“This report sheds some light on Brazil and its future importance to Australia and the world by bringing together a series of perspectives on Brazil’s recent economic transformation, its economic history, its place in the world economy, and its relationship with Australia.”

Fernando Cardim, Professor of Economics, Federal University of Piauí, Brazil

“Patrick Carvalho is an Associate Lecturer at the AMU Research School of Economics and Senior Advisor to the School of Economics at the University of New South Wales (UNSW).”

Tim Harcourt, author of The Abbot Economist, is the J.W. Hardie Fellow in Economics at the University of New South Wales (UNSW).

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ABOUT THE LOWY INSTITUTE

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GREAT SOUTHERN LANDS
BUILDING TIES BETWEEN AUSTRALIA & BRAZIL
Great Southern Lands: Building Ties between Australia and Brazil

Fernando Cardim
Patrick Carvalho
Tim Harcourt
Mark Thirlwell
CONTENTS

About the authors 03
Acknowledgments 05
Foreword 07
Overview: Two lands – Two journeys 09
Chapter 1
What’s past is past: Brazil in the long run 23
Chapter 2
The country of the future? The rise of Brazil 39
Chapter 3
Southern hemisphere superpower? Brazil in context 71
References 95
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André Levy, CIO at m2RE, a property analytics firm serving the Brazilian market, Managing Director, Brazil Foundation Australia; Cristina Talacko, Managing Editor of BRAZILTalk, the founder and a director of SalDoce Fine Foods, Past President of the Australia-Brazil Chamber of Commerce from 2003 to 2012; William Frogley, Brazil Honorary Consul, South Australia; Claudia Jarjoura, Director of the architectural/interior design firm Jarjoura Design, Associate Director at the Brazilian architectural company e-DAU in Australia; Eric Winton, sport business consultant; Ashley White, Manager, BCA Austrade; Greg Wallis, Former Trade Commissioner, Sao Paulo (now in Bangkok); Kym Fullgrabe,
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Claudia is an excellent example of the talented human capital that has benefitted both Brazil and Australia, and as a native of Sao Paulo now living in Sydney she acts as an enthusiastic and inspirational ‘bridge’ between our two nations.
Message from H.E. Mr Rubem Corrêa Barbosa, Ambassador of Brazil to Australia.

Australia has long been very well regarded within Brazilian society as an example of a hard-working nation, almost as large in territory as Brazil, characteristically optimistic, and very much looking like being not only a country of the present, but one with a potentially very bright future too.

From Brazil’s point of view, Australia cannot be looked at as being a risk. It is true that it is expensive by Brazilian standards, but it is also stable, respectful of international rules, and is able to provide long-term returns. Those assets very much compensate for the eventual costs involved. Brazil and the whole of South America see themselves, on the other hand, as a very good option for Australia within the current world economic environment. Therefore, it is hoped that Australia also takes advantage of this in the coming years.

As well as natural resources and agriculture, Brazil and Australia are doing more together in education and technical cooperation. Australia sees Brazil as an important player in the international arena. It understands that the status of development between both countries is different. It has also realised that bilateral cooperation has room to move forward. On one hand, Australia has all the credentials and the respect gathered among other developed countries. Brazil in its turn has gathered considerable acknowledgements and respect among developing countries in the world. Both countries can advance together in providing cooperation in third countries too.

It is to be hoped that both the coming FIFA World Cup in 2014 and the Rio Olympics in 2016 will play an important role in projecting the image of a modern Brazil and a friendly country. The time was long overdue to hold the World Cup again since the last one that took place in Brazil in 1950. It will also be the first time ever that the Olympic Games will be held in South America. The whole region is therefore very much
anticipating both events and Brazil is doing everything it can to hold two wonderful and unforgettable events.

**Message from H.E. Mr Brett Hackett, Ambassador of Australia to Brazil**

The global interests of few countries coincide to the extent that those of Australia and Brazil do. The economies of both countries have grown, despite global economic instability, emerging in better shape than most other countries. In large part this was a reflection of sound economic management by our respective governments, but it also reflected the important buffer provided by our wealth of natural resources.

Probably for the first time in our respective histories, geography is working in our favour, with both Australia and Brazil located in regions which are the current engines of the global economy. We produce the minerals required by others to fuel industrial output and, as importantly, we provide agricultural commodities for increasingly affluent and sophisticated consumers. We should also reflect on the policy settings both countries must adopt if we are to maximise current and prospective opportunities to expand economic ties. In a number of sectors this is already taking place, most notably in education. Awareness is growing, on both sides, that our education sectors have considerable expertise in areas of shared economic interest, and there is enormous potential for collaboration, research and development. The financial services sector represents another opportunity, based on the sound prudential regulation of our financial institutions which have stood our financial institutions in such good stead in recent years.

We still need to tackle, head on, the perception that we are half a world apart from each other. If globalisation has shown us nothing else, it has demonstrated that distances are less important to international business than ever before. And, with the world’s attention turning to Brazil for the 2014 FIFA World Cup and 2016 Olympic Games, Brazil’s national brand will be on display. It would be a missed opportunity if both countries did not seek to harness this to strengthen bilateral ties. Accordingly, I welcome this report as laying out the ground work for future engagement between our two nations.
This is a story about two countries and two economies whose distance from each other meant that for many years their relationship was characterised by a mutual but largely benign neglect. Today, there is no question that Australia and Brazil have become more important to the future of the global economy, especially as Asia and the emerging economies take market share, and eventually geo-political influence, away from the G7 economies that have dominated the world’s international economic institutions. The question is, however, how important are they to each other? This report is a small step in the attempt to answer that question. In particular, it tries to shed some light on Brazil and its future importance to Australia and the world for an Australian audience. It does so by bringing together a series of perspectives on Brazil, its economic history and its place in the world economy.

Competitors or collaborators?

After years of dashed hopes, it now seems that we may finally be witnessing what US economic historian Charles Kindleberger predicted would be the ‘age of Brazil’. Brazil is now the 6th largest economy in the world and has successfully pulled more than 30 million people out of poverty under President Luiz Inácio Lula da Silva. That success is being recognised internationally in all sorts of ways, not least in Brazil’s successful pursuit of the ‘golden double’ in international sport, winning the rights to host the FIFA World Cup in 2014 and the Rio Olympics in 2016 – something no other country has achieved since West Germany ‘did the double’ in 1972 and 1974. Certainly, Brazil’s recent economic performance to stave off the worst impacts of the global financial crisis (GFC) has given some reason for the Brazil boosters to at last feel cautiously optimistic.

A key question is, what does Brazil’s emergence mean for Australia? Brazil is already frequently seen as a competitor in commodity exports to China, and in global markets for agriculture, resources and renewable energy. Under President Luiz Inácio Lula da Silva, Brazil made major diplomatic plays in the World Trade Organisation (WTO) and the G20, opened a record number of diplomatic posts globally (53 new Brazilian embassies including 30 in Africa), and became a ‘south-south’ champion in the developing world through the BRICS (Brazil Russia India China and South Africa) alliance. But Brazil is not without its problems. As the Brazilians interviewed in this study often point out, Australia’s orderly democratic institutions mean the country runs in a much less chaotic way than Brazil – something that many Brazilians admire. As Greg Wallis, a former Australian Consul-General in Sao Paulo noted to us in an interview, a famous expression in Brazil is “Australia é o Brasil que deu certo” – “Australia is the Brazil that turned out right”. In their highly influential tome Why Nations Fail? Daron Acemoglu and James Robinson single out Australia’s economic and political institutions for special praise, comparing them favourably with those of Brazil and other countries in Latin America, which started with similar resource endowments. Brazil knows that it has a lot to learn from Australian economic institutions just as Australian observers see attractions in Brazil’s education and dynamic international business culture.

In fact, although Australia and Brazil have similar resource endowments, this does not mean that the two countries should automatically be seen as competitors. There is an almost insatiable appetite for resources in China and the rest of Asia. The two countries are becoming collaborators in their areas of comparative advantage in mining and agriculture, with Australia and Brazil swapping technology, research and development and management know-how. For example, in the lead up to 2014 and 2016, Brazil is benefitting from a knowledge transfer from the organizers of the Sydney 2000 Olympics. Meanwhile, Australia is learning from Brazilian expertise in agriculture, management education and renewable energy.

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Getting to know each other

One key obstacle to expanding this collaboration is the fact that both countries still don’t know enough about each other. Distance, differences in culture, institutions and external ties all play a part in this regard. Historically, Australia looked to London and Brazil to Lisbon and although they both later came to pay much greater attention to the United States, it was for different reasons. Moreover, until recently Brazil’s focus has been very much internal as it struggled to meet the needs of its massive population. Nor has Brazil been much on Australia’s radar. Even those Australian businesses conscious of opportunities in South America have tended to focus on Chile and more recently on Peru and Colombia.

There are signs this is changing, at least in the Australian case. There has been a shift in official Australian attitudes towards Brazil since 2010. Federal parliamentarians are now more regular visitors, although they are now competing with massive delegations from countries such as Germany, China, Japan, South Africa, the United States and the European Union, who have been visiting far more regularly. There is now a lot more competition for Brazil’s attention and it seems Australia may have suffered as a result.

According to AMR Managing Director Oliver Freedman, “the bad news is Australians and Brazilians are a mystery to each other, but the good news is of the little they do know, they like.” Each year AMR polls citizens of selected countries as to their perceptions of other nations. For many years, according to Freedman, Australia polled very highly (usually in the top 5 countries) of Brazilians’ preferences of what a country is ‘like’ to do business in, visit, study in and how it engages with the rest of the world. However, Freedman notes a deterioration in Australia’s standing in Brazil in recent years as the lustre of the Sydney Olympics has worn off. According to AMR, Australia is now ranked 12th in terms of overall reputation by Brazilians, but in the same survey in 2010 Australia ranked second. Freedman believes that Australia enjoyed a reputational boom in the years immediately after the Sydney Olympics but that this is now long gone. Hence Australia’s need to do something ‘special’ on the world stage (like hosting a FIFA World Cup) and Brazil is also conscious of its

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3 Interviewed on 19 March 2013 in Sydney.
own capacity to leave a lasting legacy after the carnival is over and the FIFA World Cup and Olympics leave their shores.

Some of the AMR branding survey data is also reflected in individual perceptions. When talking to individual Brazilians and Australians on the expert panel, they too admitted not knowing much about each other’s country in the initial phases.

“To be honest, it was completely outside my radar. I knew it’d be English in culture and Californian in climate, but that was about it.”

André Levy, Managing Director Brazil Foundation, Australia.

“I had not met a Brazilian person in business prior to my move. Prior to coming to Brazil, I knew little about the country. Football, Carnival, the tourism icons of Rio, amazing beaches and girls were my only reference points.”

Peter Huddle, Chief Operating Officer of Westfield Almeida Junior in Brasil.

**What needs to be done?**

Politically and diplomatically there remains great scope to strengthen the bilateral relationship. Julia Gillard was the first Australian Prime Minister to visit Brazil, following increased visits by senior Australian politicians in recent years. A Brazilian President is yet to visit Australia, however. There is potential for Australia and Brazil to work together more closely in multilateral fora. A good example is the Cairns Group where the two countries forged links with a number of other exporting nations to fight for the liberalisation of global agricultural trade. Both countries are also members of the G20 and could cooperate on areas of mutual interest in that grouping, although as experience in the World Trade Organisation has shown, that can sometimes be challenging given Brazil’s aspirations to be a leader of a developing country bloc on some key issues.

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4 Interview with André Levy, Managing Director Brazil Foundation Australia 21 November 2012, Sydney.

5 Interview with Peter Huddle, Chief Operating Officer, Westfield Almeida Junior Brasil, 2 February 2013, Sao Paulo.
According to Brett Hackett, Australia’s Ambassador to Brazil:

“Our economic successes accord Australia and Brazil greater authority in determining the shape of global economic architecture. But with success comes responsibility, and we now share a greater burden in the governance of the global political economy than at any time in our histories. Leaving aside the United Nations Security Council, of which Australia is currently a member, and of which Brazil (with Australia’s support) desires permanent membership, nowhere is this more evident than in our membership of the G20, and our role in ensuring that the global economy returns to growth and prosperity.

As two influential members of the World Trade Organisation, Brazil and Australia share a commitment to ensuring recognition of the importance of trade liberalisation, particularly in agriculture, to achieving economic growth. Many, including developing countries, increasingly look to Australia and Brazil for leadership.”

Ambassador Brett Hackett.

The real prospects for deepening Australia-Brazil ties lie in expanding the trade and investment relationship. As part of the research for this project we spoke to a panel of Brazilian and Australian experts with a strong familiarity with both countries and the bilateral relationship. The panel included business professionals from fields as diverse as diplomacy, law, politics, architecture, education, agriculture, mining, arts and culture and sports administration.

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6 Interview Ambassador Brett Hackett, 12 March 2013, Brasilia.

7 The expert panel consisted of: André Levy, CIO at m2RE, a property analytics firm serving the Brazilian market; Managing Director, Brazil Foundation Australia; Cristina Talacko, Managing Editor of BRAZILTalk, the founder and a director of SalDoce Fine Foods, Past President of the Australia-Brazil Chamber of Commerce from 2003 to 2012; William Frogley, Brazil Honorary Consul, South Australia; Claudia Jarjoura, Director of the architectural/interior design firm Jarjoura Design, Associate Director at the Brazilian architectural company e-DAU in Australia; Eric Winton, sport business consultant; Ashley White, Manager, BCA Austrade; Greg Wallis, Former Trade Commissioner, Sao Paulo (now in Bangkok); Kym Fullgrabe, Trade Commissioner, Sao Paulo; Peter Beattie, former Premier of Queensland, Queensland Trade Commissioner to the Americas; Sally Anne Atkinson, Brazil Honorary Consul Queensland; Osanan Barros, O & B Consulting, former Managing Director, Banco de Brasil, International Division; Oliver Freedman, Managing Director, AMR; Rob Grant, CEO, Pacific Hydro, Brazil; Ronaldo C. Veirano Chairman of Veirano Advogados, Honorary Consul General for Australia in the City of Rio de Janeiro; Juliana Bernardi Festival Manager, Brazil Film Festival, South Australia; Juliana Scalco Brum, Director of the Australia Brazil Chamber of Commerce South Australia; and Peter Huddle, Chief Operating Officer of Westfield Almeida Junior, Brazil. And a special thank you to H.E. Mr Rubem Corrêa Barbosa, Ambassador of Brazil to Australia and H.E. Brett Hackett, Australian Ambassador to Brazil.
The panel identified a number of key initiatives that would assist in strengthening the bilateral relationship. These included:

- Stronger aviation links (preferably direct links but if these were not feasible initially, then at least more regular services via Santiago de Chile, through strategic alliances between Qantas, LAN and TAM).
- Closer education ties in terms of institutions, research and development initiatives, scholarships and exchanges: (especially in science, mining engineering, agricultural science, fine arts, architecture and MBAs).
- Building closer trade ties through multilateral, regional or bilateral arrangements (FTAs).
- Closer tax and investment arrangements. Many of the panel suggested closer arrangements to prevent double taxation as has occurred between Australia and Chile and also more standardised investment arrangements.
- Bilateral studies of best practice institutions in each country (Subjects suggested for such studies included Brazil’s state education system, diplomatic career structure, Australia’s economic reform experience, superannuation system, and public policy governance).
- Business networking around 2014 FIFA World Cup and 2016 Rio Olympics (Australia should leverage the opportunities presented by these forthcoming major sporting events to build business connections. The most obvious model for this is the successful Business Club Australia program that Austrade ran at previous Olympic Games, Rugby and Football World Cups and other major international sporting events at home and abroad.)

Beyond these specific initiatives, the panel also identified a number of key industry sectors that should be the focus of any effort to strengthen the bilateral relationship.

