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From aspiring powerhouse to economic regression: the consequences of liberalism and the subordinate international insertion of the Brazilian economy

Do sonho de potência a regressão econômica: as consequências do liberalismo e da inserção internacional subordinada da economia brasileira

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Abstract: The objective of this article is to analyze how the economic policy response to the crisis of the 1980s, the passive international insertion and the adoption of orthodox policies from 2015 onwards determined a process of economic regression with a strong loss of participation of the industry in the GDP, reprimarization of export agenda and loss of efficiency of macroeconomic policies.

Keywords: Deindustrialization; Reprimarization of the export agenda; Passive international insertion; Brazilian economy.
JEL Classification: 010

Resumo: O objetivo desse artigo é analisar como a resposta de política econômica à crise dos anos 1980, a inserção internacional passiva e a adoção de políticas ortodoxas a partir de 2015 determinaram um processo de regressão econômica com forte perda de participação da indústria no PIB, reprimarização da pauta de exportações e perda de eficiência das políticas macroeconômicas.

Palavras-chave: Desindustrialização; Reprimarização da pauta de exportação; Inserção internacional Passiva; Economia Brasileira.
Classificação JEL: O10

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1. Introduction

The objective of this article is to analyze the response of economic policy to the crisis of the 1980s, passive international insertion and the adoption of orthodox policies from 2015 onwards using the method of political economy. The hypothesis is that the consequences of these policies were a process of economic regression, with a sharp loss of industry's share of GDP, a reprimarization of exports, social unrest and the inability of economic policies to stimulate economic growth.

To achieve this objective, the article is structured into six sections. The initial section examines the achievements of the Brazilian industrialization process (1933-1979) and its shortcomings in addressing the issues of dependency and inequality. The second section addresses the decline in industrial dynamism that occurred in the 1980s. The third section addresses Brazil's integration into the new international order, namely financial globalization, which commenced with the Plano Real (a Brazilian economic stabilization plan implemented in 1994 to combat hyperinflation), and the second FHC government. The following two sections will examine the Lula da Silva government and the first Dilma government. The final section of the article examines the period between 2015 and 2019, during which there was a significant shift in macroeconomic policy towards a more liberal and orthodox approach.

2. Industrialization and New Industrialized Periphery

Brazil provides an excellent case study of a peripheral country with a colonial past that only began to industrialize in the 20th century yet succeeded in building an advanced industrial structure. From 1950 to 1979, the remarkable growth in aggregate production and employment, coupled with the dynamism of the process of diversification of productive forces, led to a perception among many that the country was on the verge of becoming a developed nation and breaking its dependence on the central countries.

It is evident that the completion of the industrialization process, which enabled the constitution of this modern industrial structure, was only possible within a specific and exceptional international context of capitalist development. This context included the internationalization of American companies as part of the Marshall Plan, which induced a new international division of labor. The emergence of this new DIT, influenced by the growth of subsidiaries of American companies in Europe, Japan and Canada, compelled their counterparts to also internationalize. However, the influx of multinational corporations into Brazil, which enabled the internalization of the dynamic sectors of the department producing durable consumer goods and heavy capital goods, was only made possible through the proactive and effective intervention from the State. The State played a pivotal role, not only because it was able to invest in the sectors under its responsibility (basic industry and infrastructure), but also because it created the conditions for association between national companies and foreign capital, by establishing a capital accumulation strategy (Mello, 1987; Draibe, 1985).

With heavy industrialization, despite the small relative weight of the leading sectors (capital goods and durable consumer goods) in the industrial structure, the Brazilian industrialization process is complete, in the sense that capital accumulation can self-determine its expanded reproduction.

Industrialization, however, has not yet fulfilled two promises that were mythically associated with it (Mello, 1987).

First, to reduce poverty and inequality. In a surprising turn of events, despite the impressive growth rates in aggregate production, industrialization did not lead to a reduction in poverty levels. In fact, income inequality reached an even greater extent than before. The richest 10% of the Economically Active Population (EAP), which in 1960 appropriated a significant 39.6% of the national income, in 1980 increased their participation to 51% of the national income. On the other hand, the poorest 10%, representing just 1.9% of national income in 1960, saw their share decline to 1.1% by 1980. The richest 30%, which in 1960 accounted for 66.1% of the national income, in 1980 accounted for 75.5% of the national income (Henrique, 1999).

In other words, we have achieved industrialization, but we have not managed to create a minimally homogeneous society. As a result, we have not yet broken away from underdevelopment.

Secondly, industrialization did not manage to free the Brazilian economy from its dependence on central countries. To put it another way, we have achieved industrialization, but we failed to develop a national innovation system capable of providing us with both technological autonomy to determine our own consumption patterns and the technological competence to gain a competitive advantage in international trade.

Thus, industrialization failed to break the cycle of dependence; instead, it altered its nature, turning us into mere consumers of new industrial consumer goods. Despite being produced locally, these goods are produced according to an imported consumption pattern determined by the central countries. To summarize, while there has been a shift in the International Division of Labor, with Latin American countries also beginning to manufacture industrial products, this has not resulted in complete independence from the center. We remain reliant on technology to produce and manufacture these products, which is developed and controlled by central countries (Furtado, 2000). As Furtado (2000, p. 260-261) notes:

> Unlike developed economies, in which the driving factor is a combined process of adoption and *diffusion* of new forms of consumption (private and/or public), and new production processes, two primary factors interacting depending on the conditions of the system as a whole, in the underdeveloped economy, it is the importation of forms of consumption for the benefit of a restricted minority that constitutes the main factor dynamic.

From Furtado's perspective, the State plays a pivotal role in implementing development policies within the context of a global economic system that subordinates peripheral countries to dominant centers. However, the manner in which economic policy developed from 1979 until now ended up weakening the State and preventing it from playing an active role that would be necessary both to advance the development process and also to avoid the regression of the productive structure, as it ended up happening.

3. State Crisis and Exhaustion of Industrial Dynamism

Despite facing significant challenges, particularly after 1974, the Brazilian economy demonstrated resilience and maintained a certain level of dynamism until 1980.

From 1974 onward, the international situation shifted, and the first oil shock occurred, marking the beginning of macroeconomic instability that would affect the Brazilian economy in the 1980s. This was evident in accelerating inflation rates and imbalances in the external accounts. However, the ample liquidity in the global economy, enabled by the euro market, permitted the government to defer the definitive adjustment. While the international climate of abundant liquidity allowed external accounts to be financed through indebtedness, the government sought to reduce the pace of minidevaluations, adjust public tariffs below inflation, and implement a system of price controls to prevent inflation from accelerating further.

The increasingly challenging global economic landscape presented a challenge to Brazil's economic strategy of postponing the definitive adjustment.

In 1978, as imbalances in the American economy deepened and pressure on the dollar intensified, international interest rates rose from 6% to 8% annually. In light of the recent acceleration of Brazil's foreign debt and the heavy commitment of international banks' assets to Brazil, the terms of loans and financing to the country were shortened, and spreads were increased. The Brazilian government was forced to mobilize its entire arsenal of economic policies (interest rates, exchange rates, and credit) to stimulate public and private sector borrowing in foreign currency due to the increase in the cost of servicing the country's foreign debt, caused by the rise in interest rates and spreads, and the shortening of financing terms. “At the end of the 1970s, the country decidedly entered a Ponzi financing regime, that is, at a stage in the debt process in which the taking of new credits resulted from the need to cover the service of past debt” (Belluzzo; Almeida 2002, p. 10).

Within this situation of macroeconomic imbalances and extreme financial fragility, in space of two months, the Brazilian economy was subjected to a double external shock in 1979: in October the brutal rise in American interest rates and in November a new and violent increase in international oil prices.

