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The changing role of the state in Brazil

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Nº 337

THE CHANGING ROLE OF THE STATE IN BRAZIL¹

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² The paper benefited from comments from Marcelo de P. Abreu, Dionísio D. Carneiro and Werner Baer.

Summary

Since the late eighties privatization, trade liberalization and de-regulation have become central issues on the economic policy agenda in Brazil, as part and parcel of the stabilization effort. However, as the sense of urgency aroused by the need to put an end to high inflation starts to lose momentum, there are now mounting pressures in favor of the resurgence of a more interventionist state that, under the ample umbrella of active industrial policy, would “pick the winners” among the various industries and open to them a generous flow of government favors, in the form of tax and credit subsidies, shelter from foreign competition and cozy public-sector procurement contracts. Massive subsidization of selected industries was the hallmark of the military regime’s industrial policy that led to major blunders, widespread rent-seeking, state plundering and corruption. This paper stresses the difficulties of implementing the same kind of policy in the new Brazilian democratic environment, particularly when the government still has to impose very painful and unpopular fiscal adjustment measures, in order to consolidate the results of the current stabilization plan and to establish a firmer ground for sustained economic growth.

In her fascinating book on industrial policy in South Korea, Alice Amsden (1989) provides a neat rationale for the idea of a state-centered development strategy, based on what could be called “intelligent intervention”, during late industrialization experiences:

“Countries with low productivity require low interest rates to stimulate investment, and high interest rates to induce people to save. They need undervalued exchange rates to boost exports, and overvalued exchange rates to minimize the costs of foreign debt repayment and of imports... They must protect their new industries from foreign competition, but they require free trade to meet their import needs. [...] The state in late industrialization has intervened to address the needs of both savers and investors, and of both exporters and importers, by creating multiple prices. ...the state cannot be said to have gotten relative prices ‘right’, as dictated by supply and demand. In fact, the state in late industrialization has set relative prices deliberately ‘wrong’ in order to create profitable investment opportunities.”³

Dealing with market’s failure to assure proper growth-inducing incentives was the main idea of “intelligent intervention”.⁴ The performance of this kind of policy in different late-industrialization countries has varied widely. In Korea and some other Asian countries, it had an undeniable success, helping to take those countries from underdevelopment to the fringes of the developed world in less than forty years. Latin American countries were less successful, but Brazil was for quite a long time one of the most successful among them. From 1940 to 1980, policies that could be labeled as “intelligent intervention” did help its economy to sustain an average annual growth rate slightly above 7%, which allowed its real GDP to be multiplied by a factor of 16 over the four decades.

But the period since 1980 witnessed a breakdown of the “intelligent intervention” strategy. The maze of contradictory and off-setting interventions led to an endless

³ Amsden (1989), pp. 13-14. See also, chapter six, where Amsden presents a more extensive discussion of the idea of setting prices “wrong”.

⁴ The idea of “intelligent intervention” is discussed in Carneiro (1994) and in Abreu, Carneiro and Werneck (1994).

series of government failures, that brought about stagnation, a deep fiscal crisis, bureaucratic decay, widespread rent-seeking, outright corruption and hyperinflation. The reasons why that happened are still to be fully understood. This is not the place either to reproduce the available findings or to list all the relevant reasons, many of them common to other Latin American economies that went through similar experiences during the same period.⁵ The important fact is that many years of government failure in conducting “intelligent intervention” led to a complete change on the dominant view about the economic role the state should be playing in Brazil, as well as in other Latin American countries. Yet, the idea of “intelligent intervention” is deeply rooted in Brazil, and as the sense of urgency imposed by the gravity of the inflationary problem loses strength, there is a growing evidence that the demand for a “intelligent intervention” policies will certainly revive.

Such policies have meant in the past, in Brazil as elsewhere, “picking the winners” among the various industries and opening to them a generous flow of government favors, in the form of tax and credit subsidies, shelter from foreign competition and generous public-sector procurement contracts. That was the hallmark of the military regime’s industrial policy. This paper stresses the difficulties of implementing the same kind of policy in the new Brazilian democratic environment.

The next section presents a brief account of the brisk change of views on the economic role of the state that was observed in Brazil since the late eighties. Yet old views are re-emerging, as the initial success of the stabilization plan is opening room for the discussion of long-term policy issues. That is analyzed in section 2. The following section discusses the political obstacles that a restoration of old-style industrial policy would face. The difficulties to acclimatize a South-Korean industrial policy in Brazil are further stressed in section 4. Some conclusions are then drawn in the last section.

