

FORE~~Ø~~SIGHT

# Charting new directions:

Brazil's role in a multi-polar world



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Brazil's role in a multi-polar world

Published in 2011 by Foresight

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Section three photo: Itamaraty, the ministry of external affairs in Brasília

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Printed by Newnorth

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# Foreword

Wolfgang Nowak and Priya Shankar

We live in a period of transition, in which the centres of global power are shifting and the old order is giving way. We can only begin to see the nascent contours taking shape of what might come to replace it. Foresight, an initiative of the Alfred Herrhausen Society, the international forum of Deutsche Bank, in partnership with Policy Network, attempts to chart the course of this emerging order and its key players. Following a series of high-level forums in Russia, the United States and India, the Foresight Brazil conference will explore the priorities and role of Brazil in this changing global landscape. The new Brazilian Presidency inherits a decade of inclusive economic growth and bold international activism; how can it build on this success?

The international scenario that the new Brazilian government confronts is one of flux. Our international institutions, formed in the post-1945 environment, are no longer able to offer viable solutions to current problems. The IMF, World Bank, and UN Security Council all face a crisis of legitimacy. While the G20 has replaced the G8 as the world's premier economic forum and averted the worst of the global financial disaster, it is now beset by tensions. Brazil has been instrumental in forging informal groupings such as Brics and Ibsa, which have played a significant role in bringing the emerging economies closer together. However, these have little concrete power and are often seen as talking shops. These institutions, both old and new, find it difficult to provide effective

solutions for pressing challenges.

Indeed, many in the west blame the emerging powers for not taking on enough global responsibility. This claim overlooks the nature and magnitude of the domestic challenges that countries such as Brazil, India, China and South Africa face, the most significant of which are at home. Yet, in a world in which the global and domestic are increasingly intertwined, there are ways in which international cooperation could help address these national problems.

A big challenge that Brazil, Russia, India, China, and South Africa all face in varying degrees is poverty and inequality. While these countries have experienced rapid economic growth, the benefits of globalisation have not always filtered down and accrued to all. In large and diverse countries, existing social tensions and differences have often been exacerbated, and new tensions created. All of these countries face the challenge of potential internal unrest, whether it takes the form of crime or protest or secessionist movements. Therefore, cooperating on mechanisms for economic growth and addressing hunger, disadvantage and inequality could be of significant value. If the Brics were to set up an Economic Security Forum, where they cooperated on international economic issues and also shared success stories - such as Brazil's *Bolsa Familia* - to see what they could learn from each other, this would go a long way to help address the pressing socio-economic challenges that beset these countries.

Another field of cooperation could be disaster management. Most of the emerging economies have experienced the havoc and suffering wreaked by natural disasters. Over the last year, the floods in Rio, the Chinese earthquake, the Russian drought and the Indian floods all presented enormous and unexpected difficulties. Natural disasters have always been devastating, but their frequency and scale is due to increase with global warming. The countries that are likely to suffer the most are the ones with the weakest disaster management systems in place. If the Brics could set up a Disaster Management

Forum, in which they shared their experiences and collaborated in relief efforts, it would represent a significant step in addressing one of the biggest threats of today. Both the Disaster Management Forum and Economic Security Forum would be a way of adding concrete action to the rhetoric of cooperation.

Brazil, with its diversity and strong international links, is uniquely poised to help these ideas get off the ground. It would be a way to build on the success of the international activism that saw the emergence of forums such as Brics and Ibsa. In the past two decades, Brazil developed its own socio-economic model and proposed new ways of thinking about issues of equity, justice and prosperity. This is where Brazil's real strength lies; not just as an economic and political power, but as a thinking power, one that generates ideas and offers innovative solutions. These ideas and actions can benefit not only Brazilian citizens, but also others around the world.

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# Preface

Marcio Pochmann

In recent years, in a context of deepening democracy (where a metalworker and now a woman have been elected president), Brazil has managed to reconcile economic growth with improved income distribution. Progress has been made in the modernisation of economic activity, the promotion of more equitable and environmentally sustainable development and the valorisation of citizenship. Over ten million jobs were created between 2003 and 2010, accompanied by a significant increase in real income and minimum wage. The Brazilian state has played a strategic role in the advancement and protection of social security. Direct income transfer programmes to poor families, including *Bolsa Familia* (the family allowance programme), the continuous benefit provision and the rural pension programmes were crucial for the cycle of sustained economic growth, strengthening the internal market and improving living conditions of the poorest segments of society.

Considerable progress has also been made in foreign relations. International reserves surpassed \$300bn and Brazilian companies and banks were internationalised. The country now participates in various significant international forums, such as the

G20 major economies, the G20 developing nations, the Basel Committee on Banking Supervision and the Financial Stability Board. It has also been involved in the reform of IMF and World Bank voting and governance structures.

Considering the current innovative and creative moment in the field of ideas and public policies, the Institute of Applied Economic Research (Ipea) believes that these achievements need to be widely discussed, understood and improved, when pursuing the new model of Brazilian development.<sup>1</sup> In terms of the design and implementation of public policies, the ongoing, collective and cumulative exercise of democracy in Brazil points towards the growing maturity of institutions. But major challenges still loom over Brazilian society.

As stated by the President, Dilma Rousseff: “the economic and social gains of recent years are allowing a renewed confidence in the future. A huge window of opportunity opens for Brazil. To become an economically rich and a socially just country no longer seems a distant goal. However, there still are enormous challenges ahead. The main ones include the provision of quality education, the democratisation of knowledge and a form of development which respects the environment. Prioritising education implies the consolidation of universal values of democracy, freedom and tolerance, ensuring opportunities for all. We are making the right choices: Brazil combines the effective reduction of social inequalities with its insertion as a leading environmental, economic and cultural power.”<sup>2</sup>

The population's full social inclusion depends on universalising and improving the quality of essential public services, particularly health, education and safety. President Dilma Rousseff, in her inaugural

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1 The Institute for Applied Economic Research (Ipea) has made an enormous effort to understand the main characteristics of this “new cycle of Brazilian development,” based on the expansion of the domestic market, the reduction of poverty and income inequality, expanding popular participation and intensifying international insertion by means of the project *Perspectives of the Brazilian Development*, which articulates a comprehensive set of studies, called “Core Themes for Development.” All these documents are available on Ipea's website (<http://www.ipea.gov.br>).

2 Rousseff, Dilma. “País do conhecimento, potência ambiental”, *Folha de S.Paulo*, São Paulo, 20 February 2011, p.A3..

address, explained her government's obstinate struggle to eradicate extreme poverty and create opportunities for all. "I will not rest while there are Brazilians who have no food on their tables, while there are desperate families on the streets, while there are poor children abandoned to their own devices. Family unity lies in food, peace and happiness. This is the dream I will pursue!"

Ipea seeks to contribute to this goal by developing a measurement of extreme poverty that will allow the tracking and monitoring of government actions aimed at reducing the number of poor citizens in the country over the coming years. The national rate of extreme poverty fell from 42.9% in 1978 to 9.4% in 2008. Furthermore, rural poverty declined from 72.5% to 22.9%, while urban poverty fell more rapidly, from 18.4% in 1978 to 5.5% in big cities, and from 38.1% to 7.8% in smaller towns during the same period. Accordingly, when considering the rate of extreme poverty, for every existing destitute person in major metropolitan centres, there are four times as many in the rural areas. Overcoming extreme poverty, which still affects one in ten Brazilians, requires further refinement of policies, targeting mainly rural areas<sup>3</sup>. Therefore, these differences in rural and urban economic and social structures are important when designing public policies, capable of addressing extreme poverty throughout the country.

By sharing good practices in the formulation and implementation of public policies - be they domestic or internationally oriented - Brazil has been consolidating its presence in the world. The major transformations in the social and economic arena, resulting from the implementation of inclusive public policies, designed by the Brazilian government, have attracted the attention of the international community. At the same time, an

active diplomacy promoting global development and the increasing participation of developing countries in international trade, gross fixed capital formation, south-south cooperation and major international forums have also helped consolidate Brazil's presence in the international political arena.

According to the minister of external relations, Antonio Patriota, "In the new multipolar configuration that has been shaping geopolitics in the early years of this century, Brazil - with a tradition of peace and tolerance - stands out as an actor with favourable attributes for promoting more inclusive development models and strengthening cooperation among nations through governance mechanisms that are more legitimate and representative."<sup>4</sup> In concert with the Brazilian Agency for Cooperation (ABC) of the Ministry of External Relations, Ipea conducted a survey which indicated that the country spent R\$2.9bn (from 2005-2009) on development cooperation, including humanitarian assistance, scholarship for foreigners, technical, scientific and technological cooperation, and contributions to international organisations.<sup>5</sup> For the most part, Brazilian cooperation has been intended for the least developed countries in Latin America and the Caribbean, Africa and Asia.

In a world marked by increasing global interdependence, understanding how international trends affect local dynamics, and vice-versa, is an essential task for the success of any country. Hence the importance and necessity of the Foresight project developed in partnership with the Alfred Herrhausen Society and Policy Network.

It is the mission of Ipea "to produce, articulate and disseminate knowledge to improve public policies and contribute to the planning of Brazilian development". In this maxim it is crucial for Ipea to help pursue and

<sup>3</sup> Household income per capita up to a quarter of minimum wage

<sup>4</sup> Patriota, Antonio A. *Remarks by Minister Antonio de Aguiar Patriota during the Inauguration Ceremony for the Office of Brazilian Ministry of External Relation. Brasília*, Ministry of External Relations, 2 January 2011.

<sup>5</sup> See "Brazilian Cooperation for International Development: 2005 and 2009." Brasília: Institute for Applied Economic Research (Ipea) and Brazilian Agency for Cooperation (ABC), 2010.

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disseminate the principles and ideals of a national democratic state, of participatory government planning and public policies as vehicles for economic and social development, both locally and globally. The partnership of Ipea with the Foresight initiative supports this process by bringing viewpoints from different countries to the domestic debate and internationally disseminating national innovative practices.

MARCIO POCHMANN is president of the Institute for Applied Economic Research (Ipea).



# Introduction: Reclaiming the future

Alfredo Cabral, Elena Jurado and Priya Shankar\*

On 1 January 2011, in her inaugural address as Brazil's first female head of state, Dilma Rousseff reiterated her promise to consolidate and take forward the policies of the previous Presidency, which saw rising optimism and self-confidence in Brazil. Observers have often said of Brazil that it is "the country of the future and always will be." Over the last decade, with socially inclusive economic growth and increasing international clout, the future appears to have arrived. Indeed, there is a growing sense in the country that now is the moment of Brazil, and that the country can shape its own destiny.

There are good reasons for Brazilians to feel confident. Their country has weathered the recent global financial crisis successfully and tens of millions of its citizens have risen into the ranks of the middle class over the last few years. Rich in commodities and with a strong manufacturing base, Brazil combines a variety of attributes which promise to serve the country well in an increasingly complex international landscape. This includes a liberal democratic system and vibrant multicultural society with strong affinities to Europe, Africa and Asia – a multifaceted national identity which provides Brazil with a unique vantage in both the global north and south.

However, significant challenges remain, including in relation to education, health, crime and inequality. There are growing questions about the future path

of development Brazil should follow in an uncertain world. The global financial crisis led to the questioning of the American model of freewheeling capitalism, the European social model based on a paternalistic welfare state, and even the east Asian export-led development model. There remain no clear answers or 'models' for the future. Indeed, many countries are realising the need to rethink their future or challenge the conventional wisdom and assumptions that have guided their choices. Brazil, with its wide range of experiences and experiments, is uniquely poised to take part in this process.

The country has successfully and peacefully managed the transition to a democratic polity, a stable economy, and an increasingly middle-class society. These transitions have been based on gradual and hybrid economic, social and international policies, which defy easy categorisation. As the contributions to this reader make clear, the refusal to be bound by the constraints of a specific paradigm brought considerable achievements to Brazil, both at home and abroad. However, in order to consolidate and further its achievements, Brazil will need to complement its creative, but sometimes piecemeal, ad hoc policies with a bolder and more strategic approach.

Its success will ultimately depend on the Brazilian leadership's ability to coordinate its policies in pursuit of a clear set of goals. This reader explores Brazil's prospects for achieving this in the context of three distinct, but inter-related challenges: pursuing balanced economic growth; managing internal tensions and ensuring social cohesion; and seeking greater autonomy in an interdependent world. Each of these challenges is explored in a separate section of the reader by a selection of Brazilian and international authors. The articles provide valuable insights into Brazil's national specificities and also highlight important parallels and lessons between Brazil and other major powers.

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\* We are grateful to Ben Blackburn and Robert Tinker for their excellent assistance with this publication.

### Pathways to sustainable growth

The current financial crisis seems to have dealt a serious blow to the American neoliberal growth model, which encouraged conspicuous levels of consumption and allowed for high levels of debt. East Asian growth strategies, based on export-led growth, high savings and low levels of domestic consumption are also under pressure. And, as the global economy begins to recover, there are still no clear pathways to sustainable growth.

In Brazil, the previous President, Luiz Inácio Lula da Silva, continued the market-oriented policies of his predecessor, Fernando Henrique Cardoso, including fiscal discipline and a floating exchange rate, in order to maintain macroeconomic stability. But these policies were combined with a developmentalist approach to social policy and strategic interventions in the economy through a raft of industrial policies. This led to the resilience of the Brazilian economy in the face of the financial crisis, but significant risks and dilemmas remain.

At the macroeconomic level, there is the dilemma of how to maintain public spending in a way that is consistent with fiscal stability. As Nelson Barbosa argues, this may be possible by bringing more economic activity into the formal sector with the resultant benefits for public revenues. There is also concern about how to encourage growth and investment in a manner that does not accelerate inflation. And, therefore, the interest rate, which is amongst the highest in the world, is a highly contentious issue in Brazil with many advocating a high interest rate to keep inflation levels low while others argue for a lowering of the interest rate in order to make credit for investment more easily available.

Many are optimistic that Brazil may be able to overcome these dilemmas by harnessing its natural resources. The recent discoveries of oil and gas off the coast of Brazil present the country with a valuable opportunity and it has the potential to utilise these energy resources for its economic development,

as Mauricio Tolmasquim and Amilcar Guerreiro advocate. Brazil's rich commodity base is a huge advantage, but there are also risks associated with excessive reliance on primary products. As Yao Yang points out, a resource curse hangs over commodity rich countries, where improved terms of trade for the export of commodities (in particular currency appreciation) often reduce the competitiveness of these countries in manufactured goods.

Indeed, there is debate in Brazil about whether to emphasise commodity production or manufacturing as the path to economic growth. However, such a stark choice may not be necessary and there could be synergies between the two sectors if the Brazilian government is strategic in its choices, such as utilising profits from commodity exports to finance the diversification and development of the rest of the economy and create jobs. In addition, as Glauco Arbix argues, innovation will be increasingly significant in helping spur economic growth across each of these sectors. However, if the Brazilian economy is to enhance growth and achieve innovation, a number of complex and difficult structural changes will be necessary, including further tax and financial reforms to facilitate financing and the growth of small- and medium-sized businesses, and broad infrastructural improvements.

### Internal tensions and social cohesion

The changes associated with globalisation have put a strain on the social fabric of countries, with rising individualism in metropolitan areas, while exposing deep divisions between regions, rural and urban areas, socioeconomic groups and ethnicities. As William Galston and Niraja Gopal explore in their contributions, this is as true in advanced industrialised countries such as the United States as it is in the developing world, where huge income disparities continue to widen.

In this context, Brazil's recent experience can be considered a success story. Through a combination of orthodox macroeconomic policies and an

unprecedented expansion of social spending, Brazil achieved remarkable reductions in income inequality and extreme poverty. As Jorge Abrahão de Castro points out, the Lula administration's hybrid economic and social policies transformed public spending into a core element in the country's growth strategy, creating new consumption markets rather than only assisting the destitute. Despite the frictions which are set to mark the political cycle, described in this volume by André Singer, the cross-partisan consensus around programmes like Bolsa Família suggest long term continuity in income transfer.

However, persistent social and regional tensions and inequalities remain. Even though growth is beginning to spread to other regions, the state of São Paulo continues to account for one-third of GDP. Meanwhile, income disparities are significantly higher than in other emerging economies, including India and China. And the country faces further dilemmas in addressing public security and racial inequality.

If Brazil is to consolidate its social achievements, it will need to complement its use of income transfers with policies aimed at strengthening universal public services, but this presents considerable challenges. There is no agreement on the size and scope of government interventions, or on the kind of taxation that will provide the funding for additional public spending. Moreover, even if the funding can be obtained, it is not clear that redistributive policies will be sufficient to correct the country's entrenched inequalities. As Daniel Vargas warns in his contribution, if Brazil is to achieve a truly cohesive society, it will need to make more fundamental changes to its national model.

### Seeking autonomy in an age of interdependence

The capacity to shape international norms is a prerequisite for successful national development. The demands for reform of global governance advanced by the emerging economies over the last decade should be understood in this light. Within

Brazil, there are voices calling for greater autonomy in international negotiations. Under the banner of "sovereign international insertion," there is a growing belief that, as a big state, Brazil should have the capacity to participate in international affairs on the basis of its own national strategic considerations.

Brazil has led calls for reform of the voting structures of the Bretton Woods institutions and played an assertive role in negotiations within the WTO. It fostered closer links with the global south, particularly with other Latin American countries and Africa. Indeed, as Rubens Barbosa points out in his contribution, the prioritisation of south-south relations has given Brazil a new diplomatic soft power, which it has used effectively to promote its interests in a variety of international forums.

And yet, as Riordan Roett suggests, Brazil has not been radically revisionist. It has pursued reforms in a conciliatory manner, trying where possible to seek consensus with all the major powers rather than unilaterally disrupt the status quo. Over the last few years, Brazil maintained amicable relations with the United States, paid its IMF debt and played a cooperative role within the United Nations framework. So far, this conciliatory approach has served Brazil well. However, in order to enhance its capacity to institutionalise change, Brazil may need a more audacious approach and will be faced with difficult choices.

This will include a balancing of its regional and global pursuits. So far, Brazil's efforts at regional integration have met with considerable success but there are tensions, as Brazil's growing international presence arouses concern among its neighbours. As Marcel Biato proposes in his contribution, the task before Brazil is to continue deepening regional integration beyond its current emphasis on trade. This will help create the united regional front Brazil requires to have a greater voice in the rest of the world.

In order to further these aims, Brazil will need to work on improving its homefront as Charles Kupchan

points out. This will require greater investment in human capital and institutional infrastructure to guide and sustain its pursuit of greater autonomy and “sovereign international insertion”

### Brazil in a multipolar world

With the international and domestic legacy that it inherits, Brazil has before it a range of unprecedented opportunities. At the international level, as the global balance of power shifts, there is greater room for manoeuvre for Brazil and other emerging economies. Free of the geopolitical conflicts and enmities that constrain other emerging powers, Brazil can make the most of this changing international landscape. With the declining hegemony of the American model, there is now a plurality of choices about the paths that Brazil and other countries can follow. At the domestic level, Brazil has successfully achieved macroeconomic stabilisation and widespread poverty reduction. Its discovery of oil and gas, as well as its vast agricultural and mineral resources, offer it an environment of abundance and plenty rather than the concerns about scarcity that many other emerging powers face.

If Brazil is to further and consolidate its successes, and make the most of these vast opportunities, it will need to complement its innovative mix of policies with a more strategic and coordinated approach. As the articles in this volume point out, there are often links between different policy areas from oil exploration to education. Keeping in mind these linkages and ensuring that different measures work together will be key in the years ahead. And, in an interdependent and rapidly changing world, the decisions Brazil makes will also have important implications for other parts of the world. As such, there is a mutual interest for countries to learn from each other, a process that the Foresight initiative and this publication aim to facilitate.

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# Section one: Pathways to sustainable growth





# Building Brazil's economic future

Nelson Barbosa

Over the past eight years Brazil has initiated a new development cycle based on the expansion of its domestic market and a reduction in poverty and income inequality. The starting point of this model was an exogenous policy driven expansion in the country's social safety net, through higher income transfers to the poor and faster growth in the real minimum wage. This initial stimulus by the federal government started a virtuous circle of growth of income and employment in which the increase in the workers' income and consumption led to more investment, and which in turn raised labour productivity and allowed for further increase in real wages without excessive pressures on inflation. The virtuous circle between real wage and labour productivity was also aided by a series of government programmes aimed at social inclusion through credit expansion and higher public and private investment in housing and infrastructure.

