

# The Impact of Government Policy on Brazil Economic Miracle's Failure

Mengjia Chen<sup>1, †</sup>, Xiang Gu<sup>2, †</sup>, Yuyang Jiang<sup>3, †</sup>, Xinyu Li<sup>4, \*, †</sup>

<sup>1</sup>School of Public Administration, Shandong University of Finance and Economics, Jinan, China

<sup>2</sup>Victoria Shanghai Academy, Hong Kong, China

<sup>3</sup>School of Accountancy, Shanghai University of Finance and Economics, Shanghai, China

<sup>4</sup>School of International Study, Renmin University of China, Beijing, China

\*Corresponding author: 2019200531@ruc.edu.cn

†These authors contributed equally.

**Abstract.** From 1968 to 1973, Brazil experienced unprecedented economic growth thanks to the reform policies in the political and economic spheres of the military government. However, after 1974, due to changes in the domestic and international environment and multiple subjective and objective reasons, coupled with the impact of the global oil crisis, Brazil's economy gradually declined. And after 1980, it entered what was known as the "lost decade". The article analyzes the policy-level causes of Brazil's economic miracle recession in a comparative manner, using data from the statistical yearbooks obtained from the Brazilian National Institute of Geography and Statistics (INEGI) for the period 1970 to 1980. The analysis shows that a large part of the reason for the gradual decline of the Brazilian economic miracle came from the policies implemented by the Brazilian government during this period, such as debt development strategy, industrial-based industrial structure, trade protection and state intervention. The article further notes that the late decline of Brazil's economic miracle is precisely due to its policy nature of short-term overdraft and unsustainability. By inference, if a country implements policies during economic transition that are not based on its own national conditions, ignoring its own resource advantages, focusing on economic development and neglecting social and livelihood protection it may repeat the bad consequences of the policy backlash suffered by Brazil. Through the compilation and analysis of data, the article explores and summarizes the deep-seated reasons behind the decline of Brazil's economic miracle from the policy level, and provides lessons for other countries to learn in the process of developing their own economies.

**Keywords:** Brazil Economic Miracle, Debt Development Theory, Government Monopoly, Distorted Industrial Structure, Social Inequality.

## 1. Introduction

One cannot study the Latin American economy, especially the Brazilian economy, without studying the Brazilian economic miracle between 1968 and 1973. The economic miracle was preceded by political turmoil in Brazil until 1964, when the military government staged a coup and established a military regime. After the establishment of the military regime, a series of laws and decrees were enacted concerning censorship of the press, prohibition of political rallies, marches and strikes, dismissal of senators and deputies, dissolution of parliament and political parties, etc. The political system was reformed to eliminate the political and social instability that existed between 1962 and 1964, and to lay the foundation for economic reforms. During the period 1968-1973, Brazil's economy experienced unprecedented growth, with an average annual GDP growth rate of more than 10%, which has been called the "economic miracle".

Brazil's economic miracle did not happen by chance. In general, it was due to the political stability in the country and the economic reforms that were appropriate to the current Brazilian context: first, strict control of the domestic political situation: arrests and expulsions of political opponents; restrictions on trade union activities and repression of peasant movements; and second, bold economic reforms: wage reforms; further opening of the economy to the outside world; reforms of

the financial system; and tax policy reforms. However, the economic measures taken by the government during the economic miracle phase had their own drawbacks that eventually led to the decline of the economic miracle.

Why did the Brazilian "economic miracle" of the 1960s and 1970s fail to continue? To answer this question, there are several perspectives that provide useful insights. On the one hand, some studies have highlighted that Brazil's development strategy led to the interruption of its "economic miracle. Brazil's long-standing import-substitution strategy not only violated its comparative advantage, but the corresponding protectionism also led to a lack of competition and inefficiency in domestic industries [1]. Therefore, the implementation of an import substitution development strategy is unsustainable.

On the other hand, some studies have turned their attention to institutions, emphasizing that institutional arrangements such as protection of property rights build a good economic framework that provides incentives for people and contributes to long-term development [2]. Such literature focuses on the positive effects of institutional arrangements such as protection of property rights, but ignores the other side of the truth. In fact, the Brazilian government's emphasis on the protection of property rights in a society where there is a deep divide between the rich and the poor solidifies the existing divide between the rich and the poor, and such a political and economic structure not only does not provide a good institutional framework for sustained economic development; rather, the premature institutional arrangements exacerbate the country's political and economic problems, distorting the incentive structure and making economic growth unsustainable.

