Brazil

Introduction

Brazil is now one of the world’s principal economies. Gross national product (GNP) in 2012 ranked sixth or seventh, and population fifth. In per capita terms, adjusted by purchasing power parity, results were less illustrious. Brazil stood closer to 80th. Size alone did not translate into national productivity.

That was especially true during much of the 19th century, before income growth began to accelerate after the 1870s. During the 20th century Brazil achieved one of the highest rates of expansion among developing countries until the lost decade of the 1980s, when improvement was essentially nil. That last experience coincided with a return to civil governance and a series of failed attempts to terminate mounting inflation in two elected administrations. None the less, that period was short, and lessons were learned.

With the Plano Real of 1994, growth and price stability finally took hold. Happily, that course has continued up to the present. Along with expanding income, poverty declined and the very unequal income distribution began to improve. The Bolsa Familia, a conditional cash transfer programme, contributed to this result, as did a greater than average rise in the minimum wage. Attention turned to other social programmes, like health, education and social security, bringing improvements to all. In 2010, in rapid recovery from the Great Recession, economic expansion mounted to new heights of 7.5%. Expectations resurfaced: Brazil was not condemned to Sisyphean failure to achieve an advance to first world status.

With Dilma Rousseff’s presidency beginning in 2011, lower growth and higher inflation have returned. Seeking to cope with that recurrence has become a central issue as Brazil girds itself for the presidential campaign in 2014. In the last section of this chapter I return to present policy choices and their future implications, but beforehand, some brief discussion of the past will help in appreciating the challenges that lie ahead.

Looking back much longer

Portuguese colonial possession of Brazil, originating with Pedro Álvarez Cabral’s discovery in 1500, extended until 1822. Remissions to Portugal were financed by the export of precious metals,
diamonds, tobacco, cotton and sugar produced under slavery. As other Latin American countries struggled for freedom through military revolt in the post-Napoleonic era, Brazil’s independence emerged more peacefully. The Prince Regent, Dom Pedro I, already in Brazil as a result of prior French invasion of Portugal in 1807, simply accepted dominion as Emperor Dom Pedro I. That substitution came with a transfer of previous Portuguese debt, a dominant position of England as a source of manufactured products, and a continuation of slave importation for almost another 30 years.

Brazil succeeded in only slow expansion until the great international flow of trade and capital beginning in the 1870s. That much seems to be agreed upon. Despite the increase in coffee production, which by the 1830s accounted for more than 40% of aggregate exports, the domestic economy did not take off. Gains occurred before 1870 principally as a consequence of special circumstances: a rise in coffee prices, a late surge in sugar exports, and favourable, but temporary, effects of the US Civil War on cotton exports. Terms of trade rose by 50%, principally as a result of cheaper prices of imports between 1830 and 1850, with little change thereafter. The long war of the Triple Alliance with Paraguay in the 1860s did change the distribution of government expenditures and their magnitude, creating large deficits and inflation, as well as increasing the foreign debt. Like the US Civil War, there seem to have been only limited consequences for economic activity as a whole. According to Abreu and Lago, per capita income grew by approximately 0.2% annually between 1822 and 1870, and the population by around 1.5%.

From 1870 to 1913 Brazil entered more vigorously into the world economy. Immigration occurred from Italy to southern Brazil along with domestic movement from the north-east. Railways expanded, with large foreign investment in response to governmental guaranteed rates of return. Coffee exports multiplied, as did later expansion of rubber sales abroad. Domestic production of textiles began to expand, in the aftermath of the Encilhamento’s rapid burst of inflation and devaluation in the first years of the new republic after 1889. Despite a brief relapse thereafter, and a need to renegotiate its external debt in 1898, Brazil benefited once more from improved terms of trade in the decade before the First World War. Indeed, for the first time, Brazil adhered to the gold standard. During this period, the population expanded by 2.2% annually, and national per capita income by at least 2.5%, but much higher productivity growth was to be found in the thriving southern part of the country, possibly to the extent of allowing expansion of 1.5% per capita.²

Per capita income remained one-fifth that of neighbouring Argentina, and had declined from perhaps one-half of the US level in 1820 to about one-tenth in 1913. Brazil, despite its great size and its greater advance after 1870, lagged considerably behind other Latin American countries. Integration into an expanding international economy had come late and in a diluted form. Regional differences between the north-east and the south would continue to widen in the 20th century as more active protective policies of state engagement to enhance industrial production evolved. Concern about coffee producers stockpiling excess supply in order to regularize price came earlier. Brazil managed better than most other Latin American countries to reconcile the divergent interests of its nascent import-substituting manufacturing sector and its still dominant agricultural class. A larger state and tolerance for inflation were two significant reasons.

