

**DEVELOPMENT and
CRISIS in BRAZIL,
1930-1983**

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The Crisis of the 1960s

Until the beginning of the 1960s few people thought in terms of crisis. They spoke of the “industrial revolution,” of the great economic, social, and political transformations through which the country was passing in the “Brazilian revolution.” Of course, problems that arose during the process of economic and social development were pointed out and discussed. Yet the dominant attitude in Brazil was optimistic and positive. Since the end of the Second World War the country had been dominated by a sense of optimism that was transformed during the 1950s into a feeling of euphoria. Brazil was not merely “the country of the future”: It was rapidly becoming this country in the present.

After 1961, however, the situation changed. Optimism (not to mention euphoria) gave way to doubt and later to a decided pessimism. Little by little the country was entering into a crisis in which the emerging difficulties outpaced the available solutions. Brazil was entering a historical phase that will be termed here the Brazilian crisis.

The Crisis Defined

The Brazilian crisis assumed a fundamentally economic and political character, although it also had social and even cultural aspects. The economic aspect was most salient. The rate of growth in per capita income, which had been about 3 percent until 1961, was negative in 1964, with a reduction of 6.1 percent. This data corresponds to a 3 percent decrease in aggregate income. The principal factor that explains this phenomenon was the 4.5 percent decrease in agricultural production, but industrial output also dropped 0.4 percent. This fact is particularly serious when we remember that postwar Brazil, of all the Latin American countries, showed the largest growth in industrial output. In the period from 1945–1950 to 1956–1961, the average growth of manufacturing had reached a high rate of 9.4 percent.

However, according to the figures of the National Income Team of the Getúlio Vargas Foundation, the entire drop in industrial activity in 1964 occurred during the first half of the year, whereas the second six months marked a recuperation that almost canceled out the initial reduction.¹ From this it might have been concluded that after the second half of 1964 the economy had already begun its recuperative process, so that one could no longer speak of crisis.

Unfortunately, however, this optimistic vision was not verified by the reality. The decrease in industrial output in early 1964 was due partly to the rationing of electric power, which continued until April or May, and partly to the political crisis Brazil went through at that time. With these two most immediate causes of the problem eliminated, one might have hoped that the economy would be vigorously reactivated. This did not occur, and recuperation was slow and weak. Starting in 1965 new short-range causes, particularly the government's anti-inflationary policies, began to result in economic recession.

In this state of continuing economic uncertainty, sales fell, especially those of durable consumer goods. Without a market for their production, enterprises were forced to cut back. Many resorted to shutting down their plants for collective vacations. Often this became simply a prelude to the more severe measures that soon followed: a reduction in the work day and the firing of employees. The result was that for the first time in Brazil's history there was serious industrial unemployment.

Hidden unemployment had always existed, with people working in rural areas and even in the cities at unproductive activities in which the marginal productivity of their labor was zero. Unfortunately, this is a general evil in underdeveloped countries. But open unemployment of workers already integrated into the country's industrial economy had never occurred on a large scale before 1965. According to figures from careful research done by the Federation of Industries of the State of São Paulo (FIESP), unemployment in metropolitan São Paulo in June 1965 affected more than 13 percent of the industrial work force.² In the city of São Paulo alone there were more than 80,000 unemployed, while in the state of São Paulo the total unemployment was around 140,000. These figures, however, are conservative, for three reasons: First, they are based on the hypothesis that there was full employment in São Paulo in December 1964 (the data base used), which is highly unlikely. Second, this does not take into account the young people who reached working age and were unable to find jobs. Third, these figures do not take into account the shortened working days. Unemployment must have been worse than these figures show, and it was not confined only to São Paulo. The same phenomenon was occurring in all the large cities. The situation was especially discouraging in Recife and Belo Horizonte,

but was also bad in other cities. In Rio de Janeiro and Porto Alegre the news was basically the same: a reduction in industrial activity and unemployment.

It is not necessary to point out that this type of unemployment is much more serious than hidden unemployment. The latter is a chronic problem brought about by economic underdevelopment, and can even become a positive factor in development to the extent that it can provide a reserve of labor power that makes industrialization possible without endangering agricultural production. But open industrial unemployment is a rude blow to the economy. Beyond its obvious social impact, it forces a segment of the population that had been actively participating in the consumer market to reduce its purchases drastically. This begins a vicious circle in which the situation tends only to worsen.

Crisis thus dominated the Brazilian economic scene in early 1965. Unemployment was its most tangible evidence, but other factors also pointed to crisis. Sensing the weakness of the market, entrepreneurs suspended their investments, and the situation continued to worsen. Foreign investors did the same thing. Industrial leaders in almost every sector related pessimistic news in their reports and interviews. They also urgently recommended that labor legislation be modified to allow enterprises to reduce their working hours so that they would not be forced to fire qualified employees. It is unnecessary to point out how much it costs to train a specialized worker, and how much such workers had been sought after only a short time before. Retail stores selling home appliances began to hold drastic liquidation sales, seeking enough cash to pay off their liabilities. Credit, whose scarcity had originally been one of the short-term causes of the crisis, became very easily obtainable. Whereas previously the entrepreneurs had insistently pressured the banks, the latter now began to offer credit freely, something previously unknown in Brazil. But with their sales reduced the businesses did not have enough bonds based on merchandise to utilize the available credit effectively.

Thus during the first half of 1965 Brazil went through a drastic reduction in economic activity, the most serious crisis the Brazilian industrial economy had ever undergone. After August 1965 a rather partial recovery began. The Brazilian economy ceased to be in acute crisis, but returned to a kind of chronic crisis that had characterized it since 1962. The problem of unemployment was not resolved. The FIESP's employment index, which until February had remained at 100 percent, went down to 97 percent in March, 93 percent in April, 89.6 percent in May, 87.7 percent in June, and 86.5 percent in July. In August it began to climb again, to 88.2 percent, and then reached 90.7 percent in September, 92.6 percent in October, 94.2 percent in November,

and 95.5 percent in December. However, this was still an unemployment rate of 4.5 percent, in a month in which economic activity is usually intense, and without considering the young people who reached working age that year. The economic crisis was thus still present, although abated. In 1965 the product grew 2.7 percent. However, this growth was due basically to good agricultural harvests, an improvement over the poor year for agriculture in 1964. Industrial development during this period was negative (a reduction of 3.6 percent in industrial output in 1965), and it was here that the most important characteristic of the economic crisis lay.

There was a certain degree of economic recovery in industrial development in 1966, resulting in a 7.6 percent growth rate, due mostly to the pace of development during the first half of the year. But in the second half of 1966 the economy again showed signs of crisis. Using December 1963 as its base of 100, the FIESP's industrial employment index, after having fallen to a low of 83.5 in July 1965, rose to an extremely modest high of 101 in July of the following year, and then declined again to 94.7 in December of 1966. On the other hand, research carried out by DIEESE [Department of Statistics and Socioeconomic Studies] in São Paulo revealed that between 1963 and 1966 the number of employees in the metallurgical, mechanical, and electrical supplies industries decreased from 242,834 to 195,615, a drop of 19.4 percent. Finally, the help wanted advertisements in São Paulo's major daily newspaper, *O Estado de São Paulo*, indicate that the number of available jobs began decreasing again in mid-1966 and continued falling into 1967, reaching a low point in May that was comparable to employment opportunities in 1958.³ After June 1967 economic recovery began, starting a new expansive cycle that would continue until 1974.

Actually, there was an economic recession in Brazil between 1962 and 1966, as is shown in Table 5.1, which presents figures on the annual increase in the net domestic product in Brazil after 1962, and compares them with the period from 1956 to 1962. Even if we include 1962, a good year, the average increase in national income was only 2.6 percent per year between 1962 and 1966. As the population was increasing at more than 3 percent, per capita income declined during this period—a clear demonstration of the economic aspect of the Brazilian crisis.

But this crisis was not limited to the economy. It was also political. Without concerning ourselves greatly with the causes at this moment, we will indicate the political elements of the crisis, limiting ourselves to the two most representative ones, which include the other factors. They are the lack of political representation and military interventionism.

One of the fundamental objectives of any democratic system is to be representative. There is no democracy without representation, nor is

TABLE 5.1
 Net Domestic Product by Types of Activity
 (annual growth rates for given periods, in percentages)

| Activity | 1956-62 | 1962-66 | 1961-62 | 1962-63 | 1963-64 | 1964-65 | 1963-66* |
|----------------|---------|---------|---------|---------|---------|---------|----------|
| Agriculture | 5.7 | 2.4 | 5.5 | 1.0 | 1.3 | 13.8 | -5.7 |
| Industry | 10.7 | 2.3 | 8.3 | 0.1 | 5.5 | -3.6 | 7.6 |
| Mining | 10.8 | 19.4 | 1.5 | 18.4 | 22.4 | 21.4 | 14.6 |
| Manufacturing | 10.8 | 1.8 | 8.1 | -0.3 | 5.1 | -4.7 | 7.5 |
| Electricity | 9.8 | 5.3 | 11.3 | 2.6 | 7.2 | 4.1 | 7.3 |
| Construction | 5.4 | -4.4 | 0.6 | 1.3 | 2.2 | -24.0 | 6.4 |
| Transportation | 8.4 | 3.7 | 6.7 | 6.2 | 3.6 | 0.8 | 4.4 |
| Other Services | 4.5 | 3.1 | 3.2 | 2.3 | 3.0 | 3.7 | 3.6 |
| TOTAL | 6.7 | 2.6 | 5.3 | 1.6 | 3.1 | 3.8 | 1.9 |

*Preliminary estimates. Cf. "A Evolução Recente da Economia Brasileira," Desenvolvimento e Conjuntura, April 1967, p. 25.

