Brazil: 40 years of deindustrialization

Luiz Carlos Bresser-Pereira

São Paulo School of Economics of Getúlio Vargas Foundation. The Portuguese original of this article was published in *Jornal dos Economistas,* June 2019.

The Brazilian economy, which grew at an extraordinary pace from 1950 to 1980, has been almost stagnant ever since. If it grew an annual 4.5 percent in that period, it now grows a mere 0.9 percent. The same quasi-stagnation can be seen comparing growth in the same period with other developing countries, which was 3.0 percent, and rich countries, at 1.7 percent annually. Besides having ceased to catch up, Brazil is lagging behind less developed countries.

In 1980, while still within the framework of a developmental economic policy regime, the Brazilian economy came to a halt – the Foreign Debt Crisis – caused by the Geisel administration's misguided strategy of attempting growth with foreign savings, that is, with current-account deficits. Because the military regime had since 1964 indexed the Brazilian economy, the financial crisis became high inertial inflation and economic development came to a standstill.

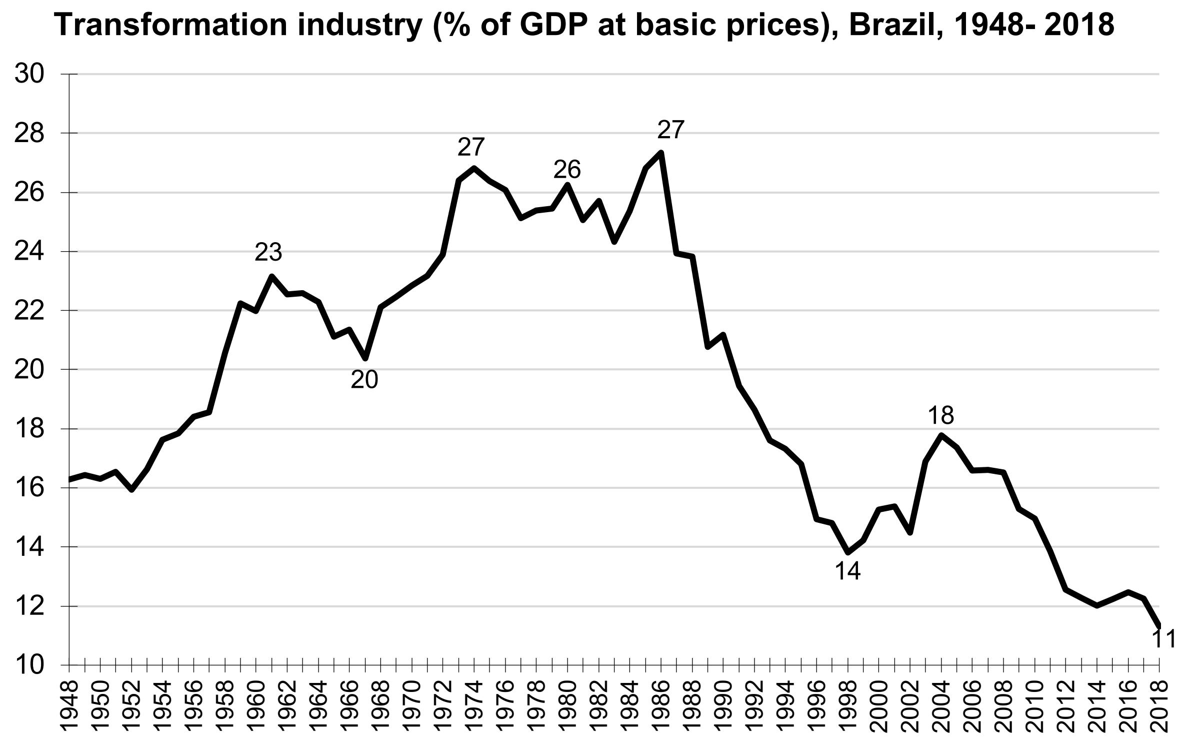
Beginning in 1990, with liberalization, deregulation and privatizations, Brazil, which had been so successful under the developmental regime, bowed to foreign pressures and embraced a liberal economic policy regime. At the same time, in 1993, it joined the Brady Plan, putting an end to the debt crisis, and managed to stabilize prices in 1994 with the Real Plan.[1] But economic development, which should have resumed at that point, did materialize. Why? Since at least 2007, when I published a first book on a theory that would be later called New Developmentalism, my understanding was that a liberal economic policy regime is incompatible with the economic development like Brazil where the exchange rate tends to be cyclically and in the long-term overvalued[2].

Within the framework of economic liberalism, industrialization ceased to be a priority for liberals and left-wing economists alike. The former put their chips on neo-liberal reforms and the macroeconomic tripod, and guaranteed for the new prevailing coalition – a rentier-financier coalition – the high interest rates and low inflation that rentier and financier capitalists demanded. The latter accepted the new economic policy regime, assumed that it would lead to economic development as long as supplemented by industrial policy, and focused on the job

Luiz Carlos Bresser-Pereira is emeritus professor of Getúlio Vargas Foundation.
bresserpereira@gmail.com, www.bresserpereira.org.br.

of reducing inequality – promoting minimum-wage increases and income transfers to the poorest.

