AN OVERVIEW OF BRAZIL POST CRISIS[1]

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International Background

On the week-end of September 13, 2008, the important US investment bank, Lehman Brothers, founded in 1844, became insolvent with losses of about US$ 4 billion, which followed a depreciation of its portfolio of approximately US$ 8 billion. Of course, the reasons for the failing of the bank were both institutional, with respect to the nature of permissiveness in the financial markets, and particular, because of the way Lehman Brothers involved itself in high risk derivatives of inconsequential real estate operations[2].

Earlier in April of 2008, another important investment bank, Bear Sterns, had folded as a result of massive losses in derivatives backed by shady real estate transactions, carried very much in the same manner as those by Lehman Brothers.

The institutional reasons were grave. Permissiveness in the regulation of financial institutions in developed countries allowed for unsupervised and uncontrolled derivative operations. By the end of 2007, the total amount of derivative contracts in the world amounted to approximately US$ 600 trillion, against US$ 80 trillion in 1998. At the same time, the value of the global Gross Domestic Product (GDP) was US$ 50 trillion, the GDP of the USA was US$ 15 trillion and the amount of global trade was US$ 13.6 trillion[3].

It should have been then abundantly clear that the main financial markets, particularly those of New York and London, were trading smoke, practice that would have carried severe criminal penalties only a few decades before, because of its inherent detrimental effect on the public at large. However, the doctrine of neo-liberalism had been accepted by most governments. According to this doctrine, the markets should be self-regulatory in addition to being the determining force in public policies.

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[1] Text of the presentation made at the opening of the 54th Congress of the International Union of Lawyers (UIA), in Istanbul, Turkey, on October 31, 2010.
[2] Goyos Jr., Durval de Noronha, Diário da Crise, Observador Legal, São Paulo, 2010, page 40.
[3] Goyos Jr., Durval de Noronha, *op. cit.*, page 61.

The situation of Brazil in 2008

The Brazilian economy had been growing at an average rate of 4.2% between 2002 and 2007[4]. More importantly, the policy inflation targeting of the Central Bank of Brazil had been working well, with an average annual inflation rate between 2002 and 2008 of 5.4%[5]. The budget deficit was only negative in 1.6% in August of 2008[6]. The country's GDP was approximately US$ 1.6 trillion in December 2008.

Strict legislative reforms introduced years before prevented municipal, state and the federal government from borrowing outside strict parameters. The regulation of the financial markets prevented excesses in the derivative markets and irresponsible lending. A history of previous financial crisis within memory of the financial agents prevented practices that were in use in other countries, notably the USA and the United Kingdom.

In August of 2008, Brazil had a trade surplus of approximately US$ 31 billion accumulated in the past 12 months. Its external trade had benefitted enormously from the appreciation in the international price of commodities and from exchanges with other developing countries, notably China. Developments in Asia ensured a projection of continuous favorable prices for Brazilian commodities.

The country's reserves in foreign currency had surpassed the mark of US$ 200 billion. Brazil had paid its debt with the International Monetary Fund (IMF) and had largely converted its public debt from the US dollar to its own currency, the Real. The country had become one of the largest recipients of foreign direct investment in the world. The unemployment rate was 7.8%[7]. Recent discoveries of huge off-shore oil deposits also contributed to a pervasive feeling of optimism in the country.

The rule of law was consolidated in Brazil. The federal government enjoyed very favorable opinion ratings in 2008. Social policies on the part of the federal authorities, cumulated with fiscal austerity, enjoyed the unanimous approval of the population at large and of the business sector.

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[4] The Economist Pocket World in Figures – 2010 Edition, London, 2009, page 122.
[5] The Economist Pocket World in Figures, op. cit., page 122.
[6] The Economist, August 16th-22nd 2008, page 90.
[7] The Economist, August 16th-22nd 2008, page 89.

Tax rate burdens, however, were at 35.8%, among the highest in developing countries.

The impact of the crisis in Brazil - Reactions

The impact of the crisis in Brazil was nothing similar to that in Europe or in the USA. The Brazilian President was very quick to point out the specificities of the country and opined that the domestic effect would be only at a minimum level. However, the conservative Brazilian banking sector, in a standard response to critical moments, immediately reduced lending to practically nothing.

