

Part I

Chapter 1

Origin and history of Brazil's public debt up to 1963

by Anderson Caputo Silva

1 Introduction

Sovereign debt is hardly something new. Brazil and other countries have been borrowing to fund various functions for centuries. To understand Brazil's economy and debt today, it is vital to review the past.¹

This chapter reviews the most important aspects of the history of Brazil's domestic and external debt. For clarity, sections have been organized according to historical periods - Colonial, Imperial and Republican - and examine the sequence of events and challenges during each.

The chapter discusses (a) the beginning of debt, (b) its institutionalization, (c) its legal framework, (d) the first debt management office, (e) characteristics of the main loans, and (f) difficulties encountered in repaying them, over time. Next, it describes restructuring and consolidation operations within the political-economic context of each period. This analysis sheds light on the challenges for managing the debt, inherited over this long period.

Following this Introduction, the chapter is organized in three sections. Section two describes public debt in Colonial Brazil (1500-1822). Section three covers the Imperial years (1822-1889), with two subsections on domestic and external debt, and Section four, also with two subsections, covers 73 years of history of both domestic and external debt in the Republican period (1889-1963). The history of debt from 1964 to the present is discussed in Chapter 2.

2 Public debt in colonial Brazil (1500-1822)²

The history of public debt in Brazil dates to the Colonial period when, during the 16th and 17th centuries, governors indulged in borrowing. Like debts assumed in other countries even much prior to that (see Box 1), they were private loans taken out by the rulers. However, unlike today, "in the Colonial period everything was unknown: the size of the debt, the purpose of the loan, the conditions under which it was made, etc."³

Historians say⁴ Luiz de Vasconcelos e Souza, the "vice-king during the golden age of Colonial Brazil," was the first to require that records be kept of the Colony's finances. Studies show that from 1761 to 1780, "instead of surpluses, the official bookkeeping recorded annual deficits in excess of 100 *contos*; as a result, public debt in that last year rose to more than 1,200 *contos*, arising from payments and uniforms to the troops, food supplies,

¹ The history of Brazil's public debt is described in several studies. Excellent references to its debt during the Imperial period, for example, can be found in the works of Carreira (1980), or on the external debt, from its origin to 1937, according to Bouças (1950).

² Main reference: Bouças (1950).

³ Neto, 1980.

⁴ Bouças, 1950.

Box 1. Origin of the public debt

Although the origin of public indebtedness is not easy to identify, there is evidence it existed in Ancient Greece. For example, Baleeiro (1976) mentions a study by Xenophon on the income of Athens, which refers to loans for publicly owned war boats.

The rebirth of trade in the 11th and 12th centuries introduced new consumption patterns that included luxury items and influenced the behavior of noblemen, princes and kings. Financial surpluses, which were common, began to be replaced by deficits due to increased spending without an increase in revenues. Since tax hikes and issuing currency were viewed as difficult or undesirable,* rich merchants began to take loans to finance ordinary and emergency expenses, such as those associated with wars.

However, loans at that time were quite different from today: Usually, they were personal loans to the ruling monarch and were not transferred to his heirs or successors. Interest rates were therefore enormous and, according to Baleeiro (1976), the guarantees required could even be humiliating: For example, Baleeiro notes “from the hair of the sacred beard of His Majesty, princes taken as hostages, and relics of saints to pawning of the crown, jewels or the linking of certain incomes to debt interest services and amortization.”

The separation of the monarch’s wealth from the public treasury started in the 17th century and was a landmark for the increased use of public credit as a means to finance government expenses.

* Hicks (1972) argues that since the tax base in these eras was narrow and collection inefficient and unfair, tax increases sparked a very negative public response. Issuing currency was also discouraged, given the limited supply of precious metals and the inflationary situation it created where adopted.

Source: Neto (1980) and Baleeiro (1976)

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salaries and even the money which the government, under formal promise of future reimbursement, had taken during wars.”

The Colony’s debt was not settled until 1799, when, “seeking to mitigate the threat of economic collapse, D. João VI ordered the payment of the debt, as well as others not yet recorded, through debt certificates with 5% interest rates.” This laid the foundation for Portugal’s debt in Brazil. Similarly, the Royal Charter of October 24, 1800, the Order of May 9, 1810 and the Decree of October 12, 1811 contributed to classifying all debts into legal and illegal, considering as *old debt* all that was incurred until 1797⁵, and establishing an amortization mechanism.⁶ Bouças⁷ argues that this procedure greatly benefited the Colony and served later “to prove that in the liabilities an independent Brazil inherited from the Colony totaled just 42 *contos*”.⁸

⁵ This order stated that all debts should be submitted for validation to the Finance Council, within a three-year deadline, a Spread-Over-Treasury (SOT) after which - if not validated - they would be considered legally prescribed. According to Leão (2003), since 1810, debt bonds prescribed within a determined timeline (in this case, three years) in the consolidation of the domestic debt. This tradition was then repeated in the other events of debt consolidations in 1956, 1962, 1967.

⁶ Every year, creditors would receive 6% over the balance of their loans - half as premium and bonus for the delay and the rest as capital amortization.

⁷ Bouças, 1950.

⁸ “*Contos*” or “*contos de réis*” was the expression used to indicate 1 million units of *reais* (or *réis*), the currency at the time, which was replaced by the cruzeiro only in 1942. Its financial representation was 1:000\$000. For details on Brazil’s monetary systems, see the Annex.

Despite these advances, deficits increased between 1808 and 1821, when D. João VI settled in Brazil with his Court at the time that Napoleon took over Portugal. The costs of maintaining the king's subjects and most of all, supporting the Portuguese army were high, and resources very limited, since Brazil could not count on Portugal's financial assistance.

During this time, events that would affect Brazil's political, economic and financial history occurred, such as the opening of the ports in 1808 (which launched the process for the country's economic independence), creation of the first Banco do Brasil and introduction of paper money (Box 2).

Box 2. Creation of the *Banco do Brasil*

One of D. João VI's initiatives while in Brazil was to create the first *Banco do Brasil* through the Order of October 12, 1808, following the suggestion of the Portuguese Finance and Navy minister, D. Rodrigo de Souza Coutinho.

With the initial authorization set to last 20 years, *Banco do Brasil* began operating the following year (December, 1809) after its minimum capital was underwritten (100 shares). The capital fund totaled 1,200 contos, divided into 1,200 shares of *one conto* de réis each.

"The start of operations of the first *Banco do Brasil*, in 1809, can be considered a fundamental landmark in the monetary history of Brazil and Portugal, both because it was the first Portuguese banking institution and represented a meaningful change in Brazil's currency through the issuance of banking notes."

The Bank's creation was closely related to the Crown's need to raise money to finance increasing public expenditures. Banco do Brasil was the fourth issuing bank in the world, behind the Bank of Sweden (1668), the Bank of England (1694) and the Bank of France (1800).

From 1810 to 1828, *Banco do Brasil* issued 28,866,450\$000 réis. Not surprisingly, the Bank's insolvency was already apparent in March, 1821, when its Board of Directors reviewed its balance sheets. The situation became even more serious after D. João VI left for Portugal with his entourage, since the guarantees represented by most of the Crown's movables and jewels had lost their effect.

With Parliament strongly opposed to renewing its authorization to operate, it decided in September, 1829 that the first Banco do Brasil would close in December of that year, when the institution would celebrate its twentieth anniversary.

