

Economic Crisis, Impact and Response:  
the case of Brazil \<sup>1</sup>

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### ABSTRACT

This paper discusses three aspects of the current economic and social crisis in Brazil, namely, the unequal distribution of income, the re-emergence of labor activism, and the fiscal crisis.

### RESUMO

Este trabalho discute três aspectos da atual crise econômica e social no Brasil: a desigualdade na distribuição da renda, o reaparecimento do ativismo sindical, e a crise fiscal.

## Economic Crisis, Impact and Response: the case of Brazil

### 1. Introduction

The Brazilian history has been marked by an alternation of democratic and authoritarian political regimes. In the 1950's and up until 1964 democratic and populist governments dominated the scene. Then came the coup d'Etat. The authoritarian militar regime remained in power until 1984. In 1974 a gradual movement of political openness started. In 1978-9 a strong strike activity gave rise to a vigorous labour movement. Today, the leaders of the two union confederations (CUT and CGT) are important social actors in the gradual transition to democracy taking place in Brazil.

The role of labour at the national level was growing before 1964. However, due to the anti-labour bias of the authoritarian regime, its role became insignificant for almost 15 years. During this period, unions were repressed, labour union leaders were arrested with the aim of weakening the labour movement. All kinds of arguments were used to justify the anti-labour attitude of the government: from the technocrat argument that unions were responsible for the absence of flexibility in the labour market to the ideological view that the labour movement was dominated by comunists, and should be seen as a threat to the national security. The repression of the labour movement represented a radical change in capital-labour relations.

In the 1980's, the labour movement reemerges after a period of repression in which the union structure and organization

was destroyed, and in which the role of labour in society and politics was quite restricted. In an analysis of the capital-labour relations in Brazil, the process of democratization seems to be crucial. Unions and labour parties are re-establishing their position at different levels of the social and political processes, and this will certainly affect the future of the Brazilian macroeconomic performance.

The transition to democracy is taking place during a period of economic crisis. Indeed, the adjustment to the debt crisis in a period when the distributive conflict reemerges together with the labour movement, seems to be at the root of the present economic crisis in Brazil. The effects of the external debt crisis are well documented: between 1981 and 1984 there was a significant contraction in the rates of growth of output, employment, and real wages; an increase in the share of the informal segment of the labour market; and a fiscal crisis which translates into a reduction in the capacity of the State to foster growth and provide social goods. The attempt to create commercial surpluses through devaluations of the domestic currency and the resistance of the unions to a reduction of the share of wages has been an important, if not the main, cause of the inflationary process in Brazil.

In the last three years, repeated attempts to reduce the rate of inflation through 'heterodox' strategies (price and wage freezes) have failed. In the first two plans (1986 and 1987), the labour union confederations did not participate. In 1988, there was an attempt to establish a 'social pact' between workers, capitalists and the government without success. In January 1989 a

new plan was launched. This time the unions have been called to negotiate the wage policy but it is not yet clear if an agreement will actually take place. For the first time after 25 years, the government seems to be considering the participation of the labour confederations in the discussions over the formulation of economic policies. But due to the government's lack of credibility, the unions have been very reticent to participate in the negotiations.

The institutions based on which the capital-labour relations take place in Brazil were created in the 1940's during the Vargas dictatorship, and are not adapted to a democratic society with a strong labour movement. Therefore, there is still a long way to go in terms of the modernization of these institutions, and the development of a socially coherent society in Brazil. It seems clear, however, that organized labour will play a major role in this process in the years to come.

This paper examines three aspects of the current process of transition to democracy and current economic and social crisis in Brazil. The first aspect, discussed in section 3, is the deterioration of income distribution in the last two decades which characterizes the Brazilian 'excludent' model. In section 4 we examine the second aspect, that is, the reemergence of the labour movement in the last ten years. Finally, in section 5, we study the fiscal crisis and the reduction in the capacity to save and invest of the State. Section 2 presents an overview of the Brazilian economic performance since the first oil shock. Section 6 presents the conclusions.

