The Growth Performance of the Brazilian Economy: Current issues and outlook

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Brazilian society has not yet found the right institutions to pave the way to its promising future

- State led ISI (1950-1980)
- Lost Decade (1980-1989)
- Pro-market reforms (1990-2002)
- No reforms (2003-2008)
- Next (2009-2010) ?

Economic Growth: 1947-2007

Annual growth -rates	GDP	GDP per capita	Pop.
• ISI - 1947/1980	7.4%	4.5%	2.9%
• Post-ISI – 1980/2007	2.4%	0.6%	1.8%
Lost Decade - 1980/1992	1.4%	-0.7%	2.1%
Stabilization - 1992/2007	3.2%	1.7%	1.5%

Growth in 2008 and Outlook

- **GDP annual growth rate**
- **Unemployment**
- **Lula's popularity**
- **Inflation and the rate of interest**
- **World economic crisis and its effects on Brazil**

Main Issues

- **What are the main causes of the slowdown in Brazil’s growth after 1980? What have been the main domestic constraints to growth? What should be done about it? Policy and reforms issues.**

- **How Brazil is and will be affected by the world economic crisis? What is the outlook for the Brazilian economy? What should be done about it?**

Import Substitution Industrialization - ISI

- **Kubitschek's administration (1956/1960)**
- **Economic Miracle (1967/1973) and II NDP (1973/1980)**

	GDP growth rate	GDP per capita growth rate
1955/1960	8.1%	4.9%
1967/1980	8.9%	6.3%
1967/1973	11.1%	8.3%
1973/1980	7.0%	4.5%

Main Results of ISI

- Income per capita more than tripled in 1956/1980!
- Urban population rose from 36.2% (1950) to 67.6% (1980)

Industrialization	1955	1960	1970	1980
Agriculture	23.5%	17.8%	11.6%	10.1%
Industry	25.6%	32.2%	35.8%	40.9%
manufacturing	20.4%	25.6%	27.4%	31.0%
Services	50.9%	50.0%	52.6%	49.0%

Main Results of ISI

- **Infrastructure:**

  energy (oil and electricity)

  transportation (roads)

- **Exports:**

  from a coffee exporter to an exporter of several primary and manufactured goods.

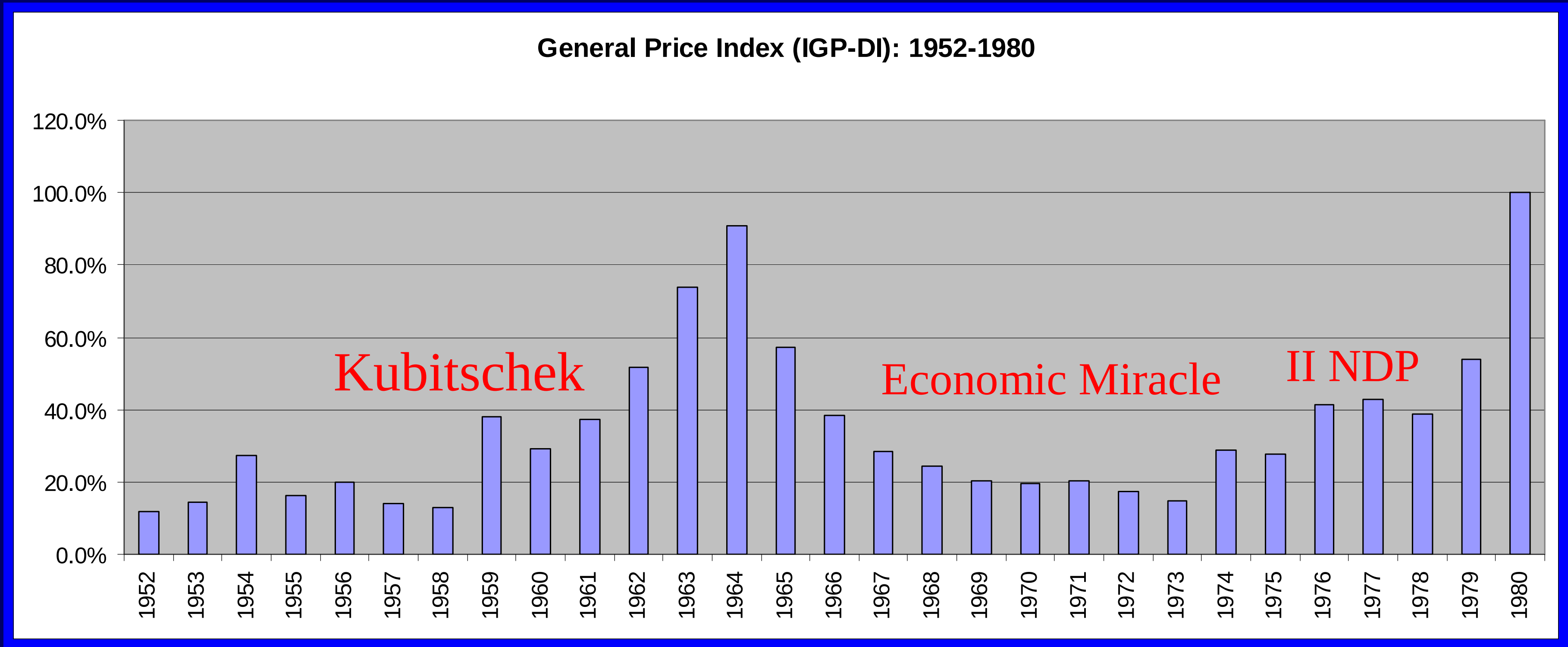
Main Results of ISI

On the other hand:

- **External debt and inflation**
- **Protectionism (autarky – oil importer)**
- **Absurd degree of market distortions => huge inefficiencies => gigantic trade barriers and significant subsidies for exports of manufactures**

Inflation rates: 1952-1980

Growth => current account deficits => external debt => foreign exchange crisis => public sector deficits => inflation => recession