The Great Depression: a saviour³

Despite early efforts at import substitution in the 1890s and subsequent rapid growth of manufactures between 1906 and 1912, Brazil on the eve of the First World War had only a primitive industrial structure. Textiles continued to be imported; external sources accounted for more than one-third of consumption. Although considerable advances in the production of processed foodstuffs had occurred, agricultural imports remained large, rivalling those of iron and steel. The
The domestic capital goods sector was essentially non-existent. No more than 3% of the labour force was engaged in manufactures.

The war interrupted this development process based upon the continuing expansion of exports and the beginning of import substitution. Trade was curtailed, especially imports, and population inflows were much lower. There was irregular and slower industrial growth, a reduced rate of capital formation imposed by limited access to imports, and evidence of rising urban profits inspired by higher inflation.

International conflict was therefore not a great stimulus for industrialization, but neither was it an unequivocal check. Absence of imports reversed an earlier rise that was gathering force owing to abundant foreign exchange generated by the Amazon rubber boom. These windfall gains found their way into a considerable post-war expansion of industrial capacity. None the less, Brazilian industrialization was still fragile. As late as 1919 imports of manufactures constituted almost as large a contribution to industrial supply as domestic value added. External competition remained, despite protection afforded by high tariffs.

That threat became apparent during the 1920s. Conservative domestic monetary policy had as its objective appreciation of the milreis. Industrial growth slowed under tight credit and cheaper imports. Between 1922 and 1926 it virtually stagnated, recovering thereafter. Had the influx of imports not occurred—financed in part by rapid expansion of foreign loans—industrial growth in those years perhaps would have been close to 8%. As a consequence, the decade ended with excess capacity and uncertain direction.

The Great Depression definitively resolved both. Brazil was among the countries initially hardest hit, not least because new investments in coffee undertaken in the 1920s began to yield output only in the early 1930s. Coffee prices fell by 60% between 1929 and 1931, and continued at low levels thereafter. Consequently, Brazilian capacity to import never went beyond two-thirds of its earlier magnitude.

Yet, Brazil succeeded in sustaining an industrial growth rate of more than 10% annually between 1932 and 1939; that of gross domestic product (GDP) attained almost 6%. In the first instance, government policy stimulated demand by protecting, at least partially, the internal income of coffee producers, through the purchase and destruction of coffee stocks, as well as by a speedy real devaluation. Coffee sector receipts modestly recovered between 1932 and 1936. Second, federal government deficits, some not initially intended and generated by the uprising in the state of São Paulo, also helped. Third, there was an expansive monetary policy.

The role of coffee policy alone should not be exaggerated. Not much more than 10% of total income was generated by the sector, and receipts were not fully sustained. In the absence of compensatory action there, however, results clearly would have been less positive. Brazil proceeded as autonomously as it did because the economy was not so open: the ratio of exports to GDP was not much more than 15%. That independence granted scope for national action.

Supply responded initially on the basis of the excess capacity accumulated in the 1920s. Competitive imports fell rapidly as limited foreign exchange was diverted to debt service. Labour intensity of production increased during the decade as extra shifts were employed fully to utilize scarce capital. New investment was undertaken during the period, but in amounts limited by access to imported machines and concentrated in the newer sectors.

Rapid growth in manufactures during the decade was underwritten by a massive substitution of imports. In aggregate, about half of the observed increase in industrial sector value added can be explained by reduced import supply. Most rapidly growing industries were found in the intermediate and capital goods sectors, reflecting earlier domestic production of consumer goods: textiles, shoes, clothing and foodstuffs. Industry became increasingly concentrated in São Paulo, which even before the depression was more oriented to these technologically advanced sectors.
By 1939 Brazil’s manufacturing sector employed some 9.5% of the labour force. Some diversification had occurred. Industry remained, however, relatively backward. Import substitution driven by necessity, while impressive, imposed a capital-scarce industrialization less capable of international competition. That was despite constant real wages—a possibility sustainable only for short periods under special economic and political circumstances. Industrialization under the impulse of adverse shocks is not without some limitations.

Table 3.1 provides a summary of income, inflation, trade and fiscal data from 1900 to 1939. Up until 1913 data were scarce. As Luis Catão has recently shown, research can produce a better measure of price movements from 1870 to 1913.\footnote{A smaller gain occurred as economic globalization proceeded between 1900 and 1913, with much more rapid advance after the early 1930s. In the first instance, outward orientation and British foreign investment predominated. In the second, it was closure and domestic demand alone that drove the economy at a much greater rate in the midst of the Great Depression.}

Import substitution unfurled\footnote{Post-Second World War industrialization evolved as a deliberate policy of state intervention. That differentiates it from earlier advances. Three elements characterize the disequilibrium model that emerged.}

One was reliance upon commercial policy to implement a large transfer of resources between agriculture and industry. Early on, an overvalued exchange rate taxed agriculture while subsidizing industry through providing low-cost imports. Later, however, this advantage to industry via more favourable exchange rates had to give way to direct fiscal support as primary export prices fell soon after the Korean War.

