

**BRAZIL IN THE 1990s:  
A SUCCESSFUL  
TRANSITION?**

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## **Abstract**

This paper looks at the transformations that Brazil's economy went through in the 1990s, which involved the adoption of a new macroeconomic policy framework and market-friendly reforms. It argues that, despite a series of policy missteps and severe external shocks, this new policy regime have laid the foundations for the resumption of sustained growth-cum-price stability. It also argues, though, that this outcome hinges critically on the country's ability to consolidate and deepen its commitment to free trade and a macroeconomic regime which rests on three pillars: fiscal austerity, low inflation and flexible exchange rates.



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## **1. Introduction**

The poor performance of the Brazilian economy in 1980-2000 is sharply at odds with the country's growth record in the rest of the twentieth century. Indeed, for several decades Brazil was one of the fastest growing economies in the world [Maddison (1995)]. In 1950-80, annual growth fell below the 4% mark in just four occasions, and in this 30-year period there was no absolute decline in GDP. In contrast, during the 1980s per capita income fell by an average 0.5% per year, growing a mere 1.1% during the 1990s, netting just 0.3% per year over these two decades.<sup>1</sup>

Despite the similar performance in terms of GDP growth, the 1980s (known as the "lost decade") and the 1990s differ in at least three important regards. First, while the 1980s were a period of rising inflation and chaotic macroeconomic policies, the nineties were marked by the successful stabilization program, which brought annual inflation down to one-digit levels. Second, whereas the 1980s saw high and often rising levels of state intervention, the 1990s can be characterized as the "decade of market-oriented reforms". Third, and largely as a consequence of the first two, while the 1980s ended with a feeling of hopelessness, without a clear consensual diagnosis of the crisis and with the country close to hyperinflation, at the end of the 1990s there were signs of a return to a trajectory of sustained growth, this time in a context of price stability.<sup>2</sup>

Despite the importance of these changes, the challenges that Brazil still must meet for this scenario to materialize are not small. Stabilization still depends on the continuity of large primary fiscal surpluses to bring the debt/GDP ratio to more manageable levels and on a sizable expansion of exports to reduce Brazil's vulnerability to external shocks. Structural reforms undertaken in the 1990s need to be consolidated and extended to areas such as the judiciary and capital and labor markets, to create an institutional environment more conducive to investment and productivity growth.

This paper seeks to look into these changes and challenges that, since the early 1990s, have been part of country's agenda to resume sustainable growth. It examines the contribution of the market-friendly reforms of 1990s, discuss the current challenges faced by Brazil and analyze whether, after two decades of near stagnation in per capita income, growth is likely to accelerate, making 2001-2010 a decade of prosperity, the first since the "golden seventies". The degree to which the transformations that

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1 Had Brazil continued to grow in 1980-2000 as in 1950-80 (7.4% p.a.), rather than at the actual annual rate of 2.1%, per capita income in 2000 would have been US\$ 9663, or 2.8 times the actual figure of US\$ 3512.

2 For a less favorable view on Brazil's accomplishments in the 1990s, see Amann and Baer (2000).

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occurred have been consolidated, and whether or not they will ensure high rates of growth in the future are questions that are discussed in the text.

The paper continues with six additional sections. Following this brief introduction, we look at the structural reforms of the 1990s. The third section analyzes the gains produced by the Real Plan (1994) and the macroeconomic imbalances unveiled by the end of high inflation. Section 4 highlights the changes in the policy regime that occurred in 1999, with the currency devaluation and the adoption of inflation targets and rigid fiscal discipline. Section 5 discusses the recent shocks that hit Brazil's economy and argues that, given the characteristics of the new policy regime, they should not threaten the country's medium and long-term growth prospects. Section 6 takes on the country's most important challenges which still lay ahead in the road to sustainable growth and a final section draws the relevant conclusions.

## **2. A Decade of Reforms: The 90's**<sup>3</sup>

The Real Plan and the ensuing reduction in inflation rates were undoubtedly the most noteworthy events in the Brazilian economy in the 1990s. Yet, a full assessment of the transformations that characterized Brazil in that decade, and indeed a proper understanding of why the Real Plan has succeeded where previous stabilization attempts failed so badly, have to account for the supply-side reforms carried out in that period. These comprised a number of initiatives aimed at raising productivity through reduced regulatory intervention and increased competition in the economy. Foremost among these initiatives were trade liberalization, privatization and deregulation.

### **2.1. Trade Liberalization**

To properly gauge the importance of trade liberalization in the 1990s, one has to take into account that over the previous two decades Brazil had become one of the most closed economies in the world. The strategy of import substitution was taken to extremes, with the imports' share of domestic consumption of manufactured goods reaching Soviet levels (4.8% in 1989) [Moreira and Correia (1998)]. These policies were clearly unsustainable and as the foreign exchange constraint lessened in the late eighties, Brazil gradually moved towards a more open and neutral trade policy.

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3 See Souza (1999) and Giambiagi and Moreira (1999).

In 1988-93 protection to domestic producers was greatly reduced. Two reforms, in 1988 and 1989, brought the average tariff on imports down from 51 to 35 percent. Most non-tariff barriers were eliminated in 1990, with the ban on imports of computer products ending in October 1992. In addition, a pre-announced schedule of tariff reductions gradually brought the average nominal import tariff down from 32.2% (with a 19.6% dispersion) in 1990 to 14.9% (with an 8.2% dispersion) in the second semester of 1993 (Table 1). Trade liberalization was particularly significant for consumer goods: tariffs for durable consumer goods came down by 66 percentage points, while elimination of the negative import list gave domestic consumers legal access to foreign goods that had in practice been banned for decades.

**Table 1**  
**Brazilian Import Tariffs: 1990-95 (in %)**

<i>Date</i>	<i>Mean</i>	<i>Mode</i>	<i>Median</i>	<i>Interval</i>	<i>Standard Deviation</i>
1990	32.2	40	30	0-105	19.6
Feb/1991	25.3	20	25	0-85	17.4
Jan/1992	21.2	20	20	0-65	14.2
Oct/1992	16.5	20	20	0-55	10.7
Jul/1993	14.9	20	20	0-40	8.2
Jan/1995	12.1	14	10	0-20	6.1

Source: Own calculation based on *Receita Federal data*.

On the export side, trade policy has also become more neutral since the mid-1980s and especially after 1990. Several subsidies were discontinued in 1983-85. As the Collor government took office, in March 1990, export subsidies were eliminated and incentives reduced. As a consequence, incentives fell from an average of 3.1% of GDP in 1981-84 to 1.3% in 1990-91. In the 1990s, the government continued to seek a complete tax exemption of exports, including some levied at the state level, and moved to strengthen export financing schemes [Sucupira and Moreira (2001)].

Another remarkable development in Brazil's trade policy was the establishment of Mercosur in 1991, a regional trade agreement comprising Argentina, Brazil, Paraguay and Uruguay. Mercosur has been key in attracting FDI into Brazil, which helped to make the country a regional export base for many multinational corporations [Pinheiro and Moreira (2000)]. Overall, Brazilian exports to its Mercosur partners increased 235% from 1991 to 2000, while imports from them went up 244%.