Sources: Müller & Lima (2007), Bouças (1950) and Wikipédia (http://pt.wikipedia.org/wiki/Banco_do_Brasil)
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However, the financial situation that D. João VI left behind was indeed worrisome, when D. Pedro (D. João VI's son) took office as prince regent (Regency 1821-1822) and later, as the first emperor of independent Brazil (1822-1831). Bouças (1950) notes⁹:

"The situation became even more critical when he (D. João VI) left with his entourage for the Kingdom, since most of the existing gold and silver currency was transferred to Lisbon on the fleet that took the king; and the Public Treasury, in the very words of the Finance Minister, counselor Martim Francisco Ribeiro de Andrada was left, 'without *reais* in its safes.'"

He adds that D. Pedro expressed his concern in letters to his father in the period before Independence. In one, from September 21, 1821, he wrote¹⁰: "If Your Majesty will allow me, I will move on to describing the sad and

⁹ Free translation of the original in Portuguese.

¹⁰ Free translation of the original in Portuguese.

pitiful situation this province has been reduced to, so that Your Majesty can give me your orders and instructions you deem convenient and I can, with dignity, free myself from the net I have been caught in.”

D. Pedro reports the difficulties due to the very limited resources¹¹: “[...] the Treasury’s cash is only that from the Province revenues and these are paid in paper; it is necessary to pay off everything that has been established, [...] there is no money, as already said; I don’t know what I will do”.

In the same letter, D. Pedro notes he was “amidst ruins.” A commission appointed by the Prince Regent to evaluate the Public Treasury status determined that D. João VI’s debt was 9,870:918\$092.

There was still time for a loan in the amount of 400:000\$, with a 10-year maturity and a 6% interest rate, during the months that preceded independence, with the Province of Rio de Janeiro revenues offered as the guarantee. The so-called independence loan, which was quickly underwritten, was authorized by a decree on July 30, 1822 and the money was to be used primarily to “acquire war vessels.” An additional amount was subsequently underwritten on October 27 “to meet the expenses, also higher, related to the consolidation of independence.”

3 Public debt in imperial Brazil (1822-1889)¹²

Brazil’s financial difficulties in the period before independence, coupled with the natural demands connected to the country’s first years of independence, were a serious challenge. Given these problems, public debt during the Imperial Period was the stimulus that created the first debt management office, institutionalized domestic debt, enhanced financing mechanisms and instruments, and introduced debt restructuring operations (the so-called liability management operations), which were, to a great extent, very similar to today’s operations.

Moreover, as will be discussed throughout this section, the evolution of domestic and external debt was closely related to a host of political-economic factors that characterize financial history during the Empire, which can be divided into two periods: The first, from 1822-1850, which was a rough period of “conflicts and consolidation,” and the second, from 1850-1889 (Republic), which was “mainly of construction.”¹³

Despite the difficulties, the state of Brazil’s public finances was admired by Latin American nations in the 19th century, given the country’s success in issuing debt¹⁴ and meeting external commitments, while its neighbors failed to do so.¹⁵ More interestingly, domestic issuances included large amounts of long-term domestic debt in the local currency at a time when the other countries defaulted on their domestic creditors.¹⁶

¹¹ Free translation of the original in Portuguese.

¹² Brazil’s Imperial Period included two reigns: (a) Pedro I (1822-1831) and Pedro II (1831-1889). The latter, however, initiated as a Regency Period, which lasted until the proclamation of Pedro II’s majority just before he turned 15 by the Legislative Branch in July 1840. Therefore, the personal reign of Pedro II extended from 1840 to the advent of the Republic on November 15, 1889.

¹³ Bouças, 1950.

¹⁴ According to Cardoso & Dornbusch (1989), the history of the Brazilian Empire is one of deficits financed by domestic and external loans. The authors cite the report by Minister Ouro Preto on the budget situation on the occasion of the Proclamation of the Republic, according to which only 30% of the Empire’s expenses were actually covered by taxes and other revenues. All the rest was financed by debt.

¹⁵ In fact, already in 1825, except for Brazil, all recently independent Latin American nations had already defaulted, a situation that would be repeated many times during the 19th century (Dawson, 1990; Marichal, 1989).

¹⁶ According to Summerhill (2008), the success during the Brazilian Imperial Period was linked to institutional changes (particularly the Constitution of 1824). The sharing of power with Parliament, for example, ended the emperor’s ability to unilaterally tax, spend, borrow or default.

3.1 Domestic public debt during the Empire¹⁷

Imperial Brazil's domestic public debt becomes significant after the decree of Emperor Pedro I to appoint a commission in September, 1825 to deal with it. "For the first time in the country's history, a measure was implemented to institutionalize the domestic public debt, give it the character of national debt for which the entire Nation is responsible, and distinguish it from the ruler's personal debt."¹⁸

3.1.1 "The cornerstone of public credit in Brazil" (law of November 1827)

The Law of November 1827,¹⁹ based on the commission's work, established the legal framework for Brazil's indebtedness policy, and is considered to be the cornerstone of public credit in Brazil.²⁰ It was rarely amended until the Central Bank was created, nearly 140 years later.

The Law, with its 75 articles, (a) acknowledged past debt up to 1826 (except for those prescribed by the Order of May 9, 1810); (b) created ledgers for recording national and provincial debt; (c) set rules for registering all acknowledged debt in the Great Ledger of Brazil's Debt and, with provincial debt, in the Auxiliary Ledger of the Great Ledger, duly "initiated and closed by the president of the respective province" (art. 50); (c) provided the "foundation" for public debt and launched the first securities of the funded domestic debt in the amount of 12,000 *contos de réis* (automatically registered in the Great Ledger); and (d) created the first institution responsible for managing both the domestic and external debt (Box 3).

Box 3. Caixa de Amortização: the first public debt management institution

The *Caixa de Amortização*, one of the main features introduced by the November 1827 Law, included a great many details with regard to institutional arrangements and operational procedures for the new entity. The Law even provided for annual salaries for its members and dedicated nearly half its articles (36 of the 75) to Title IV, the *Caixa de Amortização*.

Two aspects are noteworthy: (a) *Caixa's* independence from the Public Treasury and (b) procedures involving its control, rendering of accounts and transparent management.

The entity was managed by a directorate independent from the Public Treasury, formed by the minister and secretary of Financial Affairs (the latter served as chairman), five Brazilian capitalists and the *Caixa* General Inspectorship (art. 41).^{*} The institutional arrangements provided for a more autonomous debt structure and anticipated a debate that would re-emerge long after its time.

The law also restricted the *Caixa's* control: "the safe of the *Caixa de Amortização* shall have three keys, of which one will be kept by the inspector-general and the others by the accountant and the treasurer [...] the safe of each branch shall have an equal number of keys [...] A safe shall never be open unless all three key-holders are present." Further, it included provisions about transparency and rendering accounts that were in keeping with the best international practices of the time. Also, the council was obliged to submit an annual general balance of accounts to the House of Representatives and publish an account of all *Caixa* operations and its branches every six months.

¹⁷ Main references in this subsection: Carreira (1980), Leão (2003) and Neto (1980).

¹⁸ Neto, 1980.

¹⁹ According to Leão (2003), the 1827 Law "follows the tradition of the English financial history". In 1715, King George III ordered the English public debt to be consolidated and recorded in a ledger (Great Ledger) in the Bank of England.

²⁰ Neto (1980) mentions as an example the analyst C. J. de Assis Ribeiro.