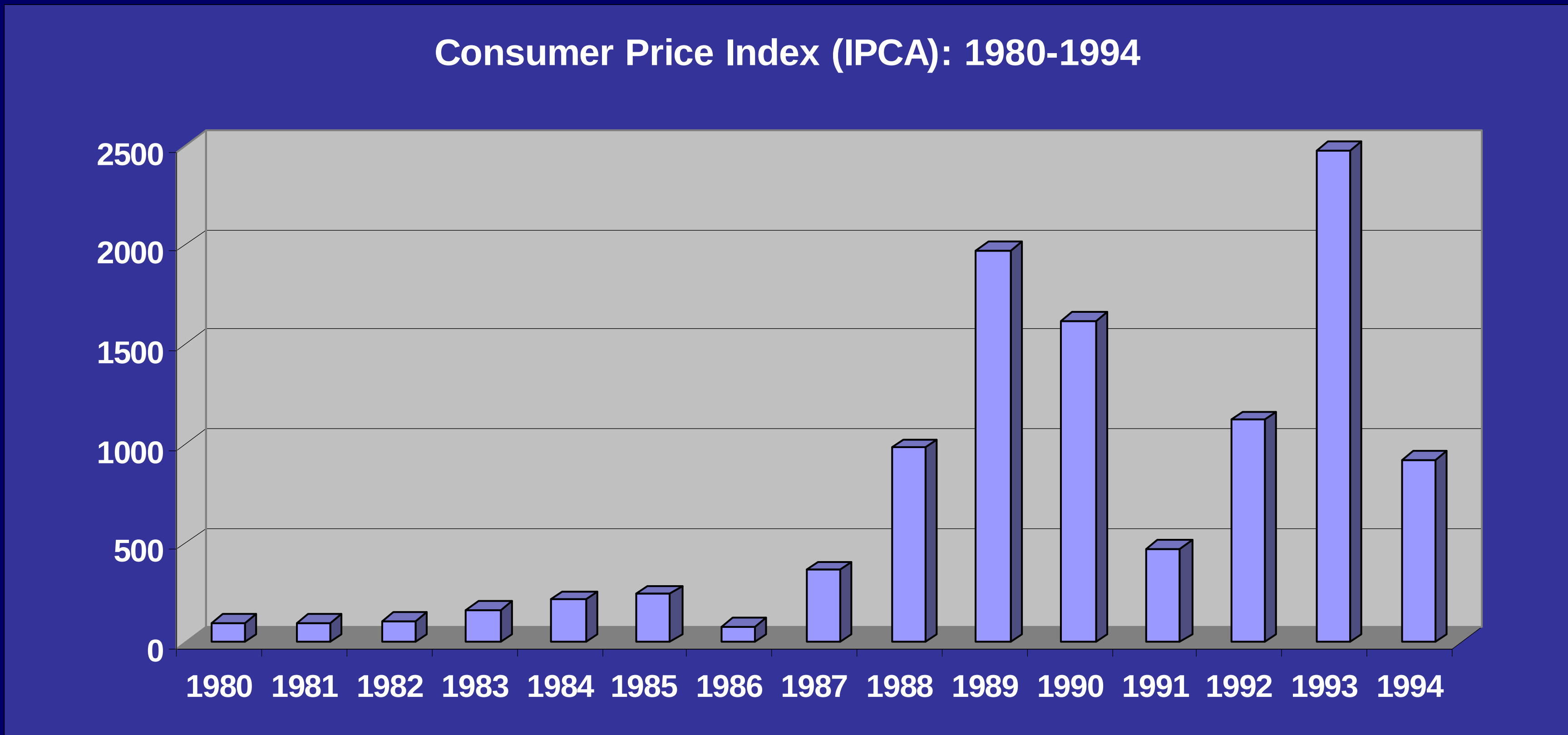


State led ISI

- The state was the driving force behind the ISI
- Supplier of credit, basic inputs (mining, metals and energy), and basic infrastructure (roads and communications)
- Major institutional reforms preceded and accompanied the main expansions (financial and trade)
- Military coup d'état in 1964.

The Lost Decade (1980/1992)

- The economy adrift as inflation soared after many stabilization attempts (inflation – new scale in %)



The Lost Decade (1980/1992)

Redemocratization: end of the military regime (1985)

New Constitution (1988)

Impeachment of the president accused of corruption (1992)

Deterioration of the state machinery:

- **Financial fragility – inflationary tax**
- **Loss of human capital resources**
- **Bureaucracy and corruption**

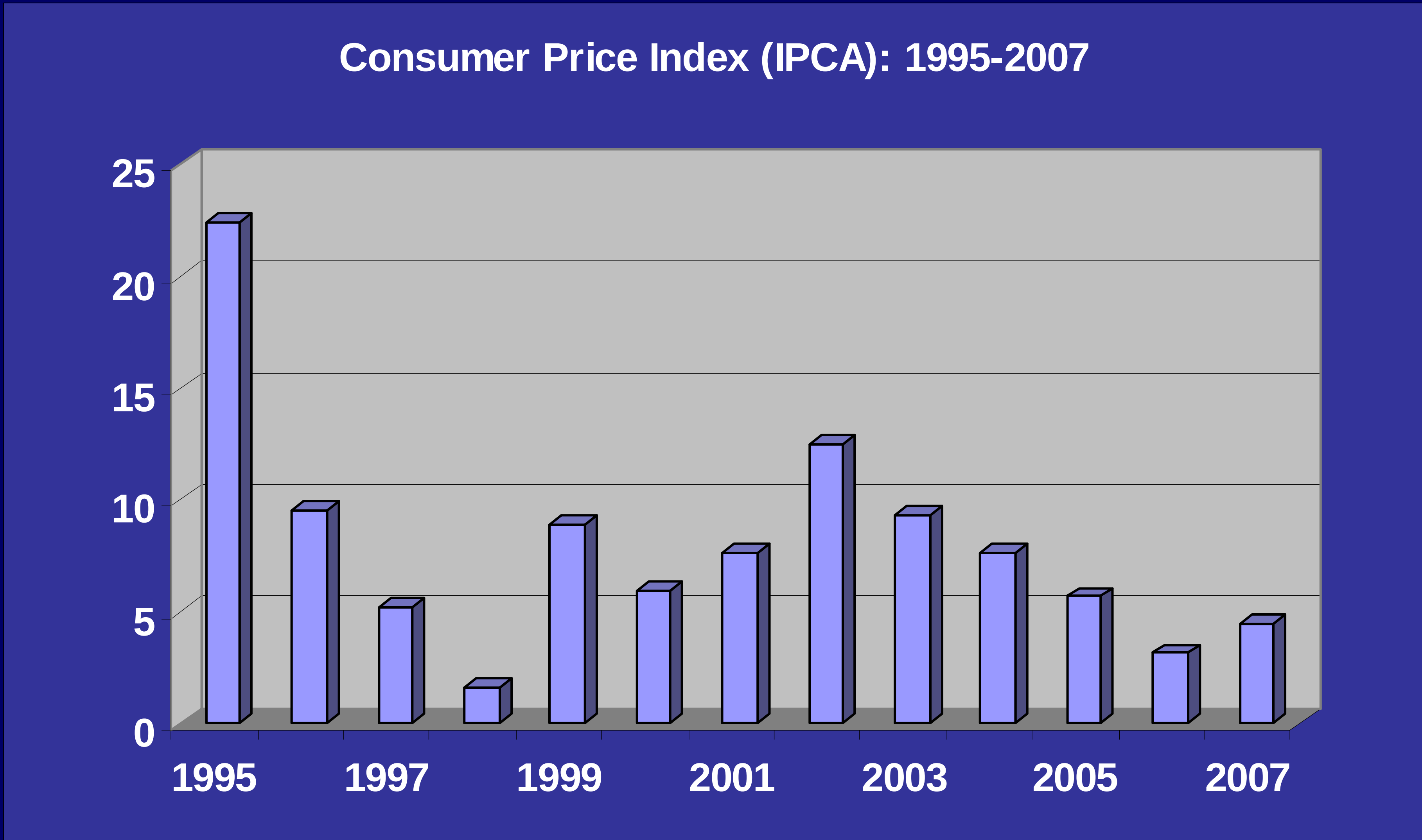
Trade liberalization, stabilization and privatization (1990/2002)

- Trade liberalization
- The Real Plan (1994); Mercosul (1995)
- Privatization and FDI
- Current account deficits => External debt => 1998/99 crisis
- Flexible exchange rate, inflation targets, primary surplus targets

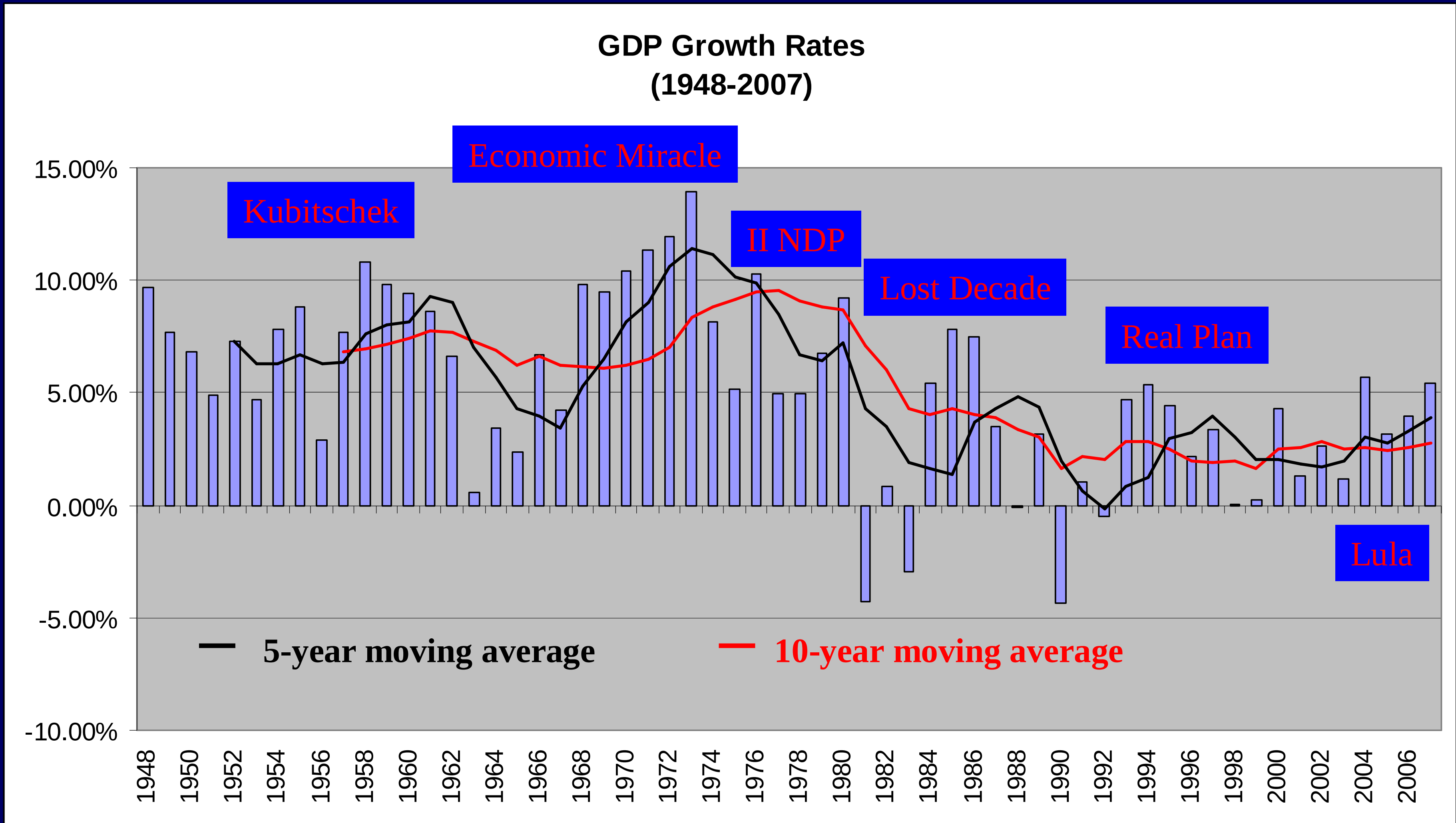
Lula’s administration (2003/2008)

