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Macroeconomic volatility and social vulnerability in Brazil: The Cardoso government (1995-2002) and perspectives

Roberto Macedo



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Abstract

This paper addresses the social effects of macroeconomic volatility in Brazil, as well as the burdens and challenges it has been imposing on social policies. Volatility is analyzed both in terms of its internal causes and those related to the world economy, as well as in its social effects and on policies aimed at counterbalancing them. The period covered by the analysis extends from 1995 to 2002, and coincides with President Cardoso's two terms. It is marked by increasing economic volatility, as he moved from the first to the second term.

To understand this increased volatility the paper looks at its origins and at the macroeconomic policies adopted to counteract it. Volatility is also examined in the context of a new national and international scenario in which three main processes can be identified: economic and financial globalization, the privatization of state companies and foreign trade liberalization.

The analysis shows that Cardoso's government made major advances in terms of price stability. It has failed, however, in its attempt to lead the country towards sustained growth, as it relied on misguided macroeconomic policies, particularly its exchange and fiscal policies during the first term which increased the economy's external and domestic vulnerability.

After analyzing macroeconomic volatility, the paper moves to its primary focus, the social effects of economic problems and policies, and what has been done to mitigate them. Following this approach, it examines the performance of social indicators of the

period. In this respect, the analysis reveals that the government accomplished major advances in education, health and income transfers to the poorest groups, following a sharp increase of the tax burden, which it was able to introduce even in conditions of sluggish growth, in a counter cyclical fashion.

In a new international scenario that has overemphasized the role of markets in solving economic and social problems, it was not a surprise that Brazil had to rely on income transfers in order to alleviate the plight of the poorest groups. Poverty conditions found in the country are so severe that it would be naïve to expect that they could be significantly reduced by the interplay of market forces, even in the medium term.

The paper also addresses the perspectives for the next government. In the short run, the serious economic scenario inherited by President Lula makes it difficult to implement new and major advances in expanding social expenditures, as the tax burden is coming close to a saturation point and faces increasing opposition. Thus, the situation is such that it requires a renewed attention to the quality of macroeconomic management, in order to improve growth rates and open room for sustainable social policies based on increased tax revenues coming from an expanded tax basis.

Given this picture, a thin path has been identified to lead the country in this direction and out the current difficulties, which have recently become less dramatic because of the adjustment presented by the foreign sector accounts, and by the stand adopted by the elected president in announcing policies that have dissipated most fears of their mismanagement. This path involves continuing fiscal discipline by maintaining and even enlarging the primary fiscal surplus, with an eye to bargaining this movement for the market's willingness to accept lower interest rates on the public debt. In the foreign front, an emphasis on export promotion and a new round of import substitution, this time coming with enhanced competitiveness on the part of local producers. In essence, what is sought is to reduce vulnerability and volatility, both from domestic and external sources.

Looking at the medium and long term, and taking into account a new national and international scenario created by economic and financial globalization, privatization and trade liberalization, other lessons from the Cardoso period are clear. In particular, they point to less dependence on external finance, more caution with globalization in general, a different course for privatization –including constraints on the use of its resources by the government, a screening of the pricing policies of the privatized sectors and a move towards public offers that democratize ownership of capital property– and an external trade and financial policy explicitly guided by national interests, with selective attention to some Trojan horses offered by globalization –as was the initially easy access to financial globalization– all this consistently sustained by other policies, in particular a realistic exchange rate.

Introduction

This paper addresses the social effects of macroeconomic volatility in Brazil, as well as the burdens and challenges it has been imposing on social policies. Volatility is analyzed both in its internal causes and those related to the world economy, as well as in its social effects and on policies aimed at counterbalance them.

The period covered by the analysis extends from 1995 to 2002, and coincides with President Cardoso's two terms. Other factors have also weighted on the choice of this period. By 1995, an anti-inflation package of macroeconomic policies unveiled in 1994 was still in its early stages. The package, named the *Real* Plan after the new currency then introduced - the *real* -, was able to effectively reduce the very high inflation that plagued the country in the previous two decades, with outbursts that almost led to hyperinflation. Thus, the *Real* Plan became an important landmark in Brazil's economic history. Furthermore, starting at the end of Cardoso's first term and throughout the second, the economy suffered increased volatility whose effects are central to the interests of this paper.

To understand this increased volatility one must look at its origins and the economic policies adopted to counteract it. Volatility will also be examined in the context of a new national and international scenario in which, following Tokman (2001), three main processes can be identified: economic and financial globalization, the privatization of state companies and foreign trade liberalization. Tokman elaborates on how these processes led to a global economy with diverse characteristics, by defining new operational rules for national policies and restricting their options. Thus, as working

hypotheses the analysis will look at this new scenario, on how its three processes were followed in Brazil and what was the ensuing impact on the options open to national policies.

In any case, the primary focus of the analysis will be on the social impact of economic problems and policies and on what has been done to alleviate it, a task that will be tackled by examining the social policies and performance of social indicators in the period.

The text is organized in four sections. Section I summarizes the main macroeconomic developments of the 1995-2002 period. Section II focuses on the impact of macroeconomic volatility on social vulnerability and the responses of social policies. Section III looks at the current macroeconomic perspectives and relates it to social issues and policies. Section IV presents a summary of the analysis and its conclusions.

I. Macroeconomic vulnerability and the response of economic policies

A. The initial success

Table 1 shows the performance of major macroeconomic indicators during Cardoso's two terms as president (1995-2002). For comparison purposes, the numbers for the preceding four years are also presented. To facilitate reference, lines have been numbered. Cardoso's main achievement in the macroeconomic area was to sharply reduce inflation rates, shown in line 1, which had been extremely high before 1995, but were successfully reduced by the *Real Plan*, unveiled in 1994. It was the final year of Itamar Franco's government, and by that time Cardoso was the Finance Minister responsible for the plan.

Previous stabilization attempts since the end of the military governments in 1985 had consisted mainly of price freezes that were not sustained by setting right the fundamentals of fiscal and monetary policy, nor by curbing existing legal and informal rules of indexation of earnings and prices to inflation indices. These rules had caused entrenched inflationary inertia. Thus, immediately at its start, price freezes adopted by previous stabilization plans to interrupt inertial behavior were already under pressure to be suspended or disobeyed, as many prices were caught lagging behind others. The *Real Plan* was successful because it adopted consistent fiscal and monetary policies,

and a very ingenious way to curb inflationary inertia.¹ Moreover, a quasi-fixed exchange rate also worked as an anchor for prices. Line 18 shows the nominal rate which remained close to R\$1 to the dollar for various years. The following line reveals that it meant a sizable overvaluation of the *real* until 1999.²

¹ In essence, for several months before the plan all earnings and prices became indexed to a form of “indexed money”, the URV or Unit for Value Reference, expressed in the existing currency, the *cruzeiro real*, but adjusted to inflation. On July 1st, 1994, the URV was converted into the new currency, the *real*, and indexation suspended, except on an annual basis. For a retrospective analysis of the *Real Plan*, see Castelar Pinheiro, Giambiagi and Gostkorszewicz (1999).

² The conversion of the *cruzeiro real* into *real* in July 1st, 1994, was based on the exchange rate of the *cruzeiro real* to the dollar that was in place before the new currency was adopted. The idea was to have at first R\$1=US\$1, similarly to Argentina’s parity system, but without its rigidity or convertibility. With the euphoria brought by the *Real Plan*, the exchange rate went down to R\$0.85 per dollar by the end of 1994, a serious fall in real terms, when taking into account that the second semester of the same year showed a “residual” inflation that reached 17%, as measured by same index shown in line 1 of Table 2.

Table 1
BRAZIL – MAJOR MACROECONOMIC INDICATORS:
ACTUAL VALUES (1994-2001) AND PREDICTIONS (2003)
(measurement units indicated on second column)

| Indicator | Units | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|-----------------------|-------|--------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Inflation | | | | | | | | | | | | | |
| 1.General price index (GPI-ID) ^a | % p.a. | 480 | 1,158 | 2,708 | 1,093 | 14.8 | 9.3 | 7.5 | 1.7 | 20.0 | 9.8 | 10.4 | 26.4 |
| Growth, savings and investment | | | | | | | | | | | | | |
| 2.Real GDP | % p.a. | 1.3 | -0.5 | 4.9 | 5.9 | 4.2 | 2.7 | 3.3 | 0.1 | 0.8 | 4.4 | 1.4 | 1.5 |
| 3.Gross savings | % of GDP | 18.6 | 20.3 | 20.6 | 21.6 | 19.8 | 18.1 | 17.7 | 17.2 | 16.0 | 17.8 | 17.3 | 18.0 |
| 4.Gross fixed capital formation(GFCF) | % of GDP | 18.1 | 18.4 | 19.3 | 20.8 | 20.5 | 19.3 | 19.9 | 19.7 | 18.9 | 19.3 | 19.5 | 18.7 |
| Fiscal (Public Sector) and monetary | | | | | | | | | | | | | |
| 5.Basic interest rate (end of year) | % p.a. | 427 | 1,156 | 2,475 | 950 | 41.2 | 23.9 | 38.0 | 29.0 | 19.0 | 15.8 | 19.0 | 25.0 |
| 6.Tax collections | % of GDP | 25.2 | 25.0 | 25.8 | 29.8 | 29.4 | 29.1 | 29.6 | 29.6 | 31.7 | 32.7 | 34.1 | (...) |
| 7.Privatization revenues | US\$ billion | 2.0 | 3.4 | 4.2 | 2.3 | 1.6 | 6.5 | 27.7 | 37.5 | 4.4 | 10.7 | 2.6 | 2.0 |
| 8.Primary result | % of GDP | 2.9 | 2.3 | 2.7 | 5.1 | 0.4 | -0.1 | -0.9 | 0.0 | 3.1 | 3.5 | 3.7 | 4.1 |
| 9.Nominal result ^b | % of GDP | (::) | (::) | (::) | -27.0 | -7.2 | -5.9 | -5.0 | -8.0 | -9.5 | -4.5 | -5.2 | -10.4 |
| 10. Real interest paid | % of GDP | 1.5 | 4.4 | 2.4 | 3.9 | 5.2 | 3.7 | 3.4 | 7.5 | 7.2 | 4.7 | 5.2 | (...) |
| 11. Net debt(end of year) | % of GDP | 38.6 | 35.1 | 31.2 | 30.4 | 30.5 | 33.2 | 34.3 | 41.7 | 49.4 | 49.4 | 52.6 | 55.9 |
| 12. GFCF(Gross fixed cap. formation) | % of GDP ^c | 2.9 | 3.5 | 3.2 | 3.6 | 2.5 | 2.3 | 2.0 | 2.8 | 1.8 | 1.9 | (...) | (...) |
| External sector | | | | | | | | | | | | | |
| 13.Trade balance | US\$ billion | 10.6 | 15.2 | 13.3 | 10.5 | -3.1 | -5.6 | -6.7 | -6.6 | -1.3 | -0.7 | 2.6 | 13.1 |
| 14. Current account balance. | US\$ billion | -1.4 | 6.1 | -0.6 | -1.8 | -18.4 | -23.5 | -30.5 | -33.4 | -25.3 | -24.2 | -23.3 | -7.8 |
| 15. Foreign direct investment (gross) | US\$ billion | 0.5 | 3.1 | 6.3 | 8.2 | 4.4 | 10.8 | 19.0 | 28.9 | 28.6 | 32.8 | 22.4 | 16.7 |
| 16. International reserves (end of year) | US\$ billion | 9.4 | 23.7 | 32.2 | 38.8 | 51.8 | 60.1 | 52.2 | 44.6 | 36.3 | 33.0 | 35.9 | 38.9 |
| 17. External debt | US\$ billion | 124 | 136 | 146 | 148 | 159 | 180 | 200 | 242 | 226 | 217 | 210 | 212 |
| 18. Nominal exch. rate (end of year) | R\$/US\$ ^d | 1,069 | 12,388 | 326 | 0.85 | 0.97 | 1.04 | 1.12 | 1.21 | 1.79 | 1.96 | 2.32 | 3.53 |
| 19. Real exch. rate (Aug.1994=100) ^e | Index | 122.7 | 131.4 | 121.5 | 105.2 | 93.8 | 98.9 | 98.4 | 99.4 | 134.5 | 121.4 | 139.6 | 144.9 |
| 20. Average import tariff | % | 32.2 | (::) | 16.5 | (::) | (::) | (::) | 13.8 | (::) | 13.8 | (::) | 12.9 | 11.8 |

Source: line (1): Getulio Vargas Foundation; (2)-(4), (12): IBGE (Brazilian Institute for Geography and Statistics); (5), (13)-(18): Central Bank; (6)-(7): BNDES (National Bank for Economic and Social Development); (8)-(11): Ministry of Finance; (19): FUNCEX (Foundation Center of Foreign Trade Studies); (20): Presidency's Civil Office.

