FACING THE CHALLENGE OF GLOBAL TURMOIL: THE POSITION OF BRAZIL IN THE INTERNATIONAL MONETARY SYSTEM

ENFRENTANDO O DESAFIO DA TURBULÊNCIA GLOBAL: A POSIÇÃO DO BRASIL NO SISTEMA MONETÁRIO INTERNACIONAL

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Abstract: This paper investigates the position of Brazil in the current international monetary system and provides a critical assessment of Brazil's capacity to maintain its recent trajectory of high economic growth and join the club of the five major economies in the future. Based on macroeconomic data, the paper analyzes Brazil's performance over the past decade and assesses the government's recent economic policy. The main conclusion holds that Brazil possesses immense potential but in order to make use of it for the benefit of the largest part of its population, macroeconomic policy is not enough. The country urgently needs profound structural changes in order to increase productivity and make the country more competitive. The current government must abandon its policy of demand-side management and monetary expansion in favor of serious structural reforms. While Brazil possesses an abundance of nature, the other factors of production such as capital, both physical and human capital, are underdeveloped as it is also the case with the country's capacity of technical progress. We use Canada as a point of reference in order to highlight some of the deficiencies of Brazil's governance.

Keywords: Brazil, international monetary system, economic policy, governance.

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Resumo: Este artigo investiga a posição do Brasil no atual sistema monetário internacional e oferece uma avaliação crítica da capacidade do Brasil de manter sua trajetória recente de alto crescimento econômico e entrar para o clube das maiores economias do futuro. Com base em dados macroeconômicos, o artigo analisa o desempenho do Brasil na última década e avalia a recente política econômica do governo. A principal conclusão segura é que o Brasil possui um imenso potencial, mas, a fim de utilizá-lo para o benefício da maior parte de sua população, a política macroeconômica não é suficiente. O país precisa urgentemente de mudanças estruturais profundas a fim de aumentar a produtividade e tornar o país mais competitivo. O atual governo deve abandonar a sua política de gestão da procura e da expansão monetária em favor de profundas reformas estruturais. Enquanto o Brasil é abençoado com uma abundância da natureza, os outros fatores de produção, tais como o capital físico e humano, são subdesenvolvidos, como também é o caso com a capacidade de progresso tecnológico do país. Nós usamos o Canadá como um ponto de referência a fim de destacar algumas das deficiências da governança brasileira.

Palavras-chave: Brasil, sistema monetário internacional, política econômica, governança.

Introduction

Together with the rest of the BRICs, Brazil holds the promise to become a future economic powerhouse and to play an increasingly important role in international affairs. Although less so than for China, but probably with more potential than India or Russia, expectations run high that Brazil will become a major global player. While as to China's rise on the ladder of the ranking of the largest economies, the question arises whether China will be a partner or a rival to the United States. In the case of Brazil, it can be fairly assumed that whatever position its economy will hold in terms of size, Brazil will remain a reliable partner of the West. With its move up on the list of the major economies and after having overtaken the United

Kingdom in 2011, there was the expectation that Brazil's economy might also surpass those of France or even Germany in the future. After all, Europe suffers from an ageing population and a severe crisis of its public finances, while Brazil has a population which is approaching 200 million and enjoys a robust fiscal situation. In terms of population, Brazil is a young country with about 29 percent of its population younger than 14 years old and about 5 percent of its population older than 65 years (BRAZIL SOURCING, 2013).

As to the size of its territory, it is as vast as the United States without Alaska. Brazil has a vibrant democracy and is largely free of severe internal conflicts. Although it is a myth that there is no racism in Brazil, race relations are far from posing a risk to political stability and there are no religious or regional conflicts that threaten domestic politics. Also different from many other societies, Brazil has fully emancipated women. In terms of its popular culture, Brazil represents one of the most modern countries of the world. Taking account of Brazil's potential the interesting question is not so much to ask about Brazil's advancement, but the curious question arises why there has not been more economic progress.

The casual observer often remains unaware of the profound barriers against economic progress from which Brazil suffers. Among these forces of obstruction, the country's bureaucracy ranks high on the list along with Brazil's judicial system. The dominant ideology of Brazil's political elite is one of the other factors behind the country's underperformance. More than any obvious facts, the obstacles for a more rapid advance in Brazil rest in the country's dominant ideology with its roots in a crude form of positivism that permeates the country's intellectual life and dominates the country's school system and its politics. Auguste Comte, the French founder of the positivist theology, provided the motto for the Brazilian flag when the country became a republic in 1889 and his idea still shapes

"Brazilian ideology" (MUELLER, 2002).

