The Political Economy of the Brazilian Economic Crisis (2014-2022) – economic policy, ideas and the limits of neoliberal austerity measures

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Resumo- Este artigo busca compreender os elementos políticos e econômicos por detrás da política de austeridade fiscal e de outras políticas liberais, como as reformas trabalhista e previdenciária, implementadas no Brasil a partir de 2015. Foca-se a política econômica dos governos do Partido dos Trabalhadores (PT) entre 2003 e 2016, para compreender os fatores que conduziram à crise econômica de 2015 e 2016, essenciais para a ascensão da direita e as orientações de política econômica que se seguiram. Argumenta-se que a política econômica, embora influenciada por interesses e ideias, tem também uma racionalidade, crítica para as possibilidades de sucesso – logo, algumas orientações de política econômica devem ser respeitadas. A política econômica é analisada de forma a apontar seus méritos e erros e as alternativas que seriam possíveis face às restrições macroeconômicas. Ao apontar quais são as questões econômicas relevantes, o artigo também destaca as questões políticas "escondidas" por trás de certas propostas de política econômica.

Abstract – This article aims at understanding the political and economic elements behind the fiscal austerity policy and other liberal policies, such as labor and pension reforms, implemented in Brazil from 2015 onwards. It focuses on the economic policy under the Workers Party (PT) governments from 2003 to 2016, intending to understand the factors which led to the economic crisis of 2015 and 2016, essential for the ascendance of the right and the economic policy directions which followed. It is argued that economic policy, although influenced by interests and ideas, has also an economic rationality, critical for the chances of success – therefore, some economic policy guidelines must be respected. Economic policy is analyzed in order to point out its merits and errors and the alternatives that would be possible given macroeconomic constraints. By pointing out which are the relevant economic issues, the article also highlights the political issues which tend to be "hidden" behind certain economic policy proposals.

Key Words: Brazilian Economic and Social Policies, Fiscal Austerity, Right and Left Wings

Área Temática: 1. Economia

Introduction

This chapter deals with the factors behind economic policy and economic adjustment adopted in Brazil from the 2015s. It intends to understand the political and economic elements behind the decision to limit public expenditure and adopt neoliberal measures such as labor and pension reforms. In order to accomplish that, the focus is mainly given on economic policy under the Workers Party (PT) governments from 2003 to 2016, intending to understand the economic policy main lines and also the factors which led to the serious economic crisis of 2015 and 2016, essential to understand the ascendance of the right and the economic policy directions which followed.

Policies are in large part influenced by political variables and interests, mediated by national institutions. Some groups are more influent and have privileged channels of access into state apparatus (Hall, 1986). Economic policy involves much more than technical decisions; they are influenced by ideas which, also politically induced, provide an interpretation and a path to tackle the main challenges (Blyth, 2002).

However, the policies' economic results tend also to be very important, given the impact on government's political support and chances to achieve their objectives. Economic performance affects employment, an important form how people obtain incomes and access to subsistence. Although the improvement of social conditions is not possible without the appropriate social policies, it is also hard to achieve it in a context of negative economic performance. So, it is also necessary to understand the elements which affect economic performance, given its relevance to economic policy decisions.

Constraints to economic policy increased with the changes which marked the new phase of capitalism initiated in the 1970s. The consolidation and growth of an international private financial market, marked by the instantaneous flows of short term capital among national borders, significantly constrained national governments autonomy. The risks of massive outflows of capital, provoking instability, made national governments very concerned to inflation control and, consequently, to public expenditure and monetary supply.

Another important point is the form how Brazil defeated a very high and resilient inflation, leading, from 1999, to a model of economic policy marked by inflation target regime (IT), primary budget surplus target and floating exchange rate regime. According to mainstream literature, IT is considered a superior framework of monetary policy, having positive impacts on inflationary expectations. Government sound finance is also seen as central for macroeconomic stability, while flexible exchange rate regimes

improves the management of balance of payments transaction and enables for foreign reserves accumulation (Plihon, 1995; French-Davis, 2003; Flassbeck, 2018; Arestis and Sawyer, 2008). This regime, nevertheless, significantly mitigated the economic policy degrees of freedom.

The point defended in this chapter is that economic policy, although very influenced by interests and ideas, has also an economic rationality, critical for the chances of success. So, it is analyzed the macroeconomic policies adopted in Brazil in order to point out its merits and errors, as well as highlighting the alternatives that would be possible in face of the aforementioned macroeconomic constraints. The objective is to do it in a very didactic way, attempting to show to those which do not have formation in economics why certain directions of economic policy need to be respected. By making clear what are the relevant economic issues, the chapter also contributes to highlight the political issues which tend to be "hiden" behind certain economic policy proposals.

The chapter is organized as follows. The second and third section provide brief historical interpretation of facts related to changes in capitalism and to past Brazilian trajectory which help to situate and understand the context which marked the Workers Party (PT) governments and the period in analysis. Section four deals with the economic policy's main decisions under the two Lula's governments (2003-2010). Section five and six deal with Rousseff's two mandates, focusing on the direction followed by economic policy and on the main consequences. Section seven deals with the two right wing governments which followed Rousseff and to the evolution and limits of neoliberal policies. Finally, section eight highlights the chapter's main conclusions and several points which need to be observed by the present Lula government (2023-2026).

1. The golden age, economic deceleration and rise of neoliberalism

The post war period (1947-73) was the golden age of capitalism, marked, particularly in developed countries, by substantial rates of economic growth and improvement in social conditions. Citizens obtained civil, social and political rights, in a process also characterized by the consolidation and strengthening of democracy. The period was also marked by the improvement and diversification of consumption patterns, increasing access to education and improvement in health services and life expectancy (Judt, 2007).

Those results were only possible due to the extraordinary performance of the economy. Economic and industrial growth was substantial and continuous for more than two decades; international trade significantly expanded. Investment expanded at very

high rates, a result of the emergence of new sectors and the opportunities to conquer new consumers. Growth was also pushed by the substantial increases in productivity, a consequence of fordism dissemination, new forms of productive organization and the transfer of workers from agriculture to industry. In addition, the Welfare State expansion, Keynesian policies and wage increases strengthened demand, consolidating a virtuous cycle, while financial regulation reduced the risks of bubbles and crises.

Another important component was the international dimension. The Bretton Woods Agreement, firmed in 1944, provided a new exchange rate regime and rules for capital flows control, while the creation of the General Agreement for Trade and Tariffs substantially stimulated international trade. The new fix exchange rate regime provided stability, without reducing national governments autonomy in the pursuit of national objectives, which was also favored by the strict regulation over short term capital flows. As a result, international integration was mainly based on productive investments (Frieden, 2008).