- **The economic policy tripod was kept in place: flexible exchange rate, inflation and primary surplus targets**
- **Inflation under control – top priority**
- **Trade responds to the 2002 depreciation of the real => trade surplus**
- **Favorable international conditions help to eliminate Brazil’s public external debt**

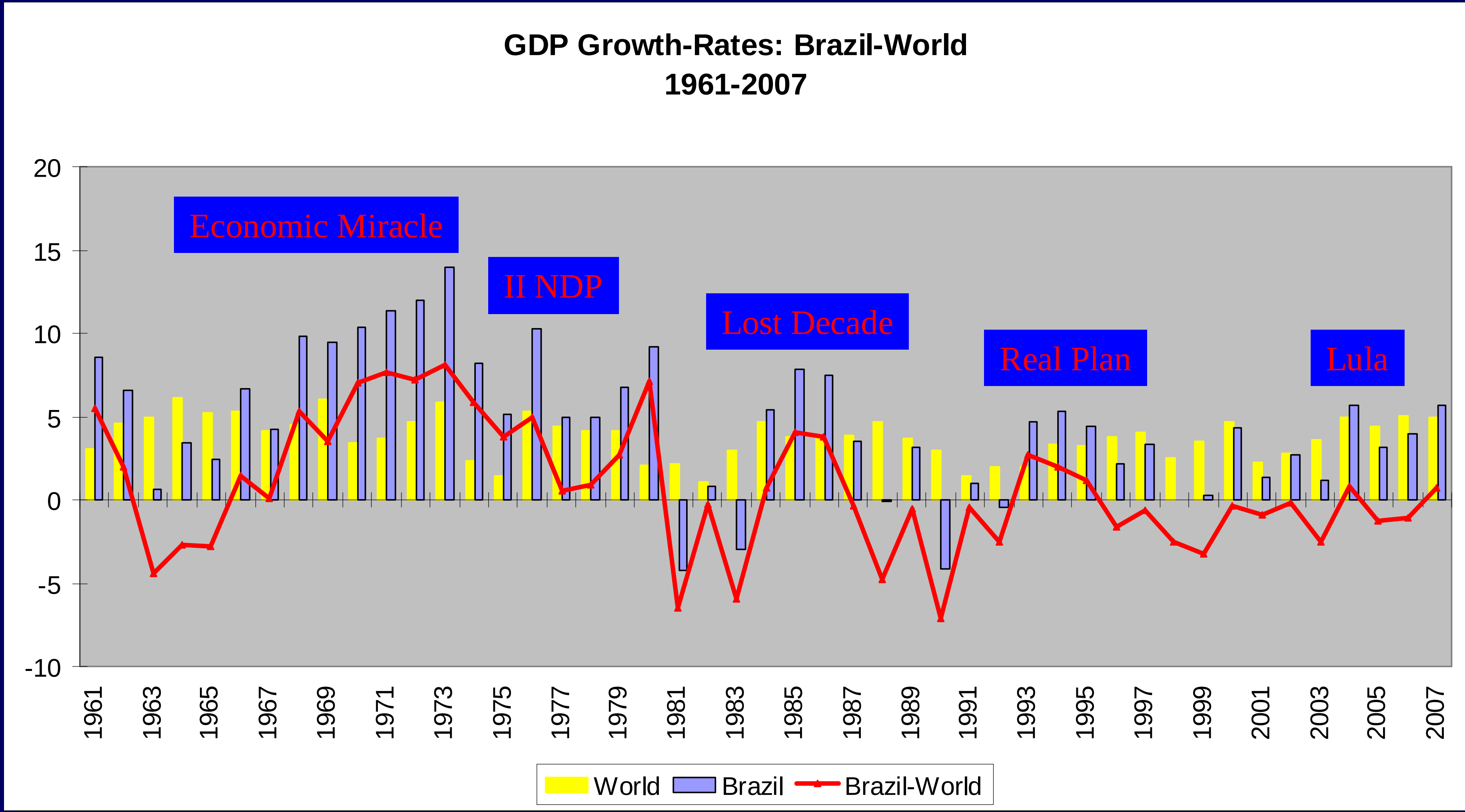
Inflation after the Real Plan



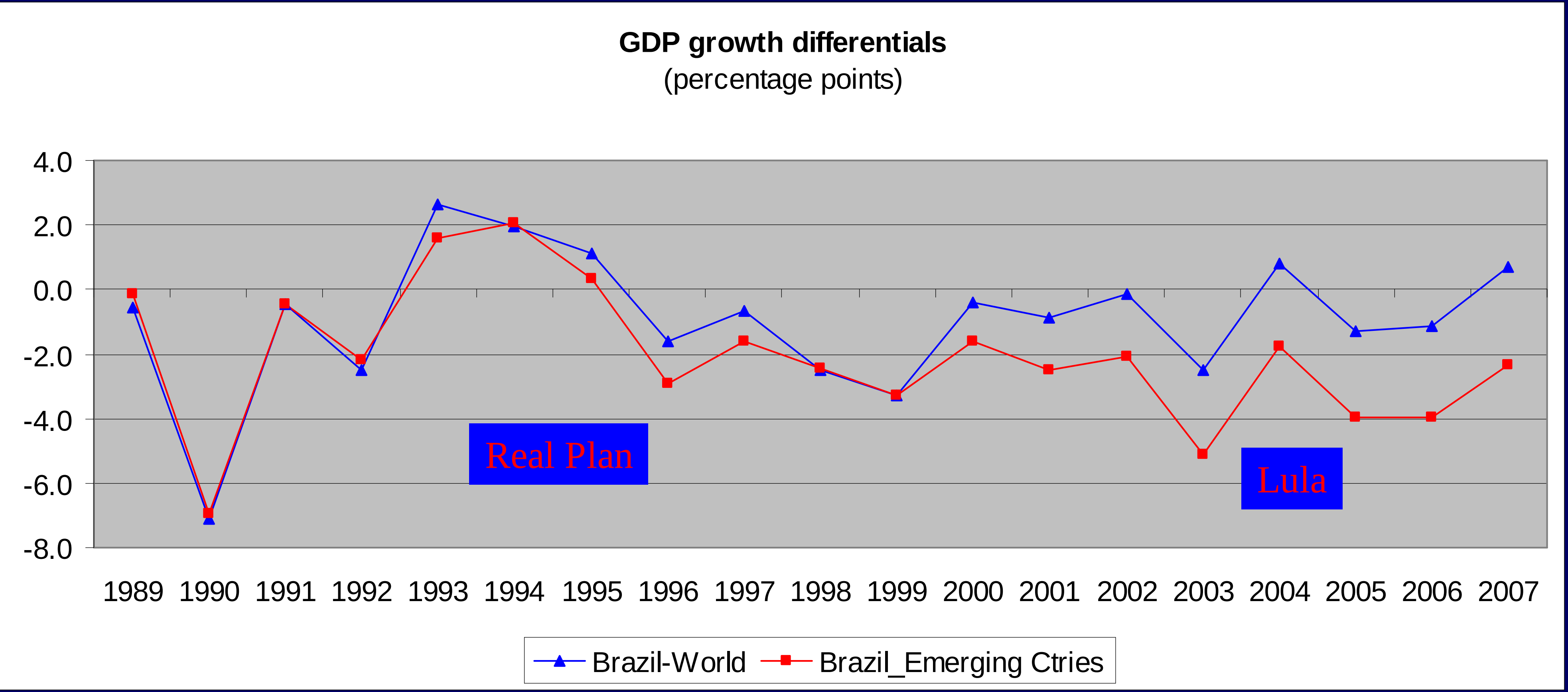
Economic Growth: 1948-2007



Economic Growth: 1961-2007



Economic Growth: 1989-2007



Main causes of the slowdown in Brazil growth after 1980

1. **Fall in TFP**

2. **Increases in the relative price of investment**

3. **The foreign debt crisis**

1. Fall in TFP

