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*BRAZIL IN THE GLOBAL CRISIS: STILL A RISING  
ECONOMIC SUPERPOWER?*

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## P R O C E E D I N G S

MR. CÁRDENAS: I welcome you to Brookings. I am Mauricio Cárdenas, the director of the Latin America Initiative. And it is a really great pleasure to chair this session, which is basically the presentation, the formal presentation and the book launch of this publication, *Brazil as an Economic Superpower?*, which was co-edited by Leonardo Martínez-Díaz and Lael Brainard. Those of you know well that she was here as vice president and director of the Global Economy and Development program, and since she worked on this book, she has left for the U.S. government.

As you probably know, Brookings is truly becoming a global think tank. And as part of that, it is creating different, new programs, one of them being the Latin America Initiative. Our main goal is to do analyses and research commentary on the issues of Latin America, and particularly on ways of reengaging the U.S. and Latin America and improving the quality of the relationship and the quality of policies of the U.S. towards Latin America. About a little bit more than a year ago, Leonardo Martínez and Lael Brainard put together a conference with some Brazilian experts. The result of that conference is what is published in this volume, essentially the different papers that were written, covering different

aspects and different answers to these questions, which is basically whether Brazil is ready now to become an economic superpower.

I am sure you probably are familiar with the materials that are published in this book, so we decided for this special event to do two things: One is to ask Leonardo, who is one of the co-editors, to tell us a little bit about the publication and about the views that are expressed in this book by the different authors and the different ways of responding to these questions, depending on the different angles. Leonardo is currently on leave from Brookings, but he will be back very soon, and he will serve as deputy director of the Global Economy and Development program. Leonardo is a very well known political scientist. He has a Ph.D. from Oxford University. He has an undergraduate degree from Northwestern. He has been affiliated here with Brookings for quite some time, and in the context of that affiliation, he has been very productive. And one of the most important achievements I like to highlight is the fact that he was a key person behind what came to be known as the Brookings Partnership for the Americas Commission. This is a commission of twenty very remarkable individuals that wrote a report to the new administration on ways to improve the relationship with Latin America. Leonardo was key to that, was the deputy director of that commission, and that left an imprint. And he has done other work. He is about to publish a book on the

banking sector, in particular on the banking reforms in different countries in Latin America, and, of course, this book that we're presenting today.

But after we hear from Leonardo, we are going to move in the direction of discussing this issue of Brazil and Brazil's role in today's economy and in today's world with two leading experts on Brazil, two Brazilians also. First, Jose Guilherme Reis, who is currently a lead economist at The World Bank in the Finance, Private Sector and Infrastructure Group in the Latin American area. Jose Guilherme has been affiliated with different institutions, particularly in the Brazilian government, in the Brazilian Ministry of Finance, the Brazilian Ministry of Planning, and has a tremendous wealth of experience in different areas. But particularly one that we would like to highlight today is trade and different aspects of the micro economy. He was one of the leading experts, providing support to the ILO's very well known and often quoted report on the social impact of globalization.

And our second guest is Paulo Vieira da Cunha. Paulo is a very well known economist, who has been doing research on the economies of Latin America for quite a number of years. He recently was involved also in government, particularly at the Central Bank of Brazil, where he spent two years as deputy governor. He stepped out of that position in 2008. He is back to what he has done for a number of years, which is essentially research and influencing trading in Wall Street, now

with a new venture called Tandem Global Markets. A very well known person in Wall Street circles, especially on research pertaining to emerging economies.

So let me ask first Leonardo to tell us a bit more about the book and the different chapters, the different views, and then we will move into the panel discussion, hoping to involve you by providing enough time for questions and comments that could enlighten this discussion. So Leonardo, we are going to go about 15 minutes and then we will give each one of the two panelists also an equal amount of time.

MR. MARTÍNEZ-DÍAZ: Thank you very much, Mauricio, and thank all of you for coming, and thank you, the panelists, for being here today and commenting on this book that we are very happy to finally have out.

Let me tell you a bit about the genesis of the project. As you will notice, -- partly because of the very colorful cover as well -- this book was written in very happy times. It was written during the twilight of the economic boom. When the conference actually gathered here in Brookings next door in April of 2008, Brazil had just been promoted by Standard and Poors. Its rating and several bonds had been rated finally "investment grade." There was a sense of optimism, of dynamism, in the world economy and in the Brazilian economy as well. The Brazilian economy had been growing since 1993 at a rate of around 3 percent on

average. Of course, it slowed then in '98 and '99, but on the whole, the performance was quite healthy. Certainly slow perhaps, as the naysayers were bound to say, compared to China or even compared to Brazil's own economic miracle from '68 to '72. But nonetheless, it was seen as a healthier, better quality type of growth. It was growth that was not highly inflationary in nature. It was growth that was not based on high levels of foreign indebtedness as it had been in the '70s. And it was growth that was based or took place in the framework of fiscal discipline. And, therefore, there was a sense that this kind of growth could be more sustainable and was built on stronger foundations.