The impact of trade liberalization has been dramatic regarding both the degree of trade and investment integration into the world economy, and the extent to which it has contributed to encourage technological modernization and rises in productivity

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[Moreira and Correia (1998) and McKinsey (1998)]. Non-oil imports jumped from US\$ 11.0 billion in 1987 to US\$ 44.3 billion in 1995, and reached US\$ 49.4 billion in 2000. Imports of consumer and capital goods, in particular, expanded substantially in the nineties. Stiffer competition and easier access to foreign intermediate and capital inputs have stimulated domestic producers to improve their competitiveness [Muendler (2001)].

Export performance, though, somewhat tarnished what would otherwise be a remarkable response to trade liberalization. Exports were slow to respond. After signs of a strong recovery in 1992-94, export growth moved into a downward trend, reversed for only a brief period in 1997. More to the point, despite the reduction in trade bias, a substantial trade-off between internal and external markets prevailed during the period, with firms switching to domestic sales whenever local demand picked up.<sup>4</sup>

The appreciation of the exchange rate seems to have played a large role in this slow response. Contrary to the advice of most analysts (see, e.g. Papageorgiu, Michaely and Choski, 1991), trade liberalization in Brazil's was not followed by a real exchange rate devaluation. Quite the contrary. By December 1998, the local currency had appreciated 18% against the dollar (see Graph 1). This trend was only broken in January 1999, when the deterioration of the international markets, disrupted by the Russian default, forced the government to float the exchange rate, a decision which produced a major devaluation (see Section 3). This change in relative prices did not take long to show its relevance. In the last quarter of 1999, exports grew by 11.3% (yoy) and in 2000, export growth accelerated to 14.7%, led by manufacturing exports (20.6 %).

Apart from an exchange rate appreciation, exports also suffered from the lack of investment in infrastructure – a consequence of the public finance crises of the 1980s – and from an inefficient tax system which penalized producers with cumulative taxes. In the case of the former, considerable progress was made in the second half of the nineties through privatization of the state enterprises (see next section). The tax system, though, has yet to be reformed.

## **2.2. Privatization**

Although Brazilian privatization dates back to eighties, it was in the following decade that it gained prominence, becoming a centerpiece of economic policy.<sup>5</sup> In March 1990, President Collor launched the National Privatization Program (PND), expanding

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4 See Pinheiro and Moreira (2000).

5 Brazilian privatization during the Collor administration is discussed, respectively, in Pinheiro and Giambiagi (1994). For a Latin-American perspective, see also Baer (1994).

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the divestiture program to include large and traditional state enterprises. In September 1992, President Collor was impeached and replaced by Vice-President Itamar Franco, who, despite earlier misgivings, continued the privatization process at its previous pace. Together, the two administrations sold 33 state-owned enterprises (SOEs), with results amounting to US\$ 11.9 billion, including both proceeds and debt transfers (Table 2). Particularly important in that period was the divestiture of the steel sector, which had been developed after World War II under public guidance and that until the eighties was thought to be critical for national security.

Brazilian privatization reached its peak during President Cardoso's first term (1995-98), when 80 companies were sold, generating US\$ 73.3 billion in total results (Table 2). Two related developments allowed such substantial expansion in the size and scope of privatization. One was the engagement of state governments in the privatization effort, leading to the sale of several electricity distribution companies. Another was the decision to amend the constitution to discontinue public monopolies and end discrimination against subsidiaries of foreign companies. This opened the opportunity to extend privatization to telecommunications, electricity and mining, in which were Brazilian largest SOEs. During this period, other sectors controlled by the state for decades, such as the railways and ports, were also partly or totally transferred to the private sector.<sup>6</sup>

The enlargement of privatization allowed it to play an important role in sustaining the Real Plan, especially in Cardoso's first term [Pinheiro and Giambiagi (2000)]. In particular, with the large sales of 1997-98 Brazil attracted sizable volumes of foreign direct investment, which helped to finance the country's high current account deficit – in 1997-2000, the ratio between FDI inflows associated with privatization and the current account deficit averaged almost 25%. Privatization was also instrumental in averting an explosion in public debt, in spite of the growing fiscal deficit posted since 1995. Carvalho (2001) shows that thanks to the predominant use of privatization proceeds to abate the public debt, in December 1999 this was 8.4% of GDP lower than what it would have been in the absence of privatization.

More important in the long run, however, is the significant change that privatization brought to the way former SOEs are managed. In private hands, those companies became more customer oriented, technologically updated, and equipped with better information systems and human resource management, with fewer but in general more motivated employees. The impact of these changes and of a greater access to capital on output, productivity and investment has been quite positive.<sup>7</sup> Becoming

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6 See the papers in Pinheiro and Fukasaku (2000) for further discussion on privatization during President Cardoso's first administration.  
7 For analyses of the impact of privatization on SOE performance, see Pinheiro (1996).

more efficient and adopting better commercial practices they were able to greatly increase their profitability, raising their creditworthiness, and in turn facilitating the finance of new investment. The results have been noteworthy in both industry and infrastructure, in which all sectors registered the rehabilitation of physical networks and increases in productivity, even if these gains have been more spectacular in some sectors than in others. In telecommunications, in particular, the density of fixed lines more than doubled after privatization, reaching 20.2 fixed lines (against 9.6 in 1996) and 15.0 cellular phones per 100 inhabitants (against 1.6 in 1996) in 2001.

In the industrial sector privatization has been not only a remarkable success – witness the gains in output and competitiveness of previously almost bankrupt companies such as steel-maker CSN and airplane manufacturer Embraer – but also a done process once ownership changed hands. In infrastructure, however, privatization is just a step in the regulatory reform process, which will not be complete until sound regulation is put in place and well-functioning regulatory agencies are fully operational. In this sense, in infrastructure it is necessary to go beyond reductions in technical losses, better management, and rehabilitation of existing facilities, and be able to foster a large expansion in output capacity and to translate productivity gains into lower prices to consumers. And in these areas the degree of success of the new regulatory framework is relatively heterogeneous across sectors, reflecting the varying quality of sector regulation.

