STRUCTURAL ADJUSTMENT

AND

BRAZILIAN ECONOMIC DEVELOPMENT

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ABSTRACT

This thesis is titled **Structural Adjustment and Brazilian Economic Development.**. This study addresses the issue of structural adjustment in Brazil from a historical point of view, looking specifically at the fundamental impact of its policies on Brazil's dependency in the development process.

The Structural Adjustment Program (SAP) is a specific policy-lending program initiated by the World Bank and the International Monetary Fund (IMF) in early 1980s, which is designed to stabilize distressed economy and to readjust the world economy into a neo-classical economic structure.

Originally, Brazil was a typical classical dependent economy. Since the 1950s Brazil initiated its industrialization process under the import substitution strategy which was aimed at establishing a self-sustaining industrial system on the basis of "state control", and successfully transformed from a colonial agriculture-dominated economy into an industrial economy.

In the 1960s, under the constraints of capital accumulation rooted in a colonial economic structure, Brazil introduced neo-classical economic policies, combining them with an ISI strategy under a

stabilization program, creating the economic miracle by taking advantages of favourable international conditions. However, over-reliance on foreign capital and the world market led Brazil economy towards a dependent form of development.

In the 1970s, the debt crisis caused by unfavourable international conditions after a series of oil shocks forced Brazil to borrow from the IMF and to adopt its SAP, which introduced a package of free market policies, distorting the leading role of the state in Brazil's development process, and creating a dependent peripheral economy..

This thesis concludes that the SAP is not an appropriate strategy for Brazil's development, and is a program designed for the benefit of the core countries.

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Zheng Lin

LIST OF ABBREVIATIONS

BOP	BALANCE OF PAYMENTS
ECLA	ECONOMIC COMMISSION FOR LATIN AMERICA
GDP	GROSS DOMESTIC PRODUCT
IMF	INTERNATIONAL MONETARY FUND
ISI	IMPORT SUBSTITUTION INDUSTRIALIZATION
LDCs	LESS DEVELOPED COUNTRIES
NICs	NEWLY INDUSTRIALIZING COUNTRIES
OECD	ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT
SAP	STRUCTURAL ADJUSTMENT PROGRAM
WWII	WORLD WAR TWO

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CHAPTER I

INTRODUCTION AND THESIS STATEMENT

1.1 INTRODUCTION

The structural adjustment program (SAP) refers to the specific policy-lending program initiated by the World Bank and IMF in early 1980s which were designed to stabilize distressed economies and to readjust the world economy into a neoclassical economic structure (Kolko, 1988). Although with different targets, the basic thinking and policies of SAPs were already included in the stabilization program of IMF instituted in the 1960s. In this sense, SAP could be considered a program theoretically developed in and as of the 1960s. (Guitian, 1980)

Under this program, each country which borrows from the IMF must sign with the IMF a standby agreement, which includes a set of economic stabilization measures prescribed by the IMF, and implement such policies under the auspices of the IMF in order to reach certain quantitative targets of various macroeconomic variables specified in the agreement (Aufricht, 1964).

After the first SAP, a $200 million loan to turkey that came into effect in April 1980, more than 28.5 of billion adjustment lending flew to 64 countries through 187 separate lending operations (Reed, 1992:1-2). Since then, a broad debate continues regarding the theory and impact of structural adjustment in stabilizing distressed economies and in creating favourable conditions for long-term economic growth as well as human development.

Industrialization in Brazil is also a controversial topic in the field of development studies. It involves a tortuous process undergone for almost half a century since the 1950s. In this period, the Brazilian economy experienced several dramatic rises and sharp falls. It is famous not only for its high-rate of economic growth from 1966 to 1970, but also an astonishing high rate of inflation, an equally significant disparity in income distribution, and a serious debt crisis.

In the 1950s, Brazil was successfully transformed from a colonial agriculture-dominated economy into an industry-dominated economy on the base of a strategy of ISI (import substitution industrialization). To achieve a continuing and sustained development, Brazil several times adjusted its development strategy after initiating industrialization. The most important two were the 1960s stabilization program and the SAP, implemented in the 1970s and 1980s. Both programs were strongly influenced by the neo-classical economic theory advocated by the IMF and the World Bank, especially the latter, which was not only indirectly influenced by the

IMF in theoretical aspects, but was also directly implemented through the lending policies of both institutions.

Two adjustments in strategy led to totally different results. The first one created Brazil's "Economic Miracle", while the second did little to fundamentally improve the Brazilian economy. Today the Brazilian economy still fluctuates at a low ebb. In the period from 1980 to 1991, Brazil experienced another sharp deterioration in its economy. The gross domestic product has fallen dramatically and the economy had several times been on the edge of hyper-inflation, generating a political crisis.

1.2. THESIS STATEMENT

In my study, I will argue that the economic crisis in brazil was fundamentally caused by its dependent economic structure and unfavourable external conditions and that the degree of dependency was strengthened by the package of classical economic policies instituted through the SAP. Most of the literature concerning Brazil's structural adjustment analyzes its economic and social impact from a horizontal point of view, focusing on a certain aspect or aspects such as inflation, the debt crisis, the class structure, income distribution, and so on during the SAP period. In my study, I will examine the role of SAP in Brazilian development with a historical comparison in terms of forms and conditions of structural change and the degree of dependency in different periods of development. I am convinced that the SAP in Brazil is not an isolated event, but a historical phase in the whole process of Brazilian industrialization. Putting SAP in a historical context will give us a much clearer insight regarding its nature and impact on Brazilian development.

Three points should be mentioned about my case study. The first one concerns the concept of "dependency". There is no unified definition concerning dependency in the large literature discussing it. It is actually a vague and sprawling concept (Packenham, 1976). Different values, different views of the world, and different angles of observation have led to various, sometime totally opposite explanations of Brazil's development. In my thesis, I will use the idea that a dependent country is a country whose development is "conditioned by the development and expansion of another economy" (dos Santos, 1970:236). To evaluate the degree of dependency of Brazilian economy, I will consider two questions. Firstly, to what extent, Brazil could make a decision on its economic activities and development model? Secondly, to what extent, Brazil could pursue a strategic alternatives when internal and external conditions change. The second point is that all my analyses concerning Brazil are based on two facts. One is that, unlike some other newly industrializing countries (NICs) such as the four tigers in Asia, Brazil is a big country in terms of territory and population, and rich in natural sources. Theoretically speaking, this fact provides Brazil a more solid condition for independent economic development than those countries with smaller territory and scare natural resources. However, historically speaking, Brazil has been an open economy which is deeply inserted into and strongly influenced by the world economy. In this respect, Brazil differs from closed and self-sustained semi-feudal economy such as China, although both countries are immense in territory and population, and rich in various natural resources. The combination of these two basic facts to an extent conditioned Brazil's economy and its development process, and should not be ignored when considering the Brazilian case.

Another point I should mention is that Structural Adjustment involves a complicated process with various dimensions and conditions in different countries. In this thesis, I will only focus on a dependency analysis of Brazilian economy. The essentially negative perspective on the SAP in Brazil should not be applied automatically to other countries, or to the evaluation of SAPs as a whole. Actually, it is not easy to evaluate SAPs as a whole with simple words such as "good" or "bad". As one of a number of development strategies, it has its advantages and disadvantages. Applying a certain strategy entails a complicated social choice which depends on the concrete conditions involved. Evaluation of the SAP which is carried out in so many countries also needs further research.

Therefore the conclusion of this thesis applies only to the impact of SAP under conditions of economic dependency found in Brazil. Some possible extensions and implications of this thesis will be presented in the concluding chapter.

The structure of this paper is as follows. An overall review of the adjustment program in terms of theoretical background, objectives and main policies will be given in Chapter two. The next three Chapters, traces out three phases of industrialization in Brazil: ISI in the 1950s, stabilization in the 1960s and the structural adjustment program in the 1970s and the 1980s. The thinking behind these programs, the associated policy measures, and their impact on the dependency of Brazil will be discussed. In these three chapters, I argue that Brazil has experienced a transformation from a relatively independent form of industrial development to one that is heavily dependent, and that the SAP is a catalyst of this transformation. In Chapter three I argue that ISI established a solid basis for self-sustained development through state intervention. It is a necessary phase for a developing country under the constraints of capital accumulation. In Chapter four, I claim that the introduction of neo-classical theory under a stabilization program led Brazil's economy towards a form of dependent development, despite the economic miracle of the late 1960s and the early 1970s based on favourable external conditions. In chapter five, I argue that the SAP failed to cure the debt crisis caused by deteriorating external conditions. By replacing ISI with a set of orthodox policies, it trapped Brazil's economy into a perpetual dependent position in which the economy is conditioned by the interests of external metropoles. In the last chapter, I conclude from this historical analysis that the SAP is designed for the benefit of interests in the core countries, Therefore it is not an appropriate or desirable strategy for Brazil's development.

CHAPTER II

BACKGROUND, THEORY AND PERFORMANCE OF SAPS

2.1. BACKGROUND TO THE STRUCTURAL ADJUSTMENT PROGRAM

As mentioned above, the SAP theoretically originated in the 1960s. At that time, the post war system of international relations experienced a transformation from polarisation between the rich and poor into a highly integrated and interdependent global economic and political system.

Since World War Two (W.W.II), the world economy has developed and undergone three phases: (i) the domestic economy; (ii) the international economy; and (iii) the global economy (Adler, Nanacy, 1991). In the first phase, the productive system was organized within a country; economic and political decisions of one country were made from a domestic or an ethnocentric perspective. In the second phase, economies were still state-oriented, but competition pushed domestic companies to the international market. Links between countries became closer and each country had to shift its policies to fit the needs of the international market. In the third phase, major economic operations breached and crossed borders, and was increasingly based on a global perspective.

The strongest expressions of the third phase are the growth and spread of transnational companies, many of whom with total sales that exceeded the GDP of all but the largest nation-states, and the growing integration of the international financial system.

After the Second World War, the dominant pattern in the world economy was the international economy, which was state-oriented with a polarized structure. Within this structure, nation-states were organized in three major blocs: (i) the market-led industrial countries; (ii) the central planned socialist countries;and (iii)the largely non-allied developing countries of the 'third world'..

In the industrial world, state intervention and the welfare state -- with reference to ideas formulated by Keynes -- prevailed. The monopolisation of capital and the strength of the working class and labour unions led to what has become known as "the historical compromise" between labour and capital at the national level. This system was based on the existence of a national system of production.

The socialist bloc, led by the former Soviet Union, with reference to or on the basis of Marxist doctrine, built a state central planning economic model for industrializing their economies. Since almost all socialist countries were established under backward economic conditions, they set industrialization and "catching up" with the industrialized countries as the basic targets of their development process.

The non-socialist developing countries, which had been liberated from colonial rule in the post-second world war period, pursued industrialization and modernization on the basis of various development strategies. Among them the most popular was "Import Substitution Industrialization (ISI)". This strategy was also supported by a national system of production, and the protection and development of domestic industries through state policies and intervention.

To sum up, in the post war world order, the national economy was the base of economic and political relations. States played the crucial role in the development process. The rich countries, a second world of countries and the bloc of socialist and developing countries confronted each other and formed relations on the basis of a national system.

As of the early 1970s, this picture has gradually given way to a more integrated process of production, which has a "global" rather than a "national" character. A technological revolution played a key role in this transformation. In this new phase, "capital is overcoming the constraints of national economic organization, subordinating it to global commodity markets that cross national boundaries" (McMichael and Myhre, 1990:58). After this world productive system emerged, the capacity of the national system was gradually eroded. This process is also leading to a reorganization of the entire productive system, in which "domestic social and political relations are increasingly shaped by global capital circuits"(McMichael and Myhre,1990:59), and "the state must adjust their domestic policies to the exigencies of the world marketplace" (Hooey, 1992:87).

This transformation has taking place under conditions of a "global economic crisis" that can be traced back to the onset of declines in profitability and the rate of production of goods and services in the late 1960s. In the early 1970s, two oil crises (in 1974 and 1979) shocked both the industrial and developing economies. After 25 years of almost uninterrupted growth -- the vaunted "Golden Age of capitalism" -- the capitalist world began to experience a painful series of cycles of stagflation, recession, and economic crisis. Meanwhile, after achieving in some cases what appeared to be a miraculous rate of development, characterised by unprecedented high growth rates and a process of rapid export-led industrialization, some developing countries experienced a serious debt crisis (Brazil being one of these Newly Industrialising Countries). The socialist bloc, after the collapse of the economy and the Communist Party control in the Soviet Union and Central Europe, has given up the central planning system because of its apparent inefficiency at the level of economic growth. And market-oriented reforms have spread to almost all socialist countries in the same way that earlier state-induced structural reform spread to and were introduced in all the OECD countries in the capitalist bloc.