Prosperity lasted for two and a half decades (Judt, 2007). It was interrupted, nevertheless, in the 1970s, a decade marked by a deep economic crisis and profound transformation in capitalism trajectory. The factors behind deceleration and crisis were in large part inherent to capitalism. The sectors which had led the expansion lost vigor, once significant part of the demand had been fulfilled. In addition, productivity increases decelerated. Thirdly, full employment and wage increases compressed profits margins, also affected by strengthening in international competition (Judt, 2007).

The crisis was also very influenced by international events. The United States incapacity to keep the convertibility between the dollar and the gold and the abandon of the exchange rates regime had deep impacts. In that moment, economic deceleration was responded with expansionist monetary policies, followed by exchange rates devaluation. It was in that context, marked by high international liquidity, which took place the first oil shock in 1973, throwing developed countries in a deep recession (Gamble, 1988).

Another key factor was the constitution of an unregulated international financial market, also influenced by the excess of dollars in international economy. This created the opportunity for international banks to supply credit in dollars for enterprises and governments, which was only possible through changes in regulation, motivated by the high profit opportunities. As a consequence, operations in dollars through national

borders marked a rupture with the previous mechanisms of regulation and control. Later, further deregulation was promoted by the United States government, motivated also by the opportunities of capital accumulation in the financial sector.

The consequence was the emergence of an unregulated international financial market, able to move considerable amount of resources among national borders.[1] This put substantial constraints on government's capacity to pursue domestic objectives, since countries with balance of payments problems and inflationary pressures tended to suffer massive outflows of capital and instability. As a consequence, the control of inflation became the key economic objective, in contrast to the low unemployment rates pursued in the anterior decades. Those changes had also very significant impacts on developing countries and on the macroeconomic regimes adopted.

The 1970s were so marked by a new phenomenon, the combination of economic deceleration, unemployment and inflation. Inflation was nurtured by both expansive monetary policies and the fiscal deficits produced by economic deceleration, since tax became unable to finance the high social expenditure which marked the new social contract. The impacts were more serious in face of previous prosperity, provoking disillusion and skepticism (Judt, 2007). Strikes and demonstrations skyrocketed, increasing political instability. The governments, nevertheless, did not know how to react; previous economic policies were impotent to deal with the new challenges. It was in this context that neoliberalism gained force, offering a new interpretation and a political package to deal with economic problems.

Neoliberal ideas had lost relevance in the post-war period, but they never completely disappeared (Gamble, 1988). From the 1960s, business increased unsatisfaction with the post-war arrangement and strengthened political action. Billions of dollars were channeled to think tanks and universities in order to produce new interpretations and theories able to provide alternatives to the post-war consensus (Blyth, 2002). Neoliberalism found its ideas and pillars in a different set of theories. The first one was monetarism, which emphasized the negative effects of inflation, responsible for creating uncertainty and deteriorating savings, investments and entrepreneurship. Its main prescription was a controlled and predictable monetary policy.

The second pillar was the *supply side economics*. According to this theory, high tax and excess of regulation damaged savings, investment and productivity, resulting in stagnation and unemployment. The reduction in tax, by increasing real wages and profits

expectations, would stimulate both labor supply and investments. The third economic pillar was rational expectations, which argues that economic agents are not deceived by economic policy, making some policies not only wasteful, but also ineffective (Blyth, 2002).

Economic interpretation was complemented by a theory about the state and the policy-making policies. According to Public Choice Theory, public agents were not disinterested actors, but selfish actors aimed at increasing their chances of promotion and reelection. Thus, they are not necessarily concerned to promote the public good. Consequently, policies tend to favor interest groups which have more resources and privileged forms of access into the state apparatus. Thus, state intervention is criticized in moral terms, followed by the defense of the insulation of organs and agencies from politicians and bureaucrats (Gamble, 1988).[2]

So, neoliberalism found in those theories a new path to tackle economic problems, defending the retreat in state intervention. The main prescription was to contain inflation, reduce tax and transaction costs, guarantee private property and provide the conditions to stimulate savings, investment and business in general. Those ideas, it is important to emphasize, supplied a group of politicians with a political program which allowed them do dispute and win elections.

In the United Kingdom, Margareth Thatcher embraced this narrative to gain the elections in 1979. Once in power, she promoted a strong monetary control which threw the economy into a deep recession. Inflation decreased, but she became the most unpopular prime minister in national history. Her government, nevertheless, was saved by the expansionist policies adopted in the United States and by the Malvinas (Falkland) Islands War, providing the support to go further with her economic program (Gamble, 1988). Thatcher also reduced tax and subsidies, privatized state enterprises and retreated the state in several areas. Expenditure was cut in a dogmatic way, causing damages in several sectors. Segments of industry suffered from the reduction of state support and the lack of policies aimed at facing the main challenges.

In addition, labor rights were cut and a strong offensive was centered over trade unions. Deregulation of labor market resulted in stimulus to business and substantial fall of unemployment, but it was accomplished through the reduction of labor and social rights. The jobs created were mainly at partial time and for a temporary contract, without

social rights. Pensions' conditions were also deteriorated and cuts were made in social assistance. As a consequence, inequality substantially increased. The most vulnerable public, including families with children and handicap persons, single mothers and ethnical minorities were those which most suffered (Kerstenetzky, 2012).

A similar movement took place in the United States, in which a neoliberal narrative supplied a political program which allowed business interests to reach power (Blyth, 2002). Billions of dollars were spent to fund researches and interpretations and channeled to more radical politicians which opposed the post-war consensus. Once in power, Ronald Regan adopted policies to contain inflation, reduced tax and state intervention and weakened the trade unions. Billions of dollars were cut from tax over the wealthiest segments, accompanied by billion dollars cuts in welfare policies and pensions. Supply side ideas were employed to argue that reduction in tax and benefits would stimulate economic recovery, solving the problems which had justified Welfare States creation. The astonishing result was the transfer of hundreds of billions of dollars from the poorest to the wealthiest segments (Blyth, 2002).

As Streeck (2012) concludes, conciliation between democracy and capitalism was a very hard task, achieved in the post-war period due to a very rare confluence of factors. The 1970s and the economic crisis led to a very different scenario. In the effort to create conditions for capital accumulation, neoliberalism adopted a range of measures to weaken the welfare state. Although international constraints increased and the governments lost autonomy in the pursuit of national objectives, national responses widely differed. Neoliberalism, as adopted in the United Kingdom and in the United States, was clearly a political program which promoted substantial changes in the economy at the costs of the trade unions and the most vulnerable groups. The responses in continental Europe and Scandinavia were very different (Guimarães, 2015).