Note: (...) data not yet available; (::) data not included in publication by source.

a General Price Index, domestic availability criteria;

b Includes impact of devaluation on public debt;

c Excludes public enterprises;

d *Cruzeiro* in 1991-92, *cruzeiro real*, in 1993;

e R\$ deflated by GPI-ID; US\$ deflated by US Wholesale Price Index.

Cardoso's role in the Real Plan gave him enormous political prestige. In the wake of the success, he became the government's presidential candidate for succeeding Franco, and won the election held at the end of 1994. The political capital created by the Real Plan continued throughout his first term and also secured Cardoso's reelection in 1998, but it was progressively eroded by sluggish growth and by a major increase in economic volatility in his second term, which presented the highest unemployment rates of the period under analysis³. In the late 2002 elections, the candidate supported by the government lost to the opposition run mate, Luis Inácio "Lula" da Silva.

In its early stages, the Real Plan promoted growth, with 1994 and 1995 showing two of the four highest annual rates between 1991 and 2002 (line 2). One of the most important reasons for its initial success was the plan's ability to sharply reduce the "inflation tax", thus increasing disposable income of consumers, therefore stimulating consumption and production. The increase in consumption occurred particularly among the lower-income classes, whose earnings used to be more intensely depleted by inflation, as they usually keep a larger proportion of their income in the form of cash balances and rely less on financial operations to preserve the purchasing power of the money they keep.

As the future rate of inflation became lower and more predictable, another effect was the facilitation of credit conditions for the purchase of durable goods, with extended terms and reduced monthly installments that also stimulated sales and production. More stable prices also pushed the development of financial markets, such as those of private pension funds, mutual funds in general and the insurance industry.

Effects of this type, however, occur only once and for all following a stabilization process. Therefore, the economy went a few steps in the growth path, without being able to advance further at the same speed. As in the past, rates of investment remained stagnated around 20% of GDP, as shown by line 4. Savings (line 3) did not make progress either, and suffered from increased government deficits and dependence on foreign resources. Growth rates decreased in 1996 and 1997 and since then high volatility contaminated the economy, with the economy growing close to the population increase, currently around 1.3% per year. The only exception was 2000, following the positive effect of the 1999 devaluation and the absence of external shocks or major domestic difficulties such as those that plagued most years of the 1997-2002 period.

B. The roots of volatility

This unhappy end to a movie that began so well can be explained by domestic and external reasons. The major were two moves made by the Brazilian policy makers in the wake of the initial success of the *Real* Plan. The first, in the beginning of Cardoso's first term, was the exchange rate policy and its associated interest rate and monetary policy. The second was the fiscal policy of the same period.

In the first case, at the origin of the problems that followed, there was the adherence to a quasi-fixed and overvalued currency exchange rate sustained by a policy of very high interest rates. In addition to a concern with price stability, there was also the belief that this policy would promote economic competitiveness, which would overcome, in the future, the imbalance generated in the external accounts, revealed in lines 13 and 14. Since there was no prediction of when this correction would occur, there was also the conviction that it would be possible to rely indefinitely on a permanent and sufficient inflow of foreign capital to sustain the external imbalance.

³ Unemployment rates are presented later in the paper, in lines 12 and 13 of Table 2.

This policy was not altered both for economic and political reasons, not until 1999 when the government opted for a floating exchange rate, following major losses of reserves (line 16). In essence, the government was concerned that a devaluation would compromise the lower inflation rates brought by the *Real Plan*, therefore damaging Cardoso's political capital and risking his election for a second term in 1998. Thus, Brazilian policy makers confronted trade offs of economic and political dimensions until the policy collapsed in following a severe loss of reserves in the wake of the Russian crisis at the end of 1998. The economic trade off involved an overvalued *real* or more inflation, while the political was between more inflation and less chances of winning the reelection.

Devaluation came three months after Cardoso assured his second term, but the long lasting overvaluation led to serious implications, as it sharply increased the economy's vulnerability to external shocks. Domestically, vulnerability also grew due to increased government indebtedness. This expanded vulnerability, still unraveling today in its damaging effects, is at the root of the various crises that the economy has been suffering, particularly since 1997. In order to sustain an overvalued *real*, the government relied on very high interest rates during the 1995, 1997 and 1998 crises in Mexico, the Southeast Asia and Russia, respectively. Line 5 shows this policy acting through the basic rate, which for a long period remains well above the inflation rates of line 1. Line 10 shows the sizable increases in the real value of the interest expenses of the public sector in 1995, and particularly in 1998 and 1999. These two years reflect moves in the direction of higher interest rates, which came late in 1997 and 1998.

As the primary result shows in line 8, the public sector did not have enough resources to pay for this increase in the interest expenses to be faced.⁴ Thus, the outcome was a significant increase in the nominal deficit (line 9) and of the public debt (line 11). The latter increases from 1995 on, and particularly in 1998 and 1999. After 1999, the devaluation opened room for a lower interest rate. With a floating exchange rate, however, the vulnerability caused by the previous policy had already taken its own course, because part of the public debt is in dollars or indexed to this currency. Thus, the devaluations that happened in 1999, 2001 and 2002 had a great impact on the public debt following the increase in the interest expenses plus devaluation.⁵

Besides the exchange rate policy used during Cardoso's first term, a second factor that brought increased vulnerability and volatility was the fiscal policy then adopted. The data in line 8 also show how the government rapidly exhausted the 1994 primary surplus, which fell in 1995, and then moved to a deficit that increased in 1996 and 1997. There was also a political factor here, because, aiming at reelection, which required a constitutional amendment, the federal government opted for expanding expenses in order to overcome resistance from state governors and Congress members.

By the end of 1998, there was already a great concern with the domestic debt increase, and markets gave signs of uneasiness. With the reelection secured, and in addition to devaluing and floating the *real*, the government moved to a policy of keeping its debt constant in relation to the GDP. It was able to do so in 1999 and 2000, as the fiscal policy moved to a primary surplus of 3% of GDP and the floating exchange rate opened room for lower rates of interest. However, the increased vulnerability brought by the previous policies remained entrenched and its damaging effects resurfaced again in the wake of new domestic and external pressures. Thus, in 2001 and 2002 the debt as share of GDP increased again, due to the combination of new devaluations,

⁴ The data refers to the public sector as a whole, of which the federal government is the major determinant of policies and results, particularly at the macroeconomic level.

⁵ At the end of October, 2002, the share of federal government bonds indexed to the dollar reached 38%, according to O Estado de S.Paulo (11/21/02, p. B7).

compounding interest on the debt and sluggish rates of growth.⁶

These developments in 2001 and 2002 were precipitated by various causes, in particular the reduction in capital flows to Brazil following the increased risk aversion on the part of international investors and Argentina's default that strengthened this aversion in the case of Latin America. In 2002, starting in the second quarter, Brazil was also particularly affected by the uneasiness of both domestic and foreign investors with respect to the result of the presidential election and the policies to be followed by the future government. As before, these difficulties found the country more vulnerable as a result of the policies described in this section.

It is clear, therefore, that the macroeconomic policies adopted during Cardoso's first term were significant factors leading to the economic difficulties experienced later on and until now. The paper proceeds by relating the analysis of this subsection to the new international and domestic scenario, following working hypotheses set in the introduction.

C. Globalization, privatization and trade liberalization: the role of a new domestic and international scenario

Globalization, particularly in its financial aspect, had an important impact on the choice of the national policies. In the end, the impact fitted Tokman's proposition that it limits national policy options, but following a different process in Brazil. In a first stage, financial globalization did not limit these options. In fact, it initially created more room for policy choices. The exchange rate policy of Cardoso's first term could not have been implemented without fast and larger access to external financing. Notice, in line 17, that the external debt went up from US\$148 billion, in 1994, to US\$242 billion, in 1998, an increase of almost US\$100 billion in four years.⁷

In a second stage, globalization imposed a limit on national policy options indeed. For instance, this was the case when foreign investors almost exhausted Brazil's reserves in 1998 as they left the country in a movement that made the 1999 devaluation inevitable. It was also the case in 2002, when, in addition to a new albeit smaller outflow of resources –as not much had been left– the inflow was again reduced. This was due to the already mentioned increased risk aversion in the world financial markets, compounded by uncertainties with regard to the policies of the candidate that would emerge as a new President in the October 2002 elections.

Thus, evidence shows that financial globalization set a trap into which Brazil fell, in great part due to its own national policy mistakes. The increased availability of resources made possible by globalization worked just as the bait. In the aftermath, financial globalization has indeed limited the policy options.

With respect to the impact of privatization, the existing literature focuses mainly on examining the efficiency of the privatized firms in comparison with their former status as state enterprises.⁸ Following a different focus, it is important to point out that, similarly to financial globalization, privatization in Brazil also enlarged the scope for misguided policy decisions.

⁶ There is an ongoing discussion among Brazilian economists that point to an underestimation of the figure presented in the last column of line 11. The reason is that the inflation rate shown by the IGP-DI (line 1), used as a preliminary estimate of the GDP implicit deflator, is believed to be overestimated due to technicalities in the index. With an overestimated nominal GDP, the ratio in line 11 is likely to be underestimated.

⁷ After 1998 the external debt began to fall, among other reasons because many companies chose to pay off their external debt given the risks presented by the floating exchange rate. Some companies also converted external debt into foreign direct investment.

⁸ For a survey, see Megginson and Netter (2001).

Table 1 also shows in line 7 the resources obtained by the government from the privatization program that began in 1991. In 1997 and 1998 the program reached its peak slowing down since then, with fewer privatizations and smaller sums coming from the auctions of state enterprises and of the government's minority shares in other companies. The data in the table also reveals that although one of the goals of privatization was a reduction of the public debt, it continued to increase even with these sizable resources from privatization.

In another study, we argued that if it weren't for these resources, the government would have had more difficulties in contracting so much additional debt, as the financial markets had been showing increasing uneasiness about it. The banner of privatization, and the resources brought by the program, helped to calm this uneasiness. Therefore, although privatization by itself brought additional resources that have reduced liabilities of the public sector, this reduction opened room for further debt expansion.⁹

Furthermore, additional direct foreign direct investments, whose total is shown in line 15, came because of the undergoing privatization program. The program's sales peaked in 1997 and 1998, years in which the pressures on the overvalued *real* were stronger.¹⁰ In this fashion, we also argued that the inflow of foreign investments helped to postpone the much needed devaluation. Consistently with this argument, devaluation took place right after the privatization process lost momentum and access to external resources decreased.

Following Kornai's concept of "soft budget constraints", in essence our argument is that privatization has softened further both the domestic constraint for public indebtedness and, together with financial globalization, the foreign constraint for additional financing either public or private.¹¹ In the process, it facilitated the maintenance of the misguided policies described in the previous subsection.

At the micro level, privatization has brought benefits in the form of increased efficiency of the privatized firms, together with enlarged public services, particularly in the area of telecommunications. It also brought costs in the form of reduced employment at some of its stages and of higher prices charged to consumers. On balance, the benefits have prevailed at the microeconomic level.¹² As a matter of fact, privatization has not been a major issue during the presidential campaign and even with the victory of opposition there is no talk of reverting it. We shall return to its impact in Subsection II.E, when examining some of its social effects.