**Table 2**  
**Privatization Results: Proceeds and Debt Transferred: 1991-2000**  
**(US\$ Million)**

<i>Sectors</i>	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	Total
Federal Government	1,988	3,383	4,188	2,314	1,628	4,749	12,558	26,606	554	7,670	65,638
Steel	1,843	1,639	3,788	917	0	0	0	0	0	0	8,187
Petrochemicals	0	1,477	174	528	1,226	296	0	0	0	0	3,701
Fertilizers	0	255	226	13	0	0	0	0	0	0	494
Vale do Rio Doce	0	0	0	0	0	0	6,858	0	0	0	6,858
Electric power	0	0	0	0	402	2,943	270	1,882	1	0	5,498
Telecommunications	0	0	0	0	0	0	4,734	23,948	421	0	29,103
Companies	0	0	0	0	0	0	0	21,069	293	0	21,362
Concessions	0	0	0	0	0	0	4,734	2,879	128	0	7,741
Banks	0	0	0	0	0	0	240	0	0	3,604	3,844
Other	145	12	0	856	0	1,510	456	776	132	4,066	7,953
States	0	0	0	0	0	1,770	15,117	10,858	3,887	3,040	34,672
Electric power	0	0	0	0	0	1,066	13,430	7,817	2,520	1,582	26,415
Telecommunications	0	0	0	0	0	679	0	1,840	0	0	2,519
Banks	0	0	0	0	0	0	474	647	148	869	2,138
Other	0	0	0	0	0	25	1,213	554	1,219	589	3,600
Total	1,988	3,383	4,188	2,314	1,628	6,519	27,675	37,464	4,441	10,710	100,310
Proceeds	1,614	2,401	2,627	1,965	1,004	5,485	22,617	30,897	3,203	10,421	82,234
Debt transferred	374	982	1,561	349	624	1,034	5,058	6,567	1,238	289	18,076

Source: BNDES

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For various reasons, the privatization process decelerated to almost a complete stop in President Cardoso's second term. Foremost among those reasons was the decline in popular support for privatization. But also relevant were the reduced pressures stemming from the needs of macroeconomic policy – as a result of changes in the fiscal regime and a large inflow of non-privatization related FDI – and the rising technical and political complexity of privatizing the remaining SOEs. As a result, the state remains the owner of sizable assets in sectors such as electricity, water and sanitation sectors, many of which would likely generate higher social benefits in the hands of the private sector.

### **2.3. Deregulation**

Brazil also adopted a number of initiatives to increase competition in domestic markets, by freeing firms and markets from a host of administrative controls introduced over the import substitution period or before. A first set of measures were implemented by the Federal Deregulation Program (PFD)<sup>8</sup> under the aegis of which 113,752 presidential decrees were revoked, from a total of 123,370 decrees issued in the previous hundred years. Other initiatives involved, *inter alia*, foreign trade (e.g., the end of public monopolies in exporting coffee and sugar and in importing wheat and the elimination of import and export licenses) and foreign investment (elimination of most restrictions).

A second set of measures aimed at strengthening anti-trust and consumer protection policies. In 1991 the anti-trust law enacted in 1962 was reinforced by new and more stringent legislation, and in 1994, a new anti-trust law was passed, consolidating the legislation on competition, while establishing harsher penalties and more expeditious enforcement. Since March 1991, a Consumer Protection Law, approved in September 1990, has made firms liable for the quality of their products and the truthfulness of their advertising.

A third group of measures comprised the elimination of a host of legal restrictions limiting entry into a number of non-tradable sectors. Foremost among these were the constitutional amendments that discontinued public monopolies in infrastructure and the differential treatment afforded to national and foreign companies. Other infraconstitutional distinctions, such as the restrictions imposed by Law 4,131 on the access of foreign firms to public credit, were also discontinued.

The end of legal restrictions limiting entry and establishing price controls in a number of sectors, such as civil air transport, ports, interstate and international road transportation, the distribution of fuels and the distribution and transportation of steel

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8 This program, established in March 1990, was quite active until Collor's impeachment in late 1992.

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also encouraged competition. Nationwide price equalization was discontinued for fuel and other prices and services. Infrastructure regulatory reform also fostered competition through the setting up of a non-monopolistic industrial structure, with several SOEs being separated horizontally and vertically before privatization. Examples of horizontal separation include the railroad, electricity and telecom sectors, while vertical breakups occurred in telecommunications and electricity. Limits were imposed on the participation of individual investors in different markets, regional and national, and even on the ownership structure of some companies (such as the mining giant CVRD and the railroads). Furthermore, restrictions to entry of new players were kept to a minimum and in some cases, such as telecommunications, were only temporary.

### **3. The Real Plan and Macroeconomic Imbalances: 1995/1998**

Unveiled in 1994, the Real Plan can be seen as the logical macroeconomic counterpart to the market-oriented reforms carried out in the 1990s, both in the sense of magnifying their impact on growth and of generating the political conditions to pursue them.<sup>9</sup> The Plan led to a remarkable fall in inflation, which, as expected, boosted efficiency, encouraged competition and attracted foreign investment. The fly in the ointment, though, was a clear worsening of the fiscal and current account deficits.

The Plan was an ingenious, alternative approach to the problem of high inflation. It is worth noting that in 1986-91 there were no less than five stabilization plans, based on price freezes or variants, all of which failed.<sup>10</sup> What made the difference in the case of the Real Plan was a virtual currency, known as the Real Unit of Value (URV), pegged to the dollar. The government set a period of four months for economic agents to adapt to this new unit. During this period, not only the exchange rate, but also some basic prices such as public-sector salaries, pensions, the minimum wage and tariffs charged by public utilities were compulsorily converted into URVs, with the private sector doing the same voluntarily for most other prices. Through this scheme, the government adopted the logic of the dollarization, without actually doing it or resorting to a currency board.

At the end of this 4-month period (on June 30, 1994), during which inflation in the old currency reached almost 50% a month, the

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9 See Pinheiro and Giambiagi (2000) for an analysis of this bidirectional relationship in the case of privatization.

10 For an overview of the history of Brazilian inflation, see Tullio and Ronci (1996).

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URV was converted into the new currency, hardly by coincidence, called the 'real', to give the idea that its purchasing power was constant. The entire monetary base in the old currency was then physically replaced in just a few days. The parallel with the classic case of the end of the German hyperinflation, in the 1920s, and the role played at the time by the new German currency is evident.

In the years following the Real Plan, the economy's performance was mixed. The Plan was very successful in reducing inflation: in the 12 months preceding the Plan, inflation had accumulated an impressive 5,154%, as measured by the general price index (IGP). After the launching of the Plan, 12-month cumulative inflation fell almost continuously for 4½ years, ending 1998 at only 1.7%. In other words, in 1998 Brazil had the same inflation rate for a year that it had had in a single day prior to the Real Plan.<sup>11</sup>

On the minus side, however, Brazil has had since 1995 a substantially larger fiscal and current account deficits, which over time led to mounting public and external liabilities, compounding the original disequilibria. In the case of the fiscal accounts, the primary consolidated result for the public sector, which excludes interest payments, fell from an average surplus of 2.9% of GDP in 1991-94, to an average deficit of 0.2% of GDP in 1995-98. This deterioration was due, on the one hand, to the unveiling of previous disequilibria, "solved" until then through rising inflation rates, and, on the other hand, by a poor management of fiscal instruments.