Beyond the mental barriers which limit Brazil's economic progress looms also the country's premature flirtations with the welfare state. Since the end of the military dictatorship, that lasted from 1964 to 1985 (SKIDMORE, 1990), Brazil's new democracy has fallen victim to a process of competition in social handouts. The groundwork for this rests with the Brazilian Constitution of 1988 (SUPREMO TRIBUNAL FEDERAL, 2010), which deserves less the name of "constitution" but rather contains a conglomerate of populist demands as goals. Constitutionally, government holds the right to the implementation of an unlimited arsenal of interventionist means. The current government of President Dilma Rousseff practices populist policies in an even more pronounced way than its predecessor and now government policies encroach upon almost all aspects of society well beyond poverty. While the boom in natural resources has provided the finances for these extravagant policies, indications of a Dutch disease are beginning to show up. Even before the Brazilian oil company Petrobras had drilled the first hole, the discovery of new deep-water oil findings at Brazil's coast launched an already fierce political bargaining about which social group will enjoy the royalties (CARTA CAPITAL, 2012).

Brazil's economic growth performance

Over the past couple of years, the Brazilian economy has experienced a steady path of growth turning Brazil into the country with the seventh largest economy of the world in 2010, and much fanfare greeted the event when Brazil overtook the United Kingdom in 2011 to become the sixth largest economy of the world. However, it took only a year for Brazil to lose this ranking and to slip back to the seventh position again (COSTAS, 2012).

Despite the popularity of such figures, one must not take these rankings at face value. Firstly, what matters more than the absolute size of a country's economy is its gross domestic product (gdp) per capita as an indicator of wealth. Secondly, as it is the case with any such international comparisons, the figures will change day from day due to the movements of the exchange rate. In part, Brazil gained its position ahead of the United Kingdom because of the relative strength of the Brazilian currency and it lost this position when the Brazilian Real weakened again. Thirdly, in order to make sensible comparison one must apply deflated figures. However, the so-called "deflator" results from the calculations of the price index and this indicator is notoriously unreliable and not free from outright manipulation so that deflated figures need also to be taken with caution.

The recent weakness of the Brazilian economy has raised the specter of another "*vôo da galinha*" – a "chicken flight" (MUELLER, 2012) of the Brazilian economy as it so often happened in the past when a short-lived boom ended in a crash and long-lasting stagnation (BAER, 2001).

Brazil has experienced a strong recovery since the beginning of the 21st century with a strong rise of its gross domestic product (IBGE, 2013). In terms of its purchasing power per capita, Brazil has moved up to a steeper trajectory after 2004 and was able to rapidly overcome the international financial crisis of 2008 (IBGE 2013). After 2010, however, a new wave of weakness has hit the Brazilian economy. Much to the surprise of the country's economic policy authorities, Brazil has experienced a dramatic decline of its economic growth rates which has brought down economic growth below an annual rate of one percent in 2012.

Much more than the Brazilian government likes to admit, Brazil's integration into the world economy comes mainly through the link with the country's wealth of natural resources. While in the 1990s Brazil experienced a reduction of the share of commodities in overall exports, since

2000 the share has risen again. According to the Brazilian classification, the share of commodities in exports has doubled since the turn of the century and commodities now make up to 50 per cent of Brazil's exports, and according to the Thomson Reuters classification system, commodities have actually a share of 70 per cent of Brazil's exports (FINANCIAL TIMES, 2012).

Brazil's position in the world economy according to IMF classification

Although the Brazilian economy ranks among the major economies by size, its overall position in the world economy is much less prominent. The quotas of the membership in the International Monetary Fund use a broader basis than only the size of the economy. These IMF quotas, which determine the shares and voting rights in the Fund, do not only take economic size into account, but also a country's financial power and integration into the world economy. According to this measure, Brazil holds a quota of 1.78 percent at the International Monetary Fund, which puts Brazil behind much smaller countries such as Belgium with 1.93 %, not to speak of the United States, which holds 17.69 percent of all quotas, or even China, which currently holds four percent (IMF, 2013).