**Resources and agriculture**

Both Brazil and Australia are major commodity exporters. The resources trade, and particularly the relationship with China, is one common feature of both countries’ international economic profiles. While Brazil and Australia may ‘compete’ in the iron ore and steel space, with BHP Billiton,
Rio Tinto on the Australian side and Vale on the Brazilian side, there will be opportunities for collaboration between junior miners and small and medium sized enterprises (SMEs) that provide services, technology and equipment to the mining sector. For instance, Australian railway suppliers have been supplying railway infrastructure to Brazilian mines (Brazilian railways are often privately owned by mining companies). Australian technology companies provide similar services to the industry in Belo Horizonte in mining services, equipment to mining and in professional services associated with construction and infrastructure. Likewise, the Brazilian agricultural sector transfers technology and knowledge to their Australian counterparts who in turn assist in terms of agribusiness services. An example may be found in the outstanding contribution of Embrapa (Empresa Brasileira de Pesquisa Agropecuaria) to Brazil’s agricultural transformation, which is Brazil’s equivalent of the CSIRO (the Commonwealth Scientific and Industrial Research Organisation). Embrapa is well co-ordinated and focussed. There could be opportunities for the CSIRO to collaborate with Embrapa, as both nations face major climactic challenges.

The Brazilian food industry is a major world player and a source of comparative advantage for Brazil. For example, in Australia, a leading Brazil food exporter, Saldoce, was set up by Cris Talacko, a member of our expert panel. According to Talacko, Australia sometimes underestimates the sophistication of Brazil’s global manufacturing in the food industry and in other sectors. She argues that “Australia could learn from Brazil in terms of development of a manufacturing industry with government support that assists in diversifying the risks of a mono-focussed economy. I think Australia relies too much on the mining and primary resources industry.”

Another member of the panel, the Brazil Foundation’s André Levy, observed:

“An area that Brazil sets the example is in the industrial policy. The Australian government seems to have given up on its role to make industrial policy, letting the mining industry abduct the country’s currency, ultimately crowding out other industries. In the last decade, Australia deindustrialised and even disserviced itself. Brazil has learned its lessons from centuries of exploitation, from gold

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8 Interviewed 11 February 2013, Sydney.
to sugar to coffee and rubber, beset by a monoculture-monoclient economic model. That is an experience Australia can benefit from as Australians typically underestimate Brazil’s technological advancement.”

André Levy, Brazil Foundation Australia

Whilst accusations are made about Australia being overreliant on resources relative to Brazil, one notable feature of the Australian economy over the past decade has been the ability of professional services and manufacturing to provide inputs to the resource sector and therefore benefit from the resources boom. Strength in areas where Australia has a comparative advantage need not adversely affect other sectors, nor inhibit Australia’s international competitiveness or economic performance. The Australian experience in this regard provides important lessons for Brazil given our similar resources endowments and strong currency. Australia has avoided the internal cost structure pressures that Brazil has experienced (the so called ‘Brazil prices’) due to industrial policy or building unsustainable projects (as discussed by our Brazilian colleagues in Chapters 1 and 2 below).

Transport

Given the physical size of Brazil and Australia, transport and infrastructure, are crucial to their internal and external economic efficiency and international competitiveness. Brazil has the advantage of being one of the world’s largest aviation manufacturers and markets (through companies like Embraer), but deficiencies in its ground transport infrastructure capacity issues are becoming exposed especially in the lead up to the 2014 World Cup and 2016 Olympics. One of our panellists, Peter Huddle, an Australian businessman based in Brazil, noted that Brazil has experienced a tremendous growth in personal prosperity in the last decade. But the key cities have incredible bottlenecks around infrastructure planning and the road system is ‘beyond breaking point’:

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9 Interviewed 21 November 2012, Sydney. Whilst these are observations regularly made by Brazilian (and even Australian observers), in fact there is no economic evidence that Australia has suffered from the ‘Dutch disease’ (or in Australia ‘the Gregory effect’ named after Australian National University (ANU) Economics Professor Bob Gregory).
“The super rich have given up using cars and I look outside my office window amazed at the uncontrolled helicopter traffic criss-crossing the commercial rooftops, many fitted with landing pads. The public transport system is underserviced, road-based and troubled with corruption. Importantly in mega cities like Sao Paulo, the public transport system which is one of the keys to future prosperity, has a cultural issue. The Brazilians are very class focussed and the strong perception (and reality) is that only the lower working class use public transport.”

Peter Huddle, Chief Operating Officer of Westfield Almeida Junior in Brasil.

Brazilian members of the panel thought that the Australian experience could be of some benefit to Brazil. Brazilian business leader and expert panel member Osanan Barros thought for example, that “Brazil could learn from Australia’s way of administration of public services, public health, ports and airports, traffic and city managements.”

New South Wales used its hosting of the Sydney Olympic Games in 2000 to upgrade its transport logistics and infrastructure. Brazil, and the state and city of Rio de Janeiro, have the opportunity to do the same in 2014 and 2016 to provide a lasting legacy for its citizens once the carnival is over, and would benefit from the Australian experience in this regard.

**Better cities**

Closely related to the potential for greater cooperation in the transport and infrastructure sectors are the prospects for collaboration in urban design. Brazilian born architect Claudia Jarjoura, who is now based in Sydney, believes this is a key area where Australia and Brazil can work together given the similarities in climate, geography and the transport preferences of Brazilian and Australian urban dwellers. She notes that Australia can be a model for Brazil in urban planning and organisation, but she also felt that Australia underestimates what a partnership in this sector offers it as well:

“The majorities of Brazils are going through a process of re-urbanisation in order to solve many issues they face such as transportation, housing and poor living conditions. Both countries, Brazil and Australia can benefit from the exchange...”

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10 Interviewed 2 February 2013, Sao Paulo.

11 Interviewed 18 January 2013, Melbourne.
of ideas, strategies and case studies in order to provide more sustainable living to its respective people. Australia can also assist Brazil in preparing to host the 2014 World Cup and 2016 Olympic games following its own successful running of the Olympics in 2000.”

Claudia Jarjoura, CEO, Jarjoura Design Architecture.

**Renewable energy**

According to Rob Grant, the CEO of Pacific Hydro, success in renewable energy particularly in wind and solar power has made Brazil a promising market in Latin America along with Chile.

“Pacific Hydro arrived in Brazil for the first time in 2005 but prior to that had been investigating opportunities generally in Latin America, and as part of that had identified Brazil and Peru as markets which would be interesting and attractive to Pacific Hydro to invest because of their opportunities in renewable energy, the power market structure and the political and economic environment. We decided to come to Brazil, or make a case to come to Brazil, in late 2005, and based on a very positive policy framework in place at the time in Brazil for wind power we started to build the business case during 2006 and we eventually invested in a small development company at the end of 2006. The perception of Brazil prior to our arrival was I suspect like most Australian companies at that time, which is the same misnomers that probably dog some views of Brazil currently - that it suffered from political instability, economic instability and high inflation. It became very clear when we were doing our investigations in 2005 and 2006 that those misnomers were incorrect and that Brazil was on a path of growing economic stability as a consequence of quite a long period, over 10 years, of political stability. This required an education process, directors and shareholders in Australia were beginning to properly understand Chile as an investment market, but the rest of Latin America was somewhat opaque for them and so to bring them up to speed with a market the size of Brazil with as many issues as Brazil had previously had economically, was quite a challenge. We did it successfully and were able to make an investment decision and make the case for a growth strategy in Brazil at the end of 2006.”

He adds that whilst there had been ‘a lot of hype’ around about ethanol,

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12 Interviewed 31 March 2013 Sydney.
the real opportunities have been in solar power and wind, where Australia and Brazil are ‘natural allies’.

“Australia and Brazil share several similarities including geographical conditions and water supply and the development of clean energy will be needed as Brazil’s middle class increases along with their expectations of having access to resources, food and water. There are similarities in the power market as well but they are probably less so than we see on a general economic basis. In power we do see that the influence of government in the generation sector will decline over the next 20 years. There will be a greater ability to introduce contestability in customers over the next 20 years and we believe, like Australia, there will be the opportunity for a secondary financial market for energy in Brazil that will allow investors to more easily hedge their exposure to spot generation. All those factors require government policy change and further deregulation of the market, but in general we see that as a journey that Brazil is currently on. Again, that’s a model for Australian companies coming to Brazil that they will be able to follow. It’s not purely Australian parallels, there are parallels out of the European and US markets but we believe that many of the macro reforms in the energy market will also take place here in Brazil.”

Rob Grant, CEO, Pacific Hydro.

Education, the arts and popular culture

The most immediate and sustainable means of forging closer ties between Australia and Brazil is by strengthening people-to-people linkages. Education is one obvious area where this can occur. Currently, there are some 16,000 Brazilian students studying in Australia, the largest single group from any Latin American country. Australian education institutions are increasingly well regarded in Brazil, particularly in the fields of management and business, engineering and technical courses. Australian universities are now starting to increase their focus on Brazil in their MBA International business courses. Brazil’s Ambassador to Australia, Mr Rubem Corrêa Barbosa, noted that the Brazilian Government’s ‘Science without Borders’ program, which aims to send roughly 100,000 graduates to top Universities all over the world is also targeting Australia. At the end of 2012, he noted, some 450 of these students were already living and studying in Australia.

13 Interviewed 5 March 2013, Sao Paulo.
Higher Education expert Simon Marginson, has highlighted the emergence of Brazil and Latin America in science and research output. Marginson, who has studied international comparisons of higher education quality and output for over three decades, noted that the tertiary sector is growing in Latin America due to the increasing size of the middle class which will grow to the size of North America’s by 2030. Scientific output in Latin America is also growing rapidly from a relatively low base and has been doing so since the 1990s. The University of Sao Paulo is currently recognised in the Shanghai Jiotong University Rankings as amongst the top 150 universities. In arts and culture, Brazil has a strong national cultural scene. Brazilians admire their artists, musicians and literary figures. Simple things like movies and cultural and sporting events seem trivial to some, but according to brand surveys they can have enormous impact in a short space of time. Brazil is very proud of its indigenous culture and Australia’s lively indigenous art and culture scene would be of great interest to Brazilians. An event like the Brazilian Film Festival has done so much to promote awareness of Brazil in Australia, along with Australian celebrations of a similar nature in Brazil. Like India, Brazil has an enthusiastic cinema going population and the success of Oz Fest Asia in Mumbai in raising Australia’s profile in India could be replicated in Brazil. Sporting events are an obvious time and place to highlight Australian culture and a series of cultural events could be staged around the FIFA World Cup and Olympics in Brazil. Brazil’s success as a multicultural nation is of great interest to Australians. As Rob Grant says “In 300 years time, Australia is going to look like Brazil in terms of multicultural and ethnic diversity.” Arts and culture is one way of promoting diversity in both countries to help broaden and deepen the bilateral relationship. The distinguished Australian historian John Hirst lamented that he will not see the day in 50 years time, when the “Australians are going to be a beautiful people.” Well, it seems that Brazil has got there already.

14 Interviewed 28-30 August 2012, Melbourne.
Investing in the relationship

Ultimately, Australian government and business needs to decide how much time and energy to invest in Brazil. We hope this report will make an important contribution to that decision by helping Australians gain a deeper understanding of the Brazilian economy and its place in the world. As Mark Thirlwell says in his Chapter, Brazil is now “too big to ignore”. Nevertheless, Australia also needs to think about the opportunity cost of investing time and resources in an amazingly complicated country like Brazil, relative to focusing on more willing partners in the rest of Latin America and of course in the Asia Pacific region.

Accordingly, the first Chapter of this report takes a deeper look at the history of the Brazilian economy. Distinguished Brazilian economist Fernando Cardim from the Federal University of Rio de Janeiro (UFRJ) describes the origins of modern Brazil and how high inflation and external vulnerability were overcome. Cardim takes us through the Real Plan and its aftermath, the economic and social reforms of President Fernando Henrique Cardoso and President Lula. He explains how Brazil withstood the financial crises of 2008, after the domestic economy was harmed by a balance of payment crisis in 1998. As Brazil looks forward, Cardim emphasises that Brazil, as one of the world’s largest economies, can use its domestic market as a major source of continuing economic growth.

The next Chapter, by Australian-based Brazilian economist Patrick Carvalho, introduces us to the modern Brazilian economy: the trends, the opportunities, and the risks. Carvalho describes the rise of Brazil, the taming of inflation, the success of President Lula’s education and anti-poverty policies and the emergence of Brazil as a global trading power. Carvalho also discusses some of the risks to Brazil’s economic performance, including infrastructure, capacity constraints, institutional governance and crime rates.
Finally in Chapter 3, the Lowy Institute’s Mark Thirlwell puts Brazil into a global context. Australians have been slow to pay much attention to the ‘B’ in the BRICs (Brazil, Russia, India and China). This largely reflects the dominance of Australia’s economic relationships with Asia in general and China in particular, as well as the modest level of current trade and investment ties with South America’s largest economy. Thirlwell argues, however, that the size of Brazil’s current economic footprint in the global economy, its possible future trajectory, and the presence of some common policy challenges between the two economies should provide ample reasons to pay more attention to what could yet turn out to be a ‘Southern hemisphere superpower’.
Chapter 1
What’s past is past: Brazil in the long run

Fernando Cardim
Between 1947 and 1973, Brazilian GDP grew at an annual rate of 7.6 per cent. Even more impressively, manufacturing output expanded at an annual rate of 9.1 per cent. This trajectory was interrupted in the mid-1970s, when two supply shocks, created by sharp increases in the price of oil, hit a country that was heavily dependent on imported oil. Inflation accelerated, the current account deteriorated under the weight of imports, and external debt grew rapidly. The collapse in the early 1980s, as contagion from the Mexican balance of payments crisis spread throughout Latin America, marked the beginning of a succession of lost decades for Brazilian growth and development. Only in recent years has the legacy of that period begun to fade.

The Brazilian economy during the period between the mid-1970s and the mid-1990s was plagued by two main problems. The first was high inflation. Brazil never experienced hyperinflation, the explosive environment that left deep scars on the memories of countries such as Germany. In Brazil, inflation was high, but its worst effects were neutralized for quite some time through the widespread use of a highly complex system of contract indexation. It was only from the late 1980s that high inflation threatened to become dysfunctional enough to prevent the economy from working at all and to force the search for a definitive solution.

The second problem was external vulnerability. Chronic deficits in current accounts made the country dependent on foreign financing which periodically led to balance of payments crises. Except for a short period in the early 1970s, exports were often penalized by macroeconomic and industrial policies designed to expand domestic markets. When growth accelerated, imports rose but exports did not follow. Current account deficits were financed by borrowing, but domestically-led growth did
not generate revenues in foreign currencies, making external illiquidity and even insolvency an ever-present possibility. Sudden stops in capital inflows were the most frequent causes of economic crises in Brazil, as they were for most Latin American countries.

The combination of balance of payments vulnerability and high inflation did not cause the economy to actually crash, but it was enough to prevent its recovery after the supply shocks of the 1970s dissipated. Stagnation was the fate of the Brazilian economy after 1980.

After more than thirty years, inflation stopped being a problem in 1994, when the country created a new currency, the real, amidst a number of institutional changes designed to give support to price stability. Balance of payments vulnerabilities, however, continued to be a threat. In fact, Brazil suffered a major balance of payments crisis in 1998/9, and another, less intense, one in 2002. Even so, growth in the period after 1994 remained subdued until the middle of the first decade of the new millennium when signs of change appeared with more clarity.

The high inflation period

It is impossible to understand how Brazilians see the prospects for their economy and the policy dilemmas to be faced without acknowledging how high inflation has shaped their behaviour.

