

A Critical Analysis of the Macroeconomic Policies in Brazil from Lula da Silva to Dilma Rousseff (2003-2014)

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Abstract

In this short article, we aim at presenting a critical analysis of the macroeconomic policies implemented by the Lula da Silva and Dilma Rousseff governments. The main hypothesis is that the economic framework of the 'leftist' governments was managed pragmatically, mainly due to the Global Financial Crisis and Great Recession, and cannot be considered as genuine Keynesian policies.

Key-words: Brazilian economy, Keynesian policies, leftist governments

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1. Introduction

During the last 12 years, more specifically over the 'leftist' governments of Lula da Silva (2003-2010) and Dilma Rousseff (2011-2014) in Brazil, the main macroeconomic results, according to Table 1 (annex), show that Brazilian economy performed relatively well, compared to the previous periods: (i) the GDP grew by an average of around 3.4% per year (5.8% per year in 2003-2010 and 2.2% per year in 2011-2014); (ii) the average annual inflation was 5.9% (inflation target is 4.5% with tolerance interval of 2.0%); (iii) the average unemployment rate was reduced from 12.3%, in 2003, to 4.8%, in 2014; (iv) from 2003 to 2014 the net public debt dropped from 52.4% to approximately 36.7% of GDP; and (v) the external situation became comfortable, with foreign reserves increasing 637.5% from 2003 to 2014 to reach a total of USD 363.6 billion in 2014, although current account deficit to GDP ratio raised to nearby 4.0% in 2013-2014.¹ Of course, these figures are modest in comparison with other emerging countries, such as China and India, but they are a remarkable change for Brazil's economy. Moreover, since 2003, Brazil has displayed a healthy combination of macroeconomic resilience, income redistribution and poverty reduction (from 2000 to 2012 the Gini Index fell from 0.589 to 0.526, while at the end of 2012 about 13.6 million families benefited from the *Bolsa Família*, a program against poverty).

The period of the 'leftist' governments can be divided into two. Lula da Silva's first term (2003-2006) was notable for continuing (and in some respects radicalizing) the macroeconomic policies of the outgoing government of Fernando Henrique Cardoso, based on the New Consensus Macroeconomics (NCM) framework, that is, inflation targeting regime (ITR), fiscal surplus and flexible exchange rate. In the second Lula da Silva government (2007-2010) and in the Dilma Rousseff government (2011-2014), some structural measures and economic policies were introduced, mainly in response to the global financial crisis (GFC) and the 'Great Recession' (GR).

In this brief article, we aim at presenting a critical analysis of the macroeconomic policies implemented by the Lula da Silva and Dilma Rousseff governments. The main hypothesis is that the economic framework of the 'leftist' governments was managed pragmatically, mainly due to the GFC and GR, and was slightly conservative; thus, it cannot be considered as genuine Keynesian policies. For this purpose the paper is divided in two sections, besides this introduction: section 2 analyses the economic policies and Brazilian economy performance during the 'leftist' governments of Lula da Silva and Dilma Rousseff; and section 3 discusses, briefly, the economic policies and institutional-structural reforms that should be implemented to ensure macroeconomic stability in Brazil.

2. The Recent Economic Policies and Performance of the Brazilian Economy During the 'Leftist' Governments

In his inaugural speech in January 2003, President Lula da Silva emphasized that his government would introduce changes to tackle social problems and rekindle self-sustained economic growth in Brazil. By the end of his first term, however, the economic results were relatively poor: average GDP growth, inflation rate and unemployment rate were, respectively, 3.5%, 6.4% and 10.9%. During this period, net exports were the main source of growth for the Brazilian economy (trade balance and current account accumulated a surplus of USD 149.2 billion and USD 43.3 billion, respectively, while average growth rate of exports was 9.9% per year; Table 1) because the global recovery, driven by economic growth in the United States

¹Data extracted from IPEADATA (2015) and Brazilian Central Bank (2015)'s website.

and, mainly, China, led to an increase in both demand for and prices of commodities on international markets. As a result, from 2003 to 2006, the foreign reserves increased from USD 49.3 billion to USD 85.8 billion (Table 1), and one of main indicators of external vulnerability improved notably.