When a country joins the International Monetary Fund, it receives an initial quota in the same range as the quotas of existing members that are broadly comparable in economic size and characteristics. The IMF uses a quota formula to guide the assessment of a member's relative position. The current quota formula (IMF, 2008) is a weighted average of a country's gross domestic product (weight of 50 percent), openness (30 percent), economic variability (15 percent), and international reserves (5 percent). For this purpose, the IMF calculates the size of a country's economy as a mixture among its gross domestic product based on market exchange rates (weight of 60 percent) and on the purchasing power exchange rate (40 percent). The formula also includes a "compression factor" that reduces the dispersion in calculated quota shares across members (IMF, 2012). The IMF quotas pretty much express the global distribution of a country's true financial and economic power (table 1).

Table 1

International Monetary Fund, IMF Members' Quotas and Voting Power, and IMF Board of Governors. Selected countries, Last Updated: March 05, 2013

COUNTRY	QUOTA (% of total)	VOTES (% of total)
Argentina	0.89	0.87
Belgium	1.93	1.86
Brazil	1.79	1.72
Canada	2.67	2.56
Chile	0.36	0.37
China	4.00	3.81
France	4.51	4.29
Germany	6.12	5.81
India	2.44	2.34
Italy	3.31	3.16
Japan	6.56	6.23
Korea	1.41	1.37
Mexico	1.52	1.47
Netherlands	2.17	2.08
Russian Federation	2.50	2.39
Spain	1.69	1.63
United Kingdom	4.51	4.29
United States	17.69	16.57
Venezuela	1.12	1.08

Source: IMF Members' Quotas and Voting Power, and IMF Board of Governors
Last Updated: March 05, 2013

Five major European economies (Germany, France, UK, Italy, and The Netherlands) taken together possess a share of quotas of 20.62 % and represent the double of the so-called BRIC countries (Brazil, Russia, India, and China) taken together with 10.7 per cent. The quotas are even more telling when one takes into consideration that China and India together make up a combined population of 2.6 billion while Germany and France together have a population of no more than 148 million people. Regarding differences in the size of population, the quota figures show how much the so-called developing countries are still behind the so-called industrialized countries. However, the discrepancy also indicates the immense potential that these emerging economies possess and the potential growth of wealth the world would experience when these emerging economies will attain the level of the economically advanced countries.

Currency War

After the fear that the government of President Inácio da Silva would practice extremist policies had settled, Brazil became highly attractive for foreign portfolio investments, particularly after the country received "investment grade" status by the international rating agencies Standard & Poor's and Fitch in 2008 and by Moody's Investors Services in 2009 (MINISTÉRIO DA FAZENDA, 2009). Yet the inflow of foreign funds into Brazil has become a two-edged sword. Given that Brazil no longer has a fixed exchange rate regime, the inflow of foreign capital makes the Brazilian currency dearer and this appreciation of the Brazilian real makes Brazil's exports more expensive while it cheapens its imports. In September 2010, a short time before the international financial summit of the Group of Twenty (G20) took place in South Korea, Brazilian finance minister Guido Mantega declared (SEO, 2010) that the world was experiencing a "currency war" where "devaluing currencies artificially was a global strategy".

By announcing the outbreak of a "currency war", Mantega wanted to draw attention to the problems caused by the on-going exchange rate manipulations that governments put in place in order to gain economic advantages. In this sense, "currency war" denotes the conflict among nations that arises from the deliberate use of the exchange rate in order to gain international competitiveness by way of currency devaluation.

Despite these warnings and their repetition after a new Brazilian government came into power, the inflow of money from abroad has continued. When the Brazilian finance minister repeated his warnings that "the currency war turning into a trade war" in January 2011 (FINANCIAL TIMES, 2011), Guido Mantega sent a signal to the world that an escalation of the trade war had begun. Because of the massive inflow of money from abroad, the Brazilian currency sharply appreciated and the Brazilian economy lost competitiveness.

In order to reduce the impact on the domestic economy, Brazil has been intervening in the foreign exchange markets in order to diminish the degree of currency appreciation. By doing so, the monetary authorities had to buy foreign currencies, mainly US dollars, in exchange for its domestic money.

By pursuing such a policy over the past couple of years, Brazil has increased its foreign exchange reserves from around US $ 50 billion in 2005 close to 400 billion US dollars in 2012 (BANCO CENTRAL DO BRASIL).