Facing a global crisis, the whole world took the road of restructuring the world economy and structurally adjusting their relationship to it. What are causes of this global crisis? What were the major responses to it? What should the new world economic order be? Representing one school of thought, a model of national economic policies that has currently achieved hegemony, the World Bank and the IMF approached the global crisis with classical economic theory. Putting this theory into practice, the IMF and the World Bank initiated (in the 1960s) a stabilization program, and followed with the structural adjustment program (in the 1980s) in order to overcome the crisis and reestablish the liberal world order set up at Bretton Woods in 1944 (Mosley, Harrigan and Toye, 1991).

2.2. THE THEORY OF THE STRUCTURAL ADJUSTMENT PROGRAM

As mentioned above, the SAP is essentially premised on neo-classical economic theory. The neoclassical school of economics was created by a group of economists that included William S. Jevons in England, Carl Menger in Austria, and Leon Walras in France; and it was developed by Alfred

Marshall in Cambridge, Eugen von Bohm-Bawerk in Vienna, Vilfredo Parito in Lausanne and John Bates Clark and Irving Fisher in the United states (Levitt, 1992).

The marginal equilibrium analysis of prices is the starting point of the neoclassical theoretical framework. Applying the price theory to explain a closed economy and an open economy, two key principles -- the "free market" and "free trade" -- were formulated. They are the policy foundation of the SAP.

Neo-classical economists hold that the market price of a commodity is determined by the demand and supply of it. The market price decreases when supply in a market exceeds demand, and increases when demand exceeds supply. The price at the level where demand equals supply is called the equilibrium price, and the output is called equilibrium output. In a perfectly competitive market, buyers and sellers of a goods are so numerous that no single buyer or seller can have an influence on the market price. Furthermore, this price acts as a signal that provides all the information necessary to distribute resources and output throughout the economy. Following the signal of the price, producers and consumers adjust their desires of buying and selling individually, consequently changing the general demand and supply of an economy. Due to the incentives of utility maximization for the consumers and profit maximization for the producers, free competition will finally lead to an equilibrium level between demand and supply, at which resources will be located at an optimal level (Campus, 1987:320-322).

Applying price theory to a closed economy, neoclassicists believe that the power of competition in free market is the most efficient regulating force of economic activity to establish equilibrium between production and consumption. They hold that the market provides a unique mechanism through which individuals, by pursuing their own interest, create wealth which benefits society in general as well as themselves in particular. In other words, with reference to Adam Smith's original formulation, the mystical functions of the "invisible hand" of the market freed from constraint -- the unrestrained pursuit of individual economic gain -- ensures the greatest social benefit (Hooey,1992).

From this analysis, the obvious policy solution for domestic economic operations is to get the government out of the market. The exponents of this theory argue that government intrusion, whether in the form of purchases of goods and services, transfer payments, regulations, taxes, or monetary actions, distorts the relative costs and prices of goods, and misleads resources allocation. Good public economic policy should reduce the government's presence in the private marketplace and create a perfectly competitive environment (Levitt, 1992:78-80).

Applying the price theory to an open economy, neoclassicists advocate free trade policy established on the theory of comparative advantage. They believe that the rule governing the profitability of buying at home or abroad is not the absolute but the relative (or comparative) advantage of countries in the production of different goods. If all countries specialized in the production of those goods in which they have comparative advantages, obtaining other goods they need through foreign trade, world output would be higher than that could have been obtained by a universal policy of national self-sufficiency, since under free competition and free trade, the production of a product will be switched to where the cost is lower in order to obtain higher profit. Resources would be allocated at an optimum level; and, as a result, every country would produce at a lower cost and get more at the same level of income. In this division of world labour, citizens of each country would be better off and nobody would lose. Therefore international trade under free competition is necessary for the benefit of the world.

To explain the worldwide crisis in capitalist production, neoclassical economists argue that the state intervention in economy and protectionism in world trade distorted the working of the price mechanism in guiding resource allocation, destroying the function of the market in adjusting investment and consumption, resulting in a global crisis.

Specifically, neoclassical economists argue that the debt crisis in developing countries was caused by the weakness of their state-controlled economic structure and policies caused by irrational government interventions. They also hold that an over ambitious industrialization in developing countries inevitably resulted in expansionary financial policies, associated with large budgetary expectations and BOP imbalances. Similarly, high inflation rates resulted from an over-aggressive investment policy. Hence an improvement of the economy should depend largely on domestic structural adjustment which would lead to a market economy free of government interference (Dale, 1983).

With strong lending powers, the World Bank and IMF, believe that limited financing would be an efficient means of promoting free trade and exchange stability since such credit would keep nations from imposing restrictions on trade, and ensure the eventual correction of the balance of payments disequilibrium. With this analysis and prognosis, the IMF initiated the structural adjustment program in the late 1970s (Crockett, 1991 and Kolko, 1988). Since then the IMF has played a leading role in restructuring the world economy.

2.3. PERFORMANCE OF THE STRUCTURAL ADJUSTMENT PROGRAM

SAP has both short-term and long-term objectives. In the short term, SAP is designed to aid severely debt-distressed economies and improve their balance of payments. In the long term, SAP seeks to adjust the Third World countries into a more favourable position in the international division of labour by promoting an export-oriented economy.

The main policy measures of SAP used to realize its objectives reflect the dominance of the neo-classical economic theory behind it (Williamson, 1983, Guitian, 1980 and Hooey, 1992). They include:

- **Currency devaluation**. It is designed to restore a balance between import and export in a country. According to classical economists, currency devaluation encourages exports by lowering the price of export goods, and restricts imports by increasing the price of import goods. The two movements in opposite direction, in turn, will improve the balance of payment.

- **Restoration of the market mechanism** including trade liberalization, phasing out tariffs and subsidiaries. This condition is based on the orthodox principle of "government get out". The goal is to diminish the state's restriction of international trade and interference in domestic economy.

- **Demand management measures** including freezing or reducing wages, cutting state expenditures, including social welfare and the education budget. These measures are aimed at controlling an over-ambitious economic expansion, and curbing inflation. According to The Bank, fiscal policy is the quickest but not the least painful form of adjustment because of its effect in domestic demand. But growing fiscal deficits have reducing implications for three key macroeconomic targets: debt, inflation and the growth rate of the economy (World Bank, 1991:22). The interesting thing here is that this policy measure actually was borrowed from Keynes' economic theory, which emphasizes the role of the state in national economic management.

- **Privatization of state owned enterprises**. Classical economists believe that public ownership and state interference is the origin of inefficiency. While all chosen policy instruments are directed at decreasing the influence of the government in the economy, privatization aims at fundamentally changing the social structure, from a state-led economy into a market-oriented system in which private enterprises competitively operate and adjust their activities according to price signals in a free market.

These policy measures clearly show that the IMF intends to guide the world economy towards to a neo-liberal model of development.

The key instrument of the IMF for carrying out SAP is "conditionality" for lending. If a country is forced by its debt to ask for assistance, the IMF always gives the country a "letter of intent" in which all preconditions for borrowing are included. Although specific terms and conditions necessarily vary from country to country, key conditions for structural adjustment lending adhere to the above-mentioned policies (Kolko, 1988).

Lending conditionalities rarely deviate from a set formula, regardless of the situation in different countries. A country can get a loan only if it abides with these conditions. Hence the IMF is able to strongly influence the recipient country's policies and economic strategy in three ways:

(1) by imposing conditionality, on the basis, the IMF can help formulate policy changes in recipient countries;

(2) by legally providing advice and consolidating reforms based on a lending contract after an adjustment program is initiated;

(3) the release of borrowed funds contingent on fulfillment of pre-agreed conditions. For example, the structural adjustment loan may be conditioned upon completion

of 20% currency devaluation. If this condition is not met within an agreed-upon time, the borrowing government has to meet the IMF to resolve the difficulties prior to release of subsequent funds (Bruon, 1990).

The "conditionality" clause became a crucial negotiable instrument for the IMF to force each country, especially developing countries, to "adjust" its economic structure to the design of the IMF. After the first program, more and more complex and stringent conditionalities were attached to IMF loans. Statistics show that the first structural adjustment loan (SAL) in 1980 had 9 conditions; The second SAL (in 1982) had 42 conditions. The average number of conditions increased from 27 in 1985 to 56 in 1989 (World Bank, 1992:33-48). In fact, through the 'conditionality" clause for lending, the IMF "took the place of the gold standards", deciding "which payment deficits were 'temporary' or 'fundamental', and which 'legitimate' and 'illegitimate'. With its power of lending, it disciplined the players in the world economy" (Moffit, 1989).

2.4. Summary

SAP is a policy lending program initiated by the world Bank and the IMF to overcome the global crisis caused by the emergence of a world productive system. "Free Market" and "free trade" are the policy foundation of SAP.

The World Bank and the IMF use neo-classical economics to explain the global crisis. They argue that the state intervention in economic activities and protectionism in the world trade destroy the free market system and has cause the global crisis. They insist that there is no conflict of interest between developed and developing countries under the free market and free trade system. All countries will benefit because free competition brings about the lowest costs for products everywhere. They conclude that the only way to overcome the crisis is to restructure the world economy into a neo-liberal world order on the basis of "getting prices right".

With their strong lending power, the World Bank and the IMF use Conditionality clause as a tool to force borrowing countries to carry out a package of neo-classical policies under SAP and to shape their development in a Neo-liberal model.

CHAPTER III

IMPORT SUBSTITUTION INDUSTRIALIZATION ANDBRAZIL'S ECONOMIC DEVELOPMENT IN THE 1950S

3.1. A PROFITABLE AND VULNERABLE COLONIAL ECONOMY BEFORE W.W.II.

Before World War Two, Brazil economy was a typical colonial agriculture-dominated economy. Two-thirds of its agricultural production was exported. This colonial economy had two basic characteristics. One was its reliance on single primary product export. The other was its reliance on import of manufacturing goods from industrial countries.

In the late nineteenth century, Brazil's exports were concentrated on several few products, especially coffee. Brazil was the major supplier of the world coffee market. Coffee exports accounted for more than half of total exports from 1889 to 1893 (Evans, 1979:58). Due to the significant proportion of coffee in total exports, the increase and decrease of demand for coffee in the world market directly influenced Brazil's balance of payments, and consequently determined the growth rate of the GDP. Brazil's economy was vividly described by Evans as follows:

> "Bags of coffee, loaded onto ships docked in the port of Santos, were Brazil's link to the international economy of the late nineteenth and early twentieth centuries." (Evans, 1979:55)

As the consequence of a single primary product economy, Brazil was very reliant on imports from industrial countries for its manufacturing goods. During the late nineteenth and early twentieth century, Brazil imported most of its manufactured goods from Britain. Through its exports and imports, the Brazilian economy was closely linked to and dependent on the international market.

As much of the literature points out, Brazil's coffee economy provided a model of a centre-periphery world economic system provided by dependency theorists in their analysis. As the major coffee producer and exporter to Britain, Brazil functioned as a primary agriculture product provider and industrial products consumer in the international division of labour.

Because the international coffee market continued to expand during the late nineteenth century, the high demand for coffee dramatically increased coffee production in Brazil. The boom of the coffee economy brought both Britain and local coffee planters large profits. And a part of these profits was used to develop manufacturing in Brazil.

While the surplus of coffee economy provided the original capital accumulation for manufacturing, the basic fact of broad size in terms of territory and population also provided a possibility for development of domestic manufacturing in a colonial economic structure. In a big country such as Brazil, it was impossible for Portugal, the suzerain country, to control the whole domestic market, which left room for domestic industries to be born and grow up. However, domestic manufacturing developed under the pressure of colonial rule and depended on foreign capital and technology, and was not allowed to be strong enough to fundamentally change the colonial structure as a whole. In a position of weakness, when pressures increased, the Brazilian state and local capitalists formed an alliance with foreign capital for the exploitation of domestic resources.

Although profitable, the Brazilian economy was vulnerable because of its reliance on the export of a single primary product. During the Great Depression, the world market for primary products, especially food and agricultural raw materials, shrank. Between 1929 to 1931, for the New York price of top grade Brazilian coffee dropped by 60% (Evans, 1979:58);the market for coffee was no longer expanding. Meanwhile new competitors stepped into the world coffee market and Brazil steadily lost its share of the world market. At the same time, with the supply restriction by industrial countries during the second world war, imports of manufacturing goods were also difficult for Brazil. Brazil's colonial economy was shaken by the recession of the world market. It was obvious that if Brazil were to continue to develop under these conditions of classical dependence, its economy would continue to fluctuate with the periodical crises in the world market.