Source: 1956-65 based on unpublished materials by the Fundação Getúlio Vargas. 1966: estimate made by the CEPAL/BNDE Center based on various sources as well as its own studies.

there liberty without participation in major decisions. One cannot speak of government by the people unless all groups and social classes, all political and ideological currents, have a voice in government.

Lack of representation is at the heart of many of Brazil's political problems. One illustration is the simple fact that more than half of the adult population in Brazil does not have the right to vote. Recently this problem has become more serious, and the lack of representation has moved to center stage, to the extent that the gulf widens between the governing and the governed.

This situation does not originate merely from the fact that after 1964 the Brazilian government was the result of an armed movement rather than of a popular election. No doubt this fact is relevant, but it is not necessarily the most important one. Nor is it sufficient to point out that this movement was more of a coup than a revolution: It did not involve all the people, nor represent structural modifications in the country's economic and social systems, nor result from armed conflict. The Congress, which had never been representative, served only to rubber-stamp government proposals after 1964. On the other hand, the executive assumed a stronger, more active role, legislating by decree. It represented only a very small segment of the broad socioeconomic spectrum. The result was a government with practically no representation, from which entire social groups are absent, conspicuously the working classes, students, the left (from the most moderate—nonradical labor groups—to the most radical), and the industrial entrepreneurs.

The other major facet of the political crisis is the emergence of dominating militarism. A professional national army arose as a powerful and organized force only after the Paraguayan War in 1865, when it took the place of the national militia. In contrast to the latter, which was no more than an unstable assemblage of military groups organized on a semifeudal basis under the control of local *coronéis*, the army has from its beginning been an organized and stable force, recruited primarily from the middle class.

Its first large-scale political action resulted in the creation of the Republic in 1889. Since then, the army has played a very important role in Brazilian political life. After Prudente de Morais's presidency (1894–1898), the army assumed a special role in Brazil, expressed by a form of military tutelage. Originally the army and the Catholic Church were the two great organized forces in the country. This fact guaranteed the army great strength, but it could also count on the force of arms, concentrating its power immensely. Naturally army officers were aware of their position, and in consequence adopted a militarist attitude. Yet for various reasons that it is inappropriate to discuss here, this militarism did not take on domineering or interventionist characteristics, but was

always moderate and tutelary in its action. The members of the military considered themselves the guardians of the country. Governing the country was the responsibility of the politicians, linked to the interests of the *fazendeiros*, big exporters and importers, bankers, and industrialists. But the military remained vigilant, arbitrating conflicts, moderating disputes, exercising its guardianship. This was the role conferred upon it by the power it represented and the position it occupied as relatively remote from immediate political and economic interests. This type of military tutelage, which tended to transform military officers into the guardians of the constitution, democracy, and public morality, did not bring particularly negative consequences to the country. The military's ideology, often characterized by a moderate nationalism, was usually exercised in favor of the progressive forces in the country. And after completing an act of more direct guardianship the army always withdrew.

This situation underwent radical change after the Revolution of 1964. Militarism as guardianship ceased to be the dominant concept, and the military not only intervened in conformity with its traditional role as guardian, but also resolved to remain in power. This was a decisive change, one that called into further question the already weak democratic system and helped to define the political crisis through which Brazil was passing.

Medium-Range Causes of the Economic Crisis

It would be naive to think that the Brazilian crisis had only recent causes or that its origins lay entirely in the government of Castello Branco. Any study would at least have to consider the medium-range causes and should also deal with the long-range causes. The latter include the developments already reviewed in the preceding chapters: the Brazilian industrial revolution, the emergence of new social classes, changes in the equilibrium of the political forces and the resulting conflicts, the emergence of political ideology, the emergence of the left as an autonomous though still weak force, the dominance of the international scene by autarchic powers such as the United States, etc. This section therefore focuses on the medium range, on those causes that date back not more than five or ten years from the period we are studying.

Personal Causes

Two factors that can be termed personal are generally pointed out as causes of the crisis: the inflationary actions of the Kubitschek government and the political insecurity and administrative incapacity of the Goulart government. The first of these can be accepted only with many reservations. In the first place, the Brazilian economic crisis,

which has already been defined as basically a recession, should not be confused with inflation. Doubtless inflation increased at a more rapid pace in the period under study, constituted a serious economic problem for the country, and was one of the causes of the reduction in the rate of Brazil's economic development. But it was not the principal cause of that reduction and was even less the cause of the recession of 1962-1966.

Second, it is only a half-truth to attribute to the Kubitschek government responsibility for this inflationary process. In 1956, 1957, and 1958 the inflation rate remained the same as in previous years. According to the cost of living index for Guanabara (Rio de Janeiro) published by the Getúlio Vargas Foundation, the rate of price increase from December to December had been 26.2 percent in 1954, and in 1956, 1957, and 1958, respectively, 21.2 percent, 13.4 percent, and 17.3 percent. In 1959, however, inflation received a sudden impulse and prices rose 52 percent. This would appear to confirm that the Kubitschek government was responsible for the inflationary surge. However, in the following year the inflation rate dropped radically, to 23.8 percent. It was only after the end of Kubitschek's term that inflation began to rise again. It is thus apparent that the Kubitschek government's role in the acceleration of inflation, while real, especially in 1959, was not so great as is often claimed. On the other hand, it was during this period that Brazil experienced its greatest period of accelerated economic growth, and that Brazilian industrial development was consolidated. Thus, it does not seem that this period is particularly relevant to the causes of the Brazilian economic crisis.

However, the same cannot be said of the Goulart government. This was truly a period of political insecurity, and it is hardly necessary to point out that in such a situation capitalists withdraw and reduce their investments. It was also a period of administrative inefficiency, of plans initiated and left unfinished, of a total prevalence of politics over administration and economics. There is no doubt that the crisis stemmed from this period to some extent.

Nevertheless, if the origins of the Brazilian crisis had been only in the Goulart government, then a recovery should have been evident when that government was toppled, or soon after. However, that is not what occurred. True, there were vague outlines of a recovery, but they were very weak. Soon the crisis returned, in dramatic proportions in early 1965, and more moderately throughout the year. What does this indicate? The personal causes help to round out an understanding of the situation but are far from explaining it fully. As will be seen below, the fulcrum of the crisis lay in structural factors.

Three medium-range causes related to Brazil's economic structure basically explain the economic crisis: the diminution of investment opportunities, limitation of export (and therefore import) capacities, and inflation.

Diminution of Investment Opportunities

The decrease in investment opportunities was the most important medium-range structural cause of the Brazilian crisis. As long as investment opportunities were limited, as long as there were no prospects for high profits with full possibilities for expansion, private investment was insufficient. National entrepreneurs and foreign investors either stopped investing or drastically reduced their investments, and without investment there is no development. The clear reduction of investment opportunities in Brazil after 1962 could be illustrated with precision if statistics were available for corporations' average real profit rates. As such figures do not exist, the fact that a reduction of investment opportunities really did occur can be established only by means of reading company balance sheets and reports and newspaper interviews with industrialists, as well as from personal experience.

The facts can be verified in Table 5.2, which shows that the percentage of gross capital formation (gross investments) fell from around 16.5 percent of the national income at the beginning of the decade to 10.7 percent and 12.8 percent, respectively, in 1965 and 1966. The responsibility for this drop, as the table shows, lies completely with the private sector. Whereas the government maintained its level of investments, the private sector, which at the beginning of the decade had invested between 11 percent and 12 percent of national income (gross domestic product), reduced its share to 5.5 percent and 7.8 percent in 1965 and 1966. Three interrelated factors directly contributed to this reduction in investment: the reduction of import-substitution possibilities, the lack of domestic markets, and idle capacity.