2. Brazil: antecedents – from rapid industrialization to the neoliberal reforms

From 1950 to 1980, a rapid process of import substitution industrialization substantially changed the structure of Brazilian economy. GDP grew 5.72% a year, per capita GDP increased 3.03% a year and productivity substantially expanded (Maddison, 2001). Brazil became an exporter of a range of manufactured goods.

This process, shared by other Latin American countries, was nevertheless also marked by distortions and difficulties. Industry in general became very dependent on state

incentives and failed to export. In addition, macroeconomic unbalances, including inflation and deficits in foreign accounts, impeded a continuous process of economic growth. Thus, changes were necessary to balance the process, but most of them were blocked by interest groups. The state, although a key actor, depended on business support and was not strong enough to induce industrialists to become more competitive and directed to the external market. The process was also marked by increasing inequality, very precarious social policies and serious deficiencies in the educational system.

Despite the domestic deficiencies, the crisis which led to the exhaustion of the development model was in large part internationally induced. The 1970s, as seen, were marked by a deep international economic crisis, amplified by two oil shocks. At that context, Latin America was captured by the wide supply of financial resources at negative interest rates. Macroeconomic adjustments were not adopted and those countries employed cheap international credit to preserve expansionist policies. As a consequence, Latin American imports grew substantially, while foreign debt duplicated between 1976 and 1981, reaching US$ 544 billion (Guimaraes and Gambi, 2022).

The problem came when the United States unilaterally changed its monetary policy and substantially increased interest rates. As a consequence, international real interest rates, which in 1977 were negative in 11.2%, achieved 22.1% in 1981, leading many countries to bankrupt. The problem was that the foreign debt crisis was also transformed into a fiscal crisis, once policies were adopted to protect private investors from the risks of exchange rate devaluation. Consequently, public finances critically deteriorated, increasing inflation and reducing state capacity to deal with the new challenges. As a consequence, the 1980s was a lost decade in most of the Latin American countries.

In Brazil, different attempts were adopted, unsuccessfully, to defeat inflation. Stabilisation was only achieved when, in the 1990s, the United States promoted a wide program of foreign debt renegotiation. Debt renegotiation and the supply of financial recourses, nevertheless, were conditioned to the adoption of policies such as the opening of the economy, privatization, a new foreign capital law, changes in labor legislation and financial deregulation. National governments, very indebted, had little capacity to resist. This does not mean that liberal reforms were imposed, once economic problems were huge and there was strong domestic support for measures able to control inflation. Nevertheless, international institutions' influence was substantial in shaping features of the process.

The control of inflation in Brazil was a very positive achievement, producing significant social gains and giving the incumbents substantial support. However, the form how stabilisation was achieved had also negative consequences. The adoption of a narrow crawling band exchange rate system as an anchor, combined with high interest rates to attract foreign capital and contain demand, resulted in problems in the balance of payments and increase in public debt. In addition, overvalued exchange rates led many enterprises to bankruptcy, many of them bought by foreign enterprises. The negative performance of many sectors had impacts on the labor and on social conditions. In addition, financial deregulation brought flows of speculative capital and risks of crisis (Guimarães and Gambi, 2022).

As a result, the measures provided high gains opportunities for foreign banks and enterprises, which bought many national enterprises at favourable conditions. The measures, nevertheless, were not consistent enough and failed to provide sustainable conditions for economic development (Panizza, 2013; Guimarães and Gambi, 2022). Since the reforms, Latin American countries have presented low investment rates, very low public investment and a slow path of productivity increase. This happened in strong contrast to other countries, mainly in Asia, which has preserved high investment capacity and high rates of economic growth (Palma, 2011)

In brief, liberal reforms promised too much and delivered too little, failing to produce sustainable conditions for national development. Economy deteriorated in the second half of the 1990s and poverty substantially increased, reversing the positive effects brough by stabilisation. Dissatisfaction with neoliberal reforms is crucial to explain the emergence of center-left governments in many Latin America countries, including the PT in Brazil.

This trajectory is important to understand key questions and directions which marked PT governments. Lula was elected with the promise of tackling deindustrialisation, creating employment, improving social conditions and reverting certain neoliberal reforms. On the other hand, he had to deal with a more open and deregulated economy, which suffered with speculative capital flows destabilising impacts. Lula inherited positive features, such as consolidation of price stabilization, more stable relations with the states' governments and a very favourable external scenario. However, he also inherited negative aspects, such as the substantial increase in domestic debt and very high interest rates.

Thus, Lula faced an institutional and international context which implied substantial constraints and limited the economic policy degrees of liberty. Campello (2015) very well sumarizes the constraints which resulted from financial capital volatility. Greater the current account deficits, as happened in Latin American countries, larger the dependency on the flows of financial capital, pressuring countries to adopt the macroeconomic policies necessary to attract foreign capital. According to Campello (2015), this tends to approximate center left and center right governments; only in very favorable international contexts, marked by low international interest rates and boom of commodities, domestic governments have higher autonomy to promote heterodox policies.

Those constraints help to understand the macroeconomic regime adopted in Brazil by Cardoso and preserved by PT governments, marked, as mentioned, by the combination of inflation target regime (IT), primary budget surplus target and floating exchange rate regime. The preservation of this regime is critical to understand economic policy in the period.

The next sections investigate the economic policy during PT governments. In order to understand the decisions, it is necessary, firstly, to make some considerations about the impacts of economic policy on investment, a key variable to explain economic performance.

3. Economic policy during the two Lula's governments (2003-2011).

Investment is marked by a high degree of uncertainty, since its yields cannot be known with certainty at the moment one decides to invest. Consequently, the investment decision is very influenced by expectations and the factors which affect confidence on it. Instability of markets, inflation, economic slowdown and balance of payment crisis tend to negatively impact it.

