Brazil Responses to the Global Financial Crisis: a well succeed example of Keynesian policies?

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Introduction

This paper analyses the policy responses of the Brazilian government to the contagion effect of the global financial crisis. Despite the recession in 2009 – the Brazilian GDP decreased 0.6% –, on the contrary to previous experiences, Brazil's economic recovery was strong in 2010 – according to the IBGE (2011), the GDP increased 7.5% – and, as result of, it was one of the less affected economies, showing a remarkable resilience. In this context we speculate about how Keynesian has been the Brazilian recovery. We consider that Brazil has experienced a period of transition, where the return of Keynesian policy elements has not been strong enough to overcome previous neoliberal tendencies. Otherwise it has opened new future possibilities, which might be explored by the new elected government. We structured our arguments in four parts. After this brief Introduction we present the theoretical analysis of the Keynesian economic policies for monetary economies in a context of globalization with financial dominance[4]. In the third part we show Brazilian economic performance before and after the global financial crisis, emphasizing post-crisis government reaction. The final section summarizes our arguments in order to answer our main question.

2. Keynesian economic policies for coordinating the dynamics of monetary economies in a global world

In *The General Theory of Employment, Interest and Money* (General Theory) Keynes proposed a new social philosophy in order to address the fact that "[t]he outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes" (Keynes, 1964: 372). The focus of his proposal was the power that the State should hold to steer the economic system, given that, if left to the free workings of market, the economic system and economic policies themselves – unless there was coordination among them – would contribute not to solving, but to enlarging the main problems of monetary production economies.

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[4] See: Davidson (2004); Arestis and De Paula (2008).

On this particular, Keynesian economic policies are structured so as to make it possible to manage endogenous features in monetary, fiscal and exchange rate policies (Skidelsky, 2009).

Nowadays, the globalization process tends to disrupt not only domestic markets but also whole countries, especially emerging counties, by establishing a kind of extended financial casino; the current international financial crisis is a good example to the nature and problems of the globalization process[5].

Analyzing the international financial crisis, it is possible to address reflection on two counts. In the first place, it calls into question the supposed concrete benefits of financial globalization with financial markets deregulated everywhere, including in the developed countries. In the second place, given the fiscal and monetary measures implemented by developed and emerging countries to mitigate the world recession, it prompts a rethinking of the very role of the State in the economy, as regards the need both to regulate domestic financial systems and to restructure the international monetary system[6].

Exploring the second count, on the one hand, the key lesson from the international financial crisis is not only that State action is fundamental in preventing or remedying crises, but that, particularly at critical moments, it is important there be greater global coordination among the various different national policies, especially in the developed countries. In this regard, the role of the State is fundamental to restoring macroeconomic balance and to creating an 'institutional environment' favorable to 'animal spirits'. As stated by Keynes (1964, p.378), "I conceive (...) that a somewhat comprehensive socialisation of investment will prove the only means of securing an approximation to full employment". Keynes' idea of 'socialisation of investment' should be understood, as can be inferred from Ferrari Filho & Conceição (2005), as the State's participating actively in the economy, through economic policies that signal to entrepreneurs the existence of effective demand for their production; State action should, nonetheless, be in keeping with the set of socially defined and legitimated institutions (such as habitual contractual compliance, confidence in the quality of legal tender, rules that ensure political stability, and so on).

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[5] For a more detailed discussion of the globalization process and the global financial crisis, see: Griffith-Jones, Ocampo and Stiglitz (2010), Wray (2009) and Guttmann (2008).
[6] See Griffith-Jones, Ocampo and Stiglitz (2010).

For that purpose, Keynes (1964, Chapter 24) suggests fiscal, monetary and income policies. In that direction, the macroeconomic policy of national economies should be coordinated in such a way as to (i) operationalize fiscal policies designed to expand effective demand and reduce social inequalities, (ii) make for more flexible monetary policy so as to galvanize levels of consumption and investment and (iii) coordinate and regulate financial and foreign exchange markets in order to stabilize capital flows and exchange rates. In short, taking up the idea of Minsky (1986), there is a need for State intervention and regulation through *Big Government* and *Big Bank*.

Keynes was aware that (i) there are causal relations among monetary, fiscal and exchange rate policies, (ii) the cyclic instabilities in monetary economies have unpredictable effects on the state of entrepreneurs' confidence, leading to stagnation in employment and income creation, and (iii) uncoordinated economic policies, by failing to bolster agents' confidence in effective demand for their products, intensify the potential amplitude of economic system fluctuations. He accordingly prescribed ways of conducting economic policies so that they would assure the good functioning of the economic system.

Such coordination does not entail a planned economy, for that would eliminate entrepreneurial action and transfer it to the agencies in command of central planning; in such circumstances, all that would remain to the entrepreneur would be to carry out the planners' decisions.

What Keynes proposed as economic coordination is economic policy action closely attuned to whatever "will co-operate with private initiative" (Keynes, 1964: 378). This complementation between State and private initiatives is also underlined by Minsky (1986: 295-296): "once we achieve an institutional structure in which upward explosions from full employment are constrained even as profits are stabilized, then the details of the economy can be left to market processes".

The State is the social entity capable of gathering together the greatest amount of the information available in society and, at the same time, is the social legislator with legal competence to safeguard institutions' ongoing existence and to alter them as required by the historical evolution of the different social systems. It is thus up to the State, for the collective good and not in private interests, to coordinate economic activity.

In the 1920s, the criticisms of liberal capitalism and the consequent need for State intervention in the economy became increasingly recurrent in Keynes' writings. One of Keynes' essays from that period, *The End of Laissez-Faire* (1972), is particularly arresting. In the essay, Keynes shows that *laissez-faire* does not reconcile individual and social interests and argues that the main economic, social and political problems result largely from "risk, uncertainty, and ignorance" (1972: 291), asserting that regulation of capitalism is capable of assuring economic stability and social harmony. The passages below point in that direction:

> I believe that the cure for these things [economic and social instabilities] is partly to be sought in the deliberate control of currency by a central institution (…) [t]hese reflections have been directed towards possible improvements in the technique of modern capitalism by the agency of collective action (Keynes, 1972: 292-293).
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> For my part I think that capitalism, *wisely managed*, can probably be made more efficient (...) [o]ur problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life (Keynes, 1972: 294, emphasis added).

Moreover, Keynes (1972: 290-291) argues that "State Socialism (...) is, in fact, little better than a dusty survival of a plan to meet the problems of fifty years ago, based on a misunderstanding of what someone said a hundred years ago". Further on in the same passage, Keynes makes it clear that his criticism of socialism was not "because it seeks to engage men's altruistic impulses in the service of society, or because it departs from *laissez-faire*, or because it takes away man's natural liberty to make a million (...) [a]ll these things I applaud" (Keynes, 1972: 290).

In short, in *The End of Laissez-Faire*, Keynes is aware that the survival of capitalism should depend on the "visible hand" of the State, so as to regulate the socioeconomic dysfunctions deriving from the market[7]. For that purpose, economic policies should be responsible for State coordination of the economy.

[7] The idea of regulatory action by the State was renewed in the 1980s by Minsky, thus: "Big Government is the most important reason why today's capitalism is better than capitalism which gave us the Great Depression" (Minsky, 1986: 296).

Accordingly, Keynes stresses that execution of monetary and fiscal policies, particularly the latter, is most important for State intervention to exercise proper guidance, along with the prominent role of exchange rate policy. Tellingly, Keynes' discussions of exchange rate policy are connected with his key proposals for restructuring the international monetary system and are directed basically to mitigating economic agents' uncertainty about the pricing of assets negotiated in world trade (Ferrari Filho, 2006b).

2.1 Monetary and exchange rate policies

To Keynes, monetary policy should be conducted so as, by administering the basic interest rate in the economy, to promote alignment among the relative prices of assets open to investment in the economic system. Keynes (1964: Chapter 17) held that all assets intrinsically posses an interest rate and that, by comparing the various remunerations on offer, agents could direct their resources – if this were more advantageous in terms of liquidity, carrying cost and quasi-income – to non-manufacturable assets. This would occur mainly when investments made in the past turned into involuntary stocks and, consequently, frustrated expectations.