## The new Brazilian model

The new Brazilian model has also benefited from the growing world demand for commodities in the past eight years. The increase in Brazilian commodity exports allowed a substantial growth in Brazilian imports of capital and intermediary goods with only a moderate reduction in the country's current account balance in terms of GDP. At the same time, the increase in foreign capital inflows allowed the Brazilian government to increase its international

reserves substantially and, in this way, it reduced the country's vulnerability to international financial shocks. However, the counter-effect of the commodity boom was the appreciation of the Brazilian currency, which initially helped the central bank to fight inflation and reduce real interest rates, but that more recently has been eroding the competitiveness of Brazilian manufacturing.

A key factor for Brazil's success in the past eight years has been a pragmatic and responsible approach to macroeconomic policy. On fiscal policy, all of the increase in the federal revenues in terms of GDP has been channelled into income transfers and public investment, leaving the net tax burden on the private sector stable. On monetary policy, the government has adopted realistic inflation targets to deal with price shocks coming from the rest of the world and the structural change in Brazil's own economy. This approach managed not only to accelerate growth and reduce inflation, but also reduced the country's net public debt in terms of GDP and real interest rate. In a nutshell, Brazilian macroeconomic policy has been marked by financial and social responsibility.

The success of the recent Brazilian model and the change in international conditions after the 2008-09 crisis created new challenges for Brazil's economic policy. On the domestic side, there is a growing demand for the expansion and improvement in universal public services, especially in health, education and public security. There is also the need to consolidate the social safety net expanded in the last eight years and to address the inevitable pressures of ageing on social security. Since all of these social demands must be attended to without compromising fiscal and monetary stability, a further increase in social spending depends on additional growth in government revenues in terms of GDP, as well as on a reduction in the growth rate of non-essential public spending.

On the international side, the appreciation of the Brazilian real and the expectation of further appreciation due to oil exports in the near future

A key factor for Brazil's success in the past eight years has been a pragmatic and responsible approach to macroeconomic policy

put more pressure on the Brazilian government to increase the country's international competitiveness through structural programmes or reforms. The list of usual suspects includes tax reform, financial development and better infrastructure, but it also includes a more active role for the state in planning and coordinating large investment projects as well as stimulating research, development and innovation.

### Fiscal and macroeconomic challenges

The new Brazilian model combines economic growth with a reduction in income inequality. The aim for the 2011-14 period is to achieve an average annual GDP growth rate between five percent and six percent, so that labour productivity and real wages keep growing, the middle class continues to expand, inflation remains on target and public finances continue to improve. There are two main challenges to this objective. First, to manage the growth of public spending in a way that is consistent with fiscal stability and, at the same time, consolidates the social safety net built in the recent past and attends to new social demands. Second, to manage the growth of investment and consumption in a way that sustains growth without accelerating inflation and, at the same time, avoids a substantial increase in the country's current account deficit.

Consider first the fiscal challenge. In general the tax revenues of the Brazilian government have been growing slightly faster than GDP in the past years because of the increase in per capita income and reduction in the share of informal markets in the

economy. Since there are still unexplored gains to be made by bringing more people and firms to the formal economy, it is reasonable to expect that government revenues will increase slightly faster than GDP in the next years.<sup>1</sup> In turn, this expected growth in government revenues means that there will be some space for tax cuts even while increasing social spending per capita. Key to this solution is that the Brazilian population is expected to grow 0.7% per year during this decade. For instance, if social spending grows five percent in real terms every year while GDP grows at 5.5%, there will be no additional pressure on the government's budget from social programmes, but per capita social spending will still increase by 52% in 10 years. The main challenge to public spending is therefore more political than economic: to manage the expansion in social programmes in a way that is consistent with both fiscal stability and people's expectations.

Moving to the macroeconomic balance, the government simulations indicate an average annual GDP growth of 5.5% would require an increase in Brazil's investment ratio from 19% in 2010 to something between 22% and 23% in 2014 to keep inflation stable. This result would require an average growth rate of 10% in investment, which in turn means that consumption would have to grow slower than GDP in the near future in order for Brazil to avoid an excessive increase in its current account balance. But is the required growth rate in consumption socially acceptable? Again the question here seems more political than economic, since even a relatively slower expansion in consumption would still increase the per capita consumption substantially in the next year.

To illustrate the previous point, a simple macroeconomic exercise shows that Brazil can reach an investment ratio of 22.5% by 2014, with a relatively stable trade balance in goods and services

1 The market estimates of the GDP-elasticity of government revenues range from 1.1 to 1.3.

in terms of GDP, provided that the country maintains an average annual growth rate of 5.5% for GDP, 10% for investment, and 4.5% for consumption.<sup>2</sup> In turn, the relatively slower growth in overall consumption is consistent with an average expansion of five percent in private consumption and three percent in government consumption.<sup>3</sup> Considering the expected growth in Brazilian population, an average annual growth rate of five percent in consumption means a cumulated increase of 18% in per capita consumption in just four years.

### Financial development

In addition to macroeconomic consistency, the expansion in Brazil's investment ratio also depends on financial development. In the past eight years most of the domestic funding in investment has been supplied by the federal government through its development bank, the BNDES. Since this source of finance has a high fiscal cost because of Brazil's high real interest rate, it is necessary to develop private sources of finance in domestic currency while reducing the economy's interest rate. This challenge would require three parallel actions.

First, maintain fiscal and monetary stability, with realistic inflation targets, to continue to reduce Brazil's real interest rate. The obvious trade-off here is that a fast reduction in inflation targets means a slow reduction in real interest rates and vice versa.

Second, change financial regulation to adapt the economy to a low inflation and low interest rate context, in particular by reducing interest-rate indexation in public debt and eliminating institutional floors to market interest rates. Here, the main trade-off is between the long term gains of changing the term and index structure of public debt and the short run cost of doing it.

Third, improve financial supervision and regulation to expand long term finance for investment in fixed

capital and housing, while preventing speculative bubbles. The obvious trade-off here is between faster credit expansion and stronger supervision.

### Commodities and manufacturing: finding a balance

Brazil has been a strong commodity-exporting economy throughout its history. Its abundant natural resources give it natural advantages in the production of agricultural and mineral commodities, whereas the newly discovered oil reserves indicate commodity exports may become even more significant in the near future. Despite this background in primary products, Brazil has also been able to develop a large and diversified industrial structure since the mid 20th century.

The main reasons for this industrial development were a set of nationalistic government policies and programmes dating back to the 1950s and, more importantly, the size of the Brazilian domestic market. In contrast to other commodity exporting economies, the size and scale of Brazil's domestic market makes it possible for the country to build competitive advantages through temporary programs of industrial or productive development. The key to success in this area is to devise a set of transparent policy instruments that is capable of stimulating investment, research and development, while avoiding the creation or permanent protection of inefficient production. In line with Rodrik's analysis of industrial policy, it is more important to drop the losers when that condition becomes clear than to pick the winners when one does not know who they might be.<sup>4</sup>

In the specific case of Brazil the challenge for the coming years is use the extraordinary "profits" from commodity production, especially oil, to finance and stimulate the development and diversification of the rest of the economy. The activities to be

2 The "starting" conditions are an investment-ratio of 19% of GDP and a trade deficit in goods and services of one percent of GDP on 2010.

3 To put these numbers in historical perspective, the average growth rate of private and government consumption in 2003-10 was 3.6% and 4.3%, respectively.

4 See, Rodrik, D. (2010), "The Return of Industrial Policy", available at: <http://www.project-syndicate.org/commentary/rodrik42/English>.

targeted include exports, investment and innovation, which have been benefiting from general tax and financial incentives in the last eight years. The new focus in the government agenda would also include labour intensive production of goods and services that employ highly skilled labour. In the short run, an important government tool to stimulate these activities is to reduce the relative cost of labour through a cut in government payroll taxes. The main focus of future government incentives should be to shape the content of domestic production together with foreign partners around performance targets to accelerate industrial catch up.

NELSON BARBOSA is executive-secretary of the Ministry of Finance, Brazil

# Navigating the labyrinth: innovation and development

Glauco Arbix

Brazil is at a key stage in its economic development. It has weathered the global financial crisis better than most countries and demonstrated high rates of economic growth over the last decade. Yet, the Brazilian economy also faces significant challenges, including an appreciating *real* and competition from cheap imports that threaten the industrial sector. In an interdependent and globalised economy, innovation has a significant role to play in spurring growth and helping national economies find their distinctive niche. In Brazil, there is a new emphasis on innovation that comes from the recognition of the need to diversify the economy, to expand exports and to increase the economy's productivity and competitiveness. It is also an area where, though Brazil has made a lot of progress in the recent past, it still has a long way to go.

## The ecosystem of innovation

The debate about the meaning and potential of innovative practice still suffers from conceptual confusion and it is important to differentiate innovation from invention. While invention and innovation are connected by a continuum, innovation refers to a first commercialisation of an idea or project. Therefore, the sphere of innovation is a company, capable of fine-tuning production and marketing, while invention has a different orientation and occurs in laboratories, universities and research centres. The transformation from invention to innovation does not always happen

quickly and requires different types of knowledge, abilities, skills and resources.

It is often the start of competition between firms, usually based on small changes, addition or copies, which enables the evolution from an invention into a viable product for the marketplace. Indeed, innovation is the result of extensive processes of improvement and redesigns, which may or may not involve technology, academic research or applied research. All processes, discoveries, new products and services, whether high-tech, low-tech or no-tech, that add economic value are innovations. Subtle mechanisms, seemingly minor and unimportant, are often the real engines of the economy rather than big leap advances in high technology.

However, it is not easy to visualise the innovation process in all its breadth. Innovation often goes beyond the horizon of business and develops through an extensive network of employees. Indeed, its commercial aspect is only one of its many faces. The web formed involves companies, entrepreneurs, researchers, distributors, academic institutions and consumers, and creates a highly diverse and complex innovation ecosystem. There is no ready recipe for guidance in this environment that, despite recent advancements, still resembles a labyrinth.

## Brazil's legacy and recent developments

Brazil is a country that industrialised late and the process of developing science and technology research only began in the 1970s, and was based mostly at universities and research institutions. It is also important to keep in mind that Brazil experienced a long period of macroeconomic instability in the next decades which significantly influenced the agenda of government, academia and business. As result, there was a low priority assigned to the economics of innovation in the 1980s and early 1990s.

The perspective began to change as the Brazilian economy stabilised and responded to the dynamics of globalisation. In the late 1990s, sector funds were introduced to make resources available for research

and innovation in different industrial sectors. In 2004, the federal government announced the Policy of Industry, Technology and Foreign Trade (PITCE), structured around innovation. The Law of Goods and the Innovation Law that were adopted in the wake of PITCE played an important role in building an environment that encourages innovation.

Today, there are a range of resources available to Brazilian companies that pursue innovation in products and processes. Bureaucratic procedures have been simplified and tax incentives for research and development (R&D) are available. There is a new system of subsidies for technological development projects as well as subsidies that help place researchers in companies. The legal framework encourages greater interaction between universities and companies, and there are funding programmes for innovation from venture capital.

### Achievements and challenges

Brazilian policies for R&D have made possible the systems that support the aerospace industry at Embraer, refining and extraction at Petrobras, agricultural training at Embrapa and, more recently, the China-Brazil satellite programme. Indeed, expenditure on research and development has gone up and is now around one percent of GDP. Brazil also has a large consumer market and a relatively large industrial sector. There are 90,000 industrial firms that employ over six million workers and invest about \$3bn a year in R&D.

A significant portion of the business community is now aware of the importance and necessity of innovation. Indeed, studies show that a new group of enterprises is emerging that grows faster than other Brazilian companies. This new group of enterprises is more productive, invests more in R&D, training and capacity building, pays better wages to employees and obtains a special price on the international

market.<sup>1</sup> Many of these companies have begun to internationalise their activities, investing in other countries and building systems of production and services abroad. They are forming a select group of competitive Brazilian multinationals.

However, significant challenges remain and technological innovation indicators in Brazil are far below those in developed countries. Indeed, China and India are making faster and wider strides in the field of innovation. China has moved to third in the ranking on investment in R&D, with a growth rate of 18% over the last few years.<sup>2</sup>

The biggest challenge is encouraging greater innovation in the private sector. In Brazil, only about 30% of companies are innovators while the average share in European Union countries is 50%. Brazilian companies invest about 0.6% in R&D compared with 2.7% in Germany and 2.5% in France.<sup>3</sup>

Making public funding more accessible to the private sector also presents a challenge. In Brazil, although the government is responsible for more than half of R&D expenditure overall, Brazilian companies use 90% of their own resources rather than applying for and making use of funding available from the government. In developed countries, governments largely fund R&D at a non-recoverable or zero interest rate, that is, under much more favourable terms than in Brazil. In fact, the investment of public resources in R&D in private companies can have a significant positive impact. Studies show that the utilisation of public funds in R&D in Brazilian companies often improved productivity and quality of wages and work. Studies also indicate that Brazilian businesses receiving public resources also invested more of their own resources in R&D. This is very beneficial for Brazilian economic development overall, but the scope of current programmes is still limited and needs to be expanded.

Another challenge is that research remains more

1 See Bahia, L. and Arbache, J.S. (2005).

2 See Rodriguez, A., Dahlmann, C., and Salmi (2008). Further see OECD (2008) and Mobit (2007).

3 Research by the Observatory for Innovation and Competitiveness in EUA, Canada, France, UK, Finland, Ireland, and Japan (MOBIT, 2007).

There is a need to rethink development and search for a new configuration of policies and instruments capable of steering Brazil through globalisation and developing an economic system that has knowledge as its backbone

academic or lab-based rather than applied and geared towards commercial viability. The number of researchers working on technological innovation remains small and there still needs to be closer relations between universities and companies.

### The road ahead: a new synthesis

While Brazil has made great progress on creating an environment suitable for innovation, much still remains to be done. New instruments need to be created and existing mechanisms improved. It will also be important to lay the roots for developing a corporate culture of innovation, especially through encouraging interaction and synergies between universities and companies. An innovation-friendly environment is characterised by the confluence of knowledge, the exchange of skills and a diversity of public and private sources. To realise an enterprise's potential, the process of planning, while important, only partially accounts for success. Reflection on the innovation agenda, therefore, points to the search for new syntheses between the public and private sectors in Brazil, far from the protectionist statism and market fundamentalism that have so often marked Brazilian history.

Moving forward, it will be essential to keep in mind that while the Brazilian state has an important role to play in spurring innovation, it cannot afford to think, formulate, implement and evaluate new development policies without consultation, cooperation and interaction with business and civil society. To face the challenges of the 21st century, the institutions

generated by the developmentalist state must be revised and restructured in order to make way for a society aligned with the times.

The institutional architecture of the Brazilian state can often be inflexible, inadequate and resistant to change. There is a need to rethink development and search for a new configuration of policies and instruments capable of steering Brazil through globalisation and developing an economic system that has knowledge as its backbone. It will be important to integrate instruments to promote technological innovation in various institutions. This will only be possible if the state has a strategic innovation policy. Whether or not there is boldness in business strategies also depends on the spread and entrenchment of this future vision. The private and public sector need to seal a new commitment to the country. Brazil needs a new synthesis, more aggregated and less polarising.

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# Becoming an energy powerhouse

Mauricio Tolmasquim and Amilcar Guerreiro

The current global energy scenario is marked by an ongoing search for energy security and efforts to meet the challenges presented by global warming. Brazil, with its vast energy potential, can contribute towards both of these processes. Moreover, the Brazilian energy sector can play a key role in the country's economic development. Brazil's dependence on external energy sources is less than five percent. It is self-sufficient in oil and also has a large renewable energy sector<sup>1</sup>, with over 47% of its overall energy matrix accounted for by renewable sources<sup>2</sup>. Indeed, if Brazil is able to harness its energy potential, this can serve as both a source of economic growth and greater energy security in the country, as well as of lower carbon emissions at the global level.

## Oil and gas: new finds, new dilemmas

Until recently, Brazil had not been a major player in the world oil market. However, this situation is changing thanks to the success of Brazil's off shore exploration and extraction. Brazil has achieved self-sufficiency in oil and has built up a level of reserves sufficient to sustain national production for 30 years. Estimates suggest that an additional 50bn barrels – equivalent to four percent of proven world reserves – may be achieved through the exploitation of recently-discovered oil located in the pre-salt region off Brazil's

coastline. Official data on gas reserves in Brazil do not grant the country a leading role in the international gas market but, just like oil, the discoveries of gas in the Brazilian pre-salt layer could change this outlook. However, while the revenue potential of these reserves has led to great optimism, it also presents significant challenges over how best to manage the reserves, regulate their exploitation, and distribute the wealth generated. While the future strategy is yet to be determined, it is likely that two fundamental elements will be present: regional integration and the sovereign appropriation of wealth generated by large reserves.

## Biomass: the comparative advantage

Much of Brazil's territory lies in the region of the planet that is most suitable for the production of biomass. Part of this potential is already being used to produce electricity, for example from sugarcane pulp. But taking greater advantage of this potential requires investment in technology and equipment to recover the biomass that is under-used or left abandoned in fields. The prospects are promising, especially for generation of electrical power. From only the sugarcane pulp that is currently available, the potential electricity generation is estimated at 10,000 MW. With the development of technology and by making good use of tips and straws, this figure could at least double.

A common concern with biomass production is its possible impact on food production and socio-environmental ecosystems. Fortunately, there is not much cause for these concerns in the case of Brazil. The numbers speak for themselves. For example, the area presently dedicated to the production of sugarcane is less than six million hectares, which is not even 0.7% of the entire national territory and less than seven percent of the total area available for agricultural activities. There is therefore enough space

1 Because of the competitive presence of ethanol, only 78% of the energy consumed in transportation comes from oil derivatives, one of the lowest rates in the world.

2 EPE [Energy Research Company]. Balanço Energético Nacional 2010. Ano Base 2009. Rio de Janeiro: EPE, 2010.

for the planted area to expand without jeopardising food production or regions of significant socio-environmental value. Another reason for optimism is the technological advances that have made ethanol and bio fuel from sugarcane competitive products. And, increased productivity contributes decisively to the preservation of areas meant for different crops, other uses and eco-systems. Indeed, over the last 25 years, an area equivalent to 2m hectares has been "saved" in this way.

Technological advances have not only been made on the supply side of energy. Flex-fuel vehicles, with engines that work on any proportion of ethanol and gasoline, are now well established. Only six years after being launched in 2003, flex-fuel vehicles already amount to 35% of the national fleet of small cars, something close to 9m units.<sup>3</sup>

The Brazilian bio-energy industry has also leant a strategic dimension to trade relations with Africa and Latin America. The development of an international market for bio fuels would improve technology, optimise and drive down the costs of production. Brazil's comparative advantage and early establishment of a bio-energy industry would make it a world leader in any such marketplace.

#### Hydro-electricity: the multifaceted potential

Hydro-electricity accounts for approximately 85% of Brazil's total energy production (2009) and is its main source of electricity.<sup>4</sup> In world terms, Brazil is behind only Russia and China in usable hydraulic potential. Taking advantage of this potential is clearly in the country's strategic interest, particularly as it combines four vital attributes: it is renewable; it does not emit greenhouse gases; it is extremely competitive; and plants can be built almost entirely using domestic contractors and service providers, thus stimulating the creation of jobs and wealth.

Generally, while economically developed countries

It must be ensured that Brazil's abundant hydraulic resources are used as effectively as possible to meet a growing need

make good use of their hydraulic potential, the rates in Africa, Asia (except China) and South America (except Brazil) are still very low. Given the rapidly growing energy demands of many developing countries, there is potential for hydro-electricity to play a key role in meeting these needs given its under-use in these regions. It must be ensured that Brazil's abundant hydraulic resources are used as effectively as possible to meet a growing need. Brazil has under construction two large projects on the Madeira river – Santo Antonio and Jirau - which together total 6,500 MW, and in 2010 the decision was made to build the Belo Monte plant on the Xingu river (11,200 MW) and the Teles Pires plant (1,820 MW).

However, there are also significant risks involved in the expansion of hydro-electricity in Brazil. Two-thirds of the national territory is covered by biomes of high environmental value (the Amazon and the Cerrado scrubland), and 70% of Brazil's hydro-electric potential is located in these biomes. Clearly the development of any hydraulic potential should ensure that the environmental impacts are minimised. Promisingly, many areas in the vicinity of existing dams are today among the best conserved, both with regards to flora and fauna, and archaeological sites. Also, from the socio-economic angle, one can see the striking effect of recent projects around which settlements are beginning to exhibit human development indices higher than those of the surrounding region. Hydro-electric plants are more than electricity factories, they can be catalysts for regional development and environmental preservation.