After 1945, when the Bureau of Currency and Credit (Sumoc), the precursor of the future Central Bank, was established, the *Caixa* would no longer manage the currency. In 1967, all its responsibilities were transferred to Brazil's Central Bank. Thus, the institution that managed the domestic and external debt for 140 years was closed, and no scandals had ever been recorded.**

* Branches were opened in the provinces, where debt certificates were issued. These were managed by a council formed by the president of the province, the general treasurer and the clerk of the Finance Council (Arts. 52 and 53).

**Leão (2003).

Sources: Law of November 15, 1827; Carreira (1980); Neto (1980) and Leão (2003)

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3.1.2 Origin and evolution of funded domestic debt in imperial Brazil

The November 1827 law established the rules for recording, controlling and managing new debt. Also, it introduced funded domestic debt, by issuing 12,000 *contos de réis* (Art. 19). Table 1 shows the evolution of funded domestic debt and divides domestic indebtedness into four sub-periods that follow the first issuance in 1827. Table 2 presents the numbers attached to the domestic debt service as well as its weight, which is sometimes higher, relative to the external debt service. These data illustrate the importance of domestic indebtedness during this period.

Table 1. Evolution of funded domestic debt in imperial Brazil
(in *contos de réis*)

Period	Issuance	Redemption	Balance
1827	12,000	-	12,000
1828-1840	23,500	3,800	31,700
1841-1860	32,000	-	63,700
1861-1880	340,000	-	403,700
1881-1889	46,000	11,300	435,500

Source: Laws of Imperial Brazil – Rio de Janeiro: *Tipographia Nacional* (reproduced from Leão, 2003)

Table 2. Domestic and external debt service in Brazilian budgets
(in *contos de réis*, 1828-1889)

debt service				
Law nº	Date	Budget year	External	Domestic
	10/08/1828	1829	1,178	381
	12/15/1830	1831/32	856	1,003
	11/15/1831	1832/33	2,988	1,046
	10/24/1832	1833/34	2,425	1,241
58	10/08/1833	1834/35	1,640	1,529

debt service				
Law nº	Date	Budget year	External	Domestic
38	10/03/1834	1835/36	480	1,348
99	10/31/1835	1836/37	2,125	1,500
70	10/22/1836	1837/38	2,111	1,490
106	10/11/1837	1838/39	2,069	1,600
60	10/20/1838	1839/40	2,055	1,970
108	10/26/1840	1840/41	2,168	2,170
243	11/30/1841	1842/43	3,020	3,120
317	10/21/1843	1843/44	3,088	2,449
369	09/18/1845	1845/46	3,026	3,909
396	09/02/1846	1847/47 e 47/48	3,026	3,473
514	10/28/1848	1849/50	2,797	3,391
555	06/15/1850	1850/51	2,798	3,479
668	09/11/1852	1853/54	4,213	3,447
719	09/28/1853	1854/55	3,823	3,447
779	09/06/1854	1855/56	3,823	3,462
840	09/15/1855	1856/57	3,823	3,461
884	10/01/1856	1857/58	3,787	3,461
939	09/26/1857	1858/59	3,787	3,460
1.040	09/14/1859	159/60	3,787	3,460
1.114	09/27/1860	1861/62	3,648	3,460
1.177	09/09/1862	1863/64	3,683	4,174
1245	06/28/1865	1865/66	3,646	4,817
1507	09/26/1867	1867/68 e 68/69	8,277	6,338
1836	09/27/1870	1871/72	8,056	15,785
2670	10/20/1875	1876/77	12,535	17,551
2940	10/31/1879	1879/80 e 80/81	14,374	24,904
3017	11/05/1880	1881/82	12,499	26,338
3141	10/30/1882	1882/83 e 83/84	20,887	20,276
3349	10/20/1887	1888	22,383	19,090

Source: Collection of Imperial Brazil Laws – Rio de Janeiro: *Tipographia Nacional* (reproduced from Leão, 2003)

The periods in Table 1 feature an indebtedness dynamic that is intrinsically linked to the socio-economic evolution of Imperial Brazil: It increased greatly in the 1860s and 1870s, followed by long periods when debt redemption was suspended, which indicate the Empire's financial difficulties.

The period from 1827-1839 was marked by issuances of securities designed almost exclusively to cover deficits and expenses incurred to appease the provinces. However, the first financial difficulties with respect to amortization service began to emerge, and in October, 1839, Law No. 91 suspended the redemption of outstanding securities.

Nevertheless, the suspension did not prevent new securities from being issued. While it became more difficult to place securities, especially from 1840-1860, which was reflected in the increased discounts - which reached 35%, 32,000 *contos de réis* were still issued and their funds were used for widely different purposes, such as covering deficits and paying the dowry of the princess of Joinville.²¹

Financing conditions began to improve in the 1860s and issuances from 1861-1889 increased in an unprecedented way. Not surprisingly, the domestic debt service also increased abruptly in those two decades (Table 2). While the expenses to be financed continued to be widely diverse, including the weddings of princesses Isabel and Leopoldina, the biggest share (more than 80% of the 340,000 *contos de réis* issued) covered war expenses and deficits, which totaled 150,000 and 130,000 *contos de réis*, respectively.

From 1881-1889, the most impressive operation was one of liability management. Although amortizations were still suspended, the high amount of issuances made annual spending on domestic debt interest rather significant, which, in 1884, reached 21% of budget revenues. To reduce this amount, a new law determined that securities paying interest of 6% a year could be converted into those paying 5% (Law No. 3,229 of September, 1884). This strategy was successfully introduced in 1886 and yielded an annual interest savings of 3,294 *contos de réis*.²²

Brazil thus ended the Colonial Period with a relatively high domestic debt, which was 435,500 *contos de réis*, while the external debt was 270,000 *contos de réis*.²³

3.2 External public debt during the Empire²⁴

The history of external debt in Brazil dates back to the first years of the Empire.²⁵ Altogether, 15 loans were taken out from 1824-1888. In addition, due to the Secret Additional Convention to the Treaty of August 29, 1825, Brazil assumed responsibility for the loan taken by Portugal in 1823, in the amount of £1,400,000²⁶ and in October 1889, on the eve of the Proclamation of the Republic, a sizeable conversion operation was carried out (more below). Table 3 illustrated the characteristics of the 15 loans.

²¹ Francisca de Bragança, the fourth daughter of Emperor Pedro I and Empress Maria Leopoldina.

²² According to Leão (2003), Belisário Soares de Souza, who was then the Finance minister, "despite the aggressions, insults and bullying conducted the operation with extreme care, discretion and efficiency [...] First of all, he authorized the amortization fund to purchase all the securities offered at par thus causing the price of securities to rise. When these were above par, which brought their yields close to 5%, the legislative option was used and the conversion effected in 1886 (Decree No. 9,581 of April 1886)".

²³ Leão, 2003.

²⁴ Main references in this subsection: Bouças (1950) and Carreira (1980).

²⁵ According to Abreu (1999), "the Brazilian external debt is characterized by two long indebtedness cycles followed, in both cases, by moratoria, temporary renegotiations and permanent agreements". The Imperial years fit into what the author calls the first cycle, which spans from 1824 to the permanent agreement of 1943; the second starts in the mid-1960s and extends to the Brady Plan negotiations in 1994.

²⁶ Bouças, 1950.