In view of the foregoing, the basic interest rate set by the Monetary Authority should by fully public knowledge and be held to a level considered normal by that public, true to its conventions, because as pointed out by Carvalho (1999: 275, emphasis added) "people form an expectation of the *normal* interest rate and expect current rates to gravitate around it". Accordingly, as the future is incalculably unknown, agents will always attempt to anticipate the interest rate, which they monitor closely so as not to incur high investment opportunity costs.

Any suspicion of oscillation in the interest rate from what is regarded as normal will produce modifications in investors' spending decisions as they stake their wagers for best monetary profit. That is why there should be no secrecy on the part of the Monetary Authority as to interest rate levels over time. Also, there should be no unexpected, significant alterations in the basic interest rates in the economy, so that constancy is credible and agents' preference for liquidity will thus demand lower premiums.

Carvalho (1994) draws attention to a valid illustration to represent how monetary policy acts to determine agents' asset portfolio composition:

> [it is] in this sense that the inverted pyramid is constructed to characterize the Keynesian view of the relationship between currency and other financial assets (...) At the vertex is legal tender, and on that vertex all other assets rest, in successive layers, each defined by the institutional arrangements that establish the rules of convertibility among the groups (...) and by the relationship among the rates of return obtained in each collection of assets (1994: 43-44).

It is precisely this relationship between currency and the various asset types that grants monetary policy some ability to manage effective demand and affords interest rate management, as an instrument of monetary policy, the ability to influence the real variables of monetary economies. That is, monetary policy acts indirectly on economic activity, initially impacting liquidity levels on the monetary and financial markets. By affecting the liquidity of the various different monetary and financial assets, monetary policy has repercussions on interest rates in the economy and thus influences the real side of the economy (Minsky, 1986).

By way of example, at times of widespread lack of confidence among economic agents, monetary policy can contribute little to balancing the economic cycle, as seen in the illustration represented by the familiar *liquidity trap*. For this reason, Keynes (1980a: 350) argues that

> [i]t is not quite correct that I attach primary importance to the rate of interest. What I attach primary importance to is the scale of investment and an interested in the low interest rate as one of the elements furthering this. But I should regard state intervention to encourage investment as probably a more important factor than low rates of interest taken in isolation.

The following quotation from the General Theory emphasizes this idea:

> I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views (…) taking an ever greater responsibility for *directly* organizing investment (Keynes, 1964: 164, emphasis added).

As for exchange rate policy, throughout his work, Keynes' exchange rate policy thinking and proposals point towards arranging a managed exchange rate regime in order to assure external balance and, particularly, price stability (Ferrari Filho, 2006a: Chapter 3). In his *International Clearing Union* (Keynes, 1980b), Keynes makes this idea clear by signaling that one of the aims of having a fixed exchange rate that is nonetheless alterable to suit circumstances should be to reduce uncertainties about future prices of assets and tradable goods when economic agents take decisions to close exchange contracts.

Moreover, Keynes was concerned to point out that the external dynamics of monetary economies could not do without an instrument to permit balanced symmetries in trade relations between countries. In that connection, Keynes proposed the creation of a multilateral coordinating body that would work to ensure that trade imbalances were cleared automatically, so that deficit countries would not be hostage to the need to attract capital in order to finance their balances of payments.

This multilateral clearance was to be effected through a universally-accepted currency, issued supra-nationally and generated for the sole purpose of operating these multilateral settlements, offering no advantage for use as a store of value. In Keynes' words (1980b: 270), the usefulness of this currency and the trade equilibrium it is designed to achieve reside in the ability:

> to provide that money earned by selling goods to one country can be spent on purchasing the products of any other country. (…) [w]e cannot hope to balance our trading account if the surpluses we earn in one country cannot be applied to meet our requirements in another country.

Automatic clearance of trade imbalances would make it possible to mitigate deficit countries' need to attract external capital in order to finance their balances of payments with deficit current trade transactions. For that purpose, controls could be imposed on international capital flows to enable monetary policy to exert more autonomous control over the interest rate. To Keynes, automatic clearance would be a restriction on countries' freedom of economic action, but would enable them to retain greater autonomy over significant domestic economic policy decisions.

Keynes regards a managed exchange rate, automatic clearance of trade imbalances and permission for capital controls as fulfilling two fundamental purposes: (i) they make entrepreneurial expectations less uncertain and (ii) they afford greater freedom to pursue monetary policy, both by hindering exchange rate pass-through effects on domestic prices, as well as by making it possible for the interest rate not to be used the whole time to attract external speculative capital[8], which can inhibit productive investments. In short, exchange rate policy in Keynes is designed to establish, intertemporally, balanced external accounts and the greatest possible autonomy for monetary policy.

2.2 Fiscal policy

Keynesian fiscal policy has direct impact on aggregate demand – more specifically on consumption and investment – and constitutes the main instrument of State intervention. It is anchored in tax policy and in administering *public expenditure* (importantly, a completely different category from *public deficit*).

Tax policy is intended, on the one hand, to enable unequally distributed income to be reallocated, either by income tax or inheritance taxes. By expanding the State's spending capacity, on the other hand, it allows aggregate demand to be boosted in the economic system. Lastly, as Keynes (1972) points out, tax policy can also serve to increase available income, thus fostering expansion of effective demand.

Meanwhile, administration of public spending, from Keynes' original perspective, centers on constituting two budgets: the "ordinary" or "normal" (current) budget and the capital budget. The current budget relates to the funds necessary to maintain the basic services that the State provides to the general public[9].

Although, as explained by Kregel (1985), Keynes believed in the importance of these current expenditures, particularly social insurance transfers, as *automatic stabilizers* of economic cycles, the current budget should always be in surplus.

[8] For this reason, Keynes (1980b: 276) says that "we cannot hope to control rates of interest at home if movements of capital moneys out of the country are unrestricted".
[9] Public health, education, urban infrastructure, national defense, public safety, social insurance, and so on.

To illustrate this concern with budget balance, Keynes (1980a: 204-205) argues, as part of discussions over what kind of social security system should be built in England after World War II[10], that it would constitute "a severe burden to meet simultaneously pensions against which no funds have been accumulated and to accumulate funds for future pensions".

How then would countercyclical fiscal policies be achieved? Keynes (1980a: 278) says that

> [i]t is probable that the amount of [current budget] such surplus would fluctuate from year to year for the usual causes. But I should not aim at attempting to compensate cyclical fluctuations by means of the ordinary budget. I should leave this duty to the capital budget.

To Keynes (1980a) the other component of the public budget was the capital budget. This discriminates public expenditures relating to productive investments made by the State in order to maintain stability in the economic system. Such investments should be made by public or semi-public bodies, providing this was done with the clear intention of regulating the economic cycle by supporting entrepreneurs' expectations of effective demand for what they decided to produce in the present.

The Keynesian capital budget could run into deficit, but the surpluses necessarily obtained on the current budget would finance this. Accordingly, any debt occasioned by the capital budget deficit would relate not to State borrowing activities on the financial markets – which might arouse agents' doubts as to the State's solvency and, consequently, its ability to continue fostering entrepreneurial expectations – but rather to "thus gradually replacing dead-weight debt by productive or semi-productive debt" (Keynes, 1980a: 277).

In this way, Keynesian public expenditure policy hinges on balancing the overall budget, even though this may be achieved in the short term by a surplus in the current budget and deficit in the capital budget.

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[10] The discussions took place on the Inter-Departmental Committee on Social Insurance, set up in June 1941, mainly between Keynes and the committee's chairman, William Beveridge. For further information, see: Keynes (1980a: Chapter 4).

As seen above, in Keynes' own words, monetary and fiscal policies should be wisely managed, not just so that their effects are not adverse to the goals of State intervention, but more importantly because economic policy is a *rule*, a *convention*, on which entrepreneurs rely in deciding whether or not to invest. The fact that economic policy is conducted according to rules is what makes it workable as a coordinator of economic activity. If economic policy were to act casuistically it simply would not function as a provider of bases for agents' forecasts; rather, on the contrary, it would leave them with even more precarious bases on which to decide how to act; after all, it would be a fiscal policy that changed constantly to suit whatever situations arose.

