The QUARTERLY REVIEW Of ECONOMICS And FINANCE

NORTH-HOLLAND The Quarterly Review of Economics and Finance 41 (2001) 609–620

Privatization, regulation and income distribution in Brazil[1]

Werner Baer[a,b,*], Donald V. Coes[a,b]

[a]University of Illinois, Urbana, IL 61801, USA
[b]University of New Mexico, USA

1. Introduction

Deep inequality in the distribution of income and wealth has been surprisingly persistent throughout Brazil's five centuries of history. Whether the state's presence in the economy was pronounced or minimal, its rulers, military or civilian, its economy relatively open or closed to foreign trade and investment, the degree of inequality has hardly changed. Many arguments have been made for this persistence, among them the political power of elites, the low levels of investment in education, and economic dependency.[2]

The economic turmoil of the 1980s included the debt crisis early in the decade, price increases verging on hyperinflation, a series of failed stabilization plans, and the fiscal exhaustion of the state. The stage was thus set in the 1990s for a profound rethinking about the way in which Brazil should run its economic affairs. This was reinforced by events outside Brazil, among them the much publicized privatization programs of the U.K and Chile and the disintegration of the socialist economic systems of the U.S.S.R. and Eastern Europe. One of the consequences of this sea change in thinking was much more support for market-oriented policies. Prominent among these policies was the privatization of state-owned enterprises.

Our purpose in this paper is to examine the potential impacts of this policy change on economic equity. Concern with equity was rarely the focus of the reforms of the past decade, which were largely driven by fiscal exhaustion and were justified as a way of improving economic efficiency. As important as efficiency and fiscal balance may be, however, we must also ask how privatization might affect the depth and persistence of economic inequality in Brazil. The potential links between privatization and equity are complex and ambiguous, but

* Corresponding author. Tel.: +1-217-333-8388; fax: +1-217-244-6678.
E-mail address: w-baer@uiuc.edu (W. Baer).

PII: S1062-9769(01)00094-1

there is already enough information to venture some preliminary hypotheses about Brazil's winners and losers in the privatization process.

2. Brazil's heritage of inequality: a brief overview

The Portuguese settlement of Brazil was based on the concession of immense tracts of land, or *donatários,* to a small group of favorites of the crown. This set a tone that has lasted until modern times, in which the state was regarded as the ultimate source of wealth. Although most evident in the sugar producing regions of Brazil's Northeast in the sixteenth and seventeenth centuries, concentrations of wealth continued during subsequent economic cycles. These cycles, although more open to entry than was the case with sugar, also produced marked concentrations of wealth. The eighteenth century mining boom that was centered in the modern state of Minas Gerais, and the nineteenth and early twentieth century coffee cycles, first in Rio de Janeiro, and later in the state of São Paulo, both reinforced inequality in the distribution of property.[3] Over most of its history, Brazil's economic cycles were essentially export oriented, and in contrast to the northern U.S., did much less to develop domestic markets supplied by small independent farmers.

Coffee production, although open to small holders, was more profitable for those planters with access to adequate transportation and an organized labor supply. It was the government, especially in the state of São Paulo, that provided for these needs by arranging for low cost immigrant labor and by granting concessions and subsidies for the building of railroads and other infrastructure that served the coffee sector. The influence of the planters in the first half of the twentieth century was such that economic policy gave priority to sustaining the market for coffee exports.[4]

With the collapse of this external market in the Great Depression, state policy maintained the wealth of these groups through price supports[5] and opened the way to new concentrations of wealth and income in the post-World War II period through deliberate import substitution industrialization (ISI). These policies, which relied heavily on trade protection, subsidized credit, and other forms of government intervention in markets produced whole new sectors which were characterized by marked concentrations of ownership. Among other examples were cement, paper, chemicals, and other industrial products.

Not only did the state favor the growth of new concentrations of wealth in the emerging protected private industrial sectors, but it too became a large direct player in the economy. This trend, which began with state development of a modern steel industry during World War II, accelerated when most public utilities were taken over by the state in the first two decades after the war. These public utilities included railroads, power generation and distribution, and telecommunications. In addition, for strategic and nationalistic reasons, Brazil restricted the exploitation of natural resources such as petroleum and other minerals through the establishment of state monopolies, such as PETROBRÁS in the oil sector, or the Companhia do Vale do Rio Doce in iron ore. State involvement in the financial sector was also pervasive. The federally owned Banco do Brasil, the Banco Nacional de Desenvolvimento Econômico, the Caixa Econômica Federal, as well as many state and regional banks resulted in a financial