Also in 2003, Goldman Sachs famously anointed Brazil as one of the BRICS, one of the poor economies destined to become one of the truly economic superpowers by the middle of the 21st century. This, of course, led to lots of debate as to which countries ought to be part of that group or should not be part of that group. But there was a clear sense that Brazil – there was something special about Brazil, something that the BRICS label captured and, therefore, ought to be perhaps analyzed in greater detail.

So this was the context in which the conference took place, but the fortunate thing from the shelf life of the publication was that the conference papers and our analyses did not focus only on the drivers of growth, per se, but it was actually trying to find out more about the

foundations of that growth and understand the dynamics behind what was making Brazil special. And that was not only about growth rates, it was something about the role of Brazil in the global economic system. And that's what we try to capture in the subtitle. There was something special and shifting in the role that Brazil was playing. First of all there was a clear leadership position in key commodity markets. It does not matter if you look at soy, for example, where Brazil's exports account for 40 percent of global exports of soy, or chicken or coffee where Brazil accounts for 30 percent of global markets, beef 20 percent, or orange juice where it is an 80 percent market share. Clearly in some of these markets, Brazil actually plays -- could play -- the role of a price leader.

And then there was the issue of energy, of course. At the time of the conference participation, the announcements of these enormous, deep-sea discoveries had been hitting the headlines. There was a sense that Brazil could become an oil producer of very large proportions. But more importantly, what actually was taking place was that Brazil was the producer of 42 percent of the world's ethanol production. And given the importance of climate change and that debate going on in the background, it was obviously a role that had precipitated -- had put Brazil in the center of that particular debate.

And finally, there was the role of Brazil as a rule maker as opposed to a rule taker in the global economy. By that I mean Brazil was

now seated at many of the important forums and tables, at that point the G-20 Finance Ministers and Central Banks Governors Forum, which has now become the G-20 Leaders Forum, includes Brazil. And Brazil had become increasingly active in its position and its rhetoric in that forum. Also, of course, in the WTO, Brazil had become one of three or four really important players that had to be at the table if there was going to be a discussion of the multilateral trading system.

In summary, there was a clear sense that we were not just trying to capture, or understand better, growth, but really something qualitatively different, which is the role of Brazil and its relationships with the rest of the economic system.

The book has nine chapters, all of them are by academics, although we had present at the conference and commenting on the papers a number of people not just from academia, but also from the private sector and from government. We had some of the best academics, both from Brazilian institutions as well as academics from the U.K. and the U.S., commenting and writing. Three of the chapters focus on agriculture and energy, two of them on trade policy, two of them on the phenomenon of multinational -- Brazilian multinational corporations and their role both regionally and globally. And finally, as an important part of globalization, we recognized that building strong safety nets is very important. In the front, we had a chapter from Marcelo Neri on Bolsa



Familia and other income programs that help the country absorb some of the dislocations and the disruptions that inevitably come from greater economic integration.

In stead of summarizing chapters or telling you what each one of the authors said, which would partly spoil the fun, I am going to pull from all of the chapters some of the main themes that cut across all of these sections. And, of course, we welcome you to read the chapters themselves. The book is certainly on sale in the bookstore just behind you and online.

The first main idea was that Brazil has capitalized or is likely to capitalize on two very important global trends. The first is the rise of a global middle class, a middle class that is based certainly in large measure in China and India and other BRICS, but also in other countries of the world, and one that is increasingly driving demand for some of the commodities that Brazil is key in producing. Not only beef and soy, but also manufactures, especially, for example, regional aircraft that (inaudible) produces. That, plus the very tight conditions in global markets left Brazil, I think, with a very auspicious circumstance, very high commodity prices, and that, certainly helped Brazil capitalize on those markets.

Second is the imperative of stabilizing global climate. As I mentioned, there was a clear sense then as there is even more now that

this is one of the most important global challenges. And it is also clear that Brazil has to play -- has a role to play -- in that debate. And, of course, there is some important economic opportunities for Brazil, especially in terms of the production of biofuels, but also in terms of global environmental services.