That imposed a new characteristic of rapid industrial growth previously absent: accelerating inflation. Rising government expenditures to support subsidies, essential infrastructure and urbanization were not matched by increased taxes. The fiscal deficit accordingly grew, and was financed by accommodating monetary expansion and forced domestic savings as inflation progressively rose.

The third characteristic was reliance upon foreign capital. Direct investment within the dynamic industrial sector matched the entrepreneurial and technological requirements of more

*Table 3.1 Aggregate economic data, 1900–39*

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<tr>
<td>1900</td>
<td>12,332</td>
<td>680</td>
<td>2.3%</td>
<td>−8.9%</td>
<td>4.21%</td>
<td>18.6%</td>
<td>15.0%</td>
<td>−3.1%</td>
<td>3.5%</td>
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<tr>
<td>1913</td>
<td>21,734</td>
<td>919</td>
<td>2.5%</td>
<td>−4.10%</td>
<td>20.33%</td>
<td>14.8%</td>
<td>18.1%</td>
<td>−2.8%</td>
<td>−</td>
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<tr>
<td>1929</td>
<td>44,941</td>
<td>1,366</td>
<td>2.1%</td>
<td>−3.57%</td>
<td>10.98%</td>
<td>11.9%</td>
<td>13.7%</td>
<td>−0.6%</td>
<td>−</td>
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<tr>
<td>1939</td>
<td>67,712</td>
<td>1,681</td>
<td>(4.2%)\textsuperscript{b}</td>
<td>2.01%</td>
<td>13.06%</td>
<td>11.2%</td>
<td>16.0%</td>
<td>−2.5%</td>
<td>1.1%</td>
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Notes: \textsuperscript{a} These data are in 2012 US$; per capita data utilize population estimates as corrected by Mortara, not those in ipeadata; \textsuperscript{b} 1932–39; \textsuperscript{c} Value is for 1901; \textsuperscript{d} Values for 1913 are high owing to large public investment that year.
sophisticated and diversified manufactures. Consumer durable and intermediate sectors then favoured by the government could not have expanded domestic auspices. Foreign investment was especially needed to finance imports of capital goods as export receipts stagnated and terms of trade fell after 1953.

All three elements so central to the Brazilian import substitution model were subject to reversal. Exchange overvaluation eventually took its toll on any diversified supply of exports. That began to inhibit access to imports. The necessary taxes went beyond the temporary of bonanza coffee profits. Forced savings relied upon a continuing rise in the rate of inflation, and such an acceleration provoked additional distortions. Not least of these was the cyclical effect upon real wages of urban workers. Apparent wage gains would fall short of any real increase when price increases were greater than they had been. As inflation mounted to 40% by the end of the decade, union resistance mounted.

Foreign investment supplemented by private short-term capital inflows attracted by very favourable returns were not stable and dependable sources of finance. Investment was bunched as large projects were undertaken to the point of completion, as in the automobile sector. This was not a smooth process even for an economy as large as Brazil’s. Time was then needed to allow the growth in supply to catch up with demand.

Efforts to resolve these contradictions in time proved inadequate. Exports responded only slowly to more favourable policies, and confronted a competitive world market where prices of primary products were falling. Fiscal and monetary policy operated irregularly and inadequately. Foreign capital flows dried up, provoking continuing balance of payments crises in the early 1960s and partial and unsuccessful short-term liberalization under the guise of the International Monetary Fund (IMF).

It later became fashionable to criticize this flawed import substitution industrialization from the perspective of the successful Asian development strategies of the late 1960s and early 1970s that relied upon industrial exports. Three observations on the Brazilian experience place the policies that were pursued in a more favourable light.

First, the contribution of import substitution during the 1950s was not a significant component of the domestic demand for manufactures. The ratio of imports to domestic production was already quite low by 1949 and its subsequent decline during the decade accounts for less than one-fifth of the observed growth of manufactures. This is in sharp contrast to the Great Depression experience. Even a constant import-income ratio would have permitted significant growth of manufactures.

In the second instance, Brazilian industrialization was not as inefficient as the inflated tariff structure made it appear. Impossibly high rates of effective protection are the result of temporary measures to deal with the balance of payments, and do not measure real cost differentials. The economic miracle of the late 1960s had its basis in the diversified industrial structure and excess capacity derived from the past rather than divine mystery. Brazil’s subsequent positive export performance in manufactures benefited from subsidies, but not entirely. That capital-intensive industrial development was accompanied by a 2.4% annual rate of productivity growth that far exceeded previous experience.

Third, exchange rate devaluation to encourage exports would have been inadequate. Primary product specialization in the later 1950s did not represent a feasible solution. Brazil faced international competition from other producers, even in coffee. Policies and priorities logically favoured industry under such circumstances, and were not as prejudiced against external market opportunities as some retrospective views suggest.

In any event, Brazilian import substitution led to increasing domestic inflation and balance of payments disequilibrium in the early 1960s. The IMF intervention was too little and too late to
help. Political circumstances—the resignation of President Jânio Quadros and the apparent radicalization of his successor, President João Goulart—rapidly deteriorated. US aid contributions from the Alliance for Progress were caught up in fears of foreign influence. By the end of March 1964, the military intervened and imposed a quite different economic solution.