Table 3. Financial history of Brazil
The different conditions of the loans raised by Brazil in London since 1824

Loans	Date of agreements**	Price of issuance	Commission and other negotiation expenses	Total amount in £	Nominal amount in £	Number of installments	Maturity of installments	Discount for advanced payments	Interest rate
1824	13 August	75%	1%	1,000,000	1,333,300	12	12 months	-	5%
	12 de January/25	85%	1%	2,000,000	2,352,000	12	12 months	-	5%
1829	3 July	52%	2%	400,000	739,500	12	12 months	-	5%
1839	5 February	76%	-	312,500	411,200	-	-	-	5%
1843	11 January	85%	-	622,702	732,000	1	-	-	5%
1852	27 July	95%	3%	954,250	1,010,000	1	-	-	4 ½%
1858	19 May	95 ½%	2 ¼%	1,425,000	1,523,500	4	6 months	-	4 ½%
1859	23 February	100%	2%	508,000	508,000	1	-	-	5%
1860	16 March	90%	2 1/8%	1,210,000	1,373,000	4	5 months	-	4 ½%
1863	7 October	88%	2 5/8%	3,300,000	3,855,300	5	5 months	-	4 ½%
1865	12 September	74%	21 1/16%	5,000,000	6,963,600	7	12 months	5%	5%
1871	23 February	89%	2 ½%	3,000,000	3,459,000	5	6 months	5%	5%
1875	18 January	96 ½%	2 ¼%	5,000,000	5,301,200	7	10 months	5%	5%
1883	23 January	89%	2 ¼%	4,000,000	4,599,600	5	10 months	4 ½%	4 ½%
1886	26 February	95%	1 ¼%	6,000,000	6,431,000	5	6 months	5%	5%
1888	-	97%	1 ¼%	6,000,000	6,297,300	-	-	5%	4 ½%

Amortization rate	Date of first interest payment	Date of first amortization payment	Commission for interest payment	Drawing by lots	Purchase	Amortization system	Term for extinction
1%	1 October 1824	1 January 1825	1%	-	1/8 %	Purchase or drawing by lots	30 years
1%	1 October 1824	1 January 1825	1%	-	1/8 %	Idem	30 years
1%	1 October 1829	1 January 1830	1%	-	1/8 %	Idem	30 years
1%	1 April 1839	1 January 1840	1%	½%	1/8 %	Idem	30 years
Not fixed	1 June 1843	1 January 1844	1%	½%	1/8 %	Idem	20 years
1%	1 July 1853	1 December 1853	1%	½%	-	Idem	30 years
1.19.0%	1 December 1858	1 December 1858	1%	½%	1/8 %	Idem	20 years

Amortization rate	Date of first interest payment	Date of first Amortization payment	Commission for interest payment	Drawing by lots	Purchase	Amortization system	Term for extinction
1%	1 October 1859	1 October 1859	1%	½%	1/8 %	Idem	30 years
1.13.0%	1 June 1860	1 October 1860	1%	½%	1/8 %	Idem	30 years
1.13.0%	1 April 1864	1 October 1864	1%	½%	1/8%	Idem	30 years
1%	1 March 1866	1 March 1867	1%	½%	1/8 %	At par drawing	37 years
1%	1 August 1871	1 February 1873	1%	½%	1/8 %	Purchase or drawing by lots	38 years
	1 July 1875	1 July 1877	1%	½%	1/8 %	Idem	38 years
1%	1 June 1883	1 June 1884	1%	½%	1/8 %	Idem	38 years
1%	1 July 1886	1 July 1887	1%	½%	1/8 %	Idem	-
1%	-	-	1%	½%	1/8%	Idem	-
1%	-						-

Source: Carreira (1980)

Note: The date of the second loan phase in 1824 was adjusted. The original table showed September 7, 1824. According to Carreira (1980) and Bouças (1950), the date was January 12, 1825. (The author of this chapter takes full responsibility for any errors herein).

Note that the 1824 loan was made in two tranches and with different bankers;²⁷ also, all the loans were taken in pounds, mostly through the house of Rothschild & Sons or their representatives. Loans in other currencies would only become more common during the Republic, starting with loans in Swiss francs in 1905 and gaining momentum, with other loans in US dollars in the 1930s.²⁸

The evolution of external indebtedness is quite similar to that of the domestic debt.²⁹ As they were related to the country's socio-economic conditions, they can be analyzed in line with the two periods of Brazilian financial history during the Empire:³⁰ (a) the rough period (1822-1850) and (b) the construction period (1850-1889).³¹ Graph 1 illustrates this evolution by highlighting loans volumes and prices in each period.

Loans taken during the *rough* period of "conflicts and consolidation" (1822-1850) began with the "first independence external loan" in 1824-1825, to shore up the Empire's finances that had been plundered due to the extraordinary expenses on defense, security and stability.³² Because the financial crisis persisted,

²⁷ The first tranche of £1,000,000 was raised among the bankers Bazeth, Farquhar, Crawford & Co., Fletcher, Alexander & Co., and Thomas Wilson & Co., while the second tranche, of £2,000,000 was contracted with the house of Nathan Mayer Rothschild.

²⁸ Abreu (1988) describes the loans by currency, in three categories: pounds, US dollars and others. He also classifies loans into those made at the Federal, state and municipal levels. External public debt during the Imperial Period was formed almost exclusively by Federal loans. States and municipalities became indebted from the mid-1880s onward.

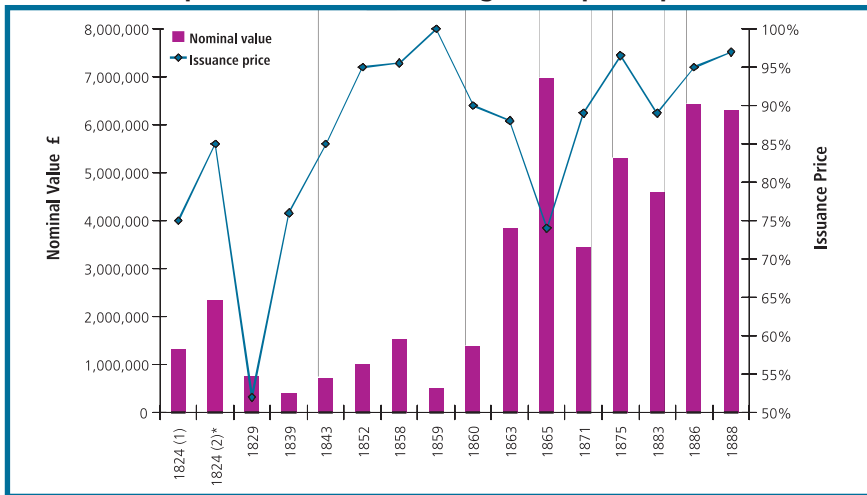
²⁹ For example, both grew substantially in the 1860s and 1870s.

³⁰ The two periods are described by Bouças (1950).

³¹ Of the 15 loans, two (in addition to the assumption of the Portuguese debt by the Secret Convention of 1825) were taken out in the First Reign, one was during the Regency Period in the Second Reign, and the other 12 were during the government of Pedro II, in the Second Reign.

³² Bouças, 1950.

Graph 1. Loans issued during the imperial period



Source: Carreira (1980). Data from Table 3
Prepared by: Anderson Caputo Silva

another loan was taken in 1829, historically known as “ravaged”, due to its extremely unfavorable conditions (e.g. the price of issuance was only 52% of its face value), caused by: (a) the precarious state of the Treasury’s finances,³³ and (b) the high risk-aversion of creditors against international loans following the default of other South American countries.³⁴ This is probably the first example of a “contagion effect” on Brazilian debt, where external events not necessarily related to the country’s capacity to honor its obligations affect the price/issuance conditions. This phenomenon was repeated later, such as during the Asian Crisis in the late 1990s, which particularly affected sovereign bonds issued by emerging economies in the international markets.