The second big idea here was that Brazil has been well positioned to capitalize on these trends for two reasons. The first, of course, is that Brazil has a very favorable sort of factor endowment. Its resource allocation is extremely favorable both in terms of iron and ore deposits or its climate, which may enable it to become the world's farm alongside, say, China, the world's factory, and India, the world's tobacco office, and secondly that -- and perhaps more importantly and in a more subtle way -- the issue of policy legacies. We wanted to highlight that policies that were put in place in the 1960s and primarily '70s, some of them have had the perhaps ironic impact of leaving Brazil in a much more strong position to capitalize on key opportunities in the global market, even though these policies were actually put in place to make Brazil more self reliant and less dependent on the rest of the global economy.

Let me give you some examples of this. As several of the authors discuss, the kinds of policies that focused on helping Brazil develop in an indigenous, technological, and agricultural capacity, led the government to finance a number of research centers, which then became

the foundation for important technological advances. For example, Geraldo Barros, in his chapter here on agriculture, talks about EMBRAPA, which is one of the most important research institutions that helped come up with innovations that allowed factor productivity in agriculture in Brazil increased dramatically over the '70s, '80s, and '90s. Cenpes is the Petrobras internal think tank, which has allowed that company to develop some of the deep-oil and deep-sea drilling capacity that will be now necessary not only to get to some of these underwater deposits that Brazil now has, but also the kind of drilling that is necessary in other parts of the world. And, of course, there's the Antarctic's Technology Center, which helped support (inaudible) developments in their regional aircraft.

The second example perhaps is the policies of this period, at least some of them, helped push some firms into markets into which they would not otherwise have gone. The key example here, of course, is ethanol. The pro-alcohol program of the 1970s was a response to the oil price shocks of that period, and it was very much an attempt by the military government to make sure that Brazil would be less reliant on foreign oil. Of course, this was the type of thing that many other countries, including the United States, wanted to accomplish, except Brazil really meant it I suppose. And the impact was considerable. I mean, Brazil's energy matrix is very different from that of the OVC countries – 46 percent of Brazil's energy comes from renewables. Compare that to only 6

percent as an average of OVC countries. So there was a very clear change, and that meant that firms had to be pushed into markets perhaps through some government encouragement. Now as you might imagine, there was a considerable debate as to whether this dialogue about the policies of the '70s was going to be a reassessment of import substitution or not. And I think it is safe to say that nobody in the room felt that this was a vindication of all of those policies. In fact, a lot of the dialogue was about trying to price those costs and to understand the duplications and distortions that many of those policies also introduced. However, we wanted to take a more nuanced view and to argue that the policies of that period should not all be thrown, dismissed completely, but that some of them actually have had these intended and sometimes unintended effects of actually helping Brazil capitalize on these new opportunities.

Of course, the role of entrepreneurialship was not lost on the participants. The book's -- the chapters especially from Edmund Amann and Ben Ross Schneider make very clear that the management teams of some of the leading Brazilian firms knew how to capitalize on these policy legacies. And they actually were able to take some of their firms, many of which had flourished during government ownership, and take them into a really different direction, perhaps a direction that would not have otherwise materialized without the importance of private sector entrepreneurialship.

Now one of the implications of all of this was that Brazil was facing at least three quite important challenges. The first, of course, is how to translate some of the wealth of the commodity boom into investment and long—term capacity that can help in sectors that are not commodity oriented. This is, of course, particularly important now, given the volatility of commodity prices. Of course, we knew this already, but at the time, it seemed that this boom would never end, and as we know, of course, this is quite fickle. Amann in particular in his chapter is concerned that the capacity of the government to support --- or I should say the capacity of Brazilians as a whole to support innovation, science, and technology has actually declined. As the government has cut back on its own expenditures in science and technology, the private sector has not come in to fill the gap. And as a result, Brazil now has one of the lowest rates of spending as a percentage of GDP in science and technology compared to other OVC countries and some BRICS. And this may be one of the perverse sides of a government—led system, one in which the private sector perhaps is not able to or willing to step in when the government steps back.

The second point here is that Brazil will have to manage this private integration in a way that will help the economy flourish in the long run. Especially the chapters on trade in the book, both of them, are very clear that within Brazilian society and within even the Brazilian

government, there is a very divided set of views. On the one hand, if you like some of those who still, I think, would emphasize the notion of the development policy in which national developmentalism and trade policies are really an instrument's hardness to try to increase policy space and, therefore, some trade agreements may not really make much sense from an economic point of view. There was, for example, a criticism of south—south trade agreements which do not make sense politically, but do not seem to make much sense from an economic standpoint.

And then on the other hand you have a rising set of increasingly, you know, aggressive liberalizers, especially those in the agribusiness sector who really want to push policy towards greater integration, greater opening because they have much to gain. The question here becomes one of political economy. What configuration of political interests in Brazil will be necessary to lead to different kinds of open? The chapters here really only begin to touch on that question, but I think that is where the frontier of research will be for the next book if you like.