⁵ See, for example, Lamounier and Bacha (1994), Werneck (1994), Abreu, Carneiro and Werneck (1994), Carneiro and Werneck (1993) and Werneck (1991).

1. THE CHANGING ROLE OF THE STATE

As happened in most of the world, views on the economic role of the state have changed dramatically in Brazil during the last two decades. By the early seventies, most of the best trained economists in the country had developed a strong belief in the benefits of a wide range of direct government interventions in many areas of the economy. Keynesian triumphalism, then already fading in the US and Europe, still thrived in Brazil, where Iberian tradition and a long historical experience of government intervention provided an especially fertile soil to the idea of giving the state an important strategic economic role.

Two decades later a totally different view on the economic role of the state has emerged in Brazil in the wake of a row of difficulties imposed by two oil shocks, a long foreign debt crisis, deep fiscal imbalance problems, prolonged stagnation and high inflation. Those difficulties have amplified in the country the recent worldwide fall-of-the-Berlin-wall effect on the dominant view about the desirable economic role of the state.

Since the late eighties, privatization, trade liberalization and de-regulation have become central issues on the economic policy agenda, as part and parcel of the stabilization effort. Such policies gathered a special momentum during the 1990-92 period, in the wake of President Collor's forceful, though often misguided and bombastic, economic reform program. After he was impeached in late 1992, charged with corruption, his successor, President Franco, followed a more careful course in the privatization and de-regulation fronts, but maintained the pre-established trade-liberalization schedule which brought the average import tariff from 35% in early 1990 to less than 14% in late 1994.⁶

⁶ As a matter of fact, President Franco even speeded up the pre-established trade liberalization schedule at the end of his term in order to avoid price hike ups during a crucial phase of his stabilization plan. For an analysis of the privatization, trade liberalization and de-regulation programs during the early nineties, see Abreu and Werneck (1993).

The October 1994 presidential election was won in the first round by Fernando Henrique Cardoso who, as President Franco's former Finance minister, had successfully launched a new stabilization plan some months before. His campaign stressed the need to push forward the privatization, de-regulation and trade liberalization programs, to refurbish the public sector and to reduce the scope for successful rent-seeking behavior and state plundering.

2. STABILIZATION, TRADE LIBERALIZATION AND THE RESURGENCE OF OLD VIEWS ON THE ROLE OF THE STATE

The resounding success of the stabilization plan, that managed to bring down the monthly inflation rate from almost 50% in June 1994 to approximately 2% twelve months later, has naturally attenuated, a bit too early perhaps, the sense of urgency which made fighting inflation the main concern of economic policy in the country for quite a long time. With a now much lower inflation rate, the debate on long-run economic policy issues -- both public and within the government -- is bound to become increasingly important. The role government should be playing in order to put the economy again on a reasonably fast and steady growth track is becoming once more a central policy issue.

But it was not only because it has turned inflation into a more manageable problem that the stabilization plan has been arousing a new discussion on long-term policy issues. There was another indirect effect that should also be taken into account. In the wake of the sharp inflation fall there was a strong demand boom, fueled by the massive cutback in inflation-tax and the rapid revival of credit. The high degree of uncertainty brought about by the long high-inflation process had had a devastating effect on credit. The dramatic fall in inflation was only possible because a large part of the demand boom was accommodated by soaring imports, enhanced by an overvalued currency. As imports almost doubled in twelve months, the one-billion-dollar monthly trade surplus,

which the economy had managed to boast, come rain or shine, for many years in a row, has given place to trade deficits since late 1994.

The government expects that demand-control measures which have been adopted over the past few months will eventually lead to a reversion of the sign of the monthly trade balance sometime during the third quarter and to an annual trade deficit close to zero in the current year. On the other hand, despite all the recent rapid increase in imports, the aggregate import-coefficient of the Brazilian economy is not much higher than 10%. Yet, even with a zero trade balance figure, Brazil would still need to finance a current account deficit of at least US\$ 15 billion in 1995, due to its traditionally negative service-account position. And, of course, after the Mexican debacle, the risks of over-extending the country's foreign financing requirements have become a matter of great concern.