TFP was the main determinant of output growth per worker from 1950 to 2000

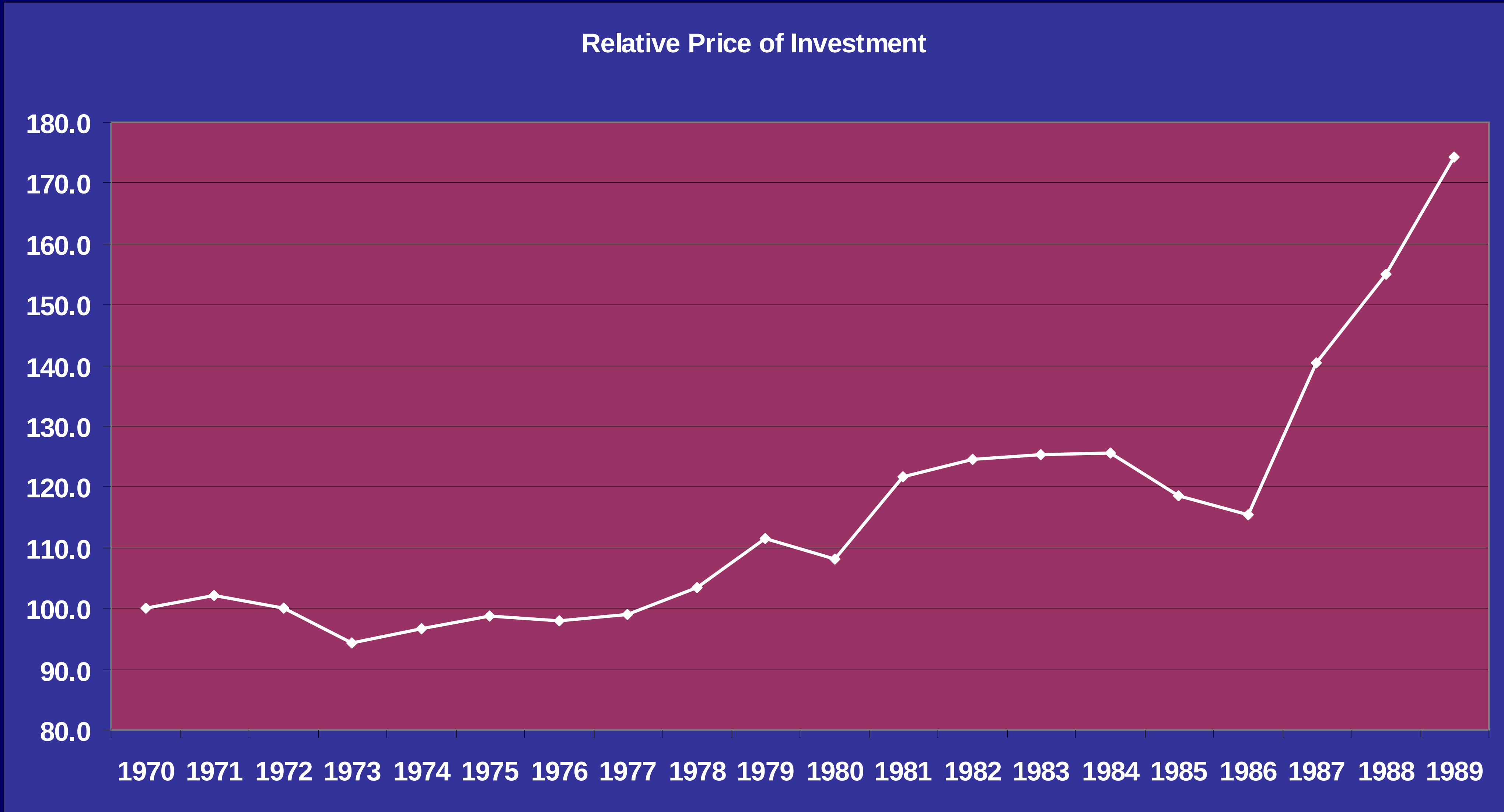
Between 1967 and 1976 there was a significant increase in the TFP relatively to the technological frontier and a small fall in the capital-output ratio.

Between 1976 and 1992 there was significant fall in the TFP relatively to the technological frontier and a sharp capital deepening.

While the increase in Brazil's TFP between 1967 and 1976 did not occur in other countries, the fall between 1976 and 1992 occurred in other countries, especially in the US, but the intensity and duration of it occurred only in Latin America.

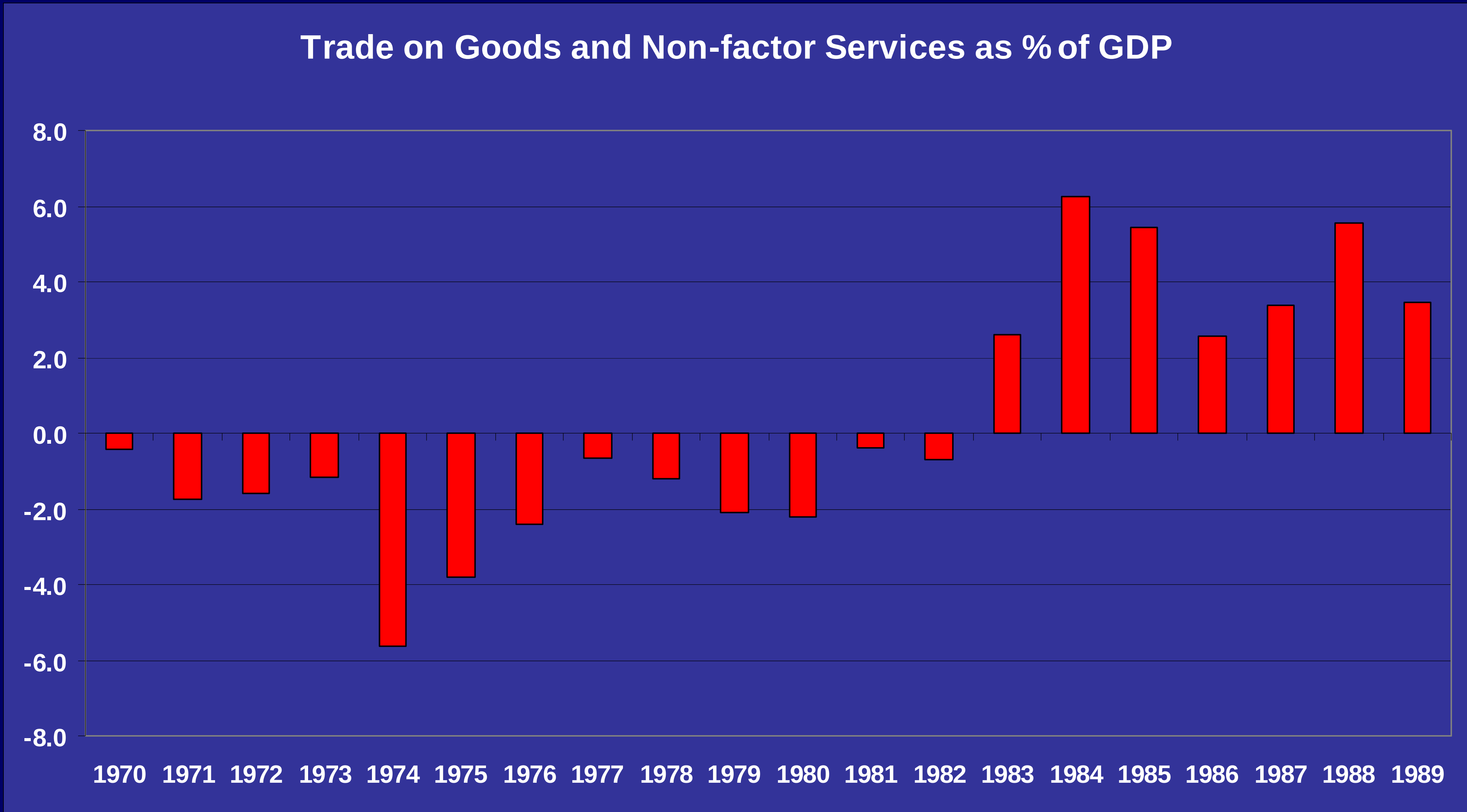
2. Increases in the relative price of investment

