THE BRAZILIAN CRISIS AND THE LOSS OF STATE CAPACITIES

Laura Carvalho

INCT-PPED and MINDS

National Perspectives in a Global Economy:
Rethinking State Capacities, Public Policies and the Brazilian Crisis"

08/12/2016

GOOD OLD TIMES: 2005-2010

Good external conditions allowed for an inclusive growth model based on two main pillars:

- **Mass consumption** thanks to higher real wage and reduction in wage inequality;
- **Public investment** in economic and social infrastructure

ECONOMIC POLICY PRE-2008

Fiscal policy:

- social transfers
- minimum wage policy
- public infrastructure (e.g. PAC),
- reduction in public debt from 48% in 2005 to 40.5% in Aug-08.

Monetary and credit policies:

- strong accumulation of international reserves (from US$ 55 billion in 2005 to US$ 207 billion in 2008),
- gradual reduction of interest rates up to 2007 (stability afterwards),
- exchange rate appreciation,
- credit expansion: public housing, BNDES, agriculture.

ECONOMIC PERFORMANCE PRE-2008

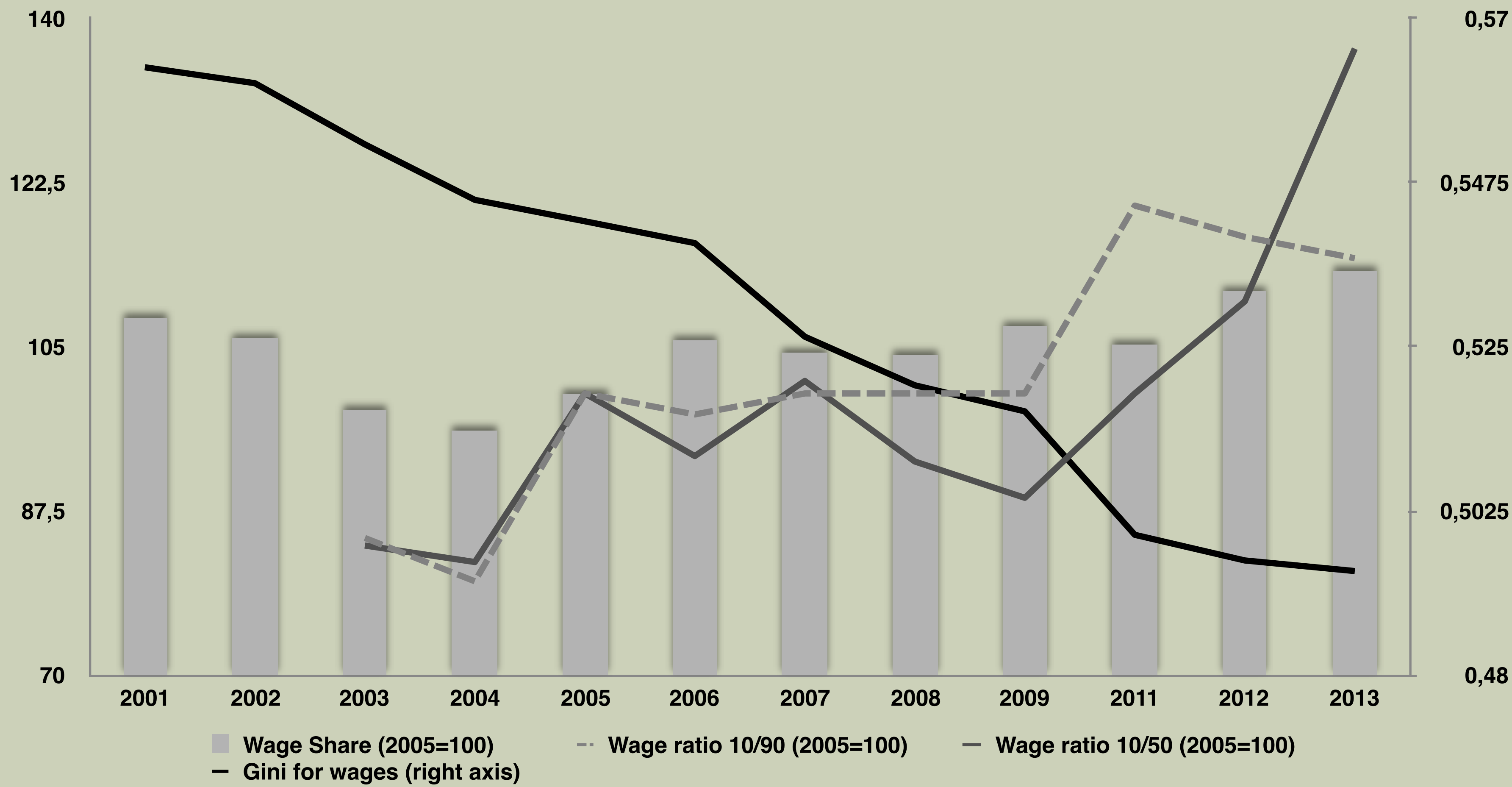
- **Average annual GDP growth:** from 3.2% in 2003-2005 to 5.1% in 2006-2008;