The loans of 1839, the only one taken during the Regency period, and 1843 (in the first years of the Pedro II government) are the last of those contracted before the Construction Period began in 1850. While the first was taken to meet the deficits of the Ministries of Finance, Navy and War,³⁵ the second was motivated by the Convention of July 1842, which ratified settlements of accounts between Brazil and Portugal, according to the Treaty of August 1825.³⁶

In general, contractual conditions began to improve in 1850, during the growing period. Also, the volume of loans rose dramatically in the 1860s, mainly to cover expenditures for the Paraguay War³⁷ and the more favorable perception of Brazilian credit overseas.

Most of the loans from the Imperial Period - 11 out of 15 external loans were taken during the Construction Period (1850-1889). Three are worth highlighting. The first (1852) marked the beginning of this new phase and was the first with interest rates below 5%. The second (1859) represented an exchange

³³ In a speech on April 2, 1829, Pedro I said: “The miserable situation of the public treasury is clear under any circumstances and I feel sorry for having to foresee that, if in this extraordinary session and in the course of the ordinary one the assembly, despite my reiterated recommendations, fails to find a substantial business to engage into, the future awaiting us is bound to be disastrous” (Bouças, 1950).

³⁴ Bouças, 1950.

³⁵ The Regency period was marked by several political conflicts in many provinces (Pará, Maranhão, Pernambuco, Alagoas, Bahia and Rio Grande do Sul), which deeply affected the country’s finances.

³⁶ Carreira, 1980.

³⁷ This had a temporary negative effect on the price of Brazilian securities.

operation, at par, of the very instruments remaining from the “ravaged” loan of 1829. Investors could choose from receiving payments in cash or new securities in exchange for the debt of 1829; since their perception of the country was so positive, more than 90% opted for securities. The third loan (1865) was notable for its large size (£6,963,600) and was taken to finance “extraordinary services of the Empire,” mainly connected to the Paraguay War. Interestingly, its conditions were not as good as those offered in most previous loans (the issuance price was 74% of face value and interest rate was 5%), due to the war and an international crisis affecting financial markets.³⁸

In October 1889, due to a positive financial situation, the government (under the leadership of the viscount of Ouro Preto, who was Minister of Finance) launched a mega-operation in the amount of £19,837,000: It converted old debts with interest rates of 5% into a new and single loan with interest rates of 4% and longer maturity (56 years). This operation to restructure liabilities, negotiated with the Rothschild bankers, was seen as a big success: Besides unifying nearly the entire debt into a single interest level and payment schedule, the loan led to an annual savings of £437,985 in interest and amortization quotas.

Brazil stepped into the Republican Period “with the long list of external loans contracted in the previous regime, redeemed almost in its entirety [...]” Those of 1883, 1888 and 1889 were outstanding, in the amounts of £4,248,600, £6,265,900 and £19,837,000, respectively.³⁹ The initial capital of the Empire’s external loans, whether redeemed or not, totaled £68,191,900 or 640,913 *contos de réis*, according to the average exchange rate at the time. Redeemed loans totaled £37,458,000.⁴⁰

4 Public debt in the republican period

The first 74 years of public debt during the Republican Period are marked by events that help explain the characteristics of the current debt. Although management of the public debt was relatively stable, as it continued to be the responsibility of the *Caixa de Amortização*, the Period was marked by difficulties in domestic and external financing and restructuring.

4.1 Domestic public debt during the Republic (to 1963)⁴¹

Despite the impressive liability management operation at the end of the Imperial Period, when securities paying interest rates of 6% a year were converted into others paying 5% (subsection 3.1), the management of domestic debt was seriously challenged at the start of the Republican Period. First, the long stretch of time during which outstanding securities could not be redeemed (1839-1889) affected its credibility. Second, the debt was highly fragmented, due to the great diversity of instruments with different maturities and interest rates. Finally, all outstanding securities were still nominative and their transfers were thus bureaucratically complicated. The last two issues spelled trouble for domestic debt negotiation and liquidity.

³⁸ “The depression in the securities market was widespread: the 7% Egyptian securities were being quoted at 95” (i.e. securities were negotiated in the market at 95% of their face value, which required returns above the interest rate contractually agreed upon—the lower the percentage, the higher the discount); similarly, “the 5% Italian and Turkish securities remained at 65 and 70, whereas US securities, with the same interest rate, had not succeeded in getting a quotation above 68” (Bouças, 1950).

³⁹ According to Carreira (1980), revenue collected by the National Treasury during the old regime, including ordinary and extraordinary revenues, did not exceed 3,738,383 contos, while expenses totaled 4,496,565 contos; hence, this produced a deficit of 758,182 contos.

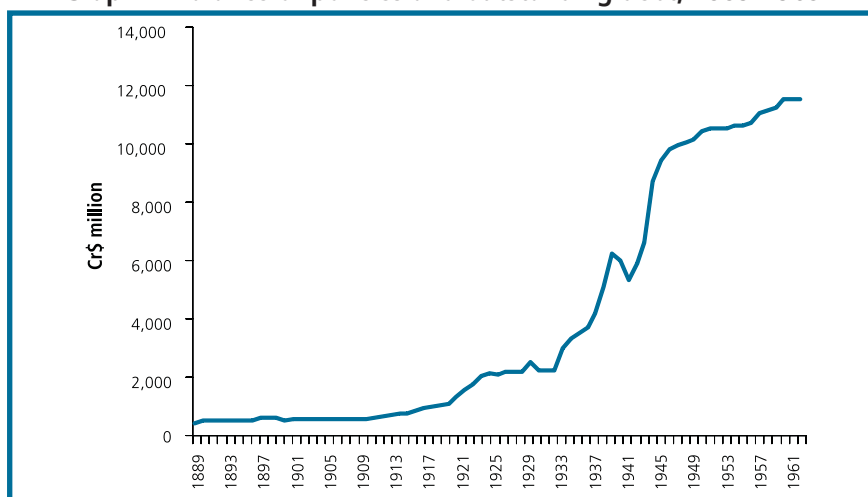
⁴⁰ Bouças, 1950.

⁴¹ Main references in this subsection: Andima (1994), Leão (2003) and Neto (1980).

Rui Barbosa, the first Finance Minister of the Republic, tried to resume the redemption of securities and issue securities to the bearers (instead of nominative). However, this process was short-lived, suspended soon after he resigned in January 1891, and the first issuance of securities to the bearers did not occur until 1903,⁴² after the consolidation of 1902, as described below. The mechanism would only be used again in 1917.⁴³

The 1902 consolidation tried to solve the problem of debt fragmentation and succeeded, at least initially. Nearly all outstanding securities were exchanged for new ones, all nominative, totaling 529,750 *contos de réis*, yielding interest rates of 5% a year.⁴⁴ However, the effect of this unification was also short-lived. From 1902-1956 (the year of a new consolidation), 145 authorizations for bond issues were granted, but they were not standardized: e.g., annual interest rates varied from 3%-7%. Further, the loans had different purposes: e.g., for covering budget deficits, sterilization of excess liquidity, funding civil works, acquiring fixed assets or companies, and repaying compulsory loans. The latter was crucial in the Republic's financing policy, especially for issuing war bonds,⁴⁵ which began in 1942, and influenced the evolution of outstanding funded domestic debt (see Graph 2).