From 2003 to 2006, the theoretical background of Lula da Silva's economic policies, as mentioned before, was given by the NCM. In that context, firstly, the Brazilian Central Bank (BCB), following orthodox guidelines, operated a tight monetary policy – in this period the average nominal and real interest rate (Selic) were, respectively, 18.3% and 11.7% per year – to keep inflation under control and also deepened the process of financial liberalization by introducing a set of new regulations that included facilitation for both outward and inward transactions. Secondly, the average primary fiscal surplus was around 4.5% of GDP (Table 1), more than 4.25 % of GDP proposed by the International Monetary Fund (IMF), in order to assure the conditions for fiscal solvency.

Moreover, the *modus operandi* of ITR, plus the adoption of a floating exchange rate, under the conditions of full opening up of the capital account, led to volatility in the nominal exchange rate and the tendency for the real exchange rate to appreciate. According to data from BCB, the average exchange rate declined from R\$ 3.08/USD 1.0, in 2003, to R\$ 2.17/USD 1.0, in 2006.

In 2007, at the start of Lula da Silva's second term, fiscal policy shifted course slightly in order to extend social protection and income transfer programs, increase the minimum wage and expand public investment, especially investment under the Growth Acceleration Program (*Programa de Aceleração do Crescimento*, PAC), that had the following objectives: to stimulate private investment; increase government investment in infrastructure; and remove the main obstacles to economic growth (bureaucracy, inadequate norms and regulation). The BCB, however, continued to operate monetary policy in such a way as to meet inflation targets. Also, once again, Brazil benefited from higher commodity prices, which contributed both to their achieving significant current account surpluses and accumulating international reserves.

In this context, before the GFC, the Brazilian economy was much better protected than at other moments of external turbulence, mainly because of the improved macroeconomic 'fundamentals'. Brazilian government's reaction was favored by some actions of the federal government that were taken before the crisis, such as the combination between previous government's reduction in its external debt and the increase in the foreign exchange reserves resulted in a government's net credit position in foreign currency, so that exchange rate devaluation favored public finance. ECLAC (2009) points out that Brazil was one of the Latin American countries that made use of greater variety of tools to face the effect-contagion of the crisis.

Indeed, Lula da Silva's response to the GFC, although late, represented an important shift from previous crisis episodes (for instance, the Brazilian exchange rate crisis in 1998-99), where central government had pursued pro-cyclical policies, usually within the framework of the IMF stabilization programs, hoping to steady the humors of financial investors, and responded to the contagion effect of the systemic crisis with a broad variety of counter cyclical economic measures, that included: the implementation of liquidity-enhancing measures (reduction of reserve requirements, incentives for larger financial institutions to purchase the loan portfolios of small and medium banks etc.); BCB undertook interventions in the foreign exchange markets – selling USD 23 billion of its foreign reserves in the last quarter of 2008 in the spot market and offering foreign exchange swaps in order to provide hedge against currency depreciation; state-owned banks were encouraged to expand their credit operations,

compensating the deceleration in the credit supply by private banks; and Ministry of Finance implemented a lot of fiscal measures in order to stimulate aggregate demand.

In terms of monetary policy, the BCB did not change the interest rate after the Lehman Brothers bankruptcy and only in the beginning of 2009 decided to reduce interest rate from 13.75 % in January to 8.75 % in September 2009. In addition to the monetary policy measures, state-owned banks – *Banco Nacional de Desenvolvimento Econômico e Social* (BNDES), *Banco do Brasil* (BB) and *Caixa Econômica Federal* (CEF) – were instructed to irrigate the economy, in a context where private banks (national and foreign) decided to not expand credit facilities to consumers and corporations.