- **Labor market:** unemployment rate in the six largest metropolitan areas falls from 10.7% in Jul-06 (peak) to 6.8% in Dec-0;

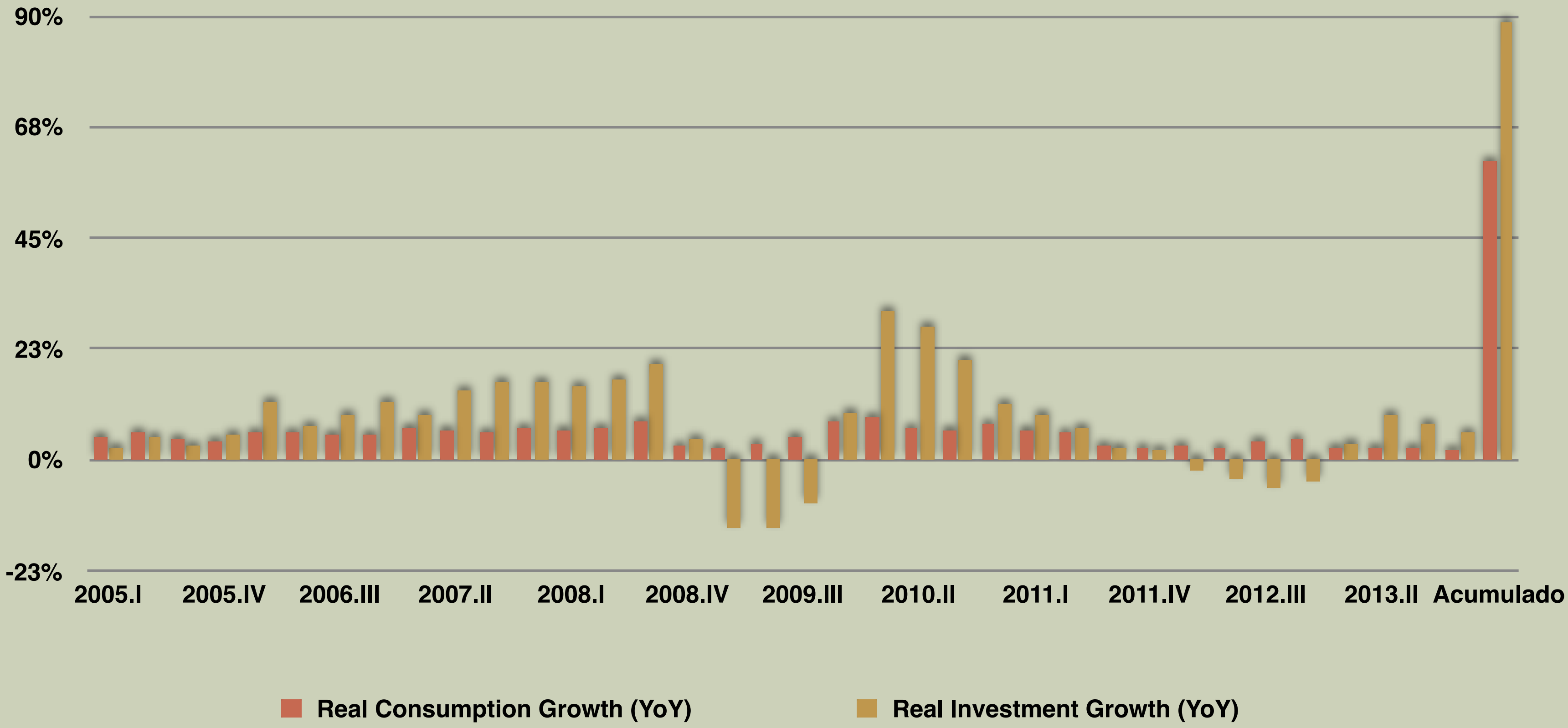
- **Current and capital account:** falls from a surplus of US$ 29.8 billion in 2003-2005 to a deficit of US$ 13 billion in 2006-2008. Huge inflow of short-term and long-term capital;