## 2. External Constraint, Distributive Conflict, and Adjustment

The relation between the external constraint and distributive conflict is quite important to understand the performance of the Brazilian economy since 1975. The suppression of the conflict due to the authoritarian regime and the favourable international conditions between 1966 and 1973 led the Brazilian economy to a period of rapid expansion. After 1974 the conditions changed drastically with the oil shocks of 1973 and 1979, the interest rate shock, and the transition to democracy which established the conditions for the re-emergence of labour mobilization, and hence of the distributive conflict.

Between 1966 and 1973 there were no external constraints and the economy grew at very high rates (around 11% per year). Exports grew on average 26% and there was a considerable increase in the share of manufactured goods in exports. On the other hand, the growth of the capacity to import and access to the international financial markets provided the conditions for the so-called 'Brazilian miracle.'

During this period, not only the abundance of liquidity in the international financial market was important, but also the performance of the OECD countries which led to an increase of world exports of the order of 19.6% per year, provided the external conditions for the Brazilian expansion. The deliberate policy to stimulate manufactured exports was also an important element.

The military regime was essentially anti-labour, and was able to repress the union activity which ultimately led to the

suppression of the distributive conflict. The effectiveness of the wage policy imposed a compulsory wage restraint which reduced the product wage measured in dollars, and increased the competitiveness of the Brazilian products.

With the first oil shock, the external situation changed. Between the 1973 and 1974, the expenditure with oil imports went up almost 300%, that is, from US\$ 769 to US\$ 2962 millions. In relation to total imports, it increased from 12% to 23%. In 1974 the commercial deficit was of US\$ 4673 millions. This year Brazil had to borrow US\$ 6254 millions to equilibrate the balance of payment.

In face of the supply shock, one alternative was the 'hard option' strategy followed by many countries, that is, a reduction in domestic absorption and a reduction in the product wage measured in dollars in order to stimulate exports. This strategy would necessarily imply the reduction of investment -- with deleterious structural effects -- and an increase in the rates of unemployment and idle capacity -- with obvious social costs.

The second alternative, actually the one followed in Brazil, was to develop an investment programme directed towards the intermediate and capital goods sectors. The idea was to promote the final phase of the process of import substitution, and reduce the dependence on imports. <sup>2</sup> These investments would be financed with funds borrowed abroad.

To a certain extent, the Brazilian alternative was the result of the domestic political situation. In 1974, the official

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<sup>2</sup> See Castro & Pires for an analysis of the Brazilian strategy.

party lost the elections, and as a consequence, the legitimacy of the militar government was hurt. The option to maintain the path of high rates growth was an attempt to regain credibility. Furthermore, the social costs associated with the 'hard option' strategy would make the process of redemocratization, which started in the Geisel administration, much harder.

Hence, 1974 can be seen as the starting point of two simultaneous processes which together would constitute the central elements of the crisis of the 1980's, namely, the growth of the external debt and the political opening, which gave rise to the labour movements of 1978-79. The growth and centralization of the union movement in the beginning of the 1980's reduced the capacity to adjust to the debt crisis after the Mexican crisis in 1982. The attempt to adjust through a shift in the functional distribution of income in favour of profits and the resistance of workers to reductions in their wages led to recurrent periods of acceleration of inflation.

The option to growth resulted in a significant increase in the external debt: it went from US\$ 7546 millions in 1973 to US\$ 38247 in 1978; the net debt:exports ratio went from 1.22 to 3.02 in the same period. The second oil shock in 1979 and the interest rate shock in the first years of the Reagan administration led the economy to an unstable situation. The hard option strategy seemed inevitable.

In 1979 the domestic currency was devaluated in 30% in relation to the US dollar. At the same time, in an attempt to control the inflationary process, the devaluation rate corresponding to 1980 was pre-established in 45%. As a response to



the strike movement of 1978-79, the period of adjustment of wages fell from one year to six months. Hence, the desired reduction in the cost of labour measured in dollars had a very short life, and as a consequence, the rate of inflation accelerated in 1980-1. In 1981 the government opted for a contractionary monetary and fiscal policy, the acceleration of devaluations, the introduction of incentives to stimulate exports and quantitative restrictions on imports. The GDP fell 3.1% in 1981, but there was a substantial improvement of the balance of payment position.