The Brazilian miracle

That new model was characterized by greater integration into international markets; by a larger and more centralized fiscal capacity; by a structure of subsidies and incentives favouring profits rather than wages; by enactment of monetary correction to diminish inflation induced distortion; by institutional reforms modernizing andaltering the rules of the social security system, internal financial markets, tax laws, etc.; and by technocratic economic management as a counterpart to authoritarian political control.

For all its frank commitment to capitalism, this strategy never corresponded to a free enterprise prototype. Brazilian economic strategy has been more pragmatic and rooted in an interventionist tradition. Government participation in the economy, an object of rightist criticism in 1963, actually increased after military intervention. Public investment, whether direct in infrastructure or through state enterprises, rose as a percentage of capital formation. Regulation of economic activity did not wither away. Subsidies and incentives proliferated and so did price controls; they were accepted and welcomed so long as private profits also grew. Public control over resources expanded via taxes as well as forced savings accumulated through the social security system.

Nor did the prior emphasis upon industrialization alter. Agricultural exports did not receive anything like the same subsidies as manufactures, and indeed continued to be implicitly taxed by protection against foreign industrial imports. Agricultural production for domestic consumption received comparatively little attention, not surprisingly since the principal foodstuffs were primarily produced by small and medium-sized units. Foreign investment and modern capital-intensive technology were again welcomed.

This model has been praised for the extraordinary growth it fostered between 1968 and 1973: a rate of aggregate expansion in excess of 10% a year is no mean achievement. Yet it was also criticized for its failure to distribute income more equitably and expand access to public services to the poor. Both reactions have a basis. Indeed, this same combination of concerns about production and distribution continues to this day.

Here I wish to stress the special character and importance of Brazilian integration into world capital markets as a component of the model. Despite rapid and unprecedented export volume growth (about 10% since the mid-1960s) and favourable price trends of the same magnitude, Brazilian recovery involved even more rapid import expansion. The current account balance moved from a surplus in 1965 and 1966 to a deficit of 2.3% of GDP in 1971–73; by the end of 1973, before the rise in oil prices had its full consequence, the external debt registered 17% of GDP compared to about 10% in 1967.

That acceleration of product growth represents debt-led, rather than export-led growth. External resources, predominantly on commercial terms as Brazil for the first time became a factor in the Euro-dollar market, guaranteed availability of foreign exchange for voracious import requirements. Those resources also permitted a surge in investment that did not have to be financed domestically at the expense of consumption. They rendered unnecessary any internal capital market reforms to achieve equivalent finance.

External indebtedness continued to expand after 1973 at even more rapid rates. The quadrupling of oil prices caught Brazil just when internal bottlenecks and cyclical excesses were creating internal economic adjustment problems and inflation was resurgent. Especially
vulnerable to the rise in oil prices because 80% of its oil consumption needs were satisfied by imports, Brazil opted to postpone its adjustment to external imbalance by relying even more heavily on debt. By the end of 1978 the external debt had mounted to more than US$40 billion, representing 25% of GDP.

Such debt-financed adjustment produced less positive economic returns than the earlier phase of debt-led growth. Aggregate expansion during the 1970s proceeded at rates almost half of the earlier period, and with a stop-go alternation reflecting the absence of a strategy to deal both with the external crisis and internal imbalances in agriculture, not to mention accumulating social disparities. Debt management has been weak, permitting massive acquisition of reserves and domestic monetary expansion. Limitation of imports—held virtually constant in nominal terms between 1974 and 1978 through stricter controls—created difficulties. Inflation, at high levels since 1974, accelerated to rates approaching 100%. Oil prices went up again in June 1979.

Despite this deteriorating scenario of the 1970s, the extent of Brazil’s advance between 1950 and 1980 is quite impressive. Table 3.2 provides some quantitative data. Continued domestic protection allowed industrial production to flourish and urbanization to advance. Brazil was the leader not only within Latin America, but even challenged the Republic of Korea (South Korea) and Taiwan as they rapidly expanded. Within a world where developing countries for the first time began to keep pace with the industrialized countries, and even exceeded them, Brazil stood out.

That was not to last. In December 1979 the government recognized the crisis confronting Brazil. A new liberalization package and a new strategy were proclaimed. This was a second coming of Finance Minister Antônio Delfim Netto. It was less beneficial than his first. The heterodoxy advanced in 1979 soon gave way to orthodox austerity in November 1980. No longer were external banks willing to offer much needed finance. Debt-led recession finally came, and stayed.

Proliferating deterioration of the international economy in the wake of US attempts to reduce its double-digit inflation rate did not help. Not until 1984 would Brazil again achieve rising per capita incomes. Before then, in 1982, after an election that was favourable to the opposition, Brazil went once more to the IMF, as it had 20 years before. A series of altered agreements ensued, at every regular evaluation, but high inflation did not yield. That breakthrough was only to occur later.