Another important rule about operationalizing the capital budget is that the public investments must not rival private investments, but must be complementary to them (Carvalho, 1999). Also, the public investments are normally related to social investments, and "[their] (…) decisions (…) are made by *no one* if the State does not make them" (Kregel, 1985: 37).

Thus, to Keynes, the main task of the *automatic stabilizer* is to *prevent* wide fluctuations by means of a stable, ongoing program of long-term investments originating in the capital budget. Keynes argued that, for the State to be an automatic stabilizer entailed "a long-term [investment] programme of a stable character [that] should be capable of reducing the potential range of fluctuation to much narrower limits than formerly" (Keynes, 1980a: 322).

It was not the State's function to intervene during peaks or slumps in the economic system's progress, but rather to *prevent* peaks or slumps from occurring. Once the budget for scheduled long-term productive investments has been established, it is easy to cope with any short-term fluctuations that occur by bringing forward certain future measures, as soon as the first symptoms of insufficient effective demand appear.

Minsky (1986), without resorting to the Keynesian notion of segregated budgets and even underlining the importance of occasional short-term budget deficits, argues that private investment deficiencies need to be balanced by *Big Government* public spending. In monetary economies, he explains, declining profits mean frustrated entrepreneurs and may trigger a whole chain of non-payment of financial liabilities, tending to lead to a critical situation among the institutions operating on financial markets. In this intricate and unstable scenario, where the real and monetary-financial dimensions of the economy are inseparable and mutually dependent, “Big Government must be big enough to ensure that swings in private investment lead to sufficient offsetting swings in the government’s deficit so that profits are stabilized” (Minsky, 1986: 297)[11].

Minsky (1986) also proposes that action by *Big Government* should coordinate with action by a permanent *Big Bank*, on the one hand, regulating the activities of monetary and financial institutions (which, incidentally, are operating with much more unstable financial innovations than those contemplated by Keynes in the first half of the 20th century) so as to deter them from constructing increasingly fragile positions and, on the other hand, at the first sign of loan defaults, acting as lender of last resort. In this way, the *Big Bank*’s monetary policy should maintain the monetary-financial system in sound, credible financial positions, so that, in the event a mounting lack of confidence among entrepreneurs’ lead to unemployment and income stagnation, no spate of bankruptcies will ensue and lead the economic system into a major depression.

If conducted continuously, automatic stabilization will not focus on containing moments of economic crisis; rather, whenever signs of surplus aggregate demand are perceived, capital budget investment projects will be postponed so that expanding national income is not corroded by any inflation resulting from scarce supply. Therefore, action to contain short-term fluctuations should not be limited to fostering periods of expansion, but should also be applied to avert episodes of surplus aggregate demand.

Returning to Keynes, his proposal of a capital budget rests on the principle that, by fostering productive institutions, it is responsible for generating its own surplus in the long run. In order to balance public finances, it is enough in the short term not to incur a current deficit, given that surpluses called for in the current budget finance any deficits in the capital budget. On the other hand, return on public investments

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[11] It is for no lesser reason that Minsky (1986) proposes that *Big Government* should be of a size, in relation to GDP, equal to, or greater than, the rate of gross capital formation to GDP, i.e., the country’s investment rate.

tends, in the long term, to balance the capital budget itself. In Keynes' words (1980a: 319-320), the "capital expenditure would, at least partially, if not wholly, pay for itself".

This possibility of a balanced capital budget in the long term makes the overall public budget much more rational and viable[12], fostering over time the construction of surpluses and consequently public saving in both components of the Keynesian budget, signaling greater intervention capability for the State to act countercyclically. This makes budget deficits an even more remote likelihood; they would occur, confirms Keynes (1980a: 352), if "the volume of planned investment fails to produce equilibrium". In, and only in, such conditions,

> [t]he lack of balance would be met by unbalancing one way or the other the current Budget. Admittedly this would be a last resort, only to come into play if the machinery of capital budgeting had broken down (Keynes, 1980a: 352).

Nonetheless, Keynes also argues that to leave no doubt about his true intentions in prescribing fiscal policy rules, "so very decidedly I should cut down all this and not lead the critics to think that the Chancellor is confusing the fundamental idea of the capital budget with the particular, rather desperate expedient of deficit financing" (Keynes, 1980a: 353-354).

2.3 A final reflection about Keynesian Economic policies

In an uncertain world, where agents risk their power of command over social wealth in order to gain more such power in the future, economic policy should be the greatest source of solidity that private enterprise has contact with. It should guarantee a dynamics of increasing wealth which, consequently, maintains and expands the society's inclination to consume, thus enhancing investors' prospects. On this point, Minsky (1986: 6) argues that "[i]f the market mechanism is to function well, we must arrange to constrain the uncertainty due to business cycles so that the expectations that guide investment can reflect a vision of tranquil progress".

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[12] In 1933, in *The Means to Prosperity*, Keynes (1972) argues that policies to expand public spending in times of stagnation, recession or depression are means for national treasuries to increase their revenue gathering and make it easier to achieve balanced budgets, given the time necessary between spending turning into remuneration and this in turn become effective consumption.

As Marcuzzo (2005: 2) argues, Keynes' theory proclaims the whole time what needs to be done in order "to sustain the level of investment, but it should be interpreted more in the sense of 'stabilizing business confidence' than a plea for debt-financed public works".

This is because,

> [Keynes'] reliance on *socializing investment* rather than a fiscal policy aimed at smoothing out consumption levels over the cycle shows his concern for the size of the deficit, and the importance ascribed to market incentives to bring about the desired level of employment (Marcuzzo, 2005: 2, emphasis added).

In short, this shows that Keynesian economic policy, in both conception and practice, is intended to maintain levels of effective demand for the purpose of mitigating involuntary unemployment by stabilizing business peoples' state of confidence.

To sum up, the desired result to be achieved through Keynesian economic policies is construction of a society with a trajectory that perpetually enjoys economic efficiency, social justice and individual freedom.

3. Brazil before and after the crises: performance and policies

3.1 Background: globalization and political transition in Brazil

After the external debt crises, Brazil and others high indebt countries in Latin America experienced their "lost decade" in the 1980s, characterized, among other things, by growth stagnation, balance of payments imbalances, governments' accounts in deterioration, inflation out of control etc. At the same time, in the political *front* several countries were living redemocratization processes. The 1990s was the "reforms" decade based on the main proposals of the Washington Consensus. Latin American governments abandoned the developmental strategies and focused on a market-friendly approach hoping to recover development momentum. Trade and financial liberalization, privatizations and deregulation, adoption of International Monetary Fund (IMF)-World Bank-Bank for International Settlements (BIS) standards in macroeconomic and regulation policies and, above all, hands off approach to government intervention characterized what was supposed to be a new development alternative.

The expectations of development were not fully accomplished[13]. On the other hand, reforms were well-succeed in terms of controlling high inflation. Thus, the most salient economic advance in the 1990s was the increasing confidence in the capacity of authorities to generate macro-stabilization policies. But this process had a price. Considering the Brazilian case, to control inflation the successive governments pursued deflationary policies that distorted fundamental prices (such as exchange rate, interest rates, wages and taxes) aggravating the economic stagnation. High interest rates (the real policy rate average has surpassed 12% per year since the yearly 1990s) and exchange rate appreciation were an explosive combination. Prices had gone down (from nearly 3.000% in 1993 to 8% average in 1995 to 2005), but public debt as proportion of the GDP doubled from 30% in 1994 to 60% in 2002. To finance this kind of debt the taxes had also almost doubled, reaching 40% of GDP. The interest payments had reached nearly 10% of GDP per year. External position also deteriorated from current account surpluses above US$ 10 billion per year since the 1980s to current account deficits of US$ 30 billion per year in the period of exchange rate appreciation (1994-1998). To close the external gap Brazil relied on the volatile international financial markets. From 1995 to 2002 the external debt plus foreign investment position in Brazil increased by nearly US$ 200 billions.