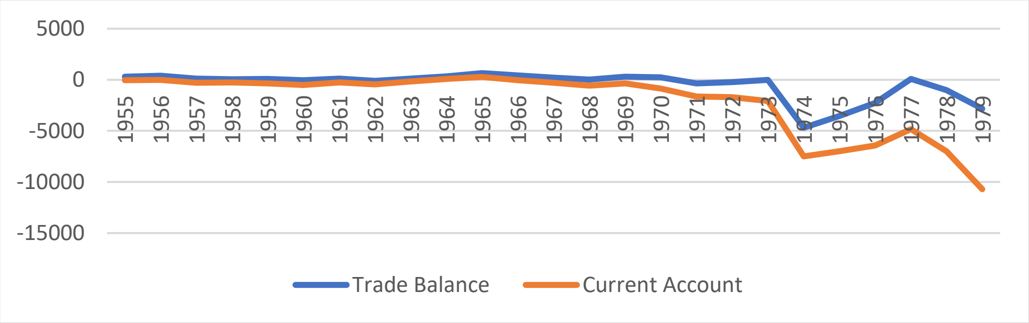
In response to the double external shock, the then planning minister Delfim Neto decreed, on December 7, 1979, a large currency devaluation of 30%. The devaluation of the Cruzeiro against the dollar aimed to reverse, or at least reduce, the current account deficit that had been growing since 1978.

It was anticipated that the devaluation would result in increased costs for imported components, which would subsequently lead to an overall rise in domestic prices. However, the government was concerned that inflationary expectations would outpace the devaluation, so it took steps to address this: pre-fixed the monetary and exchange correction indices, introduced a reduction in nominal interest rates, and announced vigorous price controls on oligopolized sectors and State-owned companies.

These measures, while insufficient to prevent inflation from accelerating, also had the unintended consequence of undermining the impact of the large devaluation on the trade balance. Fixing the exchange rate led to the anticipation of imports, particularly of intermediate goods and raw materials. While the trade deficit remained virtually unchanged, the current account deficit reached its highest point since the post-war period.

In the following year, 1980, while external accounts continued to deteriorate, international reserves decreased and inflation reached 100% per year, an increasing monetization of public debt was observed, accompanied by financial disintermediation. However, the external debt not only increased but also underwent a shift in composition, moving towards greater nationalization. As a result of the prefixing of the exchange rate, numerous companies with dollar-denominated debts passed them on to the government in accordance with Resolution 432 of the National Monetary Council[1], instituted by Simonsen in 1976.

Figure 1: Trade Balance and Current Account, Brazil-1955-1979 - USD millions



Source: Bacen.

In a modern economy, where the balance sheets of key players are interconnected, the spending decisions of companies and households are significantly influenced by the availability of bank credit. Banks and other financial institutions leverage deposits to create currency and finance the acquisition of goods, financial assets, and real assets (Godeley; Lavoire, 2007; Aglietta, 1995). The economic policy of the military government, however, led Brazilian companies to rely primarily on international banking for financing. The manner in which the cyclical reversal between 1981 and 1983 materialized, prompting banks and other national and international financial institutions to significantly reduce credit, would have resulted in a period characterized not only by a deceleration in spending

[1] Resolution 432 of the International Monetary Council allowed anyone who had debts abroad to transfer their total debts to the Central Bank, permanently or not, by depositing in Cruzeiros the amount corresponding to the principal of the obligation in date of operation.

on consumption and investment, but also by a considerable number of defaults and, consequently, a business crisis.

However, the adjustment to the crisis did not result in the business crisis that was expected, and it also allowed for the restructuring of both current assets and the assets of big business. This was made possible due to the fact that the burden of adjustment was shouldered by the State (Belluzzo; Almeida, 2002).

To understand how the government bore the burden of adjustment, it is essential to recall that, even before the external debt crisis, the debt had already been largely nationalized through two mechanisms: on the flow side, since the mid-1970s and predominantly after 1979, the public sector engaged in new external borrowing (Cruz, 1998); on the stock side, since the mid-1970s, mechanisms were created that allowed the private sector to either transfer its holdings in dollars to the government[2] or hedge against exchange rate risk[3].

Consequently, when the foreign debt crisis commenced and international interest rates increased, the amount of interest paid abroad by the private sector was minimal, as the private foreign debt had effectively been transferred to the government. Currency devaluations also had little effect on the private sector, as those who still had commitments in dollars were supported by hedge instruments. This partly explains why the private sector was preserved during the adjustment. In part, because it is necessary to analyze how debt owed to banks and internal institutions could be reduced, exactly at a time when, due to the decline in demand and profits, a consequence of the recession, the opposite was to be expected (Cruz, 1988).

Regarding this issue, it is necessary to remember that in 1980, at the same time that the government implemented a large currency devaluation, it also prefixed the monetary correction indices. The prefixing of the monetary correction, at a time when inflation was accelerating, led to a large devaluation of debts, including public debt. While the prefixing of monetary correction devalued debts, simultaneously the currency devaluations and the setting of salaries below inflation allowed companies to maintain, or, in some cases, increase profitability. Moreover, the power to set their prices above the rate of inflation worked in the same way: the increase in the prices of goods and services, along with the reduction in real wages, guaranteed the large companies located here a high and often growing profit margin.

Thus, the adjustment process allowed the restructuring of both the current and the assets of large capital.

These same policies, which allowed the restructuring of private capital, ended up weakening the government financially. The government's financial unviability is at the root of both the decline in public investment and the loss of State sovereignty, a reflection of its inability to manage the currency.

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[2] This was the case, for example, of Resolution 432 of the National Monetary Council.

[3] Public bonds with exchange rate variation clauses functioned as a hedge mechanism against exchange rate risk.

The format of the restructuring generated the financial insolvency of the State for four reasons. First, because the real stock of external debt under the government's responsibility increased, due to the expedients that allowed the private sector to transfer its dollar debt to the government. Second, because the acceleration of inflation, induced by the sudden currency devaluation and the strategy of maintaining the real exchange rate, reduced the government's tax revenues in real terms. Additionally, government revenues were negatively impacted by tax and credit incentives for agriculture and exports, as well as the use of public tariffs as a tool to combat inflation and support exporting sectors. Third, because exchange rate devaluations increased the stock of dollarized public debt in real terms. Fourth, in the absence of a comprehensive fiscal adjustment, the government had to resort to issuing public debt securities with an exchange variation clause or high real interest rates to purchase the foreign currency generated by the private sector's trade surpluses (Belluzzo; Almeida, 2002).

Therefore, the Brazilian government's finances are placed in a dead end: the high real interest rates required during the 1980s to roll over the internal debt were much higher than the growth of real product, which meant that the interest burden on public debt grew faster than revenues, resulting in a progressive increase in public debt.

The deterioration of the public sector's financial position during the 1980s was a key factor in the economic stagnation and high inflation rates that defined that decade.

In a peripheral economy, State investment plays a strategic role, particularly in Brazil, where it is concentrated in infrastructure and basic inputs. The reduction in investment spending by the state-owned productive sector and the lack of public spending on infrastructure presented a challenge to private investment due to its negative impact on effective demand, as well as due to the absence of a long-term growth horizon (Carneiro, 1993).

In addition to the decline in public spending and investment, the crisis and the manner in which public debt was rolled over would also contribute to the decline in private investment.

As demonstrated by Keynes (1991), during periods of economic instability, the potential risks associated with productive investment increase. Faced with increasing risk, capital holders seek ways to value short-term money capital, which explains the preference for non-productive assets. In Brazil, both the reduction in the time horizon and the shift in preference for liquidity were more pronounced.

During the adjustment period, the monetary correction in 1980 and the subsequent purges between 1982 and 1984, along with the undervaluation of the index in 1983, led to a reduction in the stock of accumulated wealth for rentiers, as the devaluation of the real public debt offset any potential gains.

In response to the risk of further devaluation of their assets, rentiers demanded a shorter maturity period for acquiring government bonds and engaged in arbitrage operations on the asset markets. This reaction by rentiers forces the State to align with their position in order to be able to roll over the debt, offering bonds with short maturities and high remuneration, which compromises monetary policy. Furthermore, the availability of short-term public bonds with competitive returns reduces the incentive to invest, as they offer an alternative means of increasing the value of capital (Belluzzo; Almeida, 2002).