Low growth is directly related with the deindustrialization that has been going on since the 1980s. In that decade, as seen in the Figure, the transformation industry's share of GDP was at around 26 percent, versus a miserable 11 percent in 2018.



Note: Series adjusted to the 2010 IBGE National Accounts System, correcting for methodologial changes and the financial dummy.
Source: MORCEIRO, P. C. (2019). Influência metodológica na desindustrialização brasileira e correções na composição setorial do PIB. TD NEREUS 02-2019. São Paulo: NEREUS-USP.

The Figure shows that deindustrialization took place in two waves. One from 1986 until 1999, and the other beginning in 2004. Deindustrialization began in the 1980s, when Brazil faced the severe Foreign Debt Crisis, which hit a large portion of the underdeveloped world. A direct consequence of it, already in the early 1980s, was a drop in *public savings*, which were close to 6 percent of GDP in the previous decade, to a negative 2 percent. State-owned companies, which had been responsible for a relevant share of those savings, no longer played this role; first because their prices were used in attempts to bring inflation under control, and later because they were privatized.

Despite the fact that the high inertial inflation was brought under control in 1994 (having been triggered by the foreign crisis together with the Brazilian economy's indexation dating back to 1964), the quasi-stagnation persisted in the 1990s because trade and financial openness overappreciated the foreign exchange in the long-run for manufacturers. This was due to two reasons: higher real interest rates to attract foreign capital, which discourages investment in general, and the dismantling of the mechanism that used to neutralize the Dutch disease,[3] which turned non-competitive the manufacturing industry.

The beginning of the second deindustrialization wave, in 2004, is apparently contradictory because the 2005-2010 period was the only one since 1980 when the Brazilian industry's growth rates were satisfactory. The situation can be understood, however, when one realizes that this growth was caused by the commodities boom stemming from the new and massive demand from China. The high prices increased the severity of the Dutch disease because exports of soybeans, iron ore, etc., became more profitable at an even more appreciated foreign exchange rate than the one that usually applies when commodity prices exported by Brazil are "normal".

Deindustrialization *translated* into quasi-stagnation. There is a direct causal link between the two. Economic development means rising per-capita income, which equals the increase in per capital labor productivity as long as the workforce-to-population ratio remains constant. Productivity gains, in turn, take place in developing countries due mainly to the transfer of labor from low value-added activities to others with higher per-capita value-added: in practice, from farming to manufacturing.

When the developmental economic policy was given up starting in 1990 for a liberal regime, an old truth resurfaced: that a liberal policy regime is incompatible to countries that search to grow with foreign indebtedness and suffer from the Dutch disease and, tend to have an overvalued currency cyclically but in most of the time. With the neoliberal reforms adopted since 1990 an old thesis (the law of comparative advantages) surfaced, although economic history shows that a overvalued currency is definite obstacle to growth. According to it, what matters is not for a country to industrialize, but to exploit its competitive advantages. As Gabriel Palma says in a tone at once outraged and biting, "it makes no difference for them whether a country produces *microchips* or *potato chips*." In Brazil, such notions had prevailed until the mid-1950s. Back then, liberals used to say as criticism of Getúlio Vargas's industrialization policy: "Brazil is an essentially agricultural country". However, the developmental industrialization strategy was so successful from 1930 to 1960 that, by the mid-1950s, no one dared repeat such nonsense anymore.

This didn't change with the 1990 trade liberalization (soon to be followed by financial liberalization), but the exchange rate turned overvalued in the long-term since them because: (a) the interest rate increased to attract foreign capitals, and the current account deficit became high; (b) the government dismantled the import tariffs and export subsidies that neutralized the Dutch disease, tanking them as "protectionism" when they were just establishing equal condition in the competition between companies in Brazil and abroad. The outcome was deindustrialization, which occurred despite not being an explicit objective of the government. Since 2015, however, after Dilma Rousseff's unsuccessful first term in office (2011-2014), the economic elites gathered under the banner of the rentier-financier coalition, the neoliberal ideological hegemony from abroad became very strong, the law of comparative advantages was revived, and the industrialization ideal fell by the wayside.

Investment and Interest/GDP	1971-1980	2011-2017
Private-sector investment	17.6%	17.5%
Public-sector investment	7.8%	3.2%
Total	25.8%	20.7%
Interest expense of the State	1.5%	8.2%

Productivity gains or economic development depend on many factors, but mainly on private- and public-sector investment. Brazil grew and industrialized from the 1930s to the 1970s because the state and the companies it owned made massive investments. As the table comparing the 1970s and the 2010s shows, while the private sector's rate of investment relative to GDP remained close to 17.5 percent, the public sector's investment was halved from 7.8 to 3.2 percent of GDP. The state invested because it made positive public-sector savings and its companies were profitable; the private sector invested because the investments made by the state and its companies created demand, because interest rates were low or even negative, because a system of import tariffs and export subsidies for manufactured goods kept the real exchange rate competitive and encouraged manufacturing companies to invest.