3 Losekann, L. e Vilela, T. "Estimação da frota brasileira de automóveis flex e a nova dinâmica do consumo de etanol no Brasil a partir de 2003". Available at <<http://infopetro.wordpress.com/2010/07/26/estimacao-da-frota-brasileira-de-automoveis-flex-e-a-nova-dinamica-do-consumo-de-etanol-no-brasil-a-partir-de-2003>>.

4 This considers imports coming from the Paraguayan part of the Itaipu plant.

### Wind energy: increasing competitiveness

Brazil's potential for wind energy is tremendous and growing fast. Five years ago there were only ten plants in operation providing less than 30 MW of electricity. By the end of 2010, this had risen to 830 MW. Moreover, energy auctions held in 2009 and 2010 yielded contracts to build wind farms generating 1,806 MW and 2050 MW by 2012 and 2013 respectively. In three years, this would have risen 530% to go beyond 5270 MW.

The main challenge to the development of a successful wind-energy industry is improving its competitiveness in order to make it more cost effective. The supply base of wind energy needs to be expanded and diversified. This can be achieved with the support of the BNDES (National Bank for Economic and Social Development) which is working to expand energy infrastructure generally, demonstrating that the conditions required for financing the industry are available. Indeed, the success of the auctions in 2009 and 2010 attests to the promise of improving market conditions because they simultaneously stimulated competition and conferred bankability to the projects through long-term contracts for the purchase of energy.

### Looking to the future

Brazil's energy policy aims to keep strict commitments to environmental preservation, sustainably manage natural resources, and minimise its dependence on the external market for fossil fuels. Motivated by meeting the challenge of global warming and the need for energy security, this policy has led to the development of a cleaner and more diverse energy matrix, which has set Brazil on a path that moves it away from external fossil fuel supplies towards an expanding domestic capability, and increasingly away from non-renewable sources towards bio-fuels, wind- and hydroelectric power.

Much of this optimism is, nevertheless, based on the assumption that the great potential of Brazil's future energy supply will be realised. Significant challenges

need to be overcome if Brazil's burgeoning energy industries are to fulfill their promise. If these issues are managed effectively then, given the strength of its resources, the dynamism of its economy and its political stability, the ingredients exist for Brazil to become an energy powerhouse of the 21st century.

MAURICIO TOLMASQUIM is president of the Energy Research Company (EPE) of the Ministry of Mines and Energy, Brazil

AMILCAR GUERREIRO is director of EPE



# Escaping the trade trap: The east Asian experience

Yang Yao

The neo classical economic dictum that free trade will always improve the welfare of trade partners can be challenged from two approaches. On one hand the Infant Industry Theory (IIT) questions the extent to which a country with a developing manufacturing sector can grow under the conditions of free trade. On the other, the Dependency Theory (DT) challenges the received wisdom that a relationship of free trade between a centre of wealthy states and a 'periphery' of poor states will always result in the improved welfare of the latter. Related to DT's understanding of the centre-periphery relationship is the more recently formulated theory of the resource curse according to which this relationship's terms of trade can hurt resource exporting countries by creating a "trade trap". In recent decades China has followed the trend of the east Asian Tiger economies in relying heavily on exports to achieve economic growth while simultaneously escaping the trap that the resource curse describes.

## The risks of trade

According to IIT, manufacturing is characterised by increasing returns, and for a firm to make profit they must achieve a minimal efficient scale (MES). For firms to grow and begin to achieve their MESs, high prices are needed. However, according to IIT there is a contradiction between the protection of high prices required for firms to achieve their MESs and free trade, because foreign products, presumably

produced in more advanced countries where firms operate above their MESs, suppress domestic prices. As a result, a poor country may not be able to develop a viable manufacturing sector under free trade as it would be killed when at an infant stage.

On the DT model, the world is categorised into centre and periphery. There is a relationship of dependency between a centre which generates technological progress and manufactures industrial goods, and a periphery which provides the centre's resources. Thus, the periphery depends on the centre for its growth. Against conventional wisdom however, technological progress does not improve the periphery's terms of trade, so its welfare does not improve. This can happen if technological progress in the centre is characterised and dominated by the expansion of varieties, rather than improvement of efficiency in producing existing products, or if the elasticity of price substitution is large between products.

Related to this model is a more recent theory which articulates what is called the resource curse. For DT, the periphery is negatively affected because its terms of trade for resource export do not improve, and thus nor does its welfare. The resource curse explains a process whereby improved terms of trade for resource export can damage resource exporting countries instead of helping them. Improved terms of trade for resource export imply worsened terms of trade for manufacturing export, so the manufacturing sector cannot grow and indeed can shrink, if the resource-manufacturing relative price changes dramatically. A positive and large demand shock or a discovery of large resource reserves has a similar effect. Due to the problem of the resource curse, a resource-rich country may be locked into exporting resources, perpetuating its dependency on the centre. All three theories suggest that developing countries, particularly those heavily dependent on resource export, could fall into a "trade trap" – a stage locked in exporting primary goods. The oil exporters are an example of those who have fallen into such a trap.

### East Asian success stories

However, there are also countries who, despite observing the correct economic conditions, have managed to escape the trade trap. The east Asian Tigers are an example of this group. More recently China has followed the east Asian Tigers in their reliance on exports to achieve high economic growth, and likewise its exports are becoming more and more technologically sophisticated. In the early 1980s, the share of primary goods in China's exports was close to 60%. By the mid-1990s, this share dropped to 10%, and low-tech exports such as garments and shoes became the largest category of export. Today, the bulk of China's exports consist of electronic goods. What are the common features of the east Asian success stories?

First, the east Asian governments adopted policies that encourage the export of non-primary goods. This includes a competitive exchange rate for the currency, low barriers to the export market, and absence of export tariffs. Taking the trade trap dilemma seriously, many developing countries overvalued their currencies and taxed resource export. The former measure was aimed at lowering the costs of imports of foreign equipment and technology, whereas the latter was aimed at transferring wealth from the resource sector to other sectors. However, overvalued currencies severely reduced the competitiveness of these countries' manufacturing goods in the international market. Further, taxes from the resource sector were not effectively used to foster the development of non-resource sectors. In east Asia, competitive exchange rates allowed the economies in this region to explore their comparative advantage in labour and export labour intensive manufactured goods as a first step towards escaping the trade trap.

Second, the benefits of primary good exports were spread to a large proportion of the population, especially the poor. In east Asia's early stage of development, primary good exports were concentrated on agriculture. As a result, exports

benefited farmers, typically the very poor in a developing country. As their wealth increased, farmers were able to improve their farming technologies, freeing up labour from agriculture and jump-starting economic development. This scenario is atypical of resource-exporting countries, however, where the ownership of resources is often narrowly concentrated. As a result, benefits do not spread to ordinary people, thus severing this channel of development.

Third, domestic policy encouraged the expansion of the manufacturing sector. This includes strengthening basic education, improving innovation capacities, providing infrastructure, and lowering restrictions in the labour market. The most effective way to improve the living standard of the poor is to provide jobs, but commonly the restrictions applied to large firms in the labour market discourage the expansion of industry. Many firms remain small in order to avoid being subject to the restrictive labour laws applied to larger firms. East Asian countries have addressed this issue and avoided disincentives by adopting a gradual approach to improving their labour standards. In addition, these countries prioritise education and innovation, which enables them to climb the technological ladder and improve their exports.

Fourth, a realistic and gradualist approach has allowed the east Asian economies to avoid major setbacks. In the late 1970s, Latin American countries borrowed heavily from the international market. The measure was aimed at improving economic structure in a short period of time, yet this was undermined by the two decades of high inflation and low growth the resulting debt crisis caused. By contrast, east Asia's progress has been fast but has also remained piecemeal.

### The Chinese experience

One finds the above four points reflected in China's experience of development. Prior to 1978, when China adopted the open door policy, the Chinese yuan was greatly overvalued. During the 1980s, the

Gradualism is a distinctive feature of China's transition from economic planning to the market, but it is also a feature of China's other policy changes

yuan's official value was reduced gradually, and in the meantime markets were established to allow exporters to exchange their foreign earnings into the yuan under market determined rates. By 1994, the official track was merged with the market track, bringing the yuan's value to a competitive level, and greatly enhancing China's non-primary goods export. In 2001, China joined in the World Trade Organization, which removed external constraints on China's exports. As a result, China's exports increased by a rate of 29% per annum between 2001 and 2008.

In the 1980s, China's primary good exports were concentrated on agricultural goods, which benefited farmers by increasing their income, as described above. They were then able to develop small-scale indigenous industries, which in turn changed China's export structure. In the early 1990s rural industries accounted for half of China's industrial output, and 40% of China's exports.

Though China treated capacity building as a top priority of industrial policy even before its open door policy, the close door approach did not result in achievements commensurate with the efforts exerted. During the 1980s, China began to take a completely different approach by treating foreign direct investment (FDI) as a coherent part of a national plan to upgrade the country's industrial structure. In the first 20 years, FDI was concentrated in labour-intensive industries, raising fears that FDI would reinforce China's place in the trade trap. However, China's export has become increasingly sophisticated in the last decade, and FDI has played a positive role in this process. FDI now accounts for half of China's exports.

Gradualism is a distinctive feature of China's

transition from economic planning to the market, but it is also a feature of China's other policy changes. Toward the end of the 1970s, China also followed the Latin American model by borrowing from the world financial market, mainly to finance its technological import. Yet the scale of China's borrowings was much smaller than that of Latin American countries, and China stopped borrowing soon after signs of a market downturn became visible. Moreover, the reliance on FDI to upgrade its export is also a result of pragmatism. The Chinese government was able to resist the temptation of pursuing national pride and was not shy to use FDI to upgrade China's technology.

### Lessons for Brazil

The east Asian success stories provide lessons for Brazil. Resource export can be a catalyst for sustainable, nationwide economic growth. The key is to generate positive externalities that promote the development of manufacturing. There are several reasons why manufacturing is critical for Brazil.

First, the development of manufacturing can help Brazil reduce its dependency on the export of resources, which has an appreciation effect on a country's currency. Internationally, it reduces a country's competitiveness in manufactured goods, and domestically it increases the relative price of service goods which further depresses the growth of manufacturing. To balance these negative impacts, Brazil needs to have a concrete plan to boost domestic manufacturing.

Second, for a large country like Brazil the development of manufacturing is an indispensable step toward higher income levels. Services grow faster when a country experiences a boom of resource exports, leading some to believe that a country can jump over the period of manufacturing. However, this is wrong in two respects. First, growth generated by a resource boom is unsustainable as services do not generate exports and in the end, when resource exports slow down, a country will encounter current

account deficits. Second, it is widely observed from the history of advanced economies that the share of manufacturing in the national economy experiences a hump-shaped trajectory, i.e. increasing in the early stages and decreasing in the latter stages of development. The US experienced the turning point in the late 1950s. Brazil has not yet reached this point so manufacturing should still grow.

Third, manufacturing is especially effective in raising the income of the poor because it generates jobs. This is particularly acute in the case of Brazil, which has one of the world's most unequal income distributions. The export of resources on the other hand, is not that effective in generating employment. While the services sector does generate employment, growth in services induced by a resource boom is unsustainable.

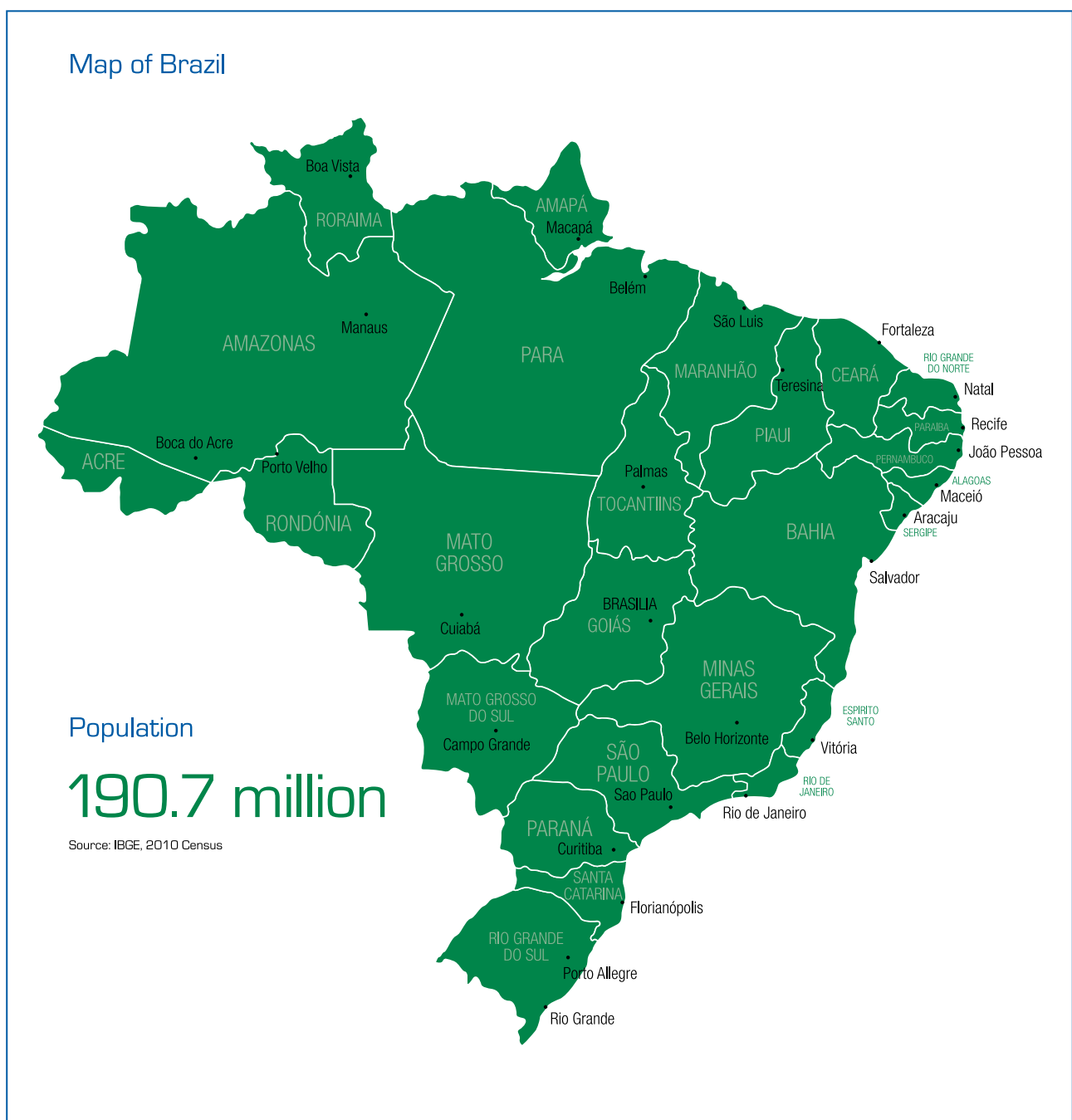
YANG YAO is professor and director of the China Centre for Economic Research, Peking University

# Data section



## Economic and social data

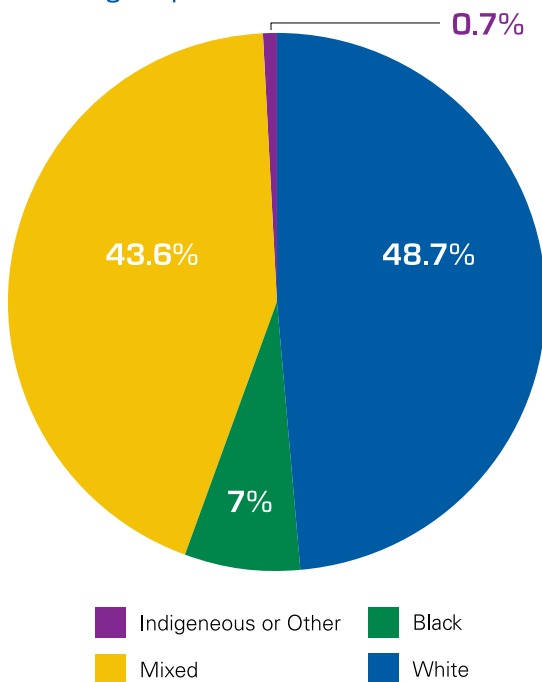
With a federal system and heterogenous population, Brazil exhibits great diversity. The country's economy is robust and weathered the recent financial crisis better than most but it also faces challenges such as the rising value of its currency. Economic growth has been accompanied by social inclusion, with rapid reduction in poverty and unemployment levels. Yet, huge inequalities and regional disparities remain. As Brazil begins to overcome these and develops further, its share of the world economy is growing and it is now widely regarded as a significant global actor.



# Brazilian political system

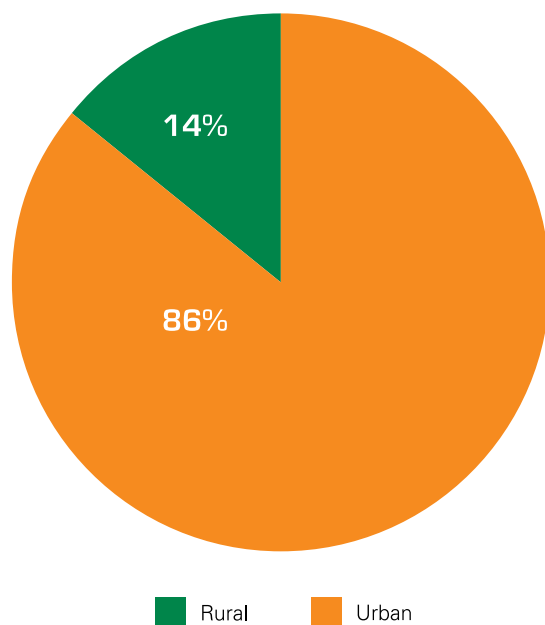
Brazil is a federal republic with a multi-party political system and independent judiciary. It is composed of twenty-six semi-autonomous states and one federal district, each with its own constitution and popularly elected legislature and governor. Democracy was re-established in the country in 1985 after twenty-one years of military rule, and a new federal constitution was implemented three years later. Over the last two decades, the country witnessed a marked increase in political stability and the rise of a vibrant civil society, including a growing number of associations representing the rights of minorities and other traditionally excluded groups. Five main parties have come to dominate the political landscape: the PT (Workers Party, leading party of the governing coalition), the PSDB (Brazilian Social Democratic Party, main opposition), the PMDB (Brazilian Democratic Movement Party), the DEM (Democrats), and the PV (Green Party).