3.2 The Theory of ISI in the 1950s

Under the threat of collapse of the economy due to the shrinking international coffee market, Brazil began to consider a new way of development. ISI was put forward and carried out in the 1950s in order to change its vulnerable economic structure and to bring about industrialization.

The basic thinking of ISI was formulated by Paul Prebisch, one of the founders of development economics. The starting point of his theory is relations of a colonial economy with the external world (Pastor, 1984:24-27). According to this theory, there were basically two groups of countries in the world economy. One was classified as dependent -- development conditioned by the development and expansion of another economy (dos Santos, 1970:236). The other group included industrial or core countries which played the central role in the world economy.

Relations between the two groups were not equal because of their different positions in the international economy. Usually, dependent countries like Brazil specialized in the production of single or a few primary agricultural goods. They were involved in the international market as a provider of a few primary products. The income from these few products constituted them major resources and was absolutely critical to the process of their initial capital accumulation which was at the base of the industrialization process. However, their exports of primary products depended on the demand for their products in the international market. In other words, "the development of the dependent country requires the continued acceptance of its products in the centre"(Evans, 1979:58). In this sense, the development of dependent countries was conditioned by the core countries. As the economy in the centre fluctuated, so did those of the dependent countries. Under the condition of this relation, the latter had no alternative but to escape from the former's influence.

At the opposite end of the spectrum, the core countries usually had strong and diversified industries. They imported raw materials and agricultural products from different dependent countries. Even one kind of product can usually be obtained from several different sources. Each product produced by one dependent country represented only a tiny fraction of total imports by core countries. Therefore, an economic crisis in the periphery would not severely threaten economies in the centre.

Such a division of labour in the international economic system placed the core countries in an absolutely superior and controlling position, and the dependent countries in a controlled and subordinate one. Dependence, in this context is defined simply as a situation in which the rate and direction of accumulation are externally conditioned by the core countries (Evans, 1979:27-28).

In the central-periphery international order, this unequal relation was mainly realized and strengthened through unequal trade exchanges. Core countries controlled prices though their monopoly of the industrial products in the world market, raising prices when they exported their industrial products to periphery countries and cut off prices when they imported raw and process materials from developing countries. Through this unequal exchange, profits flew into the countries on the periphery and entrapped dependent countries into an abyss of suffering. Dependency theory attributed the poverty and backwardness in developing countries to this unequal relation between periphery countries and core countries, and asserted that the only way for dependent countries to get rid of their backward economy was to break this unequal link between the two groups by establishing a self-sustaining system based on diversified industries. As a practical way to break out of this unequal relation, it encouraged dependent countries to protect their own industries and to substitute (set up domestic production) for imports through governmental control of imports.

The Economic Commission for Latin America (ECLA) used this theory to explain Brazil's economic situation, attributing Brazil's economic backwardness and crisis in the Great Depression to a colonial economic structure based on single primary goods export, and the lack of an industrial base (Syvrud, 1974:12). It suggested an import substitution industrialization strategy (ISI) to bring about a radical change in Brazil's economic structure. By this time Brazilian policy makers were convinced that high rates of economic growth could ultimately be obtained only by such a change.

3.3. PERFORMANCE OF ISI IN THE 1950S

The most important economic policy instruments used by the Brazilian Government in the 1950s to stimulate industrialization can be classified into three categories: (i) import control; (ii) foreign exchange control; and (iii) state investment in key industries. In this part, I will first briefly discuss each of these measures, then examine the nature and outcomes of the ISI strategy as a whole.

Import control

Import control was the most important instrument in the ISI strategy. It was aimed at restriction the import of goods and shielding the domestic market for domestic infant industries in areas previous dependent on imports, protecting them from stronger foreign competitors. It was expected that the domestic industry system would grow up under such a protection, and would finally be strong enough to replace the foreign imports. Import control was realized in Brazil mainly through direct quantitative import restrictions and indirect tax policies -- preclusive tariffs.

Quantitative import restriction was a straightforward measure not requiring any further explanation. The only thing that should be emphasized is that industries being restricted from import mainly involved consumer goods and manufacturing goods which could be and were planned to be produced in Brazil.

Preclusive tariffs were imposed with two goals. One was the same as quantitative import restriction -- protecting adequately the newly stimulated industries. The other was to attract foreign capital investment in such industries. The Tariff Law, SUMOC Institution 113, issued in 1956, obviously favoured foreign investors who invested in stimulated industries. A lower tariff rate was applied if they imported capital equipment in such industries. The later Tariff Law of 1957 expanded and solidified the protection offered to the growing domestic industry. For industries that were not favoured, tariffs were usually as high as 60,80 and 150 percent (Syvrud, 1974).

Both quantitative restriction and preclusive tariffs favoured products such as raw materials and equipment, which were considered essential for production and capital formation.

Foreign Exchange Rate Control

In the mid-nineteen fifties, the exchange system in Brazil was not only regarded as an instrument to cope with balance-of-payments difficulties as before, but more as a principal policy instrument to stimulate the great ISI drive in order to realize a radical change in the structure of the Brazilian economy. The exchange rate was purposely manipulated to protect favoured domestic industries.

The main measure of foreign exchange control executed in Brazil was the preferential exchange rate system. In the 1950's Brazil's exchange system was changed into a multiple exchange rate system, in which, imported goods were classified into two categories. A "general category" included the imports of raw materials, capital goods and certain essential consumer goods considered to be of essential and high priority, while the other "specific category" included all goods not considered essential. An special low exchange rate called "cambio de costo" was maintained for the importation of goods in the first category. Interest and amortization payments for loans were also provided for these imports(Bear, 1965:55-60). However, the price of foreign exchange for imported goods in the "special category"' would rise up to twice or three times as much as the rates of the general categories.

From the following table, it is clear that preferential exchange rate was granted mainly to equipment, petroleum and wheat products in the late half of the 1950s.

Table 3.1 Allocation of the Preferential Exchange Rate

(1955- 1960)

(Percentages)

Year	Equipment	Petroleum	wheat	Newsprint	Others
1955	46	27	20	6	1
1956	50	32	13	4	1
1957	54	28	11	5	2
1958	52	28	12	4	2
1959	57	24	14	3	2
1960	57	23	13	3	4

Source: Computed from data supplied by the research Division of SUMOC.

Investments of Government in Key Sectors

While the previous two policy instruments emphasized the protection of domestic favoured industries from competition of industrial countries, the third policy aimed to establish and strengthen domestic industries in a short period.

Governmental investments was overwhelmingly concentrated into several key sectors, such as electricity, transportation and "basic industries", in such fields as steel and petroleum, chemicals and nonferrous metal industries.

This investment distribution was a direct result of the ideology of import substitution. It was believed that a solid and diversified domestic productive capacity in several key industries was essential to modern economy and would reduce, if not end, Brazilian dependence on foreign trade and foreign lenders. With the establishment and expansion of domestic industries, Brazil wished to exclude foreign investors from control of certain sectors of the national economy (Leff, 1968:45-47).

Through intensive investments, the public sector's share in total national aggregate fixed capital increased rapidly from 15.8 percent in 1947 to 51.2 percent in 1958 (See table 3.2). In order to realize capital accumulation in public industrial sectors over a short period, in addition to expanding direct investment in public corporations, the government also offered indirect subsidies to industry through delayed payment of taxes at reduced real values. Meanwhile the tax imposed on agricultural goods was twice that on manufacturing goods.

Table 3.2 Public Sector's Share of Aggregate Fixed Capital Formation in Brazil, 1947-1960

Year	Percentage	Three-Year Moving Average
1947	15.8	--
1948	23.3	22.8
1949	29.4	29.3
1950	35.1	29.8
1951	25.0	29.0
1952	26.8	27.0
1953	29.4	26.8
1954	24.3	25.9
1955	24.0	25.4
1956	27.9	32.5
1957	45.6	41.6
1958	51.2	47.8
1959	46.5	52.2
1960	58.8	--

Source: Calculated from data published in Review of Brazilian Economy. (March 1962).

The set of policy instruments pursued by Brazilian governments to promote rapid industrialization proved to be highly effective in expanding industrial investment and in stimulating rapid economic growth. During the period from 1947 to 1961, the Brazil's gross domestic product grew at an average annual rate of 7.2 (Syvrud, 1974:16). which was the highest rate in the world. By 1962, Brazil had advanced toward its industrialization objective and became famous as a successful newly industrialized country.

A more important achievement of Brazil in the 1950's was based on the transformation of its economic structure. With the ISI strategy, it realized three shifts:

(1) From an agricultural dominated economy to an industry-leading economy. Through ISI Brazil successfully established its modern industrial framework. The share of industries in GDP continued to increase. By 1959, it surpassed the share of agriculture by almost 10 percent (see Table 3.3).

Table 3.3 Change in Sectoral Composition of GDP

Year	Agriculture (%)	Industry(%)	Service*(%)
1939	25.8	19.4	54.8
1949	26.0	26.2	47.8
1959	20.2	30.1	49.7

* Service includes government, transport and communication, financial intermediaries and rent, as well as commerce.
Source: IBGE 1972:516

As industry took over the predominant position previously held by agriculture, the industrial structure also significantly changed. With the stimulation of import substitution policy, new industries such as transportation equipment, electrical equipment Fabrication, chemicals and machinery dramatically developed, and replaced traditional industries such as food and textiles as the central core of the industrial structure.

(2) <u>From a single primary product export economy into a more diversified export economy</u>. The proportion of coffee dropped from 73% of exports in 1920's to 53% of exports in the 1960's. Meantime Brazil began to export manufactures, although in the 1960s they comprised of a tiny proportion (2%) of total exports (Evans, 1979:67). The import structure changed more quickly than the export structure. Capital goods, raw materials and intermediary products replaced non durable consumer goods as the bulk of imports. This diversified trend was also reflected in the increase of the number of suppliers of imported goods and export customers.

(3) <u>From an open colonial economy into a more closed self-reliance economy</u>. As the growth of domestic industries, overall reliance on imports and exports diminished. The proportion of exports in the gross domestic products sharply decreased from 24.9 % in 1907 to 7.0% in 1960, and import from 18.7% to 8.5% over the same period. The rise of new industries also diminished the dependence on foreign manufactured goods. According to Evans, in electrical machinery, imports decreased from over five times of local production in 1949 to less than 25% in 1962; in chemicals, form almost nine times local production to about 30% (Evans, 1979:72).

Following the development of industry, domestic purchasing power increased rapidly, which largely stimulated the demand for various consumer goods and significantly expanded the domestic market.

3.4. ANALYSIS OF THE ISI STRATEGY

The main policy instruments in Brazil's industrialization drive were based on a radical commitment to ISI. All policies were directed at diverting resources, including domestic and foreign resources into industrial capital formation. All protective measures and subsidies changed relative prices and earnings in favour of industry. In other words, capital accumulation and rapid industrial growth in Brazil was realized through moving profits of other non-industrial sectors into industrial sectors (Syvrud, 1974:24-26).

Another characteristic of Brazilian industrialization was "state control". The Brazilian government played an essential role in the ISI process. Of the three major policy instruments-- import control, foreign exchange control and government investments--all were under the control of the government. The government functioned in a wide range of production and investment activities. An ECLA study of Brazilian economic policy presents this picture:

> Brazil's public sector owns ... the country's maritime...rail transport facilities and its installations for the production of petroleum...controls most of the steel-making sector, and is rapidly becoming the principal producer of electric energy. It...markets a considerable proportion

of the exportable production;it is also the principal iron ore producer and exporter.It exercises direct...control over the exchange market,... It constitutes.. the major commercial banking enterprises since it accounts for about 35 percent of the general credit extended to the private sector through the Banco Do Brazil, and most of the agricultural credit.. through other specialized financial agencies it grants the whole of cooperative credit and long-term financing. It establishes wages, interest rates, rents, and is beginning to... operate a large scale storage and marketing system for agricultural commodities...It determines the composition of private investment and intervenes in the capital market" (ECLA, 1964:196-197).

Combining these two characteristics, it is easy to see that ISI in brazil in nature was a process in which high-speed accumulation in industry was realized through forced saving and redistribution of national resources under the direction of a non-economic agency--the state, rather than a natural accumulation based on the gradual increase of national capital. The growth of industry, to a large extent, was based on an increase of the public sector stimulated by protectionist policies.