Finally there was the issue of Bolsa Familia and the social spending programs that have been really successful at reducing at least to some degree the Gini coefficient poverty and inequality which have long been a scourge of Brazil's society. For this one, we had one of the experts on Bolsa Familia writing, and he comes up with – he tries to

puncture a bit the bubble with a great degree of optimism and praise that Bolsa Familia often gets. Certainly he documents with great care the importance of that program and the successes it's had, but he also argues that Bolsa Familia today operates side by side with some income programs that are, again, legacies of the past, but which are far less efficient and less effective. In order to really make the system work better, you have to phase out some of those programs. Also he said for all of its benefits, Bolsa Familia actually seems to be paying people to do something they would do otherwise, that they had been doing before without cash payments. And, therefore, there has to be a real hardcore assessment of the conditionalities that Bolsa Familia uses. But on the whole, he, I think, gives the structure of income programs and social networks, social safety nets, a pretty good rep.

So to conclude, is Brazil an economic superpower? Well that, of course, depends on what you mean by an economic superpower. As a major economy that ranks in the top four or five in the world, clearly Brazil has a long way to go. The last time we looked, Brazil ranked ninth, beating Russia shortly for that spot. And according to the global site projections, which are now probably dated, Brazil would have had to grow at 4 percent per year from 2005 to the middle of the century in order to become the fourth largest economy, something that seems quite difficult at the moment. But if we mean an economic superpower as a country that

has a really important, perhaps even central, role in global economic management, and which as I mentioned has an important influence in the shaping of global economic roles, then I think here we can safely say that Brazil is an economic superpower. It is very well on the way to becoming that. And I think even the current crisis will not erase that anytime soon. I think there is a real understanding now from the perspective of many key decision makers that Brazil has to be at the table in many of the key discussions from climate change to trade to financial regulation even.

Let me stop here and then take this opportunity to mention that this panel allows us to look at this work, which was created and written in a different economic world, and try to then look at it from the vantage point of the world we now know, which is one on which the economy is far more in turmoil. I propose that Paulo could begin perhaps talking to us about the macroeconomic context and how it has changed, the questions and the answers that are in the book perhaps, and then as I say we will follow touching as Mauricio mentioned on some of the microeconomic aspects of the Brazilian economy. Thanks. Paulo, over to you.

MR. VIEIRA DA CUNHA: Good afternoon. It is a pleasure to be here. I would like to thank Mauricio and thank Leonardo for the invitation, and congratulate Leonardo and the team on what is a very provocative and, I think, will be a very useful book. In reading some of the



parts of the book, it struck me that although none of the ideas one has not seen before, it is a singularly, nicely put together compendium current thinking in Brazil and the challenges for policy. And I felt that Leonardo made a great summary of the book. So I really believe that this will be a very useful and often consulted and cited book going forward. I hope it is because it is a very informed way of putting the Brazilian discussion today.

As Leonardo said, I am here to talk a little bit about the macro and the macro as a background. Of course, that was not the subject of the book, so what I would like to do is really divide my brief presentation in two parts. I am going to give a synoptic history of the macro as I see it and where we are right now, and then I am going to sort of try to put forward what I think is the Lula legacy in macro policy, which is kind of shaping the discussion today.

I think as we look at Brazil in the period that the book discusses, which is the post-import substitution phase, it really has two phases and four periods. And the critical rupture, of course, is the Real Plan, which began in 1994 and (inaudible) is one of the people -- deeply involved in making that work. And, of course, that was the period of inflation stabilization, but much more than just simply inflation stabilization because where is the change in the inflationary patent? You have to overhaul the entire financial system. And these were two major programs. It has a lot to do with what happened subsequently. On the private sector

it cost about 12 to 13 percentage of GDP, maybe less. And then later on the private sector banks, it was about 10 percent of GDP. So these were major, major programs, and interestingly enough, I think one of the objectives of the Cardoso Administration -- and I will come back to that -- was really to modernize the Brazilian state. I think it was a big, big thrust. At the time when Cardoso took office, the public sector was discredited, civil service was discredited. There was a general sense in Brazilian society that the government had exhausted its capacity, to finance itself because it was using the inflation tax to finance and that had to stop, but also its competency in most areas. And so this was a period of very strong privatization, as Leonardo said, that it gave the roots to these new firms in Brazil. If you look at Brazil, there is hardly any large Brazilian firm that does not have a link to the state, either in the past or even today because the major shareholders are still some of the state pension funds or state-appointed institutions. But there was at that time a real sense of trying to get the state modernized. And very much in the spirit of that time and very deep in the thinking of the Cardoso Administration was really limiting the size of the Brazilian state and stopping what -- and of course, Cardoso was famous for: His expression of **(Spanish)** was you know, this huge interface between the private and public sector that you would not even know where one stopped and one began in Brazil. And so he closed down the most nefarious of these lobbyists like the Brazilian Institute of

Coffee and this and that. And there must have been twenty or thirty of these things that were closed down.