Until 1994, it was relatively "easy" to control real public sector expenditures with the 'aid' of price increases, by delaying the moment of actual spending. Inflation facilitated management of intragovernment political disputes for resources.<sup>12</sup> With the fall in inflation, the "political price of saying No" became explicit and, in practice, the greater difficulty of opposing external and internal demands for funds also helped to boost the real level of public expenditure. In addition to the fall in inflation, the deterioration in the fiscal accounts was also associated to a more expansionist fiscal policy and to structural flaws in the public sector finances:<sup>13</sup>

- the significant rise in real discretionary spending of the Federal Government;
- the 43% nominal increase in the minimum wage in 1995, when inflation was just 15%, with direct impact on all pension benefits, contributing to the deterioration in the pension deficit, for both private and public sector employees; and

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11 Inflation of 1.7% per working day corresponds to a monthly inflation of 45%, similar to the inflation of June 1994, when the Real Plan was launched.

12 See Cardoso (1998) and Bacha (1994).

13 For a discussion of the Brazilian fiscal crisis of the latter half of the 1990s, see Giambiagi and Além (1999).

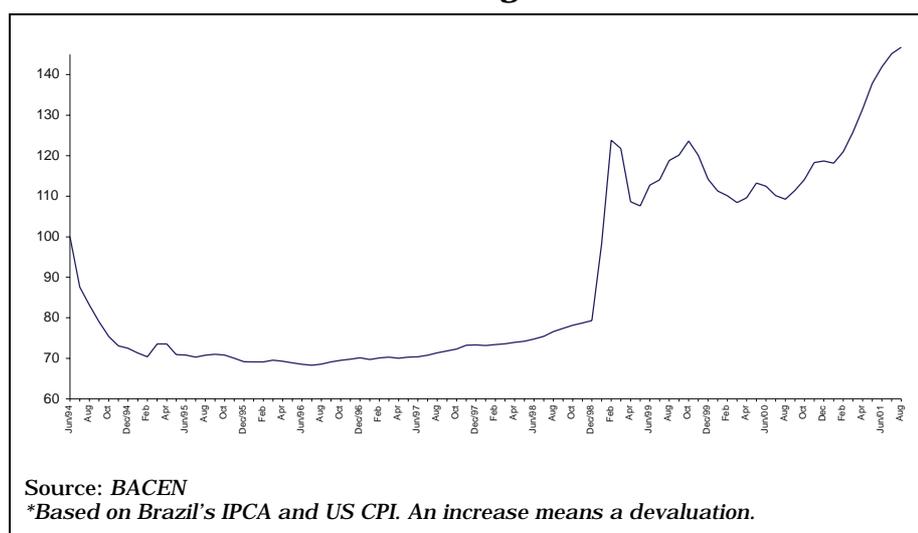
- the situation of state governments, whose revenues were drained by payroll increases observed in 1994-95, with real and lasting effects since then.

The rise in the current account deficit, in turn, was the result of demand enhancing and demand switching effects of the Real Plan. Aggregate demand went up as a result of higher real public spending and booms in private investment and consumption. On top of that, the rise in creditworthiness achieved with price stabilization and the tight monetary policy (*i.e.* high interest rates) increased the demand for reais, substantially appreciating the exchange rate, which had already been strengthening since 1992. Between June 1994 and February 1995, the real exchange rate appreciated by 30% (Graph 1).<sup>14</sup>

The government would soon abandon the free floating of the exchange rate, adopting in exchange a band system that allowed for the gradual nominal depreciation of the real. The undesirable side effect of this policy was the establishment of a relatively high floor for nominal interest rates. A large, unannounced devaluation was feared both for its inflationary impact and for the risk of severely compromising government credibility.

To a certain extent, these imbalances reflected the well-known dilemmas faced by policymakers when trying to pursue an agenda of market-oriented reforms, which includes both stabilization and trade liberalization. As Londero (1997 p. 273) put it, “while stabilization will normally result in an overvaluation of the domestic currency... for the more protected economy, trade liberalization requires a real depreciation...”

**Chart 1**  
**Real Exchange Rate\***



14 The figure presents the real R\$/US\$ exchange rate, with CPI representing the US consumer price index, and IPCA, the Brazilian consumer price index. The appreciation of the R\$ – which was initially set equal to US\$ 1 – was more than 15% in the first months of the Real Plan. To this must be added a not insignificant residual inflation.

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The appreciation of the real, combined with a jump in aggregate demand, caused a dramatic inversion in the trade balance, which shifted from an US\$ 11 billion surplus in 1994 to a US\$ 3 billion deficit in 1995. The deterioration of the trade balance was compounded by an increase in interest and dividend payments (that more than doubled from 1994 to 1998), leading to uncomfortably high current account deficits (4% of GDP in 1997) and to a drastic worsening of traditional solvency indicators – the debt-service-to-exports ratio, for instance, jumped from 38.9% in 1994 to 122.7% in 1998. The risks of these mounting imbalances did not go unnoticed to policymakers, the market or academia.<sup>15</sup> Yet the government believed that the prevailing situation in international capital markets – marked by high liquidity and wide access to capital by emerging economies – made possible a strategy of gradual adjustment.

The worsening of the current account and the fact that a large part of its deficit was financed by short-term capital flows made Brazil more dependent on external financing and, accordingly, more vulnerable to external shocks. This rise in external vulnerability was suggested initially by the Mexican crisis in March 1995, reaffirmed by the Asian crisis in October 1997 and made unbearable by the Russian default in 1998. Yet, Brazil's tribulations in late 1998 and early 1999 resulted not only from structural imbalances – the traditional Latin-American fiscal and external predicaments – but also from the policy regime's lack of credibility.

In fact, it became clear with the Asian crisis that adjustments were needed, forcing the government to gradually change course in two main ways: first, through the continued nominal devaluation of the real (around 8% per year), in an environment in which domestic inflation was very close to international levels, leading to an annual real devaluation of approximately 6% in 1998; and second, by improving the primary result of the consolidated public sector by 1% of GDP relative to 1997. Too little, too late, for despite the significance of these measures, they were insufficient to substantially reduce the magnitude of the macro-economic imbalances.

In this environment, the burden of monetary policy in sustaining exchange rate stability increased enormously, with annualized interest rates rising above 40% in October 1998 (with very low inflation, it should be remembered), negatively affecting output levels and the public accounts. Sustaining this policy over the medium term would require a level of primary surplus to support the burden of interest payments that would be politically and socially unattainable. On the external side, there was, there-

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<sup>15</sup> See, *inter alia*, Goldfajn and Valdés (1996) and Cardoso and Goldfajn (1997). For a defense of the exchange rate policy of that time, see Franco (1999).

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fore, a growing perception that this policy framework was unsustainable.<sup>16</sup>

Over 50 days, between the first days of August and the end of September 1998, Brazil lost US\$ 30 billion in international reserves. The announcement in October that an agreement with the International Monetary Fund (IMF) was under consideration brought some respite. Brazil nevertheless found itself in a situation in which it could not afford the luxury of a mistake. The rejection by Congress of an important fiscal adjustment measure and the announcement of a moratorium on federal debt by the State Government of Minas Gerais precipitated events. Between the end of December 1998 and the first days of 1999 Brazil lost between US\$ 500 million and US\$ 1 billion a day in reserves. On January 15, after rejecting suggestions of “Malaysian-style” capital controls, the authorities did the only thing remaining in their power to prevent the quick evaporation of reserves: let the exchange rate float.