Since 2003/2004, the Brazilian economy has transited from a low growth and high financial – fiscal and external – vulnerability situation to another one, characterized by higher economic growth and lower vulnerability. After averaging 1.9% between 1990 and 2002, annual real GDP growth picked up to 4.7% during 2003-2008. Inflation fell from 25% per year in 1995 to between 4% and 5% after 2006. The Government and market analysts have assumed that 4% to 5% GDP growth per year and similar figures for inflation could be considered a baseline scenario for the next years. These are modest figures in comparison to China, India or others emerging market economies, particularly in Asia, but they are a remarkable change from Brazilian experience of repeated crises throughout the 1980s and 1990s and as recently as 2002. Thus, Brazil's economic and financial resilience is an important asset for the country, which has been recognized

[13] For a recent assessment see Arestis and Saad-Filho (2008), OECD (2009), Bresser-Pereira (2009a, 2009b) and De Paula (2010).

by international investors. Despite the global financial crisis, Brazil received the investment grade status from Fitch and Standard & Poor's, in 2008, and from Moody's in September 2009.

The current global financial crisis has been a "stress test" to the Brazilian economy. Until now (2011) the country has showed resilience, which suggests that Brazil has built a stronger macroeconomic framework over the past years. The reduction of fiscal and external imbalances[14] has diminished the country's vulnerability to external shocks. Between the last quarter of 2008 and the first quarter of 2009, the economy was sharply affected by the global financial crisis[15]. Despite this fact, countercyclical measures adopted by central government and the internal market dynamism have stimulated economic recovery.

So, it is important to stress that Brazil faced several crises in the past, mainly currency crisis. However, this last crisis experience is a nice contrast with the past. The Brazilian economy was much better protected than in other moments of external turbulence (as others Latin America countries), mainly because of the improved macroeconomic fundamentals, which have increased its resilience against external shocks. That improvement was a result of a positive external environment created by Chinese commodity hunger combined with domestic policies and buoyant markets. With this background the Brazilian government was able to cope with the contagion effect of the crisis without recurring to a loan from the IMF, it did not have conditionalities to fulfil, that encompass pro-cyclical (austerity) policies. Therefore, it had greater space to adopt policies aimed to mitigate the negative impacts of the worsening situation in international markets on the economic performance. The macroeconomic better condition was also one of the factors that allowed the adoption of a broad variety of countercyclical economic policies, in marked contrast with previous crises.

Among the better macroeconomic conditions, the smaller external vulnerability of the public sector stands out, firstly. This relates as much with the increase in international reserves as with the fall in the public external debt which made the government a net creditor in foreign currency since January 2006. Secondly, the sizeable primary surplus in the country's fiscal accounts. Primary budget has shown a surplus

[14] Net public debt has been lowered in relation to GDP, from more than 50% in 2003, to 38,8% in 2008. Ministry of Finance and market analysts project a 42% relation in 2009. Since 2003, consolidated government has had primary surpluses above 3% of GDP. International reserves has soared from less than USD 50 billion in 2006 to more than USD 200 billion in 2009, despite the crisis. External debt has been stable at a USD 200 billion level, which basically matches international reserves (See: http://www.fazenda.gov.br/portugues/documentos/2009/p060809.pdf, access in September 2009).

[15] GDP shrank by 4½ percent in the two quarters to March 2009. See: http://www.imf.org/external/np/sec/pn/2009/pn0992.htm.

since 1999 (between 3% and 4% of the GDP until 2008), when the government began to pursue a target to this budget. This target increased successively between 1999 and 2007 (3.1% on 1999, 3.4% in 2000 and 2001, 3.9% in 2002 and 4.25% from 2003 to 2007). In 2008, it was reduced to 3.8% (due to the launch of the "Growth Acceleration Programme", called PAC). In 2009, in response to the fiscal impulse and the fall in tax receipts owing to the lower level of activity, the government reduced the public-sector primary surplus target to 2.5%. The target for the public-sector primary surplus in 2010 was set at 3.3%, %, and adjusted to 3% in November[16].

In contrast, during the currency crisis of 1998/1999, Brazil's macroeconomic situation was fragile, both on the internal and on the external sides. The government was debtor on foreign currency and had a domestic primary deficit around 1% of GDP. At that time, the government responded to the speculative attack against the Brazilian currency – that took place throughout the second semester of 1998 and result on the exchange rate devaluation in January 1999 – by requesting a loan from the IMF, thus, adopting pro-cyclical (that is, restrictive) monetary and fiscal policies, that reinforced instead of alleviated the negative impact of the currency crisis.

Besides the better macroeconomic fundamentals, the greater room for manoeuvring of Brazil (and other emerging countries) to pursue countercyclical economic policies, contrary to the standard economic policy adopted in previous situations of currency instability, seems to be also related with two others dimensions of the recent crisis: (i) its origin on the center of the system, the United States; and (ii) the adoption of countercyclical policies by advanced economies (Eclac, 2010).

In previous crises, the adoption of pro-cyclical policies by developing countries were also designed to regain the credibility of financial markets and, so, were seen as a precondition for the return of external capital flows (Ocampo, 2000). In the last crisis, given its systemic nature, governments of emerging countries seem to be aware that pro-cyclical policies would be totally innocuous to attract those flows, besides contributing to aggravate the consequence of the external shock, by creating a vicious cycle between currency depreciation, credit contraction, asset deflation, drop on economic activity and less capacity to pay

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[16] This adjustment was due to the exclusion of Eletrobrás (the state company in the electric power sector) of the primary surplus calculation.

debt by firms. Therefore, although they were, once again, business cycle takers, Brazil (as others emerging market countries) were able to be, for the first time, policy makers. Furthermore, the fact that even the advanced economies, the epicentres of the crises, had implemented countercyclical policies, may have contributed to increase the emerging countries degree of freedom to adopted the same kind of policies

It is also important to mention that before the onset of the crisis, the Brazilian government adopted some structural initiatives – as the expansion of the social protection and income transfer programmes, the real increase in the minimum wage and the expansion of public investment – that contribute to prevent a greater drop in economic activity and also facilitate the policy response to the crisis via ramping up or modifying existing programmes, as detailed below.

3.2 Policies and Programmes[17]

The government responded to the contagion effect of the systemic crisis with a broad variety of countercyclical economic measures, whose objective was to mitigate this effect both on the Brazilian financial system and on the economic activity. A committee was not formed to deal with the crisis, but the government responded quickly. The Brazilian Central Bank (BCB) and the Ministry of Finance spearheaded the crisis response. Beyond the stimulus package, this response also involved important measures of monetary, credit and finance, exchange rate, labor and sector policies.

Because the first effects of the crisis were felt in the Brazilian financial system, it was the monetary authority that had to respond first. In response to the contagion effect, the Monetary Policy Council (hereinafter referred to as Copom) and the BCB eased monetary policy by lowering the policy rate target and by increase liquidity in the interbank market. It is worth to mention that the strong contractions of the liquidity on this market after the devaluation of the Brazilian currency (caused by the deepening of the global financial crisis, in September 2008) were related with the losses from exchange derivatives by companies after the real devaluation. From not knowing the degree of exposure of others banks to the risk of

[17] Sources: (i) Official government websites: http://www.bcb.gov.br, http://www.fazenda.gov.br and http://www;mds.gov.br; and (ii) International agencies: http://www.eclac.org, http://www.imf.org and http://www.ilo.org.

losses in these operations, banks withdrew credit not only from companies and individuals but also from banks on the interbank market[18].

The policy rate target, called Selic[19] rate, was lowered by 5 percentage points, from 13.75% in December 2008 down to 8.75% in September 2009[20]. This was the lowest level in over 10 years (equivalent to a real annual rate of almost 4.0%), given the inflation rate of 4.3%. Moreover, it is worth to mention that the interest rate reduction in Brazil started with delay. Indeed, in the November 2008 meeting of the Copom, the committee argued that the threat of inflation caused by the devaluation of the *real* was high. BCB's rigidity in conducting monetary policy in the last quarter of 2008 strongly contrasted with the actions of its colleagues in the principal advanced and emerging economies.