And so a very aggressive thinking, particularly in the first Cardoso Administration that went together with the Real Plan. So that was a phase, a phase one, which unfortunately ended in crisis for reasons that I will talk in a minute, and in this phase one, the macroeconomic regime, was not very solidly established.

The second phase was what John Taylor calls the "New Holy Trinity," which is now all around the world. And that was that as a result of the crisis. Brazil established this tripod that has now worked through severe shocks and severe stress tests, including the last one of these during the last few months, and that is the floating exchange rate -- which took Brazil forty years to establish that idea -- an inflation targeting system copied from England and many other models, but that has been very successfully implemented and has worked pretty well. And most importantly and still problematic, and I note that (inaudible) is here in the audience so I will be careful because she knows much more about this, but there is the fiscal adjustment. And there was very significant fiscal adjustment. Of course, the lynch pin was the fiscal responsibility law, but that is the Achilles' heel that had been there before and continues to be there as I will mention in a minute.

So these are the two big phases: The transition, you know, the stabilization, the end of import substitution, the end of the debt-driven miracle that was not a miracle. It was really digging a hole that was bigger and bigger. And stabilizing the Real Plan, dealing with the skeletons and the very negative consequences of, you know, thirty years of macroeconomics, severe macroeconomic mismanagement, and then moving after a transition through a sustainable, what I think is a sustainable macro framework, which is what we are operating right now.

Now the first phase of the Real Plan from 1994 to 1998 used the exchange rate as an anchor. It had very recalcitrant inflation expectations. And that model, of course, failed primarily because of the succession of a foreign crisis and an inability to tackle with termination the fiscal discipline that, given the negative external shocks, would have been necessary to maintain that system. You know, we now know. Look at Latvia today. It was not as severe. There was another variant of these sorts of things.

And then finally in 1999, mid 1999, through a series of coincidences, but really quite a work of genius at the time, (inaudible) conceived and implemented this tripod made possible by the political situation at the time that had as the anchor the passage of the fiscal stability law, which in Brazil was a major, major sea change legislation, probably the most important legislation g over the last fifty years in Brazil.

And then the floating, which was a forced floater because it was a speculative attack that forced the floating of the currency on January 18, 1999. But the conscientious introduction in June of 1999 of the inflation targeting and unfortunately very soon had to meet very severe external crisis. Argentina and then the political crisis of the fear that the whole thing would be undone under the new Lula Administration. So from 1999 to 2003 you have the second of these two periods in which you really had not consolidated yet. But with the surprise, the positive surprise that was the Lula Administration, particularly under Minister Palasi, and you know, this enormous luck which was the global recovery, unprecedented global growth, I mean, unbalanced, but -- and that Brazil being in a capacity to take advantage of it, you have a period from 2004 to 2007 of really extraordinary growth and extraordinary development.

And what was important was a conscientious decision at the Ministry of Finance and particularly at the Central Bank to not allow the full extent of the external positive impact to pass through the economy, but to sterilize a big chunk of that and transform the structure of the public debt. So the buildup of Brazilian external reserves was not really done for precautionary reasons. It was a macro response to a shock that if you had allowed to pass through the domestic economy, it would have resulted in unprecedented growth and unsustainable growth in domestic demand that had to be sterilized. The way to sterilize it was to absorb the

reserves and use the reserves to transform the structure of the domestic debt. And that really settled the issue of the debt sustainability in Brazil, which was a lingering issue that until then had not been resolved and now because of a positive, virtuous circle in which Brazil is a lender abroad, the external shock is seen as a positive fiscal force instead of being a negative fiscal force. So it was very, very important in this period of three years to really change the structure of the macro dynamics in Brazil.

And the fourth period, of course, is the period that begins with the crisis in late 2008, which is a period of a return to an old scourge of Brazil. You see it under a new guise, which is fiscally-led growth, and we will have to see where this goes.

Now it is very interesting that if you look at these two phases, and it is an irony -- you know, somebody was mentioning the ironies of some of the import substitution measures that have produced positive results. And Geraldo Barros, wrote a very nice chapter in the book. One of the ironies of Cardoso's impetus to try to modernize the Brazilian state, and the difficulty of doing that was a very perilous macro position, was that the political economy of producing a sustainable fiscal position was one of unprecedented growth in tax. In other words, reform in Brazil was political reform. But what happened is that to produce the necessary primary surplus to stabilize the debt to GDP which was the (inaudible) which would have to be done, the only way to do this was to actually spend more. And

it proved certain things in Congress, but that Congress then completely turned a blind eye to the growth in taxes and the tax base of Brazil increased in less than ten years by 10 percentage points of GDP.

