THE BRAZILIAN ECONOMY

FGV
Economy, politics and policy issues • JANUARY 2011 • vol. 3 • nº 1
Publication of Getulio Vargas Foundation



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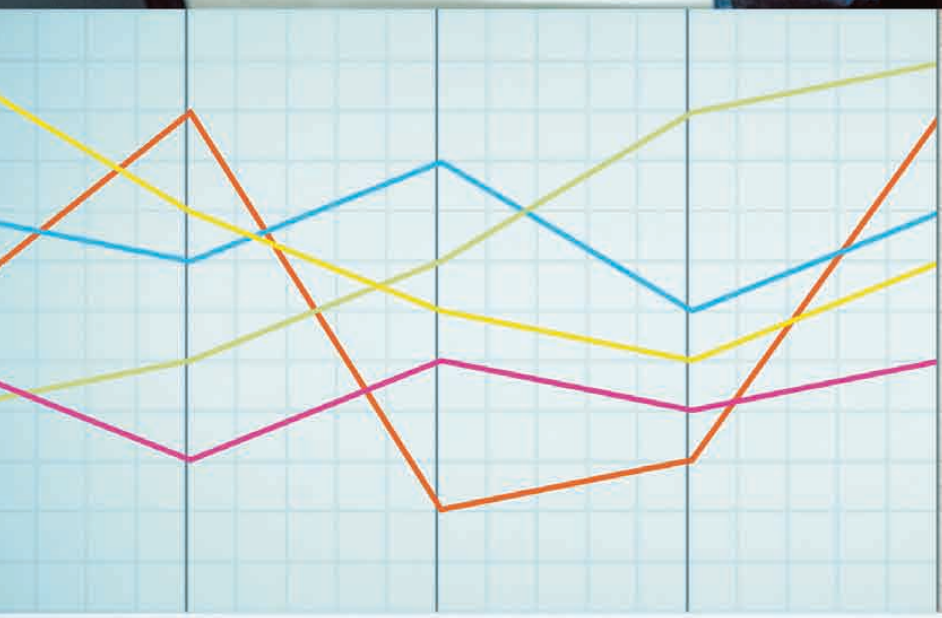
Moving Up in the World?





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Although its first few weeks were marked by disagreements between members of the cabinet, the new administration has begun to lay out its domestic and foreign priorities. At her first cabinet meeting on January 14, President Rousseff addressed the 2011 budget and called for cabinet unity. She intends to take a firm stand on public spending; in particular, the government will monitor administrative costs rigorously. In other areas, she must also quickly establish her authority, enunciate clear policies, and set the tone of her administration.

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Brazil is forging ahead in both economic power and per capita income. It has earned respect for its positions and effectiveness throughout the world. Although the experts interviewed by Liliana Lavoratti recognize what Brazil has achieved in its steady, but safe, growth path, they also recognize a number of structural problems that the country must resolve if its growth is to be sustainable.

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The most important foreign policy achievement of the Lula administration, Celso Amorim, outgoing Foreign Minister, tells Solange Monteiro, is a change in how Brazil perceives itself and how other countries perceive Brazil. He identifies milestones in past foreign policy and, looking ahead, discusses how much external relations depend on domestic trade and industrial policy.

24 Where will Brazil's foreign policy go next?

In a conversation with Solange Monteiro, José Botafogo Gonçalves, currently chairman of the Brazilian Center for International Relations and formerly Minister of Industry, Commerce and Tourism, predicts that Brazil's foreign policy is unlikely to change much. He also assesses Brazil's relationship with Mercosur as an organization and with some of its individual members.

FOREIGN POLICY

27 The battle for the White House

Lula's candidacy for president of Brazil more than eight years ago was received with considerable skepticism and mistrust in the U.S. But outgoing Brazilian president Cardoso, the new American ambassador to Brazil Donna Hrinak, and Jose Dirceu, president of the Workers' Party, orchestrated a campaign for Lula's acceptance that culminated in a telephone call from President Bush within hours of the vote count. Mathias Spektor gives a play-by-play account of how that came about.

31 Brazil and Africa: Productive technical cooperation

In 2009 the government detailed its goal for Africa — to increase Africa's share in Brazil's total exports by 5%. The 20 strategies to do so relate to finance and investment promotion, promotion of foreign trade, and cooperation and knowledge transfer. Lia Valls Pereira reports on a June seminar sponsored by the Brazilian Center for International Relations that discussed how the plan is playing out, with special attention to the work of the Brazilian Cooperation Agency and other government units, the Oswaldo Cruz Foundation, and the Brazilian Agricultural Research Corporation.

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A truly independent central bank should be questioning whether fiscal policy as conducted by the Treasury is consistent with the annual inflation target. Otherwise, a target that might be desirable for inflation may be bad for the country, says economist Rubens Penha Cysne. He calls on the central bank to do more incisive and public questioning of fiscal policy and challenge earmarking and other budgetary practices that are not compatible with a presidential democracy.

37 The Central Bank under Lula

Fernando de Holanda Barbosa gives the Central Bank under the previous administration good marks for controlling inflation and acting as the lender of last resort, but explains why he thinks it has done less well on its other tasks: Its reserves policy has produced an accumulation of reserves that is not justifiable for a country with a flexible exchange rate system. And it has not done a good job as regulator of the financial system. Several banking mergers and acquisitions have increased concentration in the sector; banking services are expensive; and banking spreads are large.

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Address
Rua Barão de Itambi, 60 – 5º andar
Botafogo – CEP 22231-000
Rio de Janeiro – RJ – Brazil
Tel.: 55 (21) 3799-6799
Email: ibre@fgv.br
Web site: http://portalibre.fgv.br/

The BRAZILIAN ECONOMY

Economy, politics, and policy issues
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Contributors to this issue
Solange Monteiro
Liliana Lavoratti
Matias Spector
Lia Valls
Rubens Penha Cysne
Fernando de Holanda Barbosa

Where in the world are we?

Brazil finds itself today with new visibility in the world, and with a much stronger voice than it has ever had before, as the articles in this issue make abundantly clear. But much must still be done to consolidate and advance from its new position.

The general financial crisis that began in 2008 underlined the necessity of rethinking the international order. Brazil now has influence on such contemporary global issues as climate change, renewable energy, and food production that is driven by its economic power, but as Ambassador Ricupero points out, "What's absolutely new is Brazil's importance in monetary and financial discussions." Former Foreign Minister Amorim sees that change as arising from the 2003 WTO meetings in Cancun. At that time, he says, "The European Union and the United States had already agreed on a result that would be totally protectionist." But Brazil spoke up, and he expects that the WTO Doha Round will result in a much better trade agreement for Brazil and many other countries than would have come out of Cancun if Brazil had not spoken up.

There is also general agreement that Brazil's role in the G-20 and its emergence as a factor in the International Monetary Fund have brought it renewed respect, although the honesty and consistency of its foreign policy have long been recognized. In recent years it has also been working hard to revive Mercosur and take a more decisive stance on regional issues — crucial considering how important our neighbors are to Brazil's international trade. It has also projected its presence abroad through technical cooperation, especially numerous initiatives of the Brazilian Agency for International Cooperation in Africa, Asia, and South America in such areas as low-income housing, agricultural research, and public health. And in the past eight years Brazil has opened or reopened 30 embassies across the world.

But although the foundation has been laid, there is no guarantee that Brazil will find it easy to consolidate its global influence. There are, for instance questions about its relationship generally with the UN and specifically with China. People may talk of a permanent seat for Brazil on the UN Security Council, but because the UN systems "touch at the heart of power, they are highly sensitive," Ambassador Amorim points out. Although there is movement in that direction, it will not happen soon.

Brazil, especially the government, lacks a clear vision of what our national interests are and where we want to be in the next 10 years or so. As a result, in response to the emergence of China, Brazil has to a large extent been simply reactive.

Where Brazil ends up as a great power in the world depends not only on its trade and foreign policy. To a large extent it depends also on how well we take care of our own people, otherwise Brazil's dreams of greatness could end up in great disappointment.

This is not simply a matter of trade policy, or foreign policy generally. Our own people are not concerned about threats from abroad; they see public health, education, and urban violence as the country's main problems. And the overvaluation of the real, as Ambassador Gonçalves, notes, cannot be blamed on China but results from an imbalance in Brazil. Businesspeople agree that Brazil needs to address such drags on the economy as undisciplined public spending and its effects on interest rates and investment.

The problems are not just financial. Tax, fiscal, labor, and infrastructure reform are long overdue. Sustainable development expert José Eli da Veiga thinks Brazil has been too optimistic about recent strides in reducing poverty considering that, for instance, even now half the population has no access to basic sanitation.

Where Brazil ends up as a great power in the world depends not only on its trade and foreign policy. To a large extent it depends also on how well we take care of our own people; otherwise Brazil's dreams of greatness could end up in great disappointment.

First steps of the Rousseff administration

Although its first few weeks were marked by disagreements between members of the cabinet, the new administration has begun to lay out its domestic and foreign priorities. The president must quickly establish her authority and communicate clear policies to set the tone of her administration.



(Foto:Marcello Casal Jr./ Agencia Brasil)

The President Rousseff coordinates the first meeting of her cabinet.

On a critical issue for balancing the budget, Finance Minister Guido Mantega said that the government would veto any amount over US$320 for the minimum wage, while Labor Minister Carlos Lupi argued that only Congress can decide on the adjustment. The government obviously needs to give Congress a clear understanding of its position.

This was not the only public disagreement. Maria do Rosário, Human Rights Minister, recommended investigation of cases of the torture and death of the politically persecuted during the military dictatorship. Gen. Jose Elito, Chief Minister of Institutional Security, spoke against it.

Government sources say the president did not like these public disagreements. Although policy debates are welcome in a democracy, the administration needs to have and communicate transparent and coherent policies so as not to unsettle markets and undermine its credibility.