The crisis of the State thus provides the impetus for financial speculation and, consequently, for a decline in the incentive to invest. Additionally, it had adverse effects on inflation.

Following the banking and financial reforms of 1966/68 and the progressive generalization of monetary correction to all financial assets, there has effectively been a dual currency system in Brazil. The Brazilian solution to the problem of the unit of money's functions in situations of chronic inflation was the existence of two currencies. Due to the accelerated devaluation caused by inflation, one currency, the legal tender – paper money and demand deposits –, is unable to fulfill the functions of a store of value. The other, "financial money," when corrected by the institution of monetary correction, fulfills the functions of money that forced currency cannot perform (Tavares, 1998).

As a result of the aforementioned adjustments, the terms of financial investments were shortened, and government bonds saw an improvement, which served as a basis for banks to issue short-term deposits. As inflation accelerates, monetary and exchange rate corrections cease to be a safe criterion for setting prices, as "the rapid acceleration of inflation necessarily implies a delay in corrections in relation to current inflation due to the period of time necessary for calculating price indices" (Carneiro, 2002, p. 217). In this situation, the use of very short-term interest rates becomes the dominant criterion for price adjustments, resulting in a process known as the "financialization of prices" (Belluzzo; Almeida, 2002).

4. The FHC Government - Passive International Insertion, Financial Fragility and Industrial Setback

Brazil's industrialization strategy included the protection of the domestic market, which shielded national companies from foreign competition. In the 1990s, there was a sudden opening up of both the current account and the capital account. The sudden convertibility of the current account was accompanied, in the Fernando Henrique Cardoso government, by a strategy of *desinflation compétitive*. As if the rapid opening was not enough, national companies are exposed to competition under highly unfavorable conditions, as the exchange rate appreciation increases the price of national products on the international market and lowers the prices of imported products.

The FHC government's economic policymakers believed that competitive disinflation, or opening up with an appreciated exchange rate, would have a double positive effect on the Brazilian economy. Firstly, it would lead to a conversion of the relative prices of the Brazilian economy to international prices, in line with the Heckscher-Ohlin Theorem. Secondly, it would force domestic companies to become more efficient, modernizing the national productive structure in the process. Gustavo Franco, president of the Central Bank, stated that over time, the Brazilian economy would adjust its level of productivity, prices, and nominal wages to align with the appreciated exchange rate. This would result in a virtuous cycle of accelerated growth, stability, and productive modernization.

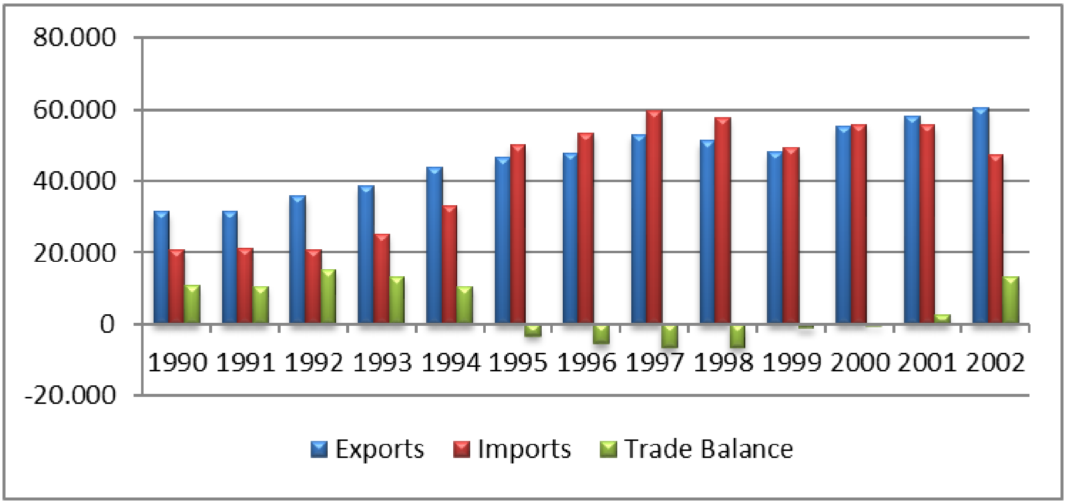
The strategy of "competitive disinflation" was part of a comprehensive set of liberal economic policies recommended by the IMF in the 1990s. These policies, collectively known as the Washington Consensus, were formulated by economists from leading financial institutions in Washington, including the IMF, the World Bank, and the US Treasury Department. They were inspired by an article by John Williamson (1992).

In Brazil, the recommendations of the Washington Consensus, which advocated the adoption of an appreciated exchange rate, liberalization of the trade and capital accounts, and a restrictive fiscal policy, were implemented by the Fernando Henrique Cardoso government as part of the so-called Plano Real.

The Plano Real was executed in three stages. The first step was the implementation of a provisional budgetary balancing instrument, namely the Social Emergency Fund (Fundo Social de Emergência). Later, in a second stage, on 03/01/1994, an almost fully indexed currency was implemented in the economy, approximately on par with the dollar, which, for a certain period of time, should circulate side by side with the Cruzeiro. The introduction of the URV (Real Unit of Value) currency was designed to align relative prices to ensure that, upon its introduction, all prices would be aligned in URV. After a five-month period of free conversion of prices to the URV, the government adopted the new currency, the Real, at a fixed conversion rate.

The Plano Real induced a rapid disinflation process. However, the decline in inflation was not solely attributable to the introduction of the new currency. Possibly, it was mostly induced by the fixation of a valued nominal exchange rate, combined with a rapid trade opening, i.e., the result of *desinflation compétitive*.

Figure 2: Exports, Imports and Trade Balance – Brazil 1990-2002 – in USD Millions



Source: Banco Central.

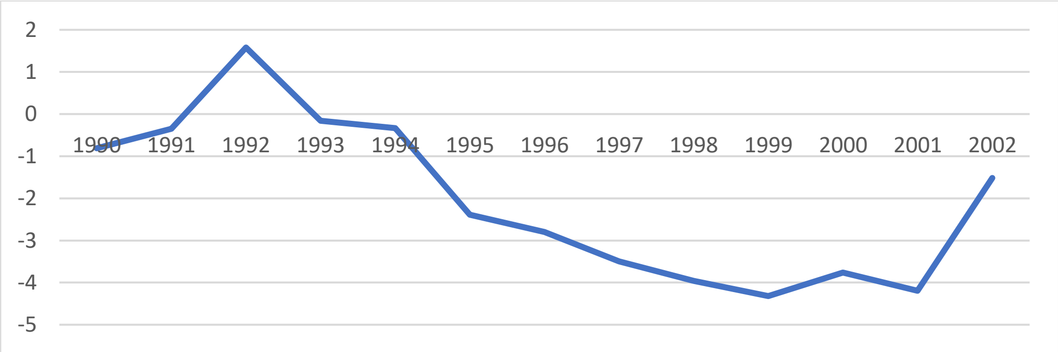
Despite the rapid and significant decline in inflation, it remained higher than that of the United States. This was due to the fixed exchange rate regime, which resulted in further appreciation of the exchange rate. The additional appreciation of the Real and intensification of trade liberalization affected the balance of trade, resulting in deficits as early as 1995, as illustrated in Figure 2. The deficit in the trade balance, coupled with the expansion of the deficit in the services account, significantly contributed to the overall deficit in current transactions, as illustrated in Figure 3.

> From 1995 onwards, the Real Plan showed its other face. The way in which the Brazilian economy was inserted into the so-called 'new international order', with an effective reduction in protection for national producers, a valued exchange rate and high interest rates, led the economy to a low growth trajectory and created a enormous external vulnerability, which can be measured by the growth of the current account deficit (Dainez; Dainez, 2019).

The slowdown in aggregate production, particularly after 1996, can be attributed to the expansion of imports and the contraction of investment and government spending.