(inaudible) was one of my heroes as a great Brazilian economist. He actually did an examination and he came out with the history, which I do not know if it is true, but knowing (inaudible), it must be, that other than during wars or severe disruptions like during the French Revolution, there are very few examples of countries that in a democratic system can increase the tax base by this extraordinary amount. And there was no opposition in Brazil. I mean, the opposition to the growth and taxes in Brazil became when they started to tax lawyers.

And so now let me just 5 minutes to finalize on what is happening today and what I think is the Lula legacy. So the irony of the Cardoso process is that although he wanted to modernize the state and create a more capitalist society with a smaller, more disciplined state, with a clearer separation of what was public and what was private, it was a break, trying to go. He created the competition authority, you know, trying to set up these regulatory bases. In the process, he engendered a capacity for an ever bigger state. And in the Lula Administration, particularly in the period after the threat of the unstable debt dynamics and taking a cue from the need for a fiscal stimulus that is countercyclical in a policy of today -- now, mind you, you have to remember that the Brazilian

state spends 40 percent of GDP. And if you include the indirect ways in which it spends through directed credits, it is over 50 percent of GDP. So this is not a small state. So what has happened is that all of this has now become again part of the orthodoxy. I do not think there are any more serious people in Brazil that have any political power that are fighting against the big state. It is on the contrary. I think this is the Lula legacy. I mean, he exposes the big state. He thinks the state has a very big contribution to do. And that is it. I mean, my old boss, Enrique Morales, in a funny way -- I do not want him to be quoted on this -- but he often said that you should really think of Brazil as comparing Brazil was to Germany. People like to think of the future like in the United States. It is not. The model is Germany and if you could get the Brazilian state to become as efficient as the German state, I think that is the kind of thing that Brazilian society would like. People in Brazil seem to be quite happy, even most of the entrepreneurial class and everything, with the idea that you have a very large state, and a state that taxes a lot and spends a lot. And how you deal with this going forward is going to be a major, major issue for Brazil because unfortunately, the Brazilian state is not the German state. It is very inefficient, very corrupt, and full of problems. And yet you have a system that lives with a very large and distortionary system of taxes that clearly imposes a heavy toll on total factory productability and on the capacity of the economy to grow. But that seems to be a political -- a new



political -- consensus, and I think is the biggest macro legacy that Lula has produced because he has engineered the support for this system that came sort of by accident through the force of producing the fiscal adjustment in the Cardoso Administration, and that then was catapulted to a very, very, very extraordinary rapid growth in taxes during the boom years of 2006 to 2008. And everything was spent. Everything was spent. I mean, so you had public expenditures growing at about 9 percent of real terms for a couple of years, which was extraordinary, and very, very large growth in civil service, both in new hires and in the real wages of the civil service. And, of course, as Marcelo Neri discusses with some alarm, a number of these social programs are not really consolidated. So you keep adding everything. You know, so Brazil spends -- there is a famous comparison -- more than Belgium in social transfers. You know, Belgium spends about 12 percent. Brazil spends about 14 percent of GDP in social transfers. Now having an economy the size of Brazil and with all the capacities that it has to continue to grow dynamically with this weight is going to be a challenge. But it seems to be a consensus and a workable consensus so far. Thank you.

MR. GUILHERME REIS: Good afternoon. Thank you very much for inviting me to participate in the launching of this important book about the Brazilian economy. For me and I think for any Brazilian economist, it would be a true pleasure to be invited to discuss a book that

brings exciting prospects for the Brazilian economy. Mauricio referred to the period I was in government. I used to come to Washington to discuss very different themes and topics actually, stabilization themes more than growth. Let me join Paulo to congratulate Brookings for the Initiative, and I think that the book really is a useful instrument to help understand the complexities and nuances of the Brazilian economy, which is by no means easy to understand. Tom Jobin, our famous composer, is also known for some remarkable sentences. One of them is "Brazil is not for beginners." And I think that the book Leonardo and Lael were fortunate to put together brought a solid group of both Brazilian and non-Brazilian professionals, whom really helped with their analyses to understand not only the recent developments, but also the challenges faced by the Brazilian economy.

. However, this sentence should not be seen as a disguise for protectionism

Paulo focused more on the macro side and I will focus more on some long-run issues, which are actually at the core of this book. I think that my structure, my comments, are divided in three main parts. One is the consequences and challenges of commodity-led integration to the world, the trade integration challenges per se, and finally some comments on the technology and innovation agenda.