Apprehension about the external accounts and the rapid increase in the economy's import-coefficient has provided a fertile soil for a resurgence of protectionism. The "imprudent" trade-liberalization pace, which was in fact rather smooth, is now under heavy attack from many pressure groups. Although the growth rate of the manufacturing has reached 10% during the first twelve months of the stabilization plan, many industrial sectors are worried about the increasing market share of competitive imports. The image of an economy on the verge of a "de-industrialization" process has been brandished with some success. The idea of rolling trade liberalization back is now openly defended -- in spite of lip service to liberalization -- as the government faces an increasingly strong and well organized lobby fighting for higher barriers against foreign competition. As the demand-control measures begin to bite that kind of lobby is bound to become even stronger.

But what requires special attention is the fact that, mingled with the resurgence of protectionism, there is a broader movement in favor of the resurgence of a more interventionist state that, under the ample umbrella of active industrial policy, could

establish specific sectoral policies and directly influence the pace and pattern of industrial expansion. Not only granting protection but also manipulating a wide range of instruments, from tax incentive mechanisms and state-owned financial institutions' credit lines to government procurement rules. Of course that would mean resurrecting the old state-centered development strategy built upon the idea of "intelligent intervention".

What has been called the positive theory of protection assumes the existence of a market for protection, a political market.⁷ In more general terms, Stigler (1971) wrote a well known and very provocative paper, suggesting that there is a market for regulation. As, according to him, the main purpose of regulation would often ultimately be to transfer resources to the affected industry, in such a market regulation would be demanded by industry and supplied by government.⁸ In that sense, it may be useful to think in terms of a market for "intelligent intervention" in Brazil. Latent demand in that market is now finding room to re-emerge, as the sense of urgency aroused by the stabilization problem starts to lose momentum, and the idea of getting relative prices deliberately "wrong" in order to induce investment begins to be seen again as sound economic policy.

The recent policies towards the automotive industry help to illustrate the point. Early this year, pressed by a strong lobby and worried about the deterioration of the trade balance, the government started to have second thoughts on the liberalization of car imports. The tariff on cars, that had been brought down from 35% to 20% in September 1994, was lifted to 32% in February 1995 only to be raised again in March to 70%. But soon even higher import barriers would be imposed. In June, a new "automotive regime", establishing an industrial policy for the sector was announced. Car imports during the last seven months of 1995 were restricted to a quota corresponding to 50% of what had already been imported during the first five months

⁷ See, for example, Borchardt (1991).

⁸ For a broader analysis of the politics of regulation see Noll (1989) and Tollison (1982).

of the year. From 1996 on, the government was authorized to restrict imports, allowing each local producer to import finished vehicles, parts and equipment up to a value established as a proportion of its total exports net of profit remittances. A quota corresponding to a small share of the total domestic market would be allocated to independent importers, i.e. those that are not local producers. The share mentioned for that purpose was 5%. In that case 95% of the domestic market would be reserved to cars either produced or imported by local producers. On top of this, the latter would also be benefited by a battery of tax expenditures in the form of near zero tariffs on imported inputs and equipment and a generous free depreciation scheme, reviving similar policies adopted in the seventies. Also, part of the investment would be added to exports in order to determine each local producer's import quota.⁹

Tariffs on electrical and electronic appliances were also raised from 20% to 70% last March on grounds of trade balance improvement. Curiously, at the time tariffs were increased, sales of domestic producers of those goods, as well as sales of the automotive industry, were growing very rapidly, fostered by the sudden inflation fall in mid-1994.¹⁰ Of course, as the government decided to pamper industries that were faring so well, putting trade liberalization into reverse and reviving strong subsidization policies, many other industries, particularly those are not faring so well, felt comfortable to enhance their lobbies for more protection and subsidies.¹¹

⁹ See *Gazeta Mercantil*, June 15, 1995 and "Setor automobilístico já tem regras para 96", *O Globo*, July 29, 1995. See also Medida Provisória Nº. 1073, July 28, 1995.

¹⁰ According to official IBGE indicators, in the first quarter of 1995, the production of electrical appliances was 32% higher than in the same quarter of 1994. The corresponding growth rate for the automotive industry was 12.3%. In 1994, 1.6 million vehicles were produced, an all time record. It should be mentioned that after tariffs have been raised to 70%, the imposition of quotas on imported cars and the new "automotive regime" have been justified by the government as a way to give investments in the automotive industry the same favorable treatment offered in nearby Argentina.

¹¹ In line with the demands of those industries, some new industrial policy proposals seem to have changed tack, and instead of defending the idea of "picking the winners" started to defend "restructuring" policies that, as has been pointed out by Marcelo Abreu, should be read as "picking the losers". See Guimarães et. alii (1995).