In those deteriorating circumstances, the original intent of the military to appoint one final general in the indirect presidential election of 1985 gave way. A civilian would be chosen.

Table 3.2 Aggregate economic data, 1950–80

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<tr>
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<th>1950</th>
<th>1973</th>
<th>1980</th>
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<tr>
<td>GDP (bill)(^a)</td>
<td>120</td>
<td>632</td>
<td>1,022</td>
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<tr>
<td>Product per capita(^a)</td>
<td>2,310</td>
<td>6,290</td>
<td>8,590</td>
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<tr>
<td>annual rate of growth</td>
<td>4.50%</td>
<td>4.60%</td>
<td></td>
</tr>
<tr>
<td>Inflation rate</td>
<td>9.0%</td>
<td>29.6%</td>
<td>92.1%</td>
</tr>
<tr>
<td>Investment/product</td>
<td>12.8%</td>
<td>20.4%</td>
<td>23.6%</td>
</tr>
<tr>
<td>Exports/product</td>
<td>9.2%</td>
<td>7.8%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Government expenditure/product</td>
<td>19.8%</td>
<td>22.2%</td>
<td>24.0%</td>
</tr>
<tr>
<td>Fiscal deficit/product(^b)</td>
<td>2.23%</td>
<td>−2.59%</td>
<td>0.60%</td>
</tr>
<tr>
<td>Current account/product</td>
<td>0.8%</td>
<td>−3.3%</td>
<td>8.6%(^c)</td>
</tr>
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</table>

Source: ipeadata, IMF, World Bank
Notes: \(^a\) These data are in US$ of 2012; \(^b\) excludes deficits of state enterprises; \(^c\) overvaluation biases direct calculation; I have tried to compensate.
instead. As it turned out, a fusion of the minority political opposition, the Partido do Movi-
mento Democrático Brasileiro (PMDB), and part of the Partido Democrático Social (PDS), the
majority party, occurred. Tancredo Neves would win as president-elect, and José Sarney as his
vice-president-elect.

An unfortunate illness interceded, and Tancredo never served. Instead, Sarney assumed leadership
of the new republic in its first years. Ever since, a new constitution, much amended to be sure,
has prevailed, and direct elections have been held regularly. Inflation was definitively tamed by
the Real Plan in 1994. Social programmes received increased attention and expenditure. Civil
society has flourished, to the extent of presidential impeachment, and in 2012 judicial conviction
of many in the Partido dos Trabalhadores (PT—Worker’s Party) leadership for participation in the

Starting over

In 1985, the Sarney government simultaneously confronted two immediate tasks: restructuring
the political system inherited from prior military rule and ending a continuing inflation of more
than 200% annually that had defied the efforts of the IMF.

The 1988 Constitution accomplished the first objective, after considerable debate and differences
that regularly led on to creation of new political parties peopled by those exiting older ones.
Frequently, individual ambitions seem to dominate any substantive divergence. At the last count,
there were more than 70 amendments in place, and more than 25 parties represented in Congress.

The heterodox 1986 Cruzado Plan, intended to implant price stability, had less success. After
an initial rapid decline to single-digit price increases, by the end of the year, after an election
where the PMDB won a congressional majority (the only time a single party was to do so),
price and wage controls had to be scrapped. They were no longer working. Not long after, the
finance minister had to go. Despite following ministers and plans, any relief was temporary.
Indeed, Brazil became unable to meet the required payments of interest and principal to private
creditors. Inflation accelerated to a level of 80% per month by March 1990, prior to the inauguration
of President Fernando Collor.

The awaited Collor Plan had its roots in the Erhard Plan of post-Second World War Ger-
many. There a sharp reduction in the quantity of money in circulation achieved success. In
Brazil, despite achieving a large primary surplus on the fiscal side, the Collor Plan did not.
Shock treatment did not work owing to erratic monetary policy, a fluctuating exchange rate and a
labour market in disequilibrium. There was no anchor to guarantee price stability. Both heterodox
and orthodox approaches need to persuade the public of likely success. Otherwise, initial con-
fidence fades and inflation rapidly returns as governments have no alternative but to increase the
quantity of money.

In October 1982 Vice-President Itamar Franco assumed the presidency following the suc-
cessful vote in the Câmara on Collor’s trial for impeachment. Immediate return to higher
growth was the goal. Inflation persisted, although the finance ministers appointed did not.
There could be no coherent economic policy when the average ministerial stay was less than
two months.

That all changed when Fernando Henrique Cardoso took office in 1993, assembling a group
of economists that had been vital to the formulation—but not the application—of the earlier
Cruzado Plan. This time, the arrangement would be done correctly, allowing market adjustments
for prices and wages rather than holding them fixed. Administered public sector prices were
able to adjust as well. This time there was no automatic inflation trigger built in, and indexing
was abolished for assets of less than a year. A primary fiscal surplus and a restrictive monetary
policy checked demand, while abundant international reserves, capital inflow, favourable terms of trade and lower tariffs allowed income growth to exceed product expansion. There was a genuine anchor provided by a stable exchange rate.