Agent's expectations for the future are formed upon conventions, beliefs that are shared by economic agents (Keynes, 2013; Aretis et al., 2019). Other agents' opinions are observed in order to conjecture on the economy's path, since the latter is affected by decisions made by the set of economic agents. Thus, conventions are also a tool to coordinate expectations, informing each investor about what others would expect as an outcome of determinate policies (Carvalho, 2014; Fraga and Resende, 2022). So, the greater other economic agents' adherence to a given optimistic (pessimist) convention, greater the confidence in its continuity and stronger (weaker) the decision to invest, in a self-fulfillling prophecy. In this way, conventions reduce uncertainty and "play a crucial

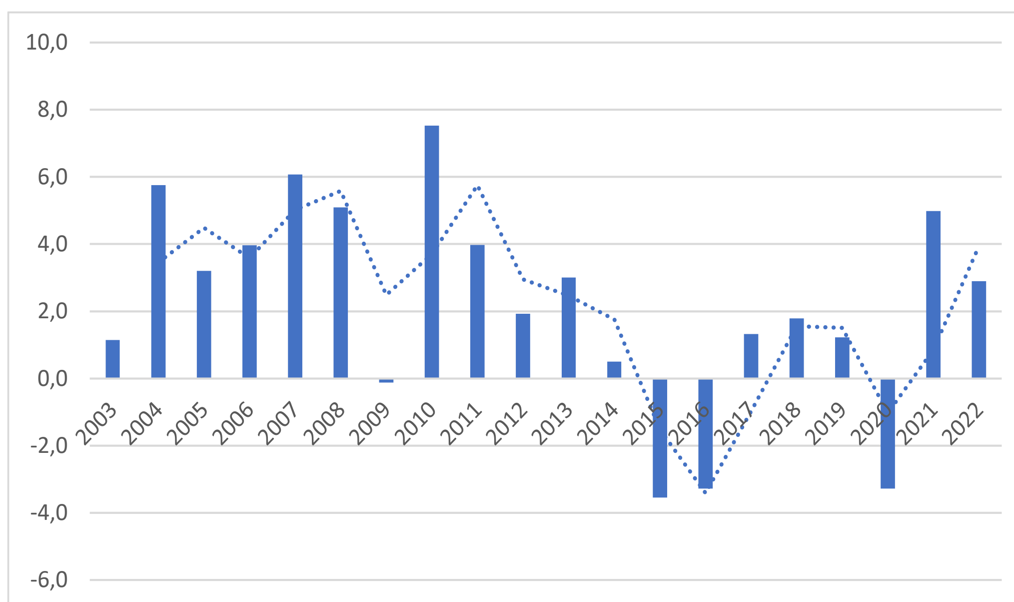
role in shaping private agents' expectations and their decision to invest". It is "a powerful device to induce investment in an uncertainty world" (Resende, 2023, p. 37).

Regarding government finances, a balanced government budget and a stable public debt trajectory tend to produce a favorable convention and stimulate businessmen to go ahead with their investments. By contrast, a public debt trajectory that seems out of control may mitigate investment. So, there are two main forms how a balanced fiscal policy may influence conventions. Firstly, budget under control indicates higher government capacity to adopt economic policies to boost demand in periods of deceleration, crisis and recessions. Secondly, unsustainable government debt tends to arise expectations of debt monetization, inflation out of control and increasing tax, a scenery which mitigate investment decisions. Thus, governments should chase a stable debt-to-GDP ratio, the main point being not its level, but the truth in its stability.

The months before Lula inauguration as president were marked by uncertainty and outflows of capital, explained by PT's previous radical positions regarding economic issues. So, a conservative economic policy was firstly adopted to conquer market confidence. Fiscal surplus target was increased in an attempt to demonstrate commitment to macroeconomic stabilisation. The first years were marked by low economic growth, pushed by exports. From 2005, nevertheless, economic growth significantly expanded, propelled mainly by consumption increase (Guimarães, 2022).

From 2004 to 2010, the Brazilian economy experienced a period of high annual growth rates, 4.5% a year (Figure 1), as well as poverty and income inequality reduction. Economic recovery was favoured by the low level of installed industrial capacity utilization and by favorable exports performance, due to strong international demand and the increase in commodity prices. The expansion was led mainly by family's consumption, a result of income transfer policies, minimum wage valorisation and the large increase in the credit-to-GDP ratio, which rose from 25.5 percent of GDP in 2002 to 40.0 percent in 2008 and 49.2 percent in 2012 (Serrano and Summa, 2015; Carvalho, 2018). Private consumption was also fostered by continuous appreciation of the real exchange rate. Although the annual average investment rate was only 17.0 percent of GDP in 2003-2005 years and 18.8 percent over 2006-2010 (Ipeadata, 2023), it did not impede growth, due to the low level of installed industrial capacity utilization.

Figure 1- Brazilian GDP growth, 2003-2022.

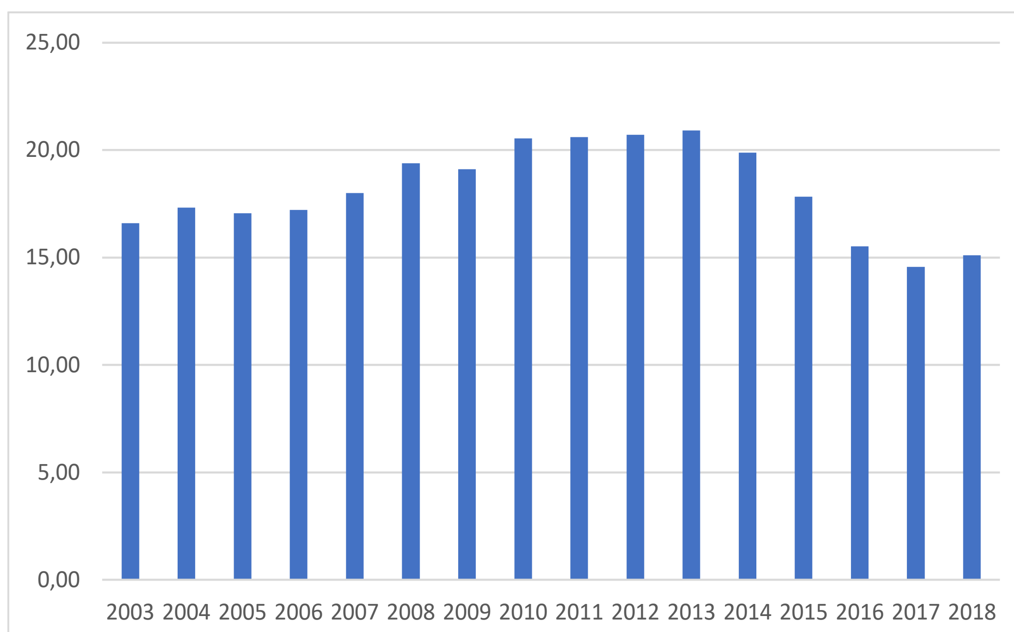


Source: Author's elaboration based on Institute of Applied Economic Research (Ipeadata).