3. PICKING THE WINNERS, FISCAL ADJUSTMENT AND DEMOCRACY

What difficulties would a state-centered economic growth strategy meet today? First of all, an effective policy of sectoral “intelligent intervention”, all its shortcomings notwithstanding, would at least require a fairly large, competent and scrupulous bureaucracy, in sharp contrast with the present dismal situation of the elite of the civil service in the country. Erecting a bureaucracy with such characteristics is bound to be a slow process. But even if that task could be easily and rapidly accomplished, the strategy would still meet today a major stumbling block, stemming from the problems of adopting it in a full-fledged democracy.

An industrial policy that “picks the winners” and opens to them the usual cornucopia of government favors, involving tax and credit subsidies, shelter from foreign competition and bountiful public-sector procurement contracts has become much more difficult to implement in Brazil, given the fast political development of the country since the end of the military regime in 1985.

Brazil has a modern and defiant press, perhaps more independent from the government than that of any other major Latin American country, not to mention those of the so-called Asian tigers. Brazil’s continental size, its geographical decentralization, with as much as twelve cities with more than one million inhabitants scattered all over the territory, and a national capital which is very distant from the economic and demographic center of gravity of the country are all factors that may help to understand the relatively high degree of independence of the press.

During the last few years, the press has helped to make public opinion less and less lenient with corruption and policies that could be labeled as some form of plundering the state. Two relatively recent corruption scandals have had a key role in that process. One of them culminated in the impeachment of President Collor in late 1992 and the other one in the expelling of several members of the Chamber of Deputies in early

1994, in the wake of an inquiry in its Budget Committee. In both cases the press conducted long, relentless and galvanizing campaigns. There is ample evidence that public opinion emerged from those campaigns showing to be much more sensitive and alert to any signs of improper use of public resources. And, of course, in response to that change, the press has become even more vigilant in what concerns corruption and the distribution of state favors.¹²

That does not mean at all that the Brazilian society was suddenly freed from problems of corruption and misuse of public money. Of course, that is not the point. It only means that the press and the public opinion have become much less lenient with those problems, in contrast with the still surprising revealed indulgence with which the same problems have been treated in some other large Latin American countries. And that means that it is not so easy any more to dispense generous state favors to a few selected sectors on the scale that would be required to put again the old state-centered development strategy on the move.

It adds to those difficulties the fact that the government is now engaged in a major and painful fiscal-adjustment effort, dictated by the necessity to both consolidate the initial good results of the current stabilization plan and open room for a substantial increase in the obviously compressed and badly needed expenditures in traditional areas, as education and health programs. To fire public servants, to cutback social-security benefits, to reduce transfers to state and local governments and to raise taxes are some of the politically difficult proposals the federal government is being forced to consider. The required fiscal adjustment effort will probably take a number of years to be accomplished. In such circumstances, it would be politically explosive to implement policies that would mean channeling an enormous amount of public resources to specific sectors that happened to be picked as winners.

¹² Curiously, such vigilant stance has become so strict as to make even some unsuspected analysts worried with what has been labeled “denouncism”. See Lamounier (1995), p. 101.

Since the 1988 Constitution, the Executive Branch has to submit to Congress an annual detailed tax-expenditure budget showing estimates of the magnitude of the implicit subsidies granted by the tax system. In parallel, the implicit credit-subsidies granted by government-owned financial institutions have also become a matter of great concern which the press tries to trail all the time. Again, those changes towards greater transparency in the use of public resources have contributed to amplify even more the difficulties to resurrect the old style state-centered growth strategy in Brazil.¹³

One could argue that, although aggressive industrial policy reached its climax in the seventies, halfway through the military regime, it was already being implemented in the country well before that, since at least the second Vargas government (1951-1954), having been one of the hallmarks of the Kubitschek government (1956-1961), still praised as a period of unequaled political freedom in the 1946-64 regime.¹⁴ That could be seen as suggesting that there would be no problem with dispensing the usual strong dose of state favors to a few industrial sectors in a democratic environment. All that would be needed would be a shrewd political negotiator, as good as Kubitschek proved to be. That would be a faulty argument. Democratic as the Kubitschek period certainly was, particularly if compared to all the political experience the country had lived until that time -- and for that matter, would live for the following 24 years, till the end of the military government --, the degree of democracy that was attained in the late fifties is not even comparable with what has been recently observed in the country. Only slightly more than one-fifth of the whole population was able to vote in 1960. That percentage had jumped to approximately two-thirds in 1994. Other relevant indicators,

¹³ Those difficulties are well illustrated by the fact that, while old tax-expenditure schemes are being revived in the new "automotive regime", the tax authorities are proposing an ambitious dismantling of tax expenditures in general, as part of the tax reform. See "Receita quer mudar IR da pessoa jurídica", *Gazeta Mercantil*, July 31, 1995 and "Governo quer corte radical de incentivos fiscais", em *O Estado de São Paulo*, July 29, 1995.

