BRAZIL

Swimming through a tsunami?

Brazil has paid the price of being "integrated" into the global economy. As foreign investors and speculators pulled out, the securities markets slumped and the currency was sharply devalued. The Government's response has been somewhat timid, with expenditure lower and slower than needed. Brazil still may be able to ride out the crisis if the Government rises to the challenge, however. Meanwhile, the world economy has a unique opportunity to promote environmentally sustainable growth strategies and new rules for making financial systems work for development and the redistribution of income and wealth.

Social Watch Brazil
Fernando J. Cardim de Carvalho[1]

Many observers saw the relatively low level of contagion by emerging economies of the financial panic, that began in the United States in 2007, as a sign that these countries could successfully "decouple" their destiny from that of developed countries. Brazil was expected to be among the lucky ones – that is, those countries that could avoid being swallowed by the shock waves of the financial crisis, sustaining some degree of prosperity and reining in unemployment by redirecting productive activities to domestic markets.

This view seemed to be vindicated by the vigorous growth of the Brazilian economy in the first three quarters of 2008. It did not grow at "Chinese rates", of course, but it grew fast enough not only to expand employment but also to move a growing share of the workforce from informal jobs to the better paid and more secure formal sector. Household consumption led overall growth, fed by the increase in real wages (particularly the minimum wage) and employment, as well as by the social policies that increased the purchasing power of the lowest income groups.

The Federal Government, with President Lula at its head, mounted a strong public campaign to keep up business and consumer morale so that demand would remain high, stimulating firms to keep producing and expand investment. The President frequently reminded the population that his Growth Acceleration Plan (PAC) should act as a lever to keep up demand, so that consumers should not fear unemployment and firms would not face idle capacity.

The strategy seemed to be successful until the virtuous path was abruptly interrupted in the last quarter of 2008, when GDP fell 3.6% in comparison with the previous quarter. All sectors of the economy actually contracted, but the manufacturing sector was by far the hardest hit, falling more than 7%. Investments, which had been growing at healthy rates, fell almost 10%. Consumers and investors could not sustain their previous spending, so the economy as a whole contracted significantly.

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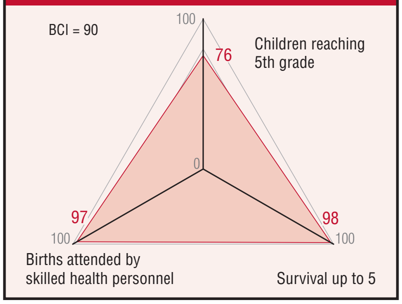
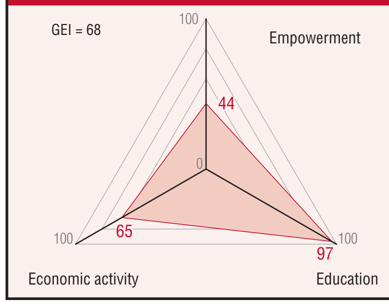
Basic Capabilities Index (BCI)



Gender Equity Index (GEI)



The Government's timid response

The Brazilian version of the international crisis has specific roots. The domestic banking system was not exposed to the kind of speculative investments that ruined the financial systems of the United States, Europe and parts of Asia. As a result of the high interest rates paid on domestic public debt, banks operating in Brazil preferred to invest in these securities instead of trying their luck with the "financial innovations" created in the United States. Nevertheless, the country could not avoid the consequences of becoming "integrated" into the global economy.

In recent years, the Brazilian economy has received a large amount of foreign capital, both in the form of direct investment and as speculative portfolio capital. The São Paulo Stock Exchange soared and large amounts of debt securities were placed on the market. When the crisis exploded in the United States and soon after in Western Europe, many of these investors and speculators took their money out, in many cases to cover their losses at home. As a result, not only did the Brazilian domestic securities markets slump but also the national currency, the real, went through a rapid and sharp process of devaluation.

The results were not as catastrophic as they had been in past crises, largely because the turmoil did not induce capital flight by residents. Domestic financial speculators, in fact, had no reason to flee since the Government was still paying the highest interest rates in the world. Besides, there was no safe place to go. In addition, Brazil holds a relatively large amount of international reserves. Thus, while foreign investors generally had little choice but to leave, Brazilian investors preferred to stay. As a result, the problems with the balance of payments did not become as serious and paralyzing as they had been in the recent past.

The disturbances in the domestic securities markets and the sharp devaluation of the real, however, were enough to induce local banks to curtail credit to firms and consumers, despite some timid attempts by the Central Bank to supply them with additional liquidity. The credit crunch created immediate difficulties in sectors such as consumer durables, particularly cars, the demand for which is heavily dependent on the availability of credit. Collective vacations and other tricks to temporarily reduce production were adopted in the automobile industry, but it could not help but transmit the fall in demand to other industries. The twin threats of idle capacity and unemployment broke the spirits of consumers and firms. Facing idle capacity, firms suspended investment plans, deepening the impact of the initial fall in demand. In the end, only the Government was still expanding its spending in the last quarter of 2008.

In contrast to the previous year, 2009 began with much more subdued expectations. Opinion polls show that fear of unemployment has made its way back to the top of most people's list of concerns, topping urban violence and public safety. In particular, and another serious cause for concern, it became clear that despite the aggressive rhetoric adopted by the President since the beginning of 2008, counter-cyclical policies have been much less vigorous and effective than they need to be. It is well known that President Lula, when he was inaugurated, acted to reassure financial markets by maintaining a *de facto* independent Central Bank, ruled mostly by functionaries of private financial institutions. It should surprise no one that monetary policy has been appallingly managed during the crisis by monetary authorities that are so far to the right of any other central banker in the world that even private banks seem to be bothered by their inability to offer any constructive contribution to economic recovery.