Racial groups in Brazil



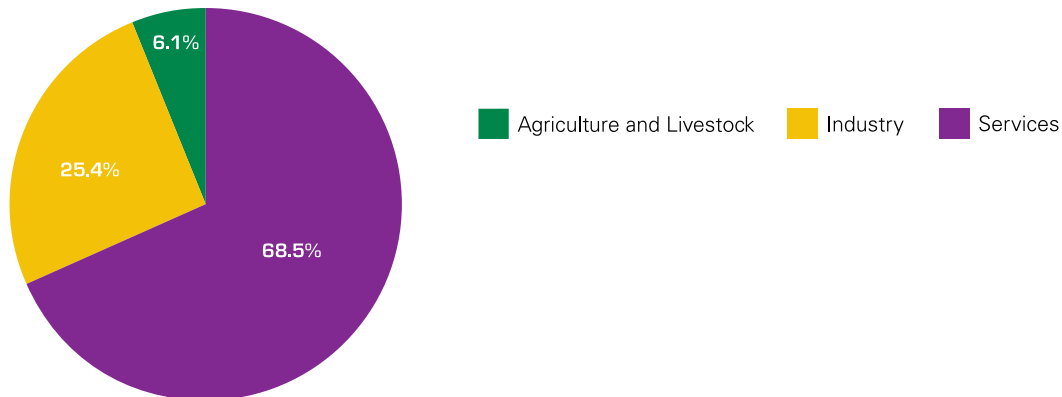
Source: Brazilian Institute of Geography and Statistics (IBGE)

Urban vs Rural population



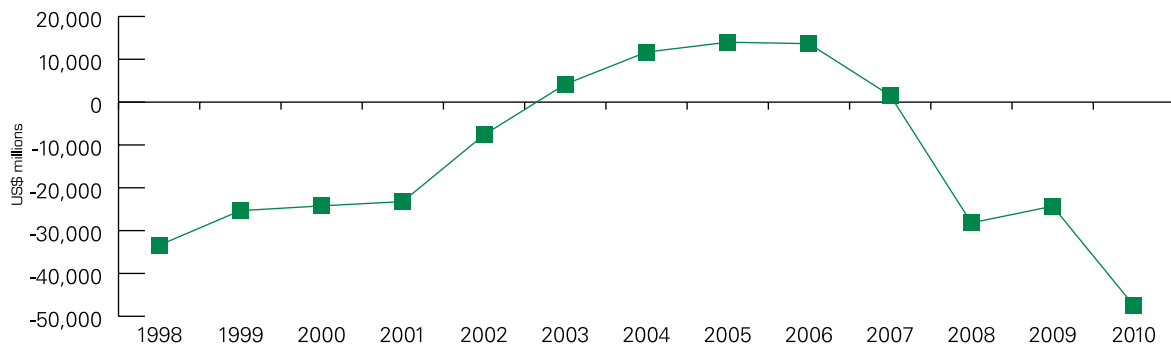
Source: IBGE

### Brazilian GDP: composition by economic sectors



Source: IBGE

### Brazilian current account balance



Source: Central Bank of Brazil

### Exchange rate: Brazilian real to US dollar



Source: Central Bank of Brazil

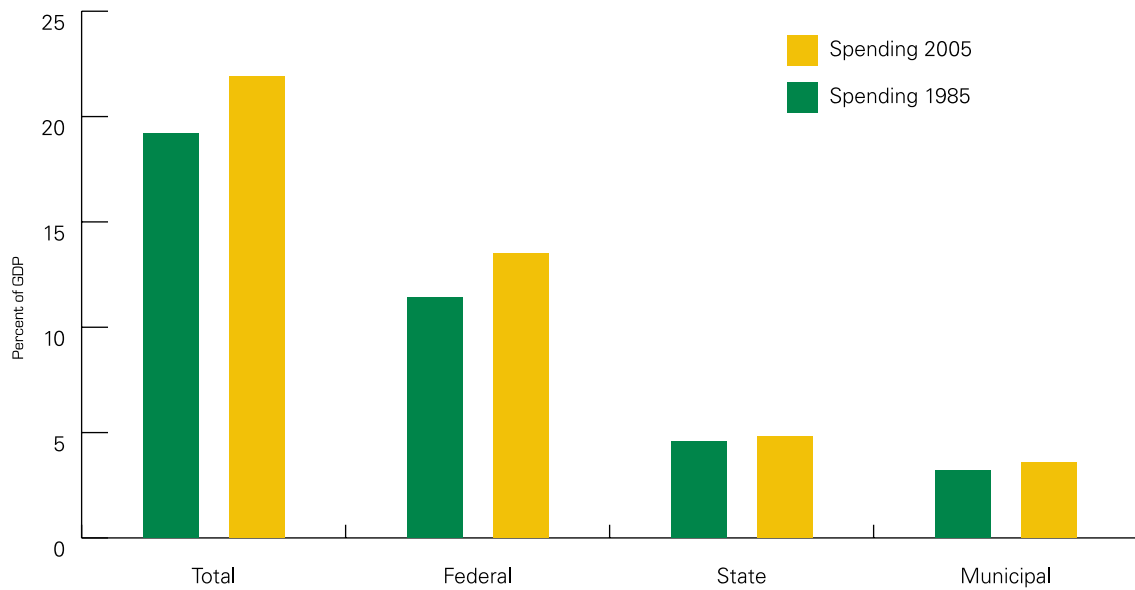
### Inflation and interest rates

Inflation 2010	Interest Rate 2010
<b>Central Bank Target</b> (Annual rate)	<b>Central Bank Target</b> (SELIC Target)
4.50%	10.75%
<b>Inflation rate</b>	<b>Interest rate (SELIC)</b>
5.91%	10.66%*

\* Average rate based on 252 weekdays

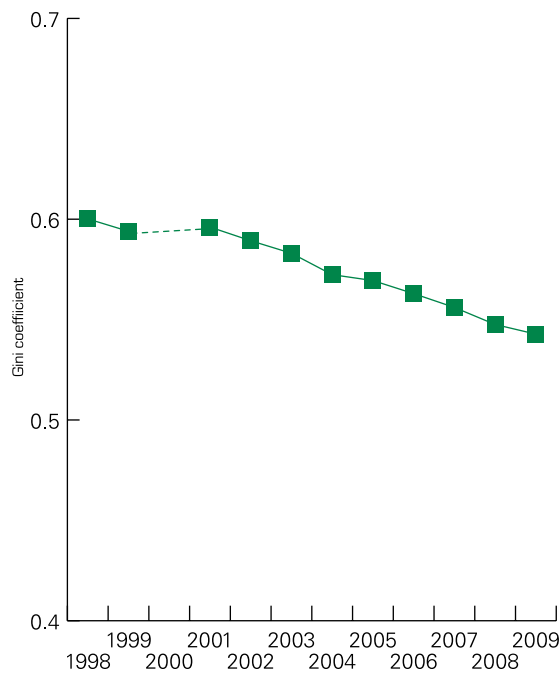
Source: Central Bank of Brazil, IBGE

### Social public spending



Source: Brazilian Ministry of Finance, Ipea, Central Bank of Brazil

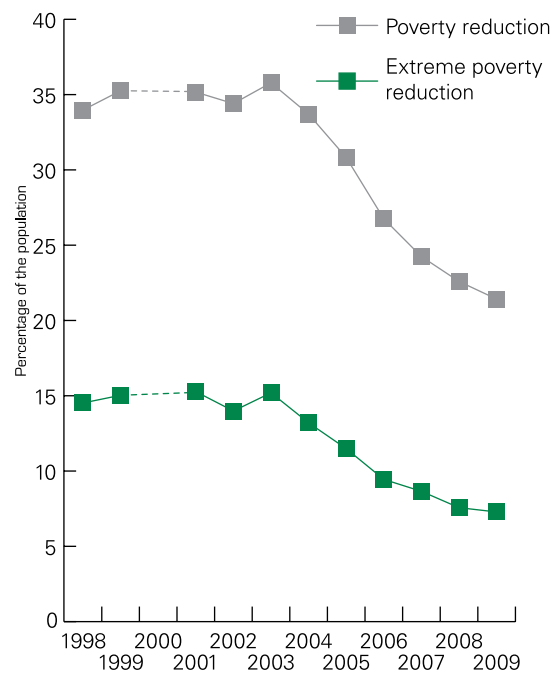
### Inequality reduction in Brazil



Source: Ipea

The Gini coefficient is a commonly used measure of inequality. The coefficient varies between 0, which reflects complete equality and 1, which indicates complete inequality.

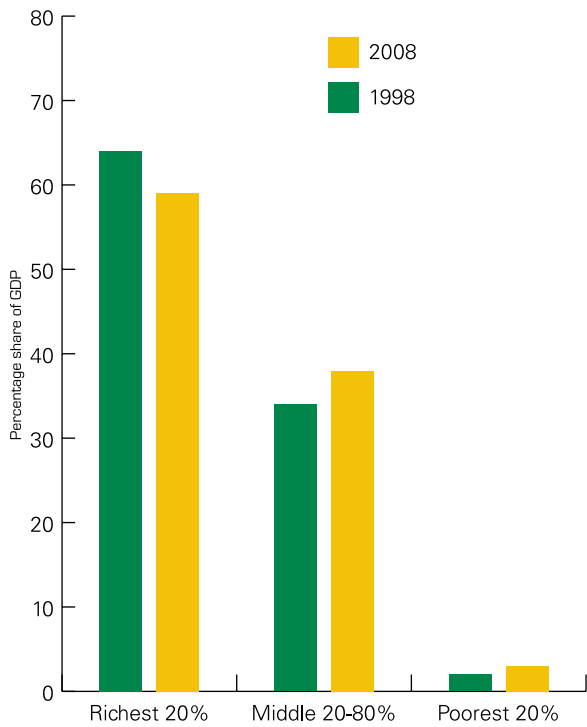
### Poverty reduction in Brazil



Source: Ipea

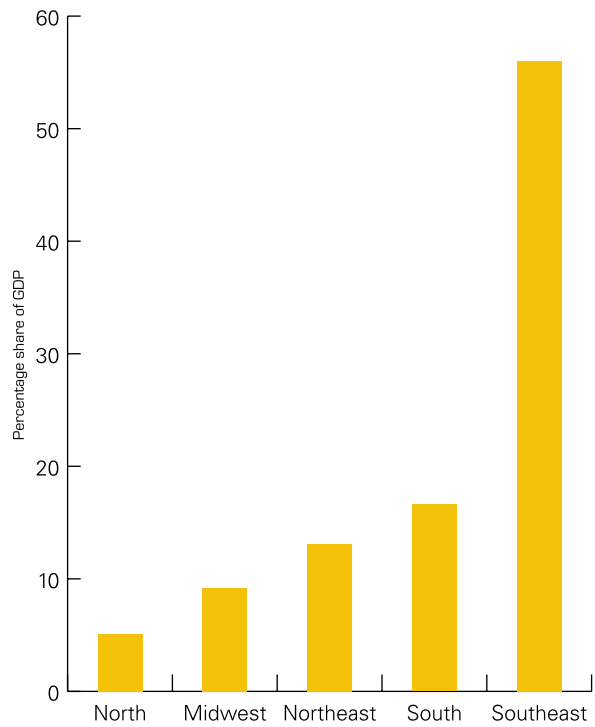
The poverty line is equivalent to double the estimate of the extreme poverty line. The extreme poverty line is an estimate of the cost of a food basket containing the minimum amount of calories required to meet the basic needs of an individual, based on the recommendations of FAO and WHO.

Distribution of national income



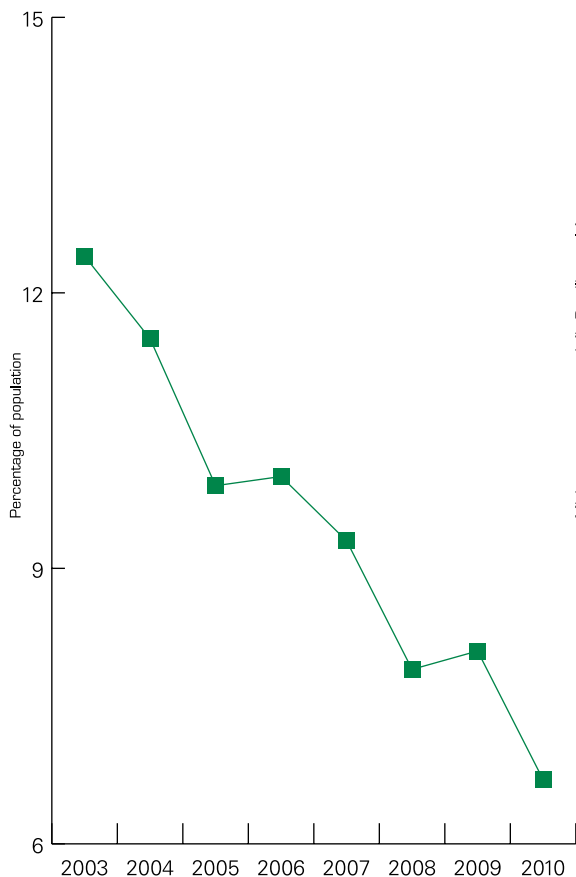
Source: Disoc/Ipea (Millennium Development Goals - 4th national monitoring report)

Regional share of national income (2007)



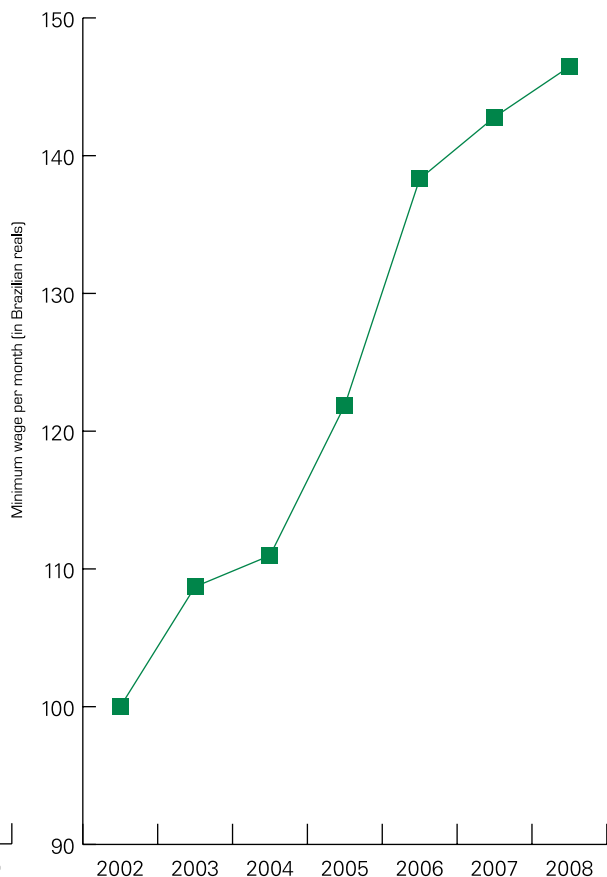
Source: IBGE

Unemployment rate



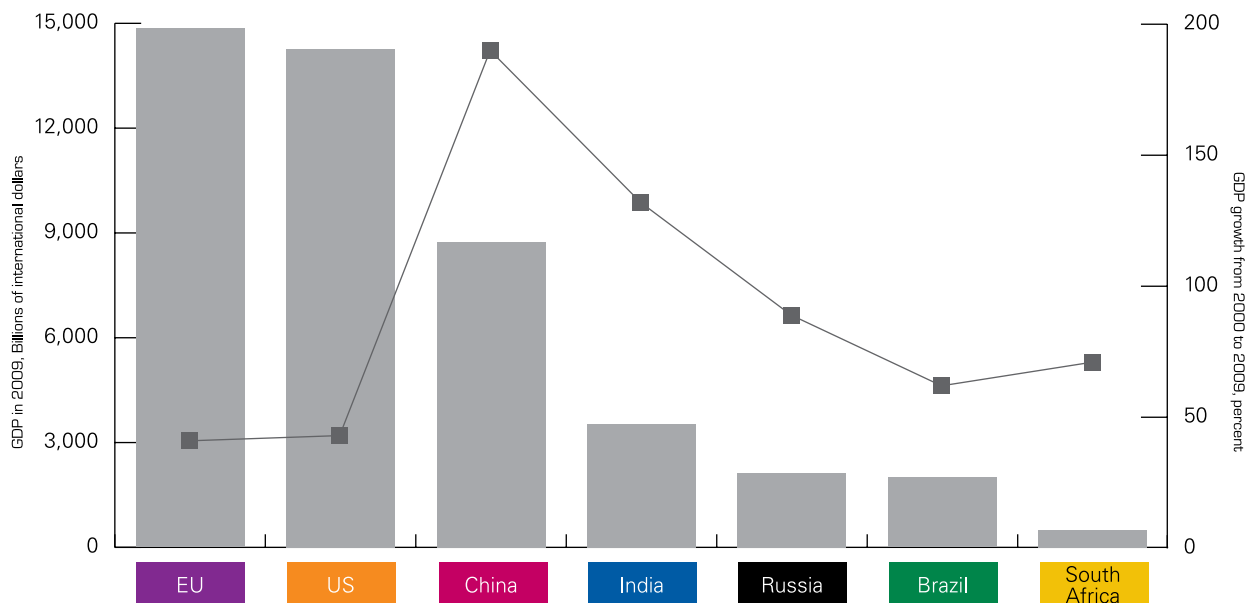
Source: IBGE

Minimum wage



Source: Ipea

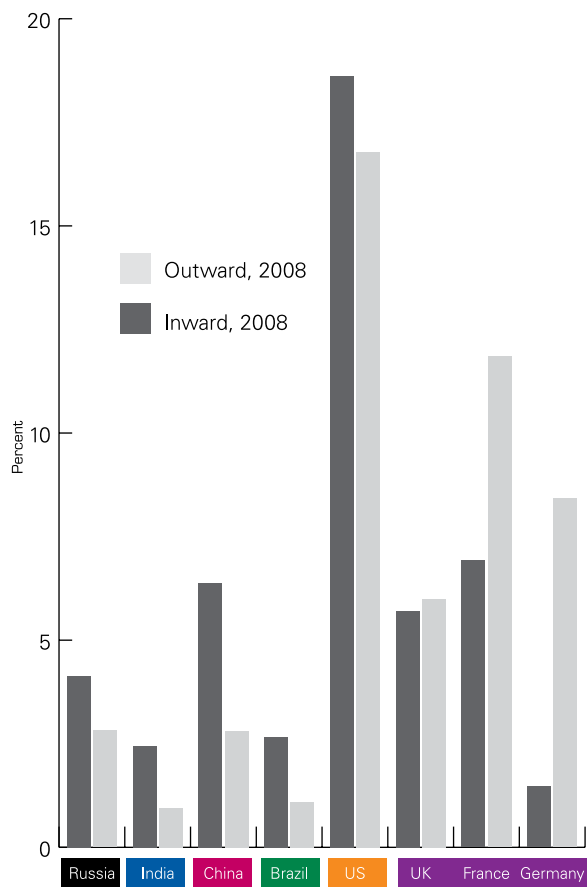
### Growth in GDP and total GDP



Source: IMF

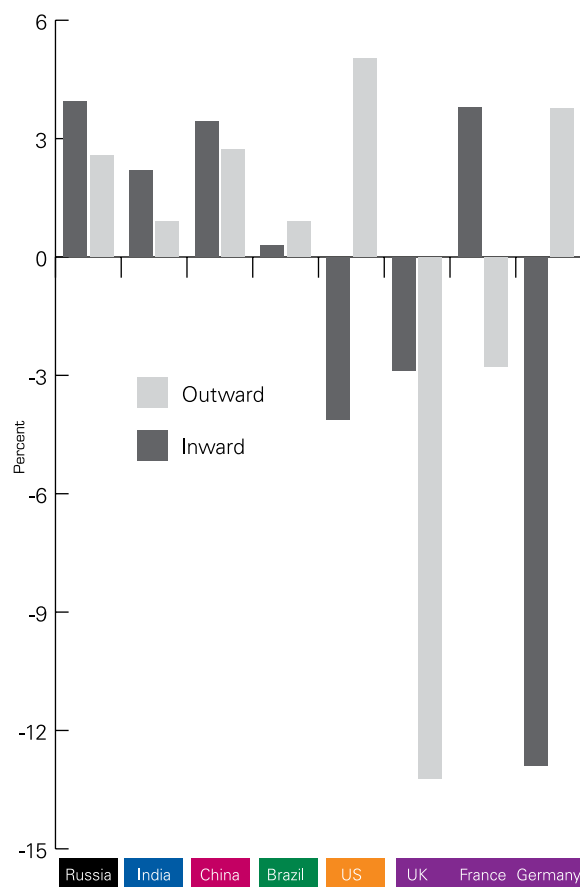
### Foreign direct investment

Share of world foreign direct investment

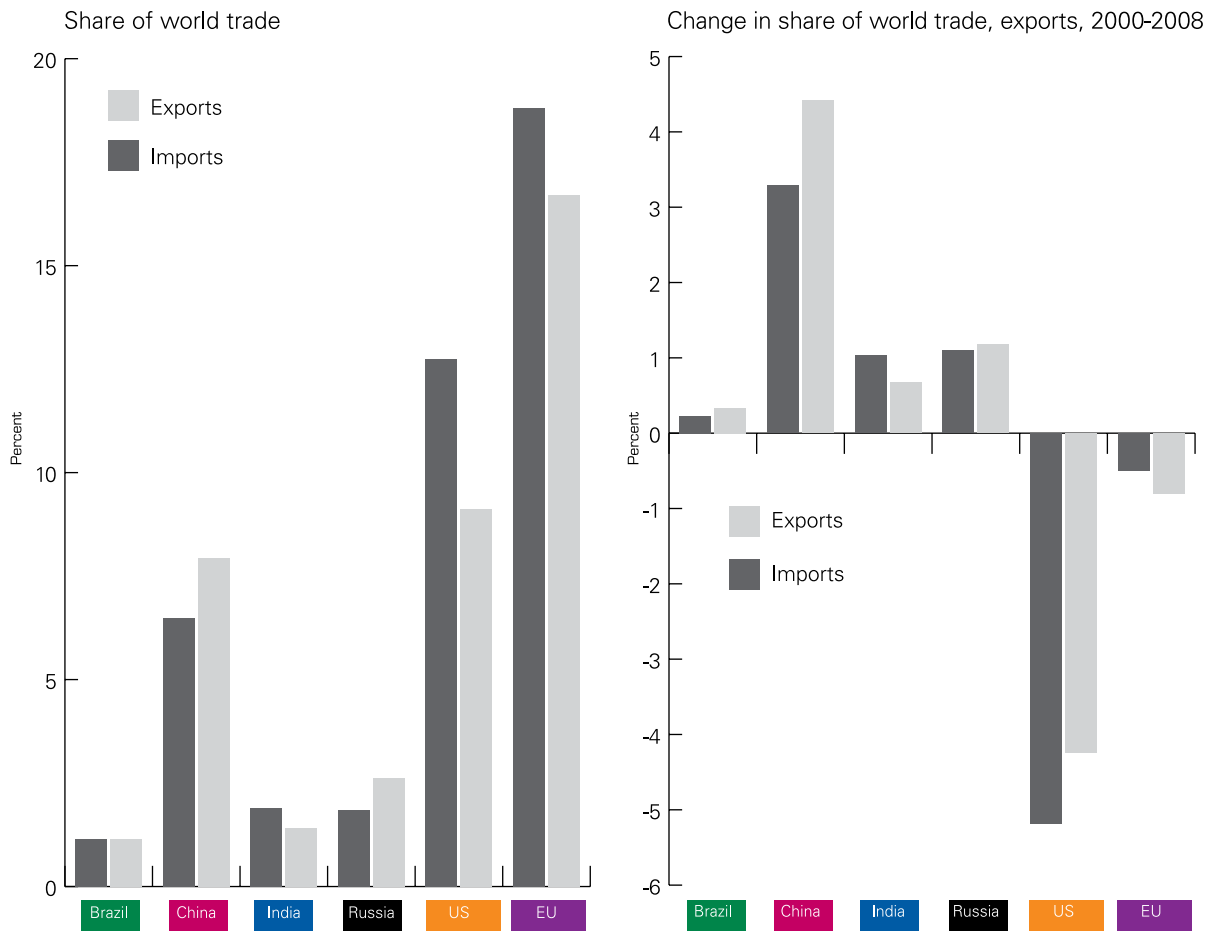


Source: Unctad

Change in share of world FDI (2000-2008)



### Share of world trade



Source: WTO

# Section two: Internal tensions and social cohesion





# Advancing a new deal for Brazil<sup>1</sup>

André Singer

The last decade has seen enormous social progress in Brazil with significant reduction in poverty and inequality. A remarkable social transformation through which most of the population enjoys a comfortable life, a Brazilian “new deal” has been set in place. Yet, the process of improving the quality of life of millions is still only in its initial stages and many difficulties remain. Indeed, the social policies of the last decade were built on the back of rapid economic growth. The nature of economic and social development is so intertwined that if Brazil is to build on its recent social successes, it will need to maintain and advance the momentum of its economic growth. There are many trade-offs and choices that the new government faces in its pursuit of development and the outcomes are likely to depend on a delicate balancing of different political interest groups.