Despite happening already in the first month of his second term (1999/2002), the currency crisis can be seen as the final act of Cardoso’s first administration (1995-98). For all its problems, this administration was particularly instrumental in deepening and consolidating the market-oriented reforms initiated in the early 1990s. The privatization of public utilities, increases in productivity, the strengthening of the financial system and, above all, the control of a runaway inflation are gains whose importance can hardly be overestimated. Yet, the failure to move quickly enough in solving the country’s main macroeconomic imbalances left major obstacles in the road to recovery. The fiscal reforms of late 1998 and early 1999 and the January 1999 devaluation were the first steps towards overcoming these hurdles.

## **4. Three Policy Changes in 1999**

The early developments of the currency crisis in Brazil followed along the paths of Mexico in 1995 and South Korea in 1997 – a substantial overshooting in the devaluation in the first months of the crisis, which did not last more than a year. Yet, while in Mexico the overshooting was eliminated via inflation, which rose to over 50% (IPC) in 1995, in the case of South Korea, the adjustment occurred mainly through a nominal appreciation, with a very limited role for inflation. In the case of Brazil, there were fears that the appreciation of the real would follow Mexico’s footsteps, given the country’s dismal inflationary record, fears

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16 Therefore, they combined elements of the two types of currency crises described by Krugman (1998), associated with the so-called models of first and second generation. As argued by Drazen and Masson (1994), there comes a time when commitment to “even more austere” policies becomes ineffective.

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that also explain why the authorities had been reluctant to voluntarily allow the exchange rate to float in the first place. In practice, however, the process was similar to that of South Korea. The R\$/US\$ exchange rate that stood at R\$ 1.21 before the devaluation, peaked at R\$ 2.16 at the height of the crisis, before ending 1999 at R\$ 1.79. At this point, the nominal devaluation amounted to 48%, against a consumer inflation of 9%, *i.e.* a passthrough of less than 20%.

The fact that the devaluation coincided with slow growth explains partly why inflation did not explode, as feared by the government.<sup>17</sup> There were also other important ingredients such as:

- the quality management of monetary policy, with an accurate and timely “fine tuning” of interest rates;
- the renegotiation of the IMF agreement, which signaled to a credible fiscal adjustment and provided room for the Central Bank to intervene in the currency market;
- the announcement of moderate increases in the minimum wage in May; and
- the decision to adopt an inflation target regime.

The limited impact on inflation, which averted a dramatic fall in real wages, and the sound balance sheets of financial institutions, which mostly benefited from the devaluation, help to explain why devaluation did not lead to a drastic recession as in Mexico and South Korea.<sup>18</sup> With a close to 50% nominal devaluation, a 10% consumer inflation and a modest expansion in GDP, driven by an improvement in the trade balance and a good agricultural year, Brazil carried out a relatively successful transition in exchange rate regimes.<sup>19</sup> Underlying this process were important changes in the economic policy regime, which, by effectively dealing with the macroeconomic imbalances inherited from Cardoso’s first term, paved the way for a new cycle of sustainable growth. Three of them stand out:

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17 In December 1998, seasonally adjusted monthly industrial production was 10% below its historic peak reached at the end of 1994, and 7% below the near-term maximum of mid-1998.

18 On the relatively sound situation of Brazil’s financial sector, see Standard & Poors – S&P (1999). The external crisis of 1999 found the Brazilian financial system relatively well adjusted to the parameters established by the Basle Accord. Moreover, Banks were well prepared for the prospect of devaluation, especially after the Asian crisis of 1997. To a certain extent, Brazil benefited from the fact that the Mexican and Asian crises had already happened, since this gave the banks considerable time to prepare for a possible crisis.

19 The change in the trade balance was much less impressive than in the case of Mexico and Korea, in the absence of a large contraction in GDP, as in Mexico and Korea. Moreover, Brazil experienced a sharp deterioration in its terms of trade in 1999, with a 13% fall in the average price of exports. Despite this, in volume terms, exports of goods grew by 8%, while imports fell by 15%, compensating the moderate falls in investment, public-sector spending and consumption, and causing GDP to grow 0.5%.

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- the adoption of a floating exchange rate regime, replacing the quasi-fixed regime in place until 1998;
  - the implementation of fiscal targets; and
  - the implementation of inflation targets.

The new exchange rate regime gives monetary policy greater room for maneuver, freeing the government from the need to defend a certain level of exchange rate. It also enhances the flexibility of the price mechanism to adjust to the structural changes that Brazil's has been going through since the beginning of the nineties. The minus side is the risk of increasing exchange rate volatility, which can be detrimental to price stability, investment and trade.

The adoption of fiscal targets under the “umbrella” of the IMF agreement<sup>20</sup> led Brazil to join an emergent worldwide trend towards adopting fiscal rules. As Bayoumi and Eichengreen (1995, p. 32) had already stated in 1995, “restraints on the fiscal freedom of budgetary authorities are increasingly in the news”. This trend has intensified over the last few years fuelled by factors such as the European Union member countries' effort to meet the Maastricht criteria and the implementation of “IMF-style” programs by several developing countries. Brazil has moved, then, from a situation in which the fiscal deficit was the variable which would equate the chronic mismatch between the society's demands for public goods and its willingness to accept the corresponding taxation, to a scenario where a rigid fiscal target is established and the adjustment falls on revenues or expenditures.

A host of extraordinary measures, such as temporary taxes or proceeds from the sale of state-owned enterprises, allowed revenues to rise as a percentage of GDP, despite the low growth and high unemployment (Table 3). All of this led to a consolidated primary surplus for the public sector of over 3% of GDP, in sharp contrast to the situation in previous years.<sup>21</sup>

The adjustment also benefited from a series of fiscal reforms, such as:

- the establishment of certain restrictions on retirement in the public sector and the approval of a constitutional amendment turning the computation of pension benefits

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20 For a defense of the logic of IMF programs, see Mussa and Savastano (1999).

21 When the December 1998 agreement with the IMF was renegotiated after the devaluation, the level of future inflation and the consequent level of interest rates and the nominal deficit for 1999 were still highly uncertain. As a consequence, the agreement was signed taking the performance criterion as the floor value for the primary deficit, instead as the ceiling for the nominal deficit, as usual in IMF programs.