From 2002 to 2008, the Brazilian real appreciated from almost four to close to 1.5 Real per US dollar. Since then, given the massive program of exchange rate intervention, as it shows in the accumulation of foreign exchange reserves, has brought back the Brazilian currency to around two real per US dollar in 2012 (FEDERAL RESERVE BANK OF ST. LOUIS, 2013).

Brazil's foreign trade suffered from an exchange rate overvaluation that attained forty percent before the outbreak of the global financial crisis. The country experienced a short period of currency weakness during the heyday of the crisis, yet came back quickly into overvalued territory again thereafter and suffered from a real effective appreciation of 50 percent compared to its level in June 2005 (THE ECONOMIST, 2011).

The performance of the Brazilian Real compared to the Chinese Yuan and the US dollar shows that since June 2005 the Brazilian currency's real effective exchange rate rose from 100 to 140, while the Chinese Yuan increased to 120 and the US dollar fell to almost 80 (THE ECONOMIST, 2011). As the so-called "real effective exchange rate" takes into account the distribution of trade as well as inflation rate differentials, the Brazilian Real appreciated more by this calculation than it would show up at the bilateral nominal exchange rate to the US dollar.

Therefore, Brazil's current account balance, which was still at surplus in 2007, has plunged into a deficit since 2008 and has sharply deteriorated recently (BANCO CENTRAL DO BRASIL, 2013).

Although in terms Brazil's current account deficit as percent of its gross domestic production the deficit has not yet reached crisis levels, the country's external position is drastically deteriorating, particularly if the plunge of Brazil's trade balance into negative territory should prove to be persistent and confirm the trend since the mid 2005 (MINISTÉRIO DO DESENVOLVIMENTO, 2012).

The country's overvalued currency explains only in part the rise of Brazil's current account deficit. Additionally, weak demand from its trading partners that have plunged into a prolonged recession is at work. Even more so, however, Brazil's weak international competitiveness in goods other than natural resources comes into play. Beyond these factors, there has been also a causal chain at work where the massive inflow of funds from abroad that boosts the exchange rate automatically leads to an increase of the country's monetary base, which in turn drives up price inflation and thereby reduces Brazil's international competitiveness.

The combination of ample liquidity at home, weak demand from some trading partners abroad and a strong exchange rate appreciation provide, together with domestic price pressure, the basis for a rise of imports that exceeds exports, particularly when services are included in the overall trade balance. Different from a country like Germany, for example, whose industry is resilient against currency appreciation, Brazil resembles in this respect the countries of the Southern periphery of the Eurozone in the incapacity to cope effectively with an overvalued currency.

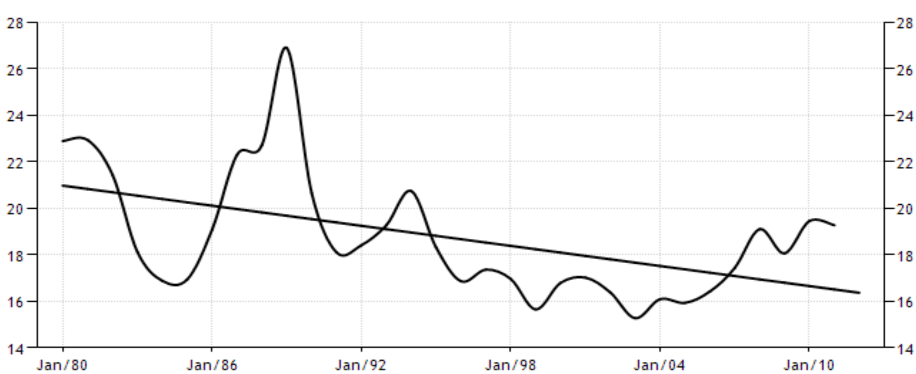
When in January 2011 a new government took power in Brazil, President Dilma Rousseff declared in her inauguration speech (ROUSEFF, 2011) that she would protect Brazil "from unfair competition and from the indiscriminate flow of speculative capital". Guido Mantega, the former and new Brazilian finance minister, did not hesitate to join in when he asserted that the government has an "infinite" number of interventionist tools at its disposal with which to protect national interests. Finance Minister Guido Mantega made it clear that the government would be ready to use taxation and trade control measures in order to stop the deterioration of Brazil's trade balance. Despite these warnings, the inflow of funds kept going on and on March 16, 2011 the Brazilian Central Bank announced that up to that date alone 30.4 billion US dollars had already flown into Brazil compared with 24.4 during the whole former year. A few days later the Brazilian Central Bank declared that it would resort to interventionist means in order to ward off the inflow of foreign funds into Brazil that threaten domestic and international stability (BANCO CENTRAL DO BRASIL, 2011).

