DEPARTMENT OF STATE

BRIEFING PAPER

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## BRAZIL: DOMESTIC ECONOMIC SITUATION

Brazil's overall economic growth in 1978 was 6.3 percent, a rate that exceeded all expectations. Industrial growth was 8.6 percent, while agricultural production declined 1.8 percent. Inflation was 40.8 percent in 1978. In comparison, Brazil grew 4.7 percent in 1977, with an inflation rate of 39 percent.

The Brazilian Government's economic targets for 1978 were five percent overall growth, agricultural growth in excess of eight percent, industrial growth of three percent, and inflation at 35 percent. The most serious drought experienced in decades in Brazil's prime Southern agricultural areas dramatically altered the GOB's plans. Heavy losses were suffered in corn, wheat and soybean production, and the decline in crop production of 7.3 percent brought down overall agricultural growth. To compensate, the GOB liberalized credit and monetary restraints to help boost industrial production. In doing so, the Brazilian Government accepted a higher inflation rate, although some of the higher inflation was due to shortages of foodstuffs.

The drop in crop production most seriously affected exports. Brazil had counted on exports of coffee and soybeans, which hit new highs in 1977, to lift the trade account into a greater surplus than the small surplus registered in 1977. Higher exports of manufactured articles saved the trade account from falling below a deficit of $900 million. Manufactured exports have grown at rates of over 30 percent yearly since 1974.

The return to a deficit in the trade account and foreign borrowing in excess of current needs to build international reserves left Brazil's foreign debt at more than $40 billion at the end of 1978. Foreign debt service equalled approximately 65 percent of Brazil's total export earnings in 1978.

The new Figueiredo administration will inherit the same constraints on its ability to seriously deal with difficult economic and social problems as did the Geisel government in 1978: strong inflationary pressures and a large foreign debt. These conditions are legacies of Brazilian attempts to maintain economic growth following the oil crisis through heavy government investment in import substitution industries and largely financed by sharply increased borrowing abroad.

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Figueiredo's appointment of Geisel's Finance Minister as Minister of Planning, and other main-line economists and managers to the Ministries of Finance, Industry and Commerce, the Central Bank and the Government banks, should assure considerable continuity in the formulation and execution of GOB economic policies. The GOB will continue to give priority attention to restraining petroleum imports and developing alternative domestic sources of energy. The recognized need to reduce the prevailing rate of inflation has already prompted policy-makers, including Simonsen and President-elect Figueiredo, to accept economic growth in the short-run well below the average of over nine percent in the decade 1968-1977. Although these constraints preclude dramatic moves to expand growth or shift income distribution, genuine concern for economic well-being and commitment to political opening also preclude the shock approach of recession as a means to bring down inflation. Within these limits, however, widespread public debate, internal GOB studies, and recent statements by GOB officials suggest that there will be important changes in emphasis and moves to improve policy implementation. Consistent with the commitment to moderate political liberalization, GOB economic policy can be expected to devote increased attention to improving the earning standards of the poorest segments of the population and to place increased reliance on decentralized government actions and on market mechanisms to bring about efficient resource allocation.

The new government is likely to increase attention to agricultural production for internal consumption and respond to demands for reform of wage policy to permit an enlarged role for collective bargaining. The GOB is likely to reject the option of a recession in order to sharply reduce inflation, but the priority given to inflation will not weaken in the early years of the administration. Accommodation of political and social pressures will--so long as they are relatively moderate--have only a marginal influence on new policy directions. In the foreign sector, the authorities are expected to reduce subsidies and restrictions while continuing to pursue export growth, narrowing of the current account deficit, and more moderate foreign borrowing. Federal government planning and budgeting will become more centralized and will probably result in more effective control of federal government spending. On the other hand, federal and state relations may become more decentralized and Figueiredo will seek to encourage private enterprise and the use of market mechanisms.

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