However, the most significant issue is the poor performance of investment. The trade liberalization and the overvalued exchange rate had a detrimental impact on domestic companies, particularly those with a significant portion of their demand in foreign markets. Furthermore, this situation discouraged export-oriented investment projects and resulted in the contraction of production chains within exporting sectors. Concurrently with the loss of competitiveness in exports, the influx of cheaper imports prompted numerous companies to substitute domestic inputs with imported ones. High real interest rates had a similar effect, because by raising the cost of bank credit, they increased both the costs of companies and financing investments. Additionally, they created an attractive alternative for the capital appreciation in the financial sphere (Dainez, 2003).

Figure 3: Current Account Balance % GDP



Source: Banco Central.

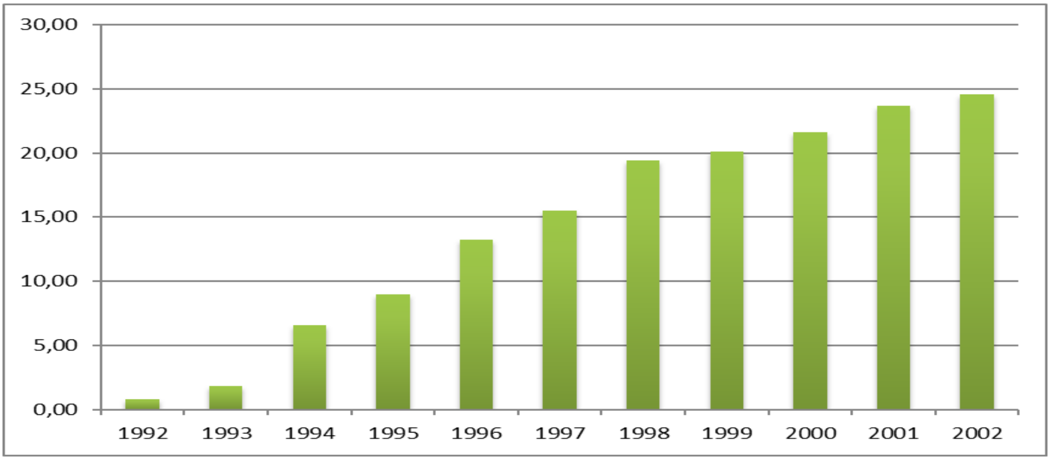
In the context of heightened external vulnerability and mounting challenges in maintaining economic policy, two external shocks compounded the situation by altering the financing conditions for "emerging economies": the Asian crisis in the second half of 1997 and the collapse of Russia in August 1998.

In addition to the reduction in capital flows and financing lines for these countries, there was another change: the inadequacy of the exchange rate regime and the deterioration of public accounts, combined with the perception of the disproportion between the mass of liquid domestic assets and the country's reserves, changed the risk perception of international investors in relation to Brazil (Belluzzo; Almeida, 2002; Carneiro, 2002).

Nevertheless, the economic policy was maintained at a significant cost to the country until the 1998 elections. Following the elections, the government attempted a final strategy in the first half of January 1999: currency devaluation, while maintaining the regime of asymmetric exchange rate bands. The 9% devaluation was insufficient to alter the situation. A few days later the government is forced to replace the exchange rate band regime with a "free" floating system. As had already occurred in the case of Asian countries, free floating led to an exaggerated devaluation, as in a space of less than 30 days the dollar exchange rate would reach R$ 1.98, which means a devaluation of 63% compared to the exchange rate of 01/17/1999, R$ 1.21 per dollar (Dainez, 2003).

Although the devaluation of the exchange rate led to significant gains in the external accounts, it did not free the Brazilian economy from its dependence on speculative capital flows. Since the appreciated exchange rate had destroyed many production chains and increased the import coefficient, the devaluation of the exchange rate does not automatically increase exports, nor does it immediately reduce imports, especially of parts, components and inputs. Thus, although the trade deficit was reduced, it was not until 2001 that there was a surplus, due to an extremely depreciated exchange rate and the recession.

Figure 4: Public Sector Net Debt* -% GDP



*Central Government + Bacen.

Source: Bacen.

Nevertheless, the current account deficit remained extremely high, given the structural increase in remittances of interest, profits and dividends. Brazil thus remained dependent on capital inflows to finance its balance of payments. As a result, domestic interest rates could not be lowered. Therefore, monetary policy remained ultimately subject to the need to maintain an interest differential between the national and international economies (Dainez, 2003).

Despite the government's enormous efforts to achieve primary surpluses since 1999, these have not been sufficient to avoid high nominal deficits due to the interest burden on the public debt. As a result of the previous exchange rate policy, the public debt not only increased, but also its maturity was shortened and a large part of it was eventually indexed to exchange rate fluctuations. Given the growth of public debt and its short-term financing profile, the government is obliged once again to maintain a high interest rate to roll over this debt.

In a heterogeneous, flexible and highly asymmetric labor market, this economic policy has led to an increase in unemployment rates and job insecurity, which is extremely serious given the inadequate social security structure.

Table 1: Average Annual Growth Rates of Gross Domestic Product Brazil 1995 – 2015

Year	Annual % variation	Year	Annual % variation	Year	Annual % variation
1995	4.22	**2002**	3.05	**2009**	-0.13
1996	2.21	**2003**	1.14	**2010**	7.53
1997	3.39	**2004**	5.76	**2011**	3.97
1998	0.34	**2005**	3.20	**2012**	1.92
1999	0.47	**2006**	3.96	**2013**	3.01
2000	4.39	**2007**	6.07	**2014**	0.50
2001	1.39	**2008**	5.09	**2015**	-3.55

Source: Banco Central.

5. The Luiz Inácio Lula da Silva Government

Upon assuming office in 2003, Lula continued the macroeconomic policy initiated during the Fernando Henrique Cardoso administration. This policy involved targeting inflation, maintaining a floating exchange rate, and generating a primary surplus. Despite predictions to the contrary, macroeconomic policy remained focused on combating inflation.

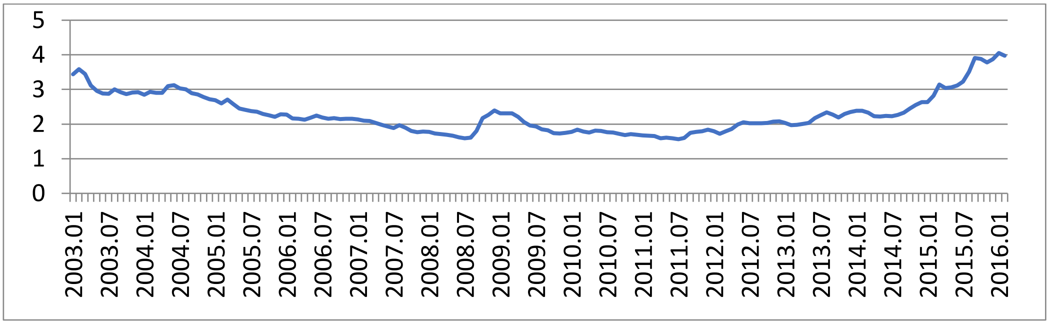
In examining the macroeconomic policies of Fernando Henrique Cardoso's administrations, it is essential to differentiate between two distinct phases. The initial period, spanning from 1994 to 1998, centered on the use of an exchange rate anchor. Following this, from 1999 onwards, the focus shifted towards the establishment of an "internal nominal anchor," which was achieved through the implementation of an inflation targeting system. The economic policy of the Lula government, with the exception of potential variations in management, is consistent with that of the 1999-2002 period. Both were based on a combination of inflation targeting, floating exchange rates, and a contractionary fiscal stance (Carneiro, 2005/2006).

During the first Lula government (2003-2006), maintaining this policy resulted in a very modest average GDP growth rate, around 3.5% per year, a rate lower than the average for the world economy in the same period[4].