Reduction of Import-Substitution Possibilities. The reduction in the number of import-substitution possibilities is probably the most serious problem that Brazilian industrial development has had to confront in recent years. From its beginnings until its consolidation in the 1950s, Brazil's industrial development was carried out basically through import substitution. The new industrial enterprises began their activities with a captive market that had been opened up by the importation of manufactured goods now barred from the country because of tariff and/or exchange policies. Only after having saturated the traditional market did these enterprises endeavor to expand the domestic market by seeking out sectors that had not previously been reached by imported products. It was this policy of import substitution that allowed Brazil to continue

TABLE 5.2
Macroeconomic Relations

| | 1959 | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 | 1966 |
|----------------------------------|------|------|------|------|------|------|------|------|
| Government Consumption/Y* | 13.8 | 15.3 | 15.5 | 15.5 | 16.3 | 15.4 | 13.7 | 13.8 |
| Gross Capital Formation/Y | 15.9 | 16.5 | 17.1 | 16.3 | 16.5 | 14.3 | 10.7 | 12.8 |
| Govt. Capital Formation/Y | 4.7 | 5.2 | 4.4 | 5.7 | 4.6 | 4.8 | 5.2 | 5.0 |
| Private Sector Capital Formation | 11.2 | 11.3 | 12.2 | 10.6 | 11.9 | 9.5 | 5.5 | 7.8 |
| Imports**/Y | 8.5 | 8.4 | 8.6 | 8.1 | 12.6 | 7.8 | 7.5 | 8.2 |
| Exports**/Y | 7.4 | 6.9 | 7.9 | 6.2 | 12.0 | 9.1 | 10.4 | 9.3 |

*Gross Domestic Product

**Includes exports and imports of both goods and services.

Sources: Computed from figures of the Centro de Contas Nacionais da Fundação Getúlio Vargas. Taken from Werner Baer and Andra Maneschi, "Substituição de Importações, Estagnação e Mudança Estrutural," Revista Brasileira de Economia, 23, no. 1 (March 1969), p. 74.

to develop, even without increasing its exports proportionally. But after the 1950s a reduction in import-substitution possibilities occurred, much as Celso Furtado observed in *Dialética do Desenvolvimento*.⁴

Until the end of the 1950s it was relatively easy to start a new industrial enterprise in Brazil. All that was necessary was to find some manufactured product that had been imported, acquire the know-how to make it, either by paying royalties or by merely copying it, obtain the necessary initial capital and financing, and begin business. Today the situation is very different. Brazil continues to import a wide range of products for which import substitution is still viable in theory. In practice, however, there is another reality. By examining the list of imports, one can see that the products Brazil continues to import are those it would be difficult to produce efficiently in Brazil or else (and this is the major problem) those that demand huge investments that national entrepreneurs, even the larger ones, are unable to finance. The solution is no longer as simple as merely raising trade barriers. For example, take the case of urea, an important raw material and fertilizer that Brazil imports in great quantity. There would be substantial difficulties in producing urea in Brazil. To begin with, domestic production would necessitate an investment so large that no financial group in Brazil could handle it. Second, in order to be efficient, urea production must be on a large scale, far surpassing the needs of the national economy. This difficulty could be overcome by exporting the surplus, notwithstanding all the difficulties that such an operation would entail. But the financial problem of the large investment necessary for its production is really the essential point, well illustrating the reduction of import-substitution possibilities.

Lack of Markets and the Fall in Real Wages. The second and third causes of the diminution of investment opportunities—the lack of a market and idle capacity—are interrelated. Decreased investment opportunities are a function equally of the lack of markets and of idle capacity, which in turn is directly related to the lack of markets.

Obviously, except for what is strictly necessary to replace worn-out equipment, companies will stop investing when they see no prospects for introducing new products or increasing production. This problem arises only after import substitution for a given article has been achieved, after the entire traditional market for what was formerly imported has been satisfied by the national industry. This process generally takes some time, allowing various enterprises to become established in order to supply the market. Until that moment there is no lack of markets. But once the so-called traditional market is satisfied, the question of how to widen the market arises. If the domestic product is cheaper than its imported counterpart because it does not include tariffs or the cost

of international transportation, the initial expansion will be easy. But later (barring increased demand brought about by such dynamic factors as changes in style, the introduction of revolutionary technological innovations, advertising, etc.) the demand for the product will tend to grow in proportion to the growth of the population and of its purchasing power, given that the income-elasticity of demand for the product is equal to 1. That is, demand will grow to the extent that per capita income and real average wage increase. If the income-elasticity of demand for industrial products is a little greater than 1 (as in fact was the case in Brazil) then demand will tend to increase a little more quickly than income, but not much more.

Thus, in order for Brazilian industrial enterprises to expand faster than the rate of population growth, real average wages would have to keep up with the growth of the per capita product—or at least, if the income-elasticity of demand is greater than 1, the average real wage would have to increase by at least the same growth rate as per capita income. Otherwise there would be insufficient markets for industrial output.

This was the phenomenon that began to occur after 1958 in Brazil. Whereas the per capita product continued to grow, real wages fell. This fall resulted in a distribution of income less favorable to the consumer class, while output and, more particularly, productive capacity were increasing. Unfortunately the statistics concerning real wages are incomplete. The only satisfactory data concerns the real minimum wage. This shows that the real minimum wage (in terms of prices in March 1964, when the minimum wage was established at 66,000 old cruzeiros), defined as the average of the real minimum wage in June and December, fell from 85,374 old cruzeiros in 1958 to 54,405 old cruzeiros in 1965 and 52,437 old cruzeiros in 1966. Thus there was a 38 percent drop in the real minimum wage between 1958 and 1966.

It is true that this represents the extremes. Table 5.3 presents the real minimum wage deflated by the cost of living in Guanabara for 1956 through 1966. It shows that the drop between 1961 and 1962 was severe and exactly coincided with the year in which economic development began to slow down. It is very unlikely that this correlation was merely coincidental. Despite intensive state intervention in the economy, Brazil is still basically a capitalist country. Thus the dynamic factor in its development is demand, not supply. In terms of aggregate demand, it was consumption rather than investment that created the dynamic forces. Investment could still be carried on for some time after consumption fell, but when reduced consumption persisted, as it did in Brazil because of reduced real wages, investments would also have to be reduced.

TABLE 5.3
 Real Minimum Wage in Guanabara
 (in relation to March 1965 prices)

| Year | Minimum Real Wage (in old cruzeiros) |
|------|---|
| 1956 | 71,591 |
| 1957 | 72,205 |
| 1958 | 85,374 |
| 1959 | 73,879 |
| 1960 | 80,910 |
| 1961 | 79,906 |
| 1962 | 61,603 |
| 1963 | 55,019 |
| 1964 | 57,753 |
| 1965 | 54,405 |
| 1966 | 52,437 |

Note: The figure for each year is the average of the real minimum wage in June and December of that year.

Source: Fundação Getúlio Vargas.

The average real minimum wage from 1956 to 1961 was 77,311 old cruzeiros; for the four following years, it was 57,195 old cruzeiros. The drop is extraordinary, about 26 percent. In other words, from the first period to the second the buying power of workers earning the minimum wage fell by about one-fourth. Aside from the social injustice involved, the effects of such a phenomenon on the economy were highly negative.⁵

This reduction in the real wage did not affect only those earning the minimum wage. The median wage in the manufacturing industry in Guanabara, in 1955 prices, fell from 2,861 and 2,790 old cruzeiros, respectively, in April and November of 1958, to 2,822 and 2,613 old cruzeiros in April and November of 1962. Nor was 1958 the year with the highest real wage for manufacturing industry workers. The decrease in real wages of workers in wholesale commerce in Guanabara was even more abrupt. Using 1955 prices, in April and November of 1958, respectively, real wages averaged 3,761 and 3,708 old cruzeiros, as compared to 2,399 and 3,285 old cruzeiros in 1962.

Thus, there was an effective drop in real salaries after 1962 that was to have negative consequences on consumption. The national product, however, continued to grow, though at a slower pace. Thus enterprises

did not have a sufficient market for their output and eventually began to reduce their investments. This problem was soon to be aggravated by the Castello Branco government's wage policy, which sought to reduce wage workers' share in the national income even more.

The backdrop of this wage reduction was the concentration of income provoked by continually more capital-intensive investments, conditioned by technology imported from the developed countries. This technology seeks to economize on labor power, which is precisely the abundant factor in underdeveloped countries. The results of this imported technology are a lower capacity to absorb labor power and, consequently, unemployment, lower wages, reductions in purchasing power, and a lack of markets.

The lack of markets is also related to Brazil's agricultural structure,⁶ which is marked by deep disequilibria between very large estates and very small farms. This fact is closely related to low agricultural productivity, poor utilization of land in the large estates, rural unemployment, and even unemployment.

These phenomena are not new to the Brazilian economy. They have always existed, and were even more pronounced in the past. The industrial revolution and the emergence of a strong domestic market created the opportunity (especially in São Paulo and adjacent states) for a rationalization of agriculture through capitalist criteria of production. There was also considerable progress in agricultural methods, as well as in the marketing of agricultural products, although this function still continued to be one of the critical points in Brazilian agriculture, dominated by speculative intermediaries and oligarchically organized industrial purchasers.

Such progress, together with the very vitality of Brazilian agriculture, was an essential factor in Brazil's economic development from 1930 to 1961. During this period agriculture was always relegated to a secondary role. In addition, the economic policy of the governments of this time was based on the transfer of income from the agricultural sector, particularly coffee, to the industrial sector. This was the only viable policy for the industrialization process in which Brazil was involved. It is an established and well-known fact that industrialization generally begins in a given country only through a transfer of income from the traditional agricultural sectors to the modern sectors.

In order for this development to occur, however, agriculture must be resilient enough to survive the transfer of income and also be able to free labor power (through a rural exodus) to be employed in industrial activities and related services. At the same time, agriculture must continue to increase production in order to meet the increased demand for agricultural products brought about by increases in population and

income. If agriculture does not have such resilience it will eventually become a serious obstacle to the process of economic development. Aside from the appearance of structural inflation, it will be necessary to import foodstuffs, diverting precious foreign exchange resources away from the importation of machinery and equipment.