Besides the cut on the policy rate, a number of measures were adopted to resolve the problem of lack of liquidity in the interbank market and the difficulty of refinancing by smaller banks. For example, the BCB postponed the timetable for implementation of the increase on reserve requirement of leasing companies. According to the schedule established by the BCB in January 2008, the reserve requirement, which was imposed in January 2008, would be increased from 15% to 20% in November and to 25% in January 2009. With the modifications introduced at 09/24/2008, these changes would only take place in January and March 2009, respectively. BCB also established, on 12/10/2008, that leasing companies could deduct from the reserve requirement the amounts referring to foreign currency acquired from the BCB. These currency transactions would be formalized under a resale commitment by the financial institution and a repurchase commitment by the BCB.

It is important to mention that the BCB still imposes several compulsory reserve requirements and also additional liability compliance on financial institutions' deposits to control liquidity within the Brazilian financial system. By changing the requirements related to reserve ratios, the BCB influences the volume of funds available for financial institutions to lend. From September 2008 to December 2008, the BCB reduced

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[18] For an analysis of these operations, see Prates and Cintra (2010).

19 Special System for Settlement and Custody.

20 Five cuts were made: the first one, in the 01/21/2009 Copom meeting, from 13.75% to 12.75%; the second one, in the 03/11/2009 Copom meeting, to 11.25%; the third one, in the 04/29/2009 Copom meeting, to 10.25%; the forth one, in the 06/10/2009 Copom meeting, to 9.25%; and the fifth one, in the 07/23/2009 Copom meeting, to 8.75%. The Copom has begun to raise again the policy rate target on 04/28/2010.

reserve requirements on cash deposits and time deposits and the additional liability compliance which affected cash, time and savings deposits. The rules for additional liability compliance were also changed. After December 1st the withdrawals would no longer be made in cash, with remuneration following the policy rate, so that they would be fulfilled in federal public bonds indexed to the policy rate. With this change, BCB attempted to assure that the demand for federal public bonds would not be affected by the change in the withdrawal rule for time deposits[21]. The compulsory reserves was reduced in R$ 99.8 billion and the liquidity for smaller institutions was increase in R$ 41.8 billion on the last quarter of 2008.

To stimulate purchases of credit portfolios from small and medium size banks by the major banks, on 10/02/2008, BCB allowed banks to deduct 40% of the reserve requirements on time deposits to purchases of credit portfolios from financial institutions (with net worth up to R$ 2.5 billion). On 10/13/2008, BCB once again changed the rules for compulsory collection on term deposits, raising the percentage of the compulsory that banks could deduct for the purchase of other banks' credit portfolios from 40% to 70% (there is also a cap of 20% per transferor financial institution for use of this deduction) and increased the net worth of the seller bank up to R$ 7 billion. Moreover, on 10/13/2008 and 10/15/208, BCB extended the range of eligible assets that banks could buy with compulsory resources, authorizing also bond acquisitions from investment fund portfolios, credit rights resulting from leasing, fixed-income instruments issued by private non-financial entities, assets that make up Receivables Investment Funds (FIDC) or shares in FIDC organized by the Credit Guarantor Fund (FGC)[22].

The government created a new liquidity assistance line. BCB was allowed to acquire credit portfolios from financial institutions. The aim was to extended authority for the BCB to assist the Brazilian financial institutions that face cash shortages, mainly small and midsize banks[23]. The guarantees for these transactions (the ratio between the assets and the rediscount value) ranged from 120% to 140%, for credits with clients that have transactions involving more than one financial institution or loans secured by the public sector payroll. When dealing with other credits, the BCB would demand guarantees from 150% to

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[21] The BCB began to increase again the reserves requirements on 02/26/2010. Until 06/30/2010 the process was not yet finished.
[22] Initially, the ending data of this measure would be 06/30/2010. In June 2010, the BCB postponed the ending data to 12/31/2010.
[23] The access for this assistance would be through the discount window and only credits rated AA, A and B (good quality assets) could be accepted by the BCB.

170% of the assets underlying the transaction. The financial institutions would be able to repurchase their assets by paying the value of the assets plus the variation in the benchmark rate, plus 4% per year; the asset resale value would be adjusted on a daily basis. The financial institutions could accelerate the repurchase of these assets, fully or in part. Upon partial repurchase in advance, priority would be given to credits ranked as a greater risk, with a longer period for maturity, or those not involving credits held with clients that have effected transactions with more than one financial institution or loans secured by the public sector payroll. Moreover, on 10/16/2008, the BCB expanded the range of assets accept as guarantee for these loans, including debentures (fixed income securities issued by companies) rated AA, A and B.

Banco do Brasil (BB) and Caixa Econômica Federal (CEF), both financial institutions controlled by the Brazilian federal government, were authorized to, directly or indirectly, acquire ownership interest on private and public financial institutions in Brazil, including insurance companies, social welfare institutions and capitalization companies, with or without the acquisition of the capital stock control. The Government instituted the Bank Deposit Receipt (RDB) with the special guarantee of the FGC, the national private deposit insurance institution. With this measure, the deposit insurance on time deposits was increased from R$ 60,000.00 to R$ 20 million. This measure was adopted because the others ones (mentioned above) were quite innocuous, that is, they did not encourage interbank lending neither the purchase of credit portfolios by major banks. Given the preference for liquidity by private banks and the possibility of the liquid, profitable and very low risk investments in public bonds, the banks simply did not expand interbank credit[24]. In fact, only the stated-owned banks (BB and CEF) acquired a lot of credit portfolios. With the RDB, liquidity in the interbank market began to flow again. Thus, this last measure was, finally, effective.

In addition to the measures of monetary policy, the Brazilian government decided to use the three major federal public banks (BB, CEF and Banco Nacional de Desenvolvimento Econômico e Social – BNDES – the stated-owned development bank) to expand credit and to play a countercyclical role in a context of tightening credit conditions by private banks. Besides the two measures mentioned before

[24] Although no takeovers took place, significant mergers were announced in the banking sector in the fourth quarter of 2008: one between the private banks Itaú and Unibanco, which became the largest bank in Brazil, and another between BB (publicly owned) and Nossa Caixa (State-owned). Furthermore, BB also acquired an ownership interest (49.9%) on Votorantim Bank (privately owned).

(authorization for BB and CEF to acquire ownership interest on private and public financial institutions in Brazil and the BNDES' capitalization), on 11/6/2008 the Ministry of Finance announced a series of new initiatives that together provided R$ 19 billion in credit lines for various sectors, via BNDES and BB in August 2009, and the government made an additional contribution of R$ 500 million in August 2009 to the endorsement funds of BB and BNDES, which would guarantee loans to small and midsize enterprises. Furthermore, the state-owned banks established also new credit lines to some sectors, as detailed below.

The countercyclical action of stated-owned banks was very important to maintain the supply of credit to individuals and companies in a context of high liquidity preference by private banks and, so, to avoid a sharp drop of the economic activity. Other measure of credit policy was the cut in the Long Term Interest Rate (TJLP), used at the BNDES loans, form 6.25% down to 6%, the lowest level in history. The measure reduced the cost of BNDES long-term loans. The countercyclical fiscal policy included the stimulus package adopted by the Ministry of Finance, as well as others fiscal measures, which even though are not components of this package, were also important to mitigate the negative impact of the global financial crisis on the economic activity and the labor market (see Table 1, Annex).

The stimulus package amounted to a US$ 20.4 billion injection into the economy, equivalent to 1.2 per cent of Brazil's GDP in 2009. It aimed at boosting aggregate demand and mitigating the negative impact of the crisis on the labor market and on the economic activity through three major channels, namely, additional government spending, tax cuts and subsidies. Before detailing each of those channels and the others fiscal measures, it is important to mention some general features of the 2009 stimulus package. Firstly, it was among the lowest amounts spent by G20 countries (as a ratio of the GDP). Because of its small size, there was a limited fiscal impact, with the nominal deficit estimated at 3.2 per cent of GDP in 2009 (around US$ 49 billion).