An initially hesitant public gradually came to believe in the stability of the real. They did so in time to elect Cardoso as president and he took office on 1 January 1995.

During his two terms, important changes occurred. Privatization, already on the agenda during previous administrations, accelerated. There was no movement back, despite the election of PT successors. Financial reform took place. While costly, and internal debt rose as a consequence, failure of domestic banks after the Real Plan was managed successfully. So was consolidation of state and municipal indebtedness. Trade liberalization, already underway since the Collor years, was maintained. Social security, health and education were revamped through constitutional amendment.

When financial crisis threatened in early 1999, following the earlier Asian and Russian downturns, forcing large devaluation and recession, the government responded by assuring regular primary fiscal surpluses and raising federal revenues. Brazil received pledges of more external assistance from the IMF and other international agencies than had any other country previously. Social policy, the intended objective of the second term, had to yield. The Law of Fiscal Responsibility was passed in May 2000 and transformed the budgetary process. An altered economic structure took shape. Fiscal discipline became a requirement, and has remained an obligation—with mounting flexibility during recent years. Exchange rate variability was introduced. Inflation targeting became the practice of the Central Bank.

These accomplishments were more appreciated internationally than domestically. Cardoso’s presidency ended with his declining popularity, and a rash of additional problems. Lack of rainfall in 2001 created an energy shortage; then came the US downturn, and the terrorist attacks of 11 September 2001. In December there was the Argentine exit of President Fernando de la Rua. Foreign inflows virtually ceased in 2002 as a clear break with recent advances threatened, amid still another agreement with the IMF for greater assistance.

**Continuity first, but changes later**

Luiz Inácio Lula da Silva, a labour leader and organizer of the PT, rose to president of Brazil on 1 January 2003. His inauguration afforded great joy to the left, not only in Brazil, but in the rest of Latin America. Lula promised profound forthcoming change in his inaugural address, rejecting the free market policies of his predecessor and emphasizing a campaign to eliminate hunger and want among the poor.

Immediate economic challenges, however, took priority. The exchange rate had devalued as his victory became likely, and the Central Bank interest rate, SELIC, had risen to more than 25%, yielding much the highest real rate in the entire world. His choice of Henrique Meirelles as head of the Central Bank (who remained in that position until the end of 2010) and of Antônio Palocci as minister of finance went a long way towards easing the anxiety of the international financial community. Together, the two managed to restrain internal demand by enlarging the fiscal primary surplus, and only slowly reducing interest rates. Recession in this first year could, and would, be blamed upon the inadequate policies of the Cardoso administration.

No Plan B, the hope of many fervent PT adherents, was ever to substitute that initial conservative stance. Those supporters sought full reversal of prior privatization and a Brazil that was receptive to globalization and foreign direct investment (FDI). Instead, to their chagrin, came an early proposal by the government for a constitutional amendment designed to limit the deficit accruing in state pensions, this time by imposing constraints for the first time upon employees in the public sector.
The economy responded with high average rates of growth in the years after recovery began to take hold in 2004. There was no miracle, but steady gains appeared not only in domestic performance, but also in the export growth of commodities, favoured by improving terms of trade. That led to a continuously large positive commercial surplus and, much more briefly, a surplus on the current account. Brazil was able to pay off its debt to the IMF, and as exchange rates regularly strengthened, to attract FDI and financial inflows. Reserves began to increase, and interest rates moved down—too slowly, as far as the industrial sector was concerned.

Upon re-election in the autumn of 2006, Lula launched the Programa de Aceleração do Crescimento (PAC), a set of public, and associated private, investments designed to accelerate the rate of growth to 5% per year. The largest components of the PAC, and its successor PAC II, were directed towards infrastructure and Petrobrás, but this effort was slow to get fully underway and could not manage to achieve its goals. Brazil experienced accelerating growth in 2007 and 2008, but investment managed to attain only 17% of GDP, too low to guarantee sustainable expansion.

At the end of 2008, subsequent to the failure of Lehman Brothers within the USA in September, Brazil got caught up in the Great Recession spreading to all parts of the world. There was no exemption for developing countries as the proponents of Third World decoupling had hoped. Two negative quarters of performance rapidly cooled the excess expansion of domestic demand. The Banco Nacional do Desenvolvimento Econômico e Social (BNDES) was given increased resources to lend, and reductions in taxes on consumer durables were put in place, as policy offsets to the decline.

Recovery rapidly occurred. The final tabulation for 2009 came out barely negative—a far cry from more pessimistic predictions—and in the final year of Lula’s mandate there was growth of 7.5%, bringing memories of the miracle years at the end of the 1960s and 1970s. SELIC rates, after falling to their lowest real levels in many years, around 5%, again moved upwards as the Central Bank sought to curb inflationary pressures. With continuing inflows of external money, the exchange rate appreciated and new taxes upon entry of foreign capital were imposed. Terms of trade again turned favourable, augmenting domestic income.