First cabinet meeting

At her first cabinet meeting on January 14,, President Rousseff addressed the 2011 budget and called for cabinet unity. She intends to take a firm stand on public spending; in particular, the government will monitor administrative costs rigorously. According to *O Estado de S. Paulo* newspaper, she warned

that though political appointments will be respected, managers must commit to results and will be held accountable. Ministers will have to set targets for reducing costs and report on progress during the regular cabinet meetings. The problem is that ministries have historically been guided by the interests of party politics.

The president's greatest challenge is to make public services more efficient, cost–effective, and responsive to the needs of the population. Recent flooding in Rio de Janeiro state has painfully reminded us how inefficient the public sector is. More than 700 people are reported dead, compared to 25 in much worse flooding in Australia. As happens in many developing countries, most of those affected by the natural disaster are poor and live in shantytowns. This tragedy, which recurs regularly in Rio during the rainy season, demonstrates both failure to enforce urban zoning laws and inadequate government investment in infrastructure.



Photo: Agencia Brasil

Minister of Communications Paulo Bernardo argues for more discussions on the new media regulations.

The president's greatest challenge is to make public services more efficient, cost–effective, and responsive to the needs of the population.

Media law

Showing sensitivity to public opinion, the new administration decided not to immediately send to Congress the draft law to regulate the media prepared by the Lula administration. Members of civil society objected strenuously to the draft law, fearing censorship of the media. Former President Fernando Henrique Cardoso even said that the way the Lula administration guided the discussion of media regulation and the perception of political meddling in media affairs raised suspicions of a threat to press freedom.

New Minister of Communications Paulo Bernardo was cautious in addressing the discussion on the media law. In an interview after meeting with President Rousseff, he said that the bill contains "issues relating to democracy itself." He called for detailed discussion within the government and submission of the draft law to public consultation through the Internet before it is sent to Congress.

Showing sensitivity to public opinion, the new administration decided not to immediately send to Congress the draft law to regulate the media prepared by the Lula administration.


Photo: Agencia Brasil

Antonio Patriota takes charge of the Ministry of Foreign Affairs.

Closer ties with the U.S.

Antonio de Aguiar Patriota has become foreign minister. Patriota has held a number of prominent diplomatic positions, having been Brazil's ambassador to the United States (2007–09), Deputy Secretary General for Political Affairs of the Ministry of External Relations, Cabinet Chief of Foreign Minister Celso Amorim, and Secretary General of the Ministry of Foreign Affairs.

The expectation is that the new administration will make no bold moves in foreign policy. In an interview with the *Washington Post* in December, President Rousseff said she considered the relationship with the U.S. to be very important to Brazil and she would try to forge closer ties. The president is expected to go to Washington in March to meet with U.S. President Barack Obama. However, Brazil's position on some human rights issues is likely to change. Rousseff criticized the fact that Brazil abstained from voting on a recent U.N. human rights resolution. She affirmed that she would have felt uncomfortable as a woman to say nothing against the stoning of a Muslim woman.

The expectation is that the new administration will make no bold moves in foreign policy. It will try to forge closer ties with the United States.



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ACTIVELY PARTICIPATING IN IMPORTANT POLICY DEBATES IN WORLD FORUMS, BRAZIL HAS WON INTERNATIONAL PROJECTION. CONSOLIDATING ITS POSITION, HOWEVER, WILL DEPEND ON OVERCOMING CHALLENGES AT HOME AND ABROAD.



BRAZIL
Moving Up in the World?

Liliana Lavoratti, Rio de Janeiro

Brazil has in recent years begun making significant contributions on such contemporary global issues as climate change, renewable energy, and food production. Its international influence is driven by its brand-new economic power.

Illustration: Daniel Bueno

TODAY, BRAZILIAN PER CAPITA INCOME IS ABOUT 20% OF AMERICAN.

GDP

(Billions of U.S. dollars)

1º	United States	14,624
2º	China	5,745
3º	Japan	5,390
4º	Germany	3,305
5º	France	2,555
6º	United Kingdom	2,258
7º	Italy	2,036
8º	BRAZIL	2,023
9º	Canada	1,563
10º	Russia	1,476
11º	India	1,430
12º	Spain	1,374
13º	Australia	1,219
14º	Mexico	1,004
15º	South Korea	986
16º	Netherlands	770
17º	Turkey	729
18º	Indonesia	695
19º	Switzerland	522
20º	Belgium	461

Source: IMF.

GDP per capita

(U.S. dollars)

1º	Luxemburg	104,390
2º	Norway	84,543
3º	Qatar	74,422
4º	Switzerland	67,074
5º	Denmark	55,112
6º	Australia	54,868
7º	Sweden	47,667
8º	Arab Emirates	47,406
9º	United States	47,131
10º	Netherlands	46,418
11º	Canada	45,887
12º	Ireland	45,642
13º	Austria	43,723
14º	Finland	43,134
15º	Singapore	42,652
16º	Belgium	42,596
17º	Japan	42,325
18º	France	40,591
19º	Germany	40,511
20º	Iceland	39,562
55º	BRAZIL	10,470

The eighth largest economy in the world, Brazil is only US$10 billion below seventh place Italy and has already surpassed emerging Russia and India and such wealthy economies as Canada, Spain, and Korea, according to International Monetary Fund (IMF) estimates. "Our children will live in a better country and perhaps our grandchildren will experience conditions like those existing today in Spain," predicts research economist Samuel Pessoa of the Brazilian Institute of Economics (IBRE).

Aggregate GDP shows the size of a country relative to the rest of the world, but GDP per capita is more relevant for measuring the well-being of its people.

In 2010 Spanish per capita income was US$29,875 (26th in the world) and Brazilian was US$10,470, moving it up from 60th in 2009 to 55th in 2010. "Over the next 40 years, we will become a middle-income economy with growth higher than in rich countries, which have virtually exhausted their capacity to create wealth," Pessoa says.

In 30 years Brazilian per capita income should reach 36% of today's U.S. per

"THE CRISIS OF 2008 SHOWED THE NEED TO RETHINK THE INTERNATIONAL ORDER. IN THIS SCENARIO, BRAZIL, WHICH HAS BEEN ADVOCATING A NEW NORTH-SOUTH DIALOGUE, HAS EARNED MORE WEIGHT." Lia Valls Pereira

capital GDP (US$47,131). Today, Brazilian per capita income is about 20% of the Americans. If average growth in per capita income continues in the U.S. at 1.25% a year (as it has for 150 years) and in Brazil at 3% a year (since 2006), "In 60 years our per capita income will be equivalent to 65% of what the Americans achieve today," Pessoa says.

He also says that with the consolidation of democracy, Brazil has chosen a slow, but safe, growth path, which may disappoint those who want the speed of Chinese development. But he also warns, "The pace of resolving pending structural problems — poor-quality education, inadequate public health, urban violence, lack of physical and urban infrastructure, low investment in science and technology, social inequality — will also be slow."

Multipolar world

The convergence of a number of factors, not just economic, is bringing about a multipolar world. Brazil is in a good position to influence the new system, says Lia Valls, IBRE researcher. "The Asian and Russian crises, the low growth rate in Latin America, the difficulties post-World War II multilateral institutions have had in dealing with political and economic crises were the first signs" that the world was changing, she says. "The crisis of 2008 showed the need to rethink the international order. In this scenario, Brazil, which has been advocating a new North-South dialogue, has earned more weight" in the discussion of such global issues as energy and agriculture.

The international reallocation of power coincided with the increasing importance of emerging economies. Pedro Motta Veiga, political scientist and director of the Center for Integration and Development Studies (CINDES), says, "In this transition, those emerging economies that are more robust have a reasonable growth path, are integrated into the international economy, respect the rules of the game, and have solid institutions and respect for democracy."

Brazilian political history since the 1990s has helped it build its positive image. Important factors were the intellectual reputation of former President Fernando Henrique Cardoso, and the fact that his successor, Luiz Inacio Lula da Silva, an union leader of a leftist party, maintained economic stability and introduced new social policies.

Another favorable factor was the modernization of agriculture, which created



the global perception that Brazil can help stave off hunger in the world. "It's as if the international agenda had moved on to topics where Brazil has by definition an important role," says Motta Veiga.

Gateway

To Ambassador Rubens Ricupero, former finance minister and secretary general of the United Nations Conference on Trade and Development in the 1990s, "What's absolutely new is Brazil's importance in monetary and financial discussions." Ricupero, who participated in the Uruguay Round General Agreement on Tariffs and Trade (GATT), says Brazil has always exerted influence in international trade negotiations, but at that time it was far from enjoying its current weight as the world's fourth-largest exporter of agricultural products.

Ricupero points out that India tends to be heard primarily in policy forums out of respect for its the military power represented by the atomic bomb; the Brazilians have other trading currencies. "The stability achieved, the accumulation of foreign reserves, and success in economic policies to counter the global financial crisis has given Brazil unprecedented standing in international forums," he says. Recently, for the

"WE ARE RELUCTANT TO DO WHAT WE SHOULD HAVE DONE LONG AGO: TO MOVE CLOSER TO THE U.S., THE GREATEST MARKET IN THE WORLD." Amaury de Souza

Illustrations: Daniel Bueno

"WHAT'S ABSOLUTELY NEW IS BRAZIL'S IMPORTANCE IN MONETARY AND FINANCIAL DISCUSSIONS." Rubens Ricupero

first time, Brazil lent funds to the IMF to help other countries, going from IMF debtor to creditor.

The G20 group of advanced economies and emerging market countries gained prominence as coordinator of global economic policies in 2008, when Lehman Brothers collapsed and the Americans took the initiative to transform the forum into an anti-crisis coordination center. At that time, Brazil held the rotating presidency of the G20. Ricupero says, "This is the single pivotal event in global economic governance in the last 15 years . . . . We now have an active voice in monetary and financial matters, which before were entirely in the hands of the rich, who alone ruled in the G7, the IMF, and the World Bank."