In her election campaign, President Dilma Rousseff pledged to eliminate hardship and extreme poverty by raising the minimum wage, gradually increasing cash transfers and strengthening the government’s role in the economy. She also stated that the Central Bank would retain its autonomy to define monetary policy, allow a floating exchange rate and to exercise fiscal tightening. One should not infer from the moderation of this platform that it is free from tensions, the outcome of which shall inform the finer

details of the path to be taken over the years to come. A large proportion of the conflicts will occur behind the scenes, manifest in intrastate negotiations, and go largely unperceived by the wider public. This involves a delicate network of pressures and counterpressures within the government.

## Manufacturing or commodities?

Reducing poverty and inequality hinges on sustaining growth at around the five percent mark. In order to attain this level of growth, a feat not achieved even during Lula’s second term, a series of choices will have to be made. The views on how best to achieve this can be divided into two main categories. The first advocates significantly increasing the amount of public investment to boost value-added manufacturing in Brazil. The funds for public investment would be found by reducing the amount set aside for the national debt, a move that the Central Bank resists. The second approach advocates a model based on the export of commodities, such as soya bean, meat and iron ore, in order to advance economic growth. Underlying these conflicting points of view are a number of different social and economic interests, and the nature of the confrontation between them will define the future dynamic.

Commodity exports played a big role in Brazil’s economic growth over the last few years. The value of exports tripled between 2002 and 2008 from \$60bn to almost \$200bn. However, there are concerns that Brazil may fall victim to the Dutch disease whereby market mechanisms tend to drive countries with vast natural resources towards a chronically overvalued currency. It then becomes cheaper to import manufactured products than to produce them domestically.

## Currency: high or low?

Some advocate that in order to combat the Dutch

<sup>1</sup> Adapted from an article published by the author in the magazine *Piauí*, October 2010

the aim of reducing poverty via income transfer to the underprivileged segments of society will be the defining tone of the coming years.

disease, it is vital to manage and devalue the currency as opposed to allowing it to fluctuate at the mercy of the markets. A coalition of interests led by financial capital has so far blocked devaluation of the currency. Since cheap imports help control domestic prices ensuring purchasing power for consumers, especially extremely low-income groups, there is pressure to keep imports at this level. Moreover, cheap imports provide the traditional middle class access to imported products (while a strong Brazilian real also makes international travel more affordable). An overvalued currency is also favourable for international holders of capital who profit from making speculative cash investments in Brazil that yield high rates of interest in a strong currency.

Detractors of a highly valued currency include industrial entrepreneurs, factory labourers and exporters. There is growing concern within industry over the relentless decline in manufacturing activity since the early 1990s. These claims provided grounds for the government to levy a two per cent tax on speculative capital in 2009 amid the global financial crisis. The measure, albeit timid, acted as a brake on further currency valuation, while also indicating the existence of significant social sectors concerned with the Dutch disease. The valuation of the Brazilian real and how to balance the competing interests of those who favour a higher value and those who favour devaluation remains a significant challenge for the current government.

### Interest rate and credit

Brazil has one of the highest interest rates in the world. High interest rates are known to stymie investment in manufacturing since capital yields

earnings without the need "to make anything". High rates also lead to a transfer of public funds - which could be dedicated to creating infrastructure - into the hands of those who seek profit for reinvestment or to spend on luxury consumer goods. Business owners in the manufacturing sector (for whom the interest rate is critical) and labourers in general (for whom increased employment is critical) have momentarily joined forces in the fight against high interest rates.

At the same time, the expansion of credit during President Lula's second term (rising from 25% to 40% of GNP) went ahead despite opposition from private banks. This expresses the government's increased ability to compel the banks to lend to the public. The support from the Brazilian Development Bank (BNDES) as financiers was crucial for offering lower interest rates to industrial companies. But the ferocity of the battle to maintain high interest rates will also relate to the enormous clout accumulated by the financial sector under the banner of globalisation.

### The social agenda

Irrespective of the result of the frictions set to mark the political cycle, the aim of reducing poverty via income transfer to the underprivileged segments of society will be the defining tone of the coming years. Universal rights to health, education and security cannot materialise without increased public investment. In Brazil, huge swathes of the population do not yet have basic sanitation or even minimal quality housing. Besides the cash transfer programmes, other programmes for health, education and public security are fundamental to reduce poverty and inequality. This calls for huge expenditure, along with a government equipped to exercise key functions. Equally important is the continuing need to value public functionaries by restructuring the careers and increasing the pay of civil servants.

No consensus has been reached concerning the size and scope the government should have in Brazil. Similarly, no agreement exists on the tax reforms

that should guarantee funding for public spending. While labour organisations suggest making tax more progressive, corporate entities seek to reduce the tax burden. The pressure from Brazil's elite to contain government spending is set to grow.

Thus, the range of public health and education services is a theme over which the majority coalition is divided. In the workers' view, the constitutional mandate of making public health and education accessible to all should be fulfilled. In the entrepreneurs' view, the privatisation process already underway and evidenced by health insurance plans, private schools and so on, should be embraced and expanded. This represents a divide over the role of profit in catering to basic needs such as medicine and education.

### Shifting alliances

A system of footloose alliances is characteristic of the current scenario, in which shifts in material conditions can orchestrate swift changes in position. The mobility generated by the reduction in poverty exemplifies this. With work cards signed up and access to credit, low-income Brazilians began to purchase fridges, television sets, computers, cars and later even houses, using long term financing. The capitalists in these business segments were able, in turn, to increase production and turn greater profits, strengthening the symbiosis between workers and productive capital.

At the same time, Brazilian society remains extremely conservative and gross inequality is a normal part of life. The rifts separating the vast legions of poor Brazilians from the traditional middle-class run deep, and society resists attempts to change a long-entrenched situation. However, the relative superiority of the elite is diminishing as upward social mobility intensifies. The pace of progress toward a potential decent and equitable society depends, to a certain extent, on the correlation of forces between the new middle classes and the traditional elite.

The fact that international headwinds, whose temperature and strength tend to influence the domestic discourse, appear confused may actually bode well for Brazil's Rooseveltian dream. In emerging countries, the global financial crisis clarified the perception that an autonomous path for development was needed that did not flow from norms or prescriptions established by the advanced powers. Brazil in particular, set in its desire to morph into a middle class society, is evolving its own model of development. The path ahead will be rife with pitfalls, and the outcome uncertain. Nevertheless, the direction of Brazilian society will be marked by an historic attempt to reduce poverty and inequality for a long time to come.

ANDRÉ SINGER is professor of politics at the University of São Paulo and former press secretary in the President's Office



# The construction of a strategic social policy<sup>1</sup>

Jorge Abrahão de Castro

Throughout history, societies have constructed a series of multi-purpose mechanisms to protect and support the social life of their members. Protection comes in the form of social security policies designed to reduce and mitigate the risks and vulnerabilities to which people are exposed, while support comes in the form of policies intended to ensure that citizens have broader access to opportunities and resources. However, contrary to popular perception, social policy is not only an altruistic and charitable pursuit to help those in need. As the experience of the recent past in Brazil demonstrates, social policy can also be a key factor for economic growth. Indeed, it can be a strategic element in national development.

## Public spending and its social impact

The level of spending on social policy in Brazil has changed significantly over the last two decades. From 1993 onwards, with the implementation of policies put forth in Brazil's constitution, social spending started to grow in a sustained manner. The analysis of the data presented in Chart 1 signals a trend of growth in social public spending of 2.7 percentage points (p.p.) of GDP in 11 years, representing growth of over 10%. More importantly, this spending growth is not just taking place at the federal level, with growth of 0.2 p.p. in state social spending and 0.4 p.p. in municipal

social spending reflecting a key trend.

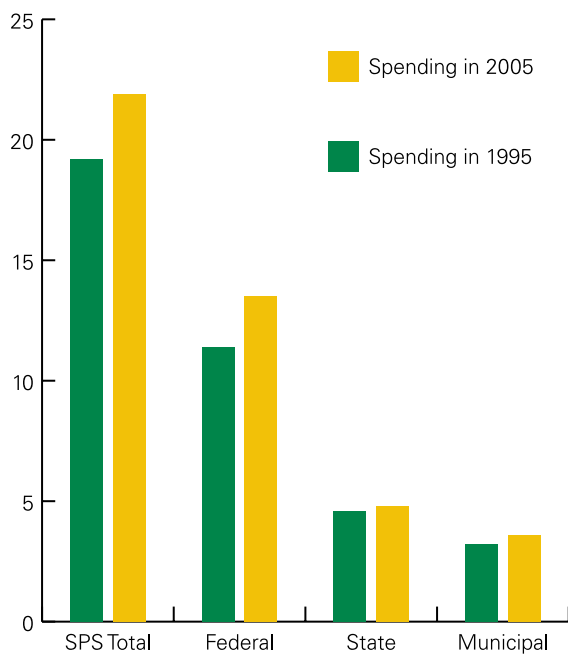
Analysing the volume of funds (see Chart 2), we can see that federal social policy has been centred on the following areas: the national social security system, pensions and benefits of civil servants, health, social assistance, education, labour and income. At the same time, the nature and priorities of public spending changed, with policy areas such as social security increasing their share.

Brazil's social policies underwent a major diversification and expansion, with changes in the scope of the Social Security System, Social Assistance and Defence of the Worker, for example (see Chart 2). As a result, social assistance, labour and income increased their shares in overall social spending. In the case of social assistance, the assistentialist model was replaced by a model of rights with an increasingly comprehensive coverage of the Brazilian population. Social assistance was recently expanded with the creation of *Bolsa Família*, a conditional cash transfer programme, and the implementation of the Unified Social Assistance System (SUAS). In the area of labour and income, a public employment system was created, expanded and consolidated. There has been major progress and expanded social protection in Brazil, driving stronger investments in this sector. On the other hand, spending on public education and health policies remained more or less static. In terms of their share of GDP up to 2005, these areas failed to increase their share of the pie. Although in absolute terms these areas now receive much more investment, spending merely tracked GDP growth and was not earmarked as a government priority. Similarly, spending on housing and sanitation declined, which is visible in the condition of this sector today.

Although significant challenges remain, overall increased public spending on social policy had an enormously beneficial impact on the quality of life of

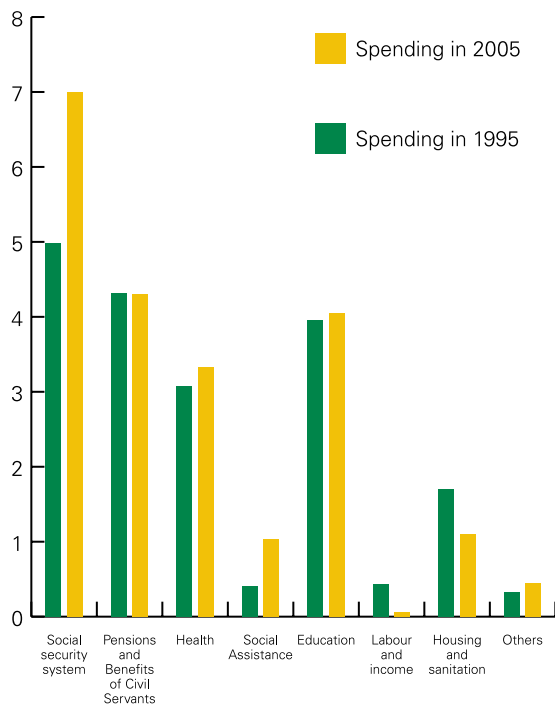
1 This text is a product of the studies, research and discussions carried out in recent years with technical experts/researchers from the Board of Social Studies and Policy (Disoc) of Ipea. The basis and main reference of this text was: Políticas Sociais – Acompanhamento e análise no 17; and Perspectiva da Política Social no Brasil (Social Policies – Monitoring and analysis 17; and Outlook for Social Policy in Brazil).

**Chart 1**  
Social public spending (SPS)  
by government sphere (% , 1995 and 2005)



Source: Disoc/Ipea

**Chart 2**  
Share of spending of areas in social federal  
spending (SFS)(%, 1995-2005)



Source: Disoc/Ipea

the Brazilian people. The higher volume of spending enabled a greater supply of goods and social services which diversified and improved social protection and the generation of opportunities for the Brazilian population. The proportion of the population living in poverty declined, as did levels of income inequality. The infant mortality rate declined from 47.1 in 1990 to 19.0 in 2008. Life expectancy increased from 68.5 in 1995 to 72.1 in 2007. The school attendance rate rose rapidly at all levels and age brackets and the illiteracy rate nearly halved from 17.2% in 1992 to 9.7% in 2009. Brazil made enormous progress on a series of social indicators and the improvements can be felt in the daily lives of Brazilian citizens.

#### A double benefit: the economic advantages

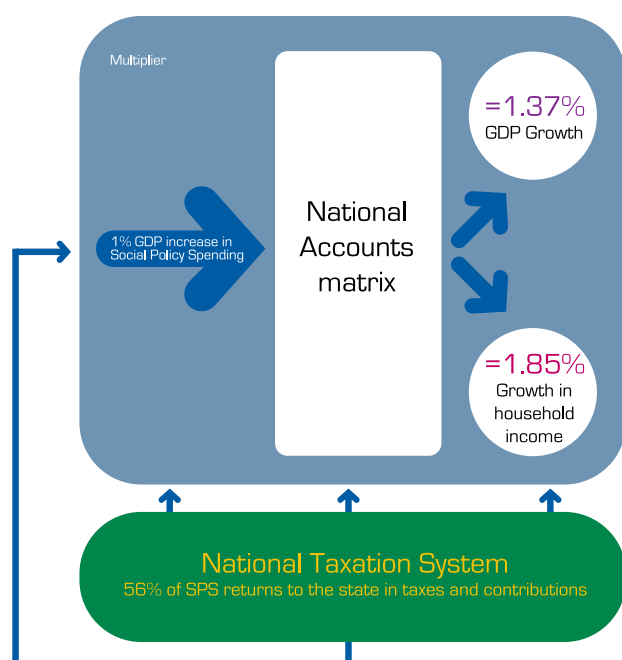
It is little discussed that the bulk of public spending on social policy has a double benefit, since it promotes growth and improves the distribution of income. Most social spending benefits the poorest strands of society, as in the case of *Bolsa Familia*, the Benefit of Continued Social Assistance Provision and the subsidised benefits of the Social Security System (family-based, domestic workers, small businesses, among others). But social spending also benefits the middle class (e.g. salaries of teachers in basic education, or the vast majority of urban social security benefits in Brazil). With better distribution of income, salaries and services, a key portion of social spending remains in the country and strengthens the circuit of income multiplication. As these sections of society start to consume and save more, this leads to stronger sales, more production and greater job creation.

Analysing the data, we reach the important conclusion of the existence of a GDP multiplier worth 1.37, resulting from growth in the exogenous variables of aggregate demand stemming from social spending (see Exhibit 1). This means that for every R\$100 spent by the government on social spending, R\$137 is generated in GDP. The multiplier of social spending, in terms of GDP is much greater than the

For every R\$100 spent by the government on social spending, R\$137 is generated in GDP

multiplier of spending on public debt interest (0.71 %) and almost identical to that of commodity exports (1.40%), but falls below that of investment in civil construction (1.54%).

Exhibit 1 Economic Cycle of Social Public Spending



The data also shows that the state receives 56% of the amount that it originally spent in the form of tax revenues. In other words, out of every R\$100 initially spent, R\$56 is returned in the form of national tax revenues.

In terms of household income, the simulations show that an increase of one percent of GDP in the aforementioned social programmes and policies raises household income by 1.85% on average, where household income represented around 81% of GDP in 2006. The multiplier of social spending on household income is much greater than the

multiplier of investment in civil construction (1.14) and commodity exports (1.04).

In other words, these results show that the notion that social spending is economically futile is untrue. Rather, it is a very important element in the dynamics of the national economy, mainly of that targeted to the local market.

In the case of monetary transfers, the biggest multiplier of GDP and of household income belongs to *Bolsa Familia*. For every R\$1.00 spent on the program, GDP will rise by R\$1.44 and household income by 2.25% in the overall circuit of income multiplication in the economy. By way of comparison, spending of R\$1.00 in interest on public debt will generate only R\$0.71 of GDP and a 1.34% rise in household income. In other words, at least in terms of GDP generation, the cost of interest payments outweighs the benefits, whereas *Bolsa Familia* generates more economic benefits than it costs.

Even the social security system's transfers to retirement, pension and assistance payments have a substantial multiplier effect (1.23). The explanation lies in the fact that, due to Brazil's still abysmal income inequality, an almost neutral transfer leads to a significant improvement in inequality levels and thus in the consumption propensity and profile of the population as a whole.

The income transfers that most benefit the poorest strands of society provide a further boost to GDP and household income because poorer people tend to consume virtually their entire income (they cannot save) and spend it on national products, with fewer imports in their consumption basket. Therefore, in this case the degree of leakage is much lower.

### Laying the foundations

The Brazilian population has achieved major social progress in recent years. These achievements demanded a greater effort in terms of funds for financing programmes and actions. This enabled the creation of a number of technical and administrative mechanisms which involved the hiring and training of

countless professionals, the creation and construction of real estate properties and the acquisition of equipment for the provision of goods and services.

These physical, financial, human and institutional resources enabled the structuring of a broad and diversified set of mechanisms of social protection and social promotion that are helping to improve the basic living conditions of the population, including those related to poverty and inequality. Social policy has also become a powerful instrument that has simultaneously enabled the expansion of aggregate demand with the capacity to create a broad local mass consumption market.

Social policy has provided a boost to production and employment, multiplied income, reduced poverty and inequality and played an indispensable and strategic role in driving the national economy. This process is laying the foundations for constructing a more democratic nation, one that is economically robust and socially just.