In the area of trade liberalization, Brazil adopted a series of tariff reductions as part of Mercosul and other international agreements, and as well others based on its own initiative, following the dissemination of the free trade gospel. As Table 1 shows in line 20, the average import tariff has been reduced over the years. However, as the table also shows, these policies had a secondary effect on the trade balance when compared to the impact of the overvalued *real*. The devaluations of 1999, 2001 and 2002, reverted the trade deficit despite lower tariffs, and the current account balance deficit rapidly decreased. In 2002, the trade surplus reached almost the same level as the one in 1993.

⁹ Macedo(2000).

¹⁰ According to BNDES (Banco Nacional de Desenvolvimento Econômico e Social), the government agency in charge of privatization, the program produced revenues of US\$105.5 billion between 1991 and 2002, including transferred debt. 1997 and 1998 accounted for 58.8% of this total. Between 1996 and 1999, foreign direct investments totaling US\$22.7 billion come to participate in the privatization program. Part of the amount that came in 1999 (US\$8.8 billion) corresponded to payments of acquisitions that occurred in 1998, as the in 1999 the sales undertaken by the program reached only US\$4.2 billion.

¹¹ Kornai (1979).

¹² For an analysis of benefits and costs of privatization in Brazil, see Anuatti et al.(2002).

In any case, the country became more open to trade. In the process, the economy became more efficient.¹³ The impact of trade liberalization has received less attention by economists and public opinion in general, maybe because the country suffered so much from the overvalued *real*.¹⁴ In any case, the prevailing opinion is not in favor resuming former trade restrictions. Rather, it is focused mainly on removing trade barriers to Brazilian exports in major markets such as the United States and the European Economic Community, as well as revamping Mercosul and moving into new markets such as China and India. Import substitution is again gaining ground, but its appeal now comes primarily from its new dressing, which excludes privileges to inefficient local producers.

Before moving to the next section, another important aspect to highlight in Table 1 is the large and increased tax burden, shown in line 6. It has moved from 25.7% of GDP in 1993, to 27.9% in 1994, also in the wake of the Real Plan. As the government lost in terms of the “inflation tax” it resorted to higher regular taxes. Continuingly increasing, it reached 34.1% of GDP in 2001, a rate unusually high for developing economies and equivalent to those found in various developed countries.¹⁵ This rise on tax collections was a major macroeconomic development as it has allowed a large primary surplus to pay for part of the larger public debt burden. At the same time, it also opened room for an increase in other government expenditures, in particular social programs, in a counter cyclical fashion, as the growth rates were coming down. Thus, this increase in the tax burden is also central to the issues examined in this paper. Table 1 also includes data on the gross fixed capital formation (GFCF) by the public sector (line 12). Worth noticing is its reduction from 3.6% of GDP in 1994 to 1.9% in 2000.

¹³ IBGE data covering the manufacturing sector shows that labor productivity in the manufacturing sector remained stagnant from 1985 to 1990. Thereafter, it increased continuously from 1991 to 2001, reaching a total increase of 103% in this period as a whole.

¹⁴ The social impact will be examined in Subsection II.E

¹⁵ Add examples.

II. Social vulnerability and the response of social programs

Subsection A presents an overview of indicators and government policies in the social area, while Subsection B examines the government programs of income transfers as a major mechanism for alleviating poverty. Subsection C covers consumer prices, which are important for their impact on real incomes and also with policy implications, while the Subsection D examines violence and crime. The social implications of the new national and international scenario, in the form of globalization, privatization and trade liberalization are also examined, in Subsection E.

A. An overview of social indicators

Table 2 sums up several important social indicators –such as employment and unemployment, poverty and school enrollment rates– including those linked to the government policies, as its social expenditures. The table shows various cells lacking data, as in various cases no complete series for the whole period were found. Differently from the macroeconomic indicators in Table 1, not all indicators in Table 2 are regularly monitored by their official sources. At other times, changes in the data collection criteria have prevented the gathering of consistent data throughout the years.¹⁶ Moreover, most

¹⁶ For instance, notice that some indicators, such as in seven final lines, lack data for the 1991 and 2000, when censuses were undertaken by IBGE (Brazilian Census Bureau). These data come from annual household surveys that adopt sampling criteria different from those of the census, thus making the series incompatible. Moreover, in 1994 IBGE did not undertake a national household survey.

data for 2002 is not yet available. Anyway, for all indicators listed it was possible to obtain information that provides a picture of the major developments in the social area during Cardoso's tenure, as compared with the situation he inherited from the previous four years.

A.1 Poverty, earnings and income distribution

The data in Table 2 is presented in seven different groupings. The first covers poverty, earnings and income distribution. As stated previously, the greatest macroeconomic success of the Cardoso's government was to reduce inflation and keep it low. In Subsection I.A we also explained how the reduction of the "inflation tax" works in increasing disposable income, particularly among the poorest groups. This had a significant social impact, because it was one of the major factors behind the significant poverty reduction following the *Real* Plan, as revealed by Table 2 in lines 1 and 2.

Table 2
BRAZIL – MAJOR SOCIAL INDICATORS (1991-2002)
(measurement units indicated on second column)

| INDICATOR | Units | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------------------|
| Poverty and income distribution | | | | | | | | | | | | | |
| 1. Persons below poverty line | % / Total | (---) | 40.8 | 41.7 | (---) | 33.9 | 33.5 | 33.9 | 32.8 | 34.1 | (---) | 33.6 | (***) |
| 2. Persons below extreme poverty | % / Total | (---) | 19.3 | 19.5 | (---) | 14.6 | 15.0 | 14.8 | 14.1 | 14.5 | (---) | 14.6 | (***) |
| 3. Average earnings – Metrop. Areas | 2000 R\$ | 680 | 552 | 629 | 665 | 725 | 762 | 768 | 765 | 723 | 719 | 695 | 673 ^a |
| 4. Income distribution – Gini index | Ratio to 1 | (---) | 0.583 | 0.604 | (---) | 0.601 | 0.602 | 0.602 | 0.602 | 0.596 | (---) | (***) | (***) |
| Social expenditures, social security and social assistance | | | | | | | | | | | | | |
| 5. Total federal social expenditures | % of GDP | (::) | (::) | (::) | 11 | 12 | 12 | 12 | 12 | 13 | 13 | 14 | (***) |
| 6. Per capita federal social expenditures. | 1999R\$ | (::) | (::) | 615 | 643 | 767 | 783 | 818 | 838 | 824 | (::) | (::) | (***) |
| 7. Persons w/ SSWWSMB – Urban | Million | 8.5 | 8.7 | 9.1 | 9.4 | 9.8 | 10.5 | 11.4 | 12 | 12.4 | 12.9 | (::) | (***) |
| 8. Idem, rural | Million | 4.1 | 5.0 | 6.0 | 6.4 | 6.4 | 6.4 | 6.4 | 6.6 | 6.8 | 7.0 | (::) | (***) |
| 9. Idem, handicapped and aged | Million | ⇒ | ⇒ | ⇒ | ⇒ | ⇒ | 0.35 | 0.65 | 8.5 | 1.0 | 1.2 | 1.6 | 2.2 |
| 10. Minimum: wage and SSWWSMB | 2000 R\$ | 106 | 110 | 120 | 113 | 124 | 130 | 133 | 139 | 140 | 145 | 158 | 163 ^b |
| 11. Average SSWWSMB | 2001 R\$ | (::) | (::) | (::) | 267 | 273 | 287 | 298 | 314 | 318 | 323 | 335 | (***) |
| Employment and unemployment | | | | | | | | | | | | | |
| 12. Unemployment rate (total) | % of labor | (---) | 6.5 | 6.2 | (---) | 6.1 | 6.9 | 7.8 | 9.0 | 9.6 | (---) | 9.4 | (***) |
| 13. Idem, metropolitan areas | Force | 4.8 | 5.7 | 5.3 | 5.1 | 4.6 | 5.4 | 5.7 | 7.6 | 7.6 | 7.1 | 6.2 | 7.1 |
| 14. Employed labor force | Million | (---) | 65.4 | 66.6 | (---) | 69.6 | 68.0 | 69.3 | 70.0 | 71.7 | (---) | 75.5 | (***) |
| 15. Formal workers ^e | Million | (---) | 22.2 | 23.2 | 23.7 | 23.8 | 23.8 | 24.4 | 24.5 | 25.0 | 26.2 | 27.0 | 27.7 |
| 16. Share of formal workers ^f | % of total | (---) | 43.4 | 42.7 | (---) | 42.7 | 43.7 | 43.3 | 42.7 | 41.8 | (---) | 43.5 | (***) |
| Health and related indicators | | | | | | | | | | | | | |
| 17. Infant mortality ^c | Per 1000 | 45.2 | 43 | 41.1 | 39.6 | 38.4 | 37.5 | 36.7 | 36.1 | 34.6 | (::) | (::) | (***) |
| 18. Life expectancy at birth ^c | Years | 65.5 | 66.3 | (::) | 66 | (::) | (::) | (::) | (::) | 68.4 | 69 | (::) | (***) |
| 19. Community Health Agts.- CHAs | Thousand | ⇒ | ⇒ | ⇒ | (---) | 29.1 | 44.5 | 54.9 | 89 | 112 | 147 | 154 | (***) |
| 20. Pop. covered by CHAs | Million | ⇒ | ⇒ | ⇒ | 16 | 19.9 | 24.5 | 30.2 | 45.8 | 60.7 | 77.8 | 87.9 | 87.6 ^e |
| 21. Family Health Teams – FHTs | Thousand | ⇒ | ⇒ | ⇒ | 0.3 | 0.7 | 0.8 | 1.6 | 3.1 | 4.9 | 7.9 | 13.3 | 14.5 ^e |
| 22. Pop. covered by FHTs | Million | ⇒ | ⇒ | ⇒ | 1.1 | 2.5 | 2.9 | 5.6 | 10.6 | 14.7 | 29.7 | 45.4 | 52.4 ^e |
| 23. Child vaccination – Avg. coverage ^c | % of age group | 71 | (::) | (::) | (::) | 85 | (::) | (::) | (::) | (::) | (::) | 99 | (***) |
| 24. Net federal health exp. per capita | 2002 R\$ | (::) | (::) | 113.4 | (::) | 141.8 | (::) | 144.8 | (::) | 142.3 | (::) | 143.3 | (***) |