In 1982, the cost of labour measured in dollars went up 22% and the US GDP fell 2.7%. Exports fell 13% but as a result of the domestic recession, imports fell 12%. A commercial surplus of US\$ 778 millions was generated but the balance of payment deficit was of the order of US\$ 9500 millions. The Mexican moratorium led to the interruption of the flow of funds to the indebted countries in Latin America.

The year of 1983 was marked by a new wave of recession and a devaluation of 30% of the cruzeiro in relation to the dollar. This time wages could not follow the inflation rate: the high levels of unemployment checked the growth of the rise of the union movement. The cost of labour fell considerably until mid-1984.<sup>9</sup> The growth of exports together with the reduction of 21% in imports which resulted from the recession and the devaluation of the cruzado led to a commercial surplus of US\$ 6500 millions.

The recovery of the US economy in 1984 and the structural adjustment associated with the process of import substitution in

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<sup>9</sup> In section 5 we study the process of labour mobilization in the democratic transition.

the second half of the 1970's led a growth rate of 23% of exports. GDP went up 5.7% but, again, due to the structural adjustment, imports fell 10% and the commercial surplus exceeded US\$ 13000 million. In 1985 the GDP grew 8.4% and imports fell 5.5%.

Hence, the growth cum debt strategy, and the deepening of the import substitution process, resulted in a significant reduction of the import coefficient and an increase in the rate of growth of GDP consistent with a commercial balance. The import coefficient fell from 11.96 in 1974 to 7.14 in 1982. In 1987 it was of 4.63.

However, the accumulation pattern adopted during the militar regime, and the necessity to adjust to the external debt problem, especially after 1979, gave rise to three important features of the current economic and social crisis. First, the extremely unequal distribution of income which characterizes the Brazilian 'excludent' pattern of accumulation. Second, the high degree of distributive conflict and labour dissatisfaction which gave rise to a wave of labour mobilization during the transition to democracy. Third, the fiscal crisis which precludes the State to foster growth and recover the high rates of public and private investment of the 1970's. In the following three sections we discuss these issues in turn.

### 3. The Excludent Model

In this section we shall argue that the Brazilian model between 1964 and 1986 was 'excludent', in the sense that it excluded from the benefits of the process of accumulation not only workers in the formal segments of the economy, but mainly those in the informal segments. We shall suggest that in face of the changes taking place in the capital-labour relations in Brazil -- in particular the increasing political participation of labour -- the system may change in the next decade, and become more inclusive at least in terms of the urban workers of the formal segment. In a sense therefore, our suggestion is that the Brazilian model may be in a transition to a model in which the growth of wages would become an important element in the determination of the level of aggregate demand.

As noted already, the militar regime was essentially anti-labour. The political participation of the labour group was minimal, and workers did not share the economic gains of the period. It is worth recalling that between 1967 and 1974 the Brazilian economy grew at an average rate of 11%, and in the following period (1975-81) around 7%. The figures of the distribution of income show however that during this period the share of income of the poorest fell considerably. The Gini coefficient went from .499 in 1960 to .562 in 1970 to .581 in 1980. In the 1960's the Gini coefficient rose 12.63%, and the share in income of all groups except the top 10% fell. The share of the latter group increased 20.5%. During the 1970's the Gini coefficient increased 3.38%. The degree of concentration of income

achieved its highest point between 1972 and 1976, then fell between 1977 and 1980, and increased again between 1981 and 1983.

Between 1966 and 1985 the level of output in the industrial sector and the productivity of labour grew continuously; the former 260% and the latter 140% over the period. The share of wages in the value of output in the industrial sector remained approximately constant between 1966 and 1975, then grew 12% between 1976 and 1979, and fell 30% between 1980 and 1985. In 1983 approximately 30% of the urban workers earned less than one minimum wage, and between 1966 and 1985 the minimum wage fell approximately 15%. Thus, in the industrial sector, the gains of growth of productivity were not shared between capital and labour.