Upon assuming office in 2003, Lula observed an acceleration in inflationary trends. In accordance with the inflation targeting system, this prompted the government to implement an increase in the basic interest rate. However, during Lula's tenure, the government employed a dual approach to combat inflation, utilizing both a high-interest rate policy and an appreciated exchange rate. Between January 2003 and December 2010, the Real appreciated by 49%, as illustrated in Figure 5. The combination of high interest rates, an appreciated exchange rate, and a primary surplus policy resulted in a less favorable economic outcome due to the distinctive international context since the post-war era.

In the period between 2003 and 2010, the Brazilian economy benefited from a relatively stable source of growth in the form of the trade surplus. The devaluation in 1999 initially contributed to the growth of the trade surplus. However, following a sharp appreciation of the exchange rate, particularly after mid-2005, it can be concluded that the dynamism of exports during this period was primarily driven by the intensity of the international trade cycle. The surge in external demand from the United States and Asian countries, particularly China, beginning in 2002, led to a rise in commodity prices, counterbalancing the appreciation of the exchange rate.

Figure 5: Real/Dollar Commercial Exchange Rate - Sale – Average 2003 - 2015



Source: Ipea.

[4] In the period 2003-2006, the world economy had an average GDP growth rate of 3.65% per year (World Development Indicators, World DataBank, World Bank).

The appreciated exchange rate has led to a continuous process of reprimarization of the export agenda, with an increase in the export of commodities and a reduction in the export of manufactured goods. The increase in international prices has offset the negative effect of the exchange rate on the export of commodities, while the appreciation of the exchange rate has penalized the export of manufactured goods, which has not been offset by any mechanism or policy. The proportion of manufactured goods in Brazil's exports declined from 60.7% in 2000 to 36.8% in 2011 (Cano, 2012).

With regard to the other components of aggregate demand, starting with investment, there was only slight growth, focused on expanding production capacity in exporting activities, particularly primary and industrial commodities. In addition, investments were made in other activities with the aim of modernizing production (Carneiro, 2005/2006). The scarce and expensive credit and a decline in income resulted in a further deterioration in the performance of the construction industry, which is only expected to show signs of recovery from 2005 onwards.

In the absence of a continuous process of rising income and high interest rates, consumption was driven by the durable goods sector. However, given its dependence on credit, this sector has little dynamism. Low wage growth and very high interest rates did not allow credit cycles to last longer (Carneiro, 2005/2006). Again, from 2005 onward, changes were driven by an increase in employment and real wages.

The economic policy underwent a significant shift in 2006, enabling the export drive to be accompanied by growth driven by the domestic market. However, the shift in economic policy during the second Lula administration did not result in a departure from the economic triad that had been in place until that point. The combination of inflation targeting regime, floating exchange rate and generation of primary surplus continued, but now complemented by the adoption of more heterodox measures, such as the expansion of consumer credit, a real increase in the minimum wage, expansion of transfer programs of direct income, the creation of the Growth Acceleration Program (Programa de Aceleração do Crescimento - PAC was a Brazilian government initiative launched in 2007 to boost economic growth through large-scale investments in infrastructure, housing, energy, and sanitation) and expansion of BNDES's activities to try to stimulate public and private investment (Teixeira; Pinto, 2012).

The real increase in the minimum wage, in conjunction with social programs, resulted in a notable reduction in income inequality (Quadros, 2015; Hoffmann, 2009).

The result of these more unconventional policies from 2007 to 2010 was an increase in the average GDP growth rate, reaching 4.6% per year. The unemployment rate, which stood at 12.3% when Lula took office, declined to 9.8% in 2010. Additionally, there was a reduction in foreign debt, and inflation remained within target.

However, the policy of maintaining high interest rates resulted in an increase in domestic debt, as primary surpluses, while not modest, were insufficient to cover interest expenses. This relative heterodoxy in economic policy was further evidenced by the response to the 2008 American Financial Crisis, which precipitated a significant economic downturn in late 2008 and early 2009. In response to the economic downturn, the government implemented an anti-cyclical policy comprising three key measures: the expansion of liquidity through the release of compulsory deposits; an expansive fiscal policy involving a reduction in the IPI (Tax on Industrialized Products) in sectors with high multiplier power in the economy; and stimuli for civil construction, exemplified by the “Minha Casa Minha Vida” Program (a Brazilian government initiative launched in 2009 to address the country's housing deficit and provide affordable housing for low- and middle-income families). In addition to fiscal and monetary policies, income redistribution policies were implemented, including compensatory measures and, most notably, real growth in the purchasing power of the minimum wage. Growth was driven by an expansion in public and private investment above GDP growth, as well as an increase in consumption, driven by growth in the minimum wage and credit, and by redistributive policies.

Table 2: Urban Open Unemployment Rate 2002 – 2015 - Brazil

Year	Annual average	Year	Annual average
2002	11.7	**2009**	8.1
2003	12.3	**2010**	9.8
2004	11.4	**2011**	6.0
2005	9.8	**2012**	5.5
2006	9.9	**2013**	5.4
2007	9.3	**2014**	4.8
2008	7.8	**2015**	6.8

Source: PME-IBGE.

The shift in economic policy from 2006 onwards, while driving investment growth at a rapid pace, did not effectively address the "regressive specialization" that has been a hallmark of the industry since the 1990s. This has led to a high propensity to import, resulting in the disruption of crucial links in production chains.

6. The First Dilma Rousseff Government

When Dilma Rousseff took office in 2011, inflation was accelerating. To control the rising inflation rate, monetary and fiscal policies were tightened in the first half of 2011. In August 2011, the monetary policy was revised, with a reduction in the basic interest rate and the IOF (Imposto sobre Operações Financeiras - a federal tax associated with financial operations conducted by both individuals and companies) on consumer credit operations, and an encouragement for public banks to increase the supply of credit and lower interest rates. Furthermore, the BNDES maintained its credit expansion policy, and introduced new regulations on capital flows and foreign exchange derivatives to prevent the appreciation of the exchange rate.

The results of this policy were not the same as those of the second Lula Government, which indicates that the success of this “model” was largely due to the favorable international situation in the 2002-2008 period.

From 2011 to 2013, the economy experienced moderate growth driven by an increase in consumer spending. However, the valued exchange rate, the “reprimarization of the export agenda” and its consequent dependence on international demand for commodities do not change the regressive specialization framework of the Brazilian productive structure. Consumption grows, but the industrial production does not expand, since part of the income ends up “leaking abroad” in the form of increased imports of manufactures, parts and components, given the disarticulation of domestic production chains, which are increasingly affected by the increase in the import coefficient. This is partly why the average annual growth rate of production (2.08%) is higher than that of Gross Fixed Capital Formation (0.91%) over this three-year period.

The opening up of trade, the appreciated exchange rate, and the progressive unlocking of production chains have resulted in a "leakage" of the effects of consumption growth abroad in the tradables sector. However, these same factors have not produced the same effects on the non-tradables sector. Therefore, we have experienced demand pressure in the non-tradables sector, which, when combined with that year’s agricultural shocks and the exchange rate shocks to come, has led to the rekindling of indexation mechanisms in the economy and the reactivation of inflationary memory.

Since 2011, the rise in idleness in the industrial sector has resulted in a contraction in private investment, which had been a significant contributor to growth in aggregate demand. Therefore, maintaining gross fixed capital formation depends on public investment, which is constrained by the need to generate primary surpluses.

The relatively modest performance of the manufacturing industry indicates a process of deindustrialization in Brazil. According to Cano (2012, p. 7), “Brazil's participation in the production of the global manufacturing industry, which was 2.8% in 1980, declined to 2% in 1990 and reached 1.7% in 2010”.

In response to accelerating inflation and mounting political pressure, the government increased the basic interest rate in March 2013, reaffirming the fight against inflation as the central objective of macroeconomic policy.

The results of this economic policy were as anticipated. Despite a decline in inflation, the economy slowed in 2014, with GDP growth approaching zero and a resulting reduction in public revenue. This resulted in a primary deficit of 0.6% of GDP. The rise in government spending on interest, coupled with the primary deficit, led to an expansion in the government's gross debt. Notwithstanding the expansion in gross debt, the net debt/GDP ratio stood at 33.1%.