More surprising, perhaps, is the timidity of governmental spending policies. The President's calls for bold action seem to have fallen on deaf ears among his own Cabinet ministers. The Government has persisted with PAC, which was defined for normal times and is obviously insufficient to fight a recession that may end up longer and deeper than it seemed at first. However, even PAC has been implemented in an uncertain and timid way. Spending plans are delayed by bureaucratic obstacles, resulting in public expenditure that is lower and slower than required. The hesitant behaviour of leading authorities in the Government's economic team betrays a worrying lack of understanding of the potential damage that a crisis such as the one currently unfolding can cause to a developing country such as Brazil.

As the Brazilian economy continued to decline in the first quarter of 2009, however, more forceful policies were implemented, although still far from what is necessary to make up for the contractionary impulses coming from abroad. Public banks increased their supply of credit, at lower interest rates. Income transference to the poor, through the Family Grants program, sustained consumption in the lower income groups. The overall improvement of expectations, after what seemed to be an overreaction in the last quarter of 2008, led to a still tentative and timid recovery, which is presently going on. All things considered, all indications point to the same direction: a small recovery, which in itself, given the international context, is still a relief.

At a moment like this, one of the biggest risks a country can expose itself to is confusing the inability to act with financial and fiscal prudence. Afraid of increasing spending, governments can resign themselves to watching private demand fall and, as a result, production and employment fall too. In such a situation, tax revenues go down while social security spending rises. Fiscal deficits then rise precisely because governments were not bold enough to act against the contraction of the economy. Paradoxically, the attempt to look prudent puts a country in an even worse fiscal position than would be the case if its government had acted decisively to support demand, increasing income and tax revenues. Incidentally, this is precisely what President Obama is trying to accomplish in the United States. It is also what the Managing Director of the International Monetary Fund (IMF), Dominique Strauss-Kahn, has defended repeatedly since 2007.[2]

THE THREAT TO FOOD SECURITY

Francisco Menezes[1]

Brazil's Zero Hunger programme and the strengthening of a number of public policies have made it a recognized world leader in the fight against hunger. However, both the food and financial crises have had significant impacts on the country's food security.

In the second half of 2007, food prices started to increase, reversing the downward trend of the previous few years and putting the gains at risk. The most vulnerable social groups are the hardest hit by food price increases, as food takes up more of their budgets. Concerned with this, the Government increased by 8% the benefits distributed through the *Bolsa Família* (a guaranteed minimum income programme).[2] It also incorporated a larger number of families into the programme and took measures to boost food production through incentives and guarantees to rural producers.

In the second half of 2008, food prices levelled off or even fell, following the trend for commodities in world markets. However, new threats to food security have resulted from lower incomes among the poorest people, increased unemployment and a likely reduction in real wages. It is necessary to follow events very closely in 2009. The food security budget is certainly a relevant indicator of the direction being followed, both in terms of releasing funds for this year and the 2010 budgetary proposal.

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2 See: <www.ibase.br/modules.php?name=Conteudo&pid=2481>.

An opportunity to reset the world economy

The current international financial crisis represents the most serious disruption faced by the global economy since the Great Depression of the 1930s. Even its duration underlines its dangerous nature: the crisis is advancing through its third year and there is as yet no light at the end of the tunnel, no sign of recovery. It is most likely that, in the short term, the situation will become still more serious, with the increase in unemployment and social disruption this phenomenon causes everywhere. Brazil still has a chance to reduce these risks if the Government rises to the challenge.

Nevertheless, it needs to be noted that crises such as this one always transform, more or less deeply, the way the economy and society work. Thus, as important as it is to stop the economic decline in the short term, it is also and perhaps even more vital to prepare for the future. The Great Depression resulted in the expansion of the welfare state and widespread public intervention in the economy, both ferociously combated by the neo-liberal revolution of the late 20th century.

Now there is another opportunity to reset the path of the world economy. All indications point to so-called "green investments" as the next frontier of investment and innovation, promoting environmentally sustainable growth strategies that increase efficiency in the generation and use of energy. Also important is to repair the damage caused by the dominance of neo-liberal ideologies that has fostered financial deregulation since the 1980s and led the world to the brink of disaster. New regulatory and supervisory strategies are necessary given their widespread failure. However, the new rules should focus on how to make financial systems work to promote development and the distribution of income and wealth, not the welfare of financial speculators. These rules are now decided in forums such as the Basle Committee and the Financial Stability Forum. The crisis forced the richest countries, which have traditionally monopolized these decisions, to open the door to emerging economies, making the G20, at least for the moment, the centre of attention. One may argue that it is better to have a G20 than a G7, but, in reality, no G can really provide the solution. These institutions must become representative, and this is not achieved by simply co-opting a few new members in order to allow existing clubs to maintain their exclusive nature. The current crisis creates an important opportunity to attain the effective democratization of international institutions. This chance should not be missed.[3]

2 Though the Fund itself has resisted adopting this view, as demonstrated by the conditionalities imposed on the Central European countries that were bailed out by the IMF.

3 In fact, this is precisely the goal of the project "Financial liberalization and global governance: the role of international entities", coordinated by Fernando J.C. Carvalho and Jan Kregel, developed by Ibase and sponsored by the Ford Foundation. See "Financial Crisis and Democratic Deficit". Available from: <www.ibase.br/modules.php?name=Conteudo&pid=1686>.