Most foreign commentators on the Brazilian economy seem to ignore the difference between high inflation and hyperinflation. A hyperinflation, like the one in Germany in the early 1920s, is an explosive configuration where prices rise so rapidly that the domestic currency loses all its functions (that is, it stops being a unit of account and a reserve of value but it also ceases to be a means of payment as well), and the economy reverts to barter in many sectors until the disorganization is so intense that a new currency is adopted, usually (but not exclusively) the US dollar. Hyperinflations cannot last because the economy crumbles very fast, forcing whoever has the power to do it to push the reset button and recreate the institutions necessary for resurrection. In one sentence, one cannot ‘live with hyperinflation’.
High inflation, in contrast, is a price formation regime where institutions change, instead of crumbling, as a result of inflation. They are adapted, deliberately or not, to live with inflation. Again in contrast with hyperinflation, high inflation can last a long time, depending on the institutional adaptations. In Brazil, adaptation was taken perhaps to its extreme. It was by far the most successful case of ‘living with inflation’ but it also illustrated the limits of institutional adaptation.

The roots of the high inflation regime in Brazil are to be found in the late 1950s, when industrialization programs were implemented by President Juscelino Kubitschek de Oliveira (the builder of Brasilia). The President’s plan involved a large amount of investment (50 years in 5 was his motto) in an economy lacking the financing facilities to support it. Public investment created fiscal deficits that were financed by issuing money. By early 1964, yearly inflation was expected to top 100 per cent.

In April 1964, a military coup toppled the civilian administration and reoriented economic policy. Rising inflation had been among the main excuses given by the military for interrupting constitutional rule, so delivering policies to control price rises had to be a priority for the new rulers. Two strategies were open to them: a ‘shock treatment’, with the rapid elimination of fiscal deficits by cutting spending and raising taxes plus a sharp rise in interest rates, or a ‘gradualist’ program in which the same results would be obtained over a longer period of time. Raising interest rates was not a particularly difficult decision given the low importance of financial markets to the Brazilian economy at the time. Cutting fiscal deficits was politically much more difficult, however, with the potential to create antagonisms that could compromise the military’s professed goal of restoring civilian rule in time for the presidential elections scheduled for 1965.

If fiscal deficits were supposed to persist for some time, it was necessary to find ways to finance them that did not cause additional inflationary pressures, such as selling government bonds to investors. Inflation itself, however, was already high enough to prevent the development of a market for public debt securities that could replace the issuance of money. A way out was found in the creation of securities where the principal was denominated in an inflation-proof unit of account, even
though its redemption, as well as interest, was to be paid in the national currency.

It is not clear how conscious the authorities were of how important this innovation was to become. Indexation was supposed to apply only to long-term financial contracts, of which public debt was the only relevant existing type. Wages, for instance, were not indexed: a specific adjustment rule was created for wages that was in fact intended to depress them, to reduce cost and demand inflation pressures. For other classes of contracts, no rule was officially adopted. Indexation, however, was, slow at first, and then in a more deliberate fashion, spread throughout a large number of classes of contracts, including wages, providing what was thought to be ‘automatic’ compensations against inflationary losses. At the end of a contractually-fixed period, all nominal values in a contract would be ‘corrected’ according to the evolution of a price index specified in the contract, so that ‘real’ values could be periodically reconstituted.

The system evolved to become a complex web of indexation clauses, defining specific price indices and periods of adjustment to each class of contracts. Its main virtue (but also its main shortcoming) was automaticity. Indexation did not really prevent inflationary losses. During the period between the adjustments in the nominal values of contracts, their real values were reduced by inflation. What indexation did do was guarantee that compensation for rising prices would always be paid. It didn’t matter if, for instance, workers were poorly organized or house owners were unable to renegotiate rents or, for that matter, securities-holders were not strong enough to litigate against the Federal Treasury, since nominal values would be automatically adjusted after some (contractually-defined) time interval. The set of institutions created around the notion of indexation became known as a High Inflation Regime, a different phenomenon than hyperinflation, where institutions simply crumble.

One should notice that the term compensation is actually misleading. Past losses were not really made up by indexation. Real income that was lost when prices went up in the past was in fact never recovered. What indexation did was to guarantee that these losses would not last forever. From time to time, indexation would put everybody back
in their initial position again. What you lost, you lost, but you would not lose forever. In other words, indexation puts a floor under each person’s real income, since it takes each person to the beginning of the line again at specific dates. So the mechanism worked as long as the social groups involved considered that having guaranteed automatic nominal adjustment, provided by contract indexation, was worth the real losses that rising prices were continuously imposing between adjustment dates. If price rises accelerated, however, increasing the size of real losses between compensation dates, the advantages of indexation could become less attractive, breaking the delicate equilibrium and thereby eroding the system.

This was precisely what happened after the two oil shocks of the 1970s. The sharp acceleration of inflation that followed convinced a large number of people that the trade-off was no longer acceptable. The economic history of Brazil from the early 1980s to the Real Plan of 1994 consisted mostly of attempts to stabilize prices and, after the repeated failure to do so, of attempts at reconstructing indexation systems on different bases to contain the damage.

In the early 1990s, the high inflation regime was crashing under the weight of supply shocks and disintegrating reactions from private agents. The effects on the economy were dramatic. High inflation bankrupted the state, disorganized relative prices, discouraged long term investments, increased already high levels of income and wealth concentration, and atrophied the development of private securities markets. It became widely believed that stopping high inflation was a necessary and sufficient condition for ‘normality’ to be rebuilt and the fast growth rates of the past to be recovered.

**The Real Plan and its aftermath**

From the early 1980s, when the indexation system showed the first signs of dysfunctionality, to 1994, successive federal administrations experimented with many different stabilization strategies to contain the inflationary process that was clearly threatening to become explosive. In the early 1980s, prodded by the IMF, orthodox macroeconomic policies to restrain aggregate demand were implemented without any visible impact
on the inflation process. The new civilian government that took power in 1985 tried so-called ‘heterodox’ stabilization policies, consisting mostly of attempts to outlaw indexation in the context of generalized price, wage and exchange rate freezes, with equally disappointing results. In fact, it can be argued that the results from heterodox plans were even worse than the outcomes of orthodox stabilisation efforts, because sellers of every type of goods and services (including productive services) learned that rising rates of inflation would increase the probability of new heterodox plans being adopted, leading to new attempts to freeze prices. Prices would then rise even faster in anticipation of freezes, and they would accelerate again after the freeze was lifted because of the accumulation of relative price distortions.

Inflation volatility was not neutral in this high inflation regime. Flow supply prices of goods were not indexed, so that businessmen had to form inflation expectations as accurately as possible to survive the process. When prices increase at a rate of 5 per cent a month or more, productivity, efficiency and competitiveness considerations take a back seat to the ability to forecast future inflation and raise one’s prices accordingly. A mistake could lead to too low relative prices that could be hard to correct. 17

The Real Plan represented a break with both traditions, orthodox and heterodox. The plan itself was not new. Reduced to its core, it was an exchange-rate-based stabilization cum monetary reform plan where a new currency was created, characterized by its stable external value. In practice, the plan was somewhat more complicated and was changed more than once in the years that followed its adoption to adapt to changing circumstances.

The plan was implemented in three stages. The first, initiated in late 1993, consisted of some emergency measures designed to neutralize eventual

17 Entrepreneurs had to set prices considering that simply recovering production costs paid in the past would not be enough to allow paying them in the future. Costs had to be calculated according to inflation expectations, so that the value of, say, raw materials embedded in selling prices would not only recover what was paid in the past but also allow the same amount of raw materials to be bought again when the production cycle began again. Expectations, however, do not necessarily converge to any particular value, so different entrepreneurs would embed different inflation expectations in their price formation decisions, increasing the dispersion of relative prices and reducing the informative content of market prices. In fact, the same goods could be found in different locations, even if they were relatively close geographically, at wildly different prices. The biggest risk for the entrepreneur was underestimating future inflation and charging prices that did not allow resuming production. A bias toward higher prices was thus introduced in price formation which fed back into inflation, pushing it ever higher.
pressures toward fiscal expansion. An emergency fund was created to receive funds that the government chose not to spend. In fact, it was a fancy way to promote cuts in government spending to ensure control of aggregate demand. The second stage, implemented in early 1994, was perhaps the more ambitious and creative. Relative price imbalances, as already mentioned, were among the main culprits for the failure of past stabilization plans. As much as sellers of goods and services tried to correctly anticipate inflation, many of them failed so that when prices were frozen by new stabilization plans, there were a large number of relative prices in need of a correction (which would, of course, trigger other ‘corrections’, reinitiating the inflation process again). It was realized that the problem was the existence of different lags that sellers would respect before changing their prices to account for current and expected inflation. The Real Plan decided to coordinate these price rises so that any lags in price adjustments would disappear. The government created an indexation unit, known by the acronym URV, the value of which was announced everyday so that indexed contracts would be adjusted daily. But the URV would also help to coordinate expectations formation so that prices of goods and services, which still depended on the ability of individual sellers in making the right pricing decisions, could be adjusted by that same unit. The real value of URV was believed by the population to be stable and prices of everything in the local currency then in use were therefore determined by the daily exchange rate to the URV. By July 1994, the government considered that the country was ready to drop the existing currency and adopt URV as a unit of account, so a new currency was created, called real, with 1:1 parity to the URV. No price freezes or other exceptional measures were adopted.

The government’s gamble paid off. Inflation rates collapsed after July 1994, falling from about 40 per cent a month in the eve of the creation of the real, to about 4 to 5 per cent a year that the country currently faces.

Of course, it was not all merely a confidence trick. Many policies contributed to the success of the Real Plan to stabilize prices, and many problems emerged as by-products of the plan itself, including

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18 It is probably easy to recognize that the government’s gamble was to reproduce ‘in vitro’ the process of dollarization that takes place spontaneously in hyperinflations but to keep it under control and prevent the actual gravitation toward the US dollar, as it happened, for instance, in Argentina.
the low growth rates that afflicted the Brazilian economy at least until very recently. Perhaps the most essential instrument to ensure the containment of inflationary pressures was the possibility of flooding domestic markets with cheap imported goods if prices kept rising. The power of import competition was magnified by the overvaluation of the new currency. In fact, during the first months after the creation of the real, the actual exchange rate had deviated from the desired R$1: US$1 parity to reach R$0.80: US$1. At this exchange rate, however, not only were imports very cheap but Brazilian exports were quickly priced out of their markets. In about six months, the trade balance swung from surplus to deficit and remained in deficit in the years that followed. Added to chronic deficits in the services and income accounts, trade deficits demanded rising capital inflows to finance them. The consequent accumulation of external liabilities made the balance of payments position of Brazil fragile. Judgment day came in the last months of 1998, when rising risk aversion among international financial investors resulting from the succession of crisis in Asia and Russia, led to a so-called ‘sudden stop’ of capital inflows and a serious balance of payments crisis occurred.\footnote{In fact, the balance of payments crisis was precipitated in December 1998, when capital flight by residents surged. Foreign investors didn’t really flee until it was realized that Central Bank’s foreign reserves would not be enough to satisfy all demands for foreign currency.}

In the period since the adoption of the Real Plan, in 1994, domestic interest rates were kept at very high levels to attract foreign capital inflows and sustain balance of payments equilibrium. As international liquidity was abundant at the time, the expectation of large arbitrage gains was enough to attract large capital inflows to the country. These inflows were decisive to sustaining the value of the real, and thus instrumental in ensuring the consolidation of price stability. However, the combination of an overvalued currency and high interest rates proved to be lethal to economic growth. A largely stagnant economy, plagued by chronic balance of payments disequilibria, could not resist the contagion of crises happening in other points of the emerging world.

The depth of the balance of payments crisis that resulted forced the government to adopt a floating exchange regime, which immediately led to a sharp devaluation of the real. Imports fell and exports expanded very quickly, allowing for some recovery of growth. The devaluation of
the currency, however, resurrected the ghost of high inflation (only about five years after the Real Plan, when memories of high inflation were still very strong). Under a floating exchange regime, the anchor to domestic prices was lost and there emerged a distinct possibility that price makers could just go back to the pricing practices they had abandoned but certainly hadn’t forgotten. To prevent this (and in harmony with IMF’s guidelines), the government adopted an inflation-target monetary policy regime at the same time as taking steps to control public finances to some degree. Two major initiatives mark the fiscal policy of the period. The first was the adoption of primary surplus targets (that is, a fiscal budget surplus before the payment of interest) to reduce public debt. The second was the passage of the Fiscal Responsibility Law, constraining fiscal policy choices by the central government as well as by state and city governments.

This three-pronged macroeconomic policy strategy was successful in ensuring that inflation was kept under control (and on a downward path) even after a major shock to prices (represented by the devaluation of early 1999). However, and somewhat paradoxically, it had the same perverse impact on growth that the previous strategy had. In fact, in the new framework, domestic interest rates were kept at very high levels, although now as a result of the pursuit of inflation targets by the Central Bank instead of a bid to attract foreign capital inflows. And once again, these high interest rates attracted foreign capital inflows in volumes large enough to lead again to the overvaluation of the real. Soon, the Brazilian balance of payments was exhibiting similar disequilibria to those suffered before the 1999 crisis and economic growth fell to a crawl.

This situation lasted until the mid-2000s. President Cardoso, who governed the country in the years immediately after the adoption of the Real Plan, finished his two terms in office with one great achievement, consolidation of inflation control, and one big disappointment, the inability to get the economy to grow. He was succeeded by President Lula da Silva, who in his first years in office merely maintained the same policies inherited from the Cardoso period. By the middle of his first term, however, President Lula began to change course, even if very cautiously. Two main changes defined his first term, making it possible for the Brazilian economy to exhibit a better growth performance by 2006.
First, after many years of financial instability, marked by a succession of balance of payments crises among emerging economies, the international context became very favourable for exporters of primary commodities, such as Brazil, dominated by the rise of China. Second, on the domestic front, large-scale redistributive policies began to positively impact domestic aggregate demand.

The best known among President Lula’s policies were probably those associated with the fight against extreme poverty and hunger. In particular, the Family Grant (Bolsa Familia) distributed money income supplements to below-poverty-line households conditional on a few commitments by the beneficiaries, such as keeping small children in school. More effective, from the economic point of view, was the decision to raise minimum wage rates above inflation and the extension of social security benefits (particularly retirement pensions) to sectors of the population without previous access to the system, particularly in rural areas. The combination of these policies was responsible for the remarkable improvement in income distribution witnessed in Brazil in recent years, but it was also instrumental in creating a floor to domestic aggregate demand that was to become one of the explanations for the resilience of the Brazilian economy to external shocks generated by the global financial crisis in 2008.

By the time President Lula was beginning his second term of office, another important change in policy orientation was announced, even though its actual implementation has not been as forceful as government rhetoric suggested. The president stated his intention to use fiscal policy more aggressively to promote economic growth, by increasing and coordinating public investments and by reducing primary surplus targets in order to increase capital expenditure.

As already observed, among the worst legacies of the high inflation period was the financial crisis that reduced the capacity of the federal government to invest. By the early 2000s, the economy’s infrastructure was (and in fact still is) in very bad shape. Highways, railroads, ports, energy production and distribution were just a few areas in which investment had long lagged behind the needs of the economy. Since the fight against inflation had pre-empted any other goal among government
priorities, fiscal policy was in the 1990s almost entirely designed to avoid aggregate demand pressures, rather than providing the needed renewal of infrastructure. Even the National Development Bank (BNDES), which remained a strong and influential institution in the price stability period, had most of its energies redirected to organizing the process of privatization of federally owned enterprises, away from supporting investments in the public and private sectors.

Deficient infrastructure was reckoned to be one of the main components of the so-called ‘Brazil cost’ (custo Brazil), a measure of the barriers to increasing Brazil’s competitiveness. A plan was announced by the president to resume these investments, but its implementation is generally regarded as being poor.