Increases in the relative price of investment and declines in the productivity of capital have been the most important factors behind the loss of dynamism of the Brazilian economy. The inward-oriented policies had negative long-run growth implications that were aggravated by populist policies in the early years of redemocratization.

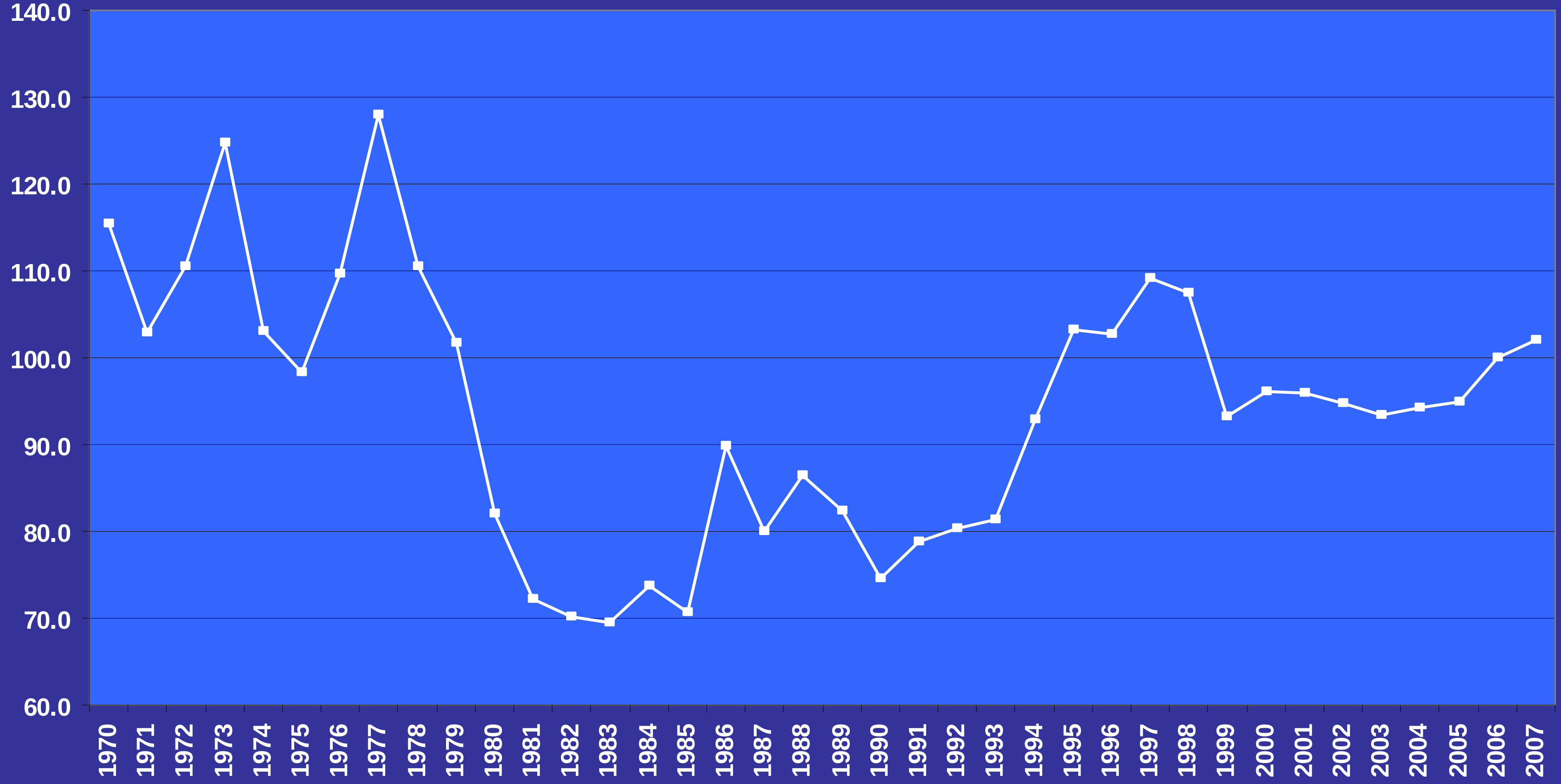

Relative Price of Investment
180.0
170.0
160.0
150.0
140.0
130.0
120.0
110.0
100.0
90.0
80.0
1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989