Brazilian agriculture has the necessary resiliency to support this double impact—the transfer of income and the loss of labor power. There are indications, however, that the limits of this resiliency are being reached.⁷ In addition (this being the most serious aspect of the problem) the import-substitution phase with its captive markets for new investments no longer exists. As a result, agriculture has been called upon to play a new role in the Brazilian economy: that of a market.

This is a role Brazilian agriculture has never played because the extreme inequality of the agrarian structure would not permit it. Agrarian reform, always promised and always hoped for, has never been carried out. During the João Goulart government a frantic and dramatic political battle revolved around this issue. Reform continued to be proclaimed after the Revolution of 1964. Until it is carried out, however, it will be difficult to incorporate the two-thirds of the Brazilian people who are alienated from the national market. Comprehensive agrarian reform and an effective and revolutionary literacy campaign are the two most important conditions for an extraordinary growth in the Brazilian domestic market, which in turn would open new and extraordinary perspectives for the Brazilian economy. Brazil still has a frontier economy. This frontier is not geographical, but consists rather in the limits on the market, which is hindered by the country's archaic agrarian structure.

Obviously there are other problems besides agrarian reform and literacy that must be dealt with in order for agriculture to cease being a stumbling block to Brazilian economic development to the extent that it marginalizes its workers. There are problems related to transportation, rural energy, the development of cultivation techniques, mechanization, the introduction of rational methods of production, and the organization of labor and systems of distribution. All these factors, however, ought to be considered within the perspective of the inadequate and unjust agrarian structure that still survives in Brazil. During the 1960s, when the lack of markets for industrial output became a crucial problem for the country, the agrarian structure was the most serious obstacle to the integration of the rural population into the domestic market.

Idle Capacity. Idle capacity is related to weak markets. If the market lacks dynamic force, enterprises will reduce their investments and development will lose some of its impulse. The result is idle capacity. It was not created, as might be expected, because the economy entered a recession after a great development. Rather, it occurred because

enterprises continued to invest for a while despite the increasing weakness of the market, and the country continued to develop. Inflation, provoking an artificial demand, made the rate of interest generally negative and complicated the calculations of profitability, leading businesses to continue to invest when in fact economic conditions favoring investment no longer existed. Thus idle capacity was created in various sectors, particularly in the consumer goods industry. Obviously, this idle capacity aggravated the lack of investment opportunities. Even though the market began to increase again and demand presented a new impulse, it was first necessary to reduce idle capacity before investors were again disposed to invest.

Limitations on Import Capacity

After the diminution of investment opportunities, the second medium-range cause of the Brazilian economic crisis was the limitation of export capacity (and, thus, of import capacity). This cause is related to the first in the sense that difficulties in importing raw materials and especially equipment reduce investment opportunities, because of the concomitant rise in the price of foreign exchange. It is true that limitations on the import of equipment create obstacles to investment, rather than directly reducing it, because investment opportunity exists internally. In one way or another, however, one of the fundamental causes of the Brazilian economic crisis was to be found in the realm of international trade.

The limitations of Brazilian import capacity can be illustrated simply. Average annual imports, which were \$1,400 million in 1950–1954, fell to \$1,360 million in 1955–1961, while the domestic product was increasing by 6.1 percent per year. The result was a reduction in the import coefficient, which went from 12.6 percent in the first period to 8.6 percent in the latter period.⁸ The situation did not improve, and in fact worsened. In 1964, Brazilian imports were only \$1,263 million. In 1965 and 1966 there was an improvement in Brazil's balance of payments, due in part to increased exports, but principally to the reduction of imports provoked by the crisis.

The 31 percent drop (from 12.6 percent to 8.6 percent) in the import coefficient demonstrates that import substitution was the escape valve that allowed the country to continue to develop despite the drop in import capacity. But when the possibilities of import substitution were drastically reduced it became necessary for import capacity to begin to grow again. However, as can be seen, this did not happen. Import capacity continued to decline, creating an extremely difficult situation for the Brazilian economy. There was an encouraging recovery in 1965, but the general picture was still not very heartening.

The limitation in import capacity was naturally related to a parallel limitation in export capacity. This in turn had classic causes such as the tendency toward a deterioration in underdeveloped countries' terms of trade, the income-elasticity of international demand for agricultural products (among which coffee is an outstanding case), growing international competition as a result of the entrance of new producers into the market (as again is the case with coffee in relation to the African countries), and the introduction of artificial substitutes such as the synthetic fibers that have reduced the international demand for cotton. These general causes were beyond Brazil's control. In addition, because Brazilian economic development was for the most part accomplished through import substitution, the Brazilian government neglected to stimulate exports of manufactured products to its traditional markets and to Latin America, and of primary products as well as manufactured products to new markets in Eastern Europe, Africa, and Asia.

This neglect is why the gap widened between exports and necessary imports, which during the mid-1960s tended to grow proportionally to the increase in national output. There is an important reservation, however, in relation to the effects of the limitation of export capacity. During the worsening of the economic crisis in 1965 and 1966, this limitation ceased to be, in the short range, an obstacle to development. Especially in 1965, Brazilian imports were drastically reduced, not because import capacity was limited but rather because the demand for imports was sharply lowered by the crisis. To the extent that enterprises reduced their output, they also reduced their imports of raw materials. And the increase in idle capacity discouraged the importation of equipment. The result was that during these years limitation in import capacity ceased to be a cause of the crisis. After 1966, however, Brazilian exports began to climb, reaching \$1,890 million in 1968. Nevertheless, a limited import capacity continued to be one of the major challenges facing the Brazilian economy.

Inflation

Finally, inflation figures as one of the medium-range causes of the Brazilian economic crisis. After maintaining for many years an annual rate of about 20 percent, inflation accelerated, starting in 1961, just as the economy was entering its crisis. At this point the discussion between monetarists and structuralists as to the causes of inflation began to become meaningless. As long as inflation was in the range of 20 percent it was still possible to seek its origins in foreign trade (that is, in a rise in the price of the dollar because of the chronic tendency toward disequilibrium between imports, essential to a country in the midst of industrialization, and exports, still based in the traditional agrarian

economy); in the insufficient supply of agricultural products for domestic consumption; and in other points of constriction of demand. The issuing of money was then more a consequence than a cause of inflation. In the mid-1960s, however, it became clear that Brazil's inflation had changed its character.

From Demand-Pull Inflation to Cost-Push Inflation. During the first phase of the Brazilian industrial revolution, which ended in 1961, one could speak neither of insufficient demand nor of predominantly cost-push inflation. But the beginning of the Brazilian crisis was marked by a change in the causes of inflation from the pull of a dynamic demand to the push of rising costs. Ignácio Rangel, in *A Inflação Brasileira*, was the first to perceive this. This book, despite its many theoretical imprecisions, is doubtless one of the most important Brazilian books on inflation. The author's extraordinary imagination and sharp observation allow him to open up new perspectives on the inflationary phenomenon in Brazil:

This missing beat in the evaluations of both these theories is idle capacity. Both schools ignore it openly or implicitly. . . . The problem is that . . . both the structuralists and the monetarists . . . place a hypothetical insufficiency of supply at the heart of the problem in relation to a supposedly excess demand, whereas the truth is that it is the level of demand that is insufficient—unable to assure a satisfactory degree of utilization for existing productive potential—precisely because of inflation.⁹

Therefore inflation stems not from demand, but rather from costs. The function of inflation is to stimulate demand, given the existence of idle capacity.

Further on Rangel gives a more precise definition to the function of inflation in the Brazilian economy:

Once the areas institutionally prepared to absorb new investments are saturated, and before new fields are ready, the profitability of new investments declines, reducing the system's total investments. In other words, a tendency toward economic depression gathers strength that would pass from potential to reality if investment were really allowed to decline. An elevated inflation rate is one of the methods by which the economy resists this tendency, sustaining the system's rate of investments. . . .¹⁰

Thus inflation "is the economy's defense mechanism against the tendency toward reduction in the rate of investment."¹¹ Continuing, Rangel shows how inflation has historically acted on the economic system in its role as a defense against economic depression:

(a) initially, as an efficient means for the accumulation of resources by the state, enabling it through its own expenditures to increase total expenditures during the initial phase of the industrialization process; (b) later, in the end of the consumer goods phase of the import-substitution process, when exchange rates were frozen, as an efficient tool to raise the marginal efficiency of capital, by reducing the price of fundamental fixed cost items (imported equipment) in relation to the principal variable cost items (labor power and domestic raw materials) and as a result inducing an increase in private investments; (c) in the end of the phase of industrialization linked to the substitution of production goods (after Kubitschek's *Plano de Metas*), as an efficient means to impede the condensation of surplus value in monetary or "liquid" form—which would imply economic depression—causing it to invest indiscriminately in either durable consumer goods or capital goods.¹²

These relatively extensive quotations are taken from Rangel's work not only because of their intrinsic importance, but also because that work presents both an inspiration and a parallel to the ideas that I will begin to develop in this section on inflation, although there are some basic divergences. For example, although the structure of rural land ownership is obviously one cause of the insufficient development of the domestic market in Brazil, I do not consider this as important as does Rangel in explaining the causes of idle capacity and insufficiency of demand. As has been shown above, the problem of idle capacity must also be considered in relation to the narrowing of opportunities for import substitution and the concentration of income.