¹⁴ On the first and second Vargas government and the Kubitschek government, see Abreu (1990b) and Abreu (1995). A detailed analysis of Kubitschek's industrial policy may be found in Lessa (1981). The military government's policies are analyzed in Lago (1990), Carneiro (1990), Castro and Souza (1985), Batista (1989) and Schneider (1991). An excellent case study of an overt and massive giveaway of public resources to private industrial enterprises through the National Bank for Economic Development during the military regime may be found in Najberg (1989).

as the literacy-ratio and the percentage of dwellings with a TV set have also shown similarly striking changes in the period.

On the other hand, the lenience with the liberal dispensing of public resources during the Kubitschek government was not as high as it seems. After all, the candidate he supported in the presidential election that chose his successor was spectacularly defeated by an opponent who run on a moralist ticket, stressing the need to put an end to corruption and improper use of public money.¹⁵ A final point is that Kubitschek did not seriously try to sell a fiscal-austerity package to Congress with one hand while using the other to dispense public money with largesse to sectors that were picked as winners. And yet that would be the odd thing the present government would be doing if it does not resist to the interests that press for the restoration of that kind of industrial policy.

Another difficulty that has to be taken into account is a simple logical consequence of the privatization process. In the past, much of the channeling of public resources into selected sectors meant pumping public money into state enterprises. No matter how inefficient and wasteful that could have been at times, the fact is that, from the political point of view, it is much easier to defend generous subsidies and favors to state-owned enterprises than to private firms. With the advance of the privatization process, restoring a pick-the-winners industrial policy means more and more to give away public money to private enterprises, pushing the government to a political ground much harder to defend.

4. LESSONS FROM SOUTH KOREA

The defense of the restoration of an industrial policy of generous dispensing of public resources to selected sectors has not only been made on the basis of the past Brazilian

¹⁵ The keynote of ill-fated President Quadros' inauguration speech was the denunciation of Kubitschek's "administrative favoritism and nepotism". See Skidmore (1967), chapter 6.

experience but also of the experience of other countries that managed to sustain a rapid industrial expansion in the past. South Korean-style policies are often mentioned.¹⁶ In fact, there is much to learn in Brazil from those policies. The fast development of a highly educated and well trained workforce in particular and the permanent strong concern with expanding exports seem to be the most interesting parts to be copied. But, again, the part that involves the prodigal channeling of public resources into favored sectors has become extremely difficult to reproduce in the new Brazilian democratic environment. Most of the Asian tigers, and especially South Korea, have had authoritarian regimes which have so far precluded the political difficulties that have been analyzed above.

Amsden (1989) presents an authoritative and candid description of the Korean industrial policy. For anyone reasonably familiar with the present mood of public opinion in Brazil, the idea of importing such kind of policy seems completely unfeasible from the political point of view. Her words are forceful and leave no room for much doubt about what really happened in Korea:

*... discipline has taken the form of refusal on the part of government to bail out relatively large scale, badly managed, bankrupt firms in otherwise healthy industries. The bail-out process has been highly politicized insofar as the government has typically chosen close friends to do the taking over of troubled enterprises. [...] This corruption notwithstanding, when the victim of bankruptcy has appeared to be poorly managed the government has deserted it. [...] Of greater importance to the credibility of the disciplinary process in Korea than punishing poor performers, however, has been insuring that government's friends -- most of whom have undoubtedly been bailed out in at least one occasion -- have generally performed well. This dimension of discipline has been critical because so much of Korean industrialization has involved rewarding the same small set of government friends with favors for expansion."*¹⁷

¹⁶ Based on the South-Korean experience, Amsden (1989) defends that "The subsidy serves as a symbol of late industrialization, not only in Korea and Taiwan but also in Japan, the Latin American countries, and so on. The First Industrial Revolution was built on laissez-faire, the Second on infant-industry protection. In late industrialization, the foundation is the subsidy...", pp. 143-144.

¹⁷ Amsden (1989), pp. 15-16.