Fiscal expansion took place from 2005 onwards, prioritizing policies such as increases in the minimum wage, civil servant wages increases and income transfer policies. The period was marked by substantial improvement of social programs. The number of people benefiting from social programs substantially increased, and also the benefits' values. Further, the expansionary fiscal policy was enlarged by the rise in public investment, mainly from 2006 to 2010. There was an increase in central government investment of 27.6 percent in real terms and the general government investment rate (central government plus federal state-owned companies) grew from 2.6 percent of GDP in 2005 to 4.6 percent in 2010 (Carvalho, 2018; Orair and Gobetti, 2017). Tax exemptions also increased and were extended to other sectors. These results were reached without a fiscal deterioration, since tax revenue kept up by economic growth and the increasing commodity prices (Orair and Gobetti, 2017).

The consolidation of stabilization and other factors, including the abundant international liquidity and, later, the impacts of the international financial crisis, also enabled the reduction in interest rates from 20% in 2003/2004 to 9.83% in 2009. In face of economic recovery and exhaustion of idle capacity, private investment also recovered and the aggregate investment rate rose from 17.2 percent of GDP in 2006 to 20.5 percent in 2010 (Ipeadata, 2023; Guimarães, 2022 – figure 2).

Figure 2- Gross fixed capital formation in Brazil, 2003-2018 (percent of GDP).



Source: Author's elaboration based on Brazilian Institute of Geography and Statistics (IBGE)

Nonetheless, as highlighted by Resende and Terra (2020), there were contradictions in the mix of the policies adopted. Firstly, the continuous appreciation of the real, although helping to mitigate inflation, damaged industrial performance. After almost ten years of continuous exchange rate appreciation, there was a reprimarization of the Brazil's industrial structure and of the range of manufacturing exports (Rossi and Mello, 2016).

Secondly, the low investment rate impeded aggregate supply to meet demand in the long run, tending to provoke inflationary pressures.[3] Moreover, it mitigated technological progress and productivity gains, which, in turn, are a necessary condition for the rise in real wages without inflationary pressures (Gala, 2008; Bresser-Pereira at al., 2015). In addition, the policies adopted to boost consumption, in a context of continuous real exchange rate appreciation, provoked leakage of demand abroad. As a consequence, the current account of the balance of payments ranged from a surplus of US$ 8.9 billion in 2004 to a deficit of US$ 35.6 billion in 2008 (Ipeadata, 2023).

In addition, Brazilian economy was significantly affected by the outbreak of the international financial crisis in 2008. GDP fell in 2009 and, despite a substantial recovery in 2010 – pushed by China's imports and fiscal stimulus –, economic growth decelerated in the following years (2011-2014). The main reason was the exhaustion of the factors which had pushed growth in the previous period, in particular the increase in consumption credit, given the very high indebtedness levels. In addition, exports suffered with the less favorable international context. It was thus necessary to strengthen private investment

and rise it to another level. The attempts by the following government to do it revealed, nevertheless, a strong failure.

4. The first Rousseff government (2011-2014) – economic policy and the road to economic crisis

At the beginning of Rousseff's first term (2011-2014), the external scenery had changed, there was a high level (84.8%) of installed industrial capacity utilization (Ipeadata, 2023) and no more room for rises in credit-to-GDP ratio (Serrano and Summa, 2015). Consequently, the drive for growth would have to shift to investment.

From 2011 to 2014, expansionary fiscal and monetary policies and greater intervention in the foreign exchange market were adopted. Nonetheless, economic policy mistakes were committed, resulting in a pessimistic convention and in a disarray in terms of expectations. Investment rates remained stagnant over 2011-2013 and fell from 2014 onwards (Figure 2), throwing the economy into a very deep crisis.

The beginning of the term was marked by the reinforcing of orthodoxy in an attempt to gain stability. A primary budget surplus target of 3.1 percent of GDP was fulfilled through a reduction in public investment. Central government and federal state-owned companies investments dropped 17.9 and 7.8 percent (in real terms) respectively in 2011 (Serrano and Summa, 2015). Further, the central bank increased the base interest rate (Selic) and implemented macroprudential measures for credit control.

However, in face of the slowdown of economic activity, the policy significantly changed from the end of 2011. At that moment, the economic team elected, as key priorities, to reduce interest rates and devalue exchange rate, intending to promote both investment and exports.

Thus, from September 2011 to October 2012, Selic was reduced from 12.5 percent per year to 7.25 percent, only 1% in real terms. In addition, commercial public banks (Banco do Brasil and Caixa Econômica Federal) cut their spreads to force private banks to lower their interest rates[4] (Resende and Terra, 2020). At the same time, measures to contain speculative actions on the foreign currency future and spot markets were adopted. As a result, the Brazilian real depreciated 42 percent between January 2011 and December 2013 (Cagnin et al., 2013).

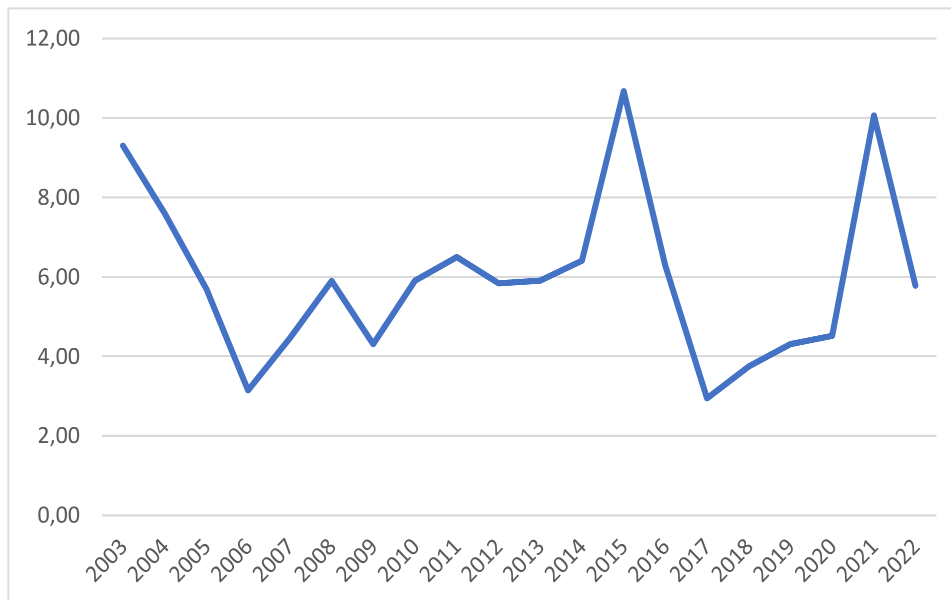
Those economic policies, nevertheless, did not bring growth, but rather inflation. The economic growth rate dropped, reaching 3.9 percent in 2011 and 1.9 percent in 2012, while the inflation rate reached 6.5 percent in 2011 and 5.84 percent in 2012 (figures 1

and 3). The reason is that a lower interest rate is not a sufficient condition to boost investment, which is critically influenced by aggregate demand and expectations. Demand had been weakened by both the restrictive policies adopted in early 2011 and the increase in household debt, which prevented the credit-to-GDP ratio to keep growing, while expectations had been negatively influenced by the conflicting signals given by economic policy, restrictive in 2011 and very expansionist in 2012 and 2013. This scenario produced a pessimistic convention and private investment did not rise.