- **Inflation:** from 5.7% in 2005 to 3.1% in 2006 (exchange rate appreciation and fall in food prices); acceleration since 2007 — 6.4% in 12 months in Jul-08 (food and commodity prices)

WAGES AND INEQUALITY

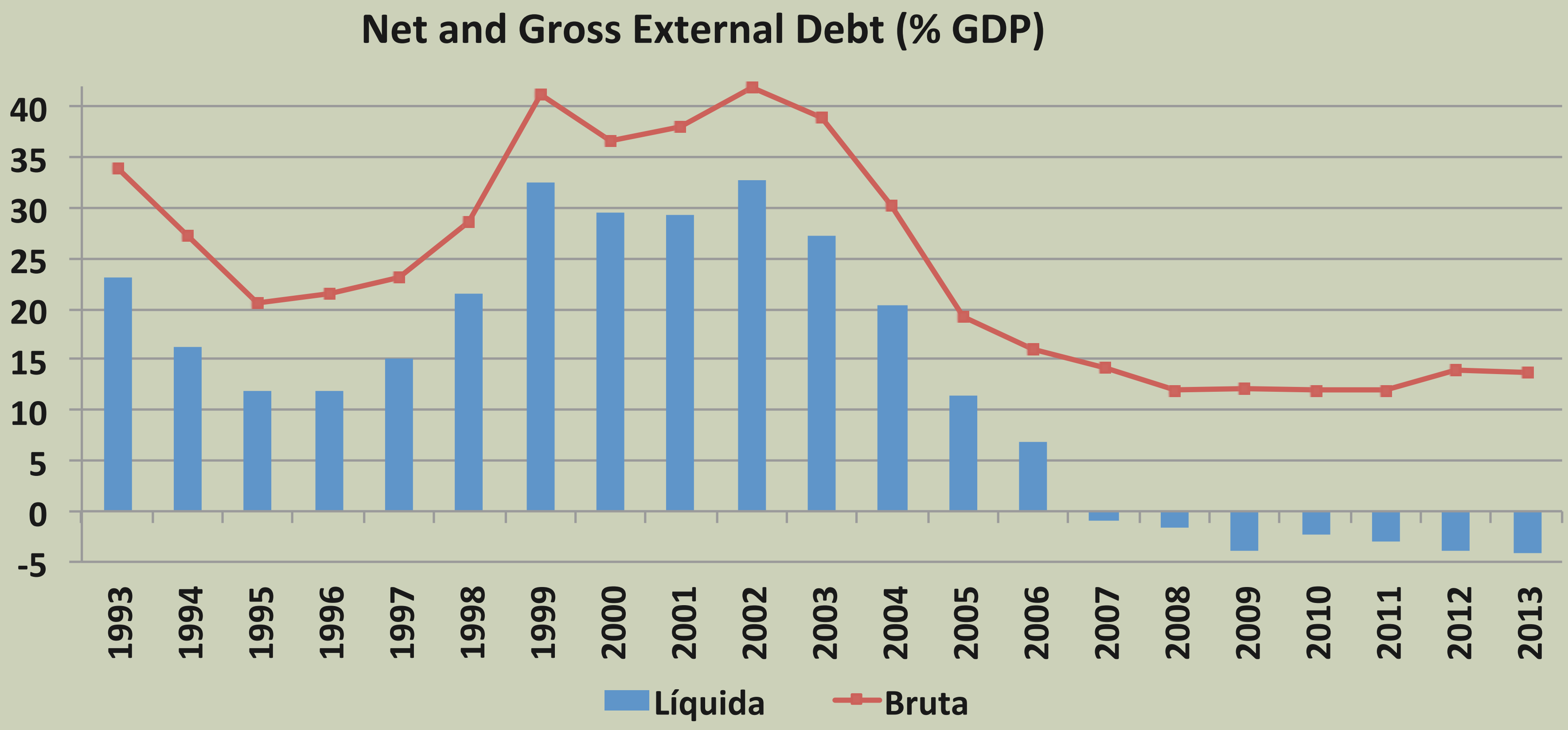


CONSUMPTION AND INVESTMENT



Source: IBGE

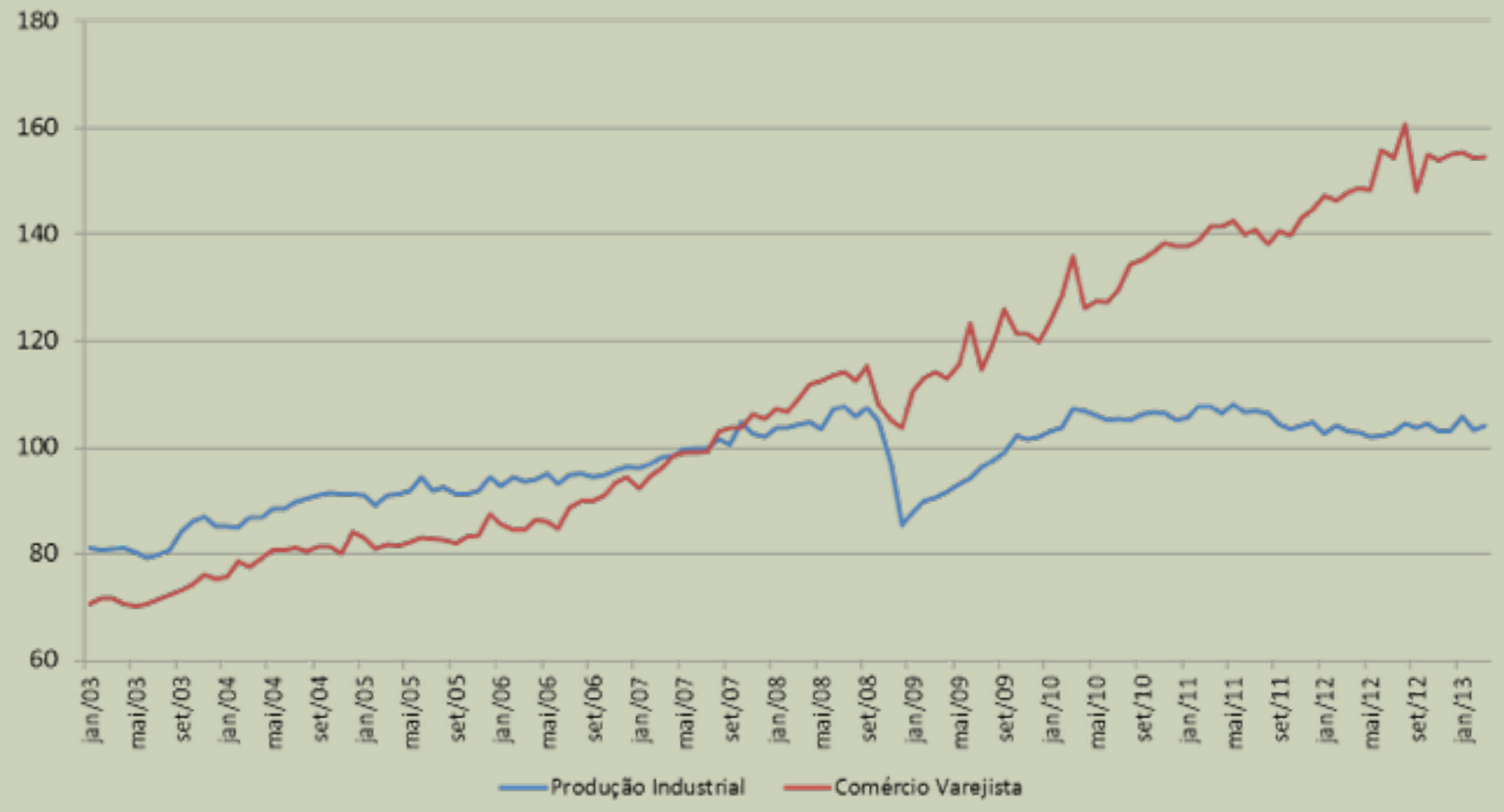
EXTERNAL DEBT



A QUICK RECOVERY: 2008-2010

- **Two quarters of GDP contraction;**
- **Pre-crisis programs helped:** honored the increase in minimum wagas, income transfers and public investment;
- **Temporary actions:** credit line (BNDES), delayed reduction in interest rates, tax cuts, transfers to state and city governments, increase in value and duration of unemployment insurance.
- **New structural actions**: new tax brackets (lower tax rates on low middle class), housing program (MCMV).