**Table 3**  
**Public Sector Borrowing Requirements – PSBR (% GDP)**

	1994	1995	1996	1997	1998	1999	2000	2001 <sup>a</sup>
Central Government	10.2	2.4	2.6	2.6	4.9	2.7	2.3	1.9
Revenues	18.9	18.3	17.5	18.6	20.1	22.0	21.7	22.9
(-) Transfers (states and municipalities)	2.6	2.8	2.7	2.8	3.0	3.3	3.7	3.9
Net revenues	16.3	15.5	14.8	15.8	17.1	18.7	18.0	19.0
Non-financial expenditures <sup>b</sup>	14.0	14.8	14.6	15.5	16.5	16.4	16.1	17.2
Payroll	5.1	5.6	5.3	4.8	5.0	5.1	5.1	5.2
Social security (INSS)	4.9	5.0	5.3	5.5	5.8	6.1	6.0	6.4
Other <sup>b</sup>	4.0	4.2	4.0	5.2	5.7	5.2	5.0	5.6
Statistical discrepancy <sup>c</sup>	-0.9	0.2	-0.2	0.6	0.0	-0.1	0.0	0.0
Primary surplus	3.2	0.5	0.4	-0.3	0.6	2.4	1.9	1.8
Nominal interest	13.4	2.9	3.0	2.3	5.5	5.1	4.2	3.7
States and municipalities	12.1	3.6	2.7	3.0	2.0	3.2	2.2	2.2
Primary surplus	0.8	-0.2	-0.5	-0.7	-0.2	0.2	0.5	0.8
Nominal interest	12.9	3.4	2.2	2.3	1.8	3.4	2.7	3.0
State companies <sup>d</sup>	4.7	1.2	0.6	0.4	0.6	-0.1	-0.8	-0.4
Primary surplus	1.2	0.0	0.1	0.1	-0.4	0.7	1.1	0.9
Nominal interest	5.9	1.2	0.7	0.5	0.2	0.6	0.3	0.5
PSBR	27.0	7.2	5.9	6.0	7.5	5.8	3.7	3.7
Primary surplus	5.2	0.3	0.0	-0.9	0.0	3.3	3.5	3.5
Nominal interest	32.2	7.5	5.9	5.1	7.5	9.1	7.2	7.2
Memo:								
Primary surplus (IMF target)	-	-	-	-	-	3.1	3.3	3.4

<sup>a</sup>Forecast.

<sup>b</sup>Includes primary deficit of Central Bank.

<sup>c</sup>Difference between the results “above” and “under the line”. A positive value means increase of PSBR.

<sup>d</sup>(-) = Surplus.

Source: National Treasury Secretary (STN) and Central Bank. For 2001, authors' forecast, based on the results of half of the year.

a non-constitutional matter (i.e. a matter for ordinary legislation);

- the approval of a new formula for calculating pension benefits, reducing the pensions of new retirees who leave service while still very young, or with only a few years of work;
- the renegotiation of state debts against collateral associated with federal government transfers to states, providing the former with the legal instruments to enforce the negotiated terms. This implied, by definition, a need for all levels of government to make their own adjustments, since they will no longer be able to count on treasury bailouts;
- the approval of the Fiscal Responsibility Law, inspired by similar legislation in New Zealand, which establishes parameters of behavior for the various levels of government, and defines ceilings for spending on payrolls for the various parts of the public sector;

- the privatization of several local state banks used in the past as alternative sources of funding for the local treasuries;
- the privatization of the majority of companies owned by state governments that have traditionally been loss-makers.

Finally, the adoption of inflation targeting meant a fundamental change in policymaking in Brazil.<sup>22</sup> The commitment to stability can no longer be understood as a rhetorical figure in the official discourse, since the message to economic agents has become extremely clear: the government will do everything in its power to meet inflation targets. In addition, the targets set were particularly strict, since they were fixed more than two years in advance, with no room for mid-term adjustments. The targets set for 1999-2001, using the IPC as a benchmark, were, respectively 8%, 6% and 4%, with a 2-percentage points margin of error on either side in all cases.

Greater confidence in the new regime will also depend on the progress made in the external adjustment. A significant step was already taken in this direction: the current account deficit dropped from US\$ 34 billion in 1998 to an average US\$ 25 billion in 1999-2001 (Table 4). External vulnerability will depend on the permanence of large inflows of foreign direct investment (FDI), which after averaging a mere US\$ 1 billion per year in 1980-94, rose steadily to an yearly average of US\$ 13 billion in 1995-98 and double that amount in 1999-2001.

**Table 4**  
**Current Account Deficit (US\$ Million)**

	1994	1995	1996	1997	1998	1999	2000	2001
1 — Trade balance	10,843	-3,353	-5,556	-8,365	-6,591	-1,203	-697	1,000
Exports	43,544	46,506	47,747	52,989	51,140	48,011	55,086	58,000
Imports	32,701	49,859	53,303	61,354	57,731	49,214	55,783	57,000
2 — Services	-14,743	-18,600	-21,044	-27,289	-28,799	-25,885	-25,705	-26,000
2.1 — Interest	-6,337	-8,158	-9,173	-10,390	-11,948	-15,270	-15,088	-15,000
2.2 — Profits and remittances	-2,566	-2,790	-2,821	-5,749	-7,305	-4,099	-3,590	-4,500
2.3 — Other services	-5,839	-7,652	-9,050	-11,150	-9,546	-6,516	-7,027	-6,500
2.3.1 — Travel	-1,181	-2,420	-3,594	-4,377	-4,146	-1,460	-2,086	-1,500
2.3.2 — Transports	-2,441	-3,200	-3,480	-4,514	-3,259	-3,096	-3,307	-3,500
2.3.3 — Insurance	-132	-122	-64	74	81	-128	-4	0
2.3.4 — Government	-327	-339	-275	-350	-385	-498	-549	-500
2.3.5 — Other	-1,759	-1,572	-1,637	-1,983	-1,837	-1,334	-1,081	-1,000
3 — Unilateral transfers	2,588	3,974	2,899	2,216	1,778	2,032	1,796	1,500
Current account	-1,312	-17,979	-23,701	-33,438	-33,612	-25,056	-24,606	-23,500
Memo: Net FDI <sup>a</sup>	934	2,569	9,966	15,516	22,619	26,888	30,812	18,000

<sup>a</sup>Excluding portfolio.

Source: Central Bank. For 2001, authors' forecast, based on the results of half of the year.

22 For a defense of the adoption of "inflation targets," see Mishkin (1999).

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## **5. Shocks in 2001: Short-Term Turbulence or the Sunset of a Would-Be Model?**

Brazil's economy finished 2000 in great style. The inflation target was met, GDP growth hit 4.4%, manufacturing output jumped by more than 7% in the last quarter, real interest rates fell for the second year in a row and investment gave strong signs of recovery. Buoyed by this performance, the government argued that the reforms have finally paid-off and that Brazil was on the thresholds of a period of sustained growth, with rates ranging from 4.5 to 5.0%. This good economic performance also gave a boost to the president's popularity, increasing the government's chances in the 2002 presidential elections.