The signals sent by the fiscal policy did not help either. As seen, a contractionary fiscal policy, launched at the end 2010, remained active in 2011, centered on the reduction of public investment. This happened, nevertheless, at the same time that a long-term government investment program, the Growth Acceleration Plan (PAC), was supposed to be running, sending contradictory signals (Resende and Terra; 2017). In addition, from 2011 the government gave up the role of public investment as one of growth devices; in the following years, it significantly fell[5] (Carvalho, 2018).

Meanwhile, the government substantially strengthened tax relief and subsidised credit policies. It was expected that the enlargement of profit margins would boost private investment. Some manufacturing sectors (automobile, household appliances, building material, basic basket goods, etc.) gained tax allowances, which were also extended to the taxes on the wage bill (payroll taxes). Those initiatives, initially centered on few sectors, were spread to other sectors following lobby pressures. In addition, a huge plan of subsidised credit was implemented, followed by a plan for concessions in infrastructure and a reduction in electricity tariffs, contributing to deteriorate fiscal accounts. Those initiatives did not follow a strategy, being lobby guided and confusedly implemented, jeopardizing optimistic conventions (Resende and Terra, 2017).

Figure 3- Inflation rate consumption index (%).



Source: Author's elaboration based on Brazilian Institute of Geography and Statistics (IBGE)

Government's intention was to promote an anticyclical policy centered on the private sector as the main investment driver (Orair and Gobetti, 2017; Carvalho, 2018). However, without a perspective of demand growth, Brazilian firms just widened their profit margins and paid or restructured their debts. A much better alternative would have been to reduce tax cuts and subsidised credit and strengthen public investment, which has a higher multiplier effect on the economy and positive impacts on logistic and externalities (Orair and Gobetti, 2017). The problem was aggravated by the government attempts, in face of a deteriorated fiscal scenery, to hide the problem through creative forms of accounting. Following Arestis et al., (2019, p.193-194):

> "(1) fiscal expansion was carried out in a manner that lacked credibility, using devices that inspired mistrust (among them the 'creative accounting' or the use of non-recurrent funds, such as selling oil fields, which are State owned by law); (2) the efforts to communicate fiscal policy measures to public opinion were particularly poor and limited to an insistence on announcing unrealistic revenue expansion and primary surplus goals (…)."

Inasmuch as government waived tax revenues and bear the cost of subsidised credit policy, in a context marked by lowering revenues due to the economy slowdown, its primary budget surpluses continuously went down. In addition, Central Bank, due to inflation acceleration, strongly raised the base interest rate (Selic) from mid-2013, resulting in the increase of government debt (Arestis et al., 2019).[6] Thus, the deterioration of primary fiscal results is explained mainly by the drop in tax revenues due to the

slowdown of the economy and the policy of tax exemption and subsidised credit policy. As stated by Orair and Gobetti (2017), this scenario does not corroborate the conventional wisdom that government's fiscal deterioration was due to its spending growing in an irresponsible way.

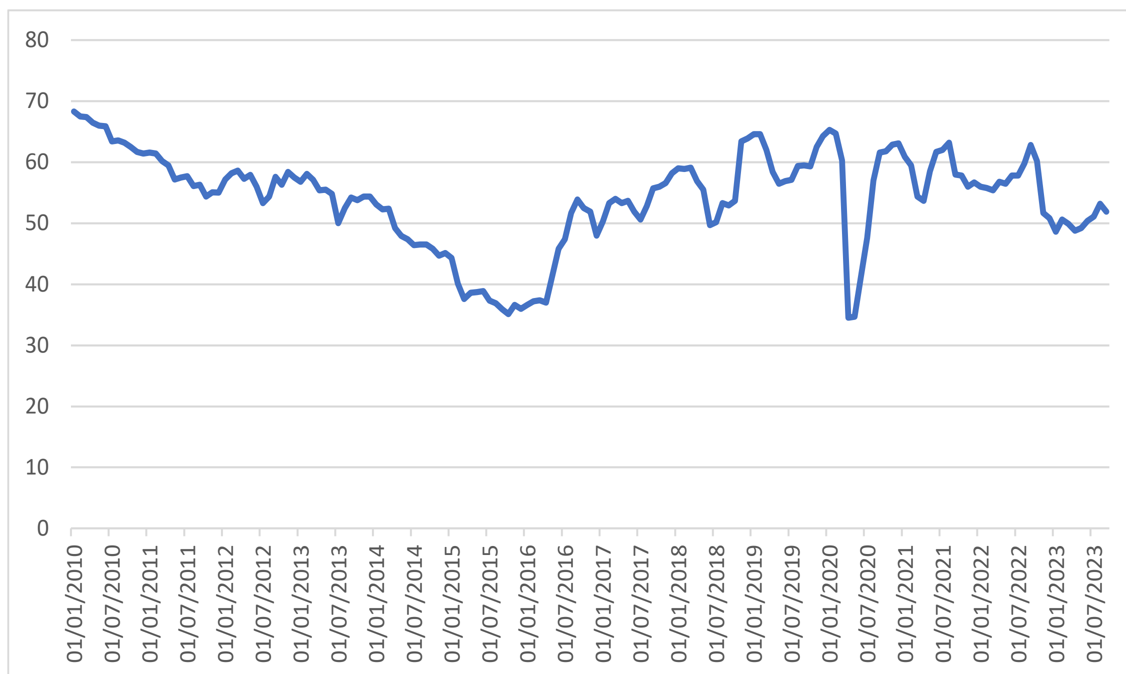
Due to the failure of fiscal policy in stimulating growth and its harmful effects on government accounts, the anticyclical fiscal policy proposed by Rousseff revealed a huge failure and became under increasing attack from the market agents and other sectors of the society, including the mass media. As a consequence, a convention that fiscal austerity is key for growth was strengthened and the idea of ‘expansionary fiscal austerity’ became predominant (Alesina, Ardagna and Trebbi, 2006). The pressure for a huge cut in government spending strengthened and reached its peak at the beginning of 2015.