In this paper, we analyzed Brazil's economic growth from the perspectives of "imbalanced industrial structure," "severe livelihood conditions," "severe foreign capital infiltration," and "overprotected domestic market." This paper analyzes a series of economic policies enacted by Brazil during the economic miracle phase and explores the root causes of the decline of Brazil's "economic miracle" and unstable economic growth. This will not only help to grasp the context of Brazil's "economic miracle", but also help us understand the problems encountered in the development of other emerging economies with similar structures to Brazil and provide a reference for the development of emerging economies and developing countries.

## **2. The reasons for the decline of Brazil's economic miracle**

### **2.1 The overestimated economic development strategy**

One of the reasons that contributed to Brazil Miracle's failure was the overestimation that the government of Brazil conducted on the productivity of their country. The military government of Brazil had set goals to become a fully developed country by the end of 2000. It was undeniable that this would help to boost people's confidence and stimulate peoples strive [3]. However, since the government ignored the weakness and hardship of the economy, this over confidence was doomed to bring failure. The overestimation and over-optimistic idea of the government led to high debt. In other words, the government borrowed huge amount of money for investment. Nevertheless, they didn't realize that were unable to return it effectively. This was fatal for Brazil's further economic development and caused the recession of Brazil's Economic Miracle.

### **2.2 The growing burden of the external debt**

The Brazilian government had been pursuing a debt development strategy during the economic miracle phase. The core of the debt development theory is the use of international funds to promote rapid economic development. This theory guided the economic development of Brazil before and after the economic miracle and was one of the main reasons for the miracle. Brazil government absorbed large amounts of foreign debt from 1968 to 1978. They maintained that foreign exchange savings from the future development of import substitution and new export capacity would produce a sufficient trade surplus to cover the foreign debt. However, Table 1 illustrates that after 1973, the foreign debt increased rapidly, with the net foreign debt rising from \$6.2 billion in 1973 to \$31.6

billion in 1978, with an average annual growth rate of 38.7%, and total foreign debt rising from \$12.6 billion to \$43.5 billion.

**Table 1.** Brazil's foreign debt: 1968-1978 (million dollar) [4]

Year	Total foreign debt	Currency reserves	Net foreign debt	Annual increase on net external debt (%)
1973	12,572	6,416	6,156	15.3
1974	17,166	5,269	11,897	93.2
1975	21,171	4,401	17,130	44.0
1976	25,985	6,544	19,441	13.5
1977	32,037	7,256	24,781	27.4
1978	43,510	11,958	31,554	23.3

Under the implementation of the "debt growth" strategy, Brazil's average annual GDP growth rate was 7% in 1974-1978, although lower than 10% during the "miracle" period, the 7% growth rate was also high [5]. Despite the successful maintenance of a high economic growth rate, the external debt burden has gradually evolved from the driving force to a serious problem for the Brazilian economy due to the continuous accumulation of external debt. From the perspective of the ratio of principal and interest repayment and export amount, it is generally believed internationally that this ratio cannot be higher than 20%, otherwise there is a risk of not repaying the debt [6]. However, Figure 1 shows that this ratio was always well above the warning line.



**Figure 1.** Total debt service to exports ratio: 1973-1979 (million dollar) [7]

In despite of Brazil's huge export potential in the 1970s, imports volume grew faster. Thus, instead of making a surplus through foreign trade revenues, Brazil had to balance the deficit with large loans. Table 2 shows that from 1973 to 1978, the increased foreign debt was mainly used to cover the current account deficit rather than increasing foreign exchange reserves, making Brazil's debt repayment extremely dependent on new loans. In this case, maintaining economic growth, curbing inflation and paying off debts was an impossible triangle for Brazil.