Secondly, given the importance assigned to tax reductions[25] and the percentage of government spending, the Brazilian stimulus package seems to show a closer resemblance to advanced countries'

[25] The tax burden in Brazil (around 36% of the GNP in 2009) compares with that of OECD countries and is far above the typical burden of other Latin American countries, of around 10-15 percent.

packages than to the emerging countries' ones. This stems from the fact that additional expenditure accounted for an average of 83 per cent of the stimulus package in emerging countries and 65 per cent in advanced countries, with higher tax cuts in the latter group of countries (ILO, 2010). But, in fact, in the case of Brazil, the additional expenditure should include, besides the increase in government spending (47.5% of the total), subsidies (15.2% of the total). That would sum up 62.7% of the total, a rate closer to emerging countries average. Moreover, the increase on social assistance, with the expansion of the program *Bolsa Família*, also represented an expenditure measure. Thus, we could conclude that regarding the composition of the actual additional spending, the Brazilian stimulus package was similar to emerging economies, where some two-thirds is concentrated in three areas, namely infrastructure, housing and social protection. In advanced economies, in turn, the top three expenditures were infrastructure, social protection and other specific support measures (such as subsidies for the purchase of new cars and appliances) (ILO, 2010).

As is well known, in periods of downturn, public spending on infrastructure stimulates economic activity and generates employment, with little risk of deterring private investment. Public infrastructure investment also enhances long-term growth prospects and has a large multiplier effect on economic activity through backward and forward linkages, although the employment impact varies considerably depending on the structure of the economy in question, the types of public works undertaken (whether they are capital or labor intensive) and the country's capacity to implement projects rapidly.

As noted by ILO (2010), taken together, emerging economies have dedicated a much higher proportion of stimulus spending to infrastructure, about 50% for 2009/2100, than advanced economies at about 21 per cent. On average, emerging G20 countries are spending close to 1% of GDP in 2009 and 2010 for infrastructure projects, compared with advanced G20 countries which are spending close to 0.4 per cent of GDP. In the Brazilian stimulus package, the increase in government spending accounts for 47.5 per cent of total, equivalent to US$ 9.7 billion or 0.6% of GNP. The rise in government spending covered: (i) an expansion of the PAC [26]; (ii) the start up of a programme of government incentives and subsidies for housing construction, called *Minha Casa, Minha Vida*, targeted at low and middle-income households[27]; (iii) budget transfers to municipalities; and (iv) extension of unemployment insurance benefits.

Besides the government commitment to maintain the planned outlay after the onset of the crisis, the stimulus package determined an increase of US$ 5 billion (or 0.3% GNP) in investments within the PAC that represents 24.5% of the stimulus package. The goal was to stimulate investment in infrastructure and thereby mitigate the economic downturn.

The programme *Minha Casa, Minha Vida* would come from the federal government (R$ 2.5 billion or US$1.4 billion) and from the Guarantee Fund for Time of Service (FGTS) (R$ 7.5 billion or US$ 4.2 billion), a monthly fund accessible at dismissal, retirement, or for the purchase of the home, financed by payroll contributions from the worker and the employer. The programme aimed at building 1 million new homes in 2009 and 2010 for low-and middle-income families, with a maximum income equivalent to ten times the minimum wage. A principal objective of the programme was to reduce the housing deficit in the country, estimated at 7.2 million houses, by 14 per cent. It was expected that 400,000 houses would be built for families with monthly incomes up to three times the minimum wage. Families in this income bracket would be expected to contribute 10 per cent of their income to the mortgage, for a period of ten years, with a minimum monthly payment of R$ 50 (almost USD 28). The remaining costs, including insurance, would be subsidized by the government, with an expected cost of R$ 16 billion (around USD 8.9 billion). An additional 400,000 houses would be built for families who earn between three and six times the minimum wage (R$ 1,395.00–R$ 2,790.00 or equivalent to USD 775.00–USD1,550.00) per month. For these families,

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[26] PAC, launched by the Brazilian government on January 2007, has three main objectives: stimulate private investment; increase government investment in infrastructure; and remove the main obstacles to economic growth (bureaucracy, inadequate norms and regulation). The main block, the increase in infrastructure investment, aims to eliminate the bottlenecks that may constrain the growth of the economy, reduce costs, raise productivity, induce an increase in private investment and reduce the regional inequalities within Brazil. When it was released, the total forecasted infrastructure investment was US$ 235 billion (R$ 504 billion) between 2007 and 2010, among which US$ 205 billion would be provided by state-owned companies and the private sector, while the rest would come from the federal government. Three areas are prioritized: logistics; energy; and social and urban infrastructure. Actually, however, the annual investments within the PAC were much smaller than the forecast. Source: www.brasil.gov.br/pac.

[27] In March 2009, the Brazilian government announced a new housing programme, *Minha Casa, Minha Vida* to subsidize low income housing construction. The programme is expected to cost the federal government R$ 34 billion (around USD 19 billion), or approximately 1.2 per cent of GDP. The cost in 2009, included on the stimulus package, is USD 3.3 billion, equivalent to 0.2% of GDP (16.2% of the package).

mortgage contributions would not exceed 20 per cent of monthly income, and the families would benefit from a guarantee fund in the case of unemployment.

In order to avoid the adoption of pro-cyclical policies in municipalities – due to the fall on fiscal revenues caused by the lower level of activity – the stimulus package also included extraordinary budgetary transfers to local governments in 2009, which were equivalent to US$ 1.1 billion or 0.07% GNP in 2009 (5.5% of this package). Those transfers were implemented, primarily, through two channels. Firstly, the federal government committed to maintain a stable nominal value of constitutional transfers to municipalities, repeating the value of 2008 despite the drop in federal revenues in 2009. Secondly, 5,564 municipalities received up to R$ 1 billion (around US$ 555 billion) to compensate the decrease in transfers of the Municipalities' Participation Fund due to the tax cuts on the federal level. It is worth noticing that federal government transfers contributed to the maintenance of municipal services, many of which are an important source of formal jobs in small cities.

In general, unemployment benefits are strongly countercyclical and have a stabilizing effect on consumption during times of declining incomes, cushioning incomes and supporting demand. They also prevent people from falling into poverty. Brazilian unemployment insurance provides temporary financial aid for registered wage-earners who involuntarily lost their job. The unemployment insurance benefit is paid for a minimum of three months and a maximum of five months, continuously or alternately, for each period of 36 months, as follows: three payments if the worker was employed between six and eleven months in the last 36 months; four payments if the worker was employed between 12 and 23 months in the last 36 months; and five payments if the worker was employed for at least 24 months in the last 36 months (Berg, 2009a).

In order to alleviate the reduction in workers' income in the crisis context, the Ministry of Labor extended the duration of unemployment insurance benefits by two months for workers whose sector of economic activity was badly strongly affected by the recession (mining, steelmaking etc.). This element represented USD 0.2 billion or 0.01 % of the GNP, equivalent to 1% of the stimulus package. In the first moment (March 24, 2009) the extension was granted to workers who were laid off in November and

December 2008 (103,707 workers). In May, the extension was also granted to workers who were laid off in January 2009 and February 2009 (more than 216,500 workers).

A series of tax cuts – equivalent to 35 % of the stimulus package (US$ 7 billion or 0.4% GNP) – was announced in order to boost consumption and give support to sectors worst hit by the crisis[28]. For example, in December 2008, the Tax on Industrial Products (IPI) was cut for motorcycles, trucks and automobiles (up to 1,000 cc from 7% to 0% and for those up to 2,000 cc from 13% to 6.5%). The tax cut for cars that would end in December 2009 was extended until March 2010, although they must be energy-saving to qualify for the reduction, in an effort to promote environmentally friendly consumption. It is worth noticing that this last measure was the only "green stimulus" measure adopted by the Brazilian government. On the first semester, the IPI tax cut was also extended to household electrical appliances and building construction materials, and capital goods. Moreover, the Social Security Tax (Cofins) on the production of small motorcycles (up to 150 cc) was reduced from 3.65% to 0.65% and the exemption of tax levied on wheat, wheat flour and bread (that would end in July 2009) was extended to December 2010. Finally, Special Tax Regime on Real Estate was introduced: tax cut from 7% to 1% for houses costing up to almost USD 56 thousand (*Minha Casa, Minha Vida* program) and from 7% to 6% to all other cases.