The pattern of Brazil's development, the transformation of its economic structure, and its performance, showed this strategy to be effective, but it required and worked only under certain conditions. To explain this point more clearly, it is necessary to review the internal and external conditions faced by Brazil before ISI. The key internal condition in Brazil at that time was the backwardness of its economy. As discussed in first part of this chapter, Brazil had an agricultural economy with extremely weak industry before the 1940s. Although a few manufacturing industries emerged on the basis of reinvested their profit from coffee exports, they struggled to survive and grow between the cracks of foreign capital, were vulnerable and grew slowly. This backward economy was not able to provide enough capital for the initial capital accumulation required by a speedy industrialization, which created a serious dilemma for Brazil's development. On the one hand, Brazil needed rapid capital accumulation for industrialization in order to break the control of colonial rules, catch up and surpass industrial countries; On the other hand, it faced an extreme scarcity of capital. Thinking about the big size in territory and population, it was obvious that Brazil could not completely rely on foreign aid or debt to finish initial capital accumulation. How could Brazil resolve the contradiction between demand and supply of capital on the base of self-reliance? One option was market with natural capital accumulation, but it would involve a long and painful development process.

In considering the external conditions Before ISI, the impossibility for Brazil to industrialize in a normal way becomes more apparent. In development of Brazil, as a provider of primary products within the international labour division, was controlled by international capital. The most important element in the external conditions is that it faced the strong industrial world which had been developing for several decades. They had abundant capital, high-level technologies and were in a dominant position in the world market. More importantly, they were reluctant to lose their power and to change the existing economic order in which they enjoyed many advantages. Under such conditions, a normal process of industrialization in Brazil could not be successful since any efforts to industrialize in this way would be easily pressed down by this strong outside force. In other words, Brazil, under these specific internal and external conditions needed a force strong enough to protect its development and industrialization.

In brief, both internal and external conditions had forced Brazil to find a non-economic force to break the economic pressure. To some extent, this was a political target rather than an economic target. While in a weak economic position, Brazil could not rely on the market to reach its target -- speedy industrialization. In contrast, the state, being a strong non-market force, was able to generate a rapid process of capital accumulation through a non-market way--forced saving and the redistribution of limited national resources, which provided Brazil with the ability to collect a relative large mass of capital in some key sectors in a short period. Brazil's success in 1950's evidenced the effectiveness of this strategy. Three shifts in Brazil's economic structure helped Brazil to break its controlling-controlled links in the traditional international labour division, and furnished basic conditions for its further self-reliant development. This achievement and the role of the ISI strategy in Brazilian industrialization process should not be ignored.

However, while the ISI strategy successfully changed the colonial structure of Brazil, through the establishment of the national industry and the expansion of the domestic market, it proved to be effective only under specific conditions in the short run. It had latent limits for long-term development due to its "single-mindedness" and the prevalence of "non-economic" instruments. The main problems which have been discussed in the literature were inefficiency (Packenham, 1976) and the ignoring of other goals in the development process, such as macro-economic balance, equitable income distribution and other social objectives, such as better housing and improvement of educational opportunities, etc. (Packenham, 1976).

It has been argued by many economists that these internal weaknesses of ISI led to significant disparities in regional, sectoral and social distributions of income, increased deficits and high inflation, all factors associated with Brazilian growth in 1950s. These problems finally blocked brazil's continued development and exhausted its potential, leading to a period of stagnation after 1973 with a lower growth rate, an astonishing high rate of inflation, and large deficits in the balance of payments (Syvrud,1974).

But this is an argument that looks only at the surface of things. Although it is true that the ISI strategy had weaknesses, most of them were a legacy of the colonial economic structure. To some extent, these weaknesses are unavoidable in the transformation of a colonial economy into a modern industrialized economy. In this sense, ISI was not a perfect or the best strategy in theory, but the more practical and best choice under the given conditions.

Taking the example of ignorance of development in agricultural sector (Syvrud, 1974), considering the processes of initial capital accumulation in different economically backward countries, it is obvious that such a process and form of capital accumulation was common in colonial economies. It is not because non-economic accumulation is the best way, but because drawing profit from the agricultural sector to the industrial sectors is almost the only choice under the unfavourable internal and external conditions formed within the traditional colonial economic structure. There was almost no other capital resources to finance a self-reliant industrialization. Without the temporary sacrifice of agriculture, the basic industrial framework would have not have been established in a short period, and Brazil would have retained a colonial economic structure for a longer time. In this sense, this weakness ultimately came from the colonial economy itself.

With respect to the large deficit, as mentioned before, historically the Brazilian economy had a close link with the international economy. Although the ISI strategy fundamentally changed classical dependency of Brazil on foreign capital, it is impossible to completely cut off such links in a short period of less than ten years. A self-reliant economy needed a strong industrial base and a broad domestic market which took time to build up. This transformation could only occur in a gradual historical process. From the same statistics recited above concerning the structure and composition of foreign trade, it can be seen that although mono-cultural exports was diminished, most exports still consisted of agricultural goods. In the import side, Brazil still needed large amounts of imports for its industrialization because of the weakness of domestic industry, although the composition of imports dramatically changed from consumer goods to capital goods. This imbalance between imports and exports also originated in the limits of the colonial economic structure itself, and was the main reason for the accumulation of large deficits.

A similar situation applied to the high inflation rate which was actually used as a tool of forced saving for industrialization. In brief, the weaknesses of the ISI strategy was fundamentally rooted in, and reflected the limits, the backwardness and dependence of the colonial economic structure. The influence of this residual colonial economy appeared in a form of limitations built into ISI.

3.5 Conclusion

ISI is an inward-oriented strategy of self-reliant development based on state intervention. Under this strategy Brazil successfully changed its colonial economic structure into an industry-leading economy through the establishment of national industry and the expansion of the domestic market under the state intervention. State intervention was proved a necessary and effective way to break the controlling - controlled links in the traditional labour division, and to finish the initiate capital accumulation needed for speedy industrialization in a developing country with limit capital resources.

Although the ISI strategy had latent limits for long-term development due to its "single-mindedness" and the prevalence of "non-economic" instruments, it provided Brazil a solid industrial basis for an independent development. In nature, the weaknesses of ISI were fundamentally rooted in and reflected the limits, the backwardness and dependence of the colonial economic structure.

CHAPTER IV

THE STABILIZATION STRATEGY IN THE 1960'S AND THE ECONOMIC MIRACLE

4.1. STRATEGIC OPTIONS IN THE 1960S

Stagnation after 1962 led to critical examination of the import substitution industrialization strategy in the 1950s. Two main schools of thought formed on the causes of stagnation. One school emphasised the weaknesses of traditional society, they attributed the stagnation to the limited market which resulted from the unchanged traditional society while ISI was processed (Furtado, 1968). The other school emphasised the improper policies involved in ISI. They believed that stagnation was the result of the distortions of the unbalanced growth process, caused by government interference (Simonsen 1969).

As far as concrete policies are concerned, four major strategic options for stabilizing the Brazilian economy at that time were well summarized by Donald E. Syvrud as follows:

> 1. To continue the trend toward greater centralization of economic decision making in the public sector or to reverse this trend and provide greater opportunity for the price mechanism and private sector initiative;
>
> 2.To continue the unbalance growth of import substitution industrialization or to shift to a more balanced economic growth with several leading sectors;
>
> 3.To continue protectionist trade policies or to liberalize foreign trade policies toward an expanding role in world trade;
>
> 4.To continue the emphasis on rapid economic growth at the expense of social objectives or to aim at a greater balance in social and economic objectives at the cost of dampening the growth rate" (Syvrud, 1974:37).

The economists who determined Brazil's policies after 1964 were comprised of a team of professional experts who were strongly influenced by neo-classical economics. They attributed the decline of the economy to the unbalanced form of development, especially the ISI policies such as inflation and price controls, the overvalued exchange rate, a selective investment policy, rigid control in exports and imports, and so on. Given the severity of the imbalances and distortions in the economy, they believed that the stabilization measures recommended by the IMF and structural changes in Brazilian economy were essential conditions for a resumption of growth.

Starting from this basic thinking, the team of economists emphasized the need to stimulate investments in the private sector and to give greater scope to the free price mechanism; They turned away from import substitution industrialization towards investment in agriculture, housing and exports sectors. They decided to move gradually toward to a more liberal foreign trade policy; to put more emphasis on increasing productivity and efficiency in the economic system; and gave social objectives such as equitable income distribution on a sectoral basis more consideration. The economic strategy of the Castello Branco government was first outlined in the Action Program for 1964-1966 (Higgins, 1964). The economic social policy objectives demonstrated in it included: a) accelerating the rhythm of economic development, aiming at 6 percent growth rate by 1966 and 7 percent in succeeding years; b) countering progressively the inflationary process during 1964 and 1965 so as to achieve a reasonable degree of price equilibrium in 1966, which, translated into specific numbers, meant a price target of 25% in 1965 and 10 percent in 1966. c) alleviating the sectoral and regional disparities and the tensions created by social disequilibrium so as to improve the standard of living; d) assuring, through investment policy, opportunities for productive employment; e) correcting the tendency for uncontrolled balance of payments deficit (Action Program, 1964:15).

Although the option of Castello Branco government obviously favoured neoclassical theory, it was not a simple application of this theory. Related government documents indicated that ISI still the foundation of the government's stabilization program.

While emphasizing the stimulation of investment in the private sector, the crucial role of the state in national economy was not given up. State enterprises and the public sectors was still the dominate force in the expansion of key industrial sectors, including the power supply, transportation system, urban infrastructure, and heavy industries --especially steel, mining, and petrochemicals. Whereas private sector investments were required to satisfy the social objectives announced by the government such as providing more equitable income distribution on a regional, sectoral, and personal basis. In other words, private sector firms operated their businesses not completely on the basis of free market principles, but under the direction of the state. The state was still a vital force in Brazil's economic development.

While considering productivity and efficiency, high-speed growth was still the most important goal of economic development. The target growth rate per year of Brazil during that period was set at 7%.

While shifting to a more liberal foreign trade policy, selective protection for some basic industries was still considered necessary and was continued in the forms of taxation and credit privilege.

While adopting classical methods to correct the distortions in the price structure, Brazil rejected the shock treatment recommended by the IMF, which was generally a monetarist solution. Theoretically speaking, gradualism was a structuralist approach. Structuralists believed that

> the shock treatment required for stability might well result in drastic unemployment, cutback of essential investment programs of the government, or restriction of credit to such a degree that financial panic and business failures would ensue" (Syvrus, 1974:42).

Therefore, Brazil's option was, in nature, a combination of structuralism and neo-classicism. One the one hand, it continued to protect domestic industries and strengthen their capacity of production though an ISI strategy. On the other hand, it carried out neo-classical economic policies for deflation, as well adjustment of resources distribution imbalances. This joint strategy was a product of compromise between the liberal theoretical framework of stabilization and Brazilian economic and political realities. It was based predominantly on an assessment of what was economically, politically and administratively feasible in the Brazilian context.

In short, the strategic option of stabilization program in 1964 was a mixture of classical economic analysis, state intervention and effective constraints. As we well known, this approach was clearly reflected in the main policies of the stabilization program.

4.2. PERFORMANCE OF THE STABILIZATION PROGRAM

All policies in the stabilization program were designed to stop inflation, promote exports and reduce deficits in the balance of payments. The overall goal was to resume high-speed growth.

The immediate problem confronting the Castello Branco government was to stop inflation, which during the first three months of 1964 reached an annual rate of 140% (Syvrud, 1974:37). A set of typical financial policies for stabilization were adopted: a curtailment of government expenditures, an increase of tax revenues, a tightening of credit, and squeezing the wage sector. These policies were designed to reduce the demand for consumer goods, so deflating the price level. At same time tight monetary and credit policies were associated with financial policy as a residual instrument.

Foreign trade policy was considered to be central importance by post-1964 governments as a means of reducing the deficit in the balance of payments. The rapid growth and diversification of exports was deemed essential to the recovery and long-term health of the Brazilian economy. To achieve these goals the government adopted a number of policies, including the abolition of state export taxes, simplification of administrative procedures for exporters, and the introduction of tax incentives and subsidized credit.

To reduce state subsidies to public sectors, Brazil made a great effort to modernize and strengthen its capital markets (Bare, 1976:48). In addition, Tax incentives were used to influence the allocation of resources among regions and sectors.

Another significant policy was to maintain government investments. Government investment expenditures were never cut back duri g the stabilization years. Existing infrastructure projects were continued. This policy, theoretically speaking, was in the opposite direction to other policies for stabilization. It reflected the eager desire of the Brazilian government to increase the growth rate.