Table 2 (continuation)

| INDICATOR | Unit | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|--|----------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Household conditions – Access to | | | | | | | | | | | | | |
| 25. Piped water | % / households | (---) | 77.4 | 79.2 | (---) | 80.5 | 83.9 | 83.5 | 85.0 | 85.9 | (---) | 86.6 | (***) |
| 26. Mains sewerage | Idem | (---) | 51.2 | 52.5 | (---) | 51.0 | 54.2 | 53.2 | 55.2 | 55.1 | (---) | 54.4 | (***) |
| 27. TV (color) | Idem | (---) | 46.3 | 50.3 | (---) | 61.1 | 69.7 | 74.7 | 78.8 | 80.2 | (---) | 82.9 | (***) |
| 28. Refrigerator | Idem | (---) | 72.1 | 72.6 | (---) | 75.4 | 78.9 | 80.8 | 82.3 | 83.1 | (---) | 84.7 | (***) |
| 29. Fixed telephone lines | Idem | (---) | 19.0 | 19.9 | (---) | 22.6 | 26.0 | 28.6 | 33.2 | 39.0 | (---) | 50.3 | (***) |
| Education and related indicators | | | | | | | | | | | | | |
| 30. School enrolment 7-14 ^c | % of age | 80.5 | 87.0 | 88.7 | 88.0 | 90.2 | 91.3 | 93.0 | 94.8 | 95.7 | 97.0 | (***) | (***) |
| 31. Idem, 15-17 | Group | (---) | 60 | 62.1 | (---) | 66.4 | 69.4 | 73.4 | 76.3 | 78.5 | (---) | (***) | (***) |
| 32. Idem, 18-25 | Idem | (---) | 21 | 22.9 | (---) | 24.8 | 26.2 | 27.2 | 29.7 | 31.6 | (---) | (***) | (***) |
| 33. Federal govt. expenditure in education | 2002 R\$bi | (::) | (::) | (::) | (::) | 13.8 | 12.3 | 12.4 | 13.0 | 12.5 | 13.0 | 13.0 | (***) |
| 34. Child labor 10-14 | % of age | (---) | 18.5 | 17.7 | (---) | 16.5 | 13.9 | 13.6 | 12.7 | 12.3 | (---) | (***) | (***) |
| 35. Illiteracy rate 7-14 | Group | (---) | 19.8 | 19.5 | (---) | 17.2 | 14.4 | (::) | 13.1 | 11.4 | (---) | (***) | (***) |
| 36. Illiteracy rate 15+ ^c | Idem | 18.3 | 16.9 | 16.2 | (---) | 15.6 | 14.7 | (::) | 13.8 | 13.3 | (---) | (***) | (***) |
| Other | | | | | | | | | | | | | |
| 37. Human Dev. Index (HDI) ^c | Ratio to 1 | 0.710 | (---) | (---) | (---) | 0.734 | (---) | (---) | (---) | 0.740 | (---) | 0.750 | (***) |
| 38. Family Development Index | Idem | (---) | 0.69 | 0.70 | (---) | 0.71 | 0.72 | 0.72 | 0.73 | 0.73 | (---) | 0.73 | (***) |
| -Vulnerability | Idem | (---) | 0.73 | 0.73 | (---) | 0.74 | 0.73 | 0.73 | 0.74 | 0.74 | (---) | 0.75 | (***) |
| -Access to knowledge | Idem | (---) | 0.50 | 0.51 | (---) | 0.52 | 0.52 | 0.52 | 0.53 | 0.53 | (---) | 0.54 | (***) |
| -Access to work | Idem | (---) | 0.60 | 0.62 | (---) | 0.63 | 0.64 | 0.64 | 0.63 | 0.63 | (---) | 0.60 | (***) |
| -Availability of resources | Idem | (---) | 0.76 | 0.75 | (---) | 0.80 | 0.80 | 0.79 | 0.80 | 0.79 | (---) | 0.79 | (***) |
| -Infant development | Idem | (---) | 0.84 | 0.84 | (---) | 0.86 | 0.87 | 0.87 | 0.88 | 0.89 | (---) | 0.91 | (***) |
| -Household conditions | Idem | (---) | 0.71 | 0.72 | (---) | 0.74 | 0.76 | 0.76 | 0.77 | 0.79 | (---) | 0.81 | (***) |

Source: lines (1)-(2), (4), (30)-(32), (34)-36): IBGE's PNAD (National Household Survey) data, assembled by IPEA (Institute of Applied Economic Research); (3), (10), (13): *Mercado de Trabalho: Conjuntura e Análise*, October 2002; (5), (33): *Folha de S.Paulo*, Oct.19,2002; (6): IPEA; (7)-(9),(11): Ministry of Social Security and Welfare; (12), (14), (16), (25)-(29): IBGE's PNADs data processed by the author; (15): Ministry of Labor and Employment; (17)-(24): Ministry of Health; (37): UNDP (United Nations Development Program); (38): Courtesy of Ricardo Paes de Barros, who used IBGE's PNADs data.

Note: (---) data do not exist or comparison is handicapped by different surveying criteria; (***) data not yet available; (::) data not included in publication by source; ⇒ new program starting at first year for which data or reference to them is shown.

^a Up to August; ^b Up to September; ^c 1990 data; ^d 2002 figures are estimates; ^e Employees of private firms and government. ^f In addition to formal employees of private firms and government, includes domestic servants under contract, employers and self employed workers affiliated to the social security system.

The Brazilian experience demonstrates that containing high inflation reduces poverty. In addition to the reduction in the “inflation tax”, the poorest groups, and wage earners in general, benefited from the reduction in inflation in another way. It came from the fact that labor earnings usually lag behind price increases when inflation accelerates and this had caused serious losses before the *Real Plan*. Such losses were only partially mitigated by the widespread use of indexation mechanisms, as they were based on price indices and applied to earnings only with a lag.

A previous experience revealing a similar impact was the Cruzado Plan, in 1986, which brought a short-lived stabilization of prices.¹⁷ Poverty reduction then, however, was also short-lived, because the plan did not go beyond a price freeze, lacking consistent macroeconomic policies to sustain the price stability reached at first. Thus the results vanished rapidly, being replaced by new and serious inflationary spurts to be controlled effectively only with the Real Plan, after a series of failed stabilization plans: Cruzado II (end of 1986), Bresser (1987), Verão (1989), Collor I (1990) and Collor II (1991).

Still looking at the indicators that use the poverty and extreme poverty lines, it can be seen that they made no further progress in more recent years.¹⁸ Moreover, as the table reveals in line 3, the average earnings of the occupied labor force in metropolitan areas has been falling since 1999. These earnings are more linked to growth and they are therefore suffering the stress caused by a weaker performance of the economy in Cardoso’s second term.

With respect to income distribution, the GINI coefficient remains close to a “historical constant”, as the values presented in the table remained roughly the same. Variations are minor and might result from sampling errors only. Moreover, given the very high interest rates practiced in Brazil, and the huge sums spent by the government in servicing its debt, it is actually surprising that income distribution did not get worse. In fact, there are reasons to believe that the income from financial investments, which have benefited from the high interest rates, is usually underreported in the census and other household surveys.¹⁹

A.2 Social expenditures, social security and social assistance

Two reasons explain the stability of the poverty line indicators in conditions that have already caused a negative impact on earnings. The first was that inflation was kept low, and therefore not exerting the serious eroding effect on real incomes that it had before the Real Plan. Second, as economic growth became sluggish at the end of the nineties and thereafter, gains in poverty reduction were also sustained by increased income transfers directed by the federal government to the poorest groups, in particular those including retirees, pensioners and poor families with children at school.²⁰

¹⁷ In 1986, according Barros, Henriques e Mendonça (2000), the percentage of people living below the poverty line in the São Paulo metropolitan region was reduced from 43,6%, in 1985, to 28,2%, in 1986, but then bounced to 40,9% in 1987. A similar movement was observed in the case of the extreme poverty line.

¹⁸ Moreover, as inflation moved to a higher rate in 2002 (line 1 in Table 1), this raises concern that these indicators might be deteriorating.

¹⁹ The income from financial investments is taxed at the source only. Thus many people do not care to report it in their income statements and it is likely that they do the same when answering to household surveys. Moreover, due to the tradition of high inflation and indexation, many people continue to see financial income as indexation of their financial assets and not as an independent financial flow. In addition, a part of financial income comes in the form of profit of financial institutions, not necessarily distributed to shareholders.

²⁰ Recall that retirees and pensioners are not, in general, accounted for by the data on earnings, which refers to the occupied labor force only.

To understand the nature of these income transfers, we move initially to the next grouping of indicators, which covers federal social expenditures and benefits from the federal social security and welfare system. Other forms of income transfers will also be addressed in the next subsection.

There was an impressive increase in total federal government social expenditures, from 11% of GDP, in 1994, to 14% in 2001, as shown in line 5.²¹ These figures also include social security benefits and social assistance or welfare expenditures, which grew faster than other social ones. In Brazil, the federal government has a single system, known as INSS (National Institute of Welfare and Social Security) for handling both social security and welfare benefits for those that work or have worked in the private sector.²² It is also a welfare system because within it many retirees and pensioners, particularly those from rural areas, receive a monthly benefit without having paid a contribution to INSS in their working years. The system also pays benefits to old and disabled people, regardless of a regular contribution in the past. For later use, as well as in Table 2, the social security and welfare system monthly benefits will be referred to as SSWSMB and further described in Subsection B.

Lines 7 and 8 show impressive increases in the numbers, in millions, of persons receiving the SSWSMB in both urban and rural areas, the sharper increase occurring in the latter, which is poorer. A new benefit for the handicapped and aged (line 9), created in Cardoso's tenure, also moved rapidly to increase its coverage. Moreover, it can be seen that the minimum SSWSMB, which is also the legal minimum wage and covers most of those receiving the SSWSMB, has increased in real value. Its value is reexamined every year. In essence, it is indexed to inflation and during Cardoso's years the policy was to give it annually an increase in real terms on an "ad hoc" basis.

It is worth noticing that the expansion of transfers from the social security and welfare system increased in coverage and in value even when economic growth was very weak, and thus acted in a counter cyclical fashion in this period, although they are permanent benefits. This move, which included the expansion of existing programs and the establishment of others to be examined in this and in the next subsection, was one of the reasons for the tax burden increase shown in line 6 of Table 1. Behind this move was the fact that when Cardoso advanced into his second term the *Real Plan* had lost momentum as a political banner, since its effect on inflation was taken for granted by the population and growth had become sluggish. The government was also under criticism for its liberal positions. To show its social concern, it moved into enhancing the social programs, also with an eye at the 2002 election. José Serra, who had been Cardoso's minister of Planning in its first term, was chosen to run the ministry of Health and later became the government's candidate.

A.3 Employment and unemployment

The economy's poor performance that played a role in reducing the earnings indicator in line 3 since 1999 is also reflected, in lines 12 and 13, by the increase in unemployment rates. The rise in unemployment rates did not stop, however, the continued expansion of the occupied labor force (line 14). The number of formal workers also increased, but their share reached its lowest point in 1999 (lines 15 and 16). Thus the informal market continued to represent an important buffer, accommodating a larger proportion of workers that cannot find formal occupations. This role of

²¹ Taking into account its percentage of tax collections, the value of this spending fell 60% to 55% in the same period. This was due to the fact that a major part of the increased tax burden was used to generate a primary surplus in the government accounts and then used to pay interest on its debt, as shown by Table 1.

²² A minority of public servants, and retirees and pensioners of the public sector are also covered by the same system. Most are under the umbrella of different systems at the federal, state and local governments.

the informal market only alleviates the problem, as earnings are lower in this market and its workers have less protection from the government's social apparatus.

This trend was reverted between 1999 and 2001, when the number and the share of formal workers increased faster than the total occupied labor force. This was caused mainly by a new law that reduced taxes and social security contributions for micro and small firms, therefore encouraging formalization of labor contracts.²³ Thus, it was rather a formalization of employment than a genuine increase in the number of employed workers.

Thus, although accommodating more people the labor market in Brazil offers a dismal picture, as earnings deteriorate in the wake of sluggish demand for labor and informal activities inflate as a survival strategy for many. This picture is even worse for young adults who face the highest unemployment rates.²⁴ It is in this group that an increasing number have been attracted to criminal activities that have shown a sharp increase.²⁵

Thus, although the government has alleviated poverty and improved human conditions by resorting to various means described in this section, a sustained solution will not come unless economic growth is accelerated and labor market conditions show a major improvement.

A.4 Health and household conditions

The third group of indicators in Table 2 covers health conditions. Progress is revealed by the various indicators of child mortality, life expectancy at birth, and health services provision - including some new programs -, as shown in lines 17 to 24. The first two fell as part of a long-term process and cannot be attributed only to developments occurring during Cardoso's government. In any case, they are part of a consistent set of improvements shown by the table. In the case of child mortality rates, an important move was the almost full coverage of the infant population by vaccination programs, as shown by line 24.

The table also includes data on the federal government's net expenditures "per capita" in health (line 22). These expenditures exclude spending on government personnel and retirees in the area, thus better reflecting spending on direct activities. Among new programs, two are worth mentioning as they received major improvements: the Family Health, developed by the Family Health Teams (FHTs), and the Community Health Program, developed by the Community Health Agents (CHAs). They have expanded rapidly both in terms of staff and population covered, as shown by lines 17 to 20.²⁶ Still in the area of health, but not covered by the indicators in the Table 2, it is also worth mentioning the efforts made by the federal government to introduce generic drugs in Brazil. Until 1999, they were practically unknown to the population as no-brand products that

²³ Chahad and Macedo (2002). The law established a single tax rate in lieu of all federal taxes (except the one on financial transactions), and social security contributions. It is charged monthly on the value of sales, regardless of the number of employees and the value of payroll.