The subsidies, which account for 15.5% of the stimulus package (equivalent to US$ 3.1 billion or 0.2% GNP), encompassed two elements. First, the government capitalized the BNDES with R$100 billion to ensure resources for private and public investments. This measure was off budget: a below-the-line loan to BNDES (IMF, 2009). This loan results, however, in a subsidy of US$ 0.9 billion or 0.06% of the GNP by the National Treasury. This stems from the fact that BNDES lends at about 6%, well below the yield on the government bonds of 12%, which the National Treasury needs to issue to raise the resources for the BNDES capitalization. The subsidy corresponds to the difference between these two interest rates that is paid by the treasury. It is important to mention that these extra resources from the Ministry of Finance allowed the

[28] Among which: (i) The tax on financial operations was cut from 3% to 1.5% for direct consumer credit operations and the overdraft credit line; (ii) Income tax brackets for physical persons were revised, creating lower rates (7.55% and 22.5%), which favour the middle class families, that is, those who earn up to USD 875 per month. As some others, this measure had already been designed before the crisis and was anticipated to combat its effects; and (iii) The tax on manufactured products was temporarily cut (fiscal impact of US$ 3.2 billion or 0.18% GDP).

BNDES to increase its credit by 85% in 2009. Second, the government subsidized the agricultural sector by reducing the cost of loans to this sector. The Brazilian government adopted other countercyclical fiscal measures that were not included in the stimulus package.

Beyond the stimulus package, the Brazilian government also adopted others countercyclical macroeconomic policies[29] (monetary, financial and exchange rate), as well as labor policies and sector specific measures (see Box Additional Policies and Programmes). While not being part of the official package, they were also extremely important to mitigate the effect of the crisis on the financial system and the economic activity.

Additional Policies and Programmes
I. Exchange rate policy
Because of the liquidity problems in the currency market that surfaced during the early months of the crisis, the BCB adopted a series of initiatives to improve external liquidity, among which: 1. Foreign exchange swaps auctions (Repos): the contracts included a commitment to resell the dollars to BCB, thus maintaining the current level of reserves (between 19 September 2008 and November 2008, USD 10.2 billion); 2. Spot market sale of dollars (USD 14.5 billion between October 2008 and February 2009); 3. Resumption of forward sales of foreign exchange in the market (USD 33 billion in sales and clearing of the BCB swap position in June 2009); 4. Provision of export financing: BCB provide dollar lending to exporters (USD 14.2 billion between October 2008 and June 2009); 5. The BCB has also offered credit lines in dollars to refinance the foreign debts of Brazilian firms, allocating up to USD 20 billion of the country's reserves).This measure benefited around 4,000 enterprises; 6. The tax of 1.5% on Financial Operations (IOF) established in March 2008 on foreign portfolio investments in fixed income (bonds and private fixed income and derivative transactions that result in yield index) was reduced to 0%. Exchange settlement transactions relating to entry and return of foreign loans (subject to rate of 0.38% since January 2008) was also exempted from

[29]For example: On fiscal front, the government extended payment deadlines for various federal taxes, thus easing pressure on corporate cash flows, such as withholding income tax (IR), social security tax (COFINS), tax on industrial products (IPI). IR: postponement from the 10th day to the 20th day of the each month. IPI: postponement from the 15th day to the 25th day of each month. COFINS: from 20th to 25th. The change was an old demand of the productive sector and has gained prominence over the lack of credit for businesses, caused by the current economic crisis, mainly in the form of working capital. The creation of a sovereign fund was agreed, with an initial amount of 0.5% of GDP (around USD 5 billion). The government intends to use these funds to provide the country with savings to compensate for any future economic fluctuations and finance the internationalization of Brazilian companies. It was announced that USD 2.5 billion will be released for infrastructure investments.

the IOF;

Several of these mechanisms were used, but once credit lines were re-established, demand tapered off. On December 2009, Brazil had unwound almost all of the emergency foreign exchange liquidity facilities implemented during the crisis.

The measures had several positive results: (i) smoothing exchange rate volatility and alleviating short-term foreign exchange pressure; (ii) providing forward dollar liquidity to alleviate pressure on corporations deterring them from unwinding hedging positions; (iii) increasing the availability and reducing the cost of foreign exchange for Brazilian corporations and banks over the terms of swap, and stemming depreciation in the short-term; and (iv) providing dollar financing for exporters.

It is worth to mention that a USD swap facility with the United States also bolstered the external liquidity of Brazil.

II. Labour market policy

As response to the crisis, the 6% real minimum wage increase (12% in nominal terms) scheduled for April 2009 was brought forward to February 2009. It is important to mention that this percentage was determined by the annual adjustment policy based on the rate of inflation and growth of GDP per capita, which was established in 2006 (and will be in effect until 2001) after negotiations between the government, representatives of unions, employer organizations and organizations of retirees and pensioners.

The new minimum wage boosts the Brazilian economy by R$ 21 billion, equivalent to 0.7% of GDP, mitigating the social impact of the crisis.

III. Sector specific measures

Assistance to SMEs

1. Credit line from BB: (i) on November 2008, creation of credit line of R$ 5 billion for working capital to small and midsize enterprises (those with annual revenues of up to R$ 3.5 million); and (ii) on June 2009, extension of this credit line on R$11.6 billion. This credit line benefited around 303,000 SMEs which accounts for 22% of GDP;

2. On 08/13/2009, the government made an additional contribution of R$ 500 million to the endorsement funds of BB and BNDES, which guarantees loans to small and midsize enterprises. Those funds allow the state-owned banks to boost the credit operations, as it provides an extra guarantee against default.

Construction sector

1. On 11/11/2008, CEF raised the ceiling of the credit line Construcard/ FGTS, for the acquisition of construction material, from R$7,000 to R$25,000. This line uses resources of FGTS and has an interest rate of 6% to 8.2% per annum, depending on the borrower's income range;

2. On 10/29/2008, CEF announced that will provide a credit line for working capital of R$ 3 billion for construction companies;

3. On 10/29/2008, the government allowed Brazilians banks to direct 5% of the savings deposits (earmarked for real estate

financing) for working capital to builders. Banks are already required to apply 65% of those deposits in real estate financing. These 5% (about $ 10 billion) could be deducted from the total; 4. Creation of a real estate credit line for public servants (including staff of public enterprises and mixed public-private firms), as a means to stimulate civil building work; 5. Real estate loans at below-market rates by BB and CEF.
Agriculture Beyond the subsidies of the federal government to Agriculture (that integrated the stimulus package) and the Agriculture Plan "Safra" 2009/2010 (R$ 107 billion), the government launched a set of initiatives to increase rural credit, which was implemented by two stated-owned banks, BB and BNDES. The main initiatives were: 1. An increase from 25% to 30% of the reserve requirement on demand deposits earmarked for the rural credit (US$ 2.4 billion increase in resources); 2. Increase from 65% to 70% of the reserve requirement on rural savings deposits (US$ 1.1 billion increase in resources); 3. On October 2008, BB announced the anticipation of approximately R$ 2.2 billion to finance the harvest; 4. On June/2009, National Monetary Council (CMN) announced the release of an additional R$ 12.3 billion in loans for agribusinesses by BNDES; 5. Use of USD 200 million in resources from constitutional funds to rural credit; 6. USD 400 million in assistance for agricultural cooperatives; 7. Allocation of USD 150 million to family agriculture using resources from the Workers' Protection Fund (FAT).
Manufacture Some credit lines to the manufacture sector were also launched, among which: 1. Program pro-trucker of BNDES on 26/09/2009: increase of the period of funding to 96 months; fall of the interest rates fall from 13.5% to 4.5%; these operations will be guarantee by the guarantee fund credit of BNDES; 2. The Codefat (FAT Deliberative Council) approved on 06/11/2009 the creation of a credit line for taxi drivers to buy new cars: the conditions include a period of five years for payment; the ceiling of each grant is R$ 60,000, with funding of up to 90% of the car; the annual interest will be compounded by the TJLP (currently 6% per annum) plus 4%; the line is operated by the BB and the resources come from the FAT.