It is well known that the stabilization program adopted in 1964 brought a remarkable seven-year boom in Brazil beginning in 1968 -- the famous "economic miracle". Here I will just briefly review four important aspects of the national economy related to the goals of Brazilian stabilization: the gross domestic product(GDP), the rate of inflation, foreign trade and investment in fixed capital.

The average annual growth rate of the GDF in the period of "economic miracle" was 11.4% (see Table 4.1), which was the highest among all countries in the world at the time.

Table 4.1 Growth Rate of Real GDP, Real GDP Per Capita, Industry and Inflation (Percentages)

Years	Real GDP	Real GDP Per Capita	Industry	Inflation
1968	9.3	6.3	15.0	82.2
1969	9.0	5.9	11.0	20.2
1970	9.5	6.4	11.1	22.1
1971	11.3	8.2	11.2	20.5
1972	10.4	7.3	13.8	18.4
1973	11.4	8.3	15.0	16.1
1974	9.6	6.5	8.2	19.5

Source: calculated from IMF, International Financial Statistics, selected issues.

This remarkable growth was an industry-led growth (see Table 4.1). Industry was expanding at an average growth rate of 12.2% per annum, peaking in 1973 at 15%. The growth rate in industry was much higher than in other sectors. Further observation on the growth rate within industrial sectors explained the structural development of Brazilian industry over this period. The highest growth rates were achieved by such sub-sectors as transportation equipment, machinery and electrical equipment, while traditional sectors like textiles, clothing, and food products experienced much slower rates of growth (see Table 4.2). In other words, the expansion of Brazilian industries was concentrated in consumer durable goods and chemicals sectors, which grew at an impressive rate of 22.9% per year.

As far as Brazil's foreign trade position is concerned, the post-1964 policies, in contrast to the policy in the 1950s, opened the economy to foreign trade. External trade grew at rates substantially higher than the growth of the economy as a whole. In the years 1970/73 the average yearly growth rate of exports was 14.7% and the growth rate of imports was 21%. Export volume more than doubled. The purchasing power of exports rose 151.% (Syvrud, 1974:44).

Table 4.2 Average Annual Growth Rate of Individual Sectors
(percent)

	1968-79	1971	1972	1973	1974
Nonmetal minerals	17.3	11.1	13.7	16.4	15.1
Metal products	14.4	5.6	12.1	6.3	4.3
Machinery	22.7	3.6	18.9	27.8	11.6
Electrical equipment	13.4	21.3			
Transport equipment	32.6	19.0	22.5	27.6	19.1
Paper and paper products	9.1	6.3	7.0	10.1	3.5
Rubber products	15.3	11.8	13.0	12.4	10.5
Chemicals	15.6	13.6	16.3	22.3	8.5
Textiles	7.4	8.8	4.1	8.4	-2.8
Clothing, shoes, etc.	1.7	-1.8			
Food products	8.3	3.6	13.3	9.6	4.4
Beverages	8.2	4.8			
Tobacco	9.6	5.7			
Total Manufacturing	14.2	11.6	13.6	15.8	7.1
Construction	14.4	8.4	13.0	15.4[a]	11.2[a]
Public utilities	12.2	N.A.	11.1	12.5[a]	12.0[a]

a: Estimates based on January-November results in 1973 and 1974
N.A. = Not available
Source: Same as Table 4.1

The rate of inflation declined from 8.2% in 1964 to 16.1% in 1973. Investments in fixed capital increased from 16.2% of GDP in 1967 to 21.4% in 1973.

The structure of exports and imports was continuously diversified in the 1970's. Coffee exports as a percentage of total exports declined to 12.6 percent in 1974; sugar rose from 5.0 percent in 1965-69 to 15.8 percent in 1974; manufactures increased to 27.7 percent; soybeans which were not a part of Brazil's export structure in the mid-1960s stood at 7.4 percent in 1974. The import commodity structure was noted for the growth of capital goods, whose portion of total imports rose from about 31 percent in the mid-1960s to about 40 percent in the mid-1970s (Bare 1976:48).

Table 4.3 Export Commodity Structure (percent)

	1965-69	1968-72	1973	1974
Coffee	42.0	32.6	21.7	12.6
Iron ore	6.1	6.7	5.9	7.2
Soybean	---	1.6	8.0	7.4
Sugar	5.0	6.5	8.9	15.8
Meat	1.9	3.3	3.1	0.9
Manufactures	7.2	15.8	22.0	27.7
Other	37.8	33.5	30.4	28.4
Total	100.0	100.0	100.0	100.0

Source: Piordan Roett (ed). Brazil in the Seventies, 1976, p.50.

Obviously, all important economic statistics regarding these four aspects showed a prosperous picture. Some economists were so optimistic that they predicted in the early 1970s that in later years Brazil would surpass Britain (Jaguaribe, 1973:462). However, a closer look at the change in Brazilian economic structure showed another side to this economic boom: a deeper involvement in the international economy.

First, as the Brazilian economy was opened to the international market, national industries were gradually internationalized. Vehicle industrialization in key sectors led to the internationalization of internal market. Secondly, Brazilian growth in this period was largely financed by the foreign capital. During the period from 1969-1973, foreign exchange reserves increased from $400 million to 6.8 billion. Both foreign debts and foreign direct investments increased rapidly. The net official and private capital inflow of direct investment grew from a yearly average of US$ 84 million in the period of 1965-69 to $ 977 and $944 million in the years 1973 and 1974, respectively. Net foreign loans increased more, from a yearly average of $604 million in 1965-69 to $4.5 and $6.6 billion in 1973 and 1974. Third, foreign trade played a more important role in the national economy. The foreign trade coefficients, that is the export/GDP and import/GDP ratios, were increased, especially in the early 1970s (see Table 4.4).

Table 4.4 Brazil's Export and Import Coefficients (percent)

	1950	1961	1964	1970	1971	1972	1973	1974
Export/GDP	9.2	6.0	5.1	5.0	6.0	7.0	8.0	8.0
Import/GDP	7.4	7.4	5.4	6.0	7.0	8.0	9.0	14.0

Source: Same as Table 4.3.

4.3. ANALYSIS OF THE STABILIZATION PROGRAM

In the discussion in Chapter two, I pointed out that the Brazilian stagnation before 1964 fundamentally came from the constraints of the colonial economy -- Lack of capital for the original accumulation needed for a rapid industrialization. These constraints were released by ISI with a redistribution of capital favouring the growth of industry. However, in both theory and practice, the expansion of reproduction in the long run was finally supported by an adequate increase in the rate of capital accumulation formed in the industrial sectors rather than by the redistribution of limited capital. Since the production circle of basic industries was longer than that of other sectors, internal accumulation needed more time. Before "development became a cumulative circular process creating its own expansionary momentum" (Furtado, 1965:108), ISI exhausted its potential. Therefore my conclusion in Chapter one was that although the expansion policy of ISI sharpened the contradictions in the process of ISI, economic stagnation with high inflation and seriously unbalanced income distribution before 1964 was rooted in the lack of capital and the needs for speedy industrialization.

Facing this practical obstacle to economic development, as in the 1950s, Brazil still had two options: reliance on international capital accumulation though the expansion of domestic industries and the market, which was the core thinking of ISI, or the pursuit of external capital and markets, which was supported by the stabilization strategy.

Brazil chose the latter as a means of resuming its high speed industrialization. The Discussion in the last section indicated that this strategy influenced Brazilian economic development in two ways: an astonishing growth rate and the internationalization of industry. Notwithstanding the positive impact of the former, the latter led Brazil's economy in the direction of dependent development.

Some literature used the export-oriented economy to describe the stabilization strategy. In my opinion, this is not accurate. The concept of "export-oriented" itself can only describe the framework of an economy, but not its nature and degree of dependency. There are possibly different kinds of developments under the export-oriented economic model. For example, the U.S.A. is an open economy which depends on foreign trade. However, it is in a position of economic power and independently stands in the international economy. But for some developing countries, the situation has been quite the opposite; their economies were significantly controlled in different ways by other countries. The nature of an open economy in term of dependency can be measured in two ways. One is the capacity of an economy to decide its own development strategy The other is the ability to adopt alternatives when external conditions change.

What is the nature of Brazilian development in the 1970s? Some scholars such as Ronald Chilcote, Marcio Moreira Alves and Helio Jaguaribe see Brazil as a prototype case of diluting or abandoning the quest for national autonomy in order to realize the benefits of capitalist industrialization and development[1]. Some other analysts such as Stefan Robock and Alastair Buchan, Robert A. Packenham hold a totally opposite view. They see Brazilian dependency to be waning and Brazil as on the way toward great power status. [2] In my opinion, Brazil experienced a transformation toward dependent development in its industrialization process. This conclusion implies two points:

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1 Ronald L. Chilcote. Book Review of Frank D.McCann, The Brazilian-American Alliance , 1937-1945. Princeton, New Hersey: Princeton University Press, 1973; Marcio Moreira Alves. A Grain of Mustard Seed: The Awakening of the Brazilian Revolution. Garden City, New York: Doubleday, Anchor, 1973; Helio Jaguaribe. Brazil: Crisis of Alternatives. Rio de Janeiro: Zahar 1974.

2 Stefan H. Robock. " Realizing the miracle", Saturday Review. Oct. 18,1975, p.30; Alastair Buchan.The End of the Postwar Era: A New Balance of World Power. London: Weidenfeld and Nicolson, 1974; Robert A. Packenham. Trends in Brazilian National Dependency Since 1964 . Washington, D.C.: American Enterprise Institute for Public Policy Research, 1976.

(1) Brazil was still an independent economy in the 1970s period of its development;

(2) Brazil was experiencing a transformation from an independent to a dependent form of development.

The real process of Brazilian economic growth in 1970s miracle was realized under the interaction of two forces: the independent elements of economic independent development and dependency.

Brazilian growth in the 1970s was largely due to the impact of government programs. Government expenditures as a proportion of GDP had grown from 17.1 percent in 1947 to 37.0 percent in 1973. The government sector accounted for over 60% percent of Brazilian fixed investment in 1969. State enterprises dominated key sectors such as steel, mining, and petrochemicals. They controlled over 80 percent of power-generating capacity and most of the public utilities. It has been estimated that in 1974 for the 100 largest firms, 74 percent of the combined assets belonged to state enterprises, While for the 5113 largest firms, only half as much -- 37 percent -- of the assets belonged to state enterprises (Bare, 1973).

The high degree of involvement of the Brazilian government in the industrialization process was the result of nationalism implied in the ISI Strategy. The dominant role of state in the 1970s economic development provided Brazil a solid basis for determining its own development strategy and main development policies. The combination choice of stabilization was an evidence of this power. Although strongly influenced by classical economics, it was not determined by external forces, but based on Brazil's economic and political reality. In practice, with a relatively stronger economic power Brazil played an important role in international economic and political activities, and was in a leading position in the third world during this period.

However, the Brazilian economy did not expand in a completely self-reliant way. From the discussion in Section two of this chapter, it is clear that foreign capital was more and more involved in Brazilian economy after 1964, eroding the independence which was half way towards self-sustained development. The consolidation of the internal market under ISI was followed by the internationalization of the domestic market under stabilization.

As mentioned in last section, the Brazilian economy has been much more open since 1964, leading to a dramatic expansion of external penetration. The most obvious development here was the Brazilian reliance on foreign capital. The yearly average of foreign debt in the years of 1960-1964 was less than $3 billion. In 1972 the figure reached $10 billion, and by the end of 1975, it was over 22 billion (Bara, 1976:94),increasing about seven times. Foreign direct investment also significantly increased from a yearly average of $70 million in 1960-1964 to $770 million in 1972-1974 (Bare, 1976:95), a tenfold increase. Both indicators experienced a significantly greater increase than the growth of the Brazilian economy as a whole. Over the same period, the national debt increased about sevenfold. Although there was is exact information about the proportion of foreign capital accounted for in the total capital formation, this phenomenon indicates the trend that more and more Brazilian capital accumulation was supported by the inflow of foreign capital, which in turn increased Brazil's dependency.

While more and more foreign capital entered the Brazilian economy, some residuals of the colonial structure could still be observed in the foreign trade structure. On the export side, as more diversified exports replaced single product exports, agricultural product exports were still 49%. Manufacturing exports mainly involved primary industrial products. On the import side, Brazil relied on the import of raw materials and equipment needed in the industrialization process. These imports were significant not because [illegible] lack of natural resources, but because of the limited development in raw material production. Because those imports were necessary inputs into the industrialization process, before domestic production capacity was strong enough to meet demand, the greater the industrial expansion, the greater need for such imports.