In 1983, around 35% of the urban labour force was in the informal segment. In the industrial sector the proportion was approximately 16% whereas in the services sector it was around 40%. Whereas in the formal segment no more than 25% earned less than one minimum wage, in the informal segment the proportion was close to 75%. Hence, the degree of poverty in the informal segment is much greater than in the formal segment.

In sum, the Brazilian model in the last 20 to 25 years has been essentially excludent in the sense that it has not improved the the standard of life of the working class as a whole. Our suggestion is that, in face of the changes currently taking place in the capital-labour relations, the Brazilian model may become less excludent in the future.

#### 4. Labour Mobilization in the Democratic Transition

In 1978 the first great strike after 1967 occurred in São Paulo. The reduction of repression, together with the dissatisfaction of workers with their economic and working conditions, led to an explosion of union activism. This is the first important aspect of the process of acceleration of inflation in the 1980's. The second is the response of the government to the debt crisis, that is, the attempt to change relative prices, and in particular, reduce the cost of labour measured in dollars. The conflict between the objectives of the government and those of the unions seems to be at the root of the current economic crisis.

The response of the unions to the government's attempt to reduce labour costs was an increasing demand for the shortening of the wage adjustment period. As noted already, in November 1979, immediately after the devaluation of the domestic currency in relation to the dollar, the adjustment period was reduced from 1 year to 6 months. As a result, the real wage measured in dollars recovered quite rapidly, and the annual rate of inflation jumped from 40% to 100% in less than one year.

The rise of workers' mobilization, however, was checked by the recession of 1981-83. Differently from the period 1974-80, when a strategic decision was made to continue growing with a growing external debt, the response this time was a strong recession. The sharp increase in unemployment increased the cost of job loss for workers, and mitigated the growth of labour mobilization. In 1983 another devaluation took place, this time leading to a reduction of the real wage which lasted until the second semester of 1984.

In June of 1984 the economy started giving signs of recovery. The level of employment started recovering, and the average real income of wage earners in the industry started growing steadily. Despite the acceleration of inflation, the average wage of workers in the formal sector were growing around 4.5% per year in January 1985 and 14.8% per year in January 1986. The acceleration of inflation and the growth of real wages is an evidence of the loss of effectiveness of the wage policy and the growth of labour mobilization.

In February 1986 the government opted for a wage and price freeze and a monetary reform -- the 'Cruzado Plan'.<sup>4</sup> The plan can be seen as a non-negotiated incomes policy, secretly designed, which counted with a great deal of social acquiescence. The latter was bought with the promise of the end of inflation, an 8% increase of wages which certainly reduced the degree of dissatisfaction of workers, a liberal aggregate demand policy, and a price freeze for an indefinite time period. The plan failed, and in 1987 another plan with the same characteristics was adopted and failed again to stop inflation. On the other hand, despite the impetus of the labour movement, since 1986, the average real wage has been falling continuously.

What is new in terms of the role of labour qua social actor in Brazil is the active participation of union leaders in discussions over the design of economic policies. The so-called 'social pact' in which union leaders, employers and the government negotiate not only the wage policy but other aspects of the

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<sup>4</sup> See Amadeo & Camargo (1989a, 1989b and 1989c) for an analysis of the Cruzado Plan in Brazil.

economic policy, has gradually become a practice. So far the results are quite frustrating, but the fact that there are signs of negotiations going on imply that an important change in the institutional setting is taking place.

In what follows we shall explore in detail the recent changes in the union organizational structure and the capital-labour relations in Brazil, as well as the rise of labour mobilization in the last ten years.