JORGE ABRAHÃO DE CASTRO is director of social studies and policies at the Institute of Applied Economic Research (Ipea)

# The national option: throw out the old clothes and build a new model

Daniel Vargas

The rise of the new middle class in Brazil is a significant social phenomenon. Mostly comprised of younger *mulattoes* and *mestizos* from the lower classes who strive to get a business of their own started, this middle class is spread throughout the north, north-east and centre-west, in the outskirts of large cities as well as in the interior of the country. It is already dictating fundamental changes in Brazil's economic, cultural, social, intellectual and political dynamics. Understanding the significance of these changes is of utmost importance in order to understand today's Brazil, its problems and their possible solutions. But more than that, it is a decisive step towards understanding the onus of historical responsibility that falls on the shoulders of all of us Brazilians who now have the chance to contribute to humanity.

The emergence of the middle class in Brazil, a theme first put forth on the political agenda by Roberto Mangabeira Unger,<sup>1</sup> was driven by a series of policy initiatives including the maintenance of macroeconomic stability, increases in the minimum wage, investments in infrastructure and social policies aimed at transferring income. People began to consume more, which led to a consumption market in the country. There began to appear thousands of small and medium informal and family-based enterprises where until a short time ago there predominated a

rudimentary economy of subsistence. In Toritama (Pernambuco), for example, a veritable industrial pole has blossomed in the middle of the north-east backwoods and already accounts for one third of the jeans sold in the country.

## Social and cultural changes

The new middle class has begun to impose cultural changes in Brazilian society. With its own style and way of doing things, it differs from the predominant values and practices of Brazil's urban centres. New musical styles transcend their place of origin and win more projection in the mass media. New accents and personalities are gradually attracting the attention of the rest of the country. But the most important aspect of this cultural change is the proliferation all over the country of new churches and associations that inspire the spirit of combat in simple people, reinforce the feeling of solidarity beyond the family and often help to make up for cultural and emotional deficits. Of course, there are problems such as commercial exploitation of the faith of poor folk. But what is certain is that the new churches are sculpting the soul of the Brazilian people and corroding the rationalist conviction that the natural outcome of progress is secularisation. Brazil is growing less and less secular and more and more advanced.

The third area in which Brazil is fast changing is its social structure. For the first time in its history the middle class represents more than half the national population. Almost 30 million people have already left the ranks of poverty in the last ten years and over 35 million have joined the middle class. The region of the country that has grown the most for years now is no longer the south-east, where the traditional commercial centres are located, but the north-east, followed by the centre-west and the north. And the cities with the highest rates of economic and population growth are not the large capitals but rather

1 Professor of Law at Harvard University and formerly minister of strategic affairs in Brazil

the mid-sized cities in the interior of Brazil. Where some years ago the poor man from the backlands of the north-east dreamed of moving to São Paulo to work for a big multinational, today it is more likely to find an employee of a big multinational in São Paulo dreaming of returning to the north-east to open up his own business.

### A shifting paradigm

These changes are already starting to cause some fractures in the social thinking that prevails in Brazil. The national conscience has often been imprisoned between two mistaken paradigms.<sup>2</sup> Brazil is viewed either according to the logic of developed centres and subaltern peripheries, or according to the colonial logic of masters and slaves. We see our problems from the perspective of an outside centre of gravity that lies beyond our control in the hands of leaders of the global economic system, or else anchored in a patrimonial and oppressive culture from which we have barely managed to set ourselves free. The rise of the simple, hard-working Brazilian who manages to join the middle class, redeems the country's self-esteem and offers a horizon of reflection that bears no resemblance to the timidity of inauthentic thinking in the country. It no longer seems enough to say that the root of our problems is in New York or London. Or that the problem of Brazil is the "little way out" that Brazilians always manage to conjure up to resolve any situation. Now it is time to build in Brazil an authentic social thinking that sees how Brazilians act not as a problem but rather as a solution.

It is precisely this change that is beginning to take place with increasing vigour in national politics. The new middle class is quickly becoming organised. It now elects local representatives, councillors, members of parliament and mayors. In the federal sphere it has just begun to influence some trajectories, as shown, for example, in the commitment of then

presidential candidate Dilma Rousseff to set up a Ministry of Small and Medium Companies. In a very short time, the national agenda is likely to be determined by the beliefs and expectations of this new social group.

### Remaining contradictions

Reasons abound for Brazil to be proud of the moment it is experiencing. Yet contradictions remain that have long split Brazil in two: the few and the many. In the productive market, although small and medium companies account for most of the jobs and income generated in Brazil they are still strangled by having no access to credit, while the vast majority of the resources made available by the National Bank of Economic and Social Development (BNDES) is distributed to a handful of large corporations. In the labour market, despite Brazilian legislation being recognised as a canon for protecting the workers, close to half of our labour force is made up of informal, precariously protected employees. In agriculture, small and medium-sized Brazilian farmers still lack proper technical assistance and advanced mechanisms that ensure they can market their production at a fair price, such as the exporting agro-businessman enjoys. In education, while the upper class enjoys expensive, private education services of high quality, the poor masses have to content themselves with a highly deficient public school system.

Until when? For the first time in history, Brazil has the chance to exercise a national option in an atmosphere of peace, political and economic stability, and in full compliance with democratic values. To choose between on the one hand carrying on with its traditional model of development, inspired in the canons of European social democracy, combining growth (in the centre) with social programmes to transfer income (to the margins), or, on the other,

<sup>2</sup> The Brazilian sociologist, Jessé de Sousa has described this syndrome as *inauthenticity*

For the first time in history, Brazil has the chance to exercise a “national option” in an atmosphere of peace, political and economic stability, and in full compliance with democratic values

throwing out the old clothes and inaugurating a new path, one that is authentic and unexplored, one that throws wide open the narrow door of the representative democracy and market economy that are currently in place. This is the real, unique chance that history offers the country today to reconcile with itself. And to do so by radically expanding the opportunities for learning, work and production, for the benefit of millions of simple men and women whom we are still learning to admire.

### Democratising the market

Brazil's future calls for building a new model of development. This model should include four sets of actions, many of them already formulated by the Secretariat of Strategic Affairs. First, democratisation of the market economy in order to expand access to the instruments of production is required. Brazil needs a new industrial policy that will increase and decentralise access to productive credit, technology and knowledge so as to enable small and medium companies to lead the process of innovation and development across the entire country. The country also must change the bases of its agriculture by investing in strengthening small, entrepreneur-based agriculture, to interiorise the generation of income, and to consolidate a strong rural middle class. A profound reform of the archaic labour legislation is also necessary. This requires combating informality with measures such as relieving the payroll, but it must also represent precariously protected workers by creating a new labour regime to complement the existing one.

### An education revolution

Brazilian education and science have to undergo a revolution in quality. If on the one hand we have advanced a great deal in the last few years in providing access to schooling, on the other hand Brazil came to a standstill years ago in the world rankings for educational quality. Brazil needs to strengthen its pre-school situation, for that is where the citizen's cognitive capacity is basically formed. Secondary school also needs to be transformed by reorganising its teaching model and making it less informative and more analytical, less committed to technical training aimed at rigid trades and more committed to training professionals with flexible skills. Brazil needs to be rudely awakened and shook up to science so as to bring its universities closer to more advanced enterprises, thereby creating a virtuous circle between technological innovation and cutting-edge economy. This will only happen when Brazil stops treating its leading research centres like fantasylands inhabited by morally corruptible intellectuals.

### Reforming politics

There has to be a change in Brazilian politics. The most pressing change involves engaging in a reform that will emancipate Brazilian politics from the influence of money, or else politics will continue to be seen as a dirty and base activity. It is also crucial to change radically the conception of Brazilian constitutionalism. The constitution is not meant for saying that “you cannot do that”, or that “it cannot be done”, for braking or interrupting politics. Quite the contrary: we need a constitution to activate politics, to join together and commit the best of our intelligence and energy to confront our most serious problems and make our noblest dreams come true. In order to do so, the steel skeleton of federalism and the separation of powers in the country must be substituted by more malleable rules that allow and stimulate collaboration among the federal bodies. It is also vital to oxygenise representative democracy with channels of direct participation by widening the

channels of political participation such as plebiscites and referenda.

### Reviving the state

The state capable of satisfying all these demands still does not exist, neither in Brazil nor anywhere else in the world. The state has to be changed in order to build this new model of development. The reconstituted state will result from the combination of three tasks. The first is to intensify the professionalisation of public administration by reducing the number of loosely (politically) appointed commissioned posts and substituting these with qualified professional staff, supervised internally and externally and operating according to flexible goals. The second task is to adapt the public sector to methods and principles that are typical of the private sector. Public administration should be ruled by efficiency, but without forgetting that in the case of the state, efficiency is dictated by public norms rather than by the free action of the civil servant. The third task is to make flexible the criteria for providing public services such as health and education by removing the gap between state, market and civil society, in a regime of collaboration aimed at fulfilling social ends.

### An open future

This set of measures shows an authentic itinerary for the development of the country that can give the great majority of the population the chance to learn, work and produce. On doing so, Brazil can also serve as inspiration for other parts of the world. In the 19th century, Hegel said that installing a new conscience in the new world – the United States of America – represented expansion of the spirit. For Hegel, spirit meant a form of self-conscious life, reflexive energy, own light. The United States represented the self-conscious expansion of the possibilities of thinking and acting in the world. Today, the new world is Latin America, Africa and Asia. It is in these regions that the world is now beginning to experience a new stage of expansion of

the spirit. The emergence of the middle class in Brazil and its effect on the economy, society, culture and conscience have spread the future open in front of us. It is now up to us to decide whether we are going to take on this responsibility and build a new model of development that embraces the middle class, unites the country and contributes to humanity, or if we are going to go on wearing the same old clothes.

DANIEL VARGAS is a former minister for strategic affairs and a researcher at Harvard University

# The search for a moral compass: India after globalisation

Niraja Gopal Jayal

India is in the throes of a tumultuous transformation, arguably even more profound in its social impact than the transition, 64 years ago, from colonialism to independence and democracy. This shift has in no small degree been mediated by economic, technological and cultural globalisation. The liberalisation of the Indian economy in the early 1990s unleashed economic energy and entrepreneurship on an unprecedented scale, translating very quickly into breathtaking economic growth rates which catapulted India to membership of the G20, and even the heady annual invitation to the G8 high table. It also heralded an unaccustomed sense of optimism in Indian society, as new economic opportunities held out the promise of making possible a better life for the vast majority of India's citizens.

Twenty years on, despite an extraordinary story of economic and social mobility for many, impressive levels of economic development co-exist with almost stagnant levels of human development. India's economy is ranked eleventh in the world by GDP and fifth in terms of GDP in Purchasing Power Parity. On the Human Development Index, however, India occupies a rank of 119 out of 169 countries. At no previous time has it been harder to come to terms with the contradictions of darkest poverty (in absolute numbers equivalent to the entire population of India at independence) coexisting with wealth of unimaginable proportions; with thousands of indebted farmers committing suicide even as India's wealthiest

man spends \$2bn on his new 27 storey home with a staff of 600 people waiting on a family of six.

## The individual-community duality

There is today a pervasive sense of crisis – moral, social and institutional – as Indian society tries desperately to make sense of a rapidly changing social world that appears to be built on quicksand. Colonialism insistently represented India as a political community made up of several social communities, and individuals chiefly as members of such communities. The Indian Constitution sought to redefine the relationship as one between the state and its individual citizens, but it is globalisation that has given impetus to the project of making individuals out of the members of this social world. In the economic context, these are consumer-citizens negotiating a marketplace of multiple choices, acquiring English language skills as an instrument of upward mobility and chasing aspirations through employment in the business process outsourcing, technology and services sectors. This energy is particularly palpable in the small towns of India, from which young people are breaking through meritocratic entry-level barriers into the diverse and intensely competitive worlds of industry, government, sport and the media.

This new spirit of individualism is somewhat at odds with the customary forms of citizenship in the polity. With the politics of caste, region and religion being dominant in the period before the economic reforms, the relationship between citizen and state has long been mediated by community. Community identity

There is today a pervasive sense of crisis – moral, social and institutional – as Indian society tries desperately to make sense of a rapidly changing social world that appears to be built on quicksand

has not entirely lost legitimacy as a form of political intermediation, but there is now a possibly creative tension between the rival pulls of individualism – born of the market – and community as constructed in the sphere of politics. New forms of individuated citizenship are now being enabled by civil society activism and the electronic media, which offer unusual opportunities for expressive citizenship, even if these are largely restricted to the educated middle-classes and may sometimes even teeter on the brink of vigilantism.

The affective bases of politics are however far from dead. Caste continues to have greater political purchase than social; it is a far more potent instrument in the political sphere than the social or ritual. The ties of family too remain strong and resilient, especially where power and/or money are involved. If the largest private corporations in India are family firms, so are the bulk of its political parties. The dynastic principle determines, with a few exceptions, succession in both. An astonishing one-third of all members of parliament come from political families, and this trend is repeated all the way down the line to the institutions of local governance. The leadership of most political parties is tightly controlled by a single individual and, with the exception of three regional parties headed by single women, the principle of inheritance is beyond question. The commercial interests of many party supremos, from ownership of educational institutions to media companies, are well-known. Economic power translates into political power with the same ease and fluidity as political power does into economic.

### A sense of crisis

The moral despair we encounter today is thus forcing Indian society to negotiate afresh the question of how and where to draw the line between the public and the private. The elite consensus on modern institutional norms that sanctified this boundary was first interrogated, three decades ago, by a new democratic vernacular, in particular the language of the backward caste parties. Their impatience with, and even rejection

of, these norms was initially valorised as a plebeian response to the norms of self-serving and hegemonic upper class/caste groups. Over time, however, the fungibility of norms has meant not the construction of an alternative moral universe, but only the breakdown of the older normative consensus. A series of recent scandals involving government, corporate interests, and the media, have generated anxieties about the relentless and all-pervasive march of greed and graft as well as about the “moral fibre” of Indian society. As is often the case, what is popularly apprehended as moral crisis is embedded in and symptomatic of a larger phenomenon.

What recent exposures of corruption have demonstrated, above all, are the enormous opportunities for profiteering afforded by the control that state personnel exercise over the licensing and allocation of hugely valuable land and natural resources such as oil and minerals, and now even spectrum bandwidth for wireless communication. Rampant cronyism between state personnel (politicians as well as bureaucrats) and private interests has rarely been as clearly marked as now. Not since slavery was legal has the marketisation of human beings been so celebrated: recent newspaper headlines in India described particular cricketers to have been “auctioned” to premier leagues for obscene amounts of money, even as others were named as having remained “unsold”. Much worse than these examples of commercial egregiousness, however, are the ecological crises, and the cynical exploitation and marginalisation of tribal people living in areas rich in mineral and forest resources.

### Social inclusion without solidarity

These moral and institutional deficits are arguably built upon an older failure – that of an earlier tradition of what may loosely be called Indian social democracy to channel the affect of community into a more secular sense of social solidarity. The constitution made the individual the fundamental political unit of the state, but it also provided for group identities to be recognised

for guaranteeing cultural rights (for religious minorities) and for providing quotas in public employment and education (for historically disadvantaged caste and tribal groups). It was not long before other community identities came to be mobilised, and as this became the pre-eminent form for the expression of political demands, the quasi-socialist agenda remained rhetorical, failing to invent an egalitarian ideology that could address and transcend class and caste differences. As group identity claims were increasingly presented as claims to substantive equality, identity politics acquired a legitimacy of its own that became almost unchallengeable. The political accommodation of these claims swiftly became a proxy for the redress of inequality. Provisions such as affirmative action policies and quotas have indeed had some success in creating opportunities for members of disadvantaged groups. However, they have not always been able to preclude the creation of elites amongst such groups, so that such successes tend to be reproduced across generations, building upon the privileges afforded to an earlier generation without necessarily being extended to encompass those who have never had similar opportunities.

On the whole, India's affirmative action policies have successfully advanced the project of social inclusion in a diverse democracy, as disadvantaged groups now have a greater presence in legislatures, the bureaucracy and universities, though admittedly less in industry and the media. They have also been effective instruments of managing diversity and therefore containing its potential for social conflict. While social conflict has been kept at bay, however, social fragmentation has not, with less than optimal implications for forging solidarity among citizens. The task of reconstructing a social democracy in India is likely to be encumbered by this lack of social solidarity and the mutuality and fraternal sentiments that should underpin it.

### Lessons from Brazil

On the other hand, Brazil, through the progressive

policies of two former presidents, and now being taken forward by its first woman president, has consolidated a social democracy whose incredible success in lifting 20 million people out of poverty, through the *Bolsa Familia* programme, has provoked worldwide admiration. At the same time, the fact that inequality of opportunity is inflected by race has recently led to some experimentation with a 20% quota for black people at university. In a society tolerant of a wide variety of colourations, with a robust social democracy based on solidarity, it will surely be that much easier to advance a programme of social inclusion and extend more opportunities to excluded racial groups.

Although India has a reasonable record of managing diversity through inclusive policies, it has performed poorly – sometimes worse than the countries of sub-Saharan Africa – on endemic malnutrition, sanitation, drinking water, primary education and healthcare. It is only very recently that secular or non-denominational welfare schemes have received a fillip, through the recognition of social and economic rights such as the right to education, the right to work and, in an ongoing initiative, the right to food. Studies show that while the implementation of these is often plagued by corruption and leakages, civil society monitoring has helped. The *Bolsa Familia* programme has elicited great interest in India, though the higher levels of education and urbanisation in Brazil, as well as the higher density of civil society networks, suggest that these may not work as well in a country like India which is predominantly rural, and where large numbers of people are illiterate. These deficits underline the urgency and importance, for India, of better educational provision and livelihood creation. These, along with the energising and strengthening of civil society to mobilise demands and claims more effectively, appear to be the lessons that India can usefully learn from Brazil.

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# Overcoming political polarisation: the future of the United States

William Galston

Differences of principle and also of interests exist in every society. In free societies, those differences are bound to find expression in political and social conflict. Social cohesion does not, indeed cannot, mean the absence of conflict or the achievement of justice. It requires agreement on the institutions and procedures through which conflicts are adjudicated; the sense that society is moving over time toward greater fairness and inclusion; and the belief that the competing groups are members of a single community that shares a common destiny.

The unity of the United States rests, not on shared ethnicity and common descent, but rather on the people's assent to common principles, institutions, and hopes. The principles are set forth in the Declaration of Independence; the institutions, in our Constitution as elaborated over centuries of interpretation; and our hopes, in the famous American dream, that individuals who are willing to work hard and play by the rules can build better lives for themselves and their children. The movement for equal rights for African-Americans defeated calls for black nationalism by appealing successfully to the historic bases of American unity. Its demand was inclusion, not separation, and it succeeded in part because white America could not deny the moral force of its claims.

## Points of tension

Having said this, there can be little doubt that

cohesion in the United States has weakened in recent decades. Polarisation between political parties has risen to its highest level in more than a century. The two major parties now espouse fundamentally different ideological orientations toward the role of government in economic and social life, the interpretation of the Constitution, and much else. The parties also represent very different constituencies. The Republicans, our conservative party, include the majority of white Americans, older Americans, and members of the business community. The Democrats, our centre-left party, include the majority of women, African-Americans, young adults, labour union members, and voters from Spanish-speaking countries. These differences of outlook and constituency are complicating efforts to make progress on daunting fiscal and economic challenges.

High levels of religious belief and observance have long distinguished the United States from most European democracies, and scholars point to religion as one of the key sources of our unusually vibrant civil society. But in recent decades religious differences have tended to weaken social cohesion in the United States. Liberal Protestants, Catholics shaped by Vatican II, and secularists have joined left-leaning movements and have aligned themselves with the Democratic Party, while evangelical Protestants, traditionalist Catholics, and Orthodox Jews have become mainstays of conservative politics and of the Republican Party. Debates over abortion, human embryo research, and legal rights for gays and lesbians both reflect and deepen moral divisions in US society.

While the United States thinks of itself as a nation of immigrants, this has not been consistent through our history. Between 1924 and 1965, the gates of immigration were all but shut, and immigrants fell to a record low five percent of the US population. The 1965 immigration reform reopened those gates, and the ensuing surge has nearly tripled the immigrant share of the population. Not only were the numbers

of immigrants very large, but also their sources were new. A far higher percentage than ever before came from Spanish-speaking countries, and many of them violated the law to enter or remain in the United States.

By the 1980s, this had become a divisive political issue and it has remained so ever since. To traditional anxieties about the economic and social costs of immigration were added fears about cultural and linguistic separatism. Most US citizens see the divisions between English and French speaking Canadians as an outcome to be avoided at all costs. The troubled history between the United States and Mexico is an added complication, especially when a few activists unwisely resort to irredentist language. Immigration has even caused divisions within conservative ranks: members of the business community typically welcome both high-skilled and low-skilled immigrants to do jobs that the native-born are unable or unwilling to perform, while social conservatives focus on issues such as language, culture, welfare, and crime.