Current Economic Policy

The Brazilian government fell into a state of panic when the economic growth rates began to deteriorate drastically in 2010 and did so throughout 2011 to recover only slightly in 2012. Although the inflation rate has been on the rise, the government via its monetary policy committee (COPOM) decided to cut policy interest rates (SELIC) to 7.25 % in mid-2011. On January 17, 2013, the Monetary Policy Committee of the Central Bank of Brazil decided to maintain its benchmark interest rate at 7.25 percent (BANCO CENTRAL DO BRASIL, 2013).

Brazil's Central Bank is doing risky business when in the face of rising inflation it cuts interest rates in order to stimulate the economy back to more growth. Short-term macroeconomic maneuvers will not make Brazil more efficient nor permanently raise economic growth rates when at the same time national investment rate remains at about 20 percent (see figure 1).

Figure 1
Brazil. Investment (gross fixed capital formation) in percent of GDP, 1980-2012

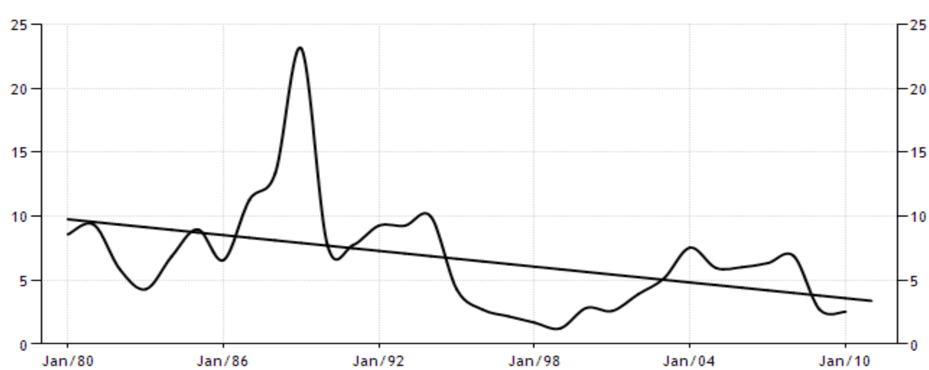


Source: The World Bank Group

The prospects are not very good for Brazil with a government which mainly focuses on the short-run and is about to neglect the major structural reforms which the country needs to confront its future. Many observers of Brazil have already addressed these fundamental problems in the past. Yet it seems as if a kind of paralysis affects the Brazilian government when it comes to address the fundamental deficiencies of the country in infrastructure, innovation, and education.

There are many problems, which inhibit the Brazilian economy from growing more consistently and at a level which will move the country out of poverty. These basic problems go beyond short-term macroeconomic management but refer to structural therapies. Brazil is a country notorious for its intricate web of irrational regulations, its heavy tributation, its judicial and bureaucratic inefficiencies, and corruption at all level of politics. These nightmares for those who do business in Brazil find their complement in a profound negligence of basic education and of widespread professional incompetence, which affects the whole society. The result is a horrendously low level of productivity, which is about one fifth of the USAmerican and Northern European standards. The lack of capital formation, which results in low productivity, is the result of an extremely low savings as it is shown by the net national savings rate, which calculates the adjusted savings rate as gross national savings less the value of consumption of fixed capital (see figure 2).

Figure 2
Brazil: Savings rate. Net national savings in percent of gross national income, 1980-2012



Source: The World Bank Group

This indicator, the adjusted savings rate (figure) 2, amounts to over 40 percent in the case of China (THE WORLD BANK, 2013). Low productivity together with a weak potential of innovation characterizes the performance of the Brazilian economy. Private companies do very little research and development. There is a huge governmental apparatus in place, which apparently should promote scientific progress but in fact, it works mainly as a bureaucratic web and actually hampers more than it promotes innovation. Instead of doing away with these burdens, the Brazilian government prefers to use the easy tool of monetary stimuli, to implement *ad hoc* interventionist measures and displays a confusing public discourse about plans and measures. All of that will rather subdue than stimulate private investments. There is no end in sight yet when the Brazilian government will reduce their preference to accompany monetary inflation with legislative inflation.

Brazil – the land of the future?