The Causes of Cost-Push Inflation. The economic crisis was defined by an increase in idle capacity. The process of import substitution that marked Brazil's industrial development between 1930 and 1961 allowed the realization of industrial investments without a concomitant and proportional growth of the domestic market. Enterprises found already existing markets that had previously been supplied by imports. But when these preexisting markets were satisfied, businesses began to depend on the activities of the domestic market, because the concept of an international market was beyond the grasp of the majority of the entrepreneurs.

It has just been shown how the Brazilian domestic market in absolute terms did not grow in proportion to the country's economic development. Aside from wage policies that tended to reduce wage workers' buying power to the benefit of the capitalist classes, after 1955 there was also an additional process of income concentration caused by the move from the first phase of the import-substitution process, characterized by the installation of light consumer industries, to the beginning of the second phase, characterized by an emphasis on equipment production, durable

consumer goods, and chemical products. The investments necessary for this type of production are much more capital-intensive than in the case of the light consumer goods industry. The technology developed by the industrialized countries seeks to economize on labor as much as possible. The nature of certain products facilitates the attainment of this objective: In the capital goods industry, the durable consumer goods industry, and, especially, the chemical industry, the capital-labor ratio tends to be considerably higher than in the light consumer goods industries typical of the first phase of the import-substitution process. The result was a tendency toward an even greater concentration of income than that already defined by the drop in real wages.

Income concentration and the relative reduction of the consumer market were aggravated to the extent that capital-intensive investments became dominant, the economy becoming increasingly less capable of absorbing the available supply of labor resulting from population growth and the rural exodus. Unemployment thus increased. Between 1950 and 1960, whereas the urban population was growing 5.4% per year, industrial employment increased only 2.6%. At the same time, the industrial sector's share in the GNP rose from 20% to 29%, while the proportion of the population actively employed in industry fell from 14% to 13%. At that time, however, the tertiary sector was still relatively capable of absorbing part of this unemployed labor, and another part adopted the activities and behavior typical of hidden unemployment. Open unemployment was avoided. During the 1960s, however, the problem got worse and open industrial unemployment arose, not only because of the economy's incapacity to absorb the approximately one million new workers who annually appeared on the Brazilian labor market, but also because of the absolute reduction of employment in various industrial sectors.

Given the inherent tendency of the capitalist system to create unemployment at the same time as it concentrates income in periods of prosperity, such as the late 1950s in Brazil, there is nothing strange in the fact that industrial sector after industrial sector found itself with idle capacity to the extent to which possibilities of import-substitution had been exhausted. It was precisely this idle capacity, resulting fundamentally from the concentration of income, that was to become one of the mainstays of Brazilian inflation in the 1960s, and that at least temporarily rendered obsolete the dispute between monetarists and structuralists.

In addition to the concentration of income and idle capacity there is another factor that helps explain the inflationary process: the monopolistic nature of the Brazilian market. We need not dwell on this factor, because it is very obvious. Oligopolies and cartels prevail in

Brazil. The concentration of income is at the same time cause and result of a permanent process of economic concentration. On the other hand, the invasion of the national economy's industrial manufacturing sector by foreign capital during the 1950s gave a large impetus to the creation of trusts. The result is that many Brazilian industrial sectors, including those that fill special orders for the government, are organized in an oligopolistic manner. The marketing and distribution of agricultural products are also notoriously oligopolistic. And the oligopolists as well as the oligopsonists (even those less structured and defined as such) organize easily into cartels, making any true price competition unthinkable.

Obviously there were other inflationary pressures. The large surplus in the trade balance in 1965 forced the government to issue a great quantity of money to pay the national exporters, at the same time as they were collecting exchange credits abroad. The enormous deficits of the state railroads and shipping enterprises, in part caused by excessively low fares and freight rates, also occasioned money issues and were thus a cause of inflation. After the Revolution of 1964 the situation reversed, and a drastic increase in rates contributed to cost inflation.

The Inflationary Process. With the causes thus defined, it is easy to understand the inflationary process that affected Brazil after the beginning of the crisis. Enterprises, operating with idle capacity, saw their costs rise and their profits diminish. The marginal efficiency of capital was rapidly decreasing, to the extent that various economic sectors were one by one finding themselves with idle capacity. In self-defense, businesses immediately began to (a) raise prices, (b) pressure the government to increase its purchases from the private sector, and (c) pressure the government and the banking system to increase credit.

Price increases during an epoch of insufficient demand were possible only because of the oligopolistic nature of the market. In face of a demand that was growing inadequately, if at all, as well as an inflationary process already at full steam, which had until then been based on excess demand, price increases were the obvious solution. In this way enterprises defended themselves against already existing inflation and also against the fall in demand. The oligopolized and cartelized market both protected against the threat of price wars and made such a policy viable. But to the extent that price hikes increased above the current rate of inflation, they were no longer merely a response to increased costs, but became a cause of the acceleration of inflation.

Pressuring the government to increase spending (despite the rhetoric of private initiative) was another perfectly natural defense mechanism of the private sector. Faced with a sharp decline in private consumption, businesses had no alternative but to try to convince the government to

increase purchases. For instance, the coffee growers pressured the government to buy their surplus production at the highest possible prices, and the government readily yielded. An inherent aspect of the development process of underdeveloped countries today is the increase in government's responsibilities, to the extent that the *laissez-faire* state has become obsolete, because the private sector has shown itself incapable of assuming primary responsibility for development, and economic planning and increasing state intervention in the economy have become universally accepted realities.

The growth of government spending brought about by private sector pressures, without a corresponding increase in tax revenues, immediately provoked a deficit in the government budget and consequently new issues of money. It should be pointed out that the autonomous increase in private sector prices, especially in those areas that directly supplied the government (which are among those most easily organized into cartels), caused inflation directly but also aggravated the governmental deficit even further. Thus the government, which had begun each fiscal year with the goal of balancing the budget, was pressured to buy more than it had planned and at prices higher than it had foreseen, and ended up being forced to issue great amounts of money in order to solve its budget problems.

Finally, in order to defend themselves against existing inflation, enterprises pressured the government and the banking system for more credit. Greater credit was fundamentally important to them for two separate reasons. First, the largest possible volume of credit would tend to reduce the necessity for working capital, particularly short-term liquid assets minus inventories. In an already inflationary situation, in addition to the price increases needed to defend real profit from inflation, making it diverge as little as possible from apparent book profit, it was also necessary to reduce to the minimum (or, if possible, make negative) the difference between short-term liquid assets such as cash and accounts receivable (but not including inventory) and accounts payable. In other words, it was important to reduce to the minimum needed for security the ratio between "quick" current assets and current liabilities, because in the final analysis what really suffers the effect of inflation in an enterprise is the difference between cash and receivables on one side and accounts payable—that is, liquid assets minus inventory—on the other side.¹³ It is natural, therefore, that businesses did everything in their power to increase their credit. To the extent that they succeeded, the economy suffered immediate inflationary effects.

Second, the credit obtained implied a negative real interest rate, in spite of carrying the nominally higher interest charged by the banking system, which benefited from its privileged position within an inflationary

system. The level of investments in a country depends on the level of income and, given this, on the relation between the marginal efficiency of capital and the market's current interest rate. In the depression in which businesses found themselves, after a long period of prosperity, at the time when the Brazilian crisis arose, the marginal efficiency of capital, that is, the profit expectation, was very low. Only a negative interest rate, made possible by inflation, would allow them to continue to invest, and even then at the risk of increasing their idle capacity. The alternative for new investments (other than, of course, the purchase of foreign exchange) was to increase the liquidity of each enterprise, but, as has been demonstrated, this solution was totally unfeasible in an inflationary situation.

The corporations then pressured the banking system for more credit, in addition to working out new forms of financing with private financiers. This amplification of credit, added to the autonomous price increases already mentioned and the pressure put on the government to increase its expenditures, was transformed into the basic cause of inflation in the mid-1960s.

Corporate Profits and Cost-Push Inflation. The entire Brazilian inflation in the mid-1960s was basically cost-push inflation. When the Costa e Silva government took power, its team of economists under the leadership of Delfim Netto immediately and very correctly defined the inflation as being primarily a matter of costs. However, the team did not define these costs very completely. Naturally, wages were not mentioned. Although they are a typical cause of cost-push inflation, they were on the decline in real terms at the time in Brazil. Three costs were pointed out: excessive interest rates, the rise in public service rates, and the increase in the tax burden. Doubtless these costs are partially responsible for inflation. However, the most important cost, whose increase constituted the basis of the entire inflationary process, was not pointed out: corporate profit.

It is necessary to remember that profit is nothing more than a type of cost. Like interest, although in different terms, profit can be considered as the cost of capital itself. When enterprises, faced with crisis, automatically began to raise their prices at a time when demand was diminishing instead of growing, they were directly provoking cost-push inflation as they sought to defend their profit rate. It is clear that cost-push inflation is possible only in monopolistic situations. The government naturally had a monopoly and thus contributed to cost-push inflation by increasing the tax burden in order to deal with the increased public expenditures demanded by business. The latter also generally had monopolistic market conditions and was thus able to provoke an inflation of costs by trying to prevent a reduction in profits. This is not to say

that inflation tended to make large profits for the entrepreneurs after 1961. On the contrary, during the crisis by all indications the real profit rate declined abruptly, when it did not become negative. What the corporations sought through autonomous price increases was simply to maintain their rates of relative profit so that they would not be totally destroyed.