As a result, many companies had difficulties in financing their cash-flows and continued operations. The government was quick to appreciate the potential gravity of the situation and instructed the government-controlled *Banco do Brasil* to increase its commercial lending operations. In addition, the compulsory deposits of the banks were eased in about US$ 25 billion.

In addition, the federal government reduced its total tax revenues from 35.8% of the GDP in 2008 to 35.2% in 2009, mostly in tax reductions ear-marked for the consumer markets, favoring the automotive and home appliances sectors. Salaries of the government sector, under severe control for many years, were increased.

A new program of monetary subsidies, credit access and bureaucratic facilitation for the acquisition of the first home for low income families was put in practice by the federal government of Brazil with enormous success among population and business alike. Interest rates were marginally reduced by the Central Bank of Brazil.

It is interesting to note that, whilst adopting many fiscal measures to ensure a successful weathering of the financial crisis storm, Brazil did not, as many countries, both developing and developed, resort to trade protectionism. Adopted measures of trade remedies remained stable: 20 in 2007; 18 in 2008; and 19 in 2009[8].

As a result, Brazil’s GDP grew in 2008 by 5.1%, but the last quarter of the year presented a negative growth. In 2009, however, Brazil’s GDP had a negative growth of 0.2%, puny if compared with the developed economies. Moreover, in the last quarter of 2009, the Brazilian economy

[8] Relatório DECOM 2009 – 13. Brasília, 2009, page 39.

was growing at an impressive and unsustainable rate of 11.2%, on an annualized basis. By then, the Brazilian currency had gained some 30% over the US dollar since 2008.

By the beginning of 2010, with a continuation of very high growth rates of the GDP, the government decided to withdraw the tax incentives granted to the consumer sector. In addition, the easing of the compulsory deposits of the commercial banks was reversed in March of that year. Interest rates were increased by mid-June 2010 to thresholds closer to those pre-crisis.

As a result of those policies, the prevailing forecast for growth of the Brazilian GDP this year is of 7.5%. The inflation rate will be around 5%, which is under the ceiling of the target, 6.5%, but higher than the center of the target, 4.5%. The unemployment rate in June of 2010 was of 7.3%[9] and by October it had fallen to 6.7%.

Reserves in foreign currency have passes the threshold of US$ 300 billion. Brazil's GDP at the end of 2010 will be approximately US$ 2 trillion. As soon as next year, the Brazilian economy will become the 5th largest in the world, after that of Germany. Optimist has returned.

Conclusions –

One of the first conclusions to be reached by Brazilian strategists in respect of the crisis was the failure of the international multilateral institutions. All measures taken by developed countries in reaction to the crisis were of a unilateral nature, and frequently in violation of international norms and statutes, such as those of the World Trade Organization (WTO).

Similarly, the IMF was marginalized from the core of actions taken to face the consequences of the crisis by the major countries affected. The UN was equally left aside. The follow-up of the crisis was assigned to an unofficial organization, ex post facto, the G-20, in which the major developing countries have seats.

The accumulation of the two factors, weakness of the major developed countries and inconsistencies in the multilateral organizations, with a perceived greater economic and political power on a short, medium

[9] The Economist, June 12th-18th, 2010, Page 105.

and long term basis, have led Brazil, together with other major developing countries to seek greater influence in the world order.

Another conclusion reached is that the major factors behind the crisis remain to be addressed in the developed countries in an efficient manner. This remains pending as countries such as the USA and the UK have again engaged in the irresponsible practice of printing money, now presented to the public at large under the euphemism of quantitative easing.

On the multilateral side, the international agencies have become both anachronic and effete in their ethos as well as in the overrepresentation of the interests of developed countries. The recent meeting of the finance ministers and central bankers of the G-20, only one week ago, evidenced the repudiation of the legal regime of the WTO by the USA when proposals of managed trade were made by that country.

Thus, international cooperation with great input of developing countries will be required to correct the many shortcomings in the world financial order. Whilst this is not done, instability and volatility will remain in the world economy.