Despite the challenging political environment, the economic situation at the conclusion of Dilma's initial term was relatively stable, particularly given the relatively low open unemployment rate of 4.8% in 2014.

From 2008 to 2014, the ongoing deindustrialization process was further exacerbated by a widening deficit in the trade balance of manufactured goods. As illustrated in Figure 6, over the 2008-2014 period, the trade balance of manufactured goods experienced a deficit due to a combination of factors, including exchange rate appreciation, the establishment of global value chains, and Chinese competition. These developments led to a reduction in the prices of industrial goods. The growth in consumption of imported final goods and the increase in the import coefficient of industry have led to a rise in manufactured goods, which displays the replacement of domestic production of final consumer goods and intermediate goods by imports (Prates; Fritz, 2019; Carneiro, 2018).

Figure 6: Trade Balance of manufactured goods 2002-2019, in USD billions.

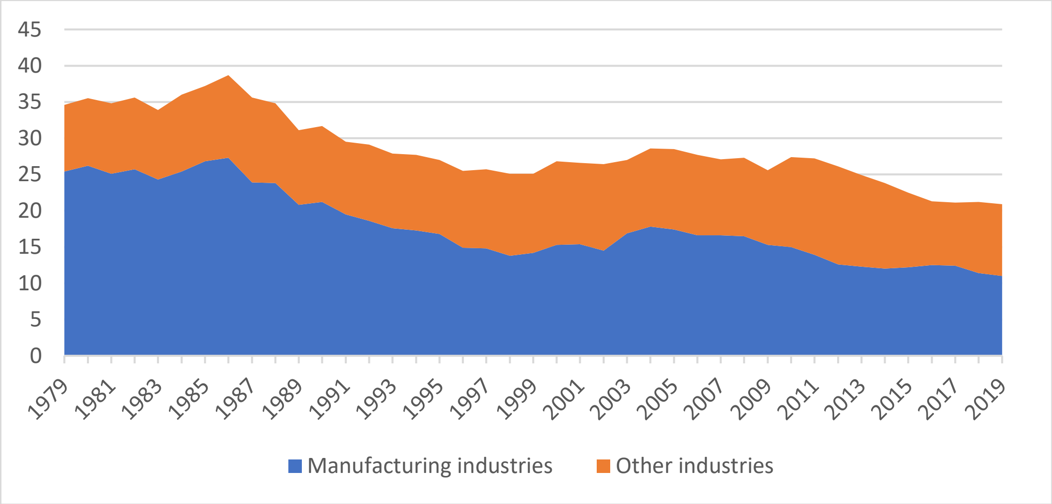
Source: Carta IEDI 974.

According to Morceiro (2021), the data on the participation of the manufacturing industry in Brazilian GDP, used by numerous studies, are overestimated, because it is measured incorrectly based on several previous studies. He states that a corrected series of the industry's share of GDP indicates that between "1986 and 1998, manufacturing lost 13.5 p.p. of GDP, characterizing the most acute phase of Brazilian deindustrialization" (Morceiro, 2021, p. 720).

Figure 7 illustrates the evolution of the industry's share of GDP between 1979 and 2019. The manufacturing sector, which accounted for 25.4% of GDP in 1979, saw a decline to 19.5% in 1991, 15.3% in 2000, and 11% in 2019.

Despite her best efforts, Rousseff was unable to alter this situation and encourage a return to the centrality of industry. To achieve this, she sought to combine exchange rate depreciation with domestic market growth. This involved maintaining real wage increases and introducing an industrial policy and investments in infrastructure (Bastos, 2017).

Figure 7: Evolution of Manufacturing's Share in GDP (in % of GDP), Brazil, 1979 to 2019, at current prices.



Source: Own elaboration based in Morceiro (2021, p. 716-717).

As Diegues (2017) points out, the failure of this industrial policy can be attributed to a flawed diagnosis that failed to recognize the significant changes in the organizational structure and accumulation patterns of local industry throughout the 2000s. The focus on measures to increase competitiveness by reducing costs proved inadequate.

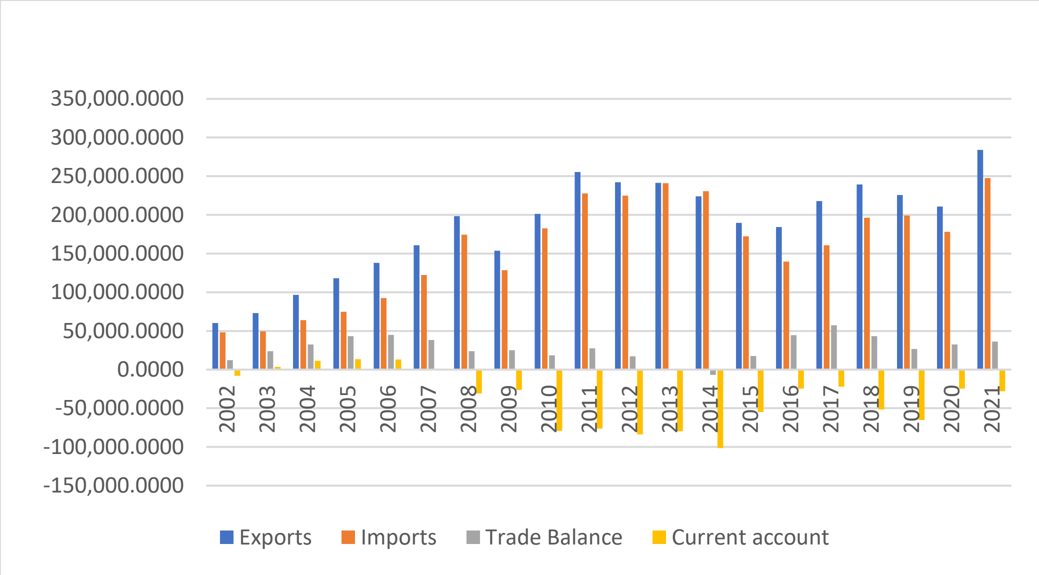
7. Sailing under the winds of liberalism and orthodoxy: the second Dilma government and the Temer and Bolsonaro governments.

In 2015, Dilma Rousseff took office for her second term as President of the Republic. Upon assuming office, Dilma appointed Joaquim Levy as Finance Minister.

Levy, based on an erroneous assessment of the causes of fiscal imbalance and inflation – and contrary to Rousseff's campaign promises – implemented an ultra-orthodox economic policy, citing inflation as the primary concern. However, inflation was largely driven by supply shocks and services inflation, not by underlying economic fundamentals. Additionally, the restructuring of public accounts was driven by rising interest charges, not by a need for fiscal consolidation.

The shift away from the unconventional policies of the initial Dilma administration commenced with a sudden increase in tariffs, including elevated fuel and electricity prices. This was followed by a significant surge in interest rates and a notable reduction in public spending. These measures ultimately resulted in a collapse in expectations, prompting a flight from domestic currency positions and further currency devaluation with a dangerous increase in exchange rate volatility (see Figure 9).

Figure 8: Exports, Imports, Trade Balance and Current Account Balance, 2002-2021, in USD millions.



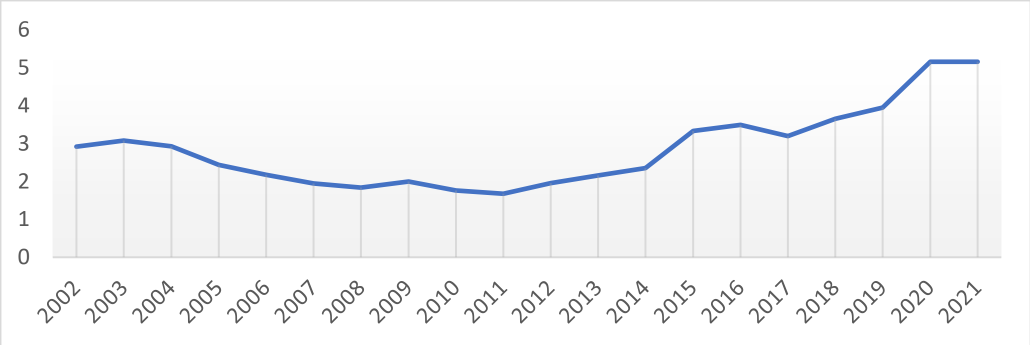
Source: IPEA.