### Changing economic patterns

Beyond these adverse political, cultural, and social trends, economic cohesion has diminished in the United States as well. In the three decades after the Second World War, as productivity rose, all sectors of the workforce enjoyed rapid economic gains, the middle class expanded, and poverty plunged. By the early 1970s, the share of income and wealth enjoyed by the bottom three quintiles of the population had reached its highest level since the 1920s. And then these trends reversed. Income increases slowed, the gains from productivity improvements went disproportionately to upper-income households, and income and wealth became increasingly unequal. While income in the bottom quintiles stagnated, those at the top saw their income more than triple. In the early 1970s, the compensation for the typical business executive was about 30 times the income of the average worker. By 2005, executive compensation

stood at 120 times the average for all workers. Not surprisingly, the share of household income received by those making more than \$100,000 more than doubled between 1980 and 2005, from 9.4% to 20.2%, and the top 10% of households held about 70% of total wealth.

Analysts have long debated the causes of these trends. No doubt immigration, technology, trade, and the decline of labour unions have all played a part. Changes within the manufacturing sector are especially significant, because for much of the post-war period manufacturing provided a large share of middle-income jobs for workers with modest levels of education and skills. While the United States remains the world's leading producer of manufactured goods, employment in the manufacturing sector has been drastically reduced. US manufacturing output in 2010 was higher than it was in 2000, but in that same decade, US manufacturing employment fell by one-third, from 17.2m to 11.6m. Very large productivity gains enabled US-based firms to remain viable despite increasing pressure from global competitors. The downside was not so much economic as social. Many displaced manufacturing workers were forced to accept new jobs at lower wages. Others never found work and were forced into premature retirement with limited resources. Manufacturing states and cities in the US heartland were particularly hard hit, exacerbating regional disparities.

### Declining social mobility

Throughout US history, a high level of social mobility has counteracted periods of rising inequality. Indeed, the belief that in the United States, anyone can rise out of poverty through self-discipline and hard work has sustained social cohesion despite levels of inequality that would have generated intense conflict in more static societies. There is mounting evidence, however, that upward mobility in the United States is harder than it was once and may now occur less often than in other advanced democracies. One study found that of American male workers today whose fathers'

income fell into the bottom fifth, 42% themselves remain in that lowest quintile. The comparable figure for Denmark was 25%; for Norway, 28%; for the UK, 30%.

Regrettably, the educational system that once sustained the US mobility advantage may now be undermining it. Roughly 30% of secondary school students leave without receiving their diploma, and very high numbers of low-income college students fail to complete their two year and four year degrees. International comparisons suggest that the US is falling behind other advanced industrial societies in both secondary school graduation and college completion rates.

In the past, social programmes have also helped ameliorate rising inequality. Since the early 1970s, public spending targeted at poor and low-income households has more than tripled and now amounts to more than \$600bn annually. Unfortunately, this spending is coming under intense pressure at every level of the US federal system. The national budget is running deficits and accumulating debt at an unsustainable pace, and it will be very difficult to move toward balance without reducing social spending. Indeed, the greater the political difficulty of reducing spending for middle-class pensions and health care, the larger the cuts in means-tested programmes are likely to be. In addition, the recent great recession dealt a body-blow to state and municipal finances, and recovery is likely to be painfully slow. In the meantime, even if governors and mayors are able to raise taxes (no easy matter in current circumstances), they will also be forced to cut programmes that finance health care, education, and social services for low-income populations.

The key to progress is a return to vigorous economic growth whose fruits are widely shared

### A hopeful future

The short to medium term prospects for improved social cohesion in the United States are not bright. Nonetheless, there is cause for longer term hope. The key to progress is a return to vigorous economic growth whose fruits are widely shared. And despite partisan contestation, there are signs of an emerging consensus around a pro-growth agenda for the second decade of the 21st century. This involves the continuation of short-term stimulus combined with a multi-year plan for fiscal consolidation and stabilisation. There would be a shift away from universal social programmes towards measures better targeted to the needs of poor and low-income households. Increased investment in areas such as research and development, innovation, infrastructure and education reform will be vital for long-term growth. This will need to be accompanied by renewed progress in international trade as well as a meeting of the minds with China on currency issues.

Throughout the past century, there have been episodes of anxiety that the US is losing ground and that our best days are behind us. The focus of this anxiety has shifted within my lifetime, from Russia to Japan to Germany and now to China. But the basic structure of the anxiety has remained the same — that the United States distinctive ensemble of economic organisation, political institutions, and social understandings was no longer suited to changed circumstances. Each time, pessimists underestimated the US ability for self-correction, adaptation, and renewal. Today, its core strengths remain intact: an energetic and hardworking population; an economy that encourages entrepreneurship; a social system that prizes individuality and innovation; and an educational system that, for all its flaws, encourages students to think for themselves.

The major question-mark today is not any of these, but rather the capacity of US political institutions to overcome polarisation and myopia and come together around the steps that are needed to ensure widely shared prosperity in the coming decades. The decline

of the United States, were it to occur, would come not at the hands of any competitor but rather from self-inflicted wounds, a failure of self-government.

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# Section three:

## Seeking autonomy in an age of interdependence





# The cautious emergence of Brazil

Riordan Roett

While a great deal of attention has been given to the extraordinary economic and financial development of the Brazilian economy, there has been less systematic examination of the country's growing regional and global political importance. It is fair to say that the emergence of Brazil politically is founded to a large degree on the astute economic management of two Brazilian administrations, that of Fernando Henrique Cardoso (1995–2002) and that of Luiz Inacio "Lula" da Silva (2003–2010). In 15 years, Brazil has established an international reputation for a pragmatic and flexible programme of banking reform, inflation targeting, a fiscal responsibility pact between Brasília and the provinces, and a series of other reforms that allowed President Lula to state that Brazil was the last country to enter the 2008–2009 crisis and the first to emerge relatively unscathed.

## Economic development through political consistency

Continuity in policy has been key. In 1993–1994 Cardoso instituted the "stabilisation programme" known as the *real* plan, which proved to be critical. He dealt with the financial crisis of 1999 when the currency was devalued in response to pressure from currency speculators by acting quickly and, ultimately, successfully. The Cardoso administration strongly supported the privatisation of state-owned enterprises, despite fierce opposition from workers and those on the political left. Unlike his predecessors,

Cardoso established the principle of Central Bank autonomy. That policy, the basis of much of the current stability, was then reaffirmed by President Lula, over the objection of members of his own Workers Party (PT) who believed the party should have the same access to inflationary policies through printing money as previous governments.

President Lula took office in January 2003 in the context of lingering concern that he would not continue the fiscal and monetary policies of his predecessor. In fact, in a "Letter to the Brazilian People" issued during the presidential campaign he had pledged to recognise contracts, maintain fiscal stability, and reduce the country's debt. He appointed a widely admired president of the Central Bank, Henrique Meirelles, and a highly competent finance minister, Antonio Palocci. The economic team worked well together and within a matter of months it was clear that the gains of the previous government were being used for the next steps needed to modernise the economy.

The Lula presidency also had the extraordinary good fortune to take office as a global commodity boom was underway, driven particularly by China. Brazil, an agricultural giant, is an important provider of a wide range of foodstuffs for the international market. It is also one of the largest producers of iron ore, used to produce steel and a key component of the Chinese development model. In addition, the biofuels programme, in which Brazil has been a leader, took off with the rapid expansion of the sugar-derived ethanol programme. And, in the middle of the Lula presidency, massive reserves of oil and natural gas were discovered off the south-east coast of Brazil.

## Leader of regional integration and cooperation

Using Brazil's financial stability and growing trade clout, the Lula government continued the expansion of the country's role in South America and, selectively, on the global scene. While for centuries Brazil had been viewed with suspicion by its Spanish American neighbours, Brazilian governments, following the transition from military rule in 1985, actively pursued

policies of sub-regional integration and cooperation.

The outstanding example is Mercosul, the common market of South America that was initiated by Brazil, Argentina, Uruguay and Paraguay. This is the first successful effort at regional integration in the history of the continent. Towards the end of his administration, President Cardoso convened the first summit of South American heads of state in Brasília (2000). That was an important turning point in Brazil's relations with its neighbours. In the following years, Brazil has come to be seen as a good partner and a collaborative neighbour. A second regional summit was convened in Guayaquil, Ecuador in 2002.

Deeper continental integration and cooperation had been a long overdue policy objective in South America. At Brazil's urging, a third summit was held in Cuzco, Peru in December 2004, moving the project forward dramatically. The Cuzco Declaration set forth the framework for a South American Community of Nations (SACN). The objective was to bring together two existing, sub-regional trade blocs, Mercosul and the Andean Community of Nations. At a summit hosted by President Lula in Brasília in May 2008 a constitutive treaty was unanimously approved to create the Union of South American Nations (Unasul) that replaced SACN.

Not only concerned about South American integration, Brazil took the initiative of convening the first Latin American and Caribbean summit in Brazil in December 2008. Symbolically, the United States, Canada, and the European Union were not invited to participate, while the Castro regime in Cuba was included. That very political decision was viewed as a deliberate criticism of the US embargo.

Another important initiative of Brazil in the region was the formation of the South American Defence Council which will serve as a mechanism for regional security and military defence cooperation. Brazil is also strongly supportive of the new Initiative for Infrastructure Integration of South America (IIRSA), the free movement of people in the region, and the South American Energy Ring. In fact, Brazil has been

Brazil will be a key player in continuing talks on how to prevent another financial meltdown, just as it has been a major player in ongoing talks to conclude a new international trade regime

the patient midwife for these regional programmes and deserves great credit for its role.

#### A growing voice in a changing global landscape

Brazil has also become a critical player in a number of global initiatives. As the 2008 financial crisis deepened, pressure from the emerging market economies led the lame duck administration of President George W. Bush to breathe new life into the G20. A collection of the 20 largest economies in the world, the group has debated and pursued a new financial architecture. They have also argued, successfully, for a more prominent role of the major developing economies at the International Monetary Fund (IMF). President Lula and his finance minister were very vocal in criticising the industrial countries for poor management, lax regulatory rules, and a lack of transparency. It is in this context that President Lula liked to remind the developed countries that Brazil was the last major economy to enter the crisis and the first to emerge. Brazil will be a key player in continuing talks on how to prevent another financial meltdown, just as it has been a major player in ongoing talks to conclude a new international trade regime. The trade negotiations began in 2001 in Doha, Qatar. The so-called Doha Round has yet to conclude, but in all of the meetings Brazil has argued forcefully for a level playing field for the newly emerging economies.

Perhaps the most important sign of Brazil's emerging role is its active leadership in the Brics, a bloc composed of Brazil, Russia, India, and China. The acronym has come to represent the beginning of the

“passing of the guard” from the post-1945 industrial powers to the strong, emerging economies that will, over the next few decades, replace the European countries as the engines of growth in the world economy. President Lula hosted the most recent summit of the Bric countries in 2010 and the next summit will be held in Beijing. Pursuing its vision of south-south diplomacy, Brazil has also been a leader in the organisation of Ibsa, the bloc comprised of India, Brazil, and South Africa. Indeed, as recognition of South Africa's growing importance, Brazil has supported the invitation by China to include South Africa in the 2011 Bric summit in Beijing.

Relations between Brazil and China have developed rapidly since the state visit to South America of President Hu Jintao in 2004. In 2010, China replaced the United States as Brazil's principal trade partner while the Chinese market is a major purchaser of the many high quality foodstuffs and raw materials that Brazil possesses in abundance. There are, however, tensions in the relationship. According to the *Financial Times*, recent Brazilian central bank data confirm that in 2010 China became the biggest foreign direct investor in Brazil, with China accounting for about \$17bn of total FDI inflows that year out of a total of \$48.46bn. The principal source of concern here is the dramatic increase of cheap imports into Brazil, helped by a surge in the value of the Brazilian real that is undermining the competitiveness of domestic industry, while most of the Chinese investment has gone to industries related to commodities. The Brazilian government may have to consider measures to impose restrictions on FDI in mining, including minimum domestic supply quotas and screening transactions to be sure they serve Brazil's interests as well as those of China.

At the global level, it is clear that Brazilian-Chinese cooperation is expanding. Some argue that the Beijing regime seeks to replace the traditional leadership role of the United States in Latin America. That is not apparent at this point in time, but we do not know what future strategic decisions will be made as the region becomes more important as a source of raw

materials and agricultural products. The United States has become increasingly unpopular in the region due to its identification with the failed policies of the so-called Washington Consensus of the 1990s. That set of policy prescriptions called for significant macroeconomic changes but overlooked unemployment, poverty, and inequality. While the United States remains a significant player in the region, it is no longer the main one. In fact, there is no longer an American veto over Latin American policy initiatives and US policy prescriptions are generally ignored.

### Brazil: a standard bearer in a new world order?

Over the last 15 years, Brazil has emerged as an increasingly sophisticated player in regional and, selectively, global affairs. As commentators have noted, Brazil has no major ethnic fault lines, it is at peace with all of its neighbours, it is a consolidated democracy, and it is not a nuclear power—nor does it have ambitions to become one. As Brazil affirms its position as an important supplier of oil, natural gas, commodities, and minerals to the world markets, its international presence will be increasingly strong. This is significant in the context of a new world order in which the United Nations seeks to restructure its Security Council, to include, for example, Brazil as the natural candidate representing Latin America.

*Newsweek's* Mac Margolis has called Brazil the “crafty superpower.” It is not clear whether or not Brazilian policy-makers agree with that characterisation, since Brazil pursues its regional and global agenda with great caution. But it may well come to represent the new realities of the 21st century as Brazil continues to be viewed as a sophisticated and necessary component of global governance.

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# Brazil at the crossroads: towards regional integration?

Marcel F. Biato

Brazil is at a crossroads as the global geography of power continues to change following the financial crisis. Do we seek strategic alliance with the other emerging countries that will perform a key role in a globalised world? Or, do we intensify the process of regional integration in Latin America?

## Globalisation and regionalisation – contradictory agendas?

The economic and cultural gap between Brazil and its Spanish-speaking neighbours has always encouraged scepticism towards the regionalisation agenda. Is it worthwhile for Brazil to join forces with its fragmented neighbours, historically more associated through divergence than shared vision? In the 19th century the Brazilian monarchy was regarded as imperialistic by many other countries in the region. Autonomy from its Latin-American surroundings was a national objective for Brazil, as intensely yearned for as it was poorly disguised.

As Brazil's position as a global actor is consolidated, this aspiration is reinforced: to utilise its size, growth and resources to win markets and forge partnerships with other countries that will emerge as the dynamic poles of the global economy. The fact that Brazil is making use of the opportunities of globalisation is beyond doubt; its foreign trade has diversified considerably, as have its partnerships with other emerging powers.

At the same time, Brazil is also pursuing an

ambitious programme of regional integration. Brazilian financing agencies and banks are at the vanguard of highway projects to shorten continental-size distances and schemes for interconnecting energy supplies. Brasília promotes the infrastructural development necessary for the rhetoric of regional solidarity to become a reality. Although Brazilian investment in capital, technology, revenue and jobs has enjoyed regional public support, there have been protectionist protests and concerns in other countries.

## The need for democratisation

Are the dual agendas of globalisation and regionalisation contradictory? Has Brazil abandoned its erstwhile ambition of overcoming geographical location? How did this metamorphosis come about? In fact, Brazil's regional integration agenda and the forces of globalisation are not mutually exclusive. The Latin American agenda should be seen as part of a strategic response to the deep changes underway in the global scenario. This may seem paradoxical, for what, many will ask, does regional integration have to do with climate change, the global financial crisis, or energy insecurity?

These challenges highlight the nature of global interdependence, and are directly linked to fundamental imbalances in the current world order. As emerging economies rise, their growing demand puts pressure on the supply of biological, mineral and energy resources. Simultaneously, globalisation accelerates the speed with which jobs, people and investments migrate. This change has exacerbated social tensions and uncertainties, and can be seen on the front pages of newspapers everyday: shops being looted for food, xenophobic reactions to poor immigrants, calls for protectionism, and competition for natural resources.

It is imperative to reorganise a productive model that wastes finite natural resources while at the same time condemning a significant proportion of the world's population to sub-human conditions of subsistence.

It has become quite clear that globalisation is not leading to increased uniformity and equity – we are not growing more alike in terms of political ideology or standards of well-being, as was predicted. On the contrary, we now see that interdependence tends to reinforce the bargaining power of the strongest and the most agile. This is why the main victims of globalisation are the same as always: the least capable of protecting themselves from global crises. How do we address this challenge?

Part of the answer lies in democratising decision-making processes at the global level. The delay in reforming the Security Council and democratising WTO institutions explains Brazil's emphasis on innovating partnerships with common objectives and defined agendas; a diplomacy of variable geometry that will facilitate alliances and partnerships designed to rebuild, rather than subvert, multilateral institutions.

The most important of these partnerships promoted by Brazil to reform the international order is regional integration. With national nuances Latin America is undergoing a true revolution, one that is democratic and essentially peaceful. It is founded on two heterodox theses.

First, there is the rejection of the idea that a trade-off exists between economic growth and income redistribution. Over the last decade Brazil has demonstrated that consolidating a market of mass consumption anchored in expanding jobs and wages – resulting from broader access to credit and income-transferring policies – is the best guarantee of sustainable growth, particularly in a period of global recession.

Second, there is the recognition that democratic restoration in Latin America is necessary but insufficient to guarantee competitive insertion of the region in the global economy. Sharing fundamental values with the advanced powers – commitment

The truth is that the dichotomy between Brazil's regional integration agenda and the forces of globalisation is a false one

to dialogue, protection of human rights, reclaiming social debt, and economic stability – will in itself not turn us into a relevant global pole of power.

### Increased integration

Latin America faces the contradictions of a society marked by high levels of socio-economic exclusion and political apathy, and a lack of effective institutions. In many cases, this has frustrated the expectations of the economic integration programme, often stimulating rivalries and unresolved nationalist conflicts, rather than encouraging closer regional ties.<sup>1</sup> Although intra-regional trade has enjoyed significant growth, little progress has been made as far as the main aim is concerned: to create an economic space capable of distributing development in a democratic fashion across all countries and sectors.

The principal instrument here – customs union – brought into relief the lack of competitiveness of the bloc's smaller economies, and their asymmetry in relation to others. Providing these economies with privileged access to larger consumer markets was of little practical use when in reality this perpetuated a historical pattern of unequal exchange. The smaller economies were unable to reduce their dependency on exports of primary products of low aggregate value.

It is still possible to utilise intra-regional trade and investments as a tool for further integration, but it is important to keep in mind and attempt to reduce the serious asymmetries among members of the bloc. Efforts have been made to achieve this aim. Brazil

<sup>1</sup> The economic integration programme was first launched by ALALC (The Latin American Free Trade Alliance) in 1960 and re-invented in 1980 with ALADI (the Latin America Integration Association).

has formulated technical cooperation programmes and extended streams of concessional credit in priority sectors of the smaller Latin American economies which seek to improve efficiency and competitiveness. However, further progress will be difficult if economic reorganisation in the region is not assisted by sponsorship from the Brazilian Development Bank (BNDES) and other regional agencies<sup>2</sup>. This is the case particularly in the area of communications, transportation and energy infrastructure.

At the same time, creating the Bank of the South, expanding trade in local currency and improving the Aladi Agreement on Reciprocal Credit are all furthering economic development in the region. The exercise is more advanced in the sphere of Mercosul, where as part of the effort to expand and strengthen its mechanisms of governability, a structural fund was launched to provide resources for reducing the structural bottlenecks of the smaller economies in the bloc.<sup>3</sup>

### Strengthening institutional architecture

If globalisation necessitates a democratic “re-founding” of the multilateral system, Latin-America’s regional architecture must also undergo reforms. Launching Unasul (The Union of South American Nations) and strengthening the dialogue between Latin America and the Caribbean through the Group of Rio in 2008 all help achieve this. What some perceive as simply multiplying forums actually reflects the enormous institutional experimentation of a region experiencing change and seeking to redefine its world role. Unasul provides an institutional umbrella for avoiding a mercantilist tendency which

seeks to limit the integration effort in the region to the area of trade.

While historically, the countries of the region have been resistant to intervention and mutual interference, the continent must overcome its distrust if it is to successfully consolidate as a zone of political and social stability, free from ideological antagonism. The South American Defence Council is therefore of great importance to regional integration.<sup>4</sup> The Council offers a forum for dialogue to negotiate tensions harmoniously among neighbours. The motivation for the creation of this body came in the wake of the border conflict between Ecuador and Colombia in 2008, and its supervision prevented the tensions between La Paz and autonomous leaders of the Bolivian “half-moon” movement descending into civil war. Underlying these initiatives is a conviction that South America will not overcome its deep challenges if it fails to arrive at collective solutions. Otherwise, dangerous vacuums of power will persist that can be used as a pretext for external actors to intervene in the region.

