a way to break through the above problems. Usually, the military intervention is seen as prolonged but temporary by both military and civilian proponents, and it has in fact proved usual for various forces to press against indefinite coninuation of military rule. However, the long-run prospects of those forces remain in doubt.

The Brazilian Military Regime's Economic Policies

The military imposed an austerity program, suppressed the pressure groups that were fuelling inflation, and reformed patronage-ridden government administrative institutions. It created an indexing system , which adjusted the values of liabilities and assets so as to remove inflation-caused distortions. This made saving attractive and enhanced investment. The government also attracted foreign investment, and undertook vast state investment programs through expansion of giant state firms. After a three year adjustment period, inflation declined from 80 percent to 20 percent, and growth rose to a 10 percent annual rate. Spurred by lower trade barriers, a less inhibiting exchange rate, and various incentive programs, exports rose dramatically. Every sector of the economy -- manufactures, agriculture, services, trade -- experienced a boom.

The boom was impressive, and it created a period of political stability. However, there was an underside to the boom. Inequality remained very severe, and some 60 percent of the population remained outside the modern economy; the capital intensive thrust of the boom reinforced a traditional inequality in Brazilian society. Inflation remained endemic, although it was much lower than under Goulart. Huge investments by state firms, and inflows of capital from multinational corporations expanded the money supply, stimulating inflation. A monetary squeeze would have a politically unacceptable result:

further damaging the indigenous private sector while the foreign firms and, above all, the state firms boomed. So inflation was accepted and indexed away.

The military growth model also led to a state takeover of the economy. The regime emphasized state investment in giant state firms. Private funds flowed into indexed government bonds, protected against inflation, rather than into unprotected private equity. The state sector expanded at the expense of both the private Brazilian sector and the multinational corporation sector. Like South Korea, Brazil became a highly state-controlled economy. Unlike South Korea, the major firms were state rather than private firms. Unlike South Korea, the thrust of development policy was capital-intensive, inegalitarian, and nationalistic in ways that inhibited rapid growth of labor-intensive manufacturing and high-technology manufacturing in cooperation with foreign firms.

Readings: Werner Baer, "The Brazilian Growth and Development Experience, 1967-1975," from Riordan Roett, editor, Brazil in the Seventies (Washington, D.C.: American Enterprise Institute)

Werner Baer, Richard Newfarmer and Thomas Trebat, "On State Capitalism in Brazil: Some New Issues and Questions," Inter-American Economic Affairs XXX, 3 (Winter 1976)

Cracks in the Military Model

By the mid-1970s, both political and economic problems began to emerge. Human rights violations strengthened opposition to the regime by academics, students, the Catholic Church, the press, and some elements of the middle class. Income inequality became an issue of rising salience. The indigenous industrialists, who had been strong supporters of the military revolution, reacted to the state takeover of the economy by going into opposition. The morale of the governing elite was affected by declining economic performance.

The oil price rise of 1973 hit Brazil, which imports most of its oil, very hard. Brazil responded by reverting to its old, pre-military regime policy of import substitution industrialization, trying to reduce non-oil imports. The result was a huge accumulation of debt, as Brazil's import substitution program required imported capital goods for mining and for building a domesitc capital goods independence program. The huge investments of the time also accelerated inflation, and further acceleration was caused by loss of control over the expenditures of the state firms. Extraordinary credit subsidies to agriculture rounded out Brazil's program for hyperinflation. The inflation rate topped 120 percent in 1981, half again higher than the worst under Goulart.

Reading: William H. Overholt, "The Future of Brazil: An Overview," from Overholt, ed., The Future of Brazil (Westview Press, 1977)

Brazil's Foreign Debt

Brazil blamed its rising debt primarily on high oil prices and secondarily on Western protectionism. But in the following the oil price rise, only one-third of the increased imports costs were for oil; two thirds were for capital goods required by the import substitution program. In contrast, South Korea, which imports an even higher proportion of its oil than Brazil, responded to the looming debt crisis by liberalizing imports and promoting exports; by 1976 South Korea was exporting more to the Middle East than it was importing. World Bank studies showed that the more open, export-oriented economies did better across-the-board than ones which followed Brazilian-style policies.

By the late 1970s, Brazil's debt was being exacerbated by yet another major problem: high interest rates. Major international loans usually float over the London Interbank Offering Rate (LIBOR), which is heavily influenced by U.S. domestic interest rates. When Jimmy Carter became President, the U.S. prime rate was 6.25 percent. When he left office, having created a massive inflation, the interest rate was in the neighborhood of 20 percent. Each rise of one percent cost the Brazilian's $325,000,000 in interest payments; thus the Carter tax on Brazil was comparable in magnitude to the Arab tax.

Reading: William H. Overholt, "Brazil's Debt Burden," from Overholt, The Future of Brazil (Westview, 1977)

This article examines the takeoff of Brazil's debt and the reasons why bankers have continued lending to Brazil. The numbers are extremely out of date, but the arguments have not changed. Because such projections have to be done in nominal dollars, against an unknown rate of inflation, the projections quickly get wildly out of line. In real dollars, Brazil's performance has been slightly worse than the pessimistic scenario.

By 1980 Brazil's foreign debt was about half the capitalization of the major international banks combined, and a business as usual projection would conclude that by 1985 it would be more than 100 percent of the total capitalization of major international banks. Thus the world monetary system cannot allow Brazil to go under, but it also cannot allow present trends to continue. This leads to delicate bargaining.

One of the noteworthy phenomena of the modern era has been the extent to which governments, particularly the U.S. government, have utterly failed to take charge of such a momentous issue. Such abdication would have been unthinkable through the mid-1960s.

The Current Dilemma

Brazil now faces the need for a political and economic transition under exceedingly difficult circumstances.

Most civilian groups and the majority of the military were by 1980 persuaded of the need for transition to a form of government which could command broader public support. This meant civilianization, liberalization, and at least a facade of democratization. But few Brazilians have any faith in the ability of civilian political parties to manage the economy in its current crisis, and many conservatives fear that electoral pressures would fatally worsen the severe inflation and massive foreign debt. Therefore, the military seeks to civilianize and liberalize without really risking that control would pass to opposition groups and without risking the rise of populist economic pressures. This is a difficult balance to maintain.

Likewise, there is pressure for a more egalitarian income distribution, and there is an economic imperative to become less dependent on imported oil and capital goods. But the shifts are politically difficult, meeting both elite and nationalist resistance.

Thus, Brazil is walking a tightrope. The fundamental shape of Brazilian society, economic and political, is at stake. Also at stake are the world financial system and much of the U.S. relationship with Latin America, for which Brazil is a primary exemplar and mediator.

In the readings, Peter Knight explores, from the vantage point of the World Bank, ways in which Brazil could evolve toward a more egalitarian and less debt-ridden future. The Overholt paper highlights the current political dilemma and the difficulties of each political-economic path that Brazil may seek to follow.

Readings: Peter Knight, "Restructuring Brazil's Economy for Equity and Energy Independence," paper for symposium on "Brazil, 1980-2000," Rio de Janeiro, 1980

William H. Overholt, "Brazil in the 1980s"

One of the central conclusions of the latter paper is that egalitarianism is a more important value to Brazilians than democracy, that democracy would once again bring the rise of a conservative regime, and that democracy would therefore remain unstable.