**Table 2.** The ratio of Brazilian principal and interest repayment to new loan: 1973-1978 [8]

Year	Total debt service	The new borrowed loans (%)
1972	1,516	36.3
1973	2,187	48.6
1974	2,572	37.3
1975	3,583	54.8
1976	4,802	47.5
1977	6,106	77.8
1978	8,394	58.4

What made the problem more serious was that the second oil crisis broke out in 1979. While the trade conditions of the importers of Latin American oil countries deteriorated dramatically, the world interest rates rose to astronomical levels through tight monetary policy. For Brazil, since most of the debt was based on floating interest rates, rising international interest rates automatically increased the cost of loans.

### 2.3 The government's monopoly on economic power

Another problem that doomed the ultimate recession of Brazil's Economic Miracle was the monopolistic power that the government had over the economy. The government set a variety of interventions in the market for the sake of "protection". As shown in Table 3, from 1968 to 1974, government involvement in major local companies in Brazil had risen from less than 60% to 75% as calculated by net worth. In infrastructure, the government involvement measured by net worth is more than 88% [8].

**Table 3.** The percentage distribution of net worth of 100 non-financial firms by controlling interest: 1968-1974 [8]

Controlling interest/Year	1968	1970	1972	1974
State	58.6	67.6	70.9	74.4
Private	13.1	11.4	10.6	10.9
Foreign	28.3	21.4	18.5	14.7

This huge government involvement was a progress of nationalization, and as a result of this, the competition and activity of the market were limited, and the impact of the monopolistic power of the government led to ignorance on social welfare, while the government focused merely on the economic development. In terms of labour and social security, the government budget on it was only \$232 million in 1971, while the budget of transportation were 13 times of it [9]. Although it did result in economic development, a relatively low-quality living standard was set up at the time. Therefore, it was obvious that Brazil's economic well-being was not ideal from the beginning.

The exports and imports of Brazil was also extremely imbalanced due to protectionist policies, which indicated a failed trade protection policy. As shown in Table 4, there was a clear trend that the exports increase and overcome imports quantities profoundly through 1964-1974.

**Table 4.** The volume of Exports and Imports-1980 [10]

Years	Exports	Imports
1964	14578	18174
1970	39970	28074
1974	78642	54898

Protection policy were beneficial for local industry to a certain extent, but in the case of Brazil, the gap between exports and imports was so profound that it should be considered as an over-protection. The low competition led to an oligopoly and finally the serious inflation which was harmful to people due to the nature of this protectionist policy.

### 2.4 The distorted industrial structure

The economic growth of Brazil in "Economic Miracle" was largely led by achievements of industrialization. In the process of industrialization, Brazil has gradually changed from an agricultural

power to the most industrially developed country in the third world. However, the development pattern dominated by industrial was not well planned, which finally developed into a distorted structure that promoted industrial developments at the expense of eliminating resources on agriculture. According to the data of Brazil's official research institute in Table 5, industry accounted for 26.2% of Brazil's GDP, while agriculture made up 25.9% in 1949. Since the 1970s, industrial proportions have remained between 36% and 40%, but agriculture only accounted for about 10%. In 1979, Brazil's industrial output accounted for 36.1% of GDP and 10.9% of agriculture, which manifested that Industrial output value was more than three times that of the agriculture. Though the change in Brazil's industrial share in the economic structure and its high growth rate was quite encouraging, growth of agriculture at an average annual rate of just 4.5% was frustrating, which directly exacerbated the serious imbalance in Brazil's dual economic structure and regional development [11].

**Table 5.** Composition of Brazil's GDP (at current year prices) [12]

Years	Total	Agriculture	Industrial	Service
1949	100.0	25.9	26.2	47.8
1959	100.0	20.2	30.1	49.7
1965	100.0	15.9	32.5	51.6
1970	100.0	10.2	36.2	53.5
1975	100.0	10.5	39.4	50.1
1979	100.0	10.9	36.1	53.0

In terms of the structure of industrial sector, Brazil has long been committed to developing capital and technology-intensive industries, which led to the lack of labor-intensive industries. Typical example, Brazil has developed a huge automobile industry. During Brazil's economic miracle, the automobile industry was the most dynamic production sector, with an average annual growth rate of 34.5%. Car production jumped from 57,300 in 1960 to 550,700 in 1975, a production level comparable to the European and American countries at the time. However, the structure characterized by capital-and technology-intensive industries had serious consequences. Most apparently, the lack of labor-intensive industries led to severe unemployment faced by people in low-income group. Moreover, the production of luxury-goods seized resources from that of daily necessities, in that manufacturers of luxury-goods successfully attracted investment, acquired intermediate products, technical talent, scarce foreign exchange, and savings. However, development depending on luxury-goods was not sustainable. Due to the limited scale of the luxury market serving the wealthy group, growth of luxury-goods production would stagnate after reaching a certain scope. Finally, the rapid development of auto industrial greatly challenged the efficiency of Brazilian transportation system, and the oil shortage was increasingly obvious.