Brazil has also projected its presence abroad through technical cooperation. Among the numerous initiatives the Brazilian Agency for International Cooperation (the ABC) has implemented projects in Africa, Asia and South America for low income housing, agricultural research, and public health. Recently, the Brazilian government opened a factory for medicines to treat AIDS in Maputo (Mozambique).

Pragmatism required

However, "If we consider that in the 1970s Brazil, China, and South Korea had the same share of world trade, about 1% each, and now the Chinese have 14%, the Koreans 6%, and we are slightly under 1%, we find we are not so important," says political scientist and consultant Amaury de Souza.

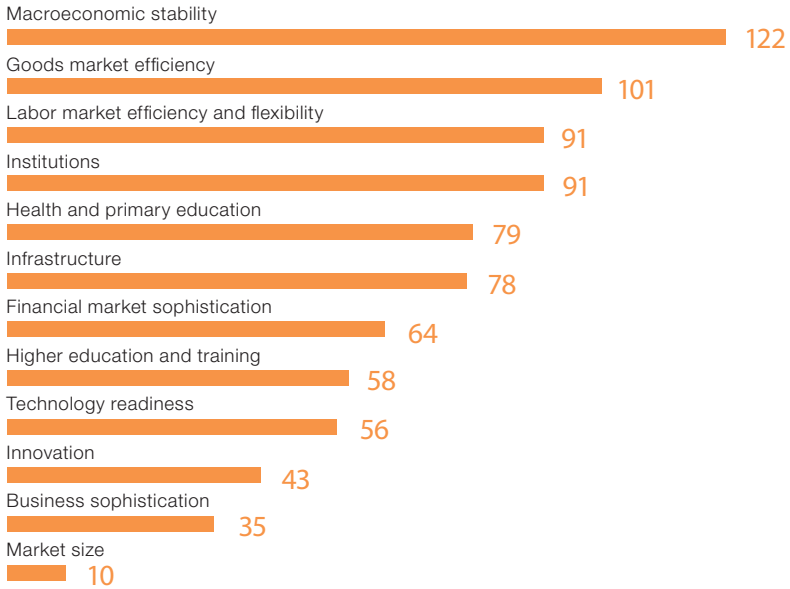
Armando Castelar, IBRE economist, explains that "Brazil has not got better because of increased productivity. . . The appreciated exchange rate has pushed up the income indicators." But he points out that the Brazilian government has become more activist, competing more intensely for positions in international organizations. Leading the UN force in Haiti, for instance, has also helped to heighten the country's image internationally.

Rubens Barbosa, Brazil's ambassador to the United States during the Cardoso administration and now a business consultant, believes Brazil's foreign policy was not assertive enough about trade: "We lost time with the Doha round, because . . . the Brazilian government had no alternative plan of multilateral negotiation, but for giving priority to South-South relations."

Brazil has signed few trade agreements, mainly with Egypt and Israel as well as some, as with Jordan, that Barbosa considers "irrelevant." And, he points out, "exports to the U.S. have never been so low. The effects were not more negative only because of Chinese demand for agricultural commodities and metals." Barbosa believes a bolder attitude could have reversed the decline in Brazilian exports.

BRAZIL STILL LAGS BEHIND IN MANY COMPETITIVENESS INDICATORS

The Global Competitiveness Report 2007-2008, World Economic Forum (1 is best and 133 is worst)



De Souza points out the damage from lack of a proactive stance to the U.S.: "We are reluctant to do what we should have done long ago: move closer to the U.S., the greatest market in the world." For him, "The two countries should join forces against the daunting common competitor that is China." If we want to develop a domestic military aircraft industry the clear option should be to seek technology in the U.S., "the largest arms market in the world . . . but the government insists on doing business with France, which then will not import our aircraft," criticizes de Souza.

Besides not allying with relevant markets, de Souza says the Foreign Ministry spends energy on areas where there are no concrete interests, as in the case of human rights and nuclear bomb construction in Iran: "This creates an image for Brazil [as a] country that does not know what it wants."

For Motta Veiga, this policy problem has arisen because the second Lula government introduced something new to foreign policy: a political dimension. "It's not that these are bad choices, but the political values Brazil has suggested with such actions undermine its credibility as an international actor," Veiga underlies.

Because Brazilian foreign policy traditionally focused on the economy, Brazilian diplomats have generally considered coups and revolutions to be internal affairs. "Lula's government broke with this policy line and Brazil began to interfere in sensitive issues such as democracy and human rights, but with many ambiguities. On the one hand, this change

"THE INTERNATIONAL AGENDA HAD MOVED ON TO TOPICS WHERE BRAZIL HAS BY DEFINITION AN IMPORTANT ROLE." Pedro Motta Veiga

has the virtue of signaling that foreign policy also has political values, but we need to be clearer about what those values are," says Motta Veiga.

This ambivalence has marked Brazil's relationship with its neighbors in South America, where it is an undisputed leader because of its area, the size of its economy, and its population. De Souza says that Hugo Chavez in Venezuela and Evo Morales in Bolivia, both much smaller economies, have been asserting leadership, and "the Brazilian government decided to let things happen rather than taking a more decisive stance on regional issues." Closer integration with the rest of the continent is imperative for Brazil's trade, de Souza adds: "We're on the wrong ocean. International trade in this century is concentrated in the Pacific, not the Atlantic. We urgently need direct access to the Pacific coast by railways, roads, and airlines."

In the interests of regional stability, de Souza also believes Brazil should be more active in the fight against organized crime in Latin America. Motta Veiga agrees: "Transnational crime has virtually made Mexico and Central America hostages. We are already victims of trafficking in drugs and weapons. We border nine countries. Sooner or later we will be affected."

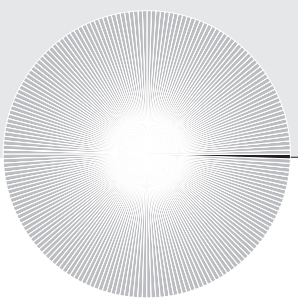
De Souza also sees problems in the region for Brazilian companies: "Most of the companies that operate in South America are medium and small. They are vulnerable because there are no treaties to protect investment from expropriations and breaches of contracts, as happened in Bolivia with the nationalization of oil and gas."

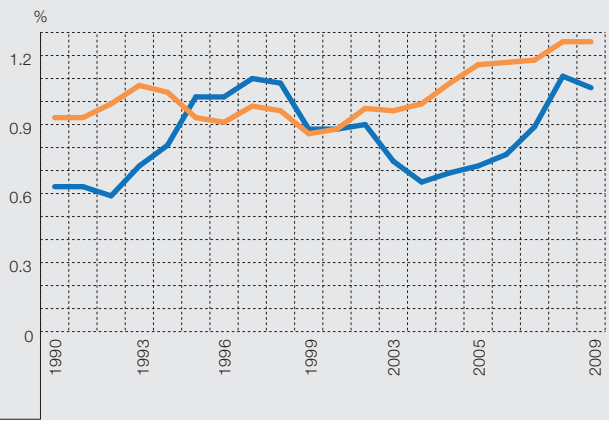
Unrealistic views?

In terms of the international importance of Brazil today, de Souza points out that in the 1970s Brazil, China, and South Korea had the same per capita income, but "Today Korea has moved ahead into the developed world and we are still almost the same. The school system in Korea then was equal to that of Brazil; now it is fantastic."

José Eli da Veiga,a specialist in sustainable development at the University of São Paulo, is another who sees inconsistencies in Brazil's new standing in

BRAZIL'S SHARE IN WORLD **EXPORTS** AND **IMPORTS**





Source: MDIC/SECEX

"WE ARE GOING TO BE THE FIFTH LARGEST ECONOMY IN THE WORLD AND STILL HAVE HUGE QUEUES AT HOSPITALS." José Eli da Veiga

the global game. "We are going to be the fifth largest economy in the world and still have huge queues at hospitals," he says.

To become a developed nation today, it is necessary to deal with basic questions, starting with investments in science, technology, and innovation. Unfortunately, Motta Veiga says, "Regardless of what the next governments do in this area, society is not pressing in that direction." He sees too much optimism about recent strides in reducing poverty, noting that "we ignore the fact that half the population still lacks access to sanitation."

Brazilians see public health, education, and urban violence as the country's main problems, according to a recent survey by the National Transportation Confederation and the Sensus Institute. In her inaugural speech, President Dilma Rousseff affirmed that her "most stubborn fight" is against poverty.

Wanted: A clear vision

From 1994 to 2002 the emphasis in Brazil was on modernization, and in the last eight years on social inclusion, but Rubens Barbosa asks, "We are laying the groundwork for what? How can Brazil aim to be one of the major powers within 10 to 15 years without knowing what we want to be?"

He calls for a clear vision of national interests: "We have sustained growth and a rapidly developing domestic market. This creates conditions for forward thinking." He thinks that this discussion needs to involve the executive branch, legislators, businesspeople, and civil society, calling for them to achieve "consensus on a realistic project to face the growing challenges in terms of economic and social policy."

It is necessary to make decisions: Should Brazil be an exporter of commodities and oil? An industrialized economy? Have closer relations with poor, or with rich countries? "Our competitiveness will be compromised if we do not address the cost of doing business in Brazil, reduce taxes, and invest more in science and technology," Barbosa warns.

Gerard Biasoto Jr., director of the Foundation for Administrative Development of São Paulo, believes that in coming years the Brazilian economy will be more determined by international prices of raw materials than by the dynamics of the domestic productive sector. But "this process is still unclear and shrouded by booming public and private domestic consumption, inflated by the financial system and based on imports," says Biasoto.