Table 1.1 Public investment by the Federal Government

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>0.7</td>
<td>0.8</td>
<td>0.9</td>
<td>1.1</td>
<td>1.2</td>
<td>1.3</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: Banco Central do Brasil (www.bcb.gov.br)

The government seemed to remain intimidated by the lingering suspicion among more conservative circles, and particularly among financial markets, that President Lula’s administration couldn’t, or wouldn’t, maintain the fiscal discipline necessary to pursue the fight against inflation. This despite the fact that high inflation has increasingly become just a memory, rather than a clear and present danger. Under pressure to control public expenditure, it is always public investment that bears the burden of fiscal ‘austerity’.

The global crisis, in 2008, changed the picture. By September 2008, Brazil, like many other countries, was hit by the shock waves of the Lehman Brothers’ bankruptcy. Foreign financial investors repatriated their investments to cover losses suffered in their headquarters, causing the real to depreciate unexpectedly. After years of currency overvaluation, many speculators (including some major non-financial firms) were exposed to exchange rate risk through bets in derivatives markets on the real continuing to appreciate in the future. The depreciation of the currency caused heavy losses to these speculators, to the point of
threatening the survival of some of the largest firms and private groups in the country. Uncertain about the repercussions of these threats, private firms reduced production and curtailed planned investments (which had been rising previously), leading to a recession in early 2009. The recession, however, was short-lived. The government seized the opportunity to implement an aggressive anti-cyclical policy based not only on the expansion of public expenditure but, perhaps even more importantly, on the expansion of credit supplied by public credit institutions. Stung by the gain of market shares by the public banks, private banks reluctantly followed the same path right afterwards.

The recovery that began in mid-2009 was fed mainly by domestic consumption and extended well into 2010, allowing the economy to grow 7.5 per cent in 2010. Investments, however, have not increased as expected or needed, remaining at less than 20 per cent of Brazil’s GDP, too low a share to support faster growth.

<table>
<thead>
<tr>
<th>Table 1.2 Total investment</th>
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<tr>
<td>% of GDP</td>
</tr>
<tr>
<td>---------------------------</td>
</tr>
<tr>
<td>15.9</td>
</tr>
</tbody>
</table>

An additional factor that explains the resilience of the Brazilian economy at the time was the fact that China kept growing very fast over the period, so that exports also contributed to sustaining the level of economic activity. In fact, growth was stimulated perhaps a little too well. By 2011, a possible re-ignition of inflationary pressures (especially in an international context of rising prices of commodities) forced the newly-installed administration of President Dilma Vana Rousseff to adopt aggregate demand control measures which included rising interest rates and macroprudential limits on bank credit. The inflationary pressure was reduced, but again at the cost of weakening the economy beyond what was desired. As a result, growth in 2011 and 2012 was well below the expected level.

20 The Federal Government owns two major banks, the National Economic and Social Development Bank (BNDES) whose main function is to finance industrial investment; the National Savings Bank (CEF), to finance construction, and holds the majority of stock in Banco do Brasil, a private bank operating in all areas of the financial system. Banco do Brasil is the largest bank in the country, and the three of them are among the six largest banks in Brazil.
Perspectives and opportunities

As 2012 began, the Brazilian federal government expected the economy to grow vigorously in reaction to the measures taken in 2011 to stimulate demand. Credit expansion by public banks to finance consumption of durables was still the most important instrument at the hands of the government, supported by temporary indirect tax cuts on sales of durables along with pressure on banks to reduce their lending interest rates. The effects of these policies were, however, deeply disappointing. It seemed that the possibility of stimulating growth based on the demand of consumers financed by bank loans, which was successful in 2008, was by now exhausted. Although the supply of credit to GDP ratio in Brazil is still relatively low (another legacy of the high inflation period), private credit still consists mostly of consumer credit and it seemed that neither households nor banks wished to increase indebtedness, especially in a time of heightened uncertainties.
### Table 1.3 Annual GDP growth

<table>
<thead>
<tr>
<th>Year</th>
<th>%</th>
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<tbody>
<tr>
<td>2000</td>
<td>4.31</td>
</tr>
<tr>
<td>2001</td>
<td>1.31</td>
</tr>
<tr>
<td>2002</td>
<td>2.66</td>
</tr>
<tr>
<td>2003</td>
<td>1.15</td>
</tr>
<tr>
<td>2004</td>
<td>5.71</td>
</tr>
<tr>
<td>2005</td>
<td>3.16</td>
</tr>
<tr>
<td>2006</td>
<td>3.96</td>
</tr>
<tr>
<td>2007</td>
<td>6.09</td>
</tr>
<tr>
<td>2008</td>
<td>5.17</td>
</tr>
<tr>
<td>2009</td>
<td>-0.33</td>
</tr>
<tr>
<td>2010</td>
<td>7.53</td>
</tr>
<tr>
<td>2011</td>
<td>2.73</td>
</tr>
</tbody>
</table>

Source: Ipeadata (www.ipeadata.gov.br)

To some extent, the failure to revive the economy through further increases in the consumption of durables financed by credit expansion may have been a disguised blessing. The government seems to have realized that sustainable growth could only be achieved through a strategy that premised raising the investment rate and reducing production costs. The pressing need for investments in infrastructure has been clear for many years. Some of them became even more urgent given the government’s commitment to promote both the 2014 World Cup and the 2016 Olympics. Early in 2012, President Rousseff announced the first step of what promises to be an ambitious plan to invest in the modernization and expansion of highways, railroads, ports, airports, power generation and distribution and other infra-structural activities. These new initiatives should be implemented in addition to already ongoing investments related to the construction of new hydroelectric plants and oil exploration in the recently discovered fields in Brazilian territorial waters.

The plan not only signals a new disposition to finally make the necessary investments, but also a new financing strategy, designed to attract private
capital, both domestic and foreign, either through concessions or through association with public entities. As usual, the National Development Bank (BNDES) will play a crucial role in financing these investments.

If the federal government succeeds in implementing this new strategy, the country may finally turn the page on the three ‘lost decades’ that took the steam out of its economy since the mid-1970s. A growth strategy relying on investments is a much safer bet than a consumption-plus-debt-led expansion. In fact, growth of investments should lead to growth of consumption (through the well known multiplier mechanism), but based on income growth instead of growing indebtedness.

Even if the plan succeeds, however, important challenges will still have to be met. In an economy where the role of government is essential, the efficiency of the Brazilian state is still low. To improve the operational capabilities of the state remains a difficult, but nonnegotiable, goal. Institutional reforms, particularly in tax structures and financial markets, are yet to be designed. More basic needs in terms of universal health and education should be the next target of the social policies that were so successful in dealing with emergency problems, such as extreme poverty.

Brazil’s economic performance in 2012 was far below what was initially expected, and certainly well below the country’s potential. Nevertheless, given the deterioration of the international economy during the year, including the (relatively) disappointing performance of China, which has became so important for Brazilian exporters in recent years, the outcome is perhaps not surprising. It is sensible to expect that the international economy may eventually stabilize, but it is hardly likely that the expansion of international markets will be significant in the predictable future. A continental economy, like Brazil’s, has the alternative of turning inward to explore its domestic markets and fulfil its needs, as in the area of infrastructure investment. It is not a xenophobic view; in fact many opportunities for association with foreign investors will be opened in the process, as is the case with the plans that were announced so far.
Chapter 2
The country of the future?
The rise of Brazil

Patrick Carvalho
Brazil is a country of contrasts, where joy meets sadness, mundane faces lavishness, and ingenuity defies adversity. Samba, the musical genre that best defines the country, is not surprisingly said to be the ‘son of sorrow and the father of happiness’. For decades, if not centuries, Brazil was called the country of the future; a future that was always anticipated, but never realised. Nonetheless, the turn of the millennium brought a new era in Brazil’s history. Democratisation in the 1980s and economic reforms in the 1990s prepared the grounds for the game change that arrived in the 2000s. International recognition of Brazil’s recent social and economic achievements came with the winning bids to stage the 2014 FIFA World Cup and 2016 Olympics. Brazil is ready to finally embrace its long-heralded prime position in global affairs.

This Chapter narrates the recent successes in the country’s history. Since the re-establishment of democracy in 1985, Brazil has opened its borders to trade and reforms. First, the implementation of an economic plan in 1994 (termed the Real Plan) stopped the calamity of high inflation and brought rational macro-management back. Later on, the Macroeconomic Stability Tripod (flexible exchange rates, a new law on fiscal responsibility and a central bank inflation-targeting regime) created a fertile environment for growth and stability. At the same time, the emergence of China as a pivotal global player and its appetite for commodities propelled Brazil’s terms of trade. The result was a massive influx of capital via export receipts and foreign direct investments. Accordingly, Brazil became – for the first time since independence and five years after its last IMF loan – a net external creditor, bringing down its country-risk premium to the lowest level in its history. Since then, many socio-economic blueprints have been realized.

Yet prosperity cannot to be taken for granted as there are still many hurdles in the growth path of Brazil. Rather than resting on its achievements,
much work needs to be done, for instance, on infrastructure, labour and taxation law reforms, and human capital investment. Development after all is a marathon, not a 100-metre sprint. In the end, momentum, not hubris, should set the tone for the future.

Panoramic View of Rio de Janeiro
Host-City of the next 2014 FIFA World Cup and 2016 Olympics
CHAPTER 2

Brazil, nice to meet you

With a geographical area of 8.5 million km², rich in minerals and biodiversity, Brazil is the fifth largest country in the world. The Federative Republic of Brazil (the official name) is formed by 26 states over five regions, comprising 5,564 municipalities. Its bicameral presidential system, with direct universal suffrage, elects every four years: the president, who is the head of government and state; 81 senators that look after the interests of the member states; and 513 members of parliament that represent the people.

Brazil is the world’s fifth most populated country, with almost 200 million people. Relatively urbanised, 86 per cent of the population resides in urban areas. Most are concentrated in the Southeast region, with Sao Paulo (40+ million), Minas Gerais (20+ million) and Rio de Janeiro (15+ million) ranking as the most populated states. Brasilia, the federal capital since 1960, has over 2.6 million people making it the fourth largest city behind Sao Paulo city (11+ million), Rio de Janeiro city (6+ million) and Salvador city (2.7 million).

Portuguese is the official and de facto language in Brazil, making it the only lusophone country in the Americas. From discovery in 1500 until the end of the African slave trafficking in mid-1800s, most migrants were Portuguese (the colonisers) and sub-Saharan Africans (the slaves). Then, after the abolition of slavery in 1888, masses of Europeans and Japanese

21 In order: 1st Russia (17.1 million km²); 2nd Canada (9.98 million km²); 3rd United States (9.6 million km²); 4th China (9.6 million km²); 5th Brazil (8.5 million km²); 6th Australia (7.7 million km²).


23 In order: 1st China (1.354 million); 2nd India (1.210 million); 3rd United States (315 million); 4th Indonesia (238 million); 5th Brazil (194 million).

24 Sao Paulo city is the capital of the Sao Paulo state.

25 Rio de Janeiro city is the capital of the Rio de Janeiro state.

26 Salvador city is the capital of the Bahia state.
filled the labour market void. Not surprisingly, 48 per cent of Brazilians classify themselves as whites (i.e. of European descent), 51 per cent as blacks or mulatos\textsuperscript{27} (i.e. some sort of African descent) and the remaining 1 per cent includes native indigenous and Asians. These large immigration movements stopped in 1970s, yet the pervasive immigration heritage is still visible in the diverse Brazilian demography and culture.

In economic terms, Brazil’s gross domestic product (GDP) – that is, the sum of all goods and services produced in a year – amounts to a staggering US$2.5 trillion. This makes Brazil the sixth largest economy in the world (Figure 2.1), ahead of the United Kingdom, Italy and Russia. However, when measured according to the wealth of its population, Brazil drops to 54th place, with a GDP per capita of US$12,789 – way below the US$65,477 of the average Australian – a symbol of the challenges and opportunities that lie in the Brazilian market.

\textbf{Figure 2.1 GDP (2011, US$trillion)}

![GDP Chart]

Source: IMF

\textsuperscript{27} Mulato is a broad term for anyone with mixed black and white ancestry.
Although services (including financial intermediation, education, telecommunications and public services in general) account for 69 per cent of the economy, industry (25 per cent of the total) and agriculture and livestock (6 per cent) also play an important role. Brazil has a diverse production and export base covering manufacturing, mining and agribusiness. From sugar, coffee and orange juice to steel, cars and aeroplanes, as well as beef, ethanol and shoes, Brazil is ranked in the top 10 exporters and producers (Table 2.1).

**Table 2.1 Brazil’s global position as a producer and exporter**

<table>
<thead>
<tr>
<th>Selected goods</th>
<th>Producer</th>
<th>Exporter</th>
<th>Selected goods</th>
<th>Producer</th>
<th>Exporter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sugar</td>
<td>1st</td>
<td>1st</td>
<td>Shoes</td>
<td>3rd</td>
<td>6th</td>
</tr>
<tr>
<td>Coffee</td>
<td>1st</td>
<td>1st</td>
<td>Soy bean</td>
<td>4th</td>
<td>2nd</td>
</tr>
<tr>
<td>Orange juice</td>
<td>1st</td>
<td>1st</td>
<td>Maize</td>
<td>4th</td>
<td>2nd</td>
</tr>
<tr>
<td>Beef</td>
<td>2nd</td>
<td>1st</td>
<td>Soy bean oil</td>
<td>4th</td>
<td>2nd</td>
</tr>
<tr>
<td>Ethanol</td>
<td>2nd</td>
<td>1st</td>
<td>Airplanes</td>
<td>4th</td>
<td>4th</td>
</tr>
<tr>
<td>Tobacco</td>
<td>2nd</td>
<td>1st</td>
<td>Pork meat</td>
<td>4th</td>
<td>4th</td>
</tr>
<tr>
<td>Iron ore</td>
<td>3rd</td>
<td>2nd</td>
<td>Cotton</td>
<td>5th</td>
<td>5th</td>
</tr>
<tr>
<td>Soy beans</td>
<td>2nd</td>
<td>2nd</td>
<td>Cars</td>
<td>5th</td>
<td>12th</td>
</tr>
<tr>
<td>Leather &amp; fur</td>
<td>2nd</td>
<td>4th</td>
<td>Aluminium</td>
<td>7th</td>
<td>6th</td>
</tr>
<tr>
<td>Chicken meat</td>
<td>3rd</td>
<td>1st</td>
<td>Steel</td>
<td>9th</td>
<td>13th</td>
</tr>
</tbody>
</table>

*Source: Ministry of Development, Industry and Foreign Trade (MDIC), 2011*

With respect to international trade, exports of goods reached US$256 billion in 2011, with a wide range of markets and goods (Figure 2.2). Brazil’s major export partners are (in order) the European Union, China and the United States – with Australia in 39th position. Among goods exports, mineral ores, oil and fuel, transport material and soybeans account for half of external receipts (Table 2.2).
Figure 2.2 Brazil’s exports of goods (2011)

a) Composition

b) Destination

Source: The Central Bank of Brazil (BACEN)

Table 2.2 Brazil’s global position as a producer and exporter

<table>
<thead>
<tr>
<th>Main Exported Goods</th>
<th>US$Billion</th>
<th>Share of the total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mineral Ores</td>
<td>44.2</td>
<td>17.3%</td>
</tr>
<tr>
<td>Oil &amp; Fuel</td>
<td>31.0</td>
<td>12.1%</td>
</tr>
<tr>
<td>Transport Material</td>
<td>25.1</td>
<td>9.8%</td>
</tr>
<tr>
<td>Soybeans Related Products</td>
<td>24.6</td>
<td>9.4%</td>
</tr>
<tr>
<td>Metallurgic Products</td>
<td>17.4</td>
<td>6.8%</td>
</tr>
<tr>
<td>Sugar &amp; Ethanol</td>
<td>16.4</td>
<td>6.4%</td>
</tr>
<tr>
<td>Chemicals</td>
<td>16.2</td>
<td>6.3%</td>
</tr>
<tr>
<td>Meats</td>
<td>15.4</td>
<td>6.0%</td>
</tr>
<tr>
<td>Machines &amp; Equipment</td>
<td>10.5</td>
<td>4.1%</td>
</tr>
<tr>
<td>Coffee</td>
<td>8.7</td>
<td>3.4%</td>
</tr>
</tbody>
</table>

Source: MDIC, 2011

Brazil’s imports of goods reached US$226 billion in 2011. In order, its major international suppliers are the European Union, the United States and China – with Australia in 21st position. The main imported products are oil and fuel (US$42 billion, 18.5 per cent of the total), mechanical equipment (US$34 billion, 14.9 per cent), electrical and electronic equipment (US$26 billion, 11.7 per cent), motor vehicles and parts (US$23 billion, 10.1 per cent) and chemicals and fertilisers (US$20 billion, 9.2 per cent).
Despite a steep increase in the last ten years, the ratio of the sum of exports and imports divided by GDP (known as the Trade Openness Index) at 11 per cent is still much lower than the OECD average, or even that of other BRIC\textsuperscript{28} countries (Figure 2.3) – which highlights the immense potential for future growth in Brazil’s external trade with the world.