Graph 2. Balance of policies and outstanding debt, 1889-1963



Source: Andima (1994)⁴⁶

The total amount of public securities outstanding increased by virtually 100% from 1942-1949, mainly due to the issuing of compulsory subscriptions, and was kept relatively constant until the end of 1963. In fact, the nominal growth rate from 1950-1963 was just 1% a year.⁴⁷ Some attempts to launch securities in a voluntary basis from the mid-1940s onwards were frustrated,⁴⁸ and the only relevant issuances during this

⁴² These were issued to pay for the port of Rio de Janeiro.

⁴³ The practice of replacing nominative securities with bearer securities was also regulated (Law No. 3,232, of January 1917).

⁴⁴ "The few securities that were not exchanged (fewer than 1%) lost their legal validity and prescribed in five years, i.e., in December 1907, as provided for in Decree 857 of November, 1851" (Leão, 2003).

⁴⁵ "War bonds were underwritten by compulsory loans of 3% of the salary of individuals, withheld by employers, in the amount equal to the income tax paid by individuals and corporations, for up to 3 million contos de réis. Collection receipts were exchanged for the bonds. They were also voluntarily underwritten, a course taken by many individuals, so they would not be seen as sympathizing with the three Axis powers" (Leão, 2003).

⁴⁶ Values shown in Cr\$ million (the monetary system in force from November 1942 to February 1967), according to Leão (2003). See Annex 1 for a summary of the Brazilian monetary system.

⁴⁷ Andima, 1994.

⁴⁸ For example, the government tried, unsuccessfully, to issue 6 billion securities in 1959 and 140 billion in 1962, to finance public deficit (Leão, 2003).

period were the compulsory subscriptions of Economic Re-equipment Bonds (“Obrigações de Reaparelhamento Econômico”) starting in 1958.⁴⁹

The fact that Brazil placed securities in a compulsory way pointed to the difficult situation of its public credit, after years of not paying interest or redeeming outstanding securities. Further, rising inflation made the interest paid on the debt insufficient (normally between 5%-7%), thus generating negative real yields and reducing the demand for these securities.

The stagnation of the voluntary issuing of public securities complicated the financing of growing budget deficits even further, especially as of the mid-1950s. Since it had no public credit and was unable to raise the tax burden, the government financed almost all its deficit by issuing currency, thus increasing inflation.⁵⁰

Table 4. Brazil: financing federal government budget deficits, 1954-1963
(Cr\$ current million)

Years	Deficit	Deficit Financing		
		Currency issuance	Net placement of securities and bonds with the public	Others*
1954	4.0	3.8	-2.5	2.7
1955	5.7	7.7	0.0	-2.0
1956	23.9	24.4	0.2	-0.7
1957	41.2	38.4	0.0	2.8
1958	30.7	19.0	9.4	2.3
1959	40.5	31.9	8.9	-0.3
1960	76.6	75.4	7.2	-6.0
1961	137.5	128.9	1.5	7.1
1962	280.9	223.8	22.8	34.3
1963	504.7	424.4	55.5	24.8

Source: Neto (1980). Central Bank of Brazil – 1965 Report, p. 222.

* Includes the following items: National Treasury Cash with Banco do Brasil S. A., compulsory loans and emergency loans.

If, on the one hand the Government was failing in its primary issuances, on the other it was able to carry out two large liability management operations (or consolidations). In 1956, it issued a law on restructuring the domestic federal public debt (DFPD) service, so as to standardize the debt and improve its control. Also, it was

⁴⁹ Law No. 1,474 of November 1951 established the compulsory loan in the form of additional income tax to be collected in fiscal years 1952-1956 (subsequently extended for another 10 fiscal years by Law No. 2,973 of November, 1956), so as to establish an Economic Re-equipment Fund of up to 10 billion cruzeiros. Reimbursement of the loan would occur six years after its collection, in the form of Economic Re-equipment Bonds. As a result, securities were not issued until late 1958 (Leão, 2003).

⁵⁰ Neto, 1980.

responding to strong pressure from financial institutions that were having a hard time purchasing securities in amounts sufficient to meet compulsory requirements: A key problem was the large debt fragmentation (there were over 130 different types of securities, with different printings and long-term maturities).

Thus, the law consolidated all outstanding loans into four grades, unified the redemption term for each and set new minimum amortization periods (21, 32, 36 and 68 years, respectively, for grades 1 to 4). However, there was at least one important flaw: because interest rates were not unified, several types of securities with varying rates had to be maintained. Also, the financial market thought the maturity period of the new securities was too long.

In 1962, the government approved a new and more complete consolidation. It issued the so-called Financial Recovery Securities (“Títulos de Recuperação Financeira”) to unify its domestic debt: It replaced all funded DFPD except for the economic re-equipment bonds. These securities could be used in exchange for old debt or issued to cover budget deficits, but Government attempts at the latter did not work. However, the exchange succeeded and interest rates were unified at 7% a year. Thus, by late 1963, the funded DFPD was formed exclusively by Financial Recovery Securities, Economic Re-equipment Bonds and compulsory loan receipts, which were to be exchanged by securities in the future.

A main feature in the 1962 consolidation was the introduction of a new form of redemption, which became effective in the fiscal year after it was issued: It allowed for 20 equal annual installments, each in the amount equal to 5% of the security’s nominal value. A tradition that had been maintained since 1827 was thus broken: i.e. redeeming public securities through buybacks when quoted below par, or on drawing lots for a percent of the total volume issued.⁵¹

4.2 External public debt during the republican period (until 1963)⁵²

“Much will have done for the Republic the government that does nothing but taking good care of its finances.” This quote, from the Electoral Manifest of Campos Salles,⁵³ points to the critical situation of the country’s finances in the first years of the Republic.⁵⁴

In fact, the long period of stability and gradual external indebtedness experienced from the 1840s onwards (described in Section 3.2) was temporarily disrupted at the start of the Republic Period. Successive balance of payment crises, beginning in the 1890s, marked that period in Brazil’s public debt, which involved a series of funding loans in 1898, 1914 and 1931.

The doors for resuming external indebtedness in the medium term were reopened after the two first funding loans, but the last of the three launched negotiations that led to the permanent external debt agreement of 1943. After that, Brazil would be absent from private financial markets until the mid-1960s, with the start of the second indebtedness cycle.⁵⁵

This section reviews the evolution of the external debt, funding loans and permanent agreement. Tables 5 and 6 illustrate, respectively, the balances of the external sector indebtedness (including states and

⁵¹ Leão, 2003.

⁵² This subsection is based mainly on Abreu (1999).

⁵³ Campos Sales was the fourth President of the Republic (1898-1902) and the second to be elected directly by the people, following Prudente de Morais (1894-1898).

⁵⁴ Guanabara, 1902.

⁵⁵ For the definition of indebtedness cycles according to Abreu (1999), see footnote 14.

municipalities)⁵⁶ and the impact of successive balance-of-payments crises on some of the main external solvency indicators: e.g., the decline in the public external debt-to-exports ratio started during the period of stability in Imperial Brazil (falling from 168% to 57%, from the end of 1830 through 1881), and then the rapid rise before the turn of the century, reaching its peak in 1930, at 404%.