Businesspeople agree on the need for Brazil to address such drags on the economy as undisciplined public spending and its effects on interest rates and investment. "The winning strategies must be adopted now and implemented

"OUR COMPETITIVENESS WILL BE COMPROMISED IF WE DO NOT ADDRESS THE COST OF DOING BUSINESS IN BRAZIL, REDUCE TAXES, AND INVEST MORE IN SCIENCE AND TECHNOLOGY." Rubens Barbosa

by 2030," says Carlos Schneider, coordinator of the Movement for an Efficient Brazil. Unfortunately, he sees no movement in that direction. We need urgently to increase investment from the current 19% of GDP to at least 25% and reduce the tax burden, which will require a permanent solution to excessive public spending. This year the Movement will launch a campaign to urge Congress to approve legislation that will put a brake on government current spending and thus make funds available to increase investment in infrastructure.

Next Steps

The next steps depend on both what happens elsewhere in the world and what happens internally. "Threats of instability and signs of fiscal indiscipline would undermine our credibility abroad. A country with many internal problems would have little time to devote to international affairs . . . . Recent advances have occurred in large part because our house here is in order," Motta Veiga says.

One thing that cannot continue is the "Brazilian way" of doing business with the rest of the world. Rubens Ricupero points out that "Brazil has acquired new responsibilities and these require a bureaucracy ready to show Brazil is proactive, not just reactive."



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Brazil in the world: What should be the priorities?



Celso Amorim

former foreign minister

Solange Monteiro, Rio de Janeiro

Celso Amorim is internationally recognized as the face of President Lula's foreign policy, which he summarized as "proud and active" as he transferred the office to his successor, Antonio Patriota. Earlier, he had defended the commercial focus on developing countries. He also said that one of the Brazil's challenges is to "have a clear concept" on relations with China and the U.S.

***The Brazilian Economy* — What do you consider your greatest achievement in terms of Brazil's international presence? And what do you regret not having accomplished?**

Celso Amorim — The most important achievement is the change in Brazil's perception of itself and the perception that others have of Brazil. There are important internal aspects of that: the economic stability that everyone thought was threatened became consolidated, the economy grew, and income became better distributed. All these things helped make the world more aware of Brazil's importance, and that allowed us to take initiatives we might have shied away from before.

Two milestones in Brazilian foreign policy had trade implications. The most obvious is the WTO meeting in Cancun

in 2003. The European Union and the United States had already agreed on a result that would be totally protectionist until Brazil spoke up and said no. We coordinated a group of countries, the G20, that not only prevented a highly unfavorable agreement but also advanced its own proposals. As the Doha Round has progressed, many things went according to what the G-20 group had proposed. The second milestone came with the financial crisis. Brazil now has a very important role not only because of the performance of the economy, but also because it is able to articulate its concerns clearly.

And the permanent seat on the UN Security Council?

That will not come easily. Because the systems of peace and security touch at the heart of power, they are highly sensitive. These are also very formal situations. To change the Security Council, it is necessary to change the UN Charter. We are moving in that direction.

Another incomplete project was the Doha Round, but we made an extraordinary breakthrough because it will eventually be concluded, and it will be a much better trade agreement than it would have been in Cancun. But anyone who participates in a negotiation would like to see it come to a conclusion.

The most important achievement [of our foreign policy] is the change in Brazil's perception of itself and the perception that others have of Brazil.

In recent years Brazil has almost tripled its exports, but its share in international trade is still just 1%. Where is Brazil failing?

In the figures I have seen, Brazil's share has gone from 0.8% to 1.1%. That does not seem like much, but it is. If you see this in a context in which all are growing, it has greatly increased. But I agree we still have to increase exports dramatically. It is countries that imported Brazilian manufactures that suffered most from recession; today we have a very strong trade deficit with the U.S., where traditionally we had a surplus. Today our largest trade surplus is with China, to which we mainly sell primary commodities.

The big change in international trade in recent times has been the much greater involvement of developing countries. The richer countries are nervous. Raise orange juice exports to the U.S. even a little, and they apply antidumping. We win the case at the WTO, but it takes years. Meanwhile, many developing countries need new things. For example, if, as we are trying to do, you support African agriculture, it is inevitable that you will export agricultural machinery. It happened here in South America with Venezuela and other countries. Developing countries will grow a great deal, and our trade with them has already grown tremendously. In 2010, trade

with India will reached US$9 billion.

Today, however, our exports are concentrated in a few products and the trade balance depends on international commodity prices. Is there a need for a clearer foreign trade policy?
The problem is not foreign trade policy. It is primarily industrial policy, because you have to develop the technology.

Isn't that part of foreign trade policy?
Yes, of course, but you need better technology to add more value. At the Federation of São Paulo Industries today, most businesspeople are connected in one way or another to the agricultural sector. And look what happened to the aircraft industry: Much of the manufacturing is not Brazilian. But the design is Brazilian; the ability to sell is Brazilian. Brazil will not compete with China to produce trinkets for daily consumption; we have to develop other sectors. We have done a lot in the generic drug sector. When we go to Africa, why not take an entrepreneur from the pharmaceutical industry?

There is a criticism about Brazil's move toward China, an important partner, that Brazil lacks a strategy for defending its interests in this relationship. What do you think?
I agree. We should have had a more defined strategy with China because things happened so fast. Suddenly we reached US$40–US$50 billion in trade. These numbers are extraordinarily high, and still surging. We have just been reacting. Our attitude should not be antagonistic, though. For example, for a long time Americans bought land in Brazil and no one worried, but when China came in, there was a sudden panic. We have to analyze this relationship in more depth.

There are two relationships about which Brazil must have a clear concept: China and the United States.

Do you believe the European Union agreement will come about?
I cannot say much about this, but I do think that while these exchange rates imbalances persist, trade becomes very difficult. Germany alone has a trade surplus with Brazil of US$3 billion. I was in favor of a Mercosur-European Union agreement because at the time nobody was talking about the Doha Round. . . . I'm leaving the government and can speak quite frankly. The greatest opportunity I see in a Mercosur-European Union agreement is to encourage the United States to advance the Doha Round.

How many embassies did the Lula administration create? What direct gain can Brazil expect from this investment?
There were about 30. Many were just reopened. For example, the Cardoso administration had closed the Tunisia embassy. In Africa, another closed embassy was the Democratic Republic

of Congo, which is the largest country in sub-Saharan Africa, poor economically but rich in minerals, and Vale is there. We had never had an embassy in São Tomé and Prìncipe, which is a Portuguese speaking country. In the Caribbean area, we opened embassies in all countries, including Venezuela and Cuba. If we're not present, we cannot hope that our ideas will prevail. A small embassy should cost about US$800,000 a year. Any business deal you do is worth much more.

What relationship should Brazil have with the U.S.?

President Obama himself has said that no one can depend on U.S. economic growth. We took that seriously. Still, the U.S. market is very important, and there are new niches to explore. There are two relationships about which Brazil must have a clear concept: China and the United States.

Has Brazil been slow in its efforts to consolidate Mercosur? Should that be a priority?

Yes, it has been slow. We could have done much more earlier. But we found Mercosur in tatters. First, economic policy decisions were made without communication, and countries like Uruguay, Paraguay, and Argentina suddenly realized that if there was a devaluation in Brazil it would greatly affect their exports. We spent a long time dealing with complaints that had accumulated from our neighbors, especially the most vulnerable, about past unilateral measures that Brazil had taken. Second, we were heading for a breakup because, for example in the FTAA negotiations, each country had a separate position. At first we had to make some concessions to address some emergencies. For example, smaller countries always defended exceptions to the common external tariff (CET) so they could import cheaper raw material and machines. We were able to agree on a timetable for the elimination of exceptions to the CET. It was also a breakthrough when it became possible to construct a power transmission line from Uruguay to Rio Grande do Sul State in Brazil, and one that is absolutely critical between Itaipu and Asuncion. People forget that Paraguay is the largest producer of electricity per capita in the world but its capital suffers from blackouts and industry lags because the energy supply is not constant. It takes time, but we're on track.

We found the Mercosur in tatters . . . we had to make some concessions to address some emergencies.

In your time as minister, was there a rupture with the previous administration?

The word rupture is perhaps too strong. The fundamentals have not changed: Brazil still

Foto: Crédito das fotos

advocates self-determination for nations, nonintervention, state sovereignty, peaceful settlement of disputes; indeed, Latin American integration itself is in our Constitution. We just focused more on South America. So it was not a rupture but a qualitative leap forward.

Take the policy toward Africa: Brazil has always been for Africa, but before it was in theory; today Brazil has embassies in over 35 African countries. If you look at trade with Africa, the Arab countries, China, India, and Latin America and the Caribbean, there has been an extraordinary leap. But when you do many things, some things are always overlooked. Now we have to think hard about our policy with China and the U.S. That does not mean being subservient, and it does not mean being always opposed. We may have to refine more, think more.

Africa was abandoned and is now our fourth largest trading partner if it were a country rather than a group of countries, it would only be behind China, Argentina, and the USA. But there is no airline there. Why? Because our companies are not bold.

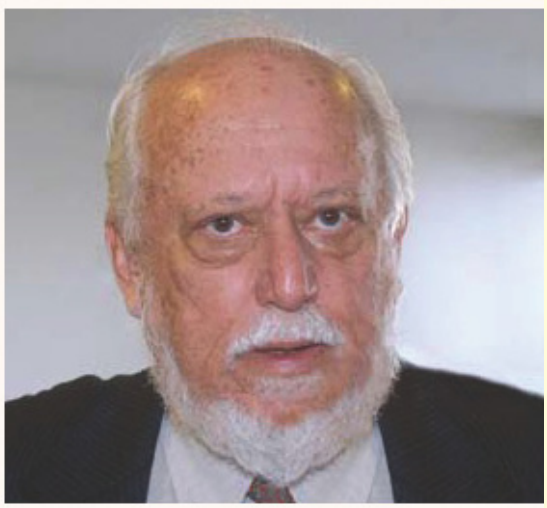
During your administration Brazil was involved in sensitive issues related to human rights, as in the case of Iran. How would you assess this theme?