\textbf{Figure 2.3 Trade openness index}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{trade_openness_index.png}
\caption{Trade openness index}
\label{fig:trade_openness_index}
\end{figure}

Source: OECD (2011)

\textsuperscript{28} BRIC stands for Brazil, Russia, India and China. This term was coined in the famous study by Jim O’Neill, Chairman of Goldman Sachs Asset Management about the potential of the four emerging countries to become the next richest countries in the world. Chapter 3 provides a detailed comparison of Brazil’s global economic footprint with that of the other BRIC economies.
Box 2.1 500 years of history... in a few paragraphs

On 22 April 1500, Brazil was claimed to be discovered by the King of Portugal. In contrast to the other parts of Latin America, there were no indigenous empires to conquer and subdue. For the first 30 years of occupation, the main activity was the logging of a reddish wood that resembles cinder (or brasa in Portuguese), paving the way to name the conquered land as Brasil.

In order to secure the claim of the Portuguese Crown, sugar plantations were introduced by the colonisers. However, the indigenous people were not acquainted with systematic divisions of labour apart from subsistence hunting and gathering and there were not enough Portuguese citizens (or convicts) to populate the vast new territory. The solution to this labour shortage took the form of a large traffic in sub-Saharan slaves. For the next 300 years, the largest forced migration in modern times was brutally imposed, making Brazil the home of the biggest population of African-descendants outside Africa, even today.

In the 1700s, gold was found. The subsequent mining boom lasted over a century bringing fortune for the lucky and brave – and for the King of Portugal, of course.

In 1808, fleeing from Napoleon’s threats, the King of Portugal moved his court to Brazil, renaming his empire the United Kingdom of Portugal, Brazil and the Algarves. Not long after the demise of Napoleon, the King and much of his entourage moved back to Portugal. However, the King’s son stayed behind and declared Brazil’s independence in 1822. The monarchy in the independent country lasted for just two generations, until the Brazilian political elite decided to form a federal republic on 15 November 1889.

At the time of the proclamation of the republic, slavery was outlawed and a new plantation wave started in the state of Sao Paulo. The new product was coffee (the so-called black gold) and the new labour supply was European migrants. The Coffee Republic lasted 40 years and ended with the 1929 international economic crisis.
The global depression of the 1930s made clear that the monoculture tradition present in the first 400 years of Brazil’s history (first, brasilwood, followed by sugar, gold and coffee) was no longer viable. A new economic approach was adopted: Import Substitution Industrialisation (ISI).

The ISI regime sponsored the prosperity of infant industries across the board, achieving its peak under the military dictatorship that lasted from 1964 until 1985. Not long after, however, the Latin American Sovereign Debt Crises of the 1980s (Latin America’s lost decade) exposed the flaws and counter-productiveness of both dictatorship and inward industrialisation.

The new constitution of 1988 paved the way for the first directly-elected president after almost 30 years (and his impeachment on corruption charges two years later), the lowering of trade barriers and a new liberal agenda. Later on, the 1994 Real Plan created a new currency, ending years of high inflation followed by other measures that set the grounds for the rise of Brazil in the new millennium.
The change of paradigm

The reforms of the 1990s, including the Real Plan and the Macroeconomic Stability Tripod, set the stage for the rise of Brazil in the 2000s. In addition, the emergence of China as a global player, and in particular the resulting commodity boom, was vital for the changes in the Brazilian economy. These factors generated Brazil’s net external creditor position from 2007, a landmark shift given the series of external debt defaults that had troubled the economy over the previous century. For the first time since independence, Brazil owns more assets abroad than external liabilities. This transformation is crucial in explaining the new way in which global crises would impact on the Brazilian market (Box 2.2).

**Box 2.2 The change of paradigm in external crisis dynamics**

- **Old dynamics:**
  
  External Crisis $\rightarrow$ Devaluation $\rightarrow$ (Dollarised) Debt Explosion and Inflation $\rightarrow$ Fiscal and Monetary Contraction $\rightarrow$ Recession (The ‘Hen’s Flight’ Business Cycle).

- **Current dynamics:**
  
  External Crisis $\rightarrow$ Devaluation $\rightarrow$ Net External Debt Creditor and Anchored Inflation Expectations $\rightarrow$ Fiscal and Monetary Expansion $\rightarrow$ Short Slowdown.

In the past, Brazil was prone to external crises because as an emerging economy, Brazilian assets in international portfolios were considered risky, compared to US Treasury Bills for instance. Therefore, every time an external shock occurred, a short-lived international capital flight followed as investors sold their Brazilian assets, leading to the devaluation of the national currency. The critical difference under the new paradigm is that, instead of this capital flight and devaluation triggering a full-blown recession as in the past, today a short slowdown is the more likely result.

In the economic paradigm before 2003, any devaluation led to an external debt explosion in national currency terms (i.e. once the dollarised face value of foreign liabilities was converted to the new devalued exchange
rate). On top of that, entrenched inflationary expectation and large devaluations produced higher inflation (known as the ‘pass-through’ effect). Because of the need to deal with higher inflation and the jump in the (dollarised) external public debt, the government was unable to respond to such shocks by increasing fiscal spending or cutting the benchmark monetary cash rate. On the contrary, exactly the opposite occurred: there was an unavoidable contraction in fiscal policy (lower spending and/or tax rate increases) and monetary policy (spike in the central bank cash rates and/or higher compulsory commercial bank reserves). The result was typically a full domestic recession. As a result, Brazil’s economic growth since the mid-1970s used to be called the ‘Hen’s Flight’ Business Cycle, characterised by short-lived spikes in GDP followed by sudden stops – just like a hen trying to fly!

Since 2003, the impact of an external crisis on the Brazilian economy has significantly changed. The 2007/8 Global Financial Crisis (GFC) put the new paradigm to the test. As before, once the external crisis occurred, a short-lived international capital flight followed. But a stark difference from previous crises was that the consequent devaluation was much milder, as international economic agents recognised the strong fundamentals of the Brazilian economy. Furthermore, the devaluation actually alleviated the external vulnerability in public finances due to the net external debt creditor position. That is, the fact that Brazil now owns more foreign assets than liabilities means that every time devaluation occurs, the net public debt decreases. That allowed the government to increase fiscal spending, supporting the economy without compromising its solvency. Another factor is that there was little evidence of ‘pass-through’ effects (i.e. devaluation causing increases in domestic prices) due to better anchored inflation expectations. These changes allowed the authorities to coordinate fiscal and monetary policies to expand domestic demand, reducing the risk of a recession. To see the difference, consider that while the 1998 Russian and LTCM29 crises produced a 40 per cent devaluation and strong contraction in the Brazilian economy, the GFC (considered to be the worst international crisis since 1929) only produced a mild short slowdown in Brazil (Figure 2.4).

29 Long-Term Capital Management (LTCM), a hedge fund management firm, collapsed in 1998 spreading fears of catastrophic losses throughout the financial system.
After many previous heterodox attempts to control high inflation in the 1980s, which included price controls, currency rebranding and even a national bank account freeze in 1990, a new plan came to the rescue in March 1994. The Real Plan, as it was called, brought orthodox economic principles back into the public policy arena.

Firstly, a new index, the URV (Unit of Real Value), was introduced and daily adjusted to keep pace with inflation. At the same time, regulation forced all prices to be displayed both in URV and national currency. In the following months, although prices kept increasing at a fast pace, their URV counterpart barely changed. This prelude was short-lived, but effective. The new currency was introduced four months later, on July 1, at the rate 1 URV = 1 R$ (real). The implementation of URV fundamentally changed inflationary expectations. After years of high inflation, Brazilians started to believe that under the Real Plan, it was possible to have stable prices (Figure 2.5).

Source: BACEN

The Real Plan

The recorded accumulated inflation (IGP-DI) from 1980 until 1993 was 16,290,334,703 per cent (Source: BACEN).

See also the discussion in the following Chapter.
Many other important measures followed the introduction of the new currency. First, a tight control of the money supply was imposed through high Central Bank cash rates and a quasi-fixed exchange rate, set initially at 1 R$ = 1 US$. Second, further lowering of trade barriers increased the access to imports that put competitive checks on any discretionary domestic price changes. Third, a large privatisation program brought much-needed foreign direct investment (FDI), improved the quality of services, and set public resources free to other areas.

The macroeconomic stability tripod

Despite the successful taming of high inflation, the Real Plan needed some important adjustments. The core of the Real Plan program was the so-called foreign exchange anchor (i.e. quasi-fixed exchange rates). Although initially a useful tool for keeping inflation expectations low, it would not be sustainable in the long run. Ultimately, exchange rates needed to reflect the fundamentals of the economy vis-à-vis other countries. Since these fundamentals (such as national productivity, input costs and cross-country inflation differentials) do change over time, the exchange rates needed to move accordingly. Maintaining a fixed exchange rate prevented these natural movements, potentially destabilising the economy in the long run. In 1999, shortly after the Russian and LTCM crisis, markets bet against the Brazilian foreign exchange anchor scheme – and won.
By then, consecutive twin deficits in the Current Account\textsuperscript{32} (partially due to the overvalued exchange rate) and in the fiscal accounts (due to uncontrolled government expenses) made clear the unsustainability of the pegged exchange rate. As a result, after a swift international capital flight from the Brazilian economy, the government had to concede devaluation of the currency. In response, the government implemented the Macroeconomic Stability Tripod.

The Tripod consisted of the introduction of a flexible exchange rate, a new law on fiscal responsibility and a central bank inflation-targeting regime. The first two measures dealt with the twin deficit problem (Figures 2.6 and 2.7). The third replaced the previous Brazilian foreign exchange anchor scheme (in other words, the quasi-fixed exchange rate) with a new anchor for inflation expectations (Figure 2.8). This Tripod proved pivotal into preparing the grounds for a decade of growth and development.

\textsuperscript{32} The current account balance shows the difference between a nation’s total exports and imports of goods, services and transfers.
Figure 2.6 Brazil’s government fiscal results (% GDP)

Source: BACEN

Figure 2.7 Brazil’s current account balance (% GDP)

Source: BACEN

The difference between the two concepts is that the Primary Result does not take into account public debt servicing, which is generally outside government control. In this regard, while the Nominal Result tells the final balance on public accounts, the Primary Result provides evidence of government commitment towards austerity.
The China effect

The Real Plan and the Macroeconomic Stability Tripod demonstrated that Brazil had done its policy homework, distancing itself from previous decades of reckless economic mismanagement. Nonetheless, the legacy of a large stock of external debt carried over from previous, less successful, periods of Brazil’s economic history continued to constitute a significant hurdle to economic stability.

The solution to this component of Brazil’s external vulnerability took the form of the ‘China Effect’. China’s economic transformation and consequent rapid economic growth, industrialisation and urbanisation significantly boosted international commodity demand and prices (Figures 2.9 and 2.10). Brazil, much like Australia, benefitted immensely from this boom. The share of commodities in total Brazilian exports more than doubled between 1999 and 2011. As a direct consequence, Brazil’s export receipts went from less than US$50 billion in 1999 to more than US$250 billion in 2011 (Figure 2.11). On top of that, a steep increase in FDI (Figure 2.12), again fuelled by the commodity boom, led to the emergence of a net external creditor position in 2007 for the first time since independence (Figure 2.13) — as mentioned above, a landmark for the rise of Brazil.
Figure 2.9 China GDP (% World GDP)

a) Composition

Source: The World Bank

Figure 2.10 Commodity Price Index (2005=100)
b) Destination

Source: IMF

Figure 2.11 Brazil’s exports of goods (US$ billion)

Source: MDIC

Figure 2.12 FDI in Brazil (US$ billion)

Source: BACEN
Brazil Redux: The long-awaited emergence

The Real Plan and the macroeconomic reforms of the 1990s, combined with the China effect, set the Brazilian economy on a new growth path. A good example of this new path relates to GDP in current US$ time series— that is, the sum of all goods and services produced in a given year measured in nominal US$ converted by the exchange rate of the time, representing the economic clout of Brazil in global markets. Over the past decade, Brazil has practically doubled its share of world income, with its GDP quadrupling from US$644 billion in 2000 to US$2.5 trillion in 2011 (Figure 2.14). Such an enormous jump in the value of national production elevated income per capita from less than US$3,000 in 2002 to over US$13,000 by the end of 2012.

34 Negative net external debt values mean positive net external credits.
Such a sharp increase in nominal GDP, combined with fiscal discipline (Figure 2.6), led to a significant decrease in the ratio of net public debt to GDP: from over 60 per cent in 2002 down to 36 per cent in 2011 (Figure 2.15). Moreover, a ten-fold increase in international reserves (Figure 2.16) played a vital role in the achievement of the net external creditor position in 2007, which contributed to the lowering of Brazil’s country risk.

As a result of all these positive developments, Brazil was awarded investment grade status by all of the major credit rating agencies (Figure 2.17) and its borrowing-cost premium\(^{35}\) fell to the lowest levels in the country’s history (Figure 2.18).

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\(^{35}\) Evidence of lower country-risk premium can be found in the JPMorgan Emerging Markets Bond Index Plus for Brazil (EMBI + Brazil), which is the most liquid US-dollar Brazilian market debt benchmark. It measures the spread between Brazilian foreign currency denominated fixed income bonds and the correspondent same-type US bonds.
Another prominent feature of the rise of Brazil concerns the management of its monetary policy. Better macroeconomic management has allowed the benchmark central bank cash rate to fall to the lowest level since the implementation of the inflation targeting system – from an average cash rate of 19 per cent in the period from 2000 to 2005 to below 10 per cent since 2011. As a result, the price of credit has both decreased and become less volatile, leading to a steady and sustainable credit growth. In the past decade, domestic credit to the private sector has doubled from 30 per cent in 2001 to 61 per cent in 2011 (Figure 2.19).
Despite this steep rise in credit, there is still plenty of room to grow, especially in housing credit. At 5.1 per cent, Brazil has one of the lowest housing credit to GDP ratios amongst middle income emerging countries and developed economies (Figure 2.20). Years of economic volatility, combined with stratospheric interest rates, have denied the lower middle income classes access to the formal credit markets. As a result, the household debt to GDP ratio is just 20.9 per cent (Figure 2.21).36

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36 The federal government acknowledged the problem and launched in 2009 the ‘My House, My Life’ programme that already benefitted 1 million lower-income households and aims to invest more than US$80 billion between 2011 and 2014.
Another important source of credit is FDI. In 2011, Brazil received US$67 billion in FDI (Figure 2.11), ahead of India (US$34 billion) and Russia (US$53 billion), making it the top FDI receiver in Latin America (more than three times the amount received by Mexico, in second place).\textsuperscript{37}

The expansion of domestic credit together with the inflow of FDI has boosted the country’s investment ratio in terms of GDP – a pivotal variable for sustainable long-term growth – from an average of 16.3 per cent between 2000 to 2006 to 18.7 per cent in the last five years (Figure 2.22).