Brazil's potential is magnificent as this country has abundance of exactly those things that are about to get scarcer in the course of the 21st century. Brazil, which has a size that is only slightly less than that of the United States, has a population of 190 million, a quarter of which is less than 14 years old and those above 65 years account for only 6.3 percent of the population. Brazil is a country without major natural risks. There is no desert in Brazil nor are there any extended mountain areas. Brazil has sun and water and it is no wonder that this country is an agricultural giant. According to the Food and Agricultural Organization, Brazil possesses a potential of around 450 million hectares of arable land of which currently only about 10 percent are in use (FAO, 2012).

There is yet no limit in sight for the growth of this sector. Along with the agricultural resources, Brazil is rich in all kinds of mineral resources.

In fact, a recent discovery of a huge oil field has put Brazil among the top ten oil reserve countries. Yet as the so-called "Dutch disease" indicates, wealth below the ground is of little value when human folly rules above the ground.

Brazil suffers from a chronic lack of savings (see figure 2 above), which limits not only private capital formation but also public investments in infrastructure and in education. The trend for Brazil's industrial production has been flat at an average annual rate of 2.6 percent since 1992. What has been driving the Brazilian economy since the turn of the century, much more than its industrial base, has been private consumption.

These trends such as low savings and investment in combination with a consumption boom cannot go on forever. As it already shows up in the country's inflation rate, there is a growing discrepancy between production and consumption. This discrepancy finds its statistical expression in a widening current account deficit.

The deplorable macroeconomic condition of Brazil with insufficient savings and a weak industrial base comes with a rotten political system and Brazil's heavy bureaucracy. Brazil's public administration is a gigantic apparatus that holds down the country with a myriad of useless and senseless regulations and its stupid execution. Brazilian bureaucracy represents a major blockade to economic modernization. Brazil has one large macroeconomic bottleneck, the lack of savings, and it has a large structural hole where a large part of the country's energy evaporates in form of the administrative over-regulation of its economy. Brazil never fully abandoned the corporatist development model of the 1930s. The result is that Brazil has a large but inefficient industrial sector ranging from the production of vehicles and small airplanes to agricultural machinery and chemicals. Yet these industries are sleeping giants, which are limited in flexibility and innovation because of a tight web of governmental regulations and direct interventions.

As the socio-economic indicators below (table 2), side by side with the impressive size of the Brazilian economy show, features that are more indicative of an authoritarian underdeveloped country than of a modern economy coexist.

Table 2
The Position of Brazil in global rankings

Subject area	Brazil's rank	Number of countries	Source
GDP nominal	7	181	IMF
IMF Quota	17	183	IMF
GDP per capita	53	183	IMF
GDP per capita PPP	103	228	CIA Factbook
Investment	112	152	CIA Factbook
Human Development	84	187	United Nations
Competitiveness	53	142	WEF
Economic Freedom	100	177	Heritage
Press Freedom	108	179	RSF
Corruption	69	174	TI
Education	53/57	65	PISA

Sources:
IMF – International Monetary Fund: http://www.imf.org/external/data.htm
CIA – The World Factbook: https://www.cia.gov/library/publications/the-world-factbook/rankorder/rankorderguide.html
United Nations - http://hdr.undp.org/en/statistics/
WEF – World Economic Forum: http://www.weforum.org/issues/global-competitiveness
Heritage – Heritage Foundation: http://www.heritage.org/index/
RWF – Reporters without borders: http://en.rsf.org/press-freedom-index-2013,1054.html
TI – Transparency International: http://www.transparency.org/cpi2012/results
PISA – *Program for International Student Assessment:* http://www.oecd.org/edu/eag2012.htm

With more privatization and deregulation, huge investment opportunities emerge on the horizon. The development of Brazil's gigantic agricultural potential has only just begun. Beyond that, there is the need of privatization and deregulation in infrastructure. Everything from ports and airports to the road system offer tremendous opportunities. With the help of foreign direct investment, Brazil's metal-mechanical sector could easily be brought up to a world class level as it is the case for the country's food processing, pharmaceuticals and chemical industry. All it takes for this to happen would be to take some courageous steps towards de-bureaucratization and Brazil could indeed emerge as the economic miracle country of the 21st century.