Nothing is better for human rights than peace. To preserve peace implies having some agreement on the nuclear issue, and we came very close to one. We have a vision of human rights that may not be the same as the majority of the Brazilian press but that is highly respected in the UN. Our ambassador in Geneva has just been invited to chair the group that oversees human rights because we have the capacity to understand different situations and solutions. You cannot have a single prescription for all.

In many countries that are allies of the Americans, there are practices that you and I would consider human rights abuses. No one talks about them. They talk about Iran, because it has a conflict with the U.S. This is pure hypocrisy. So we argue for a global examination of human rights. I regret to say it, but the Brazilian press buys the ready-made agenda from abroad. I'm not saying Iran is good, but there are other places that are not good either.

We have a vision of human rights that may not be the same as the majority of the Brazilian press but that is highly respected in the UN.

Where will Brazil's foreign policy go next?



José Botafogo Gonçalves

Former Ambassador

Solange Monteiro, Rio de Janeiro

An institutional failure: That is how Ambassador Jose Botafogo Gonçalves assesses Brazilian efforts within Mercosur, one of the major markets for Brazil's manufactures. Currently chairman of the Brazilian Center for International Relations, he was formerly Minister of Industry, Commerce and Tourism (1998), executive secretary of the Chamber of Foreign Trade (2000), Ambassador for Special Affairs to Mercosur (2001), and Ambassador to Argentina (2002–2004). Ambassador Botafogo is adamant about the lack of a national initiative to strengthen the common market and suggests that the Rousseff government cannot avoid the reforms necessary to make Brazilian exports more competitive. In this interview Botafogo says that despite the international prestige that Brazil has won, more pragmatism is necessary to prevail in the commercial arena, with "more clearly defined objectives" and without any pyrotechnics.

The Brazilian Economy **— In recent years, Brazil has gained prominence in the G20, become a creditor of the International Monetary Fund (IMF), and attracted worldwide interest to its domestic market. However, some analysts consider this more fortuitous than the result of consistent government policies. What is your opinion?**

José Botafogo Gonçalves — Brazil's current reputation is the result of both the importance of its relations with other countries in the world and the performance not only of the Brazilian state, in charge of diplomacy, but also of other institutions, such as environmental NGOs and Brazilian multinational corporations.

In the Lula administration, Brazil's presence was consolidated, because Brazil rode the global boom of the last eight years, which caused high demand for both its agricultural and mineral raw materials. And Brazil can grow significantly more because of its economic stability. So we cannot say that the government had no influence on the country's growing international presence. Going forward, the tendency will continue to be greater affirmation of Brazil on the world stage.

Do you think the Rousseff government, with Antonio Patriota in charge of the

Foreign Ministry, will change the current foreign policy path?

It's unlikely. From my almost 50 years in diplomacy, I have seen that the Brazilian presence has always asserted itself from consistent policies. There will be corrections of what might be considered points off the curve, as in policies related to Iran, Honduras, Venezuela, and Bolivia. "South-South relationship," "generosity with neighbors," "give more importance to social peace" — all are part of selling a foreign policy that is modernizing and transforming itself. But basically not much has changed.

Brazilian foreign trade has been heavily influenced by China, which today is the main destination for our exports, on the one hand because we are benefiting from high commodity prices, on the other because we are harmed by exchange rate appreciation, which is an obstacle to increasing exports of manufactures. How do you analyze this situation?

The problem lies not only in the relationship with China. We also have problems of competitiveness within industry. We have logistics that are long overdue for reform. Investments in infrastructure are only beginning to gain momentum and this has a bearing on competitiveness that far outweighs the drawbacks of tariffs and even the exchange rate. And since we're talking about the exchange rate, clearly the overvaluation of the *real* is a problem that can be attributed not to China but to an internal imbalance in Brazil. This has meant that for a long time the country has had to finance its public deficit by issuing government bonds that, to be attractive, have to pay high interest.

We also have an agenda of internal reform that is long overdue: tax, fiscal, labor, and infrastructure reform. If Brazil is to participate in the growing competition, we need to do our homework, which has been far from satisfactory in recent years. This is the great challenge to President Rousseff's government. Foreign policy can go no further if Brazil doesn't do its homework.

Do you consider the strategy of the Lula government of giving priority to relations with developing countries and the South-South axis to have been positive?

First, I do not see much evidence of preferential treatment for these markets. Greater market penetration in the Southern Cone was due to the creation of Mercosur, which dates from long before even the Cardoso administration. But one issue that very few people mention that can be attributed to the Lula government and has real relevance was supporting the transnationalization of Brazilian corporations by facilitating loans to exporting companies. The policy of the Central Bank and the Ministry of Finance to support Brazilian investment abroad is relatively new. Formerly, even during the Cardoso government, to invest abroad

One issue that very few people mention that can be attributed to the Lula government was supporting the transnationalization of Brazilian corporations by facilitating loans to exporting companies.

was regarded as a sin; you had to invest in Brazil. That has changed, and it is more important than whether or not we make trade agreements.

Can we say that Mercosur has advanced?

From the standpoint of trade, exports continue to increase, although Mercosur has been very disappointing from an institutional standpoint. There was institutional paralysis and the common market halted. The government focused on enhancing bilateral relations, which is not bad but falls short of what might be preferable.

In its last meetings in San Juan and in Foz do Iguaçu, members decided to work further on institutionalizing Mercosur. We have wasted a lot of time, but this will be overcome; and as members invest more in infrastructure, that will create a new dynamic for trade.

Has Brazil overused what you call 'strategic patience' in relation to other members of Mercosur?

Strategic patience is still valid. There was some criticism of the aid that Brazil gave to Paraguay, and perhaps the Itaipu issue could have been resolved differently. But I think investing in making Paraguay a stronger state and a stronger economy is of great interest to Brazil.

What about Bolivia and Venezuela?

Brazil must have patience and not respond to provocations from Evo Morales, because inevitably Evo Morales will leave while Bolivia will always be a supplier of energy products.

The issue of Bolivia is more complicated because it has taken hostile positions for no reason. Brazil must have patience and not respond to provocations from Evo Morales, because inevitably Evo Morales will leave while Bolivia will continue and will always be a supplier of energy products. Already a cautious policy is needed with Venezuela because I think the government of Hugo Chavez will end badly. Everywhere in the world, contrary to what many say, capitalism is modernizing, is correcting its defects. And he wants to build a socialism that he calls 21st century, but that is really 19th century.

What advice would you give to the Rousseff foreign relations team?

My recommendation would be to lower the tone of international speech, avoid the pyrotechnic actions that President Lula was able to take because of his enormous international prestige, and seek better alignment with internal governance in order to promote Brazil's economic development. The Foreign Ministry can be an important channel, for example, for increasing financing to Brazilian investments abroad, negotiating agreements on investment protection, discussing new trade agreements. You do not need a very different discourse from the current one. It only takes practice, and a management more focused on more clearly defined goals.

Foto: Crédito das fotos

The battle for the White House



Matias Spektor

The first meeting between Lula and Bush in December 2002 bear lessons for Rousseff and Obama.

When President-elect Luiz Inácio Lula da Silva walked into the White House for the first time eight years ago, George W. Bush was candid, "Mr. President, some people say that a person like you cannot do business with a person like me. We are gathered today to prove them wrong." The message spread like wildfire.

Back in 2002 many in the U.S. were unsympathetic to Lula. The *Washington Times* had warned that "if the pro-[Fidel] Castro candidate were elected president of Brazil, we would have a radical regime." According to the *Financial Times* "We all know that Brazil's solvency is at knife's edge." twelve House Republicans had voiced concern in a public letter to Bush.

Developments in the region did not help. Argentina had just defaulted on its massive debt and Venezuela was still recovering from a coup attempt against Chavez. To make matters worse, there was no direct communication between Brasilia and the White House: Presidents Fernando Henrique Cardoso and Bush never struck a good rapport, and for 14 months there had been no U.S. ambassador posted in Brasilia.

When Lula began emerging in the polls as the likely winner of the 2002 elections, however, an unlikely trio began diplomatic maneuvers to reassure the White House: Donna Hrinak, the new U.S. ambassador to Brazil; Jose Dirceu, president of the Worker's Party (PT) and Lula's right hand; and President Fernando Henrique Cardoso.

The ambassador

When Hrinak landed in Brasilia in April 2002 her Portuguese was flawless. As deputy U.S. consul in São Paulo in the 1980s she had seen dictatorship come to an end. She had also met the generation of politicians who were on the verge of reaching power in Brasilia. When a journalist asked her what she thought of Lula, she said confidently, "We're not afraid of Lula. He embodies the American dream."

Matias Spektor heads the Center for International Relations at FGV and is author of *Kissinger and Brazil* (2009) and *Azeredo da Silveira, a Testimony* (2010). He holds a doctorate from Oxford University.

On the eve of the second round of voting in October 2002 Donna Hrinak and Rubens Barbosa began to arrange for Bush to make a personal phone call to Lula if he won.

From the moment Hrinak landed in Brasilia, she started working to make the idea of a Lula administration palatable in Washington. Lula grasped the situation well. When he met Hrinak during the campaign, he said: "I want to talk to you because I know that you are not afraid of us."

The operator

In the summer of 2002, three months before the presidential election, José Dirceu visited the United States carrying an English translation of Lula's *Letter to the Brazilian People*. The piece set out to confirm Lula's commitment to economic stability and a tight fiscal policy. He visited all the institutions that mattered: the White House, Treasury, Congress, unions and the financial market. In a gesture of solidarity he took pictures where less than a year earlier the twin towers had stood. He sent letters to President Bush's father and Vice President Dick Cheney and enlisted the help of influential businesspeople to reassure Americans that the *Letter* was sincere.

The U.S. embassy reinforced the message in a telegram to Washington: "All our interlocutors have faith in Dirceu to take tough but responsible decisions .... Nobody expects a default by the government."