**Figure 2.22 Brazil’s investment level (% GDP)**

![Graph showing Brazil's investment level (% GDP) from 1995 to 2012.](image)

Source: BACEN

Another very positive aspect of Brazil’s rise is that it combines economic growth with poverty reduction and a more equitable society. For instance, Brazil’s inequality coefficient, measured by the GINI index,\textsuperscript{38} has consistently decreased in the past decade (Figure 2.23). Corroborating this view, the percentage of Brazilians living under the poverty line has been falling steadily since 2003 (Figure 2.24).

\textsuperscript{37} In 2011, Australia received US$67.5 billion in FDI.

\textsuperscript{38} The GINI index is one of the most used statistics to capture economic inequality. It ranges from zero (perfect equality) to 100 (total inequality, i.e. one person gets all the income). Australia’s GINI index is around 33 points (source: ABS website), in line with estimates for the US (38 points) and the UK (34 points).
The socio-economic improvements in the Brazilian economy are partly due to innovative conditional welfare handouts targeting the poor, such as the Bolsa-Familia (which gives monthly payments to more than 13 million poor families, provided that the kids are enrolled at school); but, more importantly, due to labour market developments. In particular, job creation in Brazil, despite the currently tepid global growth, is as strong as ever (over 12 million formal jobs created since 2003, Figure 2.25) pushing the unemployment rate to historically low levels (Figure 2.26).
The combined impact of economic growth and job creation has produced an upward movement in social mobility (Figure 2.27). In 2003, 49 million people (28.1 per cent of the population) were classified as poor in the social stratification ladder; 47 million (26.7 per cent) as low middle class; 66 million (37.6 per cent) as middle class; and 13 million (7.6 per cent) as upper middle class/rich. In 2011, the proportion of people classified as upper middle class/rich and middle class has substantially increased to 55.1 per cent and 11.8 per cent, respectively; whereas the low middle class and poor have diminished their joint participation to less than 35 per cent. This upward trend will keep boosting middle class consolidation in the years to come. It is forecast that two thirds of the population (118 million people) will be middle class by 2014. The high purchasing-power upper middle class/rich of 29 million Brazilians, a group larger than the whole Australian population, is set to be substantial.

Figure 2.27 Brazil’s growing middle class population (millions)

A healthy economy also relies on a healthy financial system. Proof of that is the 2007/8 GFC. The GFC constituted a great test for the Brazilian economy and for its banking sector. After decades of economic instability, tough regulation and experience have taught Brazilian banks to be extra conservative with respect to reckless leverage and predatory lending. As a result, Brazilian banks’ capital ratio of 16 per cent is well
above the required 11 per cent of the new Basel III rules (Figure 2.28a) –
evidence of a solid banking system. Moreover, this conservative approach
has not compromised the expansion of banking services in the last ten
years: the number of banking accounts and customers has doubled,
achieving banking services coverage in all 5,564 municipalities (Figure
2.28b).

Figure 2.28 Brazil’s banking sector
a) Capital ratio
b) Expansion of services

<table>
<thead>
<tr>
<th>Year</th>
<th>Accounts (for the banking sector)</th>
<th>Branches</th>
<th>Number of banking accounts and customers</th>
<th>Posts of service (for the banking sector)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>15,708,960</td>
<td>87,630,527</td>
<td>55,708,468</td>
<td>32,789</td>
</tr>
<tr>
<td>2001</td>
<td>18,308,800</td>
<td>151,102,765</td>
<td>83,308,800</td>
<td>53,438</td>
</tr>
<tr>
<td>2002</td>
<td>18,504,411</td>
<td>17,049</td>
<td>91,944,421</td>
<td>129,913</td>
</tr>
<tr>
<td>2003</td>
<td></td>
<td>20,046</td>
<td></td>
<td>165,567</td>
</tr>
<tr>
<td>2004</td>
<td></td>
<td>21,278</td>
<td></td>
<td>174,920</td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td>21,287</td>
<td></td>
<td></td>
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<td>2006</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: BACEN

All these numbers and indicators presented above tell the story of the
rise of Brazil. It is a country that has quietly transformed in the last 25
years: from dictatorship to democracy; from high inflation to steady
price levels; from bumpy growth to a sustainable, job-creating economy.
Crucially, Brazil’s development success has not been predestined, but
rather is the product of a hard-won learning curve. As the next section
notes, while prospects for Brazil are now bright, there are dangers in
being too complacent about current successes.

Back to the future: Challenges and opportunities

For decades, if not since independence, Brazil has been cast as the
‘Country of the Future’. Its vast territory, free of major natural disasters,39
tropical weather, unique biodiversity and sizeable, young population
have been invoked to justify some sort of predestined success. Yet,
centuries of unscrupulous rent-seeking, social exploitation, corruption
and authoritarian regimes sentenced the ‘Country of the Future’ to live

39 There are no records in modern times of earthquakes, hurricanes, tsunamis, avalanches or volcanic eruptions in
Brazil.
within its past. If the last ten years or so have been promising, the next decade could deliver even more. Current data and trends suggest that Brazil will soon overtake France to be in the top 5 biggest economies, behind only the US, China, Japan and Germany.\(^4\) However, in order to fulfil these optimistic projections, Brazil needs to meet a series of challenges (Box 2.3).

The first and biggest of these challenges is Brazil’s weak infrastructure. Airports and seaports, for instance, need serious attention and hastened privatisation. Another critical point is the convoluted and oversized tax system, which imposes unnecessary, costly procedures and a tax burden of 36 per cent on national production. Furthermore, Brazil has a labour laws code designed in the 1940s that discourages the employment of workers in the formal sector where they have access to the rights and benefits that come with formal employment (more than one-third of the workforce is outside the formal labour market); a poor educational system, which even though it now reaches 99 per cent of school-aged children, still does not deliver the skills demanded in today’s labour market; and an overcrowded and slow judicial system. In addition, the bureaucracy is extremely inefficient. Another challenge is the unfair two-tier pension system that is overgenerous towards the public sector. Last, but not least, there is the serious problem of violence and crime in the big centres.

### Box 2.3 Challenges

- **Weak infrastructure.**
- **Oversized and convoluted tax system.**
- **Outdated labour laws.**
- **Poor educational system.**
- **Overcrowded and slow judicial system.**
- **Inefficient bureaucracy.**
- **Expensive and unfair pension system.**
- **High crime rates.**

\(^4\) See for example the sample of forecasts set out in Chapter 3.
CHAPTER 2

Despite these challenges, sound economic policies and strong fundamentals have together set a new course in Brazil’s development. Moreover, in contrast to the rest of the developed world and other key emerging countries such as China and Russia, Brazil has demography on its side. A young and large population guarantees a favourable dependency ratio for a couple of decades to come. Another positive is the consolidation of a stable and nonviolent democracy that can accommodate social demands for distributive policies without political disruption.

Furthermore, Brazil is rich in natural resources at a time when the global appetite for mineral commodities is destined to continue to rise in the long-run. Irrespective of the current gloomy international economy, this century will eventually see emerging economies catch up with the developed world in terms of levels of economic wealth. In addition, with the world’s population forecast to stabilise at 9 billion people, up from the current 7 billion, an expanded global mass of consumers will further keep the pressure on commodity prices. Energy resources, for instance, will constitute a vital asset. Thus, the recent discovery of vast oil and gas reserves on the coast of Rio de Janeiro will likely make Brazil a top energy exporter by the end of this decade. Although the total amount remains uncertain, the new reservoirs already multiply the current Brazilian reserves by a factor of four: from less than 10 billion barrels of oil equivalent (BOE) to an estimation of more than 40 billion BOE. The challenges of extracting at 7,000 meters deep, 200 km from the coast, are enormous, but the current levels of investment are matched to this Herculean task.

The world in the 21st century will not only be hungry for energy and minerals, but also for food. A fast-growing middle class in emerging countries, eager to consume more protein and dairy products, will put pressure on demand for livestock and other agribusinesses. Agricultural production in Brazil has been transformed in the last ten years. For instance, the estimated harvest of grains for 2012 reached 163 million tons – a big increase from less than 100 million tons in 2000 (Figure 2.29). This amount currently places Brazil as one of the top agricultural exporters in the world, only behind the United States and the European

41 The dependency ratio is the ratio of the non-working age population (i.e. children below 14 years and elders above 65 years) to the working-age population.
Union. In addition, much of the increase in Brazil’s agricultural production has been due to gains in productivity; despite vast zones of cheap and unused land, the area covered by plantations has not expanded in the past seven years.

Figure 2.29 Brazil's agricultural production (million tons)

![Graph showing Brazil's agricultural production from 1999 to 2012.](image)

Source: The Brazilian Institute of Geography and Statistics (IBGE)

As noted above, one of Brazil’s biggest challenges is the bottleneck in infrastructure. The Federal Government, however, has already acknowledged the problem. In this regard, vital public and private infrastructure investment plans have been announced totalling more than US$600 billion in the next three years. Four areas are being prioritised (Figure 2.30): affordable housing (estimated budget of US$200 billion), energy generation and distribution (US$150 billion), oil and gas (US$115 billion) and transportation (US$60 billion).
Lastly, public and private investments in human capital are deepening the pool of skilled workers in Brazil. After tackling illiteracy, increasing the education level of the labour force became a priority and enrolment numbers are on the rise. In 2012, 924 thousand students were enrolled in TAFE-type professional courses (+63 per cent rise from 2002); 1.6 million students in higher education (+33.3 per cent); 41,396 in master’s degrees (+76.6 per cent); 13,304 in PhD programmes (+92.9 per cent). Overall, the proportion of the labour force with more than 11 years of study went up from 44.7 per cent in 2002 to 60.5 per cent in 2012. The government is committed to this task, tripling the number of scholarships granted in the last ten years. Moreover, a new scholarship programme ‘Science Without Borders’ has just been introduced, with an estimated budget of US$1.65 billion. This programme aims to send more than 100,000 top Brazilians students (half undergraduates, half doctoral students) to study overseas at top class universities by 2015.

Brazil is coming to realise its long-due future (Box 2.4). It is symbolic that Brazil is hosting the 2014 FIFA World Cup and the 2016 Olympics, the biggest sporting events in the world. They are a fitting recognition by the world of Brazil’s political and economic achievements and prospects.

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42 In 2002, these numbers were: 565,000 students enrolled in TAFE-type professional courses; 1.2 million students in higher education; 23,445 in master’s degrees; 6,894 in PhD programmes.

43 On the topic, see The Economist, Education in Brazil – Studying the world. The Economist, 17 March 2012.
Box 2.4 Evidence of the rise of Brazil

- Sound Macroeconomic Fundamentals:
  - Low inflation.
  - Unprecedented low level of interest rates.
  - Rising mass consumption class.
  - Low unemployment rate and higher salaries.
  - Better terms of trade.
  - Strong and flexible currency.
  - Positive fiscal budgets.
  - Net external creditor with robust international reserves.
  - Big recipient of FDI.
  - Solvent and transparent financial and banking system.
  - Investment grade and lower country-risk premiums.
- Young and large population.
- Stable and nonviolent democracy.
- Big natural reserves (including one of the largest water basins in the world).
- Pre-salt oil and gas and other mineral reserves.
- Potential to consolidate as the main food supplier to the world. (increasing productivity, large unexploited/cheap lands and Doha Round).
- Hosting of the 2014 FIFA World Cup and the 2016 Olympics.
- Increasing levels of investments at macro and micro level.
- Middle Income Economy with plenty of room to catch-up with the developed nations.
Chapter 3
SOUTHERN HEMISPHERE SUPERPOWER?
Brazil in context

Mark Thirlwell
Getting to know the B in BRICs

Journalists, investors and global economy watchers in general have been fascinated with the rise of the BRICs (Brazil, Russia, India and China) almost since Goldman Sachs’ Jim O’Neill first coined the phrase.44 Despite its widespread use, however, the BRICs concept has been of limited practical relevance to Australia, where the overwhelming focus has tended to be on the ‘C’ in that construct. In many ways, this is not particularly surprising. To begin with, there has always been something rather artificial about the grouping, representing as it does an investment banker’s catchy acronym rather than a coherent analytical group. More significantly, the sheer importance of Australia’s trading relationship with China in recent years has tended to overshadow our economic links with almost every other emerging market: it has only been relatively recently that serious attention has been paid to India, for example, which in 2011-12 was Australia’s fourth largest merchandise export market and 6th largest merchandise trading partner.45 Given that Australia’s trade ties with Brazil (our 30th largest merchandise trading partner in 2011-12) and Russia (ranked 31st) are still quite modest, it follows that even less attention has been paid to these other two members of the BRIC group.46

Although a Sinocentric focus is quite understandable in the context of the relative sizes of the various bilateral economic relationships, it is now time for Australia to pay more attention to the ‘B’ in BRICs. Indeed, when viewed from a perspective other than the one offered by the scale of bilateral trade and investment flows, the relative neglect


46 The annex to this Chapter provides a quick comparison of Australia’s bilateral relationships with the BRICs.
of Brazil by Australia can even seem quite surprising. This is partly because the dramatic swings in international opinion regarding Brazil’s economic performance, that have occurred in recent years as a result of the developments set out in Chapter 2, might have been expected to draw more attention. But it is also noteworthy given the clear parallels between many of the policy challenges facing the two countries. The latter would include: managing the vagaries of the commodity cycle; the policy response to Chinese investment into relatively sensitive sectors like mining and agriculture; the pressures on the exchange rate and the non-resource traded sector of the economy arising both from developments in the terms of trade and from fallout from the so-called currency wars; and trade and investment policy issues around the resource and agricultural sectors more generally.

Of course, it could be argued that in paying relatively little attention to Brazil, Australians are just being realistic in their assessment. As Fernando Cardim reminds us in Chapter 1, modern economic history has not always tended to paint Brazil in the best light. In terms of economic growth, for example, the South American giant had its own China-like growth spurt all the way back between the mid-1940s and the mid-1970s, when annual GDP growth averaged more than seven per cent. But for much of the period after 1974, growth has been both low and volatile. Granted, recent years have brought a renewed sense of optimism regarding the country’s economic prospects: the 2012 IMF country report on Brazil opens by noting that the ‘past decade has seen a remarkable social transformation in Brazil, underpinned by


49 Paulo Sotero and Leslie Elliot Armiho, Brazil: to be or not to be a BRIC? Asian Perspective 31 (4) 2007.
macroeconomic stability and rising living standards.\textsuperscript{50} Yet even this recent bout of optimism has since been followed by a reversion to pessimism in some quarters as dampened expectations about the future trajectory of commodity prices and slowing economic growth have seen questions raised as to the longevity of Brazil’s latest economic turn-around.\textsuperscript{51}

**Brazil is now too important for Australia to neglect**

Although it’s true that Brazil’s recent economic story is not as compelling as China’s dramatic take-off, and that Australia-Brazil economic linkages are currently dwarfed by the scale of Australia-China trade ties, that’s far from saying that we couldn’t benefit from paying more attention to developments in South America’s largest economic power. In fact, there is a compelling list of reasons as to why Brazil merits more of Australia’s attention.