Table 5. Outstanding balances of external public loans launched before 1931, from 1825-1955 (in millions)

	pounds*	francs*	dollars*	florins*	total in pounds*
1825	4.1	0	0	0	4.1
1840	5.6	0	0	0	5.6
1865	13.0	0	0	0	13.0
1875	20.4	0	0	0	20.4
1885	23.2	0	0	0	23.2
1895	37.5	1.5	0	0	39.0
1900	42.4	1.5	0	0	43.9
1905	83.3	5.0	0	0	88.3
1913	129.1	902**	0	0	166.0
1920	135.2	900**	0	0	172.1
1930	163.0	1,850***	371.2	0	254.4
1940	152.6	748.8**	334.7	6.5	241.0
1950	51.9	1,708****	154.3	6.4	114.4
1955	28.4	411*****	99.2	3.6	64.7

Sources: Abreu (1985); Abreu (1994), Brasil (1955) and *Anuário Estatístico do Brasil*, 1952 e 1956.

* Balances on Dec. 31.

** Provisional re-estimates. Loans in francs in 1920, considered constant since 1913.

*** Re-evaluation to take into account the French conversion of 1928 and the Hague decision against Brazil (Abreu, 1994).

**** 1951.

***** 1956.

Table 6. External debt, 1830-1940*

Year	External debt in <i>contos de réis</i> **	FOB Exports in <i>contos de réis</i>	Debt-to-exports ratio	External debt service in <i>contos de réis</i> ***	Service-to-exports ratio	Revenue****	Service-to-total revenue ratio
1830	59,013	35,135	1.68	3,289	0.0936	16,779	0.1960
1840/1841	40,995	57,727	0.71	2,087	0.0361	16,311	0.1280
1850/1851	38,181	67,788	0.56	3,547	0.0523	32,697	0.1084
1860/1861	52,281	123,171	0.42	5,151	0.0418	50,052	0.1029
1870/1871	130,660	168,000	0.78	11,044	0.0657	95,885	0.1152

⁵⁶ State and municipal loans accounted for about 4% of the total in 1895; in 1930, this share had increased to about 30% of total external indebtedness (Abreu, 1999).

Year	External debt in contos de réis**	FOB Exports in contos de réis	Debt-to-exports ratio	External debt service in contos de réis***	Service-to-exports ratio	Revenue****	Service-to-total revenue ratio
1880/1881	130,995	230,963	0.57	19,696	0.0854	128,364	0.1534
1890	328,431	280,665	1.17	16,077	0.0573	195,253	0.0823
1900	1,471,359	850,339	1.73	37,128	0.0436	307,915	0.1206
1910	1,929,746	939,413	2.05	149,867	0.1595	882,189	0.1699
1920	3,506,408	1,752,411	2.00	231,155	0.1319	1,548,168	0.1493
1930	11,753,476	2,907,354	4.04	857,432	0.2929	3,276,171	0.2617
1940	16,288,024	4,960,538	3.28	205,401	0.0414	4,664,813	0.0440

Source: Abreu (1999), base data from *Brasil em números 1960*.

* Until 1930, the nominal value of redeemed securities. After 1930, the market value.

** End of the calendar year.

*** Calendar year.

**** Federal until 1900. Federal, states and municipalities starting in 1910. The debt-service-to-Federal revenue ratio was 28.56% in 1910. Until 1880, the external debt was exclusively Federal

4.2.1 The first funding loan, 1898

As noted earlier, Brazil had serious balance-of-payments problems in the years before the turn of the century.

The trade balance fell, the debt service increased, and the entry of new loans decreased. The result was a steep decline in the exchange rate from some 27 pence per each 1,000 réis in 1889 to 7 pence in 1898. The financial crisis in Brazil had encouraged the search for solutions that mitigated the exchange crisis (Abreu, 1999).

Thus, the suspension of debt service payments was somewhat expected on the international scene.⁵⁷ In addition to the clear signal in Campos Sales' Electoral Manifest on behalf of the Republic's financial recovery, there was also the Argentine experience (the country negotiated its funding loan in 1891), which inspired a similar initiative in Brazil.

The 1898 funding loan involved the gradual issuing of £8.6 million to pay interest on (a) external federal loans, (b) the 1879 domestic loan in gold and (c) all railroad guarantees. Besides, amortizations of all debts included in the transaction (including those from new securities) were suspended for three years, until 1911. The new securities were issued at par, with a 5% interest rate and 50-year amortization, starting from the end of the suspension period. These features explain the outstanding balance of the 1898 funding loan (see Table 7).

4.2.2 The second funding loan, 1914

Table 5 shows the rapid increase in the country's external indebtedness in the first 13 years of the 20th century, when debt rose four-fold, from £43.9 million to £166 million. This impressive increase and the resumption of debt service payments were just some of the factors that deteriorated the balance-of-payments as of 1912.⁵⁸

⁵⁷ "British diplomats had expected debt payments would be suspended since early 1898. In February of that year, N. M. Rothschild & Sons Limited were visited by the Treasury delegate in London and tested with regard to their reaction in the case of a temporary suspension of the amortization funds of the Brazilian external debt" (Abreu, 1999).

⁵⁸ Abreu's (1999) examples include reduced coffee exports (due to price drops in the US) and rubber exports (due to the compe-

Table 7. Outstanding balance of funding loans in pounds and dollars, 1898-1945
(in millions)

	Funding loan 1898 pounds	Funding loan 1914 pounds	Funding loan 1931 pounds 20 years	Funding loan 1931 pounds 40 years	Funding loan 1931 dollars 20 years
1898	1.4	0	0	0	0
1899	4.3	0	0	0	0
1900	7.2	0	0	0	0
1901	8.6	0	0	0	0
1913	8.5	0	0	0	0
1914	8.4	0	0	0	0
1915	8.4	6.2	0	0	0
1916	8.3	10.0	0	0	0
1917	8.2	13.1	0	0	0
1918	8.2	13.2	0	0	0
1919	8.1	13.8	0	0	0
1920	8.0	14.5	0	0	0
1930	6.9	14.2	0	0	0
1931	6.8	14.0	n/a	n/a	n/a
1932	6.5	13.9	n/a	n/a	n/a
1933	6.3	13.7	1.9	6.6	21.8
1934	6.2	13.6	2.6	7.9	29.5
1943	5.0	12.3	1.8	6.6	18.6
1944	4.7	11.2	1.5	5.1	16.4
1945	4.4	10.7	1.4	6.8	15.5

Source: Abreu (1999) and Brasil (1955)

As a result, negotiations were begun in 1913; however, difficulties arose with banks of different nationalities which slowed the process, and talks were suspended on June 27, 1914, on the eve of Austria-Hungary's declaration of war against Serbia, and its rapid spread across Europe.⁵⁹

Brazil suspended external debt service as of August 1, 1914 and began to assess the conditions for a new funding loan. The nominal capital of the second loan would not exceed £15 million and, like the first, new securities were gradually issued at par, with 5% interest, a 63-year amortization period and redemption starting in 1927. The amortization of all Federal loans denominated in pounds or Swiss francs was also suspended until August 1, 1927 as was interest on loans falling due between August, 1914 and July, 1917.

tion from Asia) and the difficulty in contracting new international loans given the political deterioration in Europe, especially in the Balkans.

⁵⁹ Abreu, 1999.

4.2.3 The third funding loan, 1931

The history behind the third loan is similar to that of the previous ones: Rapid growth of external indebtedness as of 1925⁶⁰ (although on a smaller scale than that as of 1913), followed by factors that deteriorated the balance-of-payments, starting in mid-1928.