These favorable conditions, though, did not last long. After a promising first quarter, the economy began to face major difficulties both domestically and abroad. First came the deepening of Argentina's recession and the sharp downturn of the US economy, which reduced capital flows to Latin America and curtailed the market for Brazil's exports. Second came the energy crisis, which struck in the second quarter of 2001. The worst draught in the last seventy years (hydroelectricity accounts in average for 90% of Brazil's power supply), coupled by regulatory shortcomings and low investment, forced the government to ration electricity to avert energy blackouts. Last, in third quarter, came the terrorist attacks in the United States, which thrown the world economy, and particularly the emerging market, in disarray, delivering yet another blow to the already bleak prospects of capital flows to and exports from developing countries.

It did not take long for this combination of events to have a dramatic effect in the exchange rate. The prospects of a drop in capital flows and sluggish exports, in a country with relatively high external obligations, led expectations to change rapidly and the exchange rate to suffer a second maxidevaluation. Nominal devaluation between December 2000 and November 2001 was 30%, inflicting at least three serious 'collateral damages'. First, given that the public sector had, by the end of 2000, a dollar denominated debt (external debt plus dollar-indexed domestic bonds), which amounted to 20% of GDP, the public-debt-to-GDP ratio soared despite the stringent fiscal adjustment carried out by the government. Second, inflation rebounded, moving the 12-month index beyond the Central Bank's target, and third, and as a result of the latter, the Central Bank was forced to raise interest rates, reversing a hard-won downward trend, initiated in 1999. This deterioration of the 'fundamentals' brought the economy to a halt. GDP growth fell from 4.5% (yoy) in the first quarter to 1.8% in the second quarter.

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Against this backdrop, the opposition wasted no time in mentioning indisputable facts such as the sluggish growth, energy bottlenecks, rising inflation and interest rates, an increasingly weak currency, a current account deficit close to 5% of the GDP, and, despite the costly fiscal adjustment, a 5% of the GDP increase in the public debt. Exposed to this type of criticism, the President's popularity fell again, strengthening the lead of the opposition candidates in the opinion polls for the 2002 presidential election.

If one looks, though, beyond the immediate consequences of the second maxidevaluation, there is no reason for pessimism. As the experience of the 1999 devaluation has already indicated, Brazil's new policy regime has enough flexibility to withstand external shocks, without inflicting too much damage on the economy's long-term prospects. In this regard, one can easily think of a reasonable and likely scenario for the next two years, in which the economy gradually overcomes the current difficulties. It would be based on the following reasonable premises:

- the energy crisis dies down during 2002 as a result of a combination of factors such as the end of a very unusual draught, the ongoing increase in the government's energy-related investments, a revamped regulatory framework and growing private investments in thermal plants;
- the exchange rate will level off or even appreciate once Argentina reschedule (voluntarily or involuntarily) its debt, investors overcome the panic that usually follows dramatic events such as the terrorist attacks in the U.S. and the ongoing adjustment in Brazil's current account gains full strength;
- the stabilization of the exchange rate combined with primary budget surpluses at the current level of close to 3% of the GDP will bring the dynamics of the public debt back to a sustainable trend; and
- as in 1999, inflation will respond to the current tightening of the monetary policy and, in the next years, will stay within the target set by government.

In this context, a premature, Wagnerian finale for the new policy regime would be far from a foregone conclusion, as suggested by its critics. In fact, our view is that the current difficulties reflect a drastic and, to a great extent, unexpected deterioration of the external environment, against which the new regime is fully equipped to fight. More to the point, judging by gravity of the recent situation and by what happened during the early 1980s and late 1990s shocks, the damage to the economy's growth prospects has been so far relatively small. If the next government reaffirms its commitment to the present regime (*i.e.* fiscal aus-

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terity, inflation targets and floating exchange rate) and continue to pursue an important agenda of microeconomic and institutional reforms (see next section), the economy, once the external environment improves, has all the conditions to get back on a sustainable growth path of 4.5 to 5.0% a year. In this scenario, inflation would gradually fall to international levels, vulnerability to external shocks will be reduced by devaluation-related improvements in the trade balance and interest rates and the public debt-GDP would resume a downward trend.

## **6. The Challenges Ahead**

Even though the country seems to be a good position to weather the current difficulties, it would be wrong to say that the nineties have exhausted Brazil's growth agenda. At least two big challenges remain ahead. First, there is the need to consolidate the new macroeconomic policy regime. One can mention, for instance, the need to take the fiscal adjustment beyond temporary sources of revenue, such as ad hoc taxes and the lack of an independent central bank, with a clear mandate to support the currency and fight inflation.

Second, there are important microeconomic and institutional reforms, related to investment, productivity and exports, which are essential to any sustainable growth scenario. There has already been progress in some of these areas: the investment rate, which in the first half of the nineties remained below 15% (1980 prices), rose to 19% in 2000; total factor productivity, which had declined an average 2.4% per year in 1980-91, showed an annual increase of 1.7% in 1991-2000 [Bacha and Bonelli (2001)]; and exports, as mentioned in Section 2, after a lackluster performance throughout the decade, showed signs of recovery after the 1999 devaluation. Yet, the likelihood of consolidating or even building on these gains will be greatly enhanced if the structural and institutional reforms are deepened or extended towards areas such as the labor markets and the tax and judicial systems - an agenda of challenges that has become known as the second generation of reforms.

On the issue of investment, there is little doubt that the country has still a long way to go. According to some estimates, investment would have to rise to 23.4% of GDP for the economy to return to annual growth rates around 5%. Given the balance of payment constraints, any surge in investment will have to be funded by higher domestic savings, based not only on a solid fiscal stance (already in place), but also on higher private savings. The latter can only be boosted by further reforms in the social security system and by the strengthening and deepening of the financial market. Decades of high inflation, coupled with a flawed legal

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system that does not properly enforce investor rights, have “repressed” the financial sector’s role in mobilizing and allocating resources [Pinheiro and Cabral (1998)]. There is clear evidence that firms in Brazil are financially constrained, undermining their capacity to invest and grow [Thomas (2000)].

On productivity, whereas there is still a considerable agenda to push through in terms of trade liberalization, privatization and deregulation, it seems unlikely that these factors alone will be enough to keep productivity growing at the rates seen in the 1990s. The major source of future gains seems to be on deregulating the labor market and on upgrading the skills of the labor force, an area where Brazil lags behind even by Latin American standards [Ranis and Stewart (2001)]. The benefits of higher and more efficient investment in training and education are likely to be threefold:

- it might speed up the catching-up process;
- it would lay down the groundwork for a move towards more productive, technology-intensive sectors, with positive externalities for the whole economy; and
- it would reduce inequality, historically the black spot of Brazil’s growth record.

On export performance, the sustainability of the momentum gained after the 1999 devaluation will depend heavily on the government’s ability to promote investments in infrastructure, to carry out a tax reform, to deepen the capital markets and to provide a better institutional support and improved market access for exporters. In the case of infrastructure, as mentioned earlier, considerable progress was made in the second half of the nineties through privatization of state enterprises. Yet, there is still a lot to be done, particularly in areas such as energy (as shown by the severity of the recent crisis) and transport. Tax reform is an imperative given the characteristics of the present system, which penalizes producers with cumulative taxes. Financial deepening is a key precondition to bring small and medium firms into exporting and to allow firms to survive in sectors such as high-unit-value capital goods, where competitors count not only on more advanced capital markets, but also on state-sponsored export credit agencies.<sup>23</sup>

On the institutional side, in a highly informational-intensive activity, especially in terms of business opportunities, government support to disseminate information can be a powerful tool to promote exports. There are already initiatives in this direction — the export promotion agency (APEX), recently established, is a case in point — yet, compared to what has been done in East Asia,

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23 For a discussion of Export Finance in Brazil, see Sucupira and Moreira (2001).