- For a start, Brazil is *already* a major global economy. As of 2011, Brazil was the world’s fifth largest country by population and the seventh (on a purchasing power parity (PPP) basis) or sixth (on a US dollar basis) largest economy in the world, accounting for between three and three-and-a-half per cent of world output, depending on which measure of GDP is used.\textsuperscript{52}

- Blessed with a wealth of natural resources, Brazil has become a critical player in a world economy facing some significant resource constraints.\textsuperscript{53} Brazil’s agricultural prowess has seen it described as a ‘new food superpower.’\textsuperscript{54} Brazil is also a major exporter of iron

\textsuperscript{50} International Monetary Fund (IMF), Brazil: 2012 Article IV Consultation - Staff Report. IMF Country Report No.12/191. Washington DC, International Monetary Fund, July 2012.

\textsuperscript{51} See for example: Ruchir Sharma, Bearish on Brazil. Foreign Affairs 91 (3) 2012; The Economist, The Brazil backlash. The Economist, 19 May 2012; Joe Leahy, A high-flyer now flags. Financial Times, 10 January 2012; Joe Leahy, Downturn shakes Brazil from its dream. Financial Times, 2 December 2012.

\textsuperscript{52} Data from International Monetary Fund (IMF), World Economic Outlook Database October 2012. Washington DC, International Monetary Fund, 2012. International comparisons of GDP are typically done in one of two ways. The most straightforward is to convert national currency measures of GDP into a common currency (typically US dollars) using the prevailing market exchange rate for the period in question. The alternative approach uses the PPP exchange rate, defined as the rate at which the currency of one country would have to be converted into that of another country to buy the equivalent amount of goods and services in each country. See Tim Callen, PPP versus the market: Which weight matters? Finance and Development 44 (1) 2007.


\textsuperscript{54} Thomas Omestad, Brazil becomes the new food superpower. US News, 25 June 2008.
ore and, along with Australia, dominates the global iron ore trade.55 Brazil’s ethanol production makes it the second largest producer of biofuels in the world.56 And according to the US Energy Information Administration (EIA), Brazil’s large offshore pre-salt oil deposits have the potential to ‘transform Brazil into one of the largest oil producers in the world’.57

• Brazilian companies such as Petrobras, Vale, Embraer, JBS Beef and Ambev are now globally successful firms, and many are becoming important overseas investors.58 Brazil, like the other BRICs, is making the transition from being a major recipient of foreign direct investment (FDI) to also being an important source of FDI flows.

• Brasília is playing an increasingly influential role in global economic governance. Along with Australia, Brazil is a member of the G20; it has a leadership role in the ‘other’ G20 at the WTO and is also a member of the so-called ‘new quad’ or ‘four/five interested parties’; Brazil also has a rising voting weight at the IMF (assuming that the latest set of quota reforms are eventually agreed, Brazil’s voting share will rise from 1.7 per cent to 2.2 per cent, moving it into the top ten); and Brasília is a key player in the new international architecture being built around the world’s emerging powers in the form of groupings like IBSA and the BRICS.59

• Finally, Brazil’s economic weight is likely to be matched by diplomatic clout more generally. Brazil’s foreign policy became ‘bolder and more innovative’ during the Lula presidency, with the increase in activism visible in the country opening 33 new embassies, 19 new consulates

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55 In 2011, Brazil exported 313 million tonnes of iron ore, or about 29 per cent of world exports. Only Australia (438 million tonnes, 41 per cent) exported more. Bureau of Resources and Energy Economics, Resources and Energy Quarterly: September Quarter. Canberra, Bureau of Resources and Energy Economics, 2012.

56 In 2011, Brazil accounted for 22.4 per cent of global biofuels production, second only to the United States (48 per cent). BP, Statistical review of world energy June 2012.

57 Energy Information Administration (EIA), Brazil Country Analysis Brief. Washington DC, Energy Information Administration, US Department of Energy, 2012. ‘Pre-salt oil’ refers to oil reserves located offshore under a thick layer of salt – that is, the oil deposits were formed before (‘pre’) the salt layer; if all the pre-salt discovered reserves are proven, and then added to Brazil’s current reserves, this could lift Brazil into seventh place in the world rankings of proven oil reserves. Mamdouh G Salameh, Brazil’s pre-salt oil potential: The hype and the reality. USAEE Working Paper No. 2109947. Cleveland, OH, United States Association for Energy Economics, 16 July 2012.


59 IBSA is the India-Brazil-South Africa dialogue forum established in 2003 by the Brasilia Declaration. The formal IBSA grouping comprises India, Brazil and South Africa and is described in more detail below.
and 5 permanent missions to international organisations.60 Brasilia also has longstanding aspirations for a permanent UN Security Council seat.

As two observers of Brazil’s rise put it: after a ‘long history of dreaming of being a great power’, Brazil now finds itself attaining major power status ‘almost accidentally’.61 How Brazil chooses to exercise that power will be of interest to a range of countries, including Australia.

The country of the future?

To set alongside Brazil’s current importance in the world economy, there is also the potential for that importance to become even greater in coming years. Sure, there has long been optimism about Brazil’s place in the world economy: after all, as Patrick Carvalho reminds us in his essay, Brazil is the original ‘country of the future’.62 In the past, that optimism has frequently been misplaced, and Brazil’s undoubted potential has never quite been fulfilled. Yet analysts continue to predict a bright future for the economy, and according to a range of economic forecasts Brazil is expected to be one of the world’s most important economies over the coming decades.63 So, for example, according to Goldman Sachs – the outfit that coined the BRICs term – Brazil could be the world’s fifth largest economy by 2030 and the fourth largest by 2040, behind only China, the United States and India:

60 Andrew Hurrell, Brazil and the new global order. Current History 109 (724) 2010.
61 Sotero and Armiho, Brazil: to be or not to be a BRIC?
63 Note that some of the following forecasts are US dollar based while others are PPP based. Each individual table specifies the measure of GDP being used.
Table 3.1 Goldman Sachs projections

| Top 10 economies by GDP, in 2010 US$ |
|-----------------|-----------------|-----------------|-----------------|
| 2020            | 2030            | 2040            | 2050            |
| 1   | US  | China | China | China           |
| 2   | China  | US  | US  | US              |
| 3   | Japan   | India | India | India           |
| 4   | Germany | Japan  | Brazil | Brazil         |
| 5   | India   | Brazil | Japan  | Russia          |
| 6   | Brazil   | Russia | Russia | Japan           |
| 7   | Russia   | Germany | Mexico | Mexico          |
| 8   | France  | UK  | UK  | Indonesia       |
| 9   | UK      | France | Germany | UK             |
| 10  | Italy   | Mexico | France | France          |

Source: Constructed from Table 1 and Table A2 in WilsonTrivediCarlson and Ursua, The BRICs 10 years on: halfway through the great transformation. (2011)

Likewise, according to economists at Standard Chartered, Brazil may have become the world’s number five economy by 2020 and reached number four by 2030:

Table 3.2 Standard Chartered projections

| Top 10 economies by GDP, in 2009 US$ |
|-----------------|-----------------|-----------------|-----------------|
| 2020            | 2030            | 2040            | 2050            |
| 1   | China  | China           | -               | -               |
| 2   | US     | US              | -               | -               |
| 3   | India  | India            | -               | -               |
| 4   | Japan  | Brazil           | -               | -               |
| 5   | Brazil | Indonesia        | -               | -               |
| 6   | Germany | Japan         | -               | -               |
| 7   | France | Germany          | -               | -               |
| 8   | Russia | Mexico           | -               | -               |
| 9   | UK     | France           | -               | -               |
| 10  | Indonesia | UK         | -               | -               |

Similar optimism is on display in the projections from Citibank (5th spot by 2030) and PWC (4th largest economy as of 2050):

**Table 3.3 Citibank projections**

<table>
<thead>
<tr>
<th>Top 10 economies by GDP, in 2010 PPP $</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
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<tr>
<td>4</td>
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<td>5</td>
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<td>9</td>
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<tr>
<td>10</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Top 10 economies by GDP, in current US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>2</td>
</tr>
<tr>
<td>3</td>
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<td>4</td>
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<td>9</td>
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<td>10</td>
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</tbody>
</table>

The most negative set of (relative) projections for Brazil reported here come from HSBC, and these still see Brazil as one of the world’s top ten economies by 2050:

Table 3.5 HSBC projections

<table>
<thead>
<tr>
<th>Top 10 economies by GDP, in 2000 US$</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020 2030 2040 2050</td>
</tr>
<tr>
<td>-------------------------------------</td>
</tr>
<tr>
<td>1 - - - China</td>
</tr>
<tr>
<td>2 - - - US</td>
</tr>
<tr>
<td>3 - - - India</td>
</tr>
<tr>
<td>4 - - - Japan</td>
</tr>
<tr>
<td>5 - - - Germany</td>
</tr>
<tr>
<td>6 - - - UK</td>
</tr>
<tr>
<td>7 - - - Brazil</td>
</tr>
<tr>
<td>8 - - - Mexico</td>
</tr>
<tr>
<td>9 - - - France</td>
</tr>
<tr>
<td>10 - - - Canada</td>
</tr>
</tbody>
</table>

Source: Table 3 in Ward, The world in 2050: from the top 30 to the top 100. (2012)

Note: Of the two missing BRIIC economies in 2050, Russia is ranked 15th and Indonesia 17th.
Putting Brazil in context: From BRICs to BRIICs

Brazil is already one of the world’s largest economies and is widely expected either to maintain this importance or to increase it in coming years (subject to the usual big caveats about the reliability of long-term forecasting exercises). Of course, the same claim can be made for a range of emerging economies, not least the other BRICs. So how does Brazil stack up in comparison to those other major markets that are currently reshaping the global economy, and which are also candidates for Australia’s attention?

As already noted, it has become commonplace to use the term BRICs to describe a critical subset of the world’s key emerging markets, and this is perhaps the obvious place to start any international comparison. Somewhat surprisingly, the BRICs have developed beyond the original investment acronym to develop a formal institutional structure, a process which culminated in the inaugural BRIC summit involving the heads of state from all four countries held on 16 June 2009 in Yekaterinburg. More recently, the BRICs have become the BRICS, as in December 2010, South Africa officially became the fifth member of the formal grouping, participating in the April 2011 Summit in China as a full member.64 In many ways, however, South Africa is not an obvious addition to the BRICs club.65 With a population of around 51 million, it is much smaller than the other BRICs. Likewise, it has a much smaller economy than the other four.66 As a result, for the benchmarking exercise in the remainder of this Chapter, instead of South Africa, we have chosen to include Indonesia as a fourth comparator economy: in other words, we have opted for the BRIICs rather than the BRICS.67 Our choice reflects several factors:

64 Jack A. Smith, BRIC becomes BRICS: Changes on the geopolitical chessboard. Foreign Policy Journal 2011.


66 In 2011, South Africa’s GDP was about US$409 billion or $555 billion on a PPP basis. By comparison, the next smallest BRIC was either India (US$1827 billion) or Brazil (PPP $ 2,294 billion).

67 Along with Turkey and Mexico, Indonesia is sometimes cited as a potential future candidate for the formal BRICS grouping.
• Prior to the Asian financial crisis and the more recent rise of the BRICs concept, Indonesia was one of the five major developing and transition economies (along with Brazil, China, India and Russia) widely expected to play a key role in the global economy.68

• A growing number of analysts now expect Indonesia to return to this position as one of the major emerging economy powers.69

• Indonesia’s large population means that it is closer in scale to the BRICs, including Brazil, than is South Africa.

• Likewise, Indonesia’s economic size is also closer to that of the other BRIC economies than South Africa’s.

• Finally, Indonesia is of great interest to Australian policymakers and in particular is often seen as a country where bilateral economic ties are significantly underdone.

Brazil’s global economic footprint in context: population

As noted above, Brazil’s large population already makes it one of the world’s most important countries. In 2011, Brazil was the world’s fifth largest economy by population, exceeded in size only by China, India, the United States and Indonesia.

Table 3.6 Demographic profiles (1)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil 194.9 (5)</td>
<td>74.0</td>
<td>96.9</td>
<td>0.84</td>
</tr>
<tr>
<td>China 1,347.4 (1)</td>
<td>73.8</td>
<td>108.0</td>
<td>0.42</td>
</tr>
<tr>
<td>India 1,206.9 (2)</td>
<td>66.0</td>
<td>106.8</td>
<td>1.32</td>
</tr>
<tr>
<td>Russia 142.4 (9)</td>
<td>69.2</td>
<td>86.1</td>
<td>-0.1</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia 241.0 (4)</td>
<td>70.0</td>
<td>99.5</td>
<td>0.98</td>
</tr>
</tbody>
</table>


That said, although Brazil’s population is in the global top five, it is still only about 16 per cent of India’s and less than 15 per cent of the population of China.

Brazil has a population growth rate in the middle of the BRIICs pack – expanding at a pace faster than China and Russia (the latter’s population is actually shrinking) but at slower rate than India and Indonesia. Likewise, in terms of its location in the demographic transition, Brazil is placed between China and Russia on the one hand and India and Indonesia on the other, as captured both by the median age of the population and by the old age dependency ratio.\textsuperscript{70} Moreover, although not ageing anywhere near as quickly as Russia or China, Brazil is still forecast to experience its own period of rapid population ageing: Brazil’s old age dependency ratio is predicted to double between 2010 and 2030.\textsuperscript{71}

\textsuperscript{70} Crudely put, the demographic transition is the shift from a population structure dominated by high fertility and death rates and a rapidly-growing population, to one marked by much lower fertility and death rates and an ageing population. See Ronald Lee, The demographic transition: Three centuries of fundamental change. \textit{Journal of Economic Perspectives} 17 (4) 2003.

### Table 3.7 Demographic profiles (2)

<table>
<thead>
<tr>
<th>Year</th>
<th>Median age (years)</th>
<th>Total Child</th>
<th>Old Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>Brazil 29.1</td>
<td>48 38</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td>China 34.5</td>
<td>38 27</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>India 25.1</td>
<td>55 47</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Russia 37.9</td>
<td>39 21</td>
<td>18</td>
</tr>
<tr>
<td>Memo:</td>
<td>Indonesia 27.8</td>
<td>48 40</td>
<td>8</td>
</tr>
<tr>
<td>2030</td>
<td>Brazil 37.4</td>
<td>46 26</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td>China 42.5</td>
<td>45 21</td>
<td>24</td>
</tr>
<tr>
<td></td>
<td>India 31.2</td>
<td>47 35</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>Russia 43.3</td>
<td>54 24</td>
<td>29</td>
</tr>
<tr>
<td>Memo:</td>
<td>Indonesia 35.1</td>
<td>44 29</td>
<td>15</td>
</tr>
</tbody>
</table>


Median variant. The total dependency ratio is the ratio of the sum of the population aged 0-14 and that aged 65+ to the population aged 15-64. The child dependency ratio is the ratio of the population aged 0-14 to the population aged 15-64. The old-age dependency ratio is the ratio of the population aged 65 years or over to the population aged 15-64. All ratios are presented as number of dependants per 100 persons of working age (15-64).

### Brazil’s global economic footprint in context: output (GDP)

As of 2011, Brazil was the world’s seventh largest economy when output is measured on a PPP basis and the sixth largest economy when US dollar exchange rates are used.\(^72\) On a PPP basis, Brazil’s economy is similar in size to that of Russia’s, and almost double the size of Indonesia’s. However, Brazilian GDP in 2011 was about half the size of Indian GDP, and about one-fifth the size of Chinese output.