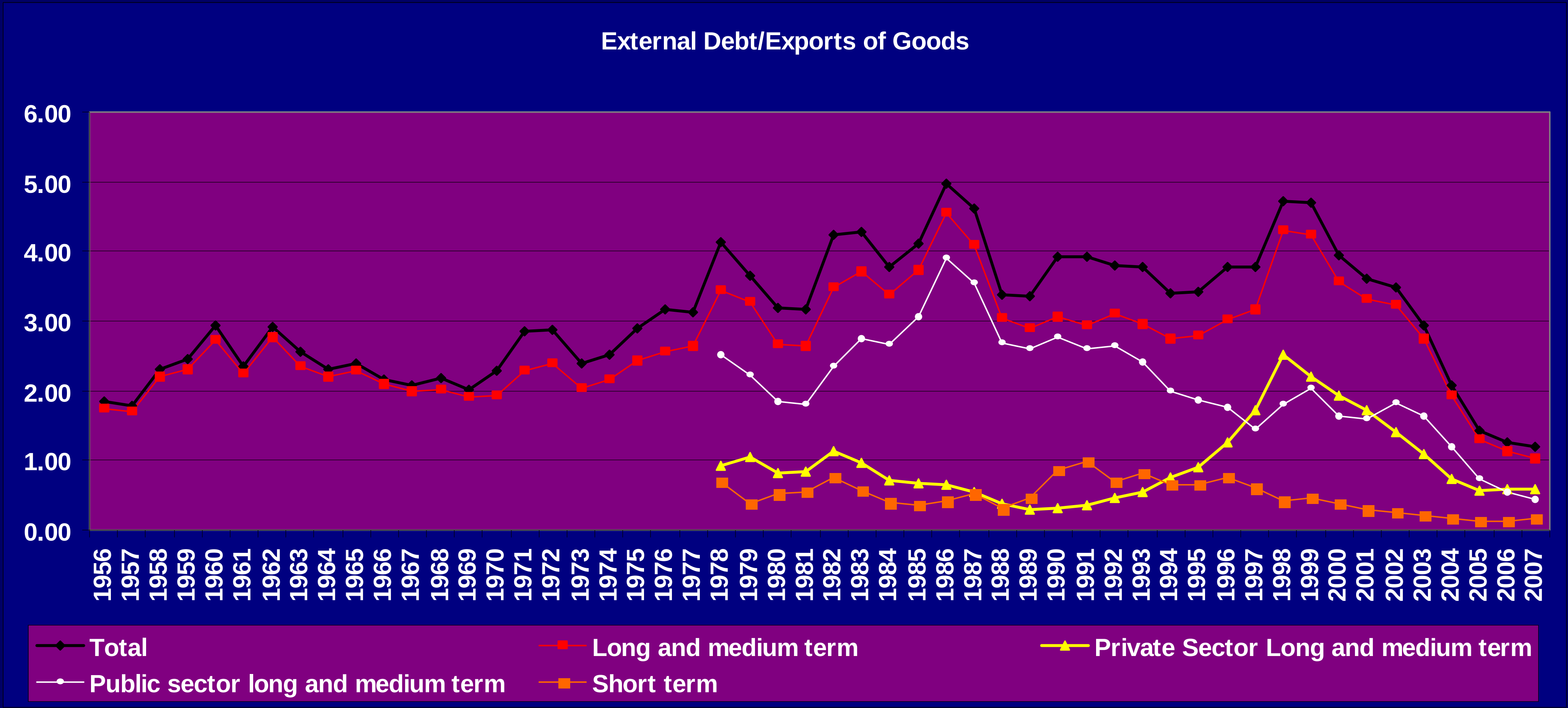
3. The Foreign Debt Crisis

- **Transfer of real resources**
- **Fall in the terms of trade (specialization in resource-based goods)**
- **Rise in the international rate of interest**
- **Deterioration in the public accounts (net debt of the public sector 49.6% of GDP)**
- **Fall in the rate of investment**


Trade on Goods and Non-factor Services as % of GDP
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
-8.0
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989

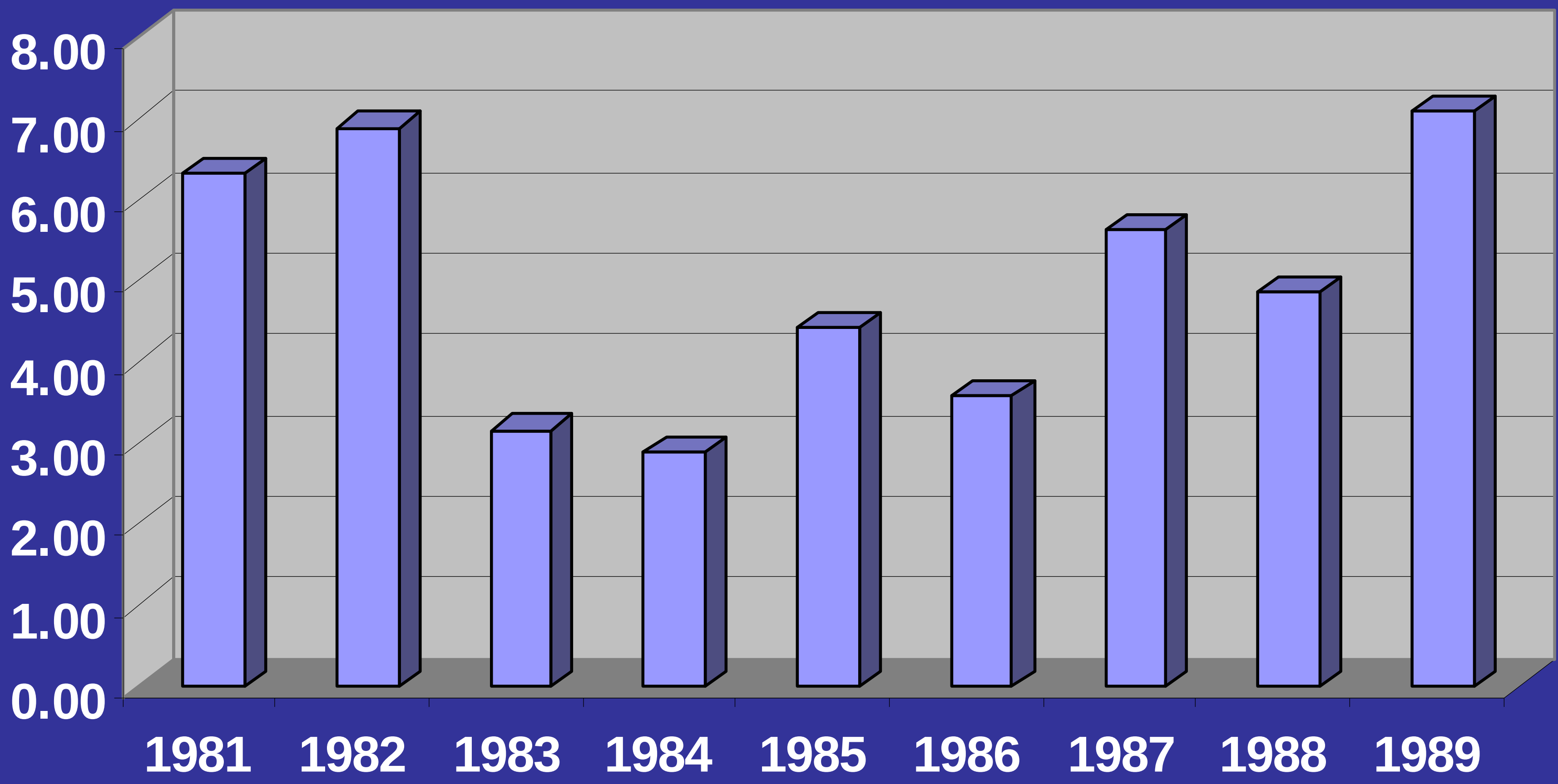
Terms of Trade 1970-2007



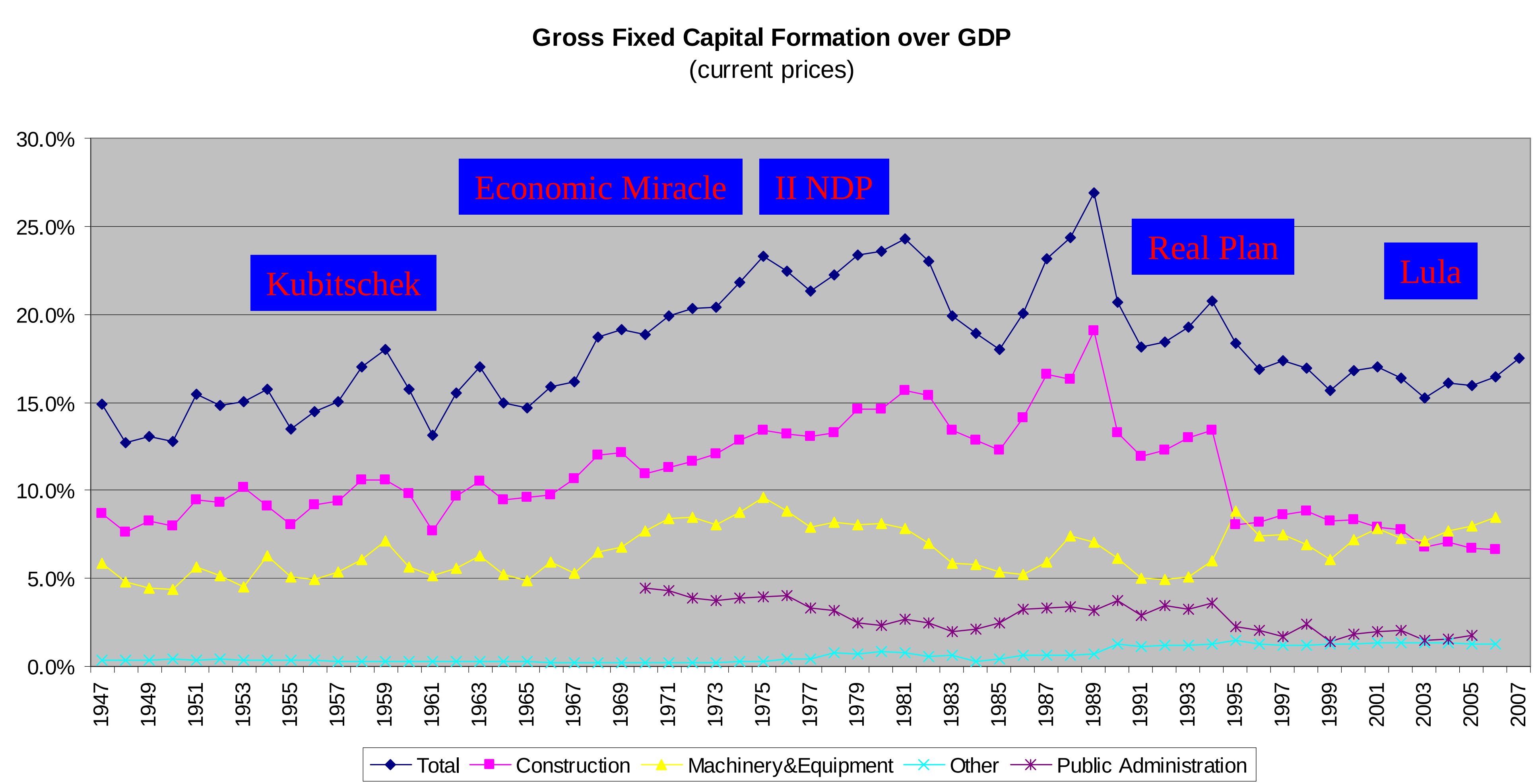


External Debt/Exports of Goods
6.00
5.00
4.00
3.00
2.00
1.00
0.00
1956 1957 1958 1959 1960 1961 1962 1963 1964 1965 1966 1967 1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
Total
Long and medium term
Private Sector Long and medium term
Public sector long and medium term
Short term