Adding to Brazilian optimism are substantial oil deposits off the coast. These sub-salt holdings promise to place the country among principal world petroleum producers over the next decade. They will require substantial investment for their development. Brazil passed legislation elevating the role, and profit share, of Petrobrás vis-à-vis private companies. Henceforth, the latter can bid for drilling rights only through production-sharing agreements, rather than by operating independently. In September 2010 Petrobrás transferred a sizeable amount of capital to the government in return for the proven Tupi field. This was the first stage of what many, especially political leaders, see as a bonanza of future riches available for expanded social programmes.

The period from 2003 to 2010 saw expansion of income at a rate of 4%. According to the PT, if one excludes 2003, the rate increases to 4.4%, a much better result than that experienced during the previous eight-year Cardoso period. Inflation came down, the real interest rate declined, poverty fell and income distribution improved as the Bolsa Família, incorporating more than 20% of the population, was launched. Minimum wages, too, grew well beyond the rise in income. Added to all of this were palpable improvements in education, health and greater provision of pensions for old age. A new lower-middle class, encompassing some 35 million persons, especially benefited as income distribution continued to improve.

Lula, as a consequence, was widely lauded for these accomplishments. He travelled abroad even more than his predecessor, and was honoured everywhere. Foreign policy became a central theme. Brazil reached out to Africa, the Middle East and Asia. A quest for a permanent position on the UN Security Council moved upward on the agenda. Brazil asserted leadership
of the developing countries in the still unfulfilled Doha Round. Regular meetings with the other BRICs (Brazil, Russia, India and the People’s Republic of China) were established. Brazil became an active member of the G20, an international grouping of the world’s leading economies. At the same time, Brazil terminated the ongoing negotiations for a Free Trade Area of the Americas, preferring instead to emphasize its association with other countries, particularly Mercosul (the Southern Common Market), in South America.

Close to the end of the Lula term, Brazil even reached out to play a role as a mediator in the Middle East, jointly with Turkey. That came to nought. The Security Council soon rejected the apparent accord. However, Brazil’s stature as an international player was enhanced, at least for a time.

It was little wonder that Dilma Rousseff won the subsequent election handily, despite no prior electoral experience. The PT, despite the publicized mensalão crisis, whereby allied members of Congress received regular payments, managed to emerge with new gains, notably in the poorer north-east, the birthplace of Lula. President Dilma started with a larger majority, constructed of many political parties, than Lula had achieved in either of his electoral victories.

Table 3.3 provides a statistical summary of renewed expansion from 1980 to 2010. Despite the positive results of recent years, all did not sit well for the new administration. Investment remained too low to achieve the growth of 5% that was the immediate objective. The exchange rate was overvalued, hampering exports, particularly of manufactured products. Educational quality continued to be a major issue, and one not entirely resolved by spending more money. Indeed, the cumulative social expenditures of Brazil were well above the Organisation for Economic Co-operation and Development (OECD) average, without evidence that they were having the desired outcome. Political reform continued to lag, too: constitutional change altering the multitude of candidacies for the Congressional House seemed unlikely ever to happen.

**Looking forward**

In the first two years of Rousseff’s presidency, aggregate economic performance went from bad to worse. In 2011 growth was 2.7%; in 2012 it was a mere 0.9%. All of this happened despite Central Bank reduction of interest rates to a nominal SELIC rate of 7.25% by the end of 2012. Along with it came additional Treasury credits to BNDES for expanded lending to the industrial sector. Public banks put pressure on the private sector by lowering their interest rates as

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<th>Table 3.3 Aggregate economic data, 1985–2010</th>
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<td>1985</td>
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<tr>
<td>GDP (bill)*</td>
</tr>
<tr>
<td>Product per capita*</td>
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<tr>
<td>annual rate of growth</td>
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<td>Inflation rate</td>
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<td>Government expenditure/product</td>
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<td>Fiscal deficit/product</td>
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<td>Current account/product</td>
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Source: ipeadata, IMF, World Bank
Notes: * These data are in US$ of 2012.
well. There was greater control over fiscal policy (partially eroded by postponing federal payments until the new year and similar delay mechanisms) to compensate. A better mix of fiscal and monetary decisions happened, but renewed growth did not.

Admittedly, the world economy did not help, but the principal blame was unresponsive domestic supply. Investment declined as a percentage of output, while real wages went up, and unemployment continued at record lower levels. What dynamism there was stemmed from consumption, assisted by lower taxes and greater credit, but domestic industry as a whole failed to advance sharply despite a considerable devaluation of the real.