5. Rousseff Second Government

The last year of President Rousseff’s first term, 2014, was marked by factors and decisions which contributed to explain the deep two-year Brazilian recession in 2015 and 2016: i) lack of fiscal control – government primary result saw its first deficit in 16 years; ii) high inflation level and contractionary monetary policy; iii) sharp drop in commodity prices; iv) the ‘Operation Carwash’ lawsuit, an ‘anti-corruption’ operation which directly affected Brazil’s largest corporation, Petrobras (which alone accounted for 8.9 percent of aggregate investment in 2013; see Loural, 2016), and major contractors responsible for building infrastructure investments; v) political polarization and the emergence of a pessimistic convention, given the drop in confidence index both of businessmen and consumers (Figure 4).

After a GDP growth of only 0.5 percent in 2014 and amid pressures to adopt an austere fiscal policy of spending cuts, president Rousseff made a complete turn and brought back a tighter version of the NCM tripod in 2015. A huge short-term fiscal adjustment was implemented, grounded upon the hypothesis that a controlled debt-to-GDP ratio would inspire confidence in private sector and then, as a (mechanic) consequence, private investment would grow up (Alesina, Ardagna and Trebbi, 2006; Reinhard, Reinhard and Rogoff, 2012).

Figure 4- Confidence index - industrial businessmen, 2010-2023



Source: Author's elaboration based on National Confederation of Industry (CNI)

So, following the 'expansionary fiscal austerity' guidelines, Rousseff's administration announced in January 2015 a drastic adjustment in public accounts of 1.4 percent of GDP based mainly in cut of government expenditures. At the end of that year, however, the cut in public expenses was actually lesser than the intended because of Congress resistance, amid the political crisis, in approving some measures. The announcement of a huge cut in government expenditures, coupled with the deep economic slowdown in 2014, produced expectations toward decreases in aggregate demand, reinforced by a further contraction of 36.7% in public investment (Orair and Gobetti, 2017). All those movements, contributing to consolidate a very pessimistic convention, provoked a deep fall in private investment (Resende and Terra, 2017). They were followed by other contractionary measures, including the increase in taxes on financial loans, company financial revenues, manufactured goods and automotive exports; reduction of subsidies for companies; cut in social benefits (unemployment and sickness insurances, for instance); and dramatic raise of public and administered prices (fuel and electrical energy).

At the same time, the Brazilian currency weakened dramatically, from an average exchange rate of R$ 2.36 per US dollar in 2014 to R$ 3.33 in 2015, very influenced by a robust drop in commodity prices. The exchange rate depreciation, coupled with the increase in administered prices, resulted in the high consumer inflation in 2015 (10.67

percent). This triggered the increase in the Selic base rate, which reached 14.25 percent per year in December 2015, further deteriorating the government debt trajectory.

This was too much for expectations and, as stressed, a pessimistic convention became predominant among economic agents, while Brazilian GDP was falling by 3.3 percent and aggregate investment declining by 13.9 percent in real terms (Figures 1 and 3). The unemployment rate increased from 4.8 percent in 2014 to 6.8 percent by the end of 2015 (Arestis at al., 2022).

The fiscal consolidation program based on spending cuts revealed a disaster. A much better economic alternative would have been to reorganize accounts by increasing personal income and property taxes and replacing government current spending with public investment. Contractionary fiscal policy, by increasing unemployment, negatively affected consumption, while exports were also negatively affected by the fall of commodity prices. All those factors, combined with political instability and the effects of 'Operation Carwash' lawsuit, led the economy to a very hard recession.

In brief, fiscal adjustment and measures to change expectations were very necessary. But they were wrongly done, guided by a set of ideas centered on "expansionary austerity". As Keynes (2013) had shown almost one century ago, cut of government expenditure in a recession is a bad response, since lower public spending further deteriorates economic activity and demand, failing thus to induce businessmen to increase investments. Meanwhile, as the government's own revenue also falls, the results tend to be the increase in public debt-to-GDP ratio and the further deterioration of expectations. This was exactly what happened in Brazil, with the public sector primary deficit achieving 1.88 percent of GDP at the end of 2015, the highest for three decades, and the financial deficit achieving 7.2 percent of GDP. As a consequence, the combination of increase in interest rates, heavy government indebtedness, a solvency crisis in the private sector (households and companies) and the contraction in the credit supply led the economy to a collapse.

Economic crisis was not produced by austerity. It was mainly a result of the badly conceived policies adopted by Rousseff's governments, unable to deal with the negative international context. The key issue in economy is not more or less state intervention, but the form how this intervention takes place. Fiscal policy, as argued, was done in the wrong way, since public investment, which has a higher multiplier effect, was cut, while the hundreds of billions of reais transferred to businessmen failed to induce investment.

Meanwhile, public debt substantially increased and further depressed expectations, negatively affecting private investment.

However, neoliberal austerity ideas had a role in the response, leading to policies which not only aggravated the recession, but prevented the government from tackling the real issues and contributed to put the onus on the workers and the most vulnerable segments. This is what in large part neoliberal ideology is about, as originally developed to adjust the welfare states, putting the emphasis on the reduction of wages and other costs to recover the conditions for capital accumulation (see section two).

6. Crisis, fiscal austerity and other steps towards the liberal agenda

On August 2016, Vice-President Temer became president in result of the controversial process of impeachment which removed Rousseff from power. The ‘expansionary fiscal austerity’ proposal was renewed, combined with a liberal-oriented process of structural reforms. In December 2016, the Brazilian Congress approved a bill establishing a constitutional amendment that created the ‘New Fiscal Regime’ (NFR), called ‘Expenditure Ceiling Law’. It was designed to achieve a very tight fiscal consolidation, since the primary expenses of the federal budget from 2017 to 2037 could only grow in as much as the annual variation of the consumer price index. The idea was that fiscal consolidation would be reached by government’s revenues growth p*ari passu* with GDP growth, whereas expenditure would be fixed in real terms. The idea was to constrain public spending growth, including investment, and interrupt the trajectory of social expenditures growth.

In addition, the labour law reform was approved in July 2017 by the Congress, radically changing Brazil’s 1943 Consolidated Labour Laws (see Chapter 13). The goal was the flexibilization of work contracts aimed at raising the level of employment.

Meanwhile, tight monetary policy continued to be applied in order to make inflation rate converge to the target. In such a context, the aggregate investment declined by 10.3 percent in real terms (Figure 3). in addition, government revenues were damaged by the economic recession and primary deficit reached 2.5 percent of GDP in 2016. GDP went 3.3 percent down and unemployment rate rose to 11.5 percent. Over 2013-2016, the net debt increased from 32.6 percent to 45.9 percent of GDP (Arestis et al., 2022; Orair and Gobetti, 2017).