The book makes a clear case that the role of Brazil in the global economy is changing given first its factor endowments, its strengths

built by some successful intervention -- policy interventions in the past, and on the other hand, boosted by changes in relative prices of commodities and by the imperative to stabilize the world's climates. It is hard to deny that Brazil is in a privileged position in the current world debate on food versus fuel. Sugar cane production in Brazil has been demonstrating a capacity to increase without any harsh competition against cereals or soy seeds. Finally, there is this recent discovery of potentially massive reserves of oil and gas in the coast of Brazil, off coast, which may transform the country even more, definitely from an oil importer to an energy power. These changes that are taking place do not look transitory. I would say quite the opposite. Some of these changes are here to stay, and the ones that are not permanent are at least -- will take a long time. So it is clear that countries like Brazil will have at least a sufficient long window of opportunity to work on these topics.

So at least in my view -- and perhaps I am suffering from contagion with the optimism with which this book was written at the time that it was written --the question is less on sustainability and more on the consequences of this integration and how to -- and which policies are required to make it a success. The question actually pops up in several chapters of the book. It is perhaps a question that is presented in several chapters, especially in an excellent chapter wrote by Ben Ross Schneider on big business in Brazil. And he observes that, with the notable

exception of (inaudible), most of Brazilian multinationals are commodity (inaudible) producers. And then he goes on asking so how to integrate -- what are the conditions for success of an integration-based on these products.

I will not bother you with the notion of natural resource course. This has haunted the development debate for a long time, especially in Latin America, fueled by some disappointing growth experiences in Latin America, Africa, and other countries. But let us set up the more pragmatic and follow what the book proposes as a discussion, a more policy-oriented discussion, to focus on what are the conditions to have a really successful natural resource of commodity-led integration. I think there are reasons, lots of reasons to think about this. I do not think that the critical analysis confirms or supports the notion of natural resource course, but there is some literature showing that first, export concentration is not good for growth, regardless of which product you are concentrating on. And second, improving the quality of your export so that your export matters -- and let us face it, in the manufacturing sector the space to increase quality is much higher than -- larger than -- the space you have in commodity, you know, products. So for these reasons, this can lead to concerns about Brazil being in some sense of disadvantage for being primarily a commodity exporter.

I must say quite frankly that Brazil is really well positioned to face these challenges. First, in terms of institutions, Brazil has very solid institutions. And in the debate between manufacturing versus commodity or agriculture products, Brazil has a strong and diversified manufacturing sector who has been exporting manufactured goods all over the world and increasingly integrated into global production networks. So, moreover, Brazil has a strong domestic market that certainly helps a lot, allowing for significant economies of scale for the manufacturing sector. So even faced with competition during certain periods of time -- Paulo was referring to the use of the exchange rate for the stabilization, and this came a few years after the trade equalization process in the early '90s. So this puts, it certainly put the manufacturing sector under competition, under pressure, and it went through a restructuring process and has been successfully restructured.

In any case, I think that putting aside changes in the exchange rate policy, what the country needs to continue to pursue the agenda of removing anti-export biases (inaudible), and addressing market feelers that prevent more export-oriented economies to flourish. I think these are priorities, and actually the agenda here is huge and a coalition of education and knowledge, infrastructure, domestic institutions, financial markets to diversify with, et cetera, could be extremely relevant in helping Brazil. A specific book suggestion is presented in the book under André

Nassar's discussion on agriculture when he mentions the need to develop insurance mechanisms for agriculture. Brazil is a superpower in every culture, but is relatively underdeveloped in terms of instruments of insurance, and relies a lot on indebtedness and constant, frequent debt restructuring processes in the agriculture sector.

Access to markets in trading (inaudible) also form part of the agenda, of course, as they are key to stimulate productivity, exports, and encourage diversification. So this leads me to the second main theme -- and It is actually in the two very important chapters of the book that deals with certain (inaudible) with trade integration. These chapters were written by two well-known experts on trade in Brazil, Pedro Motta Veiga and Mauricio Mesquita from the IADB. The tone of the chapters is a bit more on the pessimist side in the sense that they constantly remind us that since 1990 when Brazil opened up for trade-slashing tariffs and adopting reductions in non-tariff barriers, progress in this area has been very slow to put it mildly. So Brazil is still certainly a relatively closed economy and with few exceptions, they say, and especially Pedro mentions that no relevant, bilateral agreements, with few exceptions, have been signed.