A CHALLENGE



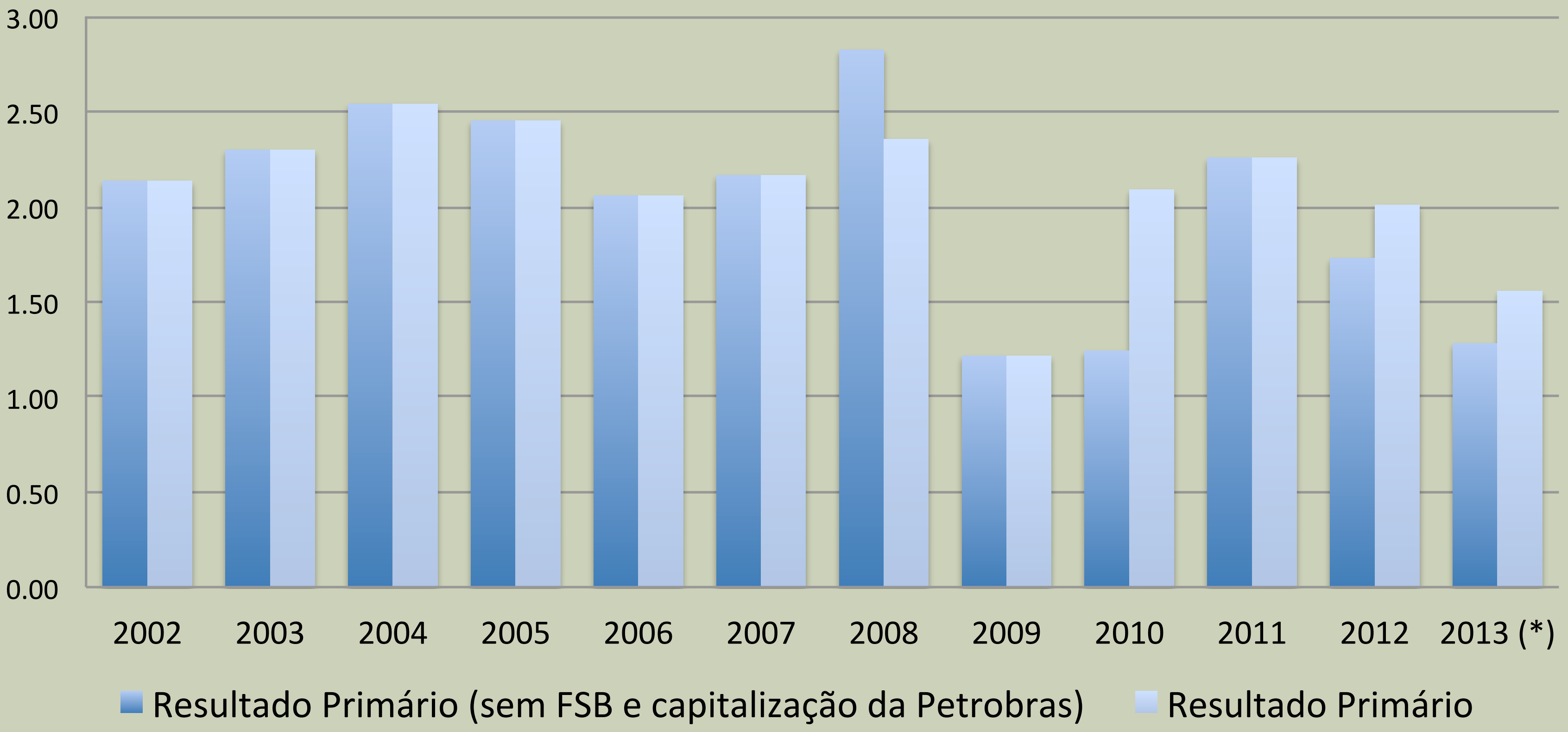
180
160
140
120
100
80
60
jan/03
mai/03
set/03
jan/04
mai/04
set/04
jan/05
mai/05
set/05
jan/06
mai/06
set/06
jan/07
mai/07
set/07
jan/08
mai/08
set/08
jan/09
mai/09
set/09
jan/10
mai/10
set/10
jan/11
mai/11
set/11
jan/12
mai/12
set/12
jan/13
Produção Industrial
Comércio Varejista