At the same time, fiscal policy was expansionary, combining tax reductions and increased spending. Thus, it was implemented a stimulus package, injecting a total of USD 20.4 billion into the economy (equivalent to 1.2 % of Brazil's GDP in 2009). This aimed to boost aggregate demand and mitigate the adverse impact of the crisis on the labor market and economic activity through three major channels, namely, additional government spending (such as *Minha Casa, Minha Vida*/My House, My Life, a program of government incentives and subsidies for housing construction), tax cuts (reduction in the industrialized products tax (IPI) burden on motor vehicles, consumer durables and construction items) and social programs (extension of unemployment insurance benefits and real increases in the minimum wage) (Barbosa, 2010)

As a result of these countercyclical economic policies, after experiencing a recession (GDP grew by - 0.2%) in 2009, the Brazilian economy increased 7.6% in 2010. Brazil's economic recovery brought with it restored flows of international capital and, as a consequence, problems associated with periods of prosperity, including the tendency for the *real* to appreciate due to the new surge of capital inflows.

During the period 2007-2010, the main macroeconomic results were the following: the GDP grew by an average of around 4.5% per year, pushed up by the increase of investment, private consumption and exports; (ii) the average annual inflation was 5.1%; and (iii) the unemployment dropped from 9.3%, in 2007, to 6.7%, in 2010.

However, the external sector deteriorated significantly: from 2007 to 2010, the trade surplus dropped almost 27% (the accumulated trade surplus was USD 109.0 billion) and the balance of payments' current account deficit has been more than 2.0% of GDP since 2010 (Table 1).

It is important to stress that, on the one hand, Brazil's reaction to the GFC, although rather delayed, was successful because Brazil did not have a high level of external debt (it was currently a net creditor to the international markets) and the composition of its public debt improved.² In this context, the BCB was able to build up foreign exchange reserves. On the other hand, although Brazil's economic recovery restored flows of international capital once again, it posed long-standing problems associated more with the period of prosperity. These include the tendency for the *real* to appreciate, affecting industry and the balance of trade, and, until 2010, the BCB's predisposition to subordinate fiscal policy to the primacy of monetary policy.³

In late 2010 and in 2011, the first year of Dilma Rouseff's term, the central government faced the dilemma of going for moderate economic growth to face inflationary pressures. At

² In the late 1990s and early 2000s, a considerable portion of the public debt was indexed to the exchange rate, while at present nearly all public debt is indexed to the Brazilian currency *real*.

³ See Bresser-Pereira (2010) for further details.

the same time, the volatility in financial markets due to the *euro* area crisis, the competitive pressures from other countries in domestic and external markets, the lack of strength in manufacturing sector (industrial production grew only 0.3% in 2011), the appreciation of domestic currency, the major deficiencies in infrastructure and the poor quality of public services and institutions, among other factors, have raised doubts about the prospects of the Brazilian economy. In this context, immediately after the Dilma Rouseff's presidential inauguration, the BCB decided to increase the interest rate to avoid inflationary pressures caused by robust economic growth in 2010, and, at the same time, the fiscal policy became more conservative. In this way, at the end of the year the interest rate and the primary fiscal surplus increased to 11.75% and 3.1% of GDP, respectively. Despite these changes in the monetary and fiscal policies, in 2011 the Brazilian economy grew by 3.9%.

Dilma Rouseff's first government, particularly after middle of 2011, was marked, on the one hand, by the gradual worsening in the international scenario due to the *euro* crisis and the decline in growth in emerging economies (including China), and, on the other hand, there was some important changes in the *modus operandi* of economic policy, including the adoption of more gradualist strategy of BCB to deal with inflation and the use of broader instruments of economic policy as a complement of the traditional tools.

In 2012, when the *euro* crisis began to affect Brazil's economy, the BCB introduced several macroprudential measures – a rise from 8% to 12% in reserves requirements on sight and fixed term deposits, an increase of minimum capital required for personal credit with maturity up to 24 months, a rise in the tax on financial transactions (IOF) from 1.5% to 3.0% in all credit operations, and an increase to 6% in the IOF on new foreign loans with maturities of up a year – to maintain its financial sector regulation and supervision (of banks, capital market, insurance, private plans, and others) to address both recent credit boom and international financial market instability, particularly the potentially disruptive effects of absorbing excessive capital flows/liquidity caused by 'quantitative easing' in 2010-11, and also decided to reduce the Selic rate to 7.25%, in December 2012. In terms of fiscal policy, the government implemented a fiscal stimulus package including government spending, tax cuts and subsidies, basically to increase household consumption, and, moreover, it was launched the PAC 2 (with investments of close to USD 500 billion planned for 2011-2014) and a new industrial policy, the *Plano Brasil Maior*.