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there is still a long road ahead. Finally, there is the issue of market access, where this and the next government face crucial negotiations, particularly in agriculture and antidumping, involving Mercosur, the FTAA (Free Trade Area of the Americas), the European Union and the WTO.

## **7. Final Remarks**

In the last two decades, Brazil's economic performance fell well short of its potential and tradition. GDP growth averaged 1.5% a year between 1981 and 1990 and 2.7% in the following ten years, a far cry from the more than 7% a year achieved in the previous 30 years. In the early 1990s, though, Brazil began to pursue a far-reaching agenda of market-friendly reforms, in an effort to regain the economy's lost dynamism. The history of these reforms can be divided into three periods. In the first (1991-94), Brazil dropped its traditional import substitution regime, opening up its economy and privatizing industrial firms. The economy responded positively, but high inflation hold back efficiency gains and growth. In 1995-98, the first Cardoso government took structural change one step further by taking privatization to infrastructure and by bringing inflation down from 5,000% a year to close 2% in 1998. Yet, delays in floating the exchange rate and lack of fiscal discipline led to mounting fiscal and current account deficits, compromising growth.

In the third and final period, 1999 onwards, a new macro-economic policy framework was implemented based on fiscal restraint, inflation targets and a floating exchange rate. For the first time since the beginning of the reforms, Brazil had managed to combine in depth structural reforms with a proper macroeconomic policy. This long overdue combination raised hopes that the elusive goal of sustainable growth was finally within grasp. These expectations were initially confirmed by a more than 4% GDP growth in 2000, yet, after a series of external and internal shocks, recovery was aborted and some began to question the ability of the new regime to deliver its promises of growth.

The shocks – the energy shortage, Argentina's crisis and the worst world recession since the 1970s – were a powerful blow to economy's fundamentals, particularly when one looks at indicators such as public-debt-to-GDP ratio and the current account deficit. Yet, as shown by the 1999 currency crises, the new policy regime is fully equipped to deal with short term disturbances, particularly those caused by external shocks. Moreover, one has to look well beyond shocks to assess the implications of extensive reforms such as those carried out during the nineties. One could, for instance, draw a parallel between these reforms and those implemented in the mid-1960s, under the "Government Econ-

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omic Action Plan” (Plano de Ação Econômica do Governo). In both cases, there were long overdue policy and institutional changes that needed to be implemented. The 1960s reforms ended up paving the way for the so-called “Miracle” (1968/1973), a period of unparalleled rapid growth. Likewise, by dealing with bottlenecks inherited from decades of antitrade bias and macroeconomic mismanagement, the 1990s reforms might become known for paving the way for a new cycle of rapid growth.

This outcome, though, will fundamentally hinge on the ability and political will of the next government (2003/2006) to reaffirm the country’s commitment to free trade and the new macroeconomic regime. This would involve not only keeping the *status quo*, but would also require, first, a move to reinforce the institutional side of the new regime and second, an effort to pursue the so-called second generation of reforms, which are essential to boost investment, productivity and exports, three key ingredients of a sustainable growth path.

All in all, one can argue that Brazil is at the crossroads of growth and stagnation. On the one hand, the country has gone through major market-friendly reforms, which paved the way for a sustainable recovery. Yet, on the other, given a number of policy missteps, particularly at the fiscal and exchange rate management, and a series of external shocks, results were slow to come, notably in terms of growth. This delay has produced a “reform fatigue” that undermined political support for the new regime and, more importantly, for a second generation of reforms, which are key to complete and consolidate the achievements of the 1990s. If, despite the fatigue, a pro-reform approach prevails in 2003, the 1990s might pass into history as laying the foundations of a long spell of prosperity. Yet, if the critics have their way, then it might be view as yet another lost decade.

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## Appendix

### APPENDIX Brazil: Economic Indicators

	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP (US\$ billion) <sup>a</sup>	429.7	543.1	705.5	775.8	807.7	787.7	528.6	593.8	500.0
GDP growth (%)	4.9	5.9	4.2	2.7	3.3	0.2	0.5	4.4	2.0
Industry (%)	7.0	6.7	1.9	3.3	4.7	-1.5	-1.6	5.0	1.5
Agriculture (%)	-0.1	5.5	4.1	3.1	-0.8	1.9	7.4	3.0	3.5
Services (%)	4.5	1.8	1.3	2.3	2.6	1.1	1.5	3.7	2.0
Inflation (IGP, January/December, %)	2708.6	1093.8	14.8	9.3	7.5	1.7	20.0	9.8	9.0
GDP deflator (%)	1996.2	2240.2	77.6	17.4	8.3	4.7	4.4	8.5	8.1
Real interest rate (%) <sup>b</sup>	7.1	24.4	25.0	16.3	18.5	26.7	15.3	10.8	10.5
Unemployment – IBGE (%)	5.3	5.1	4.6	5.4	5.7	7.6	7.6	7.1	6.5
Current account deficit (% GDP)	0.1	0.2	2.5	3.0	3.8	4.3	4.7	4.1	4.7
National accounts (% GDP, current prices)									
Final consumption	77.7	77.5	79.5	81.0	80.9	80.9	80.6	79.2	na
Private	60.0	59.6	59.9	62.5	62.7	62.1	61.7	60.4	na
Government	17.7	17.9	19.6	18.5	18.2	18.8	18.9	18.8	na
Gross capital formation	20.9	22.2	22.3	20.9	21.5	21.2	20.5	23	na
Investment	19.3	20.8	20.5	19.3	19.9	19.7	na	na	na
Change of inventories	1.6	1.4	1.7	1.7	1.6	1.5	na	na	na
Goods and non-factors services	1.4	0.3	-1.8	-1.9	-2.4	-2.1	-1.1	-2.2	na
Exports	10.5	9.5	7.7	7.0	7.5	7.6	10.6	9.9	na
Imports	9.1	9.2	9.5	8.9	9.9	9.7	11.7	12.1	na
Total	100.0	100.0	100.0	100.0	100.0	100.0	100	100	na
Tax burden, national accounts (% GDP)	25.3	27.9	28.4	28.6	28.6	29.3	31.7	32	32.5

na: Not available

<sup>a</sup>GDP divided by the average exchange rate (R\$/US\$).

<sup>b</sup>Gross rate (SELIC). Deflator: "Centered IGP". Since 1995, CPI.

Sources: IBGE, IPEA and FGV. For 2001, authors' forecast, based on the results of half of the year.

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