The immediate result of this reorientation of macroeconomic policy was a significant decline in production and income, leading to a reduction in revenue and an increase in inflation. The rise in inflation was driven by the increase in the prices of oil derivatives and electricity, as well as the sharp devaluation of the exchange rate, which led to a higher cost of imported products.

In light of the inflation-targeting regime, interest rates were once again increased in an effort to rein in inflation. The interest rate shock did not have the anticipated impact on inflation, which continued to rise. However, the increase in interest expenditure contributed to an expansion in public debt. The increase in debt and the widening of the primary deficit resulted in a rise in the net debt/GDP ratio from 33.1% in 2014 to 36.2% in 2015.

Following the 2016 Coup against Dilma Rousseff, her vice-president, Michel Temer, assumed the presidency and appointed Henrique Meirelles, who had previously served as president of the Central Bank during the Lula government, to the Ministry of Finance. The new head of the economy also relied on the traditional approach, which centered on balancing public accounts as a foundation for fostering confidence among economic stakeholders, thereby stimulating investments and ultimately driving economic growth.

Figure 9: BRL/USD Exchange Rate 2002-2021



Source: Ipea.

Meireles not only maintains the macroeconomic tripod (consisting of an inflation targeting regime, a floating exchange rate, and the generation of a primary surplus), but also reinforces it. The new president of the Central Bank, Ilan Goldfajn, not only maintains the exchange rate fluctuation regime, but also brings it closer to a free exchange rate fluctuation regime, with fewer interventions by the BCB (Brazil's Central Bank). Monetary policy was also conservative until early 2017. Although inflation had already been declining since June 2016, interest rates only began to fall from October onwards, and at a slow pace, which would result in an increase in real interest rates until April 2017 (Prates; Fritz; Paula, 2019).

Meanwhile, the Brazilian government has been engaged in efforts to achieve fiscal adjustment through the imposition of a spending ceiling. The Temer government managed to approve, at the end of 2016, the Constitutional Proposal Amendment 95/2016 (Proposta de Emenda Constitucional - PEC 95/2016), which establishes a spending ceiling for the Brazilian government for 20 years. EC 95 establishes a limit on public spending and investment, set at the same level as the previous year's spending, adjusted for inflation. The imposition of this spending ceiling has two main implications for fiscal policy. Firstly, it limits the effectiveness of counter-cyclical policies in times of crisis. Secondly, it accelerates the erosion of social rights enshrined in the 1988 Constitution.

Table 3: Inflation -IGP-M - % year

Year		Year			
1995	15.25	**2004**	12.41	**2013**	5.51
1996	9.20	**2005**	1.21	**2014**	3.69
1997	7.74	**2006**	3.83	**2015**	10.54
1998	1.78	**2007**	7.75	**2016**	7.17
1999	20.10	**2008**	9.81	**2017**	-0.52
2000	9.95	**2009**	-1.72	**2018**	7.54
2001	10.38	**2010**	11.32	**2019**	7.30
2002	25.31	**2011**	5.10	**2020**	23.14
2003	8.71	**2012**	7.82	**2021**	17.78

Source: IPEA.

Despite the introduction of EC 95, the Temer government ultimately increased the primary deficit target set by the economic team.

Another significant reform implemented by the Temer administration was the labor reform. The Labor Reform was presented by the government as a necessary measure to stimulate job creation and thereby reduce unemployment, which in 2016 stood at 11.64%. In essence, the labor reform was based on a traditional neoclassical economic model that gained popularity in Brazil during the 1990s. The increase in unemployment throughout that decade sparked an intense debate about its causes. The neoclassical diagnosis asserts that the fundamental cause of unemployment in Brazil is the rigidity of the labor market. However, given that wages in Brazil are among the lowest in the world and have been devalued in real terms due to accelerated inflation, the wage rigidity has been replaced by the rigidity of labor charges. The alleged high level and rigidity of labor charges would replace, for Brazilian analysts, the rigidity of low wages as an explanation for unemployment[5].

In alignment with this objective, the Labor Reform legislation streamlines and enhances the flexibility of labor relations in Brazil. In summary, the legislation liberalizes outsourcing, creates new hiring methods (such as expanding temporary contracts, partial contracts, intermittent contracts, and remote work), encourages companies to hire freelancers and legal entities, introduces the possibility of 12-hour workdays, facilitates and reduces associated with layoffs, introduces variable pay, and allows for wage cuts through collective bargaining. In summary, the Labor Reform has highlighted the less favorable aspects of our labor market, which is already characterized by diversity, flexibility, and significant power imbalances.

The Temer government benefited from a favorable international climate. While Rousseff faced an international situation of falling world trade and a consequent fall in the price of commodities between 2011 and 2015, mainly due to the crisis in the euro area and the slowdown in the Chinese economy, Temer benefited from the resumption of growth in

[5] For example, Pastore (1995) takes this position.

advanced and peripheral economies from mid-2016 onwards. This growth was reflected in increased capital flows, international trade and the price of commodities.

Table 4: Average Annual Growth Rates of Gross Domestic Product Brazil 2015-2021

Year	Annual % variation	Year	Annual % variation
2015	-3.55	**2019**	1.22
2016	-3.28	**2020**	-3.88
2017	1.32	**2021**	4.62
2018	1.78		

Source: Central Bank.

Despite the positive impact of an increased trade balance surplus – driven by global trade growth and by the devaluation –, the rise in commodity prices, and the decline in imports due to the crisis, the country was unable to avoid recession. As illustrated in the table above, GDP declined by 3.28% in 2016. In 2017, GDP growth was only 1.32%, despite an increase in the trade balance surplus, a decline in interest rates, an agricultural surplus, and an uptick in household consumption, driven by the release of FGTS and PIS-PASEP funds (Brazilian labor-related financial reserves). The slight increase in GDP in 2017 was insufficient to prevent a further decline in real investment, which only began to grow again in the final four months of the year. In the following year, 2018, despite further attempts at fiscal stimulus, GDP growth remained modest at 1.78%.

Table 5: Unemployment Rate 2015 – 2021 – Brazil

Year	Annual average	Year	Annual average
2015	8.50	**2019**	12.89
2016	11.64	**2020**	13.61
2017	13.37	**2021**	12.89
2018	13.02		

Source: PNAD Contínua – IBGE.

The false promises of the Labor Reform to reduce unemployment were exposed when, even in the face of a small increase in GDP in 2017 and 2018, both unemployment and discouragement increased, as shown in Tables 5 and 6. There was also an increase in informality. The proportion of employees with formal contracts in the private sector declined by 2.5% in 2015, 3.9% in 2016, 2.7% in 2017, and 1.2% in 2018. Although this percentage increased by 1% in 2019, the decline in 2019 compared to 2014 is still 8.86% (IED, 2020b).

Following the election of Bolsonaro in 2018 and the appointment of Paulo Guedes to the economy ministry, both orthodox economic policies and liberalizing reforms have continued. Guedes and Meireles are of the same opinion that the Brazilian economic crisis is the result of previous governments overspending and the size of the Brazilian state.

Table 6: Number of Discouraged Workers in Brazil (in millions) 2014 – 2019

Year	Discouraged workers	Year	Discouraged workers
2014	1.6	**2017**	3.9
2015	2.6	**2018**	4.3
2016	3.6	**2019**	4.2

Source: PNAD Contínua – IBGE.