Dirceu also sought the support of American unions. For that he mobilized the AFL-CIO's Stanley Gacek, a sort of informal ambassador for the PT in the United States. Gacek had been visiting Brazil for 20 years and knew Lula and his group well. When Lula was arrested in 1981, Gacek had been part of the international group that came to follow the case. In the 1990s he organized trips to the United States for Lula. Now Gacek worked behind the scenes to ensure that Lula's embrace of the economic policies of Cardoso would not alienate union support.

The Incumbent

In its rush to reassure the United States, the PT had an unexpected ally: Fernando Henrique Cardoso. Dirceu called him after leaving a meeting of the influential Institute for International Economics in Washington, where he had heard renowned economists say that Brazil would probably be forced into a default.

Cardoso had invented a new ritual: He formally appointed a team to manage the presidential transition, set up offices for the president-elect's team, and instructed his ministers to produce thousands of pages of information for their successors. He signed a stand-by agreement with the IMF to avoid a possible market run against the *real* and asked all presidential candidates to sign it. He also gave the new team access to secret information and opened a direct communication channel with Lula.

These decisions were not an act of benevolence, they were a precise calculation. Market turmoil, the president feared, could destroy the *real* and his greatest legacy, financial stability.

Cardoso was determined to secure that legacy. The meaning of the 2002 transition was enormous. If Lula won the upcoming

election Brazil would for the first time in its history see the transition from an elected president to another, who would in turn manage to complete his term without dying, resigning or being overthrown by the military.

During the campaign the president also sent his chief of staff, Pedro Parente, to the United States. Parente visited the White House, the State Department, and the U.S. Treasury carrying a copy of the transition project. At each meeting Parente reiterated his confidence in the PT party and the message of the *Letter to the Brazilian People*. He assured all that there would be no rupture.

Lula acknowledged the symbolic power of Cardoso's attitude and was grateful. Less than 24 hours after his victory, in a telephone conversation with British Prime Minister Tony Blair, the Lula stressed: "I would like to say that President Fernando Henrique Cardoso played an important role in this election, first working as a statesman, then creating the first transition committee ever seen in Latin America."

But Cardoso knew this would not suffice. A smooth transition would depend largely on the reaction of the White House, given its ability to guide market expectations. And he knew that repeating the *Letter to Brazilian People* to exhaustion would not be enough to disarm the entrenched distrust of Lula in Washington. He instructed his ambassador in Washington to give full support to whatever the PT team asked.

Rubens Barbosa was a career diplomat but had come to Washington because he was a personal friend of Cardoso. As ambassador to the U.S. capital he had worked to the point of hyperactivity to build an unusual network of relationships in the executive branch, the legislature, the academic world, and U.S. states. He worked just as systematically to ensure a good reception for Lula.

The invitation

On the eve of the second round of voting in October 2002 Hrinak and Barbosa began to arrange for Bush to make a personal phone call to Lula if he won. The phone call's importance would go far beyond headlines in the Brazilian media. The news would help silence anti-Lula voices in the U.S. government itself.

A phone call from a U.S. president can take months of negotiation. Hrinak remembers, "No one doubted that Bush would call if Serra would win ... but would he call Lula? And the mood in Washington was that Bush would not call immediately, he would wait. "

The meeting between Bush and Lula on December 10, 2002, revealed that the American right could do business with the Latin American left.

Just hours after the votes were counted, Bush called Lula from Air Force One, saying "Congratulations on a great victory ... you ran a fantastic campaign. We followed it closely. We were very impressed with your ability to gather this vast majority." Bush did not stop there: "If you're interested in me receiving you in Washington DC, any time, I look forward to getting to know you..."

Lula accepted immediately: "Mr. President, I hope we can meet before the end of the year. We will have many things to discuss. "

A visit had not been scripted, nor had it been discussed previously with the State Department or the

Today, in Washington, you can hear that Brazil is an obstacle to be ignored or punished. In Brasilia, the whisper in some offices is that it is not worth betting on the relationship with Washington.

National Security Council. Bush accepted the Brazilian proposal impromptu.

It was unusual for President Bush to meet presidents-elect. However, the situation was special. Condoleezza Rice, national security adviser, insisted that "Brazil is too important to be ignored." Besides, Rice and Bush had respect for Brazil. While many countries had pledged support to them if the U.S. invaded Iraq, Brazil had always said it would not. As Rice recalled, "One thing that counted in favor of Brazil was that it had always been honest with us about its position."

Setting the tone

Two days after talking with Bush, Lula met with Hrinak. "I'm prepared for this," he said. A meeting in the Oval Office, she told him, is like a delicate dance. Each side will wait for the other to take a step. "It's important to avoid surprises." "There will be no surprises," Lula reassured her, "My government will not be ideological."

Lula had understood the message perfectly: He needed to build the confidence of the Americans. Lula told Hrinak that his relationship with Cardoso was great. He expressed admiration for Franklin D. Roosevelt, Lyndon B. Johnson, and John F. Kennedy. He said he had read a translation of a speech by President Johnson on the "War on Poverty" to a group of PT activists without telling them who had written it.

He also said, "People should not confuse our youthful admiration for the Cuban revolution with our position on the current Cuban regime." He characterized himself as a defender of political and economic freedom for all peoples, and noted that there was no freedom in Cuba.

Lula took utmost care with his words. While he criticized Bush's increasingly bellicose stance on Iraq he emphasized that keeping everything within the UN was important because America was the centerpiece of global order.

The legacy

The meeting between Bush and Lula on December 10, 2002, revealed that the American right could do business with the Latin American left. It created the profile of Lula as a statesman. And although Bush was not liked in Brazil, it created an unprecedented reserve of goodwill. As the meeting ended, Bush and Lula decided to meet again in 2003. When they did, they presided over the largest bilateral meeting in history.

The honeymoon ended a few years later, choked by deep disagreements about Cuba, Honduras, Iran, Iraq and international trade. Today, during a new presidential transition, the relationship is going through a difficult time. In the corridors of power in Washington, you can hear that Brazil is an obstacle to be ignored or punished. In Brasilia, the whisper in some offices is that it is not worth betting on the relationship with Washington either due to Obama's troubles at home, State Department sentiment with regard to Brazil, or a belief in the decline of American power.

Both views are wrong, though. Looking back on Lula's first presidential trip to the U.S. might help to change the present situation.



Brazil and Africa: Productive technical cooperation



Lia Valls Pereira

In 2008 the Brazilian government launched the Productive Development Policy (PDP), which recognized the importance of integration with Africa as well as Latin America and the Caribbean. In 2009 the government detailed goals and initiatives for Africa. The goal is to increase Africa's share in Brazil's total exports by 5%. The 20 strategies to do so relate to finance and investment promotion, foreign trade, and cooperation and knowledge transfer.

Technical cooperation is an instrument that developed countries have always used in their relations with developing countries. Among other complaints, it has been criticized regularly as merely a way of ensuring a market for exports and imposing technology standards. However, when countries lack resources and knowledge, well-designed technical cooperation can facilitate their development.

In June 2010 a seminar sponsored by the Brazilian Center for International Relations (CEBRI) discussed the technical cooperation

Lia Valls Pereira heads the Center for External Sector Studies of the Brazilian Institute of Economics, Lia.Valls@fgv.br

Technical cooperation is an instrument that developed countries have always used in their relations with developing countries.

of Brazil and China in Africa. It was clear that Brazilian cooperation would be different not only from that of both China and developed countries. For one thing, it is not associated with immediate economic interests.

The ABC

The Brazilian Cooperation Agency (ABC) was established in 1987. Since 1996 it has been part of the General Secretariat of the Ministry of Foreign Affairs (MRE), though other ministries and government agencies are involved in technical cooperation. The Oswaldo Cruz Foundation (FIOCRUZ, which does biomedical research and development) and the Brazilian Agricultural Research Corporation (EMBRAPA) also carry out cooperation agreements with African and Latin American countries.

The ABC does not transfer grants or loans to other countries. Instead, it organizes and supports teams of Brazilian technicians and sends them to work on local projects. Instead of designing programs for countries, it responds to requests from embassies and Brazilian and foreign government agencies.

Projects start with exploratory missions that visit a site and exchange experiences with local communities, so they do not simply replicate the Brazilian experience. Brazil has the flexibility to adapt its instruments for local governments to use autonomously. Brazil is now working with four agricultural infrastructure projects in Africa and with worker training programs led by the National Service of Industrial Learning (SENAI). In 2009 Africa received 50% of ABC funds, followed by South America (23%) and Central America and the Caribbean (12%). The funds are spent primarily on travel and lodging for Brazilian experts.

The importance Brazil attaches to cooperation is illustrated by the rise in the number of ABC projects from 19 in 2004 to 413 in 2009. ABC also cooperates with other agencies, such as the Japan International Cooperation Agency, the German Deutsche Gesellschaft für Technische Zusammenarbeit and the British Department for International Development.

The ABC does not address inter-regional cooperation, which is handled by other units of the MRE. Its Department of Regional Mechanisms monitors two agreements that involve African countries: the India, Brazil, and South Africa Forum (IBSA) and the South America and Africa Summit (ASA).

IBSA has a cooperation fund, to which each member country contributes US$1 million a year. The objective is cooperation on projects that can be replicated and sustained by communities in recipient countries, disseminating best practices to combat hunger and poverty that countries can incorporate into their own policies.

The South-South Unit of the United Nations Development Program in New York manages the IBSA fund. Proposed projects are submitted by less

developed countries through the Brazilian, Indian, and South African governments. Among countries benefiting are Haiti, Guinea-Bissau, Burundi, Cape Verde, Palestine, Cambodia, and Laos.

The ASA has not worked so well. It requires the 12 South American countries to coordinate with 54 African countries. Brazil coordinates for South America, Nigeria for Africa, but in practice, the African Union leads, with its agenda reflected in the projects submitted.