At that time, unlike the post-subprime crisis, the economic measures failed to sustain economic activity and, as a result, the Brazilian economy experienced a poor performance in 2012: GDP increased only 1.9%. The poor economic performance was the consequence of both external and domestic factors. Although the economic situation of the *euro* area now seems to be not disruptive, the *euro* crisis affected the Brazilian economy mainly through the commercial side and through the deterioration of the entrepreneurs' expectations about the future of the world economy. In this way, exporters lost external markets due to the lack of competitiveness and low external demand, while imports increased shifting part of the domestic industrial production – years of currency appreciation seem to have eroded the competition capacity of the domestic firms. At the same time, Brazilian government hoped that the change in the mix of the economic policy (lower interest rate and more devaluated currency) together with some tax exemption to stimulate for demand and supply of goods would be enough to reach a robust economic growth. However, public expenditures were not enough to compensate the overall reduction in the aggregate demand. When it was clear that this was not the case, government sought to implement *ad hoc* measures to boost growth. Such action, however, was not well coordinated and lacked consistence.⁴

⁴For more details, see Paula *et al* (2015).

In 2013 and 2014, the monetary authorities implemented some changes in economic policy due to macroeconomic deterioration. First, the inflation rate began to increase in the end of 2012, with most pressure coming from services and food. In this way, the average interest rate increased to 10.96%, at the end of 2014. Second, exchange rate became very volatile, reflecting both the uncertainties over United States monetary policy and the deterioration of the external accounts – the accumulated trade balance and current account were, respectively, - USD 1.3 billion and - USD 172.3 billion (Table 1). However, to compensate the tight monetary policy the government continued to expand public expenditures, and, as a consequence, the primary fiscal result dropped from 2.4% of GDP, in 2013, to - 0.6% of GDP, in 2014.

At the end of the first Dilma Rousseff government, the main macroeconomic results were the following: the average GDP growth rate was 2.2% per year; (ii) the average annual inflation was 6.2%; and (iii) the accumulated current account deficit was around USD 279.1 billion. At least, surprisingly, the average unemployment rate dropped to 4.8% in 2014.

3. Economic Policies and Structural Reforms to Ensure Macroeconomic Stability

From the previous section, it is reasonable to argue that one key feature of the period post-2006 is the lack of coherence between the NCM framework adopted by the 'leftist' governments and the countercyclical macroeconomic policies implemented by the monetary authorities after the GFC and GR. In other words, Brazil's economic policy is still dominated by a monetary regime which does not appear to ensure macroeconomic stability, at least not on a Keynesian perspective, that is, keeping inflation under control, assuring sustainable economic growth and maintaining fiscal and balance of payments equilibria. In this way, it seems to be that, since 2007, the economic framework of the 'leftist' governments has been managed pragmatically, mainly due to the GFC and GR.

Keynesian policies, in a broader sense, have as their main objectives the achievement of full employment and macroeconomic stability. According to the Post- Keynesian approach, there is no endogenous mechanism in a monetary economy which ensures that economic activity tends to full employment (Arestis and Sawyer, 1998). From the Keynesian perspective of macroeconomic stability, the economic policy should be coordinated in such a way as to (i) operationalize fiscal policies designed to expand effective demand and reduce social inequalities, (ii) make for more flexible monetary policy so as to galvanize levels of consumption and investment, and (iii) coordinate and regulate financial and foreign-exchange markets in order to stabilize capital flows and exchange rates (Carvalho, 1997; Ferrari-Filho and Paula, 2009).