Brazil and Canada – some points of comparison

Comparing Brazil and Canada is fascinating because what these two countries have in common is that each of them possesses an immense landmass relative to the sizes of their populations and both countries are immensely rich in natural resources. Similarities also exist in their export structures. Beyond these characteristics, Brazil and Canada also share the trait that they have only a few companies that can count as global players. Yet when it comes to the major differences between the two countries, the most outstanding feature is governance. While Brazil has an economy of massive state interventionism, Canada has one of the freest economies of the world. According to the ranking of the Heritage Foundation (HERITAGE, 2013), Canada ranks at the sixth position in the degree of economic freedom among 177 countries, while Brazil occupies the 100th position and falls into the category of the countries with a "mostly unfree" economy. The largest differences between the two countries (see table 3), are the protection of property rights and freedom from corruption. Although contracts are generally secure, Brazil suffers from a very inefficient judiciary system; piracy as well as corruption are common. The other major difference between Brazil and Canada is the degree of business freedom where Brazil ranks on the scale of the index (from 0 to 100) at 53 points, while Canada scores 91.7 points.

An indication that Brazil's main problems are not mainly macroeconomic policy shows up in the fact that since 2004, Brazil's debt burden (public debt in percent of its gross domestic product) fell from 75 % to 65 %, while the rate for Canada rose from 77% to 85 %. As is shown below (table 3), differences between the two countries are relatively small at fiscal and monetary freedom as well as government spending.

Table 3 Brazil and Canada. 2013 Index of Economic Freedom

	Brazil	**Canada**
Overall score	57.7	79.4
Property rights	50	90.0
Freedom from corruption	38.0	87.0
Fiscal freedom	70.3	79.8
Government spending	54.8	44.8
Business freedom	53.0	91.7
Labor freedom	57.2	82.3
Monetary freedom	74.4	75.2
Trade freedom	69.7	88.2
Investment freedom	50	75.0
Financial freedom	60	80.0

Source: Heritage Foundation, 2013 Index of Economic Freedom, http://www.heritage.org/index/explore

In order to improve its position in the world economy, it is not enough for Brazil to only consolidate its macroeconomic policy. In order to advance its economy, Brazil needs to take serious steps towards better governance. As of now, however, the current government not only has been doing little for the improvement of governance, there also seems to be a lack of understanding about the urgency and importance of fundamental reforms.

Conclusion

Brazil's political leadership enjoys the dubious privilege that due to Brazil's immense natural wealth and its benevolent overall geographic conditions the country does not get much punished, even when its politicians commit severe blunders. Over the length of its history Brazil has experienced various economic crises. Even with the few wars in which the country was involved, suffering much less severely than what many other countries had to go through. Yet this bliss of the lack of immediate feedback of bad policy, the lack of this puffer against errors, has prevented the country from living up to its full potential. In fact, the extent to which Brazil has realized prosperity is extremely poor compared to the country's potential.

The government misinterpreted the achievement boom which Brazil experienced from 2004 until 2010, when in fact the strong economic growth happened, not because of but despite the government's macroeconomic measures. The massive inflow of foreign financial capital made the Brazilian exchange rate appreciate and led the Brazilian authorities to conduct interventions in the foreign exchange market in order to slowdown the rate of appreciation. This, in turn, led to an expansion of the internal money supply, which fed inflation and contributed additionally to a loss of international competitiveness for the Brazilian economy. Exchange rate appreciation and higher inflation hit Brazilian industry. The origin of the boom was the high external demand for Brazil's natural resources. At home, the Brazilian government let the Dutch disease unfold in its typical form. Instead of stopping to inflate the economy, the Brazilian government, through its Central Bank, actually increased monetary expansion based on the erroneous idea that this way it could overcome the weak growth of the Brazilian economy.

The current government is doing everything possible to revive the economy again. More spending, lower interest rates and interventions in the exchange market to lower the Brazilian currency cheap are the main tools of this policy. Yet it is only a matter of time before such policies as currently practiced will increase price inflation more drastically and will weaken economic growth even more in the future. In the meanwhile, urgent reforms remain undone. In order to bring the Brazilian economy back on track, economic policy move forward with key reforms. As any serious student of the Brazilian economy knows, the Brazilian government should also recognize that it is high time for Brazil to improve its infrastructure and its system of education. It is time to deregulate labor laws and cut red tape. It is time to end the horrendous privileges and absurd salary structures in the public sector and last, but not least, it is time to prepare the pension system to the conditions of the future, when Brazil will have to face an aging population.

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