Public Sector Borrowing Requirements as % GDP (includes real interests)

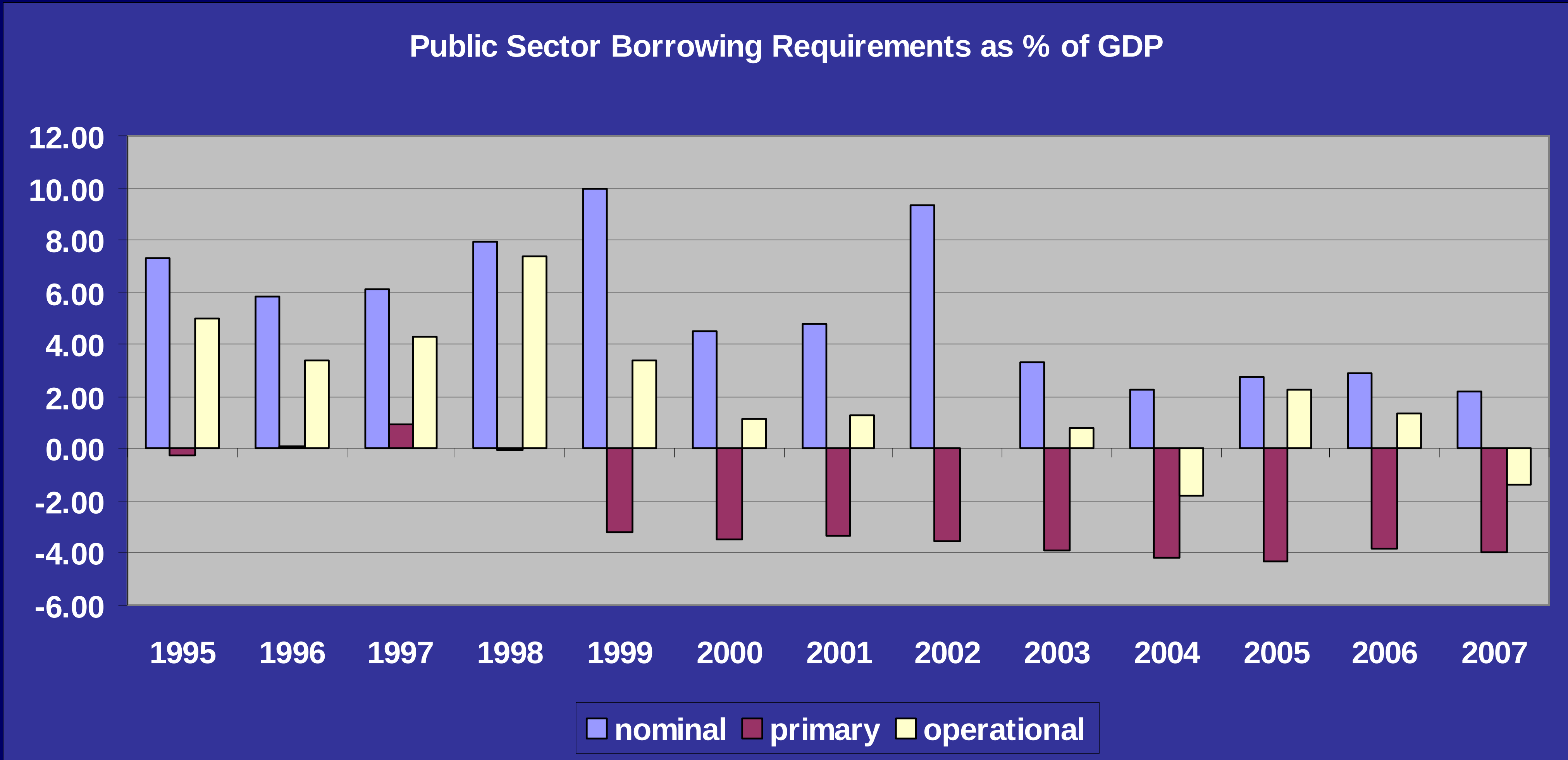


Rate of Investment: 1947/2007



Disappointing growth performance after pro-market reforms- Why?

- High rates of interest => appreciation of the exchange rate
- Large PSBR (1994-1998)
- External shocks – Mexico 1995; Asia 1997 and Russia 1998 => foreign debt and foreign exchange crisis
- 1999 tripod: flexible exchange rate, inflation target and primary surplus target; important institutional change - the Law of Civil Responsibility => primary surpluses were achieved largely through an increase in the tax burden!
- Depreciation of the real (1999-2002) maintained inflationary pressure => high rates of interest

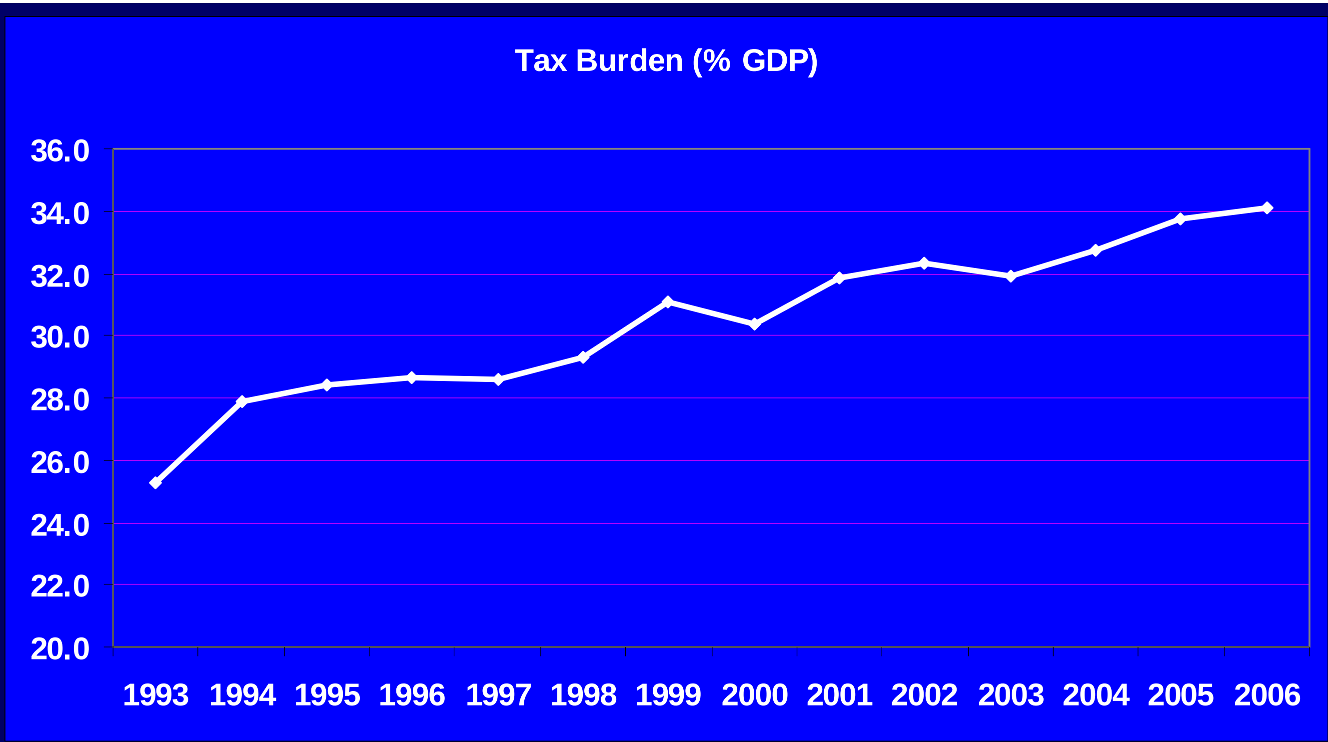

Public Sector Borrowing Requirements as % of GDP
12.00
10.00
8.00
6.00
4.00
2.00
0.00
-2.00
-4.00
-6.00
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
nominal
primary
operational

Disappointing growth performance after pro-market reforms – Why?