The transition to democracy in Brazil was marked by an increase in popular mobilization. This seems to be a result of many years of repression and of an economic model based on the economic and political exclusion of labour. Hirshman, commenting on the political opening process of Argentina and Brazil, refers to the social tensions which generally show up during the transition:

When a civilian, democratic government first comes into power after a long period of repressive military rule, it is normal for various, newly active groups of the reborn civil society -- particularly the long-repressed trade unions -- to stake substantial claims for higher incomes... New inflationary and balance-of-payments pressures are of course likely to result from the granting of such demands... [I]nflation can nevertheless be a useful mechanism in this situation: it permits newly emerging or reemerging social groups to flex their muscles, with inflation acting as a provential safety valve for accumulated social pressures. (1986, p. 39)

Union density in Brazil has never been very high -- around 22%. However, it grew considerably after 1978. Amongst the urban workers, union density increased 32%, and in the rural areas, 50%. The degree of dissatisfaction of workers and distributive conflict can be measured by the strike activity between 1978 and 1986. It can be noted in table 2 that since 1978

the number of strikes grows continuously with the exception of 1980 and 1982. It grows significantly in 1979, 1983 and 1986. It is also clear that the most important groups are the industrial workers and the middle class wage earners. In the first group, the workers of the most organized segment -- those of the metalurgy industry -- were responsible for 34.8% of the strikes. Also, 74% of the strikes between 1978 and 1986 took place in the south west of Brazil, that is, where most of the organized unions are based.

Table 1  
Number of Strikes

	1978	1979	1980	1981	1982	1983	1984	1985	1986
Industrial workers	84 (72)	77 (31)	43 (29)	41 (27)	73 (50)	189 (54)	317 (64)	246 (39)	534 (53)
Middle class workers	8 (7)	55 (22)	43 (29)	48 (3)	31 (21)	85 (24)	84 (17)	211 (34)	237 (23)
Housing industry	8 (7)	20 (8)	19 (13)	7 (5)	4 (3)	10 (4)	18 (4)	23 (5)	45 (5)
Others	5 (4)	44 (18)	18 (12)	34 (22)	11 (8)	16 (5)	11 (2)	14 (2)	1 (.1)
	118 (100)	246 (100)	144 (100)	150 (100)	144 (100)	347 (100)	492 (100)	619 (100)	1004 (100)

Source: NEPP/Unicamp reproduced from Tavares de Almeida (1988)



As noted by Tavares de Almeida (1988, p. 329), who reports these figures, the "workers, and their unions, responded with more strikes to the frequent demand for moderation and social pact on the part of the [new civilian government]... and increased the number of strikes during the Cruzado Plan." The growth of labour mobilization during the plan is understandable since the government was proposing a wage freeze in a period when real wages were growing 15% in real terms yearly. The freeze virtually implied a zero growth rate of real wages.

In the last ten years the organization of the union structure has changed dramatically, and both the activity and strength of the labour movement have increased considerably. In a sense, the 'new unionism' fills the gap opened by the inefficacy of the corporatist labour laws introduced in 1943 during the Vargas dictatorship, and the wage policies of the military governments. These laws are incompatible with a democratic regime with an independent and strong labour movement. In the recent years, the unions have forced the employers to negotiate not only wages but also working conditions, union leaders have influenced the preparation of the new constitution, and recently have been able to affect the decisions over the wage policy and, to a certain extent, the macroeconomic policy in general.

The wave of labour mobilization led to the formation of a centralized union movement which has in a national confederation (the Central Unica dos Trabalhadores, CUT) and a political party (the Partido dos Trabalhadores, PT) its pivotal institutions. These two institutions are unique in terms of the Brazilian labour history for the degree of centralization of the representation of

the organized labour interests, their complete independence from the State, and the tight relationship which they attempt to establish between the union movement and the parliamentary activity. Until 1988, when the new Constitution was promulgated, the CUT was illegal and nevertheless was recognized by the government. Today it represents a significant proportion of workers at the national level, including workers from the public sector, despite the fact that the labour laws discourages the centralization of the labour movement.

The growth of the PT as a representative labour party and its importance in the parliamentary debates (especially during the preparation of the new constitution), has put the discussion over wage policy and the labour rights at center stage. The attitude of the population towards the labour movement and the union leaders has changed favourably in the last decade as a consequence of the popularity of the Labour Party, especially in the urban centers.