### Overcoming history: first allies

The high rates of growth of the last ten years suggest that the region is on the right path, yet Latin America continues to manifest contradictions. It possesses vast energy reserves, but electricity is scarce. It enjoys enormous biodiversity, but its environment is still not fully respected. It is one of the richest agricultural and mineral areas in the world, but deep social injustice and economic asymmetry prevail.

Moreover, there are a number of risks on the current path. How can we ensure that the Chinese demand for commodities will continue to help, and

2 The Banco Interamericano de Desenvolvimento (Interamerican Development Bank) and the Corporación Andina de Fomento (Andean Development Corporation).

3 With the intention of avoiding or reproducing the “democratic deficit” that threatens the European Union, here the aim is to broaden citizens’ participation through Mercosul Social, the Forum of Cities and the Mercosul Parliament. FOCEM - The Mercosul Structural Convergence Fund.

4 Conselho Sul-Americano de Defesa (South American Defense Council – CSD)

not hinder, development in Latin America? How can we guarantee that the region does not fall prey to the Dutch disease, and its natural resources become a source of prosperity and autonomy?<sup>5</sup> How can we make the exceptional biodiversity of the region a factor of comparative advantage in a world that is more and more urbanised, rather than a factor of fragility under the threat of climate change?

In its effort to resolve these challenges and attempts to place the country at the centre of global decision-making, Brazil's first allies are its neighbours. These nations have travelled similar trajectories, each trying to overcome a history of political authoritarianism that worsened social and economic exclusion. Together, these countries enjoy the best conditions to promote reforms – both at home and at the level of global governance. These reforms are necessary to realise Latin America's potential and meet its many challenges.

Only unified regional action will allow Latin America to overcome its history of social and economic fragility, thereby enabling it to exert influence on the changing international order. At a time when old paradigms are subject to scrutiny, it is indispensable that we should dare to create new links of interest and synergy. For Brazil, the point of departure will be the continent itself.

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5 The Dutch disease describes the experience of the Netherlands during the 1960s in which a rapid increase in wealth had negative consequences for the competitiveness of some sectors of the economy.

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# The diplomacy of generosity<sup>1</sup>

Rubens Barbosa

An aspect of Brazilian foreign policy that has received little attention is the technical and financial assistance provided by Brazil to many developing countries, especially in Africa and Latin America. This is one of the ways in which the Brazilian government has strengthened its policy of south-south cooperation over the last eight years. Brazil is gradually becoming one of the leading providers of financial and technical assistance to less developed countries. In 2010, the country committed itself to over \$4.5 billion (US dollars) in overseas assistance.<sup>2</sup>

The reason provided by Itamaraty<sup>3</sup> for overseas assistance is to strengthen solidarity between Brazil and the rest of the world. Brazilian technical cooperation has no attached conditionalities and is driven by demands made by partner states. It is always developed in keeping with the guidelines of Brazilian foreign policy, with priority given to support for the socio-economic growth of relatively less developed countries, especially in Latin America and Africa. Cooperation is characterised by a transfer of knowledge that places emphasis on improving the quality of human resources, employing local labour and pursuing projects that acknowledge the peculiarities of each country. It is based on the solidarity that underpins the relationship between Brazil and other poorer countries, and is aimed at

spreading knowledge towards the autonomous development of recipients.

## Scale and methods

The resources deployed in Brazil's overseas assistance programmes amount to \$1.2bn: more than Canada and Sweden, both traditional donors and providers of assistance to developing countries. There are currently 221 projects and 324 isolated activities in 81 countries: 19 in Central America and the Caribbean, 12 in Asia and the Middle East, two in Europe, 38 in Africa and South America. These projects range from a bureau for agricultural research in Ghana to a model cotton plantation in Mali to a factory for anti-retroviral medicine in Mozambique. The main policy areas of cooperation in the period from 2003-2010 were agriculture (21.8%), health (16%), education (12%), environment (7%) and public security (6%).

In addition to technical assistance project, there are also resources devoted to humanitarian aid for countries affected by natural disasters. Some of this funding is directed through international agencies such as the United Nations Development Programme and the Food and Agriculture Organisation.

The Brazilian government has spearheaded the International Action to Combat Hunger and donated food to a wide range of countries in different parts of the world including Sudan, Somalia, Niger and Portuguese-speaking African countries, the Gaza Strip, El Salvador, Haiti, Cuba, South Africa, Jamaica, Armenia, Mali, Kyrgyzstan, Western Sahara, Mongolia, Iraq and Sri Lanka.

Along with providing assistance, the Brazilian government has also granted credit and forgiven debts to countries including Congo, Angola, Mozambique, Bolivia, Ecuador, Paraguay, Surinam and Tanzania.

There have been a number of Brazilian agencies and ministries involved in international assistance programmes including Itamaraty, the Treasury, the

1 Adapted from an article published by the author in the newspaper O Estado de S. Paulo, 11 October 2010

2 *The Economist*, July 15 2010

3 The popular name for Brazil's Ministry of External Relations

The prevailing principle in cooperation is that of horizontality, whereby a recipient is not subservient to the donor but acts on an equal footing

Brazilian Development Bank (BNDES), the Bank of Brazil, Embrapa (Brazilian Enterprise for Agricultural Research), CNPq (the National Council of Scientific and Technological Development) and others. This demonstrates that there is a wide range of consensus and coordination that overseas assistance is a valuable part of Brazil's policies.

### Unique principles

Since 2008, the Brazilian Agency of Cooperation has endeavored to establish a new strategy of action that prioritises "structuring" projects, which are more holistic, long-term and complex, rather than specific small-scale projects. These "structuring" projects tend to have a more meaningful socio-economic impact. They encourage more sustainable results of cooperation and facilitate the mobilisation of Brazilian institutions to carry out the projects.

This form of action also contributes to creating space for drawing up triangular partnerships with other international actors. Provided that the conventions of Brazil's technical cooperation policy are respected, the Brazilian government is open to the possibility of developing trilateral cooperation with any other country, including those of the 'south' (for example the trilateral-cooperation health project in Haiti which relies on the joint actions of Brazil and Cuba). Other examples of trilateral cooperation include the Strengthening of the Investigation Institute project in Mozambique with the United States (USAID) and the Pro-Savanna project to develop the tropical savannas in Mozambique in association with Japan (JICA).

Developed countries and international organisations are beginning to turn to Brazil for its technical capacities, its cultural and linguistic characteristics,

or simply for its way of doing things. In all cases the principles of Brazilian south-south cooperation must be respected. This means it must be demand-driven, that local resources must be deployed, and that it is not for profit. Brazil does not see itself as an emerging donor. Rather than the relationship being of one between a donor and a recipient, Brazil considers south-south cooperation not as an aid donation but as a partnership which benefits all parties. In other words, the prevailing principle in the cooperation is that of *horizontality*, whereby a recipient is not subservient to the donor but interacts on an equal footing and where entering into the relationship is beneficial to all.

### Factors guiding assistance

Potential profit is never a determining factor for Brazil entering into south-south or trilateral cooperation agreements, and while any secondary impacts on exports or Brazilian investments are seen as positive collateral effects, they are never prerequisites for the approval of projects. Commercial interests, then, are not an inherent part of projects for Brazilian south-south cooperation.

Indeed, rather than commercial factors, it is political dynamics – particularly President Lula's search for both national and personal prestige in the international arena and the desire to win a permanent position on the United Nations Security Council - that better explain the motivations behind the diplomacy of generosity undertaken by Brazil in Latin America and Africa over the last few years.

Although Brazil imposes no conditions on the countries that receive aid, it is equally true, however, that the Lula administration did not take into consideration values that Brazil defends internally, such as democracy and human rights, instead preferring to adopt the perspective that "business is business".

### Impact on domestic industries

Itamaraty has also sought to help poorer countries

by opening up the Brazilian market to products from these countries on a tariff- and quota-free basis – a move which may have negative effects on some Brazilian industries. The textile sector, for example, would be seriously affected by imports from Bangladesh, which exports more than \$70bn of textiles per year. Itamaraty has also concluded negotiations to expand and intensify the General System of Trade Preferences (GSTP), which offers tariff reductions with quotas for poorer countries. Therefore, it seems that foreign policy has not been driven by the interests of domestic industries.

Showing generosity overseas is at the very least controversial. The rate of domestic investment is low (around 17% of GDP) and financial assistance abroad diminishes resources that might otherwise be invested internally - on infrastructure, housing, energy, food and so on. It is highly apparent that the Brazilian cooperation for development policy has clear political motivations based on a general principle of solidarity with poorer countries. In the last few years aid and technical cooperation have become one of the main lines of foreign policy, especially concerning Latin America and Africa. Cooperation does not involve reciprocal commitments on the part of the receiving countries, nor is it linked to defending Brazil's economic and industrial growth.

At times, overseas assistance is directed toward improving infrastructure such as roads, and other public works. By releasing credit for public works in African and South American countries, Brazilian companies could come to benefit by winning competition for providing services and exporting Brazilian products. In some cases, overseas assistance does enjoy the support of the Federation of Industries of São Paulo and its equivalent in other states.

### The future direction

There are already commitments in place with Mercosul and bilateral agreements with countries in Latin America that the Rousseff administration will

need to uphold. The commitment of the Brazilian government to offer solidarity to relatively less developed countries is likely to continue.

However, bearing in mind the need to reduce public spending in order to restore the balance of government accounts, financial aid beyond the limits of the Mercosul area may be reduced. One can also expect the new government to avoid expanding its engagements with countries that fail to respect the same values that Brazil defends at home, such as human rights and democracy.

At the same time, the soft power approach adopted by Brazil will continue to grow and develop based on the principles of horizontality and lack of conditionality that today characterise the Brazilian model of cooperation with less developed countries.

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# Charting a course for Brazil's rise

Charles A. Kupchan

Brazil is blessed among the world's rising powers. It is emerging in a uniquely peaceful region populated mostly by democracies. In comparison with east Asia, south Asia, west Asia, and Africa, Latin America – South America, in particular – is remarkably free of geopolitical competition. That is one reason that neither Brazil nor any of its Latin American neighbours have nuclear weapons. India, like Brazil, is a rising power that enjoys a stable democracy. But India resides in a very dangerous neighbourhood and has a long history of rivalry with both Pakistan and China; one reason why all three countries possess nuclear weapons. In short, Brazil's rise is taking place in a singularly fortuitous political and geopolitical environment.

Brazil should capitalise on these benign conditions as it maps out a strategy for the future. Unfettered by the political and strategic constraints that face other rising powers, Brazil is free to play a leading role in shaping the international order that comes next. Brasília should take advantage of this opportunity to serve as a bridge builder, a rising state that helps guide the transition from the current order (one dominated by the west) to one in which power and authority will be more widely distributed.

This essay lays out a number of principles to guide the evolution of Brazil's foreign policy as the country continues to rise. Overall, Brazil should be mindful of the need to keep resources and commitments in balance and to pursue a paced and judicious course

that expands the country's influence while avoiding the dangers of overreaching.

## The importance of strategy

Rising powers need to develop the political capacity and institutions as well as the intellectual resources required to formulate and implement a grand strategy of global reach. The political will and purposeful strategic choices that guide emerging states do not come naturally of their own accord. They must be cultivated and nurtured.

The United States, for example, was a major power in economic terms well before it aspired to global reach. It was not until the 1890s that the country began in a purposeful manner to translate its material resources into geopolitical influence. That shift was possible only as a consequence of institutional changes: the federal government strengthened its powers vis-à-vis the separate states and the executive branch strengthened its position with respect to Congress. The onset of what came to be called the "imperial presidency" enabled President McKinley, President Roosevelt, and those that came after them to allocate resources to building a high-seas fleet and developing a grand strategy of global engagement. During the 20th century, the United States went on to build the broad and deep national security establishment that exists today. The State Department, Pentagon, and National Security Council are the most visible manifestations, but they draw on a foundation of universities, public policy schools, and think tanks.

The lesson for Brazil is to invest in and develop the human capital and institutional infrastructure essential to guiding and sustaining Brazil's rise as a global player. That means allocating new resources to expand institutions of higher learning aimed at training diplomats as well as policy analysts and scholars of international relations. Brazil should also continue investing in its diplomatic capacities and its representation abroad. And consideration should be given to whether changes are needed in decision-

Political cohesion and effective governance are required to turn material capability into both hard power and soft power

making and advisory structures to improve the formulation and implementation of national strategy. As the case of the United States makes clear, institutions matter.

### Power starts at home

State strength rests on a combination of economic capacity and political cohesion. Political cohesion and effective governance are required to turn material capability into both hard power and soft power. China, for example, has enjoyed substantially higher rates of growth than India in part because an autocratic state, without the pulling and hauling of democratic politics, has provided generally purposeful, competent, top-down governance. The result has been shrewd policy that has maximised growth and dramatically reduced poverty. China has also made domestic economic growth its top priority, and has adjusted its foreign policy accordingly. India, meanwhile, faces a more complicated and fragmented political landscape. Its decisions often aim more at satisfying a wide array of domestic constituencies than maximising growth. This is hardly to endorse autocracy, but only to reinforce the extent to which sound domestic policy, particularly on the economic front, is essential to sustain a steady rise in state strength.

Brazil therefore needs to continue its focus on the home front, pursuing the combination of sound macroeconomic policy, poverty reduction, and balanced growth across different sectors of the economy. This domestic focus is particularly important in light of the fact that rising powers experiencing rapid economic growth are prone to the strategic excesses that are often a byproduct of social dislocation. Changes in social hierarchy

driven by domestic economic development have considerable potential to lead to social imperialism i.e. the resort to aggressive foreign policies as a means of consolidating domestic control through populism and nationalism.

Germany before World War I provides an illustrative example. From unification in 1871 through to the middle of the 1890s, Germany pursued a paced and judicious growth strategy, one that deliberately avoided direct rivalry with its neighbours. By the end of the 1890s, however, a domestic clash pitting iron and rye (industrialists and the landed aristocracy) against the rising working class prompted the government to use foreign policy as a tool of domestic manipulation. The rapid naval build-up coupled with the propagation of nationalist ideology succeeded in rallying the country around *weltpolitik*. But the turn in German grand strategy also upset the European balance of power, entrapped the country's leaders in their own nationalist propaganda, and pushed the great powers toward World War I. Germany's peaceful rise fell prey to a destructive grand strategy born of domestic political dysfunction.

Despite Brazil's impressive economic progress, the country still faces numerous domestic challenges, including reducing economic inequality and poverty, distributing land ownership more equitably, and ensuring balanced political representation of all classes and races. Rapid economic growth, despite its numerous benefits, does have the potential to produce social dislocation and the populism and social imperialism that often accompanies it. Even as it enjoys robust economic growth, Brazil must guard against the temptations of seeking to export domestic political tensions, that is, to use foreign policy as a tool of domestic politics.

### The centrality of regional integration

The benign strategic conditions in which Brazil's rise is taking place stem in large part from the successful process of regional integration that has taken place during the last three decades. Brazil and Argentina

embarked down the path of rapprochement beginning in 1979, clearing the way for the launch and development of Mercosul during the 1990s. Had that effort at regional integration failed, Brazil's rise would likely have quite ominous implications for South America, encouraging Argentina and other countries in the region to balance against Brazilian power. Indeed, the rise of countries like China, India, and Turkey is causing considerable geopolitical uncertainty precisely because these powers are rising in regions still plagued by dangerous rivalries.

Even as Brazil's strategic horizons expand in step with its rising power, it must continue to invest time and energy into regional integration. Moving from the economic interdependence afforded by Mercosul to the deeper political and strategic cooperation afforded by Unasul would be an important step forward. The European Union, after all, has been so successful in bringing lasting peace to Europe because it is far more than a trade bloc; along with Nato, the EU provides a framework for collective management of the region's security. To be sure, Brazil's growing stature gives it the wherewithal to become a player in the middle east and other regions well beyond its own neighbourhood. But consolidating peace and prosperity in South America must remain a top priority. Only if Brazil continues to reside in a stable and cooperative neighbourhood will it be able to effectively project its voice and pursue its interests further afield.

### The exercise of strategic restraint

When it comes to the scope of international influence and foreign ambition pursued by rising powers, less is more. Rising states that tread lightly and speak softly will find their ascent less encumbered and turbulent than those that swagger and shout.

Bismarck was so effective in guiding Germany's early rise because he reined in German ambition, focusing the country on economic growth and diplomatic clout rather than military capability. He argued against the acquisition of colonies, contending

that overseas empire would distract Germany from its continental vocation and needlessly provoke rivalry with Great Britain and France. Bismarck succeeded in maximising German influence by making it Europe's diplomatic pivot. His successors did exactly the opposite, and paid a heavy price. They propagated nationalist myths at home and embarked on a military build up that led to Germany's self-encirclement and an unintended great-power war. The exercise of strategic restraint worked to Germany's advantage, while unbridled ambition led to Germany's downfall.

China's recent diplomatic track record is also instructive. Over the past decade, China focused on domestic growth and practiced restraint in its foreign policy; its rise consequently met with little resistance. More recently, China adopted a more muscular stance, speaking in blustery terms about its "core interests" in the South China sea, confronting Japan over disputed islands, and refusing to isolate North Korea even after it sank a South Korean naval vessel and shelled a South Korea island. The international response was immediate. The United States shored up its alliance network in east Asia and launched a new strategic partnership with India. Japan announced that it was changing the strategic focus of its military, ending its emphasis on the north in favour of concentrating on the Chinese threat to its southern islands. China's more assertive diplomacy did more harm than good to its strategic position.

The lesson for Brazil is to ensure that even as it aspires to a level of international influence commensurate with its power, it does so in a cautious and judicious manner. Brasília's focus should be on steps aimed at contributing to the provision of public goods and strengthening a rules-based order, meanwhile avoiding actions that appear to be more self-serving or intended to provoke. For example, the Brazilian-Turkish initiative to strike a deal with Iran on the export of its uranium stockpile was a constructive move; the United States and the EU should have reacted more favourably and used it as

baseline for further discussion. In contrast, President Lula da Silva's chummy relations with President Ahmadinejad were a mistake. Brasília seemed to be embracing the Iranian leader at the very moment that the international community was seeking to reinforce his regime's isolation. The move may have been intended to bolster Brazil's credentials as an independent player, but it did more harm than good to Brazil's international standing. As the Wikileaks cables made clear, even in the middle east itself, Ahmadinejad is anything but a respected leader.

### Bridging the developed and developing worlds

Due to its benign geopolitical environment, stable democratic government, and its history of working with developed and developing countries alike, Brazil should seek to cast itself as a bridge between the two groupings. Brasília should align with the west as appropriate, and it should align with the Brics or other developing groups as appropriate. Rather than seeking to cast itself in a particular role or adhere to a particular ideology, Brazil should be guided by a pragmatic, problem-solving agenda.

In this respect, Brazil might seek to be a rule-generator; a country that consciously helps recast a rules-based international order. At this point in the transition to a post-western international system, rising powers are very adept at articulating what they do not want: an international system under western hegemony. But they are not yet ready to articulate what they do want; in other words, to articulate what norms would guide a post-western order. Brazil is particularly well-placed to help fill that gap. It has 'street credibility' with rising powers, but its open economy and democratic institutions also give it strong credentials among western powers.

### Diplomacy before commercial engagement

Conventional wisdom holds that commercial integration is a key ingredient of peace; economic interdependence leads to geopolitical stability. The conventional wisdom, however, is wrong. It

is diplomacy that is the critical ingredient to peace making, and only after the diplomats have done their work can commercial integration help seal the deal. Brazil's own experience bears out this insight. Rapprochement proceeded with Argentina primarily as the consequence of diplomacy; commercial integration remained quite limited during the critical years of exchanges, dialogue, and confidence-building. Only after relations between Brazil and Argentina were on a much better footing did Mercosul take off and succeed in deepening economic interdependence.

Brazil should shape its regional and global strategy accordingly. Expanding economic engagement is important in its own right; it will facilitate Brazilian growth and contribute to global prosperity. But Brazil's engagement strategy should also entail a healthy dose of diplomatic initiative. In the Americas, the middle east, and beyond, Brazil should capitalise on its growing power and influence to help solve intractable disputes and prevent new ones from emerging. Effectively playing this role would help mark Brazil's arrival as a responsible great power.

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