Source: Authors elaboration based on official sources (see websites consulted).

4. Final Remarks: is Brazil a Keynesian show-case?

The global financial crisis affected economic activity dramatically, both in the developed countries and in the emerging economies, casting doubt on the very notion of decoupling the emerging countries.

The developments from the crisis were observed not just in the financial system, but most importantly in the real realm of the economy. After a long period of prosperity in the world economy running from 2003 to 2007, the scenario that unfolded from September 2008 (after the Lehman Brothers bankruptcy) onwards in terms of economic downturn, shrinking trade flows and asset deflation caused the world economy to go into collapse in 2009.

It is important to stress that the world recession in 2009 could be worse if the actions of the Economic Authorities of both the G-7 countries and the emerging countries did not have occurred: aware that the global financial crisis had stemmed from inaction by the State and not from its purported proactive role, as supposed by the theoreticians of neoliberalism, these countries' Economic Authorities took an active part in mitigating the impacts of the global financial crisis on the productive sphere of the economy. Thus, they implemented countercyclical fiscal and monetary policies in order to reverse the steadily deteriorating state of expectations among economic agents. In that regard, the injections of liquidity and substantial reductions in interest rates practiced by central banks, as well as fiscal incentives, along Keynesian lines, were important in reducing the impact of the crisis on the 'real economy' and seeking to restore agents' confidence in the workings of the markets.

In Brazil, the situation was not different. Early in 2009, after the initial impact of the global financial crisis had been absorbed, the Economic Authorities decided to implement countercyclical economic measures to reverse the recessive economic trends.

In fiscal policy terms, tax rates (income tax, tax on consumer credit financial operations and tax of industrialized products in the automobile and major household appliance industries) were reduced, public investments were expanded (particularly under the PAC) and a more flexible target fiscal surplus was introduced (from 3.75% to 2.5% of GDP).

In its monetary policy, the BCB injected liquidity into the economy and reactivated the credit market with measures that included changes and reductions in the compulsory deposits required of small and medium banks and large banks and an international export finance credit line set up from funds available from Brazil's international reserves. In addition, however conservative the BCB might be in terms of meeting inflation targets at any cost, in the course of 2009, monetary policy underwent a slow, gradual process in which the Selic was reduced from 13.75% at the start of the year to 8.75% in December 2009.

Accompanying this, another measure played an important part in righting the Brazilian economy: the public banks (BB, CEF and BNDES) operated on the credit market so as to counteract the scarcity of funds caused by the private financial system's preference for liquidity.

These measures produced the impact expected, because from the second half of 2009 onwards the Brazilian economy began to show signs of recovery, in turn encouraging expectations among consumers, businesses and the financial system, even to the point of persuading them to take decisions, respectively, to spend (consumption and investment) and borrow. As a result of, the Brazilian economy increased 7.5% in 2010.

In conclusion, Brazil's reaction to the global financial crisis, although tardy, was successful because Brazilian Economic Authorities operated countercyclical economic policies. For this reason, answering the main question of the final remarks, Brazil can be considered a Keynesian show-case! The challenge of the Brazilian government is to keep Keynesian policies in normal times, in the monetary, fiscal and exchange rate areas.

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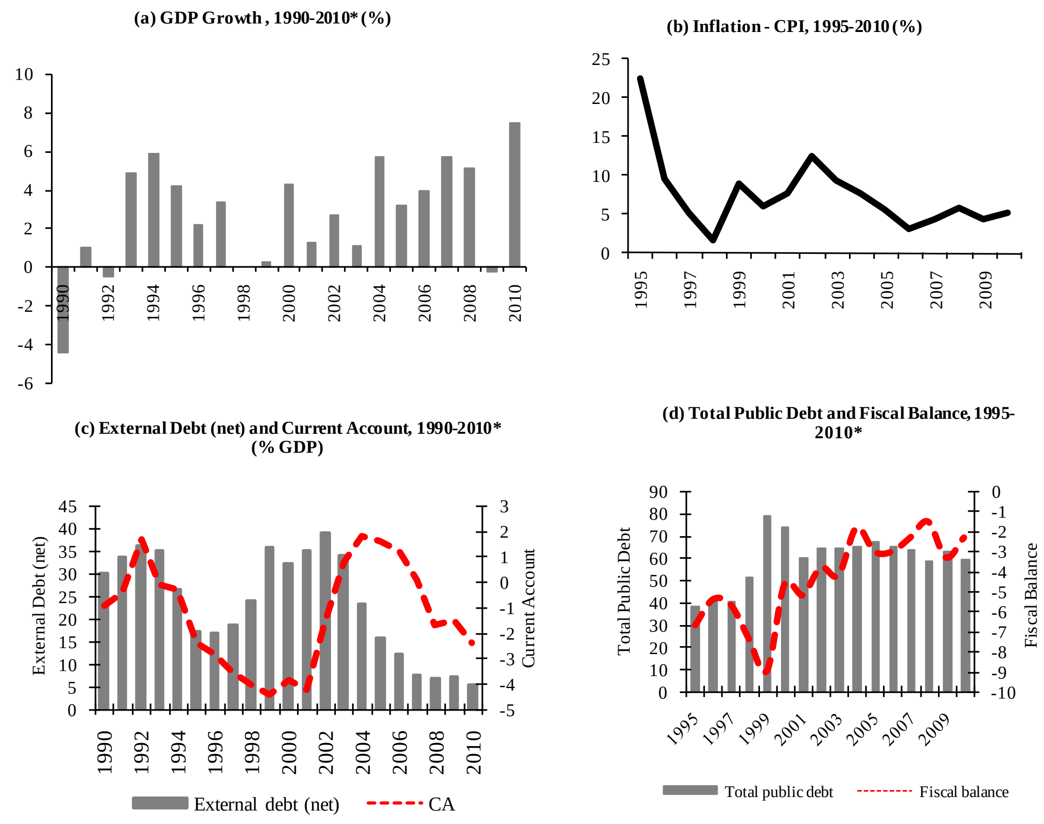
Annex

Figure 1. Macroeconomic Indicators - Brazil



Source: IMF - International Financial Statistics on Line; Deutsche Research (http://www.dbresearch.de, access on December, 2010)
(*) 2010 - Focus Market Readout and Deutsche Research.

Table 1. Countercyclical fiscal policy

Stimulus package	US$ billion	% GDP	% of Stimulus Package
Increase in Government Spending	**9,9**	**0,61**	**48,1**
Increase in investments (PAC)	5,0	0,31	24,3
Minha casa Minha Vida	3,3	0,20	16,0
Transfers to Municipalities	1,1	0,07	5,3
Extension of UI	0,2	0,01	1,0
Increased social assistance (Bolsa Família)	0,3	0,02	1,5
Tax Cuts	**7,6**	**0,40**	36,9
IRPF (Income Tax on individuals)	**2,7**	**0,14**	13,1
IPI (Tax on industrial products)	**3,2**	**0,17**	15,5
IOF (Tax on Financial Transactions) - credit	**1,4**	**0,07**	6,8
Cofins (Social Security) - motorcycles	**0,2**	**0,01**	1,0
RET (Special Tax Regime) - on Real Estate	**0,1**	**0,01**	0,5
Subsidies	**3,1**	**0,20**	15,0
BNDES	0,9	0,06	4,4
Agriculture	2,2	0,14	10,7
Total	**20,4**	**1,20**	**100**
Other measures			
Creation of the Sovereign fund	n,a,	n,a	-
Extended payment deadlines for federal taxes	n,a,	n,a	-

Source: Minister of Finance (Ministério da Fazenda, 2011).