The centralization of the labour movement and the relation between the union and parliamentary activities is an important feature of the labour organization in European countries and most especially in neo-corporatist societies (such as in Sweden and Austria). These features are completely different from those which characterized the labour movement before 1978 in Brazil. As a consequence of the centralization of the movement, this new structure favours the capacity of unions to mobilize workers. The connection with the parliament, on the other hand, implies that the gains obtained by the major unions are many times brought to the Congress by the workers' representatives, and may be extended to the less powerful unions if they are eventually voted and

become national laws. In short, it seems unquestionable that there is a transformation taking place in the capital-labour relations in Brazil as a result of the growth of the CUT and the PT and that the change in the organization of the labour movement tends to make it powerful social actor.

## 5. External Debt and Fiscal Crisis

The third element of the current economic crisis refers to the relation between the external debt problem, the fiscal crisis, and the significant reduction in the rate of investment which has deleterious short run effects on the levels of employment and capacity utilization, and long run effects on the formation of fixed capital.

Since the late 1970's the rate of investment has been falling. In 1972, it was around 25%, and in 1975 it reached its peak level of 29.6%. It then started falling, and in 1984 it reached its lowest level (16.5%). Since the II World War, the Brazilian economy, has had the highest rates of investment in Latin America. Today, the rate is close to the lowest in the region.

The question to be posed is to what extent the lack of dynamism of the Brazilian economy is associated with the recent process of adjustment to the external debt crisis, or to what extent it is associated with structural changes related to the role of the State in the economy, and the capital-labour relations. In face of the huge external transfer of resources, and the intimate relation between the external debt and the public debt (to be examined presently), there seems to be no doubt that the solution for the lack investment and growth prospects depends on some kind of negotiated policy between the main social actors, that is, the State, the representatives of the employers, and the leaders of the organized segment of the labour force. So far, the

absence of negotiations has led to a process of chaotic 'solution' to the distributive conflict in which inflation plays the part of the adjustment variable par excellence, and the prospects of a relatively stable growth path are close to zero.

The primary causes of the external debt in each Latin American country are different. In some cases they are associated with capital flight (Venezuela and Argentina), in others to the expansion of the import of consumption goods (Mexico), and in others to the finance of investment projects (Brazil). However, there is a common cause for the tremendous jump of the debts in the end of the 1970's, namely, the interest rate shock.

According to the World Development Report (1987) the interest rates (including spreads) in 1970 varied between 6.8% (Chile and Brazil) and 7.5% (Argentinian, Mexico and Venezuela). In 1985, the rates were around 9.5%, and in 1981-83 they were close to 20%. As a result, as shown in table 2, there was a considerable increase in the interest payments as a proportion of GDP, and the debt service as a proportion of the GDP and of exports.

Table 2  
Debt and Debt Service

	Total Interest payment on long-term debt (millions of dollars)		Long-term debt as percentage of GNP		Long-term debt service as percentage of of exports	
	1970	1985	1970	1985	1970	1985
Peru	162	278	38.0	74.9	40.0	16.0
Costa Rica	14	353	25.3	113.6	19.9	39.8
Colombia	59	861	22.5	33.3	19.3	33.4
Chile	104	1646	32.2	123.9	24.4	44.1
Brazil	224	7950	12.2	43.8	21.8	34.8
Uruguay	17	291	12.5	58.4	---	36.5
Argentina	---	---	23.3	56.4	---	---
Venezuela	---	---	8.7	46.1	---	---

Source: World Development Report, 1987.

After the Mexican moratorium in 1982, there was a considerable reduction in the flow of resources to Latin American countries. As a result, many countries had to implement restrictive policies to reduce domestic absorption. The social costs of the adjustment process are well known. As a result of the lack of external resources, there was an inversion in the sign of the net financial transfer (NFT) -- the difference between the growth of the debt and the debt service in a given period. In Argentina, Brazil, Mexico and Venezuela, the NFT was positive in 1980-81, and became negative in 1983-85, as shown in table 3. A negative NFT implies that the country should generate a commercial surplus in order to equilibrate the balance of payments which in turn requires a reduction in domestic absorption and a reduction in the product wage measured in dollars. If there is wage resistance, which is generally the case in countries where the

union movement is organized, the adjustment variable tend to be the level of employment and the rate of inflation.