From the monetary police side, inflation lost strength and reached 2.95 percent in 2017. Central Bank, thus, lowered the base interest rates, but did it very slowly, so that

Selic reached its lower level of 6.5 percent per year in March 2018. In a context of huge economic recession over 2015-2016, high interest rates were unnecessary to contain demand (Resende and Terra, 2020). Thus, the Central Bank excess of conservatism damaged economic recovery.

As an attempt to revive the economy, the government, in 2017, released withdrawals from the Guarantee Fund for Length of Service (FGTS - *Fundo de Garantia por Tempo de Serviço*).[7] Thus, demand was boosted in a context of decreasing interest rates and low level of installed industrial capacity utilization. Investment rate, nevertheless, remained at low levels of 15.0% and 15.8% in 2017 and 2018. The GDP grew respectively 1.3 and 1.8 percent, very little after a recession which provoked a GDP contraction of 7 percent in 2015 and 2016.

In 2018, Bolsonaro, embracing a far-right discourse, was elected president. He promised to implement a radical liberal agenda, based on structural reforms, privatization and government expenditures reduction. Once more, the 'expansionary fiscal austerity' proposal was renewed, combined with liberal-oriented structural reforms. A social security reform, designed in large part by the previous government, was approved by Congress in 2019 (see Chapter 7). In the same year, the government implemented an '*Economic Freedom Law'* and more public expenditures were cut. In February 2021, the Central Bank gained autonomy through a law passed by Congress.

In 2020 the world was hitted by the Covid-19 pandemic. Economic policy was substantially changed, especially due to the social programs adopted to protect people and enterprises from the lock-down and the paralisation of the economy. The new economic context also allowed a substantial reduction in interest rates. In the following years, public expenditure increased and the government found ways to flexibilize the "Expenditure Ceiling law". From 2021, economic policy became centered on increasing the chances of the president's reelection and all possible measures were adopted to increase its popularity, in a package which combined populist and even illegal measures.

In general, Bolsonaro government was marked by very poor public policies, mainly in social area, although his voluntarism and unpredictability had also negative effects in the economy. The form how pandemics was combated was especially negative, having very negative effects on the president's popularity. In addition, nothing was done to tackle and correct the negative impacts on education, while his environmental policies were disastrous. Bolsonaro demonstrated both lack of capacity and lack of will to govern. His

only aim became to stay in power. The poor policies and the negative effects on job creation and social conditions played important role in his electoral defeat in 2022.

Final considerations

Brazil has been, since the 1980s, in a trajectory marked by low economic growth. Investment rate has been low and has never recovered the levels from previous import substitution industrialization. Productivity has been stagnated, raising very slowly. The 2000s were marked by important advances, especially in social policies, which had positive effects on the economy. However, the necessary structural reforms were not done. Lula achieved high economic growth and improvement in social conditions without tackling politically difficult reforms, which would have faced strong opposition in the congress. In addition, his economic policies were also marked by contradictions, which came to the fore when the international context changed and the consumption led growth founds its limits.

Rousseff's attempts to deal with those challenges revealed themselves a huge disaster. She lacked political abilities to deal with delicate issues and her economic response was inconsistent. Her government conducted Brazil to a very deep recession, an important condition to allow the right and, later, the extreme right to achieve power. In her second term, Rousseff acritically adhered to neoliberal ideas, including terrible decisions which contributed both to reduce her political support and aggravate the economic situation.

Liberal ideas provided the interpretation and the justification for a political response which imposed the costs of adjustment in the vulnerable groups, while the richer groups, as usual, found forms to protect their income and wealth, including the huge financial gains provided by high interest rates. Inequality and poverty increased as a consequence. However, in contrast to what happened in Britain four decades ago, this process failed to put the economy in a new economic growth path. The combination of political difficulties, economic structural problems, bad policies and international events limited the economic achievements of neoliberal economic policies. This was not a surprise in face of the results generally achieved by "expansionary fiscal austerity policies" around the world.

This is the scenery which marked the return of Lula to power in 2023. Even before taking office, President Lula declared his commitment to the strengthening of social expenditure, changing in the environment policy and the abandoning of austerity. In the first months in office, a new fiscal rule was approved aimed at both indicating the

government's commitment to fiscal responsibility and giving more leverage to public spending, with the intention to frame a positive convention. In addition, the government succeeded in approving a tax reform which, despite several restrictions and proposals of changes by the congress, is a critical reform and has many chances to stimulate investment and contribute to economic recovery.

In brief, important lessons were learned from Brazilian trajectory in the two decades. The mistakes committed by Rousseff tend not to be repeated and the government's financial minister has shown the disposition to keep fiscal conditions under control and provide favorable macroeconomic conditions for capital accumulation. Investments, in a capitalist economy, are mainly done by private businessmen and any economic program needs their "support" in order to be successful. Meanwhile, the government is also aware of the necessity to avoid the excesses and inconsistencies inherent to neoliberal ideology. One of the contributions of this chapter is to make clear in which sense fiscal control is important and why excessive austerity measures are mainly motivated by political and ideological concerns, failing to produce positive economic results. In this sense, the government is ready to avoid those claims and to adopt a wider range of economic policy options, with much more chances of success.

The challenges of economic development in Brazil are considerable and go much further than macroeconomic policies. They imply the adoption of successful industrial policies, the stimulus to technological development, the improvement in business environment, the radical improvement in education and in labour force skills and a wide range of measures to improve productivity, among other policies and reforms. This requires a wide political capacity to deal with a hostile congress and the opposition from conservative political groups. This tends to be a long process, to be followed with patience and high capacity of articulation. The lessons from previous periods, including those summarised in this chapter, tend to be very helpful.

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[1] Capital available in international financial markets increased from US$ 160 bilhões in 1970 to US$ 1.5 trillion in 1980 and US$ 5 trillions at the beginning of the 1990s (Frieden, 2008, p. 405).

[2] According to this interpretation, the main difference between public and private agents is that the last ones are permanently subject to competition.

[3] As calculated by Oreiro (2013), it was necessary an investment rate of 24 percent of GDP in order to produce a sustainable annual average economic growth rate of 4.5 percent.
[4] Interest rates on private banks fell, but the credit offered by them also decreased.
[5] In 2014 central government investment was 1.4 percent lower (in real terms) than in 2010.
[6] The ratio of the federal interest payments to GDP went up from an average of 3.05 percent in 2013 to 6.07 percent in 2015
[7] The FGTS is a compulsory fund and is fed every month with a percentage of the wages. It was created in the 1960s aimed at protecting the workers in case of dismissal.