Viewed in these terms, with profit having been the fundamental cost in the cost inflation that became dominant in Brazil during the 1960s, the problem of the interest rates charged by the banking system can be understood more easily. In the first phase of galloping inflation the banks, which received deposits at nominal interest rates, demanded an elevated rate from businesses. The latter paid because even so, the real interest rate was negative for them. Thus we see a typical case of demand inflation. The banks charged such high rates, and were not very concerned about their own operating costs, because the enterprises' demand for credit was so enormous. When the inflation rate began to decline, the real interest rates went from negative to positive. The demand for credit tended to diminish. It would have been natural for the banks to reduce their interest rates, in order to increase the number of applications. Because of their high costs, however, they were unable to lower rates in proportion to the fall in demand. And even if some of them had been better administered and therefore in a better position to make decisive cuts in their interest rates, they would not have done so because of a tacit agreement among the banks to avoid an interest rate war. Once again it was cost-push inflation, motivated by the profit factor, and made possible by the imperfect organization of the market.

In summary, during the Brazilian crisis, when import-substitution possibilities were severely restricted, enterprises found themselves with growing idle capacity, aggravated by the concentration of income. In order to defend their declining profit rates they began to provoke a cost inflation that was possible because of the monopolistic nature of the market. Thus, during a period of declining demand, they began to raise their prices autonomously, directly provoking inflation, to pressure the government to increase its expenditures, and to pressure both the government and the banking system to provide more credit. The government, in response to these pressures, increased its expenditures and acquired a growing deficit, resolving the situation initially by issuing new currency and later by increasing taxes, which came to be a new focus of cost-push inflation.

Inflation, although it still played a certain role in the Brazilian economic system, could no longer be considered a factor favoring development. Its major merits continued to be the creation of forced

savings, the transfer of these savings to the government and to industry, the creation of greater demand (even an artificial one) for durable consumer goods, and the stimulation of investment by resources transferred from wage workers to the private sector, a stimulation made more significant by financing and negative interest rates. On the other hand, these savings were continually diminishing as the classes affected by inflation, especially the workers, succeeded in readjusting their wages more frequently. The distortions in investments provoked by inflation were accentuated. The idle capacity of some industrial sectors increased. Accounting and financial control became more difficult and less precise, to the point that many enterprises effectively lost control. The social injustices provoked by redistribution of income were heightened. Inflation became a permanent focus of social instability. Thus it is typically considered to be a medium-range cause of the Brazilian economic crisis.

Thus there are three general and interrelated medium-range causes of the economic crisis: the lack of investment opportunities, limitations on import capacity, and inflation. Directly related to the reduction of investment opportunities are the narrowing of import-substitution possibilities, idle capacity, the lack of markets, and political insecurity.

Medium-Range Causes of the Political Crisis

If one were to seek the long-range causes of the political crisis it probably would be necessary to go back to the Paraguayan War, the proclamation of the Republic, and the system of social stratification and political control at that time. Then we would have the agitated 1920s, the Revolution of 1930, the formation of political parties, the passage from the stage of clientele politics to a populist and then to an ideological style, the struggle between industrialism and agriculturalism and its waning importance in the face of the rise of an autonomous left, and finally, the medium-range causes of the crisis. The former elements have already been discussed in Chapter 4, which analyzes the structural transformations in Brazilian politics. Thus the present discussion can be limited to the more recent causes of Brazil's political crisis.

As in the case of the origins of the economic crisis, there are both personal and structural aspects of these causes. In this case the personal causes are probably almost as important as the structural ones. Among these personal causes the resignation of Jânio Quadros is obviously the first. Quadros, who had obtained one of the most remarkable political victories in the history of Brazil, represented many classes and social groups and incarnated the hopes of millions of Brazilians. This president, incapable of resolving the conflicts and inherent contradictions in the

coalition of forces that had elected him or of making the compromises the presidency demands, resigned overnight, dramatically deepening the existing crisis of representation in Brazilian politics.

The vice-president, João Goulart, sworn in only after an abortive coup by considerable sectors of the armed forces, succeeded only in making the situation worse. Representativeness was not the only thing lacking in his government. Its instability, its lack of goals and policies, its lack of seriousness and political authenticity, its systematically demagogic approach to problems, the left image it presented—all these factors, which were accentuated with time, could only worsen the political crisis.

Among the medium-range structural causes we will touch briefly upon only three, though this topic is worthy of much more lengthy analysis. First, there is the emergence of the left as an autonomous political force, and its lack of maturity. It was only after the Kubitschek government that the left relegated industrialism and nationalism to a secondary plane and became autonomous in relation to the industrial entrepreneurs. This victory, however, had to be paid for with the price of immaturity. Suddenly the left not only gained autonomy but also won some electoral victories and saw in the federal government a president who would allow it to operate freely—who up to a certain point even opened up some doors for the left. These facts gave rise to a serious error in calculating the left's real political strength, and thus to a policy of agitation that, by the end of the Goulart regime, brought some of the most extreme left groups to begin to prepare for the revolution. Some even imagined that in a country like Brazil, where industrial capitalism was already a well-established fact and where the middle classes were an indisputable political reality, they could gain power and socialize the country by means of a simple government coup.

Second, there was the alarmism of the right. Since the first days of the João Goulart government, alarmism had obviously been the great political strategy used by the most radical elements of the right to bring together the middle classes and the productive classes. The theme was always the same: Communism is knocking at the door, the government is dominated by communists, the communist conspiracy has a foothold and is moving forward. The rightists repeated this so often that finally many left elements also began to believe what the right was saying and acted correspondingly, with the result that alarmism began to have some base in reality.

Third, within the armed forces there was a growing influence of the graduates of the Escola Superior de Guerra (National War College), who were better prepared and better organized than the rest of their colleagues, and who had developed a specific ideology and military strategy based

on the inevitability of a third world war and the necessity for Brazil to be linked to the U.S. bloc.

Finally, as a medium-range personal cause, there is the death of President Kennedy, whose progressivism, idealism, and courage had transformed the world political scene and opened new political, economic and social perspectives, particularly for the Latin American countries, and the succession of Lyndon Johnson, who hardened foreign policy, reviving, in the attempt to affirm U.S. continental leadership, methods that had long since died and been buried.

The convergence of these personal and structural factors made possible the Revolution of 1964, whose victory came to be the dominant short-term cause of the political crisis.

Short-Range Causes of the Economic Crisis

The short-range causes of the economic crisis, and particularly of the recession that began in early 1965, are directly related to the economic policy of the Castello Branco government. This policy will be dealt with here only briefly so as not to give it greater importance than it deserves in relation to the Brazilian crisis.

The *Government Economic Action Program: 1964–66* very correctly placed as its first objective “the acceleration of the country’s tempo of economic development,” and as the second objective “to progressively contain the inflationary process during 1964 and 1965, aiming for a reasonable price equilibrium after 1966.” Then it cited three other objectives. On the next page the priority given to development was even more strongly emphasized in the depiction of a model in which the objective of accelerating development was located in the center and those of countering inflation, assuring full employment, correcting deficits in the balance of payments, and doing something about sectoral and regional inequalities were circled around it as if they were the means toward this goal.¹⁴

However, there was a contradiction between theory and practice. In the *Economic Action Program* itself there was mention of the “urgency” of combatting inflation.¹⁵ And in reality this policy was given full priority, whereas development was relegated to a secondary position. The whole emphasis of governmental policy, as expressed in the speeches and statements of those responsible for the concrete actions taken, was put on the fight against inflation.

Thus it is necessary to examine the government’s economic policy through this prism, which shows a more general contradiction in the very heart of the *Economic Action Program*. The program stated that a “shock treatment” would be inadvisable.¹⁶ Nevertheless it aimed to

reduce the rate of inflation, which was 92 percent in 1964, to 25 percent in that year and 10 percent the next year.¹⁷ Although some people might say that this is merely a question of semantics, only a shock treatment could achieve such a drastic reduction.

This drastic approach, which received the name “progressive containment,”¹⁸ was put into practice. It took off from a strictly monetarist analysis of inflation,¹⁹ although later it presented price indexes in which the agricultural deflator grew from 66 in 1949 to 456 in 1960, whereas the industrial deflator increased from 72 in 1949 to only 333 in 1960. The contradiction was even more obvious in light of the following statement from the program:

If the historically observable tendency of agricultural production for domestic consumption persists, the potential demand for foodstuffs in Brazil derived from a regular annual economic growth of 3.4 percent per inhabitant (which would be quite a favorable rate) and an average elasticity of demand of 0.49 would result in an average annual difference of 5 percent in the rhythm of expansion between supply and demand whose cumulative effect would represent an increasingly intense inflationary pressure.²⁰

Nevertheless, this structuralist position, which contradicts the monetarist position adopted earlier in the same document, had no effect on the solutions that were adopted. The anti-inflation strategy was strictly monetarist, erroneously defining inflation as if it were exclusively a demand-pull type of inflation, and was based on three fundamental points: reduction of the budget deficit, reduction of demand, and combat against the psychological and speculative causes of inflation.