Public-sector investment began to drop in the 1980s, when what I called the "fiscal crisis of the state" began. In the 2000s the government made a great effort to revert this tendency and increase public investment, but, with the recession that began in 2014 and the ensuing fiscal crisis, the government adopted since 2015 an orthodox austerity, a procyclical policy that brought pubic investment down to around 1 percent of GDP. As a consequence, the economy will grow 1 percent in 2019, and GDP should only return to 2014 levels in ten years, compared with an average recovery time of seven quarters from previous recessions.

Why did public investment decrease as much? As noted earlier, public savings have since the 1980s gone into negative territory: the state's current, or consumption, spending exceeds its revenues. This happened, at first, because big companies required relief from the state within the framework of the Foreign Debt Crisis; then, because many profitable state-owned companies were privatized; and finally, because two sources of spending greatly increased: one is necessary (social spending on education and healthcare), the other, absurd – the huge state expenditures with the high interests on its public debt. These expenditures on behalf of rentiers and financiers have increased immensely. As the table shows, the average interest expenses of the state rose from 1.5 to 8.2 percent of GDP from 1971-80 to 2001-17.

Why did private-sector investment remain steady instead of increasing as it should have, given that many large and profitable companies were privatized? Basically because, starting in the 1990s, the Brazilian economy fell into the macroeconomic trap of high interest rates and long-term appreciated foreign exchange rate, discouraging private-sector investment by making several administratively and technologically competitive companies uncompetitive on the economic level. In other words, because although the abusive levels of 1994 have decreased, they remain high on average. This is due to several reasons, but the main ones are: the presence of a "two-way" contagion effect from public debt between the banking reserves market and the public securities market; the rentier-financier coalition's great power in Brazil; and the fact that Brazilians continue to believe that they may incur current-account deficits in an attempt to grow with foreign savings – which is a mistake because capital inflows attracted by high interest rates to finance the current-account deficit increase the supply of US Dollars and appreciate the Brazilian Real in the long run, stimulating consumption instead of investment.

The high interest rate and the policy of growth with foreign savings were, therefore, the first reason why the foreign exchange rate remained overappreciated; the second reason was the trade and financial openness that dismantled the Dutch-disease neutralizing mechanism. This was based on high customs tariffs that neutralized the disease for the domestic market; and on subsidies to manufactured goods exports, neutralizing it for the foreign sector.

A long-term appreciated foreign exchange rate discourages investment because well-managed companies employing current technology lose competitiveness and cease to invest, even if demand – both foreign and domestic – is satisfactory. A high interest rate, in addition to causing exchange rate appreciation, directly discourages investment and reduces the state's investment capacity.

What interests lie behind high interest rates and an appreciated exchange rate? The political economy explanation can be summarized in a single sentence: workers, rentier capitalists and the high-ranking public bureaucracy are only concerned with their immediate consumption, each group in a different way: workers and the left prioritize wage increases, are not concerned with the public deficit and argue that the increase of public spending is the path for a sustained demand and economic development; rentiers, who liberal orthodox economists represent, are keen on high interest rates that they justify with the threat of inflation; the corporatist high-ranking public bureaucracy legitimizes itself by means of the war on corruption and disregards the matter of development. The two first groups proved not to worry with current account deficits that they see as "structural", or as "foreign savings". In other words, in the past 40 years, fiscal populism (recurrent public deficits) and exchange rate populism - both practices representing a preference for immediate consumption - were the dominant traits of the macroeconomic policies.

To resume growth, Brazil must lower the interest rate and keep its foreign exchange rate competitive. It must solve the fiscal crisis, embracing a countercyclical policy of increased public investment, even if this means higher public deficits in the very short run. It needs to reduce its expenses with interests. It needs to recover the state's savings and investment capacity. It needs to resume making primary surpluses. It needs to embrace a foreign exchange policy that keeps the foreign exchange rate close to the competitive equilibrium. It needs to quit trying to attract capitals that only replace substitute foreign for domestic savings. It needs to neutralize the Dutch disease. It needs to achieve a small current-account surplus, which is needed for the foreign exchange rate to be competitive and for business firms to go back to investing.

[1] This was a heterodox stabilization plan based on the theory of inertial inflation, which had been developed in the precedent decade. See Bresser-Pereira (2010) "A descoberta da inflação inercial" [The discovery of inertial inflation] *Revista de Economia Contemporânea* 14 (1): 167-192.

[2] See Bresser-Pereira (2007 [2009] *Developing Brazil*, *Overcoming the Failure of the Washington Consensus*, Boulder: Lynne Rienner Publishers, originally published in Portuguese as *Macroeconomia da Estagnação.* For a more recent analysis of the Brazilian economy according to New Developmentalism, see Bresser-Pereira (2018) "Brazil's macroeconomic policy institutions, quasi-stagnation, and the interest rate–exchange rate trap" (2018) *in* Edmund Amann, Carlos Azzoni and Werner Baer, eds. *The Oxford Handbook on the Brazilian Economy,* Nova York: Oxford University Press: 221-240.

[3] From 1967, high import taxes on manufactured goods neutralized the Dutch disease on the domestic market side, while high subsides to the exports also of manufactured goods neutralized the Dutch disease on the export or foreign side.