Table 3  
Net Financial Transfer  
as percentage of GNP

	Average 1980-81	Average 1983-5
Argentina	1.9	-6.3
Brazil	1.2	-3.9
Mexico	4.4	-5.0
Venezuela	5.2	-4.7

Source: Reisen, H. & van Trotsenburg, A. (1987).

Another common phenomenon in highly indebted Latin American countries after 1982 is the growth of the government debt. This phenomenon, and its effects in terms of the limitations it imposes on the monetary and fiscal policies, are the object of many recent studies, including those prepared by international agencies such as the World Bank and the OECD. Reisen & Trotsenburg (1987, p. 26) note that an important cause of the growth of the public debt has been the conversion of the debt of the private sector into public debt.

In many countries --Brazil included -- the government took responsibility for a significant proportion of the external debt in order to reduce the impact on the private agents of major changes in the exchange rate or interest rate. Hence, depending on the volume of the private debt absorbed by the public sector, the external debt may become an important elements of the government's expenditures. To the extent that the fiscal deficit increases or

that the government has to cut other expenditures, the private debt becomes a social debt. The service of the public debt as a proportion of the GDP increased around 70% in Mexico and more than 100% in Argentina between 1981 and 1984. In Brazil it was already very high in 1981, and reached 41.1% in 1984.

Table 4  
Public and Publicly Guaranteed Debt Service  
as percentage of GNP

	1981	1984
Argentina	10.2	22.1
Brazil	39.1	41.1
Mexico	23.4	39.9
Venezuela	11.5	17.1

Source: Reisen, H. & van Trotsenburg, A. (1987).

In Brazil, the fiscal debt starts to grow in the 1970's due to the massive subsidies to the private sector (especially to the agriculture and export sectors) and the payments of interests on the debt. As a consequence, the capacity to save of the government (measured by the difference between taxes, on the one hand, and transfers plus subsidies, on the other) which accounted for 32.5% of the GDP in 1970, fell to 12.8% in 1980. <sup>25</sup>

After the first oil shock, the public enterprises played an important part in the process of structural adjustment through import substitution. Indeed, in the intermediated goods sector, the public enterprises were the main investors. The relation

<sup>25</sup> See Werneck (1986, 1987) for a detailed analysis of the reduction in the capacity to save of the government and its consequences.



between public fixed investment and GDP went from 2.8% in 1970 to 8.2% in 1980, whereas the share of public enterprises in the total formation of fixed capital went from 15% to 37.3% in the same period.

The structural adjustment process of the second half of the 1970's was highly depended on imports, and was essentially financed through external borrowing. This only implies that the external debt of the public enterprises grew considerably during this period. Thus, the public sector as a whole became quite vulnerable to external shocks, and was seriously hit by the interest rate shock in the early 1980's.

The effects of the increase of the interest rate over the public debt are not restricted to the short run. It affects the capacity to save (and hence invest) of the public sector which, in turn, maintains a high degree of complementarity with the level of investment of the private sector. Thus, the restrictions imposed on the capacity to save of the government tend to affect the aggregate level of investment, and the rate of growth of the economy. This is particularly true in the case of Brazil where the proportion of public investment on the overall level of capital formation is not at all insignificant. Before we examine these effects, let us first study the other causes of the external debt of the public sector in Brazil, and the precise relation between the service of the external debt and the fiscal deficit.

Not only the debt of the public enterprises were responsible for the growth of the external debt under the responsibility of the public sector. In 1983, the Central Bank started to absorb the dollar denominated external debts of the

private agents who then became debtors in cruzeiros of the Bank. This was a way to reduce the vulnerability of the private debtors to changes in the exchange rate policy and the international rate of interest. Hence, since 1983, the share of the external debt of the public sector over the total net debt started to grow. <sup>6</sup> This undoubtedly represents a process of socialization of the debt and of the costs associated with the adjustment to the debt crisis. In 1988, close to 80% of the external debt was under responsibility of the public sector.