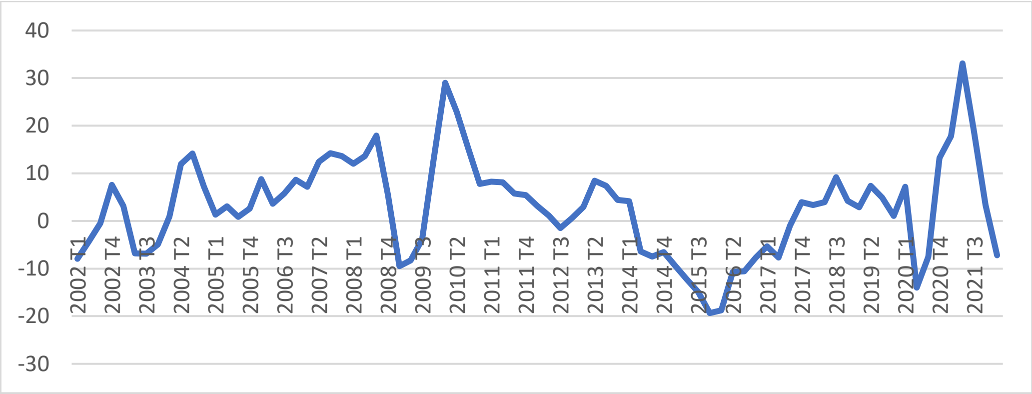
Therefore, the Bolsonaro government continues its orthodox monetary and fiscal policies and liberalizing reforms. As part of this strategy, a pension reform was approved in November 2019. Among other changes, it raises the minimum retirement age, establishes a minimum contribution time, and changes the pension rules for widows and children.

Additionally, Paulo Guedes has proposed privatizations and the elimination of budgetary "ties," including the de-indexation of budgetary spending (such as the end of the automatic annual adjustment of the minimum wage and social security benefits for inflation) and the elimination of budgetary obligations (health and education).

In light of the slow economic recovery, Guedes announced at the end of July 2019 that withdrawals of up to R$ 500.00 from active and inactive FGTS and PIS/PASEP accounts would be authorized as a measure to stimulate household consumption.

The continuation of orthodox economic policies resulted in a decline in investment throughout 2019, which, combined with a reduction in the trade balance, led to a modest increase in GDP of 1.22% in 2019. However, this growth was insufficient to significantly reduce unemployment, discouragement, and informality rates. In addition to failing to stimulate economic growth in Brazil, economic policy has contributed to an increase in inequality. Graph 9 illustrates that, following a sustained period of decline, inequality in Brazil resumed its upward trajectory between 2015 and 2019. In 2019, there was an increase in inequality of 5.6% compared to 2014.

Figure 10: Real Investment Rate - % p.a., 2002-2021

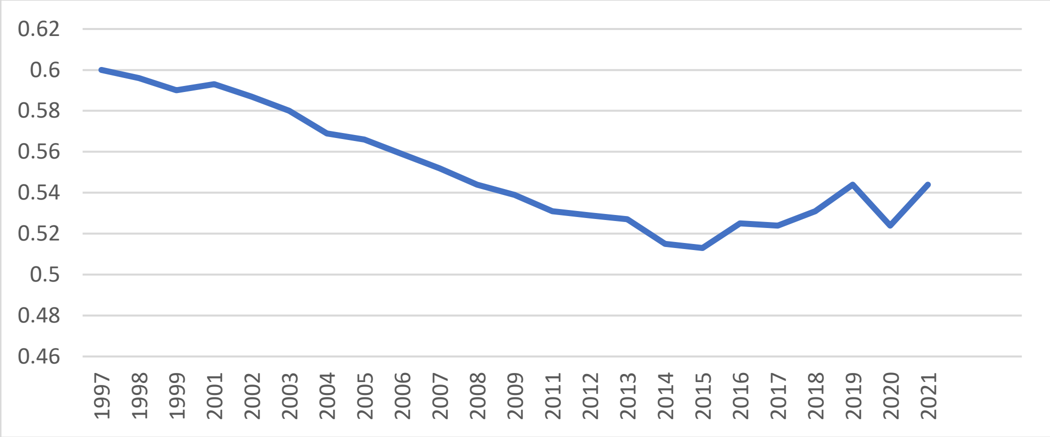


Source: Ipea.

In 2020, the Brazilian economy was already facing significant economic and social challenges when the global pandemic emerged. The immediate effect of the coronavirus crisis was a violent outflow of non-resident capital, which was mainly invested in debt securities and shares, which generated a strong devaluation. Furthermore, the health and social distancing measures that were implemented to control the spread of the coronavirus had a negative impact on the economy as a whole, particularly on the services and commerce sectors. This worsened the already challenging social situation, as the crisis led to an increase in unemployment (Paula, 2021).

The sharp decline in economic activity, income, and employment prompted the government to implement a series of countercyclical measures that ran counter to the free-market principles espoused by Economy Minister Paulo Guedes. Among these measures is the Emergency Program for Maintaining Employment and Income (Programa Emergencial de Manutenção do Emprego e da Renda), which allows employers to temporarily reduce wages and working hours or suspend employment contracts (up to 60 days) in exchange for temporary stability for employees and the receipt of an emergency benefit paid by the government. Also, the emergency aid (Auxílio Emergencial) program provided a monthly payment of R$600.00 for three months, which was then extended for another two months and extended again for another four months with an installment of R$300.00, reaching its conclusion in December. The emergency aid program was designed to support unemployed and informal workers, as well as individuals enrolled in social programs, with a family income of up to three minimum wages (Paula, 2021). Approximately one-third of the Brazilian population received this aid, which can be compared to a minimum income program. This initiative was responsible for a reduction in inequality and extreme poverty, as illustrated in Figure 11.

Figure 11: Gini Index – Brazil – 2002-2021



Source: IBGE.

However, the end of countercyclical measures, the return of liberal policies, and a sharp rise in inflation in 2021 led to an increase in inequality and poverty and continued high unemployment rates, even in the context of a recovery in GDP compared to the previous year.

8- Closing remarks

The exhaustion of the industrial dynamism of the Brazilian economy in the 1980s was accompanied by a State crisis, which fueled financial speculation and accelerated inflation, while simultaneously depressing investment incentives.

The combination of extremely high inflation, economic stagnation, and the State's fiscal crisis led Brazil to adopt a new external insertion policy in the 1990s, the Plano Real. This included the adoption of an appreciated exchange rate, liberalization of trade and capital accounts, and a restrictive fiscal policy.

The appreciated exchange rate had the effect of disrupting many production chains, increasing the import coefficient and reducing exports, which made the country dependent on capital inflows to finance the balance of payments. Consequently, monetary policy was ultimately contingent upon the necessity of maintaining an interest differential between the national and international economies. In 1999, the government was compelled to replace the external exchange rate anchor with a free-floating exchange rate and an "internal nominal anchor," namely, an inflation-targeting system. From that point forward, economic policy was based on a combination of inflation targeting, floating exchange rates, and a contractionary fiscal stance.

The initial Lula administration was distinguished by the implementation of an economic policy that closely resembled that of the second FHC administration. The very favorable external environment enabled the government to maintain its foreign policy of an appreciated exchange rate and high interest rates. The international trade cycle had a significant impact on the reprimarization of exports, as prices of primary products increased more than the negative effect of the exchange rate. However, this was not the case for manufactured products, which experienced a decline in export share.

From 2011 to 2013, the Dilma Rousseff government presided over a period of moderate growth, which did not result in a shift towards a more productive and diversified Brazilian production structure.

In 2015, Dilma Rousseff took office for her second term and put into practice an ultra-orthodox economic policy, which placed the economy in a crisis, with rising unemployment, declining GDP and worsening the fiscal situation.

The governments of Michel Temer and Bolsonaro have pursued a more orthodox monetary and fiscal policy, along with liberalizing reforms, including the independence of the Central Bank. The government was compelled to implement a series of countercyclical measures in response to the challenges posed by the global pandemic, a decision that ran counter to the liberal convictions of Minister Paulo Guedes. Following the conclusion of the countercyclical measures in 2021, a return to liberal policies was observed, accompanied by a notable surge in inflation. This led to an increase in inequality and poverty, along with persistent high unemployment rates, despite a GDP recovery compared to the previous year.

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