It is also hard to believe that at this point in time the business community in Brazil would be prepared to accept, in exchange for any kind of generous access to various forms of government subsidies, a degree of state-control on the private sector similar to the one imposed in Korea.¹⁸

The histories of the so-called Asian tigers and Latin American countries have differed in many ways. Comparing their economic performance over the last four decades have now become almost a commonplace in the profession.¹⁹ Yet, not enough attention seems to have been given to how widely different the two groups of country may be from the political point of view. Having in mind the stronger democratic roots and traditions of some Latin American countries and their recent stride towards the construction of full-fledged democracies is extremely important to evaluate the possibility of importing what has been considered foolproof policies in Asia.²⁰ Ironically, it is precisely in Brazil that this warning is not being properly considered today.

¹⁸ Again, Amsden provides a forcible description. *"Where Korea differs from most other late-industrializing countries is in the discipline its state exercises over private firms. ...firms have been subject to five general controls in exchange for government support. First, the government has owned and controlled all commercial banks. [...] Second, in luring firms to enter new industries with the plums of protection and subsidies, the government has imposed discipline by limiting the numbers it has allowed to enter (although usually to not few than two firms per industry). This has ensured the realization of scale economies and the rise of the mammoth business groups that the government foresaw as necessary to build basic industry. [...] the government became premier entrepreneur by using its industrial licensing policies to determine what, when and how much to produce in milestone investment decisions. Third, discipline has been imposed on "market-dominating enterprises" through yearly negotiated price controls, in the name of curbing of monopoly power. [...] Fourth, investors have been subject to controls on capital flight, or the remittance of liquid capital overseas. [...] Fifth, the middle classes have been taxed and the lower classes have received almost nothing in the way of social services"*. Amsden (1989), pp. 14-18.

¹⁹ For a recent and brief comparison of Brazil and Korea over the last thirty years, see *World Economic Outlook* (International Monetary Fund), May, 1995, pp. 48-49.

²⁰ It should be pointed out that Amsden herself, despite being an overt enthusiast of Korean-style policies, seems to be aware of those limitations. She does confess that *"it is unclear whether the strong economic measures taken by the Korean state could have been taken under political democracy..."* But only to add immediately, and seemingly unconvinced: *"although Japan, the etatist European countries, and recent events in Korea all suggest that such measures and political democracy are compatible."* See Amsden (1989), p. 18.

5. CONCLUDING REMARKS

The idea of “intelligent intervention” has lasted too long to be forgotten overnight in Brazil. The government is under a mounting pressure to embark again into an ambitious active industrial policy program, massively subsidizing selected industries. Policies of the same kind in the past involved major blunders, widespread rent-seeking, state plundering and corruption. Yet it is only natural that a newly elected government, boasting a strong political support and a very good public image, is tempted to try it again. After all, if the idea is exactly to refurbish the bureaucracy and to reinstate scrupulousness and competence in the steering of state affairs, an optimist would say that there would be no reason why this time an aggressive industrial policy could not be implemented *comme il faut*. Of course there is ample room to dissent from such view. But even if it was not unrealistic there would still be the issue of political feasibility.

As was stressed above, conducting such kind of policy in a democratic environment is bound to be a very difficult process. Even in a most favorable scenario, President Cardoso will probably spend the largest part of his term in office carrying on a painful fiscal adjustment effort. The dream of “doing everything that has to be done” in this area during the first year seems out of reach by now, as the government just starts to negotiate with Congress a heavy and intricate political agenda involving a tax reform, a social security reform and a public administration reform. A structural fiscal adjustment in a poverty stricken but increasingly democratic country as today’s Brazil will be no easy task. The government will be forced to implement very unpopular fiscal policy measures. The budgetary allocation will become an increasingly sensitive issue and that means that the use of public money will be under continuous surveillance. Under such circumstances there seems to be no room for a policy that requires ample dispensing of favors and subsidies to industries that happened to be picked as winners, often meaning channeling public money into big business. An

attempt to combine such policy with the fiscal adjustment effort may simply erode the political coalition that could make the fiscal adjustment feasible.

The use of public resources to close the gap between private sector's savings and investment has been done before in Brazil, on a large scale, when the public sector was able either to generate a large part of domestic savings or to resort to foreign savings through external indebtedness. Under the present circumstances, when the public sector's savings capability has been seriously impaired and a still unsolved fiscal crisis keeps a rise in public foreign indebtedness out of reach, simple public intermediation of savings will not help much in closing the economy's savings gap. But it may surely become a major cause of political dissension, particularly if it assumes again the form of a massive subsidization scheme, and put the very success of fiscal adjustment effort in jeopardy.

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