“FIESP" AGENDA: 2011-2014

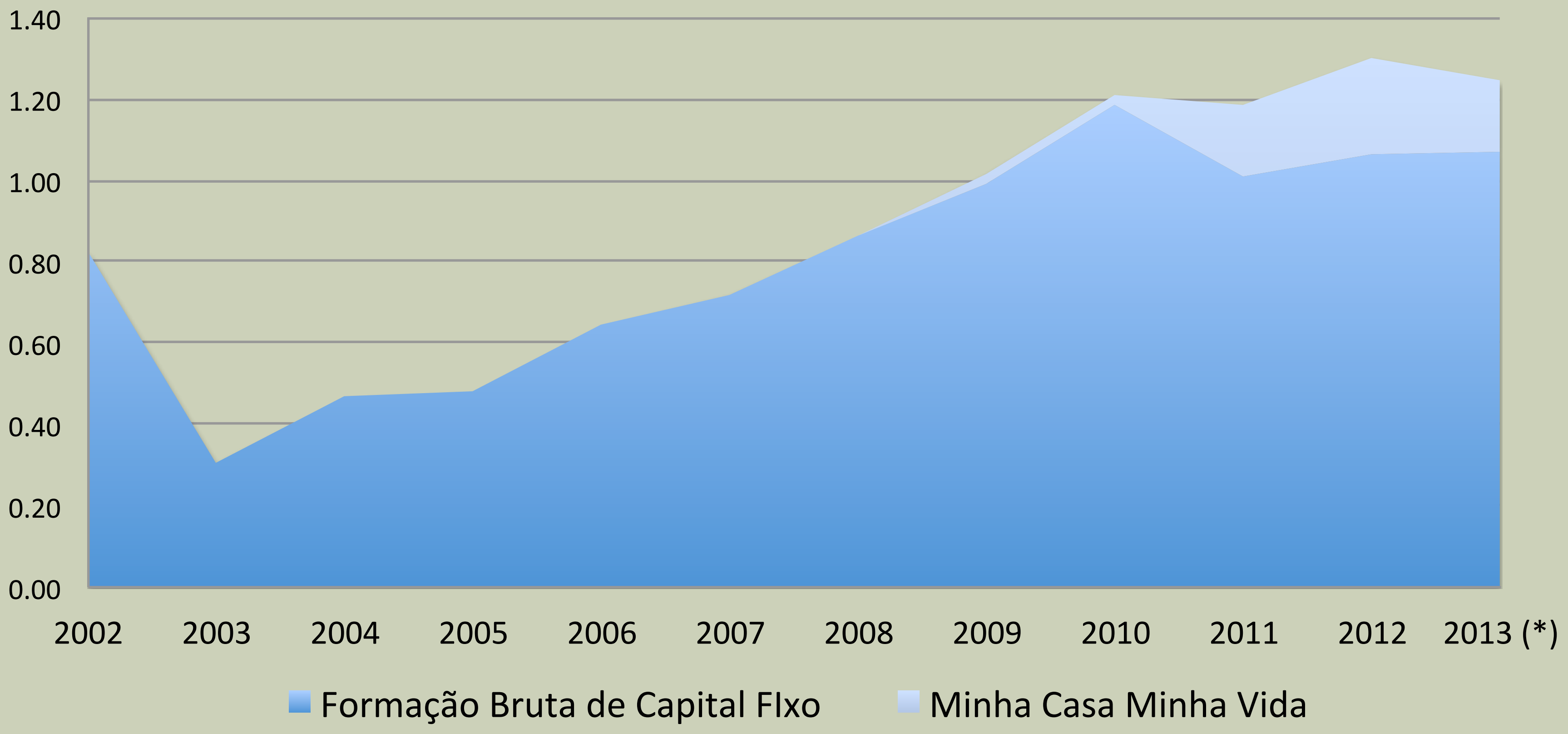
- **Fiscal adjustment in 2011** "for" interest rate reduction;
- **Exchange rate devaluation;**
- **Stagnation of public investment;**
- **Extensive tax cuts;**
- **Subsidized credit expansion** via BNDES;
- **Public-private partnerships** for infrastructure;

Ends up being corporate welfare: fall in commodity prices and exports (European crisis); fall in consumption due to inflation acceleration; weak private investment; fiscal deterioration.