²⁴ The rates of unemployment in the 15-17 and 18-24 age groups were roughly twice the average rate of unemployment in the six largest metropolitan areas in Brazil, in 2001, according to IBGE's Monthly Employment Survey.

²⁵ Subsection D will present data showing the increase in the State of São Paulo.

²⁶ The FHTs are composed of a medical doctor, a nurse, a nurse assistant and five or six community health agents (CHAs). These agents live in the area covered by the team. The team's work is essentially preventive, providing guidance and seeking to identify illness at its start. The FHTs also work in emergence work and in screening patients before they seek help at the public hospitals. One of the tasks is to reduce crowding at these hospitals, as there is tradition of seeking them for all consultations and the simplest medical procedures. The CHAs have been initially created as a separated group to provide various services, such as preventive care, guidance to the public services in the health area, vaccination drives and inspection of housing conditions to prevent spread of diseases such as dengue. A decision has been taken to convert the existing CHAs into FHTs as new teams of this sort are created. Therefore, the trend is to work only with FHTs.

can be bought at lower prices. Measured in units (boxes), the penetration of generic drugs increased from 4.6 million, in 2000, to an estimated 71.5 million, in 2002, or 7% of the total.²⁷

Health conditions depend very much on household conditions. In the next group of indicators the table documents important advances in access to treated water and sewage facilities. Other items have been added as they are indirectly related to health access. For example, a greater access to TV has, for instance, facilitated the effectiveness of vaccination and anti-AIDS campaigns, which have received intense media coverage. A refrigerator is important in preserving food and a telephone line helps the access to several services in the area of health. New telephone lines, which used to cost a few thousand dollars before privatization, are now offered in abundance and have also reached even part of the poorest groups.

A.5 Education

Moving to the next group of indicators, those of educational nature, it is well known that a better educational status does not have an immediate impact on poverty and income distribution, but it is important for planting seeds for future gains. In Brazil, however, a specific educational program at the federal level has combined education with income transfers to the students' families, therefore having an immediate impact on poverty reduction. It is the program known as Money in School (Bolsa-Escola), which provides monthly grants in cash to poor families that enroll their children in school. This program will receive additional attention in the next subsection. Another federal program that deserves attention is not based upon income transfers to families but it has caused a major shift in the allocation of public resources to education. It is the Fund for the Maintenance and Development of Elementary Education and the Teaching Career, known as FUNDEF. It allocates federal money to state and local governments when their constitutionally required minimum expenditures on education do not reach a guaranteed minimum expenditure per student as set by the program. It also provides resources to promote higher qualification for teachers and enhanced career opportunities.²⁸ Both programs have been addressed to the so-called fundamental schooling, the first 8 grades.

It is important to have the Money in School and the FUNDEF programs in the background when analyzing the educational indicators in Table 2, whose improvement reflects another accomplishment of Cardoso's government in the social area. The increase in school enrollments for children between 7 and 14 (line 30) has almost reached 100%, thanks in part to these two programs. Enrollment increases for 15-17 year olds (line 31) were also significant, but the educational coverage of this age group is still low and singles it out as a major target for a next round of improvement of educational conditions. The improvement of enrollment in the 18-25 group (line 32), largely of college students, occurred mainly in private schools, as the federal government contained its own expenditures in third level education, as shown by its stagnant total real expenditures in education (line 33). As federal programs such as the Money in School and FUNDEF expanded supported by federal grants to the state and local governments, there was a crunch on the federal colleges and universities, where the direct role of the federal government in education is concentrated. Still in this group of indicators, child labor (line 34) reveals a sizable reduction, which has been the result of stronger law enforcement and the workings of programs such as the Money in School and FUNDEF. Illiteracy rates (lines 35 and 36) also fell following improvements such as those just described and specific programs for adults.

²⁷ As reported by *O Estado de S. Paulo*, December 29th, 2002, quoting ANVISA, the federal government agency in charge of licensing drugs. This increased presence of generic drugs is now evident at the drugstores counters, as the boxes are distinguished by their conspicuous yellow labels. The concept of generic drugs became popular, in spite of initial difficulties.

²⁸ Almeida (2001).

A.6 General indicators: human and family development

The last group in the table includes two indicators. The first is UNDP's Human Development Index, which shows in line 37 an improvement also consistent with the overall results shown by other indicators presented in the table. The second is a new index, the Family Development Index (IDF) announced in early November 2002, and presented from line 38 on. It is the work of Ricardo Paes de Barros, an economist well known for his studies of the labor market and social issues. The IDF is based on data from the annual National Household Surveys (PNADs) undertaken by the Brazilian Census Bureau (IBGE). The index inputs are 49 indicators of family development. The indicators are aggregated into six groups or dimensions: vulnerability (covering data on fertility, mother's presence in the household and economic dependence, among others), access to knowledge (education and vocational training and others), access to work (employment, work quality, income and others), availability of resources (poverty and others), child development (infant work, infant mortality, schooling and others) and housing conditions (type of housing, availability of services and of durable goods, and others). Measured in aggregated form, the IDF ranges from 0 (no access) to 1 (total access).²⁹

The IDF has the advantage of condensing scattered information of the type shown by other indicators in Table 2. Focusing on the large number of factors that influence family development, it goes well beyond income as a measure of poverty. In any case, it confirms the view that poverty was alleviated during the Cardoso years. Notice also that the IDF has shown no increase since 1998, therefore revealing the same stress suffered by other indicators in recent years. Given the current macroeconomic picture, this raises concern about the perspectives for further poverty alleviation in Brazil, an issue to be resumed in Section III.

Before moving to the next subsection, it is important to clarify an additional aspect of the government social expenditures. Table 2 includes only federal social expenditures, as we found no consistent series that included also expenditures at the state and local levels. It should be noticed, however, that all three levels of government are subject to constitutional requirements for expenditures in these two areas, in the form of a minimum rate of their tax collections. In the case of education, the rate for the states and local governments is a minimum of 25%. Health expenditures at the state level must absorb at least 12% of their tax receipts, while local governments must expend at least 15%, but in both cases the deadline for a adjustment to these limits is 2004, with a minimum of 7% in 2000 and a progressive adjustment at the rate of one fifth of the difference per year. All these details point to the conclusion that the expenditures at the state and local governments have very likely gone up, as their taxes collections have grown and the federal government pushed them into spending more, as in the above mentioned case of the FUNDEF program in education.

B. The role of income transfers

In the previous subsection, the increase in income transfers by the federal government was singled out as an important factor in alleviating poverty in Brazil. To further clarify the role of these transfers, this subsection details the federal programs designed for this purpose. These programs are described in Table 3 and reached a total of R\$27 billion, or roughly 2.5% of GDP. To focus the discussion on the aspects that are more relevant to the objective of this study, such as

²⁹ The IDF can be used to monitor different groups of the population. At the regional level, for instance, in 2001 the state of São Paulo, in the Southeast, showed the largest value (0.80), while the lowest was found in the state of Maranhão (0.61) in the Northeast. Reflecting the wide social inequality that prevails in Brazil, Paes de Barros has found values as low as 0.18 in some families.

the impact on poverty reduction, three of them are initially singled out in the information provided by the table, by a gray shade over their names in the first column.

The first aspect is that these three programs are among the four most important ones, that is, those having a higher total cost and a wider coverage in terms of the number of persons they attend. Moreover, they have either been established in the period 1995-2002, such as the Money in School program (line 3) and the Disability Benefit, regardless of social security contribution (line 10), or, although inaugurated before, came into full force in the same years. This is the case of the Rural Workers Pension (line 9).

The second aspect emerges from the fact that these three programs have been targeted to the needs of groups that are particularly vulnerable, that is, the children in the case of first program, and the old, in the case of the second and third programs. Within these groups, the poorest individuals, either defined by themselves or their families, have been targeted by the programs.

The third aspect is that the majority of the income transfer programs, including the major ones, are indexed to the value of the minimum wage, as shown by various gray shades in the second and third columns. Therefore, their beneficiaries have benefited from the increase in real value of the minimum wage in the Cardoso years, as shown in line 10 of Table 2. This increase, therefore, again shows its role as a major development in alleviating poverty in Brazil.

In addition to these points, it is important to understand how the administration of income transfers is made. Over the years, the government has assembled a roster of the groups that qualify for these programs. Once a person or a family qualifies, the benefits in cash are paid in bank branches and/or automatic teller machines scattered all over the country, as the Brazilian banking system has managed to reach even the most remote areas. The various banks and their branches are integrated on line and in real time by a paraphernalia of modern means of telecommunications. All municipalities, which number around 5,500, have either a branch of the federal savings bank (*Caixa Economica Federal*), or a representative in charge of making payments such as the SSWSMB, as well as other income transfers. Moreover, the latter can also be picked up at federal lottery stands, scattered all over the country. In some cases, such as the Money in School program, the benefits are paid to the mother of the family, to reduce misspending risks.

Table 3

SUMMARY OF MAJOR FEDERAL INCOME TRANSFER PROGRAMS (2002)

| Program | Target Population | Benefit | Number of Beneficiaries | Cost:R\$ Million ³ |
|---|--|---|--------------------------------|-------------------------------|
| 1. Food Money (Bolsa-Alimentação) ¹ | Children between 0 and 6 years old, pregnant and nursing women in families living on up to ½ minimum wage per capita | R\$ 150.00 per children up to 3 children | 1,623,000 | 300 |
| 2. Child Labor Eradication (Programa de Erradicação do Trabalho Infantil) – PETI ¹ | Children between 7 and 14 years old performing insalubrious, hard or degrading labor, in families living on up to ½ minimum wage per capita | R\$ 25.00 per children in rural areas and R\$ 40.00 in urban areas | 813,000 | 411 |
| 3. Money in School (Bolsa-Escola) ¹ | Children between 6 and 15 years old in families living on up to ½ minimum wage per capita | R\$ 15.00 per children up to 3 children | 10,195,000 | 1,835 |
| 4. Youth Development Agents Program (Agente Jovem de Desenvolvimento) ¹ | Youth between 15 and 17 years old living in low-income communities and on a family income per capita of up to ½ minimum wage. | R\$ 65.00/month | 51,900 | 52 |
| 5. PIS-PASEP Wage Bonus (Abono Salarial PIS/PASEP) ² | Worker who received on average up to 2 minimum wages in the previous year, and has been enrolled in the PIS/PASEP for at least 5 years, and who has worked in the previous year (employed for at least 30 days). | 1 minimum wage | 5,185,016 | 884 |
| 6. Professional Training Grant (Bolsa Qualificação) ² | Worker whose contract was suspended, enrolled in a course or professional qualification program offered by the employer | Based on the 3 last monthly wages received by worker | 10,417 | 12 |
| 7. Unemployment Insurance (Seguro-Desemprego) ⁴ | Worker (including domestic) who is dismissed without legal reasons and fishermen during the period in which fishery is prohibited. | 1 minimum wage for domestic workers and up to R\$336.78 for others and fishermen. | 133,530 4,120,991 75,844 | 5,166 |
| 8. Harvest Insurance (Seguro-Safra) | At-risk families in drought-stricken areas | R\$100/installment (up to 6) | 938,148 | 253 |
| 9. Cooking gas bonus ⁵ | Poor families in general, with per capita income up to ½ minimum wage | R\$7.50 per month | 6,001,145 | n.a. |
| 10. Rural Workers Pension (Aposentadoria Rural) ¹ | Rural workers | 1 minimum monthly wage | 6,370,547(*) | 15,562 |
| 11. Disability Benefit (Benefício de Prestação Continuada) ¹ | Seniors over 67 and disabled living on a per capita monthly income of up to ¼ of the minimum wage | 1 minimum monthly wage | 1,450,660 | 3,284 |
| 12. Old Age Pension (Renda Mensal Vitalícia) ¹ | Citizens 70+ or disabled without family support or other income | 1 minimum monthly wage | 724,124 | 1,687 |
| TOTAL | | | | 27,928 |

Source: Presidency's Civil Office.