\(^72\) It is worth noting here that as an emerging market, Brazil is unusual in having a US dollar value of GDP greater than the PPP value of GDP. As the comparison table suggests, typically emerging markets have US dollar exchange rates that are significantly undervalued relative to their PPP rate, but Brazil is an exception.
Table 3.8 Size of economy in 2011

<table>
<thead>
<tr>
<th></th>
<th>PPP basis</th>
<th>US$ basis</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>GDP($ billions)</td>
<td>% World output</td>
</tr>
<tr>
<td>Brazil</td>
<td>2,294</td>
<td>2.9</td>
</tr>
<tr>
<td>China</td>
<td>11,300</td>
<td>14.3</td>
</tr>
<tr>
<td>India</td>
<td>4,421</td>
<td>5.6</td>
</tr>
<tr>
<td>Russia</td>
<td>2,383</td>
<td>3.0</td>
</tr>
<tr>
<td>Memo: Indonesia</td>
<td>1,125</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: International Monetary Fund, World Economic Outlook Database October 2012 (2012)

On a US dollar basis, Brazil’s economy is much larger than Indonesia’s and appreciably larger than India’s or Russia’s. It is still only about one-third the size of the Chinese economy, however.

While Brazil’s absolute economic size places it firmly in the world economy’s top league not just of emerging economies but also of developed economies, its performance over time is less impressive – at least when measured on a PPP basis. In particular, while China and India have managed to grow their share of the global economy significantly over recent decades, the same is not true of Brazil. Brazil’s share of world output in 2011 was still below the almost four per cent share it attained in 1980. In comparison, India has seen its share of world output rise from 2.5 per cent in 1980 to 5.7 per cent by 2011, while China has experienced a stunning increase from 2.2 per cent to 14.3 per cent of world output over the same period.\(^{73}\)

\(^{73}\) Note, however, that the appreciation of the Brazilian currency against the US dollar over some of this period means that Brazil’s story is different when world output is measured using market exchange rates. On this basis, Brazil increased its share of world GDP between 1980 and 2011 by more than two percentage points – a greater gain than that experienced by either India or Indonesia, although still well below the dramatic rise of China’s share of world output. See the discussion in Chapter 2.
Brazil's global economic footprint in context: wealth (GDP per capita)

Brazil had a GDP per capita in 2011 of $11,769 on a PPP basis, meaning the country was the 76th wealthiest in the world, and US$12,789 on a US dollar basis (ranked 54th in the world).

Table 3.9 GDP per capita in 2011

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP per capita (PPP $)</th>
<th>% US level</th>
<th>Rank(#)</th>
<th>GDP per capita (US$)</th>
<th>% US level</th>
<th>Rank(#)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>11,769</td>
<td>24.4</td>
<td>76</td>
<td>12,789</td>
<td>26.5</td>
<td>54</td>
</tr>
<tr>
<td>China</td>
<td>8,387</td>
<td>17.4</td>
<td>93</td>
<td>5,417</td>
<td>11.2</td>
<td>90</td>
</tr>
<tr>
<td>India</td>
<td>3,663</td>
<td>7.6</td>
<td>128</td>
<td>1,514</td>
<td>3.1</td>
<td>137</td>
</tr>
<tr>
<td>Russia</td>
<td>16,736</td>
<td>34.6</td>
<td>55</td>
<td>12,993</td>
<td>26.9</td>
<td>53</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>4,666</td>
<td>9.7</td>
<td>121</td>
<td>3,512</td>
<td>7.3</td>
<td>110</td>
</tr>
</tbody>
</table>

Source: International Monetary Fund, World Economic Outlook Database October 2012, (2012)

In relative terms, GDP per head in Brazil is roughly one quarter the level of that of the United States, making Brazil the second richest of the BRIIC group, behind Russia. Brazil is a much wealthier economy than India or Indonesia and is also comfortably richer than China. However, Brazil's income distribution is more unequal than that of the other BRIICs, despite the significant reduction in inequality reported in Chapter 2.\(^{74}\)

\(^{74}\) As measured by the income Gini coefficient as reported by the World Bank. Note however that the availability of this data differs markedly by country. For example, the most recent reading for Brazil is 2008 and for China and India is 2005.
Brazil’s global economic footprint in context: international trade

Brazil’s trade profile is characterised by a much higher share of agricultural products in its exports than the other BRIIC economies, with Indonesia demonstrating the closest mix of exports and imports:

Table 3.10 Merchandise trade structure (2011)

<table>
<thead>
<tr>
<th></th>
<th>%</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Agriculture</td>
<td>Fuels &amp; minerals</td>
</tr>
<tr>
<td>Brazil</td>
<td>33.8</td>
<td>30.4</td>
<td>32.8</td>
</tr>
<tr>
<td>China</td>
<td>3.4</td>
<td>3.1</td>
<td>93.3</td>
</tr>
<tr>
<td>India</td>
<td>11.3</td>
<td>23.7</td>
<td>61.7</td>
</tr>
<tr>
<td>Russia</td>
<td>5.7</td>
<td>71.8</td>
<td>19.3</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td>24.0</td>
<td>42.2</td>
</tr>
</tbody>
</table>


Brazil’s international trade performance has been hampered by a history of high transport costs, relatively high tariff barriers, heavy regulatory burdens and the legacy of a prolonged period of import substitution policies. Partly as a result, Brazil’s share of world trade is appreciably lower than its share of global output. Brazil’s share of world trade in 1980 was just over one per cent, and this had moved only marginally higher by 2011. In that year, Brazil was only the world’s 22nd largest exporter of merchandise goods (accounting for 1.4 per cent of global exports), and the 21st largest importer (1.3 per cent):
The story is broadly similar with regard to international trade in commercial services, where Brazil is only the world’s 31st largest exporter and 17th largest importer:

**Table 3.12 Commercial services trade (2011)**

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>US$ billions</td>
<td>Share (%)</td>
</tr>
<tr>
<td>Brazil</td>
<td>37</td>
<td>0.9</td>
</tr>
<tr>
<td>China</td>
<td>182</td>
<td>4.4</td>
</tr>
<tr>
<td>India</td>
<td>137</td>
<td>3.3</td>
</tr>
<tr>
<td>Russia</td>
<td>53</td>
<td>1.3</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>20</td>
<td>0.5</td>
</tr>
</tbody>
</table>


Although its overall footprint in global trade is relatively modest, Brazil is a very significant exporter of agricultural products, including food. For example, in 2011 Brazil accounted for 5.2 per cent of world agricultural exports, behind only the EU and the United States. Likewise, in the same year Brazil accounted for 5.7 per cent of global food exports (again behind the EU and the United States). Brazil is now one of the world’s most competitive producers of agricultural commodities with
large market shares in a range of products including sugar, ethanol, chicken, beef, coffee, tobacco, and soybeans. This comparative advantage in agricultural products rests on one of the largest renewable reserves of freshwater in the world along with a vast territory and varied climate that currently support efficient, large-scale commercial agriculture. Brazil is home to around 18 per cent of the world’s available freshwater resources.

In addition, Brazil is also an important resource exporter, with the country benefitting from a considerable amount of mineral and energy wealth, from iron ore to oil and gas.

**Brazil’s global economic footprint in context: foreign direct investment**

Brazil has been a large recipient of foreign direct investment (FDI), ranking only behind China in terms of the total stock of inward FDI out of the BRIIC economies. Since the early 2000s, Brazil has also become a significant source of outward FDI, to date directed mainly towards neighbouring economies as well as the United States and Europe.
Table 3.13 Stock of foreign direct investment (2011)

<table>
<thead>
<tr>
<th>Country</th>
<th>Inward US$billions</th>
<th>Share (%)</th>
<th>Outward US$billions</th>
<th>Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>669.7</td>
<td>3.3</td>
<td>202.6</td>
<td>1.0</td>
</tr>
<tr>
<td>China</td>
<td>711.8</td>
<td>3.5</td>
<td>366.0</td>
<td>1.7</td>
</tr>
<tr>
<td>India</td>
<td>201.7</td>
<td>1.0</td>
<td>111.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Russia</td>
<td>457.5</td>
<td>2.2</td>
<td>362.1</td>
<td>1.7</td>
</tr>
<tr>
<td>Memo:</td>
<td>173.1</td>
<td>0.8</td>
<td>9.5</td>
<td>0.0</td>
</tr>
</tbody>
</table>


Brazil’s global economic footprint in context: a green superpower?

In a world economy where there is a growing emphasis on environmental issues in general and on sustainability in particular, Brazil’s biofuel and hydro sectors are increasingly treated as important sources of comparative advantage, along with the country’s other environmental resources.80 Some observers have suggested that Brazil could position itself as an emerging environmental power, emphasising the country’s ownership of the world’s last major tropical rainforest, one of the largest renewable reserves of fresh water, and of the planet’s largest stock of biodiversity.81 Certainly, Brazil has already been able to draw upon these resources to become a powerful voice in international climate change negotiations.82

Conclusion: A Southern hemisphere superpower?

Brazil is now a major player in the global economy. Already one of the world’s largest economies by both population and GDP, Brazil’s vast resource wealth and great biodiversity leave the country well-placed to prosper in a resource-constrained global economy. Its economic weight has already allowed Brazil to play an increasingly important role in global

80 Brainard and Martinez-Diaz, The ‘B’ belongs in the BRICs.
81 Sotero and Armijo, Brazil: to be or not to be a BRIC?
82 Sweig, A new global player.
economic governance through bodies such as the G20 and the WTO, and has prompted an upgrade to its quota and (hence) voting rights at the IMF. Brazil’s overall diplomatic clout is also growing to match its international economic presence.

On these grounds alone, Australia would do well to pay attention to what could well be the emergence of a Southern hemisphere superpower.

Granted, Brazil is not an economic power on the same scale as China. Brazil’s bilateral economic relationship with Australia remains modest relative to that of some of the other BRIIC economies. However, as Tim Harcourt’s overview emphasises, there is potential for the relationship to be strengthened. In addition, Australia and Brazil currently share a range of significant policy challenges, from adapting to the swings of the resource boom to managing Chinese foreign investment, which should also offer ample scope for worthwhile discussion and cooperation in the future.
Annex: Australia’s trade and investment ties with Brazil in context

This short annex provides a brief comparison of the level of Australia’s bilateral trade and investment ties with Brazil to those of the other economies discussed in Chapter 3. Not surprisingly, it confirms that Australia’s economic ties with the BRICs plus Indonesia, or the BRIICs, are dominated by the bilateral trade relationship with China.

Trade

The value of Australian merchandise exports to Brazil in 2011-12 was almost A$1.3 billion, or about half of one per cent of total Australian exports. That was less than 10 per cent of the value of Australian exports to India in the same year and less than two per cent of the value of Australian exports to China. It was also significantly less than the value of exports to Indonesia, although it was slightly larger than Australia’s exports to Russia:

Table 3.1A Australia’s merchandise trade 2011-12

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th></th>
<th>Imports</th>
<th></th>
<th>Total</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A$ mns</td>
<td>% Rank</td>
<td>A$ mns</td>
<td>% Rank</td>
<td>A$ mns</td>
<td>% Rank</td>
</tr>
<tr>
<td>Brazil</td>
<td>1,294</td>
<td>0.5 24</td>
<td>825</td>
<td>0.3 37</td>
<td>2,017</td>
<td>0.4 30</td>
</tr>
<tr>
<td>China</td>
<td>76,824</td>
<td>29.1 1</td>
<td>43,405</td>
<td>18.1 1</td>
<td>120,229</td>
<td>23.9 1</td>
</tr>
<tr>
<td>India</td>
<td>13,125</td>
<td>5.0 4</td>
<td>2,494</td>
<td>1.0 21</td>
<td>15,619</td>
<td>3.1 6</td>
</tr>
<tr>
<td>Russia</td>
<td>944</td>
<td>0.4 28</td>
<td>1,060</td>
<td>0.4 32</td>
<td>2,004</td>
<td>0.4 32</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>5,285</td>
<td>2.1 11</td>
<td>6,205</td>
<td>2.6 11</td>
<td>11,490</td>
<td>2.3 13</td>
</tr>
</tbody>
</table>


Australian merchandise imports from Brazil in 2011-12 were even more modest, at just A$0.8 billion, or less than half of one per cent of total imports. That’s roughly one third of the value of Australian imports from India, but just two per cent of the value of Australian imports from China. It is also appreciably smaller than the value of imports from Indonesia. The relationship with Russia was again of a similar order of magnitude to the relationship with Brazil.
In terms of total merchandise trade, Brazil is Australia’s 29th most important trading partner, with A$2.0 billion worth of two-way trade, equivalent to about half of one per cent of total trade. Again, as the table above confirms, Australia’s bilateral merchandise trade relationship with Brazil is of a similar order of magnitude to the relationship with Russia, and is far behind the relationship with the two Asian BRICs. It is also significantly smaller than the trade relationship with Indonesia. Geography and comparative advantage mean that today Australia’s merchandise trade (particularly exports) is dominated by trade with Asia.

Australia’s trade in services with the BRIICs tells a broadly similar story about the low level of trade integration with Brazil. Indeed, Australia’s bilateral services trade with Brazil is so small that it doesn’t even rate a separate mention in the Australian Bureau of Statistics’ report on services trade by country. Once again, it is the trading relationship with China that is by far the most important one for Australia:

Table 3.2A Australia’s services trade 2011

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A$ mns</td>
<td>% Rank</td>
<td>A$ mns</td>
</tr>
<tr>
<td>Brazil</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>China</td>
<td>5,654</td>
<td>11.3</td>
<td>1,793</td>
</tr>
<tr>
<td>India</td>
<td>2,140</td>
<td>4.3</td>
<td>726</td>
</tr>
<tr>
<td>Russia</td>
<td>113</td>
<td>0.2</td>
<td>85</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>1,267</td>
<td>2.5</td>
<td>2,258</td>
</tr>
</tbody>
</table>

Investment

Move from trade to investment and the story changes a little. In large part, however, this is because Australia’s foreign investment profile – both with respect to investment into Australia and investment from Australia overseas – has traditionally been dominated by ties with the United States and the United Kingdom, and that continues to be the case today. As the table below shows, an examination of the stock of inward and outward foreign investment confirms that no BRIIC economy accounts for as much as two per cent of the total stock in either case.

Table 3.3A Australia’s foreign investment stock 2011

<table>
<thead>
<tr>
<th></th>
<th>Into Australia</th>
<th></th>
<th>From Australia</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A$ millions</td>
<td>%</td>
<td>A$ millions</td>
<td>%</td>
</tr>
<tr>
<td>Brazil</td>
<td>1,128</td>
<td>0.1</td>
<td>16,449</td>
<td>1.4</td>
</tr>
<tr>
<td>China</td>
<td>19,047</td>
<td>0.9</td>
<td>16,994</td>
<td>1.4</td>
</tr>
<tr>
<td>India</td>
<td>10,954</td>
<td>0.5</td>
<td>4,299</td>
<td>0.4</td>
</tr>
<tr>
<td>Russia</td>
<td>1,895</td>
<td>0.1</td>
<td>1,339</td>
<td>0.1</td>
</tr>
<tr>
<td>Memo:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>454</td>
<td>0.0</td>
<td>5,405</td>
<td>0.5</td>
</tr>
</tbody>
</table>


In terms of the stock of inward investment, as of June 2011 Brazilian investment into Australia amounted to just over A$1 billion, or less than 0.1 per cent of the stock of total foreign investment in Australia. That’s larger than the stock of Indonesian investment in Australia, but is still smaller than the very modest stock of Russian investment. It’s about 10 per cent of the value of the stock of Indian investment in Australia, and less than six per cent of the value of the stock of Chinese investment, which itself is only a small share of the overall total.
Likewise, none of the BRIICs have yet become major destinations for Australian outward investment. As of 2011, Australian investment in Brazil was some A$16.5 billion, or about 1.4 per cent of the total stock of outward investment. Note, however, that this is similar to the value of Australian investment in China, and well above the value of Australian investment into India, Russia and Indonesia.


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"Patrick Carvalho is an Associate Lecturer at the ANU Research School of Economics and shares Head of Economic Studies Division at the Federation of Industries of Rio de Janeiro."

"Tim Harcourt, author of The Alter Ego Economist, is the J.W. Hincks Fellow in Economics at the University of New South Wales (UNSW)."

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