Pro-market reforms in Brazil were incomplete and insufficient to create an environment conducive to private investment, especially in transportation (roads, railways, inland waterways, air transportation, ports and airports), electricity generation and transmission, urban infrastructure and housing.

Disappointing growth performance after pro-market reforms – Why?

- Lula’s administration did not reverse the reforms (trade and capital liberalization and privatization), but did not make any progress (public-private partnership did not work out and the microeconomic reforms stopped in Congress). It has weakened the regulatory agencies, reducing the confidence of the private sector in the pro-market institutions.
- The state is clearly incapable of carrying out the most needed investment projects in infrastructure, but the government has hesitated in providing the institutions for the private sector to take up the job.



Tax Burden in Selected Countries: 2005 (as a percentage of GDP)

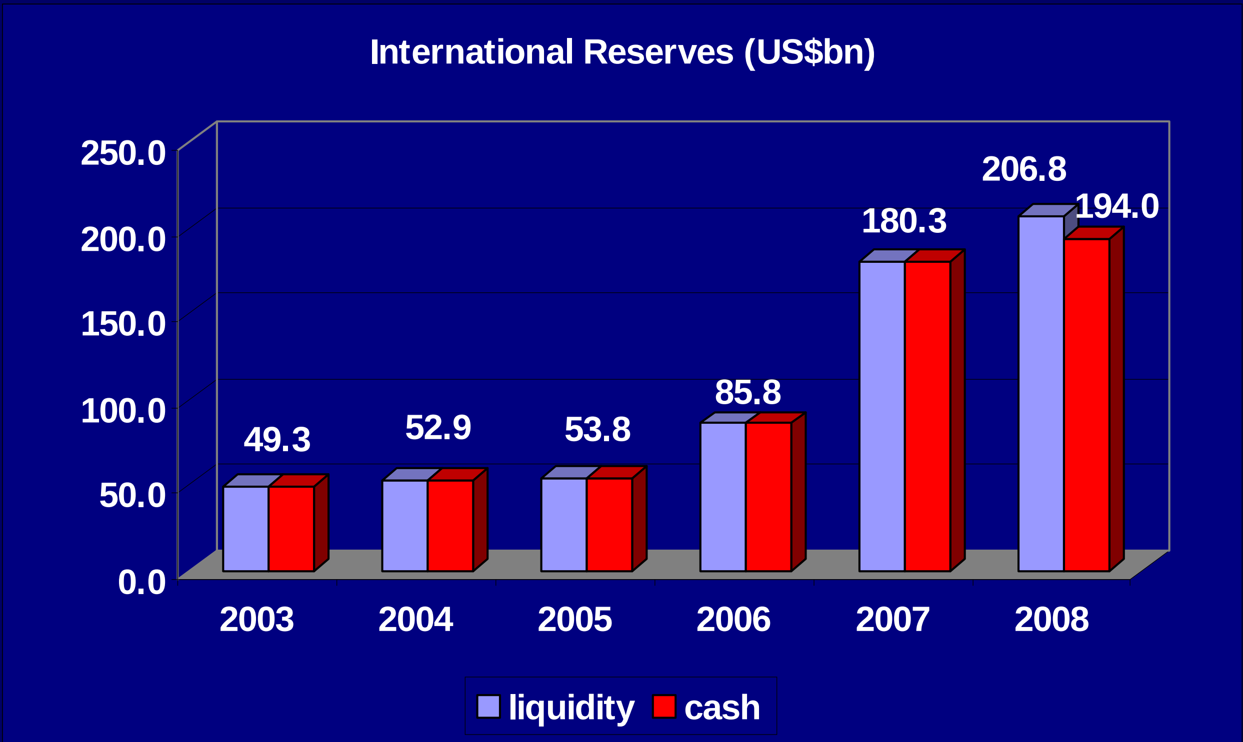
Countries	Tax burden	Countries	Tax burden
Hungary	37.7%	Korea, Republic of	24.6%
Russia	35.2%	Argentina	24.2%
Brazil	**33.7%**	China, P.R. of	18.8%
Poland	32.9%	Chile	18.7%
Turkey	31.1%	Mexico	18.5%
South Africa	25.0%	India	15.7%

Source: Ministry of Finance of Brazil and IMF.

Current Economic Situation

Economic Growth (same quarter of previous year)	2008.I	2008.II	2008.III
GDP	6.1%	6.2%	6.8%
Private Consumption	6.3%	5.9%	7.3%
Government Consumption	6.5%	4.3%	6.4%
Gross Fixed Capital Formation	15.4%	16.6%	19.7%
Exports	-2.3%	4.9%	2.0%
Imports	18.8%	26.0%	22.8%
Industrial Output	6.4%	6.2%	6.7%
Capital Goods	17.3%	19.2%	19.7%
Intermediate Goods	6.1%	4.4%	5.2%
Durable Consumer Goods	13.7%	14.1%	9.0%
Non-Durable Consumer Goods	1.3%	1.9%	3.6%

Balance of Payments	2007		2008	
	December	Jan-Dec	December	Jan-Dec
Trade balance	3 638	40 032	2 301	24 746
Services	- 1 166	- 13 219	- 1 608	- 16 672
Profits and Dividends from FDI	- 2 673	- 17 489	- 3 053	- 26 775
Other factor income	- 794	- 12 250	- 1 040	- 14 332
Net Direct Investment	- 2 894	27 518	4 970	24 603
Other	6 656	60 811	- 7 935	7 292



Outlook

	Recent Past		Market expectations	
	2007	2008	2009	2010
GDP growth-rate (%)	5.7	5.5	2.0	3.8
Inflation rate (%)	4.5	5.9	4.6	4.5
Exchange rate (end R$/US$)	1.77	2.34	2.30	2.28
Exchange rate (average R$/US$)	1.95	1.84	2.29	2.23
Selic target (end of year %)	11.25	13.75	11.00	10.75
Selic target (average %)	11.18	12.59	11.50	11.25
Net debt of public sector (%GDP)	42.7	36.0	36.5	35.3
Current account (US$bn)	1.6	-28.3	-25.0	-30.0
Trade balance (US$bn)	40.0	24.7	14.5	13.4
Source: Central Bank of Brazil				

Outlook

- Great uncertainty in forecasts.
- The situation is manageable (best and worst scenarios).
- But it might worsen quickly, depending on:

1. Monetary and fiscal expansionary policies
2. Deterioration in the world economic situation

- Main indicators of the situation are the level of international reserves and the exchange rate
- Trade balance
- Supply of external refinancing
- Inflow of FDI net of profit and dividends sent abroad

Long-run policy debate

- Brazil’s specialization on natural resource-based goods
- Natural resource curse and Dutch Disease
- Industrial policies to ‘upgrade’ exports
- Capital controls to avoid appreciation of the exchange rate
- Concentration x diversification: empirical evidence
- Brazil’s experience with industrial policies: automobile industry, electronics (consumer, IT, and Telecom)

Final Considerations

- Moving from a state led growth to a private sector led growth - difficulties at various levels: history, culture, beliefs; political (Congress); implementation level (resistance-bureaucracy and human capital)
- Democracy and markets – institutions ≡ rules of the game
- Debate: pro-market reforms x heterodox policies (demand and industrial policies)
- Direct government investment in infrastructure versus more reliance on investment by private sector (improve regulations)