Note: ¹Transfers without contributions from beneficiaries

²Transfers with some contributions from beneficiaries.

³ 2002 Union's Budget Appropriations Project.

⁴ With and without contributions.

⁵ Programs that started in 2002

To further illustrate the workings of the Money in School program and welfare benefit for rural workers, we briefly describe them. The first allocates funds from the central government's share of the Education Tax on Payroll (Salário Educação). The program is managed at the end line by local governments and schools that screen the children and families that qualify for the program. The goal is to stimulate families to bring their children to school. The program started at the local level, in the cities of Brasilia and Campinas, and has received favorable evaluation by

international agencies, such as the World Bank. The project also stimulates community participation in school management.³⁰

The welfare benefit for rural workers is paid to workers in rural areas who retire by age or length of service, as well as to their survivors entitled to pensions. Eligibility is based on proof of formal or informal contracts, including testimonial evidence. In the past, their access to the SSWSMB was very limited, due to the requirement of formal social security contributions. An analysis by Gomes (2001) shed light on how the combination of an increase in the number of retired people, particularly of rural workers, plus the increase in the real value of the minimum wage, made a strong impact on living conditions in the poorest of the Brazilian regions, the “drought-stricken Northeast”. This region had in 1997 a population of 25 million scattered in 1,122 municipalities, of which 2.2 million were receiving SSWSMB. The sum of these benefits then represented 133% of the formal wage bill of the private sector in the region and 20% of total money income of the families. Gomes estimated that in this region the value of SSWSMB payments, plus the payroll of public servants of local governments, is larger than the income provided in isolation by the economic activities, excluding government. Moreover, the amount of the SSWSMB payments is larger than the revenue sharing transfers from the federal and state governments that make up for the majority of resources that sustain local governments and their payroll in the region. Gomes painted the picture as an “economy without production”.³¹

To provide a broader picture of the impact of the SSWSMB and other public pensions on poverty, Figure 1 shows the profile of poverty distribution by age in 1999. The two poverty lines in the Figure show that when all income is considered, the poverty line at the bottom is a lot lower than the other line, where the income from SSWSMB and other public pensions was excluded.

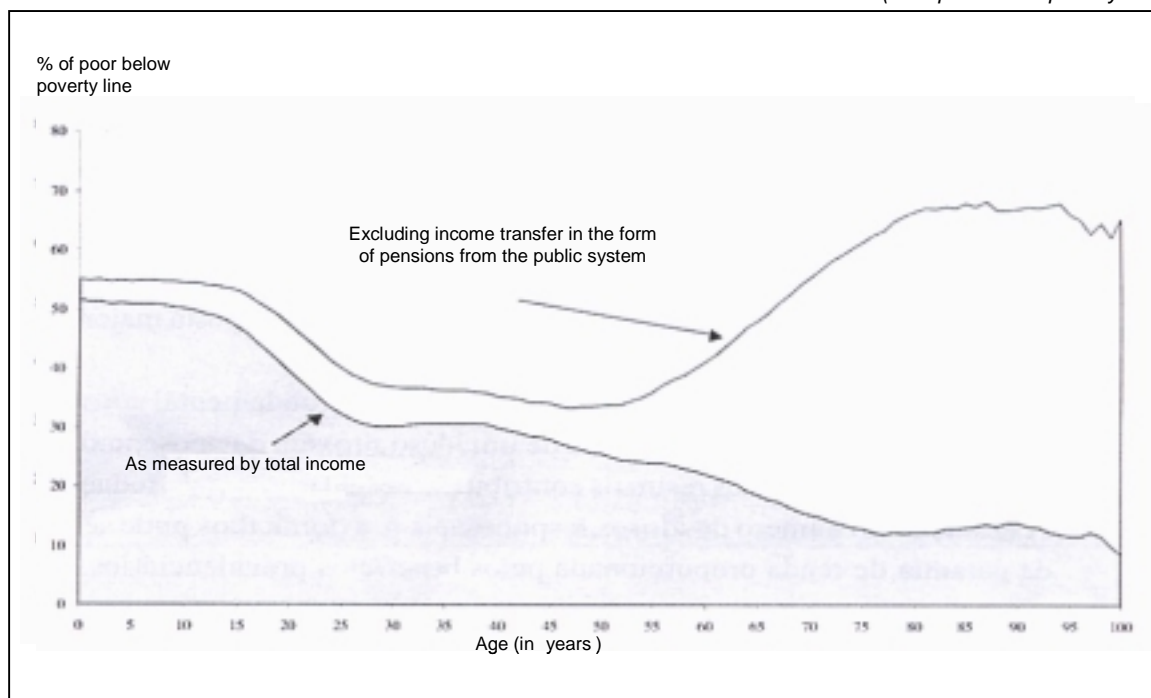
Thus, Brazil has become a country where the income transfers from the government now plays a major role in alleviating poverty conditions. This feature also stands out also in international comparisons. Thus, an analysis of the composition of household income in 18 Latin America countries in 1999 revealed that Brazil, together with Uruguay, has the largest rate of income transfers in this composition, second only to wage income.³²

³⁰ Idem, p.25. Some state and local governments continue to move in adopting similar programs, such as the city of São Paulo. A pioneer was Brasilia, whose former governor, Cristovam Buarque, of Lula’s Workers’ Party, became now his Minister of Education and has been pressing for additional funds to push the program further at the federal level.

³¹ Gomes (2001), chapter 5.

³² ECLA (2002).

Figure 1
POVERTY LINE BY AGE (*) – 1999
 (% of poor below poverty line)



Source: IPEA with PNAD data, as published in Informe de Previdência Social (14):19 (September, 2002).

Notes: (*) Poverty line: R\$ 98 per month.

C. Consumer prices

To further understand some of the improvements experienced by the poor in their living conditions, as well as some additional hardships they came to face, a brief picture will be presented of the price changes of major items of their cost of living from 1994 to 2002. A review of consumer prices is also important because leads to policy implications in the area of poverty alleviation. Table 4 shows the increase in the cost of living index in the city of São Paulo, together with the changes for its major items in aggregated form. For later use we have added some detailed expenditures: housing rent, electricity, water, telephone and cooking gas. Looking at the major items, food prices lagged behind other prices, thus representing another positive factor in alleviating poverty conditions. Clothing prices added another plus, as they showed an amazing stability against a cost of living that increased by an average of 108%.

Table 4
CITY OF SÃO PAULO – COST OF LIVING CHANGES BY NATURE OF EXPENDITURE
(JULY 1994 TO SEPTEMBER 2002)

| Nature of expenditure | Change in % (percentage) |
|----------------------------|-----------------------------|
| Household maintenance | 202 |
| - Rent | 535 |
| - Water and sanitation | 169 |
| - Electricity | 174 |
| - Fixed telephone services | 500 |
| - Cooking gas (*) | 355 |

| Nature of expenditure | Change in % |
|-----------------------|-------------|
| Food | 67 |
| Transportation | 160 |
| Personal expenditures | 69 |
| Health | 155 |
| Clothing | 1 |
| Education | 182 |
| TOTAL | 108 |

Source: FIPE – Foundation Institute of Economic Research.

Note: (*) Bottles of liquefied petroleum gas.

At the other extreme, housing rent skyrocketed. There is no solution in sight for housing rental prices, although a public policy for alleviating the problem is badly needed. It should be noticed that many among the poorest families, either in a city like São Paulo or deep in the “drought-stricken Northeast” live in their own precarious “houses”, as they cannot afford to pay rent. In the large cities, badly assembled housing in precarious neighborhoods have been a major factor behind the high crime rates in these areas. Regardless of their housing conditions, most families pay the cost of public services in the form of electricity, water, and, in a few but increasing cases, also telephones, whose price change show the largest increase in the table. The case of cooking gas will be commented later on.

We are convinced that the price of these services reveal distortions that should be the concern of government policy in general and social policy in particular. Following privatization, or even before it, as the state companies were prepared for sale, more realistic tariffs were adopted. Moreover, with the memory of inflation still prevailing, most public tariffs have been annually linked to price indices, in order to avoid an uncertainty on the part of private investors that could discourage them from participating in the privatization auctions.

The distortion comes from the fact that the price index used for indexation is a general price index that has been contaminated, more than CPI indices, by dollar linked prices, such as those of commodities. This has been true particularly after 1999 because of the various devaluations of the *real* that occurred since then.

Thus, an undergoing discussion in Brazil is that these indexation contracts should be reviewed. An alternative would be to have the tariffs indexed by sectoral prices reflecting their costs, and not prices in general. A major obstacle is that the whole issue has been cast by the providers of these services in terms of “respect to existing contracts” and the elected president has been pressured to abide by this rule. Foreign investors also think in terms of dollars and they see even the current indexation as unsatisfactory. In spite of this sensitivity, its clearly an issue that requires reexamination, because it is a case in which the effects of greater macroeconomic volatility and international exposure are causing distortions in domestic prices which have major impact on consumers, in general, and on the poorest ones, in particular.³³

The case of cooking gas is singled out because although provided by private distributors it has the characteristic of a public service and is present in most of the Brazilian households. Moreover, at the end of November, 2002, a 13kg bottle, the average monthly consumption per family, was costing around R\$25, or 12.5% of the minimum wage (R\$200). For decades and until 2001, the cooking gas price was subsidized at the refinery, but this had the effect of favoring all consumers, including business. Starting in 2002, the government eliminated this subsidy and opted

³³ A note on existing lower tariffs for low consumption groups will be added.

for a new one, shown in Table 3, again in the form of an income transfer, at the rate of R\$7.5 per family per month. As the transfer is provided to the consumers, the cooking gas price changes shown in Table 4 do reflect the end of old subsidy but not the impact of the new one.

This scheme that combines a more realistic price with a subsidy targeted to the poorest groups is worth of attention, as it could serve as a model for other public services with serious increasing costs. In any case, as in other services in Table 4, there is room for disputing the way the price is set. The cooking gas price is linked to the international market and has risen very fast in the wake of the recent increases in the price of oil and in the exchange rate. Moreover, it is supplied in wholesale practically entirely by Petrobrás, the giant state enterprise in the oil production, import, refining and distribution business. Although Petrobrás has formally lost its monopoly in the upstream market, in practice it has not suffered significant competition, as private investors are still reluctant to face its power. In such conditions Petrobrás has continued to act as a monopoly and in the case of cooking gas it sets domestic wholesale prices to CIF international prices even for the product produced in Brazil. In fact, its import prices are set by long-term contracts and specific deals where it gets prices below international ones and the CIF clause makes no sense for the local production. Thus, there is room for disputing these monopolistic practices to reduce the price of cooking gas, but thus far Petrobrás has remained virtually unchallenged.

To sum up: the behavior of the prices of major items of cost of living show wide dispersion and reveal room for policies concerned with alleviating the burden of the cost of public services to the poorest groups, which became heavier following deregulation and privatization, as well as in the case of a basic need such as housing.

D. Violence and crime

Crime rates are high and increasing in Brazil. As there is an enormous pressure on the government to react effectively, it is moving additional resources for this purpose and there is evidence that this is compromising resources that otherwise could be directed to social programs, such as those in the areas of education and health.

The fact that crime rates are high can be illustrated with some comparisons. For instance, the city of Diadema, in the greater S. Paulo, had in 1997 a murder rate of 146.1 per 100 thousand habitants. Medellín well known for its high crime rates, had 248, São Paulo 55.8, Santiago 8 and Buenos Aires 6.4.³⁴

Crime is an issue treated at the state level and we obtained data for the State of São Paulo that show both the increase in crime rates and the strain that the response of the state's security apparatus is putting on resources that could be assigned to other uses. Table 5 shows the percentage increase in various types of crimes from 1995 to 2001 and their rates per 100 thousand inhabitants at the end of this period, for the state as a whole and the city of São Paulo. For comparison purposes, the rate of population growth in the same period is also presented in both cases.