The greater the proportion of the debt under responsibility of the government, the greater the relation between the service of the external debt and the fiscal deficits. This is so because the proportion of exports of public enterprises over the overall volume of exports is quite small in comparison with the share of the government's external debt. Thus, to each dollar generated by net exports there corresponds an increase of almost one dollar in the fiscal deficit or the supply of money. <sup>7</sup> Not only that, but any devaluation of the domestic currency automatically increases the value in cruzados of the internal transfer between the private and the public sectors.

The relation between the service of the debt and the internal transfer between the private and public sectors imposes a serious constraint on the capacity of the government to save, and hence reduces its capacity to invest and foster growth and provide public goods. The causality chain relating the external debt and

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<sup>6</sup> See Bontempo (1988) for an analysis of this process.

<sup>7</sup> In 1982 the share of the domestic public debt in GDP was around 13%, and in 1985 it had reached 20%.

the formation of fixed capital in Brazil starts with the growth of the debt under the responsibility of the public sector which reduces the capacity to save and invest of the government, and increases the fiscal debt. The reduction of public saving leads to a smaller rate of investment of the public sector which in turn affects the inducement to invest of private agents. The growth of the fiscal debt has a positive effect on the interest rate, which also tends to reduce the level of private investments. The investment in fixed capital of the government fell 25% between 1980 and 1984, in the same period, the investment of the public enterprises -- a leading sector in the 1970's -- fell 33%. As noted already, the rate of investment fell from an average level of 25% in the 1970's to 16% in 1984.

Table 5  
Central Government Expenditures  
as percentage of Total Expenditures

	Education		Health	
	1970	1985	1970	1985
Chile	20.0	13.2	10.0	6.1
Brazil	8.3	3.2	6.7	7.6
Uruguay	9.5	6.4	1.6	4.1
Mexico	16.4	12.4	5.1	1.5
Argentina	20.0	9.5	---	14.7
Venezuela	18.6	17.7	11.7	7.6

Source: World Development Report, 1987.

Table 6  
Government Fixed Capital Formation

	1980	1981	1982	1983	1984
Government	100.0	103.6	99.03	70.16	74.84
Public Enterprises	100.0	105.68	104.10	73.1	67.42

Source: Werneck (1987).

The process of socialization of the debt implied in many Latin American countries a substantial reduction in the share of education and health expenditures in the government's total expenditures. In Argentina and Brazil the share of education fell more than 50% between 1970 and 1985. In the same period, the share of health expenditures fell 70% in Mexico and more than 35% in Chile and Venezuela.

## 6 Concluding Remarks

Part of the responsibility for the current economic and social crisis may be attributed to the external debt crisis. The growth of the volume of resources transferred abroad imposes serious restrictions on the capacity to save of the State, which in turn limits the overall process of accumulation. However, the crisis also has domestic causes. These relate to the decisions over public expenditures and the relations between capital, labour and the State.

What is new in terms of the Brazilian social structure in the 1980's is the rise of a strong and centrally organized labour movement. Any successful attempt to stabilize the Brazilian economy and recover its capacity to grow will depend on the cooperation of the organized labour movement. Hence, only a concerted solution seems to be able to reestablish the conditions for a systemic balance in the Brazilian society.

However, the institutions in which the capital-labour relations are based as well as the attitude of the elites towards the labour movement are not congenial for a negotiated solution. There are certain institutional and political requirements for the establishment of concerted policies. The main social actors must be centrally organized and representatives, there must be a certain degree of agreement in terms of the necessity to negotiate and the objectives, and the government must have a certain degree of credibility.

None of these requirements are really met in the Brazilian society today. As for the political aspects, there is a strong

resistance on the part of employers to negotiate the demands of the union confederations. There are signs of change in the Brazilian social and political structure, but there are conservative forces threatening the process of modernization.

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