More specifically, Keynesian fiscal policy has direct impact on aggregate demand – consumption and investment – and constitutes the main instrument of State economic intervention.⁵ It is anchored in tax policy, on the one hand, and in administering public expenditure (importantly, a completely different category from public deficit), on the other hand.

Tax policy is the key source of the public resources that finance public expenses. Furthermore, as Keynes (1972) pointed out, tax policy can also serve to increase available income, thus fostering expansion of effective demand. Lastly, it can also be used to enable unequally distributed income to be reallocated, by either income or inheritance taxes.

⁵In this sense, Arestis (2012, 2015) offers a wide number of theoretical and empirical arguments supporting the strong role fiscal policy plays in positively impacting effective demand.

Throughout his work, Keynes proposed capital levies (1971a) and progressive income taxes (1973) as means of improving income distribution.

Meanwhile, in Keynes's (1980a) original perspective, the public spending management is split in two budgets: the ordinary, or, current, and the capital. The former relates itself to the funds necessary to maintain the basic services the State provides to its population, whereas the latter accounts for expenditures regarded to automatically stabilizing economic cycles. Although Keynes (1980a) believed in the importance of these ordinary expenditures in fostering effective demand, he either had argued that the current budget should be in surplus or, at least, in equilibrium. In Keynes's words, "for the ordinary Budget should be balanced at all times. It is the capital Budget which should fluctuate with the demand for employment" (1980a: 225), so that, "I should not aim at attempting to compensate cyclical fluctuations by means of the ordinary Budget. I should leave this duty to the capital Budget" (1980a: 278).

For monetary policy, Keynes (1982: 137) suggested that, "as a rule, I should expect that its chief problem would be to maintain the level of investment at a high enough rate to ensure the optimum level of employment". In light of that, the ultimate goal of monetary policy is to impede that "disastrous fluctuations in the volume of employment continue in the future as severely as in the past, and perhaps more severely" (Keynes, 1982: 137). The straightforward embodiment of Keynes's concerns and wishes within a monetary policy strategy is setting economic growth as its ultimate goal, instantaneously bringing investment and employment levels under central bank's surveillance.

Besides its ultimate objective – and in the way to accomplish it – monetary policy also has five immediate goals: (1) as Keynes (1982) stated, one of these is price stability. Inflation affects expectations as long as it devalues wealth, shortens the long run, and unleashes liquidity preference, likely to lead the economy to an insufficient effective demand; (2) another immediate goal is focused on financial stability. It is understood, according to Buiter (2008), as the absence of asset price bubbles, illiquidity, and insolvency, whose occurrence threatens the financial markets and the real economy; (3) as it is by means of expectations and its counterpart, liquidity preference that monetary policy transmits its effects, a good state of expectations is required for the success of central bank policy. This makes the third immediate goal of monetary policy be maintaining expectations stable. If misguided prospects dominate, they result in volatile speculative and precautionary money demand, turning monetary policy ineffective; (4) the fourth immediate goal is the supervision and control of the economic system liquidity. It means that monetary policy needs to avoid shortage of liquidity as well as it should prohibit banks from creating money in excess. Moreover, when controlling liquidity, central banks also act as lenders of last resort, preventing bankruptcy of financial institutions and its financial contagion risks; and (5) the last immediate goal of monetary policy is to stabilize the "value [of money] in terms of an international standard" (Keynes, 1982: 128), that is, the exchange rate stability. Exchange rate movements have a vast influence not only on expectations, but also on the firm's financial and operational stances.⁶

⁶In this way, throughout his work, Keynes's exchange rate policy thoughts and proposals pointed towards arranging a managed exchange rate regime in order to enable external balance and, particularly, price stability (Ferrari Filho, 2006). In his *International Clearing Union* (ICU) proposal, Keynes (1980b) made this idea clear by signaling that one of the aims of having a fixed exchange rate, that is nonetheless alterable to suit circumstances, should be to reduce uncertainties about future prices of assets and tradable goods, when economic agents take decisions to close contracts that involve any kind of foreign transaction. Moreover, to manage the exchange rate, Keynes proposed capital controls. In his words, "we cannot hope to control rates of interest at home if movements of capital moneys out of the country are unrestricted" (Keynes, 1980b: 276).