Following the increase in crime rates, the state is investing a lot more in security: more policemen, equipment and prisons, a move that is absorbing increasing resources from the state's budget. This is shown by the share of expenses in security, which has increased from an average of 15.1% of the disposable receipts of the executive branch in 1991-93, to an average of 18,1% in 1998-2000. In more recent years, on the basis of another definition of the disposable receipts of the

³⁴ Lisboa (2002).

executive branch, the share of security expenses continued to increase, from 19,1% in 2000, to 19,4% in 2001 and 20,6% as predicted in the 2002 budget.³⁵

Meanwhile, the state has complied with the constitutional requirements for expenditures in health and education, but at their minimum rates. It is clear that without the push in security expenditures the state of São Paulo could have invested more in these areas or in others, such as infrastructure or in housing, where investments are also badly needed.

Table 5

**STATE OF SÃO PAULO AND ITS CAPITAL – % INCREASE in crimes by type
AS COMPARED TO POPULATION GROWTH (1995-2001) and crime rates (*) BY TYPE (2001)**

| Region/Population/Crimes by type | % increase (1995-2001) | 2001 rate (*) <i>(percentage)</i> |
|----------------------------------|---------------------------|--------------------------------------|
| Estate of São Paulo | | |
| Population | 12.7 | |
| Theft | 51.1 | 1,165 |
| Robbery | 117.4 | 582 |
| Stealing and robbery of vehicles | 85.2 | 569 |
| Intentioned homicides | 27.0 | 33 |
| City of São Paulo | | |
| Population | 8.0 | |
| Theft | 35.7 | 1,091 |
| Robbery | 111.4 | 1,059 |
| Stealing and robbery of vehicles | 54.4 | 1,027 |
| Intentioned homicides | 7.8 | 49 |

Source: State Secretary of Security. Data assembled by the Fernando Braudel Institute.
Note: (*)Per 100 thousand inhabitants.

E. The social impact of globalization, privatization and trade liberalization

As in the previous section, we look at these three processes, this time outlining some of their social implications. We start with privatization, as it bears a close relation to the prices paid by consumers for public services, as examined in the previous subsection. As already pointed out, privatization made companies more efficient, although with costs such as higher prices for more accessible public services. Following privatization, regulatory agencies were formed in various sectors – oil, electricity and telecommunications among others – but their work has not yet been scrutinized. The discussion of the previous subsection indicates that there is room for the dispute of these agencies practices in the area of prices, as they face the risk of a pro-business bias and low concern for the public interest. This is an important issue for policy-makers, among other reasons because of the impact of the public tariffs on the real earnings of the poorest.³⁶

The impact of privatization on employment by former state enterprises was initially negative and directly linked to the efficiency gains brought by new managers more focused on profits than the former ones. In a second stage and in some cases, the impact on employment was positive. For instance, in telecommunications, following the industry's expansion after privatization, employment increased through outsourcing and various downstream activities generated by the expansion, such as the installation of new lines and enormous call centers. Even manufacturing companies that went through privatization present signs of recent increases in employment due to expansion of their activities. On balance, the picture that emerges is one of a fall in direct

³⁵ According to data assembled by the state Secretary of the Economy and Planning.

³⁶ Anuatti et al.(2002).

employment, with some recovery later on, with a more robust expansion occurring along the productive chain, as in the case of telecommunications. Workers directly affected by the initial impact undoubtedly suffered in the process.³⁷

Studies on the social impact of privatization emphasize outcomes of this sort. We see the process more vulnerable from another perspective, concerned with the distribution of the efficiency gains brought by privatization. In Brazil, the access to them was restricted to big business. Until 1999, when privatization had already advanced, no major public offers had been made to comply with one of the stated objectives of the program, that is, the democratization of capital ownership. Middle class and even some groups among the poorest could have had access to these public offers as they are entitled to some forms of public debt that could have been exchanged for the shares being offered. Thus, workers in the formal markets have funds accumulated in their personal accounts in the FGTS (Workers Tenure Guarantee Fund), which receive roughly the equivalent of a monthly wage every year. Apart from the regular unemployment insurance, the accumulated balance in the FGTS is to be used in cases of unemployment, retirement or as a down payment in house financing, but could have been accepted also in exchange for equity in the privatized firms.

Moreover, workers could have also participated in public offerings by exchanging the present value of their current or future social security benefits for shares of the privatized companies. Furthermore, the government was fond of implementing income transfers, but a more radical move would have been to consider capital transfers in the form of shares of the privatized companies or participation in funds created to administer blocks of these shares.

The argument that the money was needed to reduce the public debt proved weak, as Section 2 has shown that no reduction was obtained and that the resources from privatization opened room for further public indebtedness and helped to sustain wrong policies in the fiscal and exchange rate areas.

Only recently has the government become aware of the importance of democratizing capital property, by publicly offering its remaining shares of an already privatized mining company, Vale do Rio Doce, and minority shares from Petrobrás. In the process, it accepted FGTS deposits in successful bids where hundreds of thousands of workers became shareholders in these companies. Since there are companies still to be privatized – particularly in the energy, banking and oil sectors – this path remains as an attractive alternative. In addition to improving the democratization of capital ownership, it could lead to a new model for managing the privatized companies, competing in results with the one followed by those privatized thus far.

As far the social impact of trade liberalization during Cardoso's years is concerned, Mesquita Moreira and Najberg (1999) did a major study focusing on the employment effects and reached conclusions which in essence resemble those already referred to in the case of privatization. That is, a negative impact came in the short run, thereafter compensated by structural changes along the production chain leading to increasing labor absorption, in addition to enhanced growth perspectives due to increased efficiency. As pointed out in Section I, the role of the appreciated *real* was predominant over trade liberalization in increasing external imbalance and vulnerability, with their own economic and social consequences. Consumers have also been happy to enjoy the enlarged choices brought by trade liberalization and there is no talk of reversion to the stronger restrictions of the past. In any case, a clear social handicap was that many firms and their workers suffered in the process, and no specific program was designed to face their adaptation to the new environment.³⁸ The only safety nets have been the existing ones, such as unemployment compensation and retraining programs.

³⁷ Idem.

³⁸ Mesquita Moreira and Najberg (1999) estimated an initial loss of 1,012,260 jobs, or 1.7% of total labor force.

With respect to globalization, we single out some effects also likely to have a social impact. In sectors where foreign capital was expanded, such as telecommunication and electricity distribution, in addition to demanding dollar indexed tariffs, the foreign investors have been anxious to preserve their capital in dollars. This increased demand for hedge operations, met by government by offering bonds pegged to the dollar, in a movement that transferred risks to the public sector and added to its vulnerability, with the ensuing social consequences.

Even in the case of sectors where privatization has made only minor advances, such as water and sewage, financial globalization has been affecting tariffs, because state-owned companies contracted loans in dollars, attracted by the expanded supply that came with financial globalization. As state enterprises, they have not engaged in hedge operations because of their loyalty to the government's economic policy. As devaluations occurred, they suffered great capital losses and cost increases, which were transmitted to tariffs.³⁹

We thus maintain our reservations towards financial globalization. Those we have made before have now been extended to the role of foreign direct foreign investments and their expectations to keep their assets and revenues linked to the dollar, again reducing the options for national policies as pointed out by Tokman's analysis. All this underscores the need for depending less on foreign savings, and managing with greater hindsight those that come to the country.

A positive side of globalization that emerges from the preceding discussion has been the access to high tech. It has facilitated, for instance, the functioning of income transfer programs in Brazil, with millions of people enrolled and paid through electronic cards. Another example in the social area has been the access to new drugs, such as those for AIDS treatment. However, Brazil had to fight aggressively in the World Trade Organization to facilitate an enlarged and cheaper access to the new drugs. The strong lobbying of international drug companies has been another obstacle and it has also surfaced in the process of expanding the use of generic drugs in the country.

In retrospect, globalization has had its bad and good aspects. Although with unavoidable difficulties, the right path is obviously one that maximizes benefits and minimizes costs, according to national interests, in a strategy that we call "globrazilization".⁴⁰

³⁹ This has been the case, for example, of the Cia. de Saneamento Básico do Estado de São Paulo (SABESP), which increased its tariffs for this reason, among others. The impact is clear in the data shown by Table 4.

⁴⁰ Macedo (2002). In this paper, we examined five globalization-related moves adopted by the country, using five criteria: impact on growth, social effects, enhanced competitiveness, reduction of vulnerability and focus on international institutions. The moves analyzed were financial globalization, trade liberalization, privatization, patents on drugs, and the use of generics and disputes within the World Trade Organization. The first three moves received a negative evaluation – the second, for reasons different than those presented in this paper –, while the others were rated as positive ones.

III. Perspectives

A. Difficult choices

Obviously, Lula's government will inherit a very difficult situation. In spite of poor growth rates, Cardoso has shown an impressive performance in the social area, not only expanding programs, but also doing so in a counter cycle manner in his second term. The new government will start by facing an economic picture that, more than in Cardoso's years, will offer very limited space for new and major advances in the social area. In particular, it cannot count on an increase in tax collections of the same proportions reached by Cardoso. Thus, Lula will start with the risk of frustrating many of its campaign promises of strong pushes in social programs.⁴¹

Let us summarize the picture he will inherit in the social programs area. In retrospect and comparing the situation at the beginning and at the end of Cardoso's years, the expansion of social programs at the federal government was accomplished mainly by raising additional taxes, but new increases of the same sort are unlikely. They could be forced at a lower magnitude, but this would put an additional strain on the private sector that could compromise growth. Moreover, it would face stronger opposition. Thus, the room for a new round of social expenditures financed by a heavier tax burden, is much more limited than the one Cardoso had. Moreover, some of the tax increases that followed the Real Plan were politically

⁴¹ The terms of reference for this paper did not include the non governments policies.

marketed as “temporary”, and even before inauguration the new government had to make a major effort in Congress, late in 2002, to keep some tax increases that are supposed to expire by 2003.⁴²

On the expenditure side, there is some room for raising additional money, but it would require harsh difficult political choices. Most taxes have a pre-determined destination by law: health, education, payroll etc. The indexation of many income transfers, based on the minimum wage, also makes it difficult to change priorities. If some of these constraints were eliminated, resources could be reallocated towards Lula’s priority areas. Camargo (2002) has recommended more money for education, through programs like the Money in School, at the expense of limiting the growth in the value of benefits to retired people. His argument is that 50% of the children are in the poorest families, compared to only 10% of the elderly.⁴³ The latter group, however, has a lot more political clout than children in or out of school. Moreover, it is not unlikely that children and young people have also benefited from the income transfers made to the old age groups.

The federal government could also start charging a social security contribution (on account of survivors pensions) to its retired public servants, as it is done by the State of São Paulo, which charges 5% on payroll for both active and retired servants. Another area that has a potential for raising additional resources are the public universities, as they do not charge tuition, a benefit that does not go to the poorest groups. The idea of charging tuition fees has been around for a long time. Both these ideas, however, are not popular among Lula’s supporters, among them major groups of public servants and public university students.

The large number of social programs that Lula will inherit from Cardoso has also room for improvements in the form of savings and other gains by making better use of resources. In our search for information, we have had access to many programs and their coverage, but not to any cost-benefit analysis, even unsophisticated ones. Effective evaluations are badly needed since all that is available so far is a broad appraisal based on results shown by aggregated social indicators, plus an evaluation of costs and head counting of beneficiaries. In any case, it is unlikely that such improvements could play any major role in solving the current and future fund shortages.

Another area in which existing resources could be brought to a more efficient use is the armed forces. They remain largely practicing exercises and waiting for defense actions that never comes. Although they are not fit for police work, they could deal with issues that are crime-related, such as drug traffic and arms smuggling at the frontiers and coastal areas. Moreover, since illegal use of arms is rampant, and includes those typical of armed forces, such as machine guns and rifles of high potency, the defense forces could be used in gun control by establishing check points in roads and in urban areas where crime rates are higher. However, given past memories of the dictatorship period (1964-1984), politicians are reluctant to put the armed forces into actions of this sort.