The funding was issued in two series, both with a 5% interest rate, which planned redemption for 20 and 40 years, depending on the guarantee of each loan, whose interest rates were being refinanced. For loans in dollars, only 20-year securities were issued. Total issuance was limited to about £18 million to refinance the interest of Federal loans falling due as of October 1931 for a three-year period.⁶¹

4.2.4 The permanent agreement of 1943

As mentioned earlier, the third funding loan (1931) was the first step in long negotiations that led to the permanent external debt agreement of 1943. There were some noteworthy events during this period: (a) a temporary agreement in 1934 named the "Aranha scheme" which was to last four years and resume paying the external debt in that same year; (b) the 1937 default, which was blamed on the November 1937 coup,⁶² and which interrupted the "Aranha scheme" before its planned deadline;⁶³ (c) another temporary agreement (the "Souza Costa scheme") in 1940, also interrupted before the end of its planned four-year duration; and (d) signing of the 1943 permanent agreement, which solved the issue regarding servicing the external debt incurred until 1931.

The rush to find a permanent solution even before the end of the "Souza Costa scheme" arose from the realization (by Souza Costa himself) that Brazil once again had difficulties financing its balance-of- payments.⁶⁴

As described by Cardoso and Dornbusch,⁶⁵ the permanent agreement consolidated the external debt, lengthening its maturity from 40 to 60 years and reducing both interest and principal. The plan offered bondholders two options:⁶⁶ Option A, which did not include reducing the principal, lowered interest with a provision for a sinking fund. As a result, debt service (interest plus the sinking fund) would reach 2.9%-5.9% of the principal annually. Option B would involve reducing principal and interest. For each \$1,000 of the original security, new securities with a face value of \$800 (or \$500 in some cases) and 3.75% coupons were issued. Also, bondholders would receive a cash payment from \$75-\$175. These securities had no fixed maturity but rather a sinking fund. Debt service in this option (interest plus sinking fund) totaled 6.4% of the principal. These conditions implied a 50% drop in the balance of outstanding external debt (Table 5).

⁶⁰ "The unique aspect of the new indebtedness was the presence of loans in dollars, which, over the decade, accounted for 75% of the inflows of external resources relative to loans in Brazil" (Table 5) (Abreu, 1999).

⁶¹ Abreu, 1999.

⁶² November 20, 1937 witnessed the beginning of the Getúlio Vargas dictatorship. Vargas took office for the first time in 1930 and through a coup d'état, remained until October 29, 1945. This republican period became known as the New State. He would be elected president again and remain in office from 1951-1954 (when he committed suicide and his term of Office, which should have lasted in 1956, was ended).

⁶³ This is the only complete default by the Brazilian central government before 1987

⁶⁴ Souza Costa realized early in 1943 that, after the war, Brazil's exports would have problems adjusting to the competition in a normalized global market, and there would be intense pressure on the existing foreign exchange reserves for imports of essential capital goods, for which there was a strong pent-up demand (Abreu, 1999).

⁶⁵ Cardoso and Dornbusch, 1989.

⁶⁶ This exchange proposal, early in 1946, was agreed to by 78% of bondholders; 22% chose option A and the other 56% chose option B (Cardoso and Dornbusch, 1989).

Despite the impressive debt reduction resulting from the 1943 consolidation, Brazil once again experienced imbalances in its external accounts early in the 1950s as a result of the high trade deficits that followed the flexible import controls during the Korea War. The explosive growth of current account deficits exhausted international reserves and led to a crisis in the balance-of-payments in 1952.⁶⁷ Since these imports were financed mostly by trade credits that were subsequently rolled over by short- and medium-term loans, the total external debt (public and private) doubled between 1946 and 1953, reaching over \$1 billion.⁶⁸

The policy to expand infrastructure and industrialization led by the incumbent president Juscelino Kubitschek in his "Plano de Metas" or Target Program (1957-1960), increased the demand for imported capital goods, which were financed mostly by suppliers' loans with sovereign guarantees. Thus, by the end of 1961, total external debt was already twice that of 1955 and the balance-of-payments situation was critical.⁶⁹

Kubitschek's successor, Jânio Quadros, tried to stabilize external accounts but his resignation a few months after taking office created renewed pressure on current accounts in 1962. Economic problems (inflation, low economic growth and the balance-of-payments crisis) worsened during the short administration of President Goulart, who was removed from office by a military coup in 1964.

As the next chapter shows, the management and characteristics of the domestic and external public debt were strongly influenced by institutional reforms begun in 1964. Significant changes occurred since then. The second cycle of Brazilian external indebtedness was emerging at the same time that an internal debt market was developing; these shed light on the current structure and institutional development of the country's public debt.

⁶⁷ Abreu and Fritsch, 1987.

⁶⁸ See Cardoso and Dornbusch (1989).

⁶⁹ The Kubitschek administration started negotiations with the International Monetary Fund. However, in mid-1959, the Government did not accept the IMF conditions and ended negotiations.

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Annex 1. Brazilian monetary systems

Monetary system (symbol)	Legal effect	Equivalence to previous standard	Equivalence R\$ 1.00 (one real)
Réis (Rs) and (\$)	Beginning of colonization, early 16th century to 10/30/1942	...	Rs2,750,000,000,000:000\$000
Cruzeiro (Cr\$)	11/01/1942 - 12/01/1964	Rs1\$000 = Cr\$1.00 (1,000 réis = 1.0 cruzeiro)	Cr\$2,750,000,000,000,000
	12/02/1964 - 2/12/1967	Cr\$ 1.00 = Cr\$ 1 (1.0 = 1.0) * cents were abolished	Cr\$2,750,000,000,000,000
Cruzeiro Novo (NCr\$)	2/13/1967 - 5/14/1970	Cr\$1,000 = NCr\$1.00 (1,000 cruzeiros = one cruzeiro novo)	NCr\$2,750,000,000,000
Cruzeiro (Cr\$)	5/15/1970 - 8/15/1984	NCr\$1.00 = Cr\$1.00 (one cruzeiro novo = one cruzeiro)	Cr\$2,750,000,000,000
	8/16/1984 - 2/27/1986	Cr\$1.00 = Cr\$1.00 (one cruzeiro = one cruzeiro) * cents were abolished	Cr\$2,750,000,000,000
Cruzado (Cz\$)	2/28/1986 - 1/15/1989	Cr\$1,000 = Cz\$1.00 (1,000 cruzeiros = one cruzado)	Cz\$2,750,000,000
Cruzado Novo (NCz\$)	1/16/1989 - 3/15/1990	Cz\$ 1,000.00 = NCz\$1.00 (1,000 cruzados = one cruzado novo)	NCz\$2,750,000
Cruzeiro (Cr\$)	3/16/1990 - 7/31/1993	NCz\$1.00 = Cr\$1.00 (one cruzado novo = one cruzeiro)	Cr\$2,750,000
Cruzeiro Real (CR\$)	8/01/1993 - 6/30/1994	Cr\$1,000,00 = CR\$1.00 (1,000 cruzeiros = one cruzeiro real)	CR\$2,750.00
Real (R\$)	As of /07/01/1994	CR\$ 2,750.00 = R\$ 1.00 (2,750 cruzeiros reais = one real)	...

Source: Central Bank of Brazil

Note: Equivalences are neither to correct values nor to show the purchasing power of the currency.