Other initiatives

The 2009 PDP specified the following goals:

- strengthening systems of weights and measures in Africa, with the support of both ABC and Brazil's National Institute of Metrology, Standardization and Industrial Quality;
- transferring institutional technology to promote industrial skill development (Brazil's National Institute of Industrial Property, PTO);
- promoting the creation of African entities to support small businesses (Brazil's Agency for Support to Entrepreneurship and Small Business Owners and the ABC);
- promoting technical, scientific, and innovation cooperation (Brazil's Ministry of Science and Technology);
- transferring knowledge in urban development (Brazil's Federal Savings and Loans and the ABC);
- partnering Brazil's Agricultural Research Corporation with African institutions;
- building a pharmaceutical plant in Mozambique (FIOCRUZ); and
- reinforcing the IBSA dialogue.

Besides the PDP's plan there are other initiatives. FIOCRUZ began its cooperation activities in the 1990s in the Portuguese-speaking African countries, sending instructors to help disseminate recommendations on public health. In 2005 it expanded its activities to infrastructure projects. The objective is to provide institutional capacity for each country to create its own public health governance and build its systems. A school of public health was established in Angola and national institutes of public health in Angola, Guinea-Bissau, and Mozambique. In 2008 FIOCRUZ opened an African cooperation office in Maputo, Mozambique.

Development cooperation is facilitated when challenges are similar in African countries and Brazil in such areas as health, agriculture, and poverty reduction.

Brazil's Ministry of Social Development and Fight Against Hunger (MDS) provides technical assistance on cash transfer programs for poor families, food security and nutrition, social assistance, program evaluation, and information management. Its programs are based on MDS programs carried out in Brazil.

Altruism?

China's cooperation is more centrally planned and coordinated and is guided by the country's strategic plans. Its cooperation has strategic and economic ramifications; for instance, it may construct stadiums and buildings for African governments at no cost. Brazil operates in areas

Africa's participation in Brazilian exports peaked at 5.7% in 2009 but fell to 4.6% from January to November 2010.

that are less directly related to economic interests, but the fact that the ABC is part of the PDP makes it clear that coordination is an economic policy tool for Brazil.

Diplomat Samuel Pinheiro Guimarães summarized the guidelines of Brazilian cooperation in Africa when he was Chief Minister of the Strategic Affairs Secretariat of Brazil. Cultural and historical ties unite Brazil and Africa, and because Brazil has political interests related to South-South coalitions in multilateral agencies, alliances with African countries are even more welcome. Economic interests are clear in the promotion of investments in Africa by Brazilian corporations. Development cooperation is facilitated when African countries and Brazil have similar challenges in areas like health, agriculture, and poverty reduction. The importance of Africa in Brazilian foreign policy can be measured by the number of embassies there: 16 countries in 2002; 35 in 2010. According to Ambassador Guimarães, "Embassies are only opened in countries where there are mutual political and commercial interests."

Benefits and costs

How much does Brazilian technical cooperation cost? No funds are transferred directly, but there are staff, travel, and equipment costs. The absence of a strategic plan is one of the concerns of Brazilian experts who made presentations at the June CEBRI seminar.

Monitoring projects through the Information System for International Agreements could provide useful information for assessing future programs. The MRE and the Institute of Applied Economic Research have therefore initiated a survey on cooperation activities undertaken by various agencies.

The increasing demand for cooperation will require formation of a network of managers and experts. With resources limited, it is necessary to have a cooperation plan on which to set priorities. Without a central plan, agencies try to preserve their autonomy and use their performance models to reflect their own priorities. This raises a risk of fragmentation of initiatives that would affect continuity, consistency, and ability to evaluate results.

Brazil cannot ignore the potential of the African market. Africa's share of Brazilian exports peaked at 5.7% in 2009 but fell to 4.6% (January-November 2010). Political instability and conflict were in the past widespread throughout sub-Saharan Africa, but African countries rich in natural resources have shown high growth rates since this century began, and the outlook is hopeful. For 2011 the International Monetary Fund predicts growth for natural-resources-rich countries of 6.4% and for resource-poor countries of 5%.

But the Brazilian technical cooperation agenda cannot be evaluated only by potential economic gains. Sending national experts and designing technical assistance programs in other countries is an experience that brings new knowledge not only for Africans but also for Brazilians.

Wanted: Discussion on the fiscal-monetary policy mix



Rubens Penha Cysne

There is recurrent discussion in the press about the benchmark interest rate fixed by the Central Bank Monetary Policy Committee (COPOM) at its regular meetings. Less common, but economically much more relevant, is debate about how the inflation target for each year is set. A truly independent central bank should be publicly questioning whether fiscal policy as conducted by the Treasury is consistent with the annual target. Otherwise, a target that might be desirable for inflation may be bad for the country.

A more efficient institutional design, one that is also common in international practice, is for the Ministry of Finance to set the inflation target for the central bank, taking into account political considerations about, for instance, the optimal trade-off between short-term inflation and employment. The central bank would then make public its estimate of the maximum nominal public deficit that would be consistent with that target over the next few years.

In a flexible exchange rate system where capital is mobile, the central bank could use a very simple argument to argue for fiscal consistency: "If fiscal policy is not consistent with the inflation target, the only interest rates the central bank can set to meet the inflation target will be too high. That will deter private investment and growth of the economy. Such rates would also attract short-term international capital that would cause our currency

Rubens Penha Cysne is Director of the Graduate School of Economics of the Getulio Vargas Foundation (EPGE / FGV),http://www.epge.fgv.br/users/rubens/

A truly independent central bank should publicly question whether the fiscal policy conducted by the Treasury is consistent with the required inflation target.

to appreciate too much, which would carry the danger of adding imports and reducing exports. The consequences would be lower employment and the closing of some [or many] factories. It is not clear that with such a fiscal policy, setting interest rates to meet previously defined inflation targets would be effective for the country as a whole."

Making such an argument and promoting public discussion on the matter at the time the inflation target is being established should be an obligation of every governor of an effectively independent central bank. First, such a debate would protect the monetary authority from political pressures when setting interest rates to meet its statutory obligations of carrying out monetary policy. Second, it would also make clear the source of the problems for those who complain of excessive exchange rate appreciation.

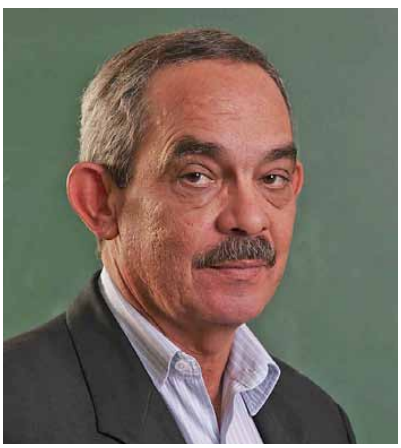
In short, at the time the annual inflation target is set generating public discussion on the most appropriate fiscal and monetary policy mix is important to change the focus of discussion from the interest rate set by the COPOM to the amount and quality of public expenditure. If the central bank could encourage such a public debate, it would be a better measure of its independence from the government.

Today, incisive and public questioning of fiscal policy by the central bank is still very far from our reality. There is, moreover, an institutional obstacle that makes such questioning difficult, though not impossible. In Brazil inflation targets are determined by the National Monetary Council, whose members are the President of the Central Bank, the Minister of Planning and the Minister of Finance (chairman of the Council). Ideally, the Treasury alone would set the inflation target, as is done in other countries.

In this new context, discussion about the budget and macroeconomic policy would take precedence, at the expense of repeated discussions about how high central bank benchmark interest rates are, or are not. The change would also add value to the legislature: transparent and honest discussion of excessive earmarking and obligatory expenditures could revitalize the prestige of the current legislature.

The monetary authority engaging more actively in public discussions on the appropriate fiscal and monetary mix could create a virtuous circle: Subsequent discussions about earmarking and other budgetary practices that are not compatible with a presidential democracy could lead to a better balance between powers and generate a more constructive type of argument between the legislative and the executive. This conflict, as we know, can be very constructive when well designed.

The Central Bank under Lula



Fernando de Holanda Barbosa

The Central Bank of Brazil[1] during the Lula administration did a good job in controlling inflation, complying strictly with inflation targets set by the National Monetary Council (CMN). Its reserves policy, on the other hand, has produced an accumulation of reserves that is not justifiable for a country with a flexible exchange rate system. The social cost of maintaining large international reserves is incompatible with the needs of a still large poor population. Nor has the Central Bank performed satisfactorily as a regulator of the financial system; it should create a committee to take over this function. Finally, the Central Bank has done well as the lender of last resort. It acted promptly and created the necessary domestic liquidity in 2008 to prevent a spillover of the international financial crisis onto Brazil.

Inflation under control

Since 1999 the CMN has set the inflation target. Its members are the President of the Central Bank, the Minister of Planning, and the Minister of Finance, who presides. The Central Bank since the Real Plan[2] has had in effect operational independence to implement monetary policy, even though it does not have

Annual inflation targets (%)

	Target range	Actual inflation
2003	2 - 6	9.30
2004	3.5 - 7.5	7.60
2005	2.5 - 6.5	5.70
2006	2.5 - 6.5	3.14
2007	2.5 - 6.5	3.14
2008	2.5 - 6.5	5.90
2009	2.5 - 6.5	4.31
2010	2.5 - 6.5	5.80*

*Projection.

Fernando de Holanda Barbosa is a professor of economics at the Graduate School of Economics of Getulio Vargas Foundation (EPGE-FGV).

Since 2004 the Central Bank has fully complied with the CMN inflation targets.

such independence statutorily. In the Lula government, when he accepted the job Central Bank governor Henrique Meirelles obtained the "closed gate," which gave him freedom to choose, without political interference, all Central Bank board members.