Rousseff’s strong initial commitment was to industrial policy and a domestic sector increasing its share of product and utilizing more sophisticated technology. That undoubtedly remains, but in 2013, with low growth persisting, inflation still high, and Central Bank interest rates again on the rise, a new direction has been signalled. BNDES has turned its attention to looming infrastructure requirements: ports, roads, railroads, airports, electricity generation and transmission, housing and others. That is reinforced by preparations for the upcoming World Cup in 2014 and Olympic Games in 2016, and, of course, there is the reality of an upcoming presidential election in which Rousseff, with impressive public support, is favoured.

There remain two sharply different domestic perceptions of the Brazilian economic future. One, emanating from the PT, seeks a partial return to protection, import substitution and public sector expenditure as key. A large and expanding state is fundamental. The other emphasizes a need to take advantage of a globalizing world affording opportunities for greater Brazilian trade participation, with the North as well as the South. This is hardly a free enterprise alternative, but one in search of efficient intervention. The state will hardly disappear, nor shrink in importance. In particular, education will be a prime area of importance.

To a considerable extent, Brasil em 2022, produced at the very end of the Lula administration, conveys the former. That document specifies an annual growth rate of 7%, along with impressive social gains and much greater income equality. Those hundreds of objectives—although some are mutually inconsistent—have hardly been forgotten. In April 2013, at an event announcing expanded public works, Rousseff reiterated that doubling income per capita by 2022 remained the goal.7

That is a miracle of historic Chinese proportions, but one achieved with considerably less drastic means. Brazil accomplished its miracle with an investment rate that was less than half China’s, a labour force already urban, much greater government less reliance on social objectives, and international trade. Social security obligations will rise in future years, gradually eliminating the primary surplus, and increasing the financial deficit, even with lower real interest rates. Potential profits from the sub-salt oil reserves run the risk of lower international petroleum prices stemming from expanded use of ‘fracking’ technology in the USA and elsewhere.

Even to grow at an annual rate of 3% per capita, half that proposed above, Brazil will need to raise its investment rate gradually to 25% of output, as other Latin American countries have been doing, matched by gains in domestic savings. The public sector has to play a role by cutting expenditure while continuing its revenue stream. Ending annual escalation of pensions by the rate of increase of minimum wages is a place to start. So is a real sovereign wealth fund to prevent export price booms from stimulating more domestic consumption.

Indeed, for higher growth to occur regularly, productivity gains will have to be generalized throughout the economy. Brazil’s future development depends upon integration of the agricultural, mineral, petroleum, manufacturing and services sectors. Present-day commodity exporters differ greatly from those in the past that relied on goods such as sugar and coffee. Their competitiveness stems from efficiency. Few countries benefit from such a diversified base. Perhaps God is truly Brazilian.
Perhaps the most important task of all political persuasion. Brazilian citizens, including those who have moved recently into the lower-middle class, must learn the virtue of postponing immediate gratification for the greater good. This is a different message from that emphasized in the past. The ability to move forward to a higher, and sustainable, level of annual growth depends upon lower domestic consumption. Otherwise, the future will become more clouded. Another recent projection can be found, from the largest private Brazilian bank, Itaú, for 2020. Its base scenario suggests an annual increase of only 3%, declining to 2.8%. Brazil can, and should, do better.

Notes
2 Raymond W. Goldsmith, Brasil 1850–1984: Desenvolvimento Financeiro sob um Século de Inflação, São Paulo, 1986, is often invoked for estimates going back to the 19th century, but with little basis. He uses real imports and exports, money stock and a small selection of salary rates with the latter two deflated by incomplete price indexes. The subject of 19th-century growth—which seems to have been too slow by most accounts—is complicated by the circumstance of slavery, with sharp differences in income levels.
3 See my ‘Brazilian Development in Long-Term Perspective’, American Economic Review, May 1980, 102–8, and additional references cited there for more detail. Marcelo de Paiva Abreu and Afonso S. Bevilaqua, ‘Brasil Como uma Economía Exportadora’, in Enrique Cárdenas, José Antonio Ocampo y Rosemary Thorp (eds), La Era de las Exportaciones Latinoamericanas, Mexico City, 2003, provides further and more recent contributions to the literature on this period.
6 My book, Starting Over, Brookings, 2011, covers the period from 1985 to 2010 and affords many relevant additional references.
7 Brasil em 2022 and the underlying submissions of goals from ministries and agencies can be found on the website of the Secretaria de Assuntos Estratégicos. In the Plan’s Preparatory Papers from the ministries, also available, many key objectives have a lesser level than is later cited in the final document. For example, the rate of growth proposed is 6%, not 7%; investment as a proportion of income is set at 23%, not 25%; fertilizer production is not to attain 100%, but for potassium, 70%; high school education is to become universal, but 80%; social security coverage is to reach 80%, not 100%; and so on. Influenced by the exceptional growth in 2010, the final report winds up bolder than initially proposed. Dilma’s statement regarding the increase in income per capita can be found on the Mercopress site, 13 April 2013.
8 This report from Banco Itaú is entitled Brasil 2020, and was published on 12 April 2013.