PRIMARY SURPLUS (% OF GDP)

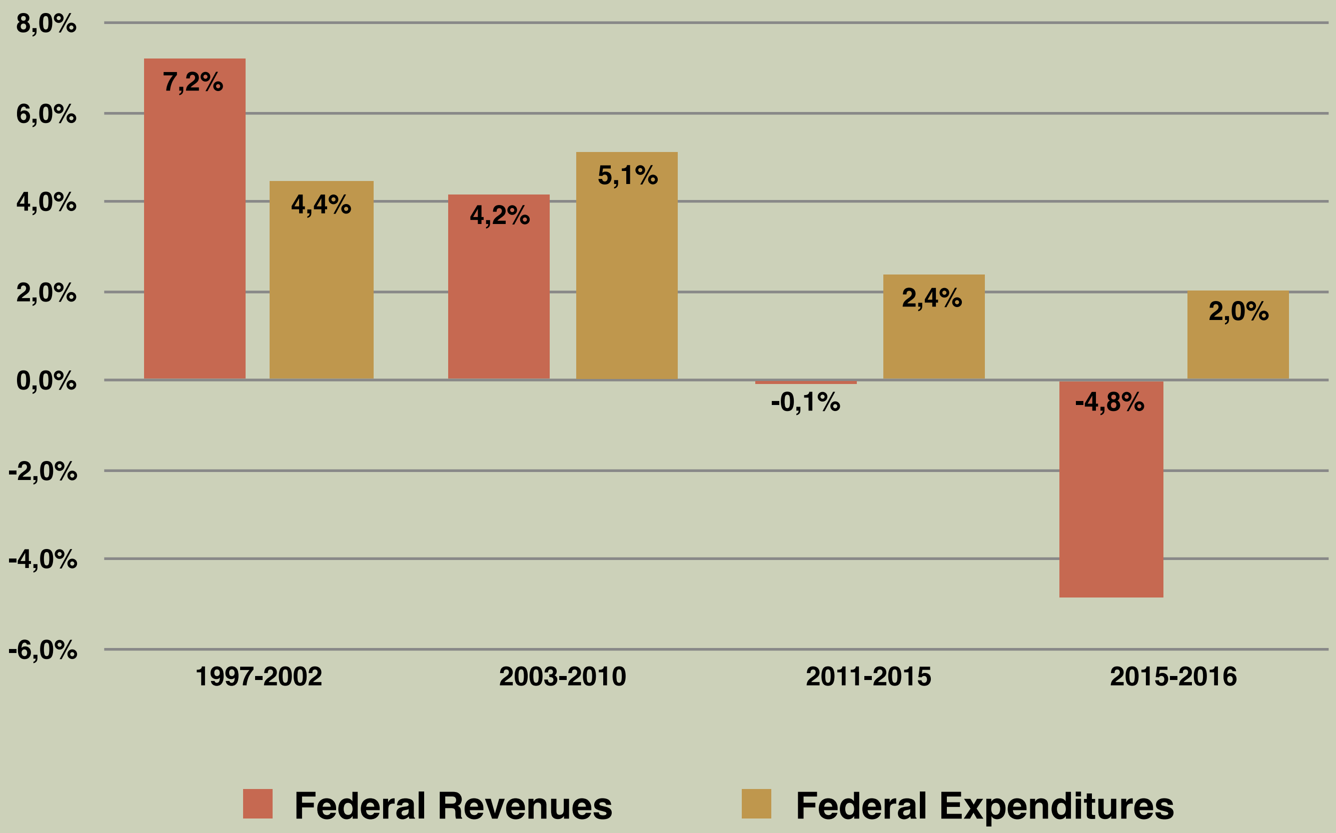


FEDERAL PUBLIC INVESTMENT (% OF GDP)