The increased reliance of the Brazilian economy on international capital and the world market undermined Brazil's ability search for and adoption of strategic alternatives policies when external conditions changed. In other words, as the degree of dependency increased, the Brazilian economy was placed in a vulnerable position. By 1974, external debts had reached US$ 22 billion (Cline, 1976:71), becoming one of the crucial obstacles in the process of Brazilian development.

This dependency of the Brazilian economy in the 1970s took a different form from a classical dependency in three aspects. First, this dependency was not realized with unequal international commodities exchange through the control of the prices, but with the direct investment of foreign capital through the control of production. Second, the direct political and economic control of core countries over colonial countries was replaced by an indirect control of economic power over the production process. Thirdly, the economic structure of peripheral countries changed from mono-cultural agricultural export to primary-manufacturing exports following the technology revolution which dramatically changed international economic relations.

This different picture of dependency was a product of the new international division of labour. As mentioned in the first chapter, in the 1970s the world economy was in the second phase of internationalization. Following the development of new technology, more and more traditional manufacturing moved to developing countries. Although the international division of labour shifted substantially on the surface, the fundamental effect remained the same. A theory of the "Product life cycle model" explains this point well: New products are to be first produced and sold in the centre, later produced in the centre and exported to the periphery, and finally produced in the periphery. Over time, more and more products will be manufactured in the periphery. However, production moves to the periphery only after the technology involved has become routinized. At this point, windfall profits associated with new products, had already been obtained by the centre. The peripheries are forced to rely on the low cost of their labour to maintain a comparative advantage in the international market, which leads to low living standards. The introduction of manufacturing on the peripheries lacks the traditional "multiplier effect" associated with manufacturing investments in the centre. Firms in dependent countries buy their equipment and other capital goods from the outside, so that the "multiplier effect" of new investments is transferred back to the centre. Increases in the output of export sectors do not feed back into the peripheral economy in the same way that they would feed back into a core economy (Evans, 1969). It is clear that such development will not benefit peripheries in self-accumulation. Evans defined such development as dependent development. The stabilization program in Brazil is a case in point.

Another important point in the Brazilian case was that such dependency development was realised through an alliance between the state and international capital. This feature developed from the combination choice of stabilization. The penetration of foreign capital could not be realized around the state because of the dominant role of the state in Brazil's development. Most direct investment of foreign capital, specially in key sectors dominated by public enterprise, took the form of joint ventures between multinationals and state enterprises.

A large amount of the debt also took the form of national loans which were then distributed to various groups. In this alliance, the state functioned in two ways: On the one side, acting as an independent element against multinationals, it protected the interest of the nation; on the other hand, as a profit sharer it submitted to the demands of international capital.

The last question about stabilization is: "how could the Brazilian economy achieve such a positive result while in such a vulnerable position? The answer is that the Brazilian economy was operating under favourable internal and external conditions. Within the country, a relatively strong industrial base was already established in the ISI period. Meanwhile external conditions were favourable to the development of Brazil. The world economy, especially the industrial world, was expanding. Output growth increased dramatically in the advanced countries; world trade rapidly expanded; primary commodity prices improved. More important, the high liquidity in the international monetary system and, especially in the private banking system, provided Brazil with plenty of capital.

Under these conditions, the combination choice of stabilization took the advantages of both development strategies: with plenty of intentional capital supplies the economy boomed on the basis of the basic industrial infrastructure established in the ISI period. In this sense Brazil found a good balance between two opposite development strategies in resolving its dilemma in the industrialization process.

However, the potential weakness of stabilization was still there because of the lack of capacity for self-accumulation and over reliance on the foreign capital, Brazil was deprived of a lot of surplus generated in the country and transferred to the centre. Development was also constrained by the external environment, which would finally damage Brazilian economic development. The crisis after the two oil shocks exposed this weakness, dimming the shining achievement of the Economic Miracle.

CONCLUSION

The strategy of stabilization program introduced neo-classical principles and policies into Brazil and mixed them with ISI policies. Under a favourable international environment, this combined strategy worked very well in terms of economic growth, bringing about Brazil's famous "economic miracle". However, as this strategy opened Brazil's economy to the international market, Brazil's industries were gradually internationalized, and more and more dependent on foreign capital, the main financial resources for its industrialization process. As more and more foreign capital penetrated Brazil's economy, it gradually entered a new international division of labour and moved away from inward-oriented strategy of self-reliant development implied in ISI. Since then it has entered into a dependent development process. Brazil's economy, although growing at a high speed, was vulnerable to the external environment and became highly reliant on external capital.

CHAPTER V

STRUCTURAL ADJUSTMENT AND ECONOMIC DEVELOPMENT AFTER THE OIL CHOCKS

After the first oil shock, Brazil's external terms of trade deteriorated 18.2% in 1973/74 due to quarter-times increase of the oil price (See Table 5.1). This drastic deterioration in the external terms of trade (See table 5.2) resulted in a substantial deceleration of economic growth in Brazil. The growth rate of GDP significantly declined from 14% in 1973 to 9.0 % in 1974, and 5.2 % in 1975. (See Table 5.3). The growth rate of industry fell from 16.6% in 1973 to 7.8 % in 1974, and 3.8 % in 1975 (See Table 5.4). The deficit in the current account was increased to US $ 1688 million in 1973, and $7211 million in 1974 (See Table 5.5). The inflation rate climbed to 34.3 in 1974 (See Table 5.6). In order to sustain its growth rate and to avoid recession, Brazil initiated its macroeconomic adjustment.

Brazil's adjustment can be divided into two main phases. The first phase began after the first oil crisis and marked by the Second National Development Plan (II NDP) with growth-cum-debt strategy. The second phase began after the second oil shock and characterized by orthodox adjustment policies.

In this chapter, I will first review the course of this adjustment, then discuss its impact on the dependency of Brazil's economy.

Table 5.1 Brazil's Crude Oil Import Prices (US$/barrel)

Year	US$/barrel	Year	US$/barrel
1977	12.3	1982	32.9
1978	12.4	1983	29.4
1979	17.1	1984	28.6
1980	29.5	1985	27.4
1981	34.4	1986	12.7

Source: Batista, Jorge Chami. Debt and Adjustment Policies in Brazil. 1992.

Table 5.2 Brazil's Price Index of External terms of Trade (Based on Price in US$ and 1977=100)

Year	Terms of Trade	Year	Terms of Trade
1966	81.5	1977	100
1967	79.7	1978	87.5
1968	76.3	1979	78.9
1969	80.0	1980	65.3
1970	88.7	1981	55.3
1971	82.3	1982	53.7
1972	87.1	1983	53.7
1973	95.7	1984	57.6
1974	78.4	1985	57.7
1975	75.9		
1976	85.2		

Source: Same as Table 5.1.

Table 5.3 Rate of Growth of Selected Components of Aggregate Demand (% per annum) and Foreign Debt (in US$ million)

Year	Investment	Exports	Imports	GDP	Net foreign Debt
1971	14.10	5.50	24.50	11.30	
1972	16.50	24.20	20.00	12.10	
1973	12.10	14.30	20.40	14.00	6154.8
1974	16.50	2.30	28.50	9.00	11896.6
1975	10.10	11.60	-4.50	5.20	17130.9
1976	0.50	-0.30	-1.20	9.80	19441.5
1977	-0.30	-0.40	-7.60	4.60	24781.1
1978	1.50	13.30	4.60	4.80	31615.6
1979	1.00	9.30	8.20	7.20	40215.5
1980	11.70	22.70	0.60	9.10	46934.9
1981	-14.00	21.30	-12.30	-3.40	53904.0
1982	-7.80	-9.20	-6.00	0.90	66203.5
1983	-23.30	14.30	-17.40	-2.50	76756.2
1984	-	22.10	-3.00	5.70	79096.0
1985	-	6.90	0.00	8.30	84248.7

Source: Same as Table 5.1.

Table 5.4 Rate of Growth of Manufacturing Industry (in % per annum)

Year	Rate of Growth	Year	Rate of Growth
1967	1.6	1978	16.1
1968	17.0	1979	6.9
1969	10.5	1980	9.1
1970	10.4	1981	-10.4
1971	11.9	1982	-0.4
1972	14.0	1983	-6.1
1973	16.6	1984	6.1
1974	7.8	1985	8.3
1975	3.8	1986	11.4
1976	12.1	1987	1.0
1977	2.3		

Source: Same as Table 5.1.

Tabla 5.5 Current Account Deficits

Year	Current Account	Year	Current Account
1967	-237	1977	-4037
1968	-508	1968	-5927
1969	-281	1979	-10021
1970	-562	1980	-12456
1971	-1307	1981	-10993
1972	-1489	1982	-14717
1973	-1688	1983	-5593
1974	-7122	1984	495
1975	-6700	1985	302
1976	-5978	1986	-4028

Source:SelectedfromBatista,JorgeChami.Debtand Adjustment Policies in Brazil, 1992.

Table 5.6 Rate of Inflation in Brazil (% per annum)

Year	GDP Deflator	Year	GDP Deflator
1970	16.4	1979	55.6
1971	20.4	1980	91.7
1972	19.5	1981	102.5
1973	22.6	1982	92.9
1974	34.3	1983	151.9
1975	33.9	1984	210.5
1976	47.4	1985	234.8
1977	46.2	1986	142.4

Source: Same as Table 5.1.

5.1. THE FIRST ADJUSTMENT AFTER THE FIRST OIL CHOCK

In September 1974, in order to deal with increased deficits in the BOP and to restore the growth rate of GDP, General Geisel's government issued the Second National Development Plan (II GDP) with the target of sustaining a rapid expansion of the gross domestic product at a growth rate of 10% per year between 1974 to 1979.

This plan designed a medium and long-term strategy which emphasized the need to make a significant change in the structure of the economy. Joao, Paulo Dos Reis Velloso, the minister of Economic Planning in Geisel's Administration in 1973/74 explained the thinking behind this strategy in this way:

> Given the inflexibility of Brazil's import structure in 1973/74, heavily concentrated on industrial raw materials, petroleum, and capital goods, a recessive adjustment strategy following the first oil shock would not have solved Brazil's external imbalance. A recessing would certainly have reduced Brazil's deficits on current account of the balance of payments. But once the economy eventually resumed growth, the external imbalance would have reappeared. Brazil 's external imbalance required a structure change with new and large investments in capital goods and basic intermediate guilds which would not been feasible in a recessive environment." (Batista, 1992:4)

On the basis of this thinking, the government placed a higher priority on long-term structural adjustment and sustaining growth than on dealing with financial disequilibrium with a short-term recession policy (Griffith and Rodrigue, 1984:61). Brazil used various mechanisms for import control, such as the prohibition of imports of 'superfluous' items, an increase in tariffs, high deposits on many imports, and additional incentives for import substitution, as well as subsidies for certain types of exports so as to increase investment and to promote exports.(Kaplinley; 1984:60-63)

Under this plan, the investment policy was consistent with the objective of increasing the economy's capacity to produce international goods competitively and increasing the production of competitive international goods both for domestic consumption, as well as for exports. Investment was encouraged mainly in three major priority areas:

(1) the production of capital goods and basic intermediate goods;

(2) import substitution in energy; and

(3) infrastructure development in transportation and communication (II NDP).

In order to sustain a rapid expansion of the GDP under deteriorating international and domestic conditions, NDP II emphasized the needs to absorb a substantial inflow of foreign capital. According to the Plan, Brazil would rely on the foreign capital to finance the increase of the trade and current account deficits in the first few years, which could subsequently increase the foreign debt. However, as this inflow of external finance would be used to increase the level of investment and sustain the growth of the gross domestic product in line with the desired change in the structure of the economy, the exports would be finally raised and the imports would be reduced. With this tendency, sufficient foreign exchange was expected to be generated in the medium and long-term to repay and eventually eliminate the debt. That was the growth-cum-debt strategy in the II NDP (Batista, 1987 and 1992).

Recognizing the existing limits to foreign indebtedness and the obligation to the repayment of debt in the future decades, the II NDP also stressed the need for a rapid improvement in the balance of payments. It emphasized that while borrowing from abroad importance should be "attached to gradually channeling foreign loans to areas which could enhance the country's capacity to export or to replace imports"(II NDP: 19). Guidelines for the current account deficits and foreign indebtedness was given in the II NDP:

(1) The inflow of foreign saving as measured by the current account deficit would be limited to a maximum of 20% of gross capital formation;

(2) foreign indebtedness would be managed so as to maintain an adequate ratio between foreign debt and exports and a prudent debt profile;

(3) International reserves would be kept at high level so as to preserve the country's credit worthiness and to protect the balance of payments against unforeseen developments in world trade (II NDP: 121).