A sensitive issue also ahead is the strong desire for change that comes with Lula’s victory and his program. The risk is to make changes for changes’ sake. For example, the first program announced by Lula shortly after his election was the “Zero Hunger” initiative, aimed at distributing food to the population in need. As announced, the program does not define its target populations clearly. It is adopting money income as the only targeting criterion but the correlation between income and hunger is not well established, especially where there is production for own consumption, as in rural areas. Furthermore, although it has been announced that the new program

⁴² These increases were in the highest personal income tax bracket, from 25% to 27.5%, and the business social contribution over net profits, from 7% to 8%. The total funds involved reach R\$15 billion, roughly 1% of the GDP. In 2003 the new government will need to renegotiate a reduction on the “temporary” fiscal contribution on financial operations, which would cause a loss of R\$20 billion in 2004.

⁴³ José Márcio de Camargo, as quoted by Gilberto Dimenstein, Folha de S. Paulo, November 17th ,2002, p.C-8.

will also resort to electronic cards, the beneficiaries would not receive money but could use them to buy food at specially designated stores. This new mechanism has received severe criticisms from the media and academics, as it may encourage patronage and other distortions. Finally, the sources of funds for this new program have not yet been defined, except for its initial and very limited coverage.

B. Improved macroeconomic management: the crucial issue

Given all these difficulties in securing new resources and reallocating the existing ones, the crucial issue is to improve the quality of macroeconomic management in order to circumvent the current crisis and find a way to stimulate growth. In spite of its gloomy picture at the moment, the Brazilian economy overcame many problems in the last decade: it has reduced inflation, curbed the fiscal deficits and indebtedness of local and state governments, pushed a large privatization program, got rid of most of the state banks and their legendary mismanagement, and imposed discipline on money-printing by Central Bank. It also took out many skeletons out of the government's fiscal vaults.⁴⁴ The private sector has become more efficient as it was exposed to stronger competition, and the banking system has been strengthened. The recent move into an adjustment of external accounts reveals that the productive sector has been agile in responding to the stimulus brought by the new exchange rate regime. Thus, if the current macroeconomic clouds dissipate, the economy is more prepared to grow than it was 10 or 15 years ago.

Recent discussions among Brazilian economists and politicians, stimulated by the debates among presidential candidates and their teams, made the difficult macroeconomic options ahead and their costs explicit, given that the most serious constraints are the shortage of foreign resources and the management of the domestic public debt. Harsh options such as default or rescheduling, partial monetization of domestic debt, freezing of financial assets, centralization of foreign exchange controls, more inflation, more taxes and others have emerged in these discussions.

In the end, they have indicated a path with less unwanted consequences, albeit a narrow one. To show its main characteristics, let us start with a diagnosis of the current situation, with its pressing issues of how to manage both the foreign and the domestic debt. For this diagnosis, we resort to a paper by Schwartzman (2002), which has been largely praised among Brazilian economists and public opinion in general.⁴⁵ The paper, in its original version aptly named "J'accuse", came in response to news in the international press, around mid-2002, including statements by financier George Soros, that Brazil was going into default. Schwartzman starts with an analysis of the external debt, as follows.

- The needs for financing the external debt in 2003 add up to US\$39.7 billion, US\$14.5 billion owed by the private sector and US\$25.2 billion in public debt. Within this last number, US\$16.4 is money owed to the IMF and deposited as part of the country's reserves.

⁴⁴ Among these skeletons, in the scale of tens of R\$ billion, there were various new debt recognitions that emerged from judicial disputes involving price and wage freezes, and conversions of one currency into another, in the stabilization plans previous to the *Real*, the largest one emerging from a "subindexation" of the FGTS deposits. Also worth mentioning was the hefty subsidy given to those who had housing financing and whose loans were not fully indexed, with the government assuming the cost to financial institutions. A similar procedure was adopted for loans made by Banco do Brasil to farmers. In the case of states, the federal government assumed their public debt and became their creditor at lower rates, a concession, however, that was given in exchange for fiscal and financial discipline, including privatization of state banks and other enterprises, debt ceilings, and the threat of federal confiscation of tax revenues of the states if the transferred debt is not serviced. In a few cases where this occurred and the tax revenues were effectively confiscated from the states' bank accounts, the affected states challenged the federal government in court, but the confiscation was upheld, thus discouraging new initiatives of the same sort. In essence, in Brazil the federal government was able to impose to its "estados" a fiscal and financial discipline not accomplished in Argentina in its "provincias".

⁴⁵ Schwartzman (2002).

- Thus the sovereign net debt owed in 2003 totals US\$8.8 billion and include amortizations of US\$4.7 billions, gross interest of US\$5.9 billions, less roughly US\$2 billion as interest earned by Brazilian reserves.

- Since what is left in debt service payments in 2002 reach US\$2.3 billion, total government commitments until the end of 2003 reach US\$10.9 billion, but there are net reserves (excluding IMF funds) of US\$21.1 billion, which go down to US\$16.1 billion, given the commitment with the IMF to keep reserves at a minimum of US\$5 billion.

- Expanding this analysis until 2004, there is an additional need of US\$12 billion to serve the public external debt, but there are almost US\$7 billion promised by the World Bank and the IDB, besides additional resources from the IMF.

Therefore the public external debt is manageable if the IMF agreement is kept and the Central Bank doesn't sell its reserves to the private sector. Besides, the interest on public external debt is close to 8% p.a., far from the values shown in the spreads evaluated by J.P. Morgan-Chase's country risk analysis, which have oscillated around 15% and some times gone above 20% during the worse months of volatility in 2002.

As long as the Central Bank does not sell reserves to the private external debtors, they will seek help in the exchange market and pay or renegotiate its debt. There are also opportunities for converting external debts into foreign investments in Brazil. The risk is a greater pressure on the exchange rate and on inflation, but by year's end the market was showing signs of calming down, given the adjustment in the foreign accounts and the comforting economic team and policies announced by the new government.

The risks linked to the domestic public debt come primarily from the fact that part of it is pegged to the dollar, but recall that the service is all in *reais*. Because the government has faced difficulties in rolling the part that is indexed by the dollar, it has been repaying part of the debt, expanding the money supply. But this money largely ends up coming back to the Central Bank in the form of bank reserves and overnight deposits. There have been extreme situations in Brazil when all public debt was rolled in the overnight system. Even so, the country has not observed, now or in the past decades, and differently from Argentina, any serious run from deposits into dollars and real assets. It should be noticed, also, that transactions in real assets involve *reais* that also return to the banking system and largely end up into bank reserves, Central Bank and Treasury Bonds or overnight deposits. Thus, as long as there is no bank run, the money circulates in a closed system. Under these conditions, the domestic debt is also manageable, as long as perspectives for continuing servicing it remain and that is why a sizable primary deficit is crucial.

Given this scenario, a narrow path out of the current crisis could be found through an effective macroeconomic management combining: (i) around 4% of primary surplus to convince markets that the fiscal side and the debt will not be moving into disarray, plus a social security reform to reduce government expenditures in this area, particularly in the case of civil servants and military personnel, thus opening room for a lower primary surplus in the future; (ii) a cautious move into lower real basic interest rates sustained by confidence on the fiscal policy and the perception that financial markets would accept this move, as it has realized that continuously increased real interest rates would create a much worse scenario (default or rescheduling of the domestic debt etc); (iii) continuing support, but no further squeezes by the IMF, other international agencies and rich countries; (iv) an export and import substitution drive to alleviate the external constraint, reducing the pressure on the exchange rate and the need to use higher interest rates to contain its effect on inflation; (v) the maintenance of the undervalued *real*; (v) inflation rate targets between 5 and 10%, rather than below 5%; (vi) staying away from formal indexation; (vii) in the medium term, a move away from dollar indexed government bonds.

Of course, this path will depend also on the conditions of the world economy in general. If it moves into deflation with a new round of credit crunch affecting emerging markets, in general, and Brazil, in particular, the path will show additional bumps. The scenario at the moment is still unclear about how the world economy will move in the immediate future.

Bresser and Nakano (2002) and Toledo (2002) have been the most outspoken preachers of a course of action along these lines. Lula's economic advisors have indicated that they will follow it. The new president has a strong leadership among his supporters, which will be a major asset, as this course of action depends on containing pressures from the "opposition in government" to immediately deliver promises of new expenditures, particularly in the social area. Lula will have the difficult task of moving from the magic of hopeful expectations that now surround him to a realistic public support sustained by consistent government management, particularly in the macroeconomic area. This is his only chance to succeed in building a scenario where growth advances can sustain a new round of poverty alleviation with sound fundamentals.

IV. Summary and conclusions

This paper has shown that Cardoso's government has made great advances in terms of price stability, along with economic and institutional adjustments that strengthened the economy, such as the state governments' fiscal and financial discipline and a more competitive productive sector. It has failed, however, in its attempt to lead the country towards sustained growth. Even worse, it relied on misguided macroeconomic policies, particularly with its exchange and fiscal policies during the first term. These policies compromised his second term, as they led to sluggish growth and increased the economy's external and internal vulnerability. In the end, these developments also played a role in giving the opposition a victory in the 2002 presidential election.

In the social area, however, the Cardoso government accomplished major advances, mainly at the cost of a heavier tax burden, which is coming closer to a saturation point. The economic environment inherited by the new government, plagued by shortage of foreign resources and a high domestic public indebtedness that requires huge fiscal primary surpluses for its service, makes it difficult to implement new advances of the same nature and magnitude in the foreseeable future. Thus, the situation is such that it requires a renewed attention to the quality of macroeconomic management, to improve economic growth and open room to sustainable social policies.

In the short run, a thin path has been identified to lead the country out the current difficulties, which recently have become less dramatic because of the adjustment presented by the foreign accounts, and by the stand adopted by the elected president's announcement of policies that have dissipated most fears of mismanagement. This path involves continuing fiscal discipline by maintaining and even enlarging the fiscal primary surplus, with an eye to exchange this course for the market willingness to accept lower interest rates. In the foreign front, an emphasis on export promotion and a new round of import substitution, this time together with enhanced competitiveness. In essence, what is sought is to reduce vulnerability and volatility, both from domestic and external sources.

Looking at the medium and long term, and taking into account on the new national and international scenario created by globalization, privatization and trade liberalization, the lessons from the Cardoso period are clear. In particular, they point to less dependence on external finance, more caution with globalization in general, a different course for privatization – including constraints on the use of its resources by the government, a screening of the pricing policies of the privatized sectors and a move towards public offers that democratize ownership of capital property - and a foreign trade and financial policy explicitly guided by national interests, with selective attention to some Trojan horses offered by globalization, as was the initially easy access to external financing. All this should be consistently sustained by other policies, in particular a realistic exchange rate.

In this new international scenario that has overemphasized the role of markets in solving economic and social problems, it is not a surprise that Brazil had to rely on income transfers in order to alleviate the poorest groups' plight poverty conditions such as those found in the country are so severe that it would be naïve to expect that they would be quickly and significantly reduced simply by market forces. Out of sight is the growth rate required to rapidly expand the demand for labor, including unskilled labor, in order to increase real earnings at faster rates and thus bring poverty alleviation induced by market forces. Furthermore, as Brazil has fallen into the debt trap set by financial globalization, in a move that since 1997 has brought nearly asphyxiating proportions, it cannot count on financial markets to help in solving the poverty problem, except by not making things worse.

Thus, it is worth quoting what Paul Krugman said in a recent visit to Brazil: “in the immediate future, it is not possible to count on the financial markets to help the poor. It is necessary to help them directly”.⁴⁶

Cardoso's government had the merit for having reached this perception, despite the errors it made in other issues. President Lula will face the difficult challenge, first, of avoiding a move backwards, and then of making further advances along another path at this point narrower than that followed by Cardoso.

⁴⁶ Paul Krugman , in an interview to Folha de S.Paulo, November 8, 2002, p. B-6.

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