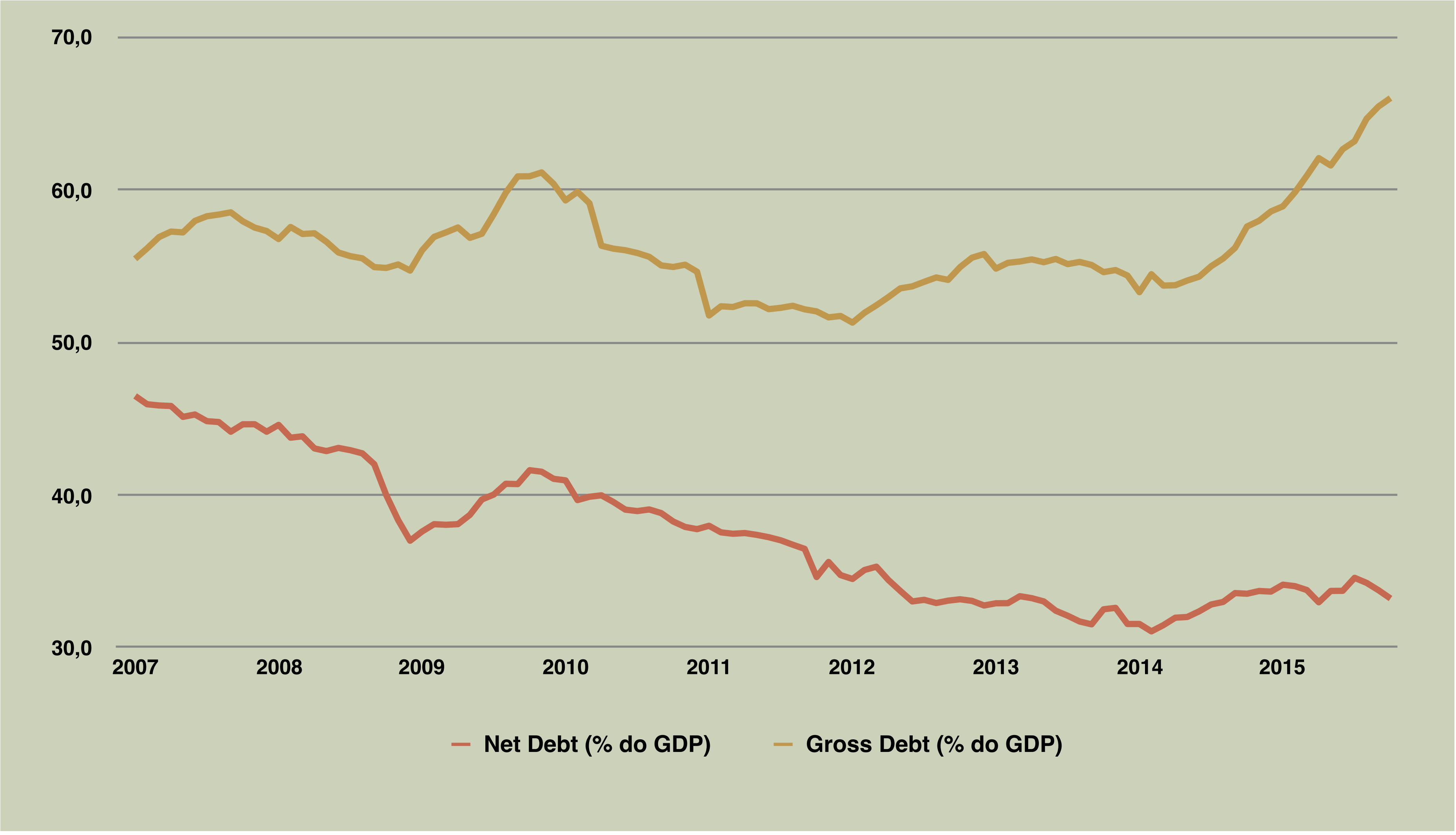


INFLATION - EXCHANGE RATE NEXUS

FISCAL DETERIORATION



PUBLIC DEBT



70,0
60,0
50,0
40,0
30,0
2007
2008
2009
2010
2011
2012
2013
2014
2015
Net Debt (% do GDP)
Gross Debt (% do GDP)

HOW TO KEEP DIGGING: 2015-2016

- **Strong fiscal adjustment in 2015:** more than 35% real decrease in public investment;
- **Raise in tariffs (fuel, energy)**: explains more than 40% of a 10.5% rate of inflation in 2015.
- **Monetary contraction**: raise in interest rates;

Failure to stabilize **public debt**, deepest **recession** in recent history, **unemployment**, fall in **real wages**, quick reversion of **inequality** reduction,

HOW TO MAKE IT PERMANENT

- **Impeachment** based on a compromise between political leaders under investigation and economic elites;
- **Crisis deepens** and ignores confidence indicators;
- **States** are bankrupt (Rio de Janeiro, Minas Gerais);
- **20 years freeze** in real federal spending + draconian **reform of the pension system**;
- Collapse of institutions and social chaos.