In practice, the accumulation currency account deficit was over 30 million US$ in the period between 1974-1979. These deficits were largely financed by debt-creating capital. Outstanding borrowing by Brazilian banks over the period 1979 to 1982 soared from US$ 7.7 billion to 16.1 billion (Jeffry 1987:118), and most of the debt-secured capital served the expansion of basic industries.

To carry out this growth-cum-debt strategy, the plan emphasized a joint action among state-owned, private domestically owned and foreign enterprises as an essential element of the II NDP strategy.

The government was keen to attract private investment to the areas established as priorities. It gave incentives to the private sector such as lower taxation, restriction on import and export subsidies, provided subsidized credit basically through official institutions to encourage operations of large national private corporations,(II NDP:43)

Foreign enterprises were expected to perform the following functions:

(1) to develop new export markets;

(2) to contribute to the development of technological research in Brazil;

(3) to retrain from market control practices and from the absorption of competitions. (II NDP:45)

The government's responsibility was focused on two areas:

(1) infrastructure sectors such as energy, transportation and communications;

(2) the area of social development such as education, health and social services(NDP II, p.45).

In brief, the II NDP advocated a mixed economy where state, private, national and foreign enterprises played important roles, each in their own spheres of operations.

In spite of fluctuations between 1976 of 1977, the II NDP brought about a weak temporary recovery in Brazil's economy. From 1974 to 1980, the overall expansion of output was at a satisfactory level. The growth rate of investment increased from 0.5 in 1976 to 11.7% in 1980, The average growth rate of GDP was 7% and well above that of most developing countries and industrial countries. The growth rate of exports increased from -0.3 in 1976 to 22.7% in 1980, while the growth rate of imports was reduced during the same period, although it did not move in a stable way (See Table 5.3)

However, since the large amount of foreign capital inflow from 1974 to 1978 Brazil experienced a balance of payments deficit on its current account every year in this period. the deficit of POB sharply increased and reached US$ 30.8 billion. This huge deficit was financed by and large through loans and credits. As a result, the net foreign debt continued to rise during the period of adjustment, although the exports increase and imports decrease over the same period (See Table 5.3).

5.2. THE SECOND ADJUSTMENT AFTER THE SECOND OIL SHOCK

The second rise in the price of oil rekindled a trade balance deficit which once again met with as increased interest rate, pushing Brazil into its debt crisis.

In the late 1970s and the early 1980s, the Brazilian economy confronted a dramatic deterioration in its international economic environment. Brazil's economy was first hit by the sudden rise in the price of oil (See Table 5.1) and international interest rates (See Table 5.7), then by the stagnation of world trade, finally by a near-total cut off of voluntary new lending following the adoption of very restrictive monetary policies in the advanced economics (Frienden, 1987).

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Table 5.7 Real Rates Of Interest (in % per month)

Year	Real Rates of Interest	Year	Real Rates of Interest
1977	0.77	1982	2.42
1978	3.26	1983	1.77
1979	-4.50	1984	0.76
1980	-0.59	1985	1.18
1981	2.90	1986	0.17

Source: From Batista, Jorge Chami. Debt and Adjustment Policies in Brazil. 1992.

As interest rates soared, Brazilian net interest payment tripled times from $2.7 billion in 1978 to 9.2 Billion in 1981, while the country's net debt increased by 70%. Meanwhile, the country's exports were faced with the general stagnation of world trade after 1980. Brazil's terms of trade decreased 30 percent between 1979 and 1981. By 1981 debt service payments equaled 72% percent of Brazil's exports, up from 51 percent in 1977 (Alejandro, 1986). More seriously, while Brazil badly needed more financial resources to roll-over its debts, international private financial resources dried up after 1982. Unable to repay for its previous debts Brazil jumped into its debt crisis. The debt problem became the dominant and determinant element of Brazil's economy.

It was this debt crisis that forced Brazil to negotiate an agreement with the IMF, which led to a complete turn towards the orthodox structural adjustment process. The IMF insisted that Brazil's growing deficit was largely caused by its over-ambitious expansion policies and its unbalanced growth model, as well as the market distortion caused by improper government policy (Pastor, 1987). The shock recession policy was introduced in order to cure the deficit problem. Since then the strategy in the second national development plan was completely reversed: the balance-of-payment replaced growth as the main concern under SAP strategy.

Since the theories and conditions of SAP were introduced in Chapter Two, I will not discuss them here. In Brazil's case, in order to quickly get rid of the crisis, an aggressive exchange rate policy and expansionary fiscal policy was adopted, and the main policy instruments to deflate the economy was the domestic rate of interest with a combination of restrictive credit policies to the private sector and tight control of the expansion of money supply (Batista, 1992).

Faced with adverse international conditions, the government first devalued the cruzeiro by 30 percent. Then various policies were implemented to keep foreign finance coming into the country. The most important was the drastic raising of domestic interest rates, which soon surpassed 50% in real terms for consumer credit. Domestic credit was controlled while foreign borrowing was exempted from any quantitative limits. Substantial interest-rate subsidies were also offered to energy-related and export activities. Domestic firms outside these favoured sectors were permitted and thus pushed to increase their foreign borrowing. At the same time, the government reduced government investment spending to overcome the widening gap in the balance of payment. (Frieden, 1987:116-118). To reduce the deficit, investment in the public sector was also seriously cut off (Rocha, 1992:84).

The macro-performance of Brazil after the second adjustment was not successful. The main macro-criteria set by the IMF for SAPs such as the rate of growth, inflation, external debt, public sector deficits, were disappointing except for the trade balance account.

As the result of recession policies, Brazil's manufacturing production dropped 10 percent in 1981, stagnated in 1982, and dropped a further 8 percent in 1983. Output of the capital goods sectors fell 19 percent in 1981, 11 percent in 1982, and another 20 percent in 1983. The growth rate of GDP fell to a negative level of -3.4 (Batista, 1992).

One of the main goals of adjustment in Brazil was to decrease inflation. However the recessive policies and structural policies which had been implemented since 1974 were ineffective in this aspect. The reduction in the rate of inflation in 1981/1982 was relatively minor, then continued to rise, peaking at 234.8% in 1985 (See Table 5.6).

Although the Current account sharply improved (See Table 5.5) because of a slight increase in exports and a decrease in imports, the public sectors account seriously deteriorated. The percentage of public sector deficit, as a percentage of the GDP rose to 12% in 1989 from 6.6% in 1982. (See Table 5.8)

In the 1990s the federal government accepted the Washington Consensus and started its privatization and liberation reforms which constituted a continuing of the structural adjustment. This reform was aimed simply to fundamentally change Brazil economy from a state-led economy into a free market economy. Between October 1991 to August 1992, 13 state-owned enterprises were sold at a low price to the private sector. Foreign investors were allowed to acquire 51% or more of the voting shares of sold companies (Rocha, 1992).

TABLE 5.8 Macroeconomic Performance in Brazil, 1982-1989

	GDP	Inflation (% of Year %change)	PublicSector Deficit (% of GDP)	Exports (US$ mil)	Imports (US$ mil)	External Debt	External Debt (as % of GDP)
1982	0.7	100.3	6.6	20,173	19,395	62,221	35.8
1983	-3.4	178.0	3.0	21,898	15,429	97,496	50.1
1984	5.0	209.1	2.7	27,002	13,916	104,331	52.3
1985	8.3	239.1	4.3	25,643	13,168	104,593	48.2
1986	7.5	58.6	3.6	22,348	14,044	112,042	41.7
1987	3.6	396.0	5.5	26,210	15,052	123,865	39.4
1988	0.0	994.3	4.3	33,773	14,605	114,592	30.7
1989	3.6	1,910.6	12.4	34,392	18,281	114,572	...

Source: Pastor, Manuel JR. Inflation, Stabilization, debt. 1992.

Substantial liberation of policies and regulations were granted to private sectors including multinational corporations. For example, foreign investors were free to move their profits abroad instead of waiting two years before sending it home; a twelve years period of capital repatriation was reduced to six years; taxes on capital repatriation was reduced from 25% to 15%. However, all these measures under the SAP failed to bring Brazil's economy out of heavy debts and high inflation. In order to get a new Fund approval for the 2.1 Billion "standby" loan. To reducing inflation, Brazil signed an other agreement with the IMF under very tight policy conditions (Rocha, 1992:82).

5.3. THE IMPACT OF THE SAP ON THE DEPENDENCY OF BRAZIL'S ECONOMY

The structural and recessive policies completed since 1974 led Brazil's economy into an even more dependent position in its international relation through two fundamental structural changes in Brazil's economy: within its internal relations, the collapse of the public sector, and within its external relations, perpetual reliance on foreign capital.

The Collapse of the Public Sector

To explain the first change, it is necessary to review the evolution of policy concerning structural adjustment. As mentioned above, the Second National Plan intended to restore the high rate of growth through a joint action among the state, local capital and foreign capital in the first step of adjustment. Although the government maintained its leading role at the beginning of adjustment, with the acceptance of the orthodox economic principles, Brazil's priority was "to make market capitalism work" (Fishlow, 1973:80). Thus the government expanded both its indirect intervention (control of fiscal , monetary, wage, and credit policies) to "perfect" the market and its direct intervention (state enterprises) to provide important inputs to the private sector at subsidized prices. In this course, the government functioned as a "privatized" state (Rocha, 1992: 77-82). In the second adjustment, the public sector was considered as the main source of inefficiency and the deficit, and thus the main obstacle to growth. The privatization associated with orthodox theory aimed at changing the state-led economy into a free market economy in which government should retire from economic activity. With the further development of the SAP in Brazil, the leading role of public sectors in development process was weakened and replaced by the private sector.

In the process of adjustment, the state performed a supporting role for the private sector in two ways:

(1) By transferring the public resources into the private sector through a subsidised price regime imposed on the state enterprises;

(2) By socializing the debts of the private sector via a quasi-insurance scheme.

Brazil's state-owned enterprises invested primarily in those sectors which provided inputs or infrastructure important to industry, such as electrical energy, petrochemicals and steels. Over the adjustment period, public firms were forced to sell goods and services to private companies at a subsidised prices. For example, in 1980 the public firm Siderbras was allowed to increase the price of its steel by only 60 percent while inflation was running at about 110 percent (Anglade, 1985:114). Also the electrical energy sector was forced to donate electricity to the aluminum industry, whose major representative, ALCOA, is one of Brazil's most profitable private firms (Rocha 1992:81). Subsidised prices for electrical energy, petrochemicals and steel benefited primarily the automotive pharmaceutical, and chemical industries with a dominant foreign presence. In this way, state enterprises continued to transfer massive resources to the private sector, and generated massive losses. Between 1979 and 1989 the steel industry, for example, lost US$17 billion in subsidies to the private sector (Rocha, 1992:84).As
a result, their ability of self accumulation greatly declined and relied heavily on borrow funds, usually from overseas. The artificial low prices became the primary mechanism to force public firms to borrow more and more abroad. Taking the example of the eclectic energy and steel sectors, by the late 1970s, 30 percent of its investment funds came from net

operating income and half of all investment was financed through borrowing, almost all of it from abroad. By 1980-1981, debt was nearly double the equity of the sector, and the foreign debt accounted for three-quarters of the total. Public investment in the steel industry averaged $1.9 billion a year between 1976 and 1981, nearly 5 percent of national investment. However, its operating earnings financed less than one-fifth of steel investment in the late 1970s, half of it through borrowing, the majority from abroad.(Frieden, 1987:104-108).This happened in the same way among most state-owned enterprises in the petrochemical, mining, railroad, and telecommunications sectors. The accumulation of foreign debts in the public sector was so high that governments were forced to borrow more and more abroad just to service their ever-increasing debts the in 1980s.

Another way to support the private sector was the "Stabilization" of the foreign debt. Brazil public sector had run a serious of quasi-insurance scheme for private firms with foreign-currency liabilities. Under this scheme, private firms were allowed to write down their foreign debts. Because of this policy, private-sector foreign borrowing declined after 1974, meanwhile the share of public sector in Brazil's foreign debt climbed from 68 percent in 1981 to nearly 80 percent in 1985(Frieden, 1987 122). As the financial costs increased dramatically following the soaring interest rates, in 1983 the state firms' financial expenses equaled 90 percent of their operating expenses compared with 28 percent in 1978. The rise for domestic private firms was from 23 to 50 percent (Frieden, 1987:122-126). This meant the public sector was forced to swallow losses during the period of crisis.