The reduction of the budget deficit was carried out through increased taxes, decreased government expenditures and investments, the elimination of government subsidies, and an increase in public service rates. A reduction in demand was again sought through an increase in the tax burden, thus reducing the disposable income of the general public, through credit restrictions limiting enterprises’ investment possibilities, and through a wage policy aimed at reducing consumption. Finally, the attack against the psychological and speculative causes of inflation was attempted by means of instruments such as the establishment of price controls (Resolution 71), the Stimulus Law, numerous speeches and appeals, and the Campaign in Defense of the Popular Economy carried out by the Women’s Civic Union (União Cívica Feminina) with the collaboration of the government agency for controlling consumer prices, developed around the idea that inflation was in fact over and Brazil was now in its “corrective” phase.

This was the strategy to combat inflation, but government economists were sufficiently realistic to admit that a reduction of investments and consumption would threaten the country with recession. Therefore various compensatory mechanisms were suggested in order to counter-balance the negative effects of the deflationary measures. The major ones were a housing plan, an increase in public works, an increase in exports, and the acceptance of foreign investments.

All of these compensatory mechanisms failed. The housing plan, which was supposed to create many jobs because of the low capital-labor ratio in the construction industry, did not have much effect, as members of the government themselves recognized. It was unrealistic to think that the expected results would be attained in the short term, especially since the whole plan was based on the simplistic and idealistic notion that the problem would be resolved merely by proclamation of a law permitting monetary correction (price indexing) for real estate financing and the creation of means for financing. It was also naive to think that occupational mobility was so great that people working in the metallurgical or textile industry would be able to transfer to the construction industry when they lost their original jobs.

With respect to the increase of public works (among which projected highway construction was especially important), in addition to the difficulty already mentioned in connection with the housing plan, there was also a conflict with the government's objective of reducing the budget deficit. It can thus be easily seen that this compensatory mechanism did not have much chance of success.

There was an increase in industrial exports but it did not have the desired effect, because Brazil's industrial exports are so negligible that a large increase in them makes very little difference in the total list of either exports or industrial activity. For example, in 1964 Brazilian exports of manufactured goods rose only \$63.1 million, amounting to 4.6 percent of exports.²¹

Finally, the great influx of direct foreign investment, which was expected when the conservative Marshal Castello Branco took over the presidency and modified the law for the remission of profits, never materialized. Once again it was demonstrated that foreign investors were much less interested in the question of legal restrictions on the remission of their profits than in real opportunities for profitable investments.

All the deflationary measures, which had so aggravated the fundamental problems of the Brazilian economy such as the lack of markets and insufficient demand, together with the nonfunctioning compensatory mechanisms, necessarily resulted in crisis, unemployment, and a general reduction in economic activity.

Another very simple factor contributed further to this situation. Inflation, despite all the distortions it had provoked in the economy, still had a role to play within the economy: to maintain, albeit artificially and only to some extent, the level of demand. The anti-inflationary measures, although they partially succeeded in countering inflation (according to figures from the Getúlio Vargas Foundation, the cost of living in Guanabara rose 45 percent in 1965, 40 percent in 1966), also caused inflation to lose its efficacy for this purpose. Suddenly a vacuum was created in the economic system. Inflation no longer stimulated demand, and nothing arose to take its place. On the contrary, the inflationary practices previously referred to had a negative effect on the economy.

And as if this were not enough, not only was the artificial demand provoked by inflation eliminated, but what could be called the normal demand also shrank. Foreseeing this reduction, if not the absolute stagnation of the inflationary process, businessmen immediately began to reduce their stocks. This is a typical attitude for entrepreneurs to adopt when there are prospects of monetary stabilization. Thus a lowering of inventory was added to the reduction of demand caused by increased taxes and credit restrictions. However, reduced inventory itself is only one of the factors that helped to bring about the reduction of intermediary demand. It is not the only one, as some governmental spokesmen claimed when confronted with the crisis.

Additionally there was a reduction in final demand on the part of the consumers. For they also naturally reduce their spending—especially for durable goods—when there are prospects for the stabilization of the economy. On the other hand, the government's wage policy, particularly the establishment of the minimum wage, had negative effects. The new minimum wage at the beginning of 1965 represented a drastic drop in workers' real wages (see Table 5.3) and, naturally, had a negative effect on the final demand for consumer goods. Later, with the decree of new minimum wage levels at the beginning of 1966 and 1967, the government maintained the policy of reducing real wages, always allowing for an inflationary margin that was lower than the one that ought realistically to have been foreseen. It was only in 1968 that the government of Costa e Silva began to reverse this policy.

July 1965 was the high point of the crisis. Unemployment in São Paulo reached 13.5 percent. After June, however, the unemployment rate had begun to diminish. This tendency was probably the result of the large agricultural harvests of 1965, which sustained the rural population's purchasing power. On the other hand, although the government itself was making only trifling investments, the state enterprises were continuing to buy intensively in the private sector. In July a very fortuitous

governmental measure was adopted: a temporary reduction in the retail sales tax. The consequent price reductions had a favorable psychological effect on the public. Confidence began to be shown again. Investments took on a new impulse, especially those made through the recently created National Machinery and Equipment Fund, which made possible generous financing for the purchase of domestically produced machines and equipment. Foreign investments also became more frequent, although still of a lower volume than the government hoped for. Consumers began to spend again; unemployment was reduced. The indexes of bankruptcy and moratoriums dropped, as well as the Labor Department's legal approvals for dismissing workers. The economic crisis was far from being overcome, however. It had lost its strong impulse, but continued in the already existing unemployment, idle capacity, unsatisfactory investment opportunities, and slowdown in industrial investment. In late 1966, however, the crisis returned in full force, and economic recession continued until mid-1967.

The policy that fought inflation by reducing demand when the inflation was in fact caused by costs resulted in economic stagnation or, more precisely, economic recession. An intermediate result of this policy that acted as a fundamental cause of the economic crisis was the reduction in private consumption, which dropped from 69.2 percent in 1960 (a year when Brazil was in a full process of economic development) to 65.6 percent in 1965 (see Table 5.4). This reduction in consumption, basically a fruit of wage policies and the concentration of income, did not result in growth in the rate of gross formation of fixed capital. On the contrary, the latter declined from 17.3 percent to 14.9 percent, basically because of the reduction in private investment. What did increase was inventories—a fact that illustrates the basic nature of the crisis. To the extent that enterprises were accumulating stock in their warehouses because of workers' lower purchasing power, there was no stimulus to production.

Short-Range Causes of the Political Crisis

The short-range causes have already been touched upon in the discussion of the symptoms of the Brazilian political crisis. First there are the general problems that constituted the long- and medium-range origins of the crisis: lack of representativeness, denial of voting privileges to illiterates, the leadership elite's intransigency and refusal to engage in dialogue, the immaturity of the left, and the political instability of the Goulart government. Then we have the Revolution of 1964, which to some extent dealt with some of these problems, especially that of

TABLE 5.4
Real Product by Type of Expenditure
1956-1965 (Selected Years)

Billions of Cr.\$ at 1960 value
Percentages of Total Gross Product

| Activity | 1956 | 1960 | 1961 | 1962 | 1963 | 1964 | 1965 |
|----------------------------------|-------|-------|-------|-------|-------|-------|-------------------|
| Total Investment | 14.0 | 18.1 | 18.1 | 19.7 | 17.4 | 18.1 | 18.9 |
| Gross Formation | | | | | | | |
| of fixed capital | 12.3 | 17.3 | 16.8 | 17.8 | 16.5 | 16.1 | 14.9 |
| a) Public ² | 3.5 | 7.4 | 7.6 | 8.2 | 7.0 | 6.7 | 7.2 |
| b) Private | 8.8 | 9.9 | 9.1 | 9.4 | 9.4 | 9.4 | 7.7 |
| Inventory Variation | 1.7 | 0.8 | 1.4 | 1.8 | 1.0 | 2.0 | 4.0 ¹ |
| Total Consumption | 87.6 | 84.6 | 83.5 | 82.2 | 83.7 | 82.2 | 79.9 |
| a) Government | 14.7 | 15.3 | 15.5 | 15.5 | 16.3 | 15.4 | 14.3 ¹ |
| b) Personal | 72.9 | 69.2 | 68.0 | 66.7 | 67.4 | 66.7 | 65.6 |
| Exports of Goods and Services | 8.5 | 7.2 | 7.4 | 6.4 | 7.2 | 6.3 | 6.9 |
| Imports of Goods and Services | 10.1 | 9.9 | 9.1 | 8.3 | 8.3 | 6.6 | 5.7 |
| Gross Domestic Product | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

¹ Estimates made by the CEPAL/BNDE Center.

² Includes mixed enterprises.

Source: Cf. "A Evolução Recente da Economia Brasileira," *Desenvolvimento e Conjuntura*, April 1967, p. 28. Differences between this table and Table 2.4 are due to differences in criteria. These differences, however, are not significant enough to alter the conclusions.

political instability, but which also, and more importantly, aggravated them.

In particular, the already acute problem of the government's lack of representativeness became worse. The executive office became the fruit of a *coup d'etat*; the legislature, which had been truly representative, lost what little representativeness it had had and became totally subservient to the executive branch because the latter revoked the political rights of those congressmen it considered a threat to its power.