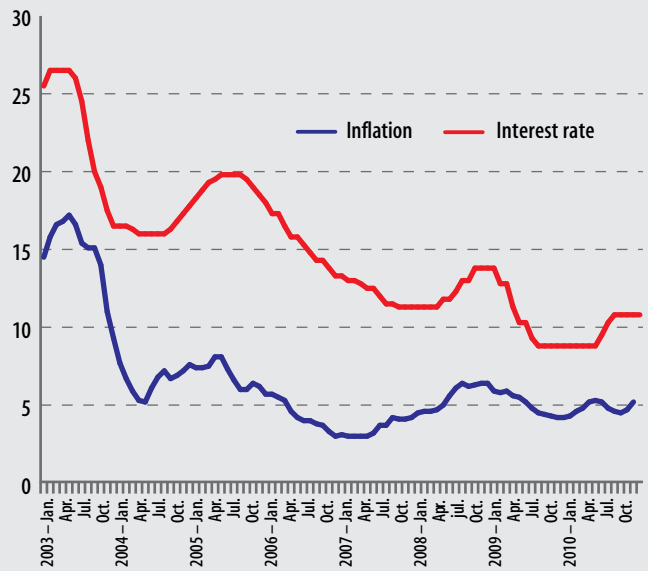
In 2003 the Central Bank was not able to meet the CMN inflation target because of "the Lula effect." Much of Brazilian society thought that the victory of the Worker's Party candidate in the 2002 election meant that default on the public debt was quite possible. The resulting capital flight depreciated the exchange rate substantially, increasing the prices of goods and services. Much of the population also believed that the Central Bank under Lula would not use interest rates to contain inflation. As inflation expectations increased, inflation threatened to jump. The Lula administration had to deal with these public perceptions in its first year, so it increased both the interest rate and the fiscal primary surplus (fiscal deficit less interest payments).

Since 2004 the Central Bank has fully complied with the CMN inflation targets. In 2006, 2007, and 2009 inflation was below or near the center of the band, and in the other years, it was slightly above the center.

The criticism that the Central Bank blundered by increasing the interest rate excessively is unfounded. If this were the case, the rate of inflation would have been systematically below the center of the target. That did not happen. Indeed, the data suggest otherwise: in the eight years of the Lula government, inflation was above the center of the target range in five.

Monetary policy during the Lula government can be divided into four cycles. The first began in January 2003 and ran through April 2004. At that cycle, to rein in inflation the benchmark interest rate peaked at 26.5% early on and had begun to fall by June 2003. An interest rate of 16% is the lowest in this cycle. The second cycle, the longest, began in November 2004 and ended in April 2008. During it the interest rate peaked at 19.75% and the trough was 11.25%. The third cycle began in April 2008, when the COPOM

Inflation versus Central Bank benchmark interest rate



increased the benchmark rate to 11.75%, and ended in March 2010, when the annualized interest rate was down to 8.75%. During this cycle, the benchmark rate peaked at 13.75%. In January 2009 COPOM reduced the rate by 100 basis points, setting it at 12.75% to counter the threat of the international financial crisis, and continued to reduce the rate down to 8.75%. The fourth, a tightening cycle, started in March 2010 when the benchmark rate increased to 9.50% and ended the year at 10.75%. This last cycle is unfinished. The benchmark rate will certainly increase in coming months to curb inflation

It appears from these cycles that the Central Bank was not able to fine-tune a soft landing. After each monetary policy tightening cycle, the Central Bank would try cutting interest rates gradually, only to have to raise them again abruptly.

It is also noticeable that the difference between interest rates at the peak of a cycle and at the trough has become smaller. This corresponds to a reduction in the economy's natural rate of interest, which was extremely high at the beginning of the Lula government but has been falling since. The reduction is associated with the falling rate of interest on public debt in Brazil. Rates fell for two reasons: The first was President Lula's decision to honor contracts and pay the public debt. As a result, Brazil's sovereign risk fell substantially. The second was that interest rates on its public debt also dropped because of excess global liquidity.

The Central Bank benchmark interest rate is contaminated by the rate on Brazilian public debt because Treasury bills are indexed to the benchmark rate. Arbitrage in financial markets implies that the interest rate in the interbank market for reserves, the benchmark rate, would be equal to the interest rate on government securities. This creates a bizarre situation: short-term liquidity in Brazil is remunerated at the same rate of interest as long-term bonds. The Central Bank during the Lula administration ignored this fact; as a result Brazil still has the highest short-term interest rates in the world.

The real reason for the accumulation of large international reserves since 2006 was to prevent the exchange rate from appreciating.

Inflated International reserves?

The Central Bank in 2006 changed its policy and began to accumulate international reserves. In a pure flexible exchange rate regime, central banks do not intervene, leaving the market to set the price of currency. In practice, the flexible exchange rate regime is "dirty" floating — central banks do intervene. Why? For several reasons: A central bank may act to reduce foreign exchange market volatility. Or, because the foreign exchange market is an asset market, the central bank intervenes every time it believes there is a destabilizing asset price bubble. Or the central bank may accumulate reserves in case an international financial crisis stops the flow of credit to the country, causing an abrupt change and a deep devaluation of the exchange rate.

The Central Bank created liquidity tools that nipped the crisis in the bud and kept the problems of the international crisis out of Brazil.

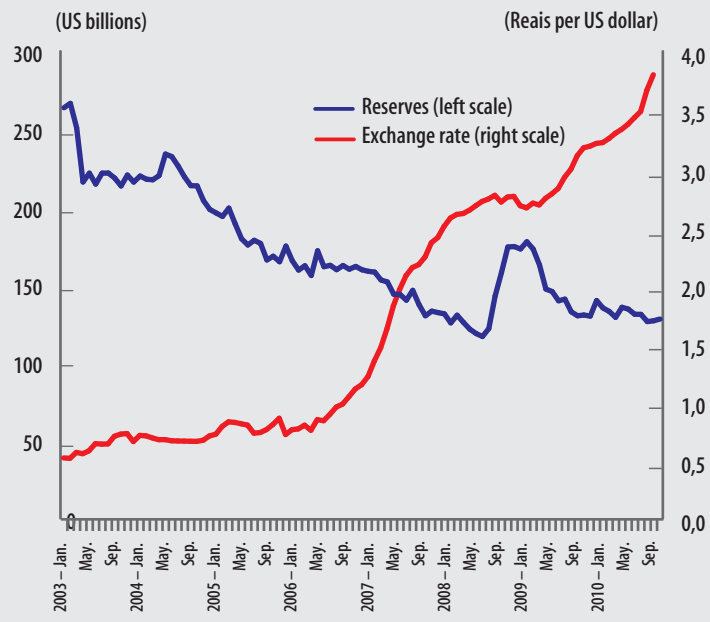
Accumulating reserves has a cost. Sterilization of reserves requires that funding in the national currency (*reais*) at the benchmark interest rate, while remuneration of international reserves is close to zero because reserves are invested in foreign short-term securities with very low yields. Those who advocate a policy of large international reserves argue that reserves are insurance against crisis and the cost is simply an insurance premium (even though estimates suggest that the price of this insurance is excessive). Advocates also argue that the 2008 financial crisis showed that international reserves were essential to reducing the international financial crisis tsunami to a ripple in Brazil. The numbers do not support this argument either, because at that time Brazil used only a fraction of its reserves.

The real reason for the accumulation of large international reserves since 2006 was to prevent the exchange rate from appreciating. Officially, the Central Bank does not interfere in the market. In practice, the policy of accumulating reserves was intended to prevent appreciation of the *real*. To what extent did the Central Bank prevent a much greater appreciation than the one that took place? That is a difficult question to answer. However, if the intent is to prevent appreciation of the exchange rate, why not use fiscal policy?

Financial system regulation

The Central Bank is the regulator of the financial system. In other countries, the institutional arrangement is different. For example, the European Central Bank is not responsible for regulating the financial system. Why should we regulate the financial system? Economic theory of information has advanced greatly in recent decades, and has been studying the problems posed by asymmetric information: the accountholder is the last to know. The bank knows

Exchange rate and international reserves



what it is doing with your money, but you usually do not. A central bank has to issue rules and procedures that discourage practices detrimental to the social interest. Moreover, the entry of new firms into the banking sector is not free; it must be authorized by the central bank. Barriers to entry give existing financial institutions market power to increase lending interest rates and keep deposit interest rates low and charge exorbitant fees.

In the Lula administration, several banking mergers and acquisitions took place that increased concentration in the sector. Here, the Central Bank as regulator of the financial system has let us down: banking services are expensive, and banking spreads are large. Brazil may even be the world champion in banking spreads.

Lender of last resort

Central banks are vital in any financial crisis. They are the lenders of last resort, preventing an institution that has funding difficulties from becoming insolvent and contaminating other institutions in the system. The financial crisis triggered in 2008 in the U.S. by the market for subprime mortgages showed that this function has much wider scope than it had in the past; even quasi-financial institutions received central bank bailouts. Otherwise, a major recession might have become a depression.

Here in Brazil, during the international crisis some small and medium banks had difficulties accessing external credit lines to finance their operations. If the Central Bank had not helped, they would have had to sell assets for very low prices, making the situation worse. This did not happen because the Central Bank created liquidity tools that nipped the crisis in the bud and kept the problems of the international crisis out of Brazil.

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[1] The Central Bank of Brazil, according to Law 4595 of December 31,1964, and subsequent legislation: (i) implements monetary policy; (ii) formulates and executes international reserves policy and manages reserves; (iii) is lender of last resort for the financial system during liquidity crises; (iv) regulates and supervises the financial system; (v) manage and oversees the system of government payments; and (vi) acts as a bank for the government.

[2] The Real Plan was a set of measures that successfully stabilized the Brazilian economy and brought inflation under control in 1994, under then Finance Minister (later President) Fernando Henrique Cardoso. On July 1, 1994, it introduced a new currency, the *real*, and enacted a number of fiscal and monetary measures, increasing tax revenues, restricting public expenditures, and raising interest rates.