### 3. Discussion

#### 3.1 The hidden dangers of debt development theory

Despite maintaining Brazil's high growth rate, the debt development theory did have obvious hidden dangers. Most apparently, if large amounts of loans decreased or stopped abruptly, Brazilian economic growth would inevitably fall. In the meantime, the interest rates on most commercial bank loans were linked to those in the European dollar (Eurodollar) markets, making the future debt burden unpredictable. What's more, as the main borrower, Brazilian private sector faced a huge risk of repayment. In Brazil, the domestic interest rates were controlled by the Brazilian government, which were usually above those on European dollar. This measure was aimed at prompting Brazilian borrowers to invest in the European dollar market, thus attracting more foreign capital to help make up the balance. As a result, the repaying ability of Brazil's private sector was linked to two potentially unstable factors: interest rates on the European dollar and Brazil's

currency policy. As a matter of fact, these hidden dangers of debt development theory were evident in the later years of Geisel's administration. In addition to the bad effects of the rise in international interest rates caused by the oil crisis, another pressure was from the developed countries who asked Brazil to eliminate fiscal and credit subsidies for exports. Nonetheless, due to the need for export revenues, Brazilian government must increase the extent of the depreciation of Brazilian Cruzeiro as compensatory measures [11]. As a result, this further depreciation would inevitably increase the inflationary pressure, thus increase the financial burden of indebted companies. In this vicious circle, the solvency of the private sector was greatly reduced, and the country's economic development had to slow down by severe inflation as well.

### **3.2 The unavoidable social inequality behind the rapid growth**

The rapid economic growth under the authoritarian government was a remarkable characteristic of the Brazilian modernization process in the 1970s. Because of its character of "strong government", and its clear nature of "development-oriented", the authoritarian regime in Brazil made great contribution to economic growth during the "Economic Miracle". However, the quick economic growth could not obscure the bad impacts this system had, which mainly referred to widening social inequality. As a matter of fact, the rise of the military junta and the stability of this regime largely depended on the wealthy group, which required this regime to continuously serve the interests of the wealthy instead of majorities of poor. As a result, in the period of military junta, a lot of measures on wealthy distributions and protections benefited the wealthy group, such as the design of the structure of industrial sector and the inequitable incentive structure, etc. Nonetheless, in this instance, the poor in Brazil, on the one hand, cannot subvert the military junta through democratic election; on the other hand, the only way for them to upward mobility was monopolized by the wealthy. In Brazil, the funds and resources government invested in the higher educations were much more than those in basic education, which constantly consolidated the social statues of the wealthy, meanwhile prevented the poor from moving upward. In addition, as parts of the wealthy, military officials themselves benefited greatly from this authoritarian system.

### **3.3 A predictable market failure under the nationalized monopoly**

As most major non-finance firms were gradually nationalized by the Brazil military government from the end of 1960s to 1970s, this made the market of Brazil to develop into a monopolistic competition market, meaning that it was difficult for other producers to invest and join the market because most materials and factors of production were dominated by a few state-owned companies. The influence of government expanded from politics to economics. The economy shifted closer to a planned economy, as the allocation of resources was determined by the government. This eliminated the power of free demand and supply, and would theoretically lead to predictable market failure, causing losses in the economy. More significantly, the reduction of competition in the market was lethal to economic development. As there were no new competitors joining the market, it was hard to create innovation and advancement, it was also disadvantageous for market to compete globally. Even though the central organization of the planned economy brought some short-term growth in Brazil, this caused a huge disparity between regions and other long-term disadvantages.