But this is not all. The left was severely repressed, the authentic left as well as the more demagogic elements. In the revocation of political rights, opportunists were confused with leaders of integrity, moderates with extremists. This revocation almost totally destroyed the dialogue among the progressive forces in the country. And nothing jeopardizes the nation more than the suspension of dialogue.

There are other short-term causes of the political crisis, but these factors also had a direct economic influence and can hence be dealt with as general short-term causes of the Brazilian crisis. These causes are a direct function of the ideological position and social framework of the Castello Branco government.

The Social and Ideological Framework of the Castello Branco Government

Obviously, the men who governed Brazil from 1964 to 1967 were military officers. But there were others working together with the military whose power was almost as great, especially in matters relating to the economy—the technocrats. They were almost all economists. During the Castello Branco government they occupied every key economic position in Brazil except for the presidency of the Bank of Brazil. There were economists in the Treasury Ministry, in the Planning Ministry, in the presidencies of the Central Bank and the National Bank for Economic Development, all technocrats who left their positions as technical advisors to take over command of the government.

Brazil had never had a government socially and professionally defined in this manner. The other groups that have usually participated in power in other countries, or at other times in Brazil, were absent from this government. There were no politicians. The government was set up with almost all politicians in a subservient position. Even members of the now extinct National Democratic Union, who would appear to have been the major beneficiaries of the Revolution of 1964, were more instruments than agents of the government. The labor unions were absent. One fact is self-evident, without need of further proof: The old Brazilian aristocracy and the traditional Brazilian economic system based on agriculture did not receive economic benefits from the new government policy. The 1966 coffee policy, which was very hard on the coffee growers, proves this point. Thus it cannot be said that this government was representative of the old Brazilian aristocracy, at least the rural aristocracy. Finally, the entrepreneurs (using a broader definition of this term, rather than Schumpeter's) were also missing, particularly the industrial entrepreneurs. Together with the industrial workers they were the ones who suffered the greatest losses from government policy. They did not participate in policy making. At the most they were called upon on certain formal occasions to applaud, receive instructions, and collaborate with the government. The significance and consequences of their minimal role will be discussed further on.

The Castello Branco government was thus basically a government composed of military men and technocrats only. In other words, it was

a government of the middle class. More specifically, it was a government of the traditional middle class, the old middle class, the middle class of professional liberals, public functionaries, priests, and military officers as they had existed before the Brazilian industrial revolution. It was a government in which other Brazilian social groups, especially the industrial entrepreneurs and financiers, did not participate. This government's ideological position was an almost direct consequence of the social outlook of the traditional middle class.

In philosophic terms, it was an idealist government, in the sense that it believed in ideas more than in reality. It was idealist in that it denied reality, or at least never managed to come to grips with it. It was idealist because it believed that it had to change attitudes before it could change structures, that it was more important to "convert" or persuade someone than to set up conditions for social change. The Castello Branco government's idealism can be illustrated by a very significant statement by one of its representatives, who expressed the following ideas in discussing the economic crisis of early 1965:

The economic situation is really difficult, but there is one compensation. The most important thing now is to change the attitude of the industrial leaders, to make them become concerned with costs and increasing productivity. The time has passed when it was enough merely to sell and to make big profits. Now they either change their attitudes and begin to compete effectively in a free market or they will not survive.

This is a typically idealist approach. Attitudes do not change overnight; concern for costs is not created in the midst of economic depression when the question is not to cut costs but rather to reduce output, fire employees, and struggle to survive.

Another facet of the philosophical idealism of the Castello Branco government was its faith that economic development could be brought about by means of laws. Few governments have promulgated laws so prolifically. And there is no question that many of them were good, well made from a technical point of view. This is the case with the laws concerning rents, the Council on Foreign Commerce, real estate incorporation, the creation of the Central Bank (although this was not really bank reform), and tax reform. One may not agree with all aspects of these laws, but it must be admitted that they are the fruits of the work of intelligent and capable technical experts. The whole problem was in thinking that laws could resolve Brazil's short-term problems, that changes made in the laws concerning the remission of profits would bring foreign capital showering down on the country, that the law concerning capital markets would produce greater public participation

in the savings and capital markets, that the housing plan laws would cause houses and more houses to spring up in every corner of the country. This is an attitude completely divorced from reality, comparable to the theories that education is necessary before development can take place, or that the main task is to change attitudes. This is a type of idealism typical of the traditional middle class, stemming from the fact that it is made up basically of independent professionals, military men, and educated public functionaries, and consequently of people who are not integrated into the country's productive process.

If this government was philosophically idealist, in the economic sphere it was immobilist and anti-industrialist. It was immobilist, not because it desired economic stagnation for Brazil, but because it placed monetary stabilization as its primary objective and was ready to sacrifice development to the fight against inflation. It was anti-industrialist not in the sense that it sought to check Brazil's industrial development, but rather because it viewed industrialists and entrepreneurs in general through the typical moralism of the middle class, mistrusting them, suspecting them of seeking to earn maximum profits, of speculating, and therefore of needing government supervision. It was also anti-industrialist to the extent that in its fight against inflation, the government did not hesitate to sacrifice industry, restricting its credit, for example, more than that of agriculture.

Finally, the Castello Branco government was internally conservative, seeking to preserve the status quo; moralist, in that it saw the solution of Brazil's problems in the honesty of its politicians; and anticommunist, to the point of being almost paranoid. Internationally this was a colonialist government, to the extent that it placed the country under the total domination of a foreign power, increasingly servile, a political cover for this power's international activities. It was also colonialist because it believed that Brazil's development could be realized only with foreign aid, that the country did not have conditions for autonomous development.

Conservatism, paranoiac anticommunism, and colonialism are not ideological positions confined to the traditional middle class, but doubtless they form a general part of this class's world view. Moralism is essentially an ideology of the traditional middle class.

The Industrial Entrepreneur and the Crisis

Thus we see the Castello Branco government as a government of military men and technocrats, a government of the traditional middle class, defined by an immobilist economic policy alienated from reality. It was a government from which workers, peasants, students, and entrepreneurs were excluded.

A government that lacked the participation of these socioeconomic groups could not promote the economic and social development of the country, because it lacked the minimum of representation necessary. All the economic and social development that took place in Brazil after 1930, especially during the terms of Getúlio Vargas and Juscelino Kubitschek and through the influence of the Brazilian Workers Party and the Social Democratic Party, was the result of a complex alchemy of compromises and mutual concessions. This was possible because a range of social interests was represented in the power structure, from industrial laborers to entrepreneurs and even the aristocracy. The only socioeconomic group that was always maintained on the periphery of the Brazilian political process was the rural poor, the peasants.

The generalized exclusion of the most representative groups in Brazilian society, particularly those most directly involved in the productive process, such as industrial workers and entrepreneurs, was an extremely serious error and without a doubt the general and most important cause of the Brazilian crisis. In the short term, however, yet another distinction can be made. The most serious omission, within the framework of a capitalist regime, was that of the industrial entrepreneurs.

In fact, to the extent that Brazil continued its economic development within the framework of a mixed capitalist model by means of the entrepreneurial activity of the state and of private enterprise, it was necessary that industrial leaders, as well as businessmen and financiers, take an important, even a main role, though not an exclusive one, in the control of the government. It is possible for a country to develop rapidly in capitalist terms only if the state represents the interests of the capitalists. It is possible to pursue industrialism only if the industrial entrepreneurs have a hand on the reins of the government. The Castello Branco government tried to maintain capitalism in Brazil but sought to exclude industrial entrepreneurs from participation in the government, creating an inherent contradiction.

Thus the question arises, Why were industrial entrepreneurs and the productive classes in general excluded from participation in the government? It will be answered here only with respect to the entrepreneurs, in accordance with the more general focus of this book.

On the part of the Castello Branco government, this exclusion was a natural occurrence, probably not the result of deliberate calculation. The industrial leaders were initially excluded because the Revolution of 1964 was a revolution of the middle class, led by military men of the middle class, and taken over by technocrats from the middle class. The next question then becomes, Why did the industrial leaders allow themselves to be excluded? There are two answers.

First, the industrial leaders had always been silent and lacking in political organization. One of the typical characteristics of Brazilian entrepreneurs had been their lack of political participation and presence, the fact that they limited themselves to the narrow boundaries of their enterprises and the profit motive. When Brazil's economic policy was focused totally on industrialization, as in the Kubitschek years, the government represented the industrialists almost in spite of them. It was not the industrial leaders who brought Kubitschek to power, nor were they the ones who kept him there. On the contrary, especially in São Paulo, when they did manifest themselves politically, it was often in opposition to Kubitschek.

This leads us to the second reason. When the industrial leaders did begin to participate actively in politics, especially in more recent times, it was only after they had begun to realize that industrialization was already an established fact, that the battle of industrialism against agriculturalism had been won, and they acted in an increasingly conservative manner. They did not perceive the importance of keeping open the dialogue with the left. They did not see that it was fundamental to the maintenance of the democratic process and the country's political stability for workers to continue to organize and to express their demands. Instead they let themselves get involved with the conservatives, becoming their pawns, and thus abandoning themselves to the immature alarmism that predominated in the year before the Revolution of 1964, maintaining a totally intransigent attitude, unwilling to make any compromise. Thus they identified themselves with the Revolution of 1964, which later ignored them or worked against them.