In the 1980s, the bankrupt Brazilian state could no longer continue to invest in its public firms. Public investment was sharply reduced. The proportion of state enterprises investment in gross formation decreased from 22.5 percent in 1980 to 9 percent 1989 and 6.3 percent in 1990 (Bielschowshky, 1990:52). Since state enterprises historically held 40 percent share of the economy's gross investment in capital-intensive infrastructure and basic-input sectors, and provided the structural linkages to the private sector, the decline of investment in public sectors consequently led to the overall stagnation of the economy (Rocha, 1992)

Following the weakness of the public sector, the "privatization" began in 1992 led to the complete withdrawal of the state from Brazil economic activities. However, this withdrawal of the state will not leave local capital developing independently. With the internationalization of the domestic market, local capital in Brazil was closely allied with international capital and "internationalized" under conditions of historical and structural weakness

(Graham, 1989). Therefore, the withdrawal finally reinforced external dominance, leading to a new reliance on external capital by shifting the leading role in national development from the state to "internationalized" local capital.

Perpetual Dependence on the Foreign Capital

From the description of the course of Brazil adjustment in the previous section, it is obvious that the debt crisis was one of the main reasons for Brazil's gradual acceptance of IMF's orthodox development strategy. But this adjustment failed to rescue Brazil's economy from the debt crisis. Instead, it reduced the economy under an even heavier pressure of a foreign debt burden.

To adjust the serious deficit in BOP, the second national development plan purposely used foreign capital as a major resource to finance its economic growth so as to avoid recession, which led to a major increase in foreign borrowing after the first oil shock. As mentioned in the first section of this chapter, although the steady growth of export and the improvement in the terms of trade turned the trade balance into surplus during the period of II DNP, the invisible trade deficit, and consequently foreign indebtedness rose continuously after 1974. The second oil shock increased again the trade balance deficit and Brazil's indebtedness. To get rid of the new crisis, a set of orthodox policies such as liberation, deregulation, and privatization were used to realize the structure reform in the second step of adjustment. All these policies were directly linked to the promotion of large inflows of foreign capital. Under this strategy Brazil's foreign indebtedness continued to rise and peaked at $11493 million in 1988 (See Table 5.6), becoming the major obstacle to Brazil's economic development.

Theoretically speaking, developing countries are prone to foreign exchange constraints in their development process due to the shortage of domestic financial resources. International financial inflows can thus finance their capital demand beyond domestic resources, if this capital is used for developmental process, gross fixed capital formation can be accelerated. Paul Prebisch argued for the useful role of foreign capital inflows. He pointed out that acceleration of the rate of growth of developing countries in the process of industrialization increased the demand for imports of manufactured and other goods, creating a serious bottleneck that if not overcome may inhibit development. Under the conjunction of foreign capital inflow and need for development, such flows would pay a useful role in increasing exports and/or the substitution of imports.(Griffith 1984:47-49). However, external capital is a two-fold knife, in spite of its necessity for accelerating growth and industrialization, it possibly becomes an efficient mechanism for foreign debtors to control the development of borrowing countries, when the volume and conditions of such foreign capital inflows are not appropriated to the countries development needs of these countries.

An inappropriate performance in foreign debts can be caused by unfavourable external economic conditions and an improper macroeconomic strategy or both.

Reviewing Brazilian borrowing experiences from 1950s, the debt crisis after two oil shocks was mainly caused by unfavourable external economic conditions and worsened by the IMF-led SAP. In the 1950 and the 1960s, the inflow of foreign capital was encouraged as a supplementary policy to the ISI. The main foreign financial resources were private and official investors who pursued greater profits (Grifith 1984:18). In this period, the amount and direction of foreign capital inflow were controlled by the government so as to assist the industrialization process.

During the 1970s, The most important debtors were multinational banks which eagerly expanded their lending to developing countries in search of greater profit (Grifith 1984:18). Because of the rich and diversified resources of foreign capital at that time, Brazil possessed a relative stronger negotiation power in borrowing abroad. It enjoyed a great degree of autonomy in choosing better lending conditions which were more suitable for its development needs. Thus, the foreign debtors were under the pressure of competition, partly responding to the needs of Brazil's development and played a positive role in accelerating Brazil industrialization and easing the balance of payments, although they basically provided capital on behalf of their own interests. As the rapid increase of GDP attracted plenty of foreign capital resources, Brazil did not meet difficulty in obtaining enough foreign capital, in spite of the large deficit in the BOP.

Structuralists termed this kind of deficit as a "development deficit", which is a necessary and temporary cost of industrialization in the developing countries, and will be eliminated by the increase of the domestic GDP (Pastor, 1987:21-24). As an inherent vulnerability of debt financed development, this deficit was subject to a deterioration in the external environment. Any of exogenous changes can easily and rapidly increase any existing payments deficits (Dell 1982, Dell and Lawrence 1980).

This was the case for Brazil. When external conditions suddenly deteriorated because of the unprecedented oil shocks, Brazil jumped into a serious debt crisis. This change was due to factors entirely beyond Brazil's control.

Under this condition, Brazil resorted to increased external indebtedness to avoid recession at all costs. This accelerated the increase of foreign debts to an unmanageable level. After 1977-78, the Government launched a "loan hunt" to roll over its debts. In the extremely vulnerable position, the nature of borrowing was completely reversed from that of the 1950s and the 1960s. Between 1976-1989, in order or get more foreign inflow, a lot of state enterprises signed contracts with foreign debtors to link currency loan to the purchase of capital goods (faucher, 1981:22-25); Since then "it is no longer investment projects of public firms that attract foreign loans but the necessity to roll over the debt that creates projects"(Beluzzo in Rocha, 1992:81).

After the second oil shock in 1980, with a further deterioration of external conditions and more and more debts, Brazil was unable to not only finance its current account deficits but also to roll over its previously accumulated debts. Given the permanence of the current account deficit and the exhaustion of Brazil's international private financial resources, Brazil was unable to honour its debt service commitments. The country was forced to submit an adjustment program to the International Monetary Fund which had monopoly lending power at that time.

However, the SAP rejected the positive role of the deficit and ignored the fact that a deteriorated external condition was the main reason of Brazil' debt crisis. Instead, it insisted that deficits caused by an over-ambitious expansion industrialization strategy program and would impede growth and the payment problem. It introduced the recession policy to cure Brazil's crisis (Pastor, 1987)

Brazil's experience proved that a growth strategy based primarily on external capital bears a heavy economic cost for a developing country, and damaged the long-run development of Brazil's development. "To try to 'correct' the development deficit is to halt the development effort itself" (Abdalla 1980:39).

With a heavy dependence on the inflow of foreign capital in this growth model, large profits of brazil were transferred to foreign investors and debtors. Between 1982 and 1991 foreign firms transferred $11.3 Billion abroad in profits and dividends (Korton 1992:28). Between 1985 and 1989, Brazil transferred to foreign creditors $54.48 billion, an amount equivalent to half of the country's total foreign debt in 1992. (Cadernos 1992:3) In this way, the industrialized countries did not provide aid for Brazil to overcome its crisis; rather Brazil provided profit for the growth of industrialized countries.

The damage of debt was not only reflected in the outflow of profits through interest repayment to the countries at the centre, but also reflected in the location of decision making structures was outside Brazil.

As mentioned in the previous section, this strategy produced a sharp fall in investment, which fundamentally damaged Brazil's ability to generate in the long run more foreign exchange for its repayment of accumulated debts, trapping Brazil in a permanent reliance on foreign capital.

With the huge outflow of profit and due to the lack of internal accumulation, Brazil has had to resort to foreign capital to sustain its development. In the process it has been subjected to the policies of foreign capital, which has trapped it into borrowing more, further damaging its ability to repay the debts. This vicious circle has put Brazil into an extremely weak position in negotiations with foreign capital while borrowing from the IMF. It can do little in its own interest except for obeying IMF policies. In this sense, Brazil has become completely a 'periphery' of various of global capital accumulation. Foreign capital inflows no longer serve the development of Brazil, but the interest of foreign debtors. It is clear that SAP is leading Brazil's economy towards complete reliance on foreign capital. As a result, the rate of capital accumulation in Brazil has not been conditioned by its own interests, but by the interests of metropolitan capital.

Brazil's experience under an externally conditioned growth model shows how international capital severely undermined the state control over the national economic system and over policy decision crucial for local development. And it shows that the advancement of the interests of foreign capital has remained a central goal of national economic policy-making.

CONCLUSION

Facing the serious debt crises and high inflation caused by the dramatic deterioration of external conditions in Brazil, The IMF ignored this specific reason for crisis and the needs of Brazil, and forced Brazil with its lending power to adopt SAP . The whole package of neo-classical policies in the SAP have led brazil's economy into a particular dependent position in which its economy has been conditioned by external metropolitan interests within an international relationship of interdependence and integration. It remains extremely vulnerable to external conditions; its national and local development significantly controlled by the centre. This has been a defining characteristic of Brazil's economic development.

CHAPTER VI

GENERAL CONCLUSIONS

Since 1950, Brazil has experienced a tortuous industrialization process. In nature, It has been a process of dependent development. "Development" because it is characterized by capital accumulation and an increasingly complex differentiation of its internal productive structure, "dependent" because it is indelibly marked by the effects of continued dependence on capital located in the current core countries(Evans, 1979).

Historically speaking, Brazil was a typical colonial country characterized by backward agricultural economy and close relation with the international economy. As a result, the economic development of Brazil has been influenced in a major way by its lack of capital and dependence on external conditions. How to get enough capital to finance its industrialization has been a key problem in Brazil's development process.

In order to break out the classical dependent ties to the Centre and to get rid of the backward colonial agriculture-dominated economy, Brazil initiated its industrialization under an ISI strategy aimed at establishing a self-sustaining industrial system on the basis of "state control" over imports and the non-economic redistribution of domestic resources. Through this strategy Brazil successfully established its diversified industries and became a Newly Industrialized Country. However, under the constraints of capital accumulation rooted in its colonial economy, before development became a cumulative circular process creating its own expansionary momentum, ISI exhausted its potential.

To seek enough capital for its continuing industrialization, Brazil turned to a combination strategy in its stabilization program which introduced neo-classical idea and policies of the free market and free trade. Under a favourable international environment, this strategy worked very well in terms of economic growth, bringing about Brazil's famous "economic miracle". However, as this strategy opened Brazil's economy to the international market, Brazil's industries were gradually internationalized, and more and more dependent on foreign capital as the main financial resources for its industrialization process. As more and more foreign capital penetrated Brazil's economy, it gradually entered a new international division of labour and moved away its from an inward-oriented strategy of self-reliant development implied in ISI. Since then it has been subject to what can be viewed as a dependent development process. Brazil's economy, although growing at a high speed, was vulnerable to the external environment and became highly reliant on external capital.

Two oil shocks resulted in a dramatic deterioration of its external environment, which fully exposed the vulnerability of Brazil's dependent development. As the private external financial resources gradually dried out, Brazil suffered a debt crisis of major proportions. In order to roll over its heavy debts and sustain its economic growth, Brazil was forced to completely accept SAP designed by the IMF. Through conditional lending, the IMF gradually came to control the process of Brazil's development and shape its development according to the needs of the core countries.

The growth strategy of SAP, based primarily on external capital, has meant a heavy cost for Brazil in its development. In addition to a large outflow of capital to the centre in the form of debt repayment and profit remittances, Brazil totally lost its autonomy at the level of policy decision making because of the shift of the public sector's leading role towards a private sector aligned with international capital, and also because the recession policy, fundamentally damaged its capacity for domestic capital accumulation in the process of further development. In this way, SAP has led Brazil into a particular dependent position on external capital with all of its consequences, many of them negative.

Brazil's industrialization experience proves that SAP is not an appropriate or desirable strategy for its development. The basic reason for this is rooted in its consequent one-way policy. In a world separated into different groups with conflicting interests, there is no universal development model. Although both developed countries and developing countries are facing an economic crisis, the causes are totally different. In developed countries, the crises resulted from their internal structural weakness which might be cured by effective financial management and stabilization policies. But for developing countries, their difficulties derived from their remaining colonial economic structure and unfavourable external conditions. It is the case of Brazil. Brazil has confronted the need and sought to break out of its old structure and establish a self sustaining economy. Facing economic powers reluctant to give up their control over the world economy brazil has had to protect itself through state intervention. However, SAPs ignore the needs of developing countries, and are aimed at distorting the leading role of the state in the development process , and so create a dependent peripheral economy that confronts to the general interests of the developed world, integrating Brazil into the new international division of labour in which core countries enjoy considerable advantages. SAPs by their nature, generally are designed to the benefit of core countries.

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