## **4. Conclusion**

Through observing the impact of Brazilian government policies on "Economic Miracle" from 1968 to 1973, this research found that the late decline of Brazil's economy in 1980s was to some degree predictable due to its policy nature of short-term overdraft and unsustainability. The overestimated economic development strategy, boosted people's confidence and stimulate strive, however, ignored the level of the development of the productive forces, which disrupted the normal pace of economic development and led to a series of unrealistic developments planning. The debt development theory put up a case, which greatly overestimated Brazil's solvency and directly contributed to the debt crisis.

Simultaneously, the involvement under the military government in nationalism did stimulate economic growth but limited the competition and activity of the market; while the protectionism benefited for local industry for a certain period, led to the imbalance of imports and exports in the long-term. Finally, this research argued Brazilian economic development pattern which promoted industrial developments at the expense of eliminating resources on agriculture and gave prior to the capital and technology-intensive industries insides the industrial sector. This distorted industrial structure was bound to economic decline after the demands of luxury reaching to the peak and agriculture reduction shook the foundation of people's survival and development.

In essence, these policy nature of short-term overdraft and unsustainability to a certain extent originated from the nature of power. Though the authoritarian regime in Brazil made great contribution to economic growth during the "Economic Miracle" for its clear goal of "development-oriented", the highly dependence on the wealthy group required this regime to continuously serve the interests of the wealthy instead of majorities of poor. As a result, in the period of military junta, a lot of measures for development designed benefited the wealthy group, such as the design of the structure of industrial sector and the pursuit of rapid growth. The interests demand of ruling class greatly affected the designer of the policy. As we see, in fact, these policies implemented during economic transition were not based on Brazilian own national conditions. As a result, for emerging countries like Brazil, if it blindly pursues radical development and imitates the successful international experience, though achieve economic miracle in short-term, the precocious system may hinder the long-term development of the economy. In order to achieve sustain economic growth, creating favourable political conditions and examining national conditions are dispensable prerequisite.

## References

- [1] Domínguez, J. Explaining Latin America's Lagging Development in the Second Half of the Twentieth Century. Fukuyama F. Falling Behind: Explaining the Development Gap Between Latin America and the United States [M]. Oxford University Press, New York, NY, 2008. 81:82 – 86.
- [2] North, D. Institutions and Economic Growth: An Historical Introduction [J]. World Development, 1989, 17(9).
- [3] Lv Yin Chun. Re-understanding of Brazil's economy [J]. Latin American Studies, 1994(04):12-17+64.
- [4] De Oliveira, A. The political economy of the Brazilian power industry reform: Program on Energy and Sustainable Development [M], Stanford University Press, Stanford, CA, 2003.
- [5] Brazilian Modernization Road Study —Development during the military regime 1964-1985 [M], World Book Press, 2009.
- [6] Skidmore, T. The Politics of Military Rule in Brazil: 1964 – 1985 [M]. Oxford University Press, New York, NY, 1988.
- [7] The Brazilian Statistical Yearbook-1977, Brazilian Institute of Geography and Statistics [DB], Retrieved from <https://biblioteca.ibge.gov.br/index.php/biblioteca-catalogo?view=detalhes&id=720>, 2022.9. 18
- [8] Barros, José Roberto Mendonça de, and Douglas H. Graham. The Brazilian Economic Miracle Revisited: Private and Public Sector Initiative in a Market Economy [J]. Latin American Research Review, 1978(13): 5-38.
- [9] Statistical Yearbook of Brazil-1971, Brazilian Institute of Geography and Statistics [DB], Retrieved from <https://biblioteca.ibge.gov.br/index.php/biblioteca-catalogo?view=detalhes&id=720>, 2022.9. 18
- [10] Ministry of planning and general coordination, Brazilian Institute of Statistics [DB], <https://biblioteca.ibge.gov.br/index.php/biblioteca-catalogo?view=detalhes&id=720>, 2022.9. 18
- [11] Frieden, J. A. The Brazilian Borrowing Experience: From Miracle to Debacle and Back [J]. Latin American Research Review, 1987, 22(1): 95-131.
- [12] Su Zhenxing, Chen Zuobin, Zhang Baoyu, Zhu Zhong, LyU Yinchun: Brazilian Economy [J], People's Publishing House, 1983:16.