To sum up, according to Keynes, macroeconomic stability is a combination of full employment and stable prices. For developing countries, according to the new developmentalism perspective (Bresser-Pereira, Oreiro and Marconi, 2014), macroeconomic stability also means long-term fiscal and external equilibrium and social development, among others. In this way, the Brazilian macroeconomic stability has to be focused on the macroeconomic side and on the institutional-structural reforms.

In terms of macroeconomic measures, it is necessary to wake up and stimulate the 'animal spirits' of the entrepreneurs, by signaling that economic policies supporting aggregate demand be pursued. Furthermore, economic policies must be focused on reversing macroeconomic constraints, both fiscal and external.

In this light, the challenge facing the Brazilian government is to maintain its countercyclical economic policies and developmentalist strategy not only in response to international financial crises, but – more importantly – in normal times. Thus, rather than conducting macroeconomic policy to suit inflation targeting, fiscal austerity, exchange rate flexibility and capital mobility, monetary policy should be guided by employment and inflation, fiscal policy should not sacrifice all other goals to guarantee interest payments to *rentiers*, the exchange rate should be administrated by the BCB, and an efficient anti-speculation mechanism to control (or regulate) capital movements should be created in order to prevent financial and exchange rate crises, prevent exchange rate appreciation and balance the balance of payments.

Going in the direction of the institutional-structural reforms, it is necessary to expand supply capacity and potential GDP, improve income distribution, reduce social gaps and mitigate infrastructure bottlenecks. In this way, the government should: (i) implement a progressive income tax reform; (ii) continue to expand social programs, such as *Bolsa Família*, to improve standards of living among the poor; (iii) propose income policies to regulate wages and prices; (iv) implement an industrial policy program to coordinate private and public efforts to assure the Brazilian economy a place in the international scenario; (v) promote public-private partnerships to expand, mainly, the infrastructure sector; and (vi) invest in innovation, research and development and education, which are essential for productivity gains.

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Annex

Table 1: Brazilian Macroeconomic Indicators, 2003-2014

Macroeconomic Indicator/Year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Inflation Rate (IPCA*), %	9.30	7.60	5.69	3.14	4.46	5.9	4.31	5.91	6.50	5.84	5.91	6.41
GDP growth (%)	1.2	5.7	3.1	4.0	6.1	5.0	- 0.2	7.6	3.9	1.9	3.0	0.1
Unemployment rate (%)**	12.3	11.5	9.8	10.0	9.3	7.9	8.1	6.7	6.0	5.5	5.4	4.8
Interest rate (Selic), average (%)	23.0	16.4	19.2	15.2	12.0	12.7	10.1	9.9	11.75	8.63	8.29	10.96
Trade balance (US\$ billion)	24.8	33.6	44.7	46.1	40.0	24.7	24.6	20.3	29.8	19.4	2.6	- 3.9
Current account/GDP	0.8	1.8	1.6	1.3	0.1	-1.7	-1.5	-2.2	-2.1	-2.4	-3.6	-4.2
Foreign reserves (US\$ billion)	49.3	52.9	53.8	85.8	180.3	193.8	238.5	288.6	352.0	373.2	358.8	363.6
Fiscal surplus/GDP (%)	4.3	4.6	4.8	4.3	4.0	4.1	2.1	2.8	3.1	2.4	1.5	- 0.6
Net public debt/GDP (%)	52.4	47.0	46.5	44.7	48.0	36.0	43.0	39.1	36.5	35.1	33.8	36.7
Investment rate (% GDP, 1980 prices)	15.3	16.1	15.9	16.4	17.4	19.1	18.1	19.5	18.5	18.1	18.5	19.4

Source: IPEADATA, *Séries Históricas*, <http://www.ipeadata.gov.br> (2015) and BCB, *Séries Temporais*, <http://www.bcb.gov.br> (2015).

Notes: (*) National Consumer Price Index, and (**) Unemployment rate by IBGE methodology.