The book on the other hand notes -- and this is important and here comes some hope -- that there are some changes taking place. First, regardless of policy actions and even without any major change in terms of access to markets, it is impressive how Brazil increased both

exports and imports, so how Brazil became more integrated into world markets. There is definitely a (inaudible) here. This happened everywhere. But certainly these changes are -- I should not say "certainly," but probably some of these changes help to explain what has been seen recently in Brazil which is a significant increase in productivity. Most of the analysts have been revising for instance potential (inaudible) estimates. (inaudible) is one of them, showing that there was a rise in the potential output, and this certainly is related to the increase in imports and exports in the Brazilian economy.

Second -- and here is also a positive note -- as noted in Pedro's paper, there are new forces at work and there is a dynamic agribusiness in Brazil that is actually pushing Brazil to a more clear and firm position in the negotiations arena in support of opening markets. So here in spite of the generally pessimistic view on one side and this new force, I think that there is -- from a more pragmatic approach -- there is also a huge competitiveness agenda to be careful. And as noted by Mauricio in his chapter, this forms parts of the other trade costs. The World Bank has been trying to measure these costs through different instruments. There is a logistics performance index, well-known doing business indicators, which estimates the logistics costs. And in general what these different instruments show is that while Brazil can be considered well positioned compared to Latin American countries, in

general the costs or the performance is relatively weak when compared with the United States or other OCV countries for sure, but also with China and India. So there are -- there is here the possibility of working more actively on infrastructure, investments, the public infrastructure, recovering a bit of space to invest in public investments and infrastructure, attract private capital to infrastructure in Brazil, and work on the soft side of the logistics, which are basically the bottlenecks related to customs and other issues related to trade facilitation. There are here good possibilities of concerted action, and I think that already there are agencies in Brazil, public agencies in Brazil, heavily involved with this discussion, such as (inaudible), especially on the trade facilitation agreement.

Finally, and this is my final point, as the recent performance has shown, being competitive is as important as market access to boost exports. So this leads us to the third block, which is mentioned also in the book, which is the innovation agenda and the (inaudible) economy. I think that the book correctly identifies innovation policies as key for Brazil's success, and two points here are worth noting: First, there are some very interesting success stories in Brazil. (inaudible) with (inaudible) which is an Institute of Technology of the Aeronautics, EMBRAPA, which is the research, state-led research institution for agriculture products, and Leonardo mentioned, Cenpes in Petrobras. And all of them are the result of the involvement of the Brazilian public sector or the Brazilian state.



Second, the second point made, and Leonardo mentioned it here, is that spending in R&D is relatively low and should be increased. And this is especially true for agriculture where productivity certainly has been increasing, but will permanently be a challenge in terms of increasing productivity. Here I must say that I am not sure -- let me try to be precise here -- I do agree that spending on R&D could be higher. The studies that we have done at the Bank suggest that perhaps even more important would be to focus, to create the mechanisms to attract the private sector to invest in R&D. This is more the issue in Brazil, in the sense, that there is some significant amount of public resources being spent in R&D, but trying to attract the private sector to invest in innovation broadly defined the (inaudible) not just lead products, but also processes, new ways of carrying out productivity, et cetera, seems to be to me the main challenge.

Some important progress has been made recently. The innovation law of 2004, sector funds from the previous administration. But anyway, this is a key question for the future of Brazil and to make sure that instead of islands of having knowledge and capacity in technology, you can spread this throughout the country. And here, of course, the links to the human capital agenda are extremely important. Brazil is still a country where functional illiteracy is relatively high. Brazil does not score well in tests of quality of education. So this is, certainly, perhaps the most

important agenda for Brazil in the near future. And I think that there is a broad consensus on this point that investments in education will really shape the ability of Brazil to -- again returning to my first point --leverage commodity exports into long-term development.

In summary, and let me stop here, I think that there is no shortage of challenges for Brazil to successfully integrate into the world economy. Agendas on innovation, human capital, trade integration, infrastructure, all of them presented in the book, but again -- forgive me if I am suffering of contagion from the book -- but what has happened in the last fifteen years to me and the changes that have taken place in the world are a clear sign that the country has already changed its role and is well positioned to solidify its position. Thank you.

MR. CÁRDENAS: Thank you very much, Jose Guilherme. Thanks, Paulo, also for those very well thought out comments. I think there are many ways in which this conversation could evolve. I would like to suggest as a positive for the conversation the idea of a superpower. I think we are aware of the fact that Brazil is to a large extent a success story in terms of economic performance. The economic performance to some extent is based on good, sound macro policies. These three building blocks that Paulo was mentioning: Inflation targeting, which has allowed the inflation rate to come down after Brazil's suffering from high inflation; exchange rate flexibility; and fiscal responsibility. These are

three elements that I think no one would question that they are prerequisites. They are to some extent, to put it in the economic terminology, necessary conditions, but I do not think they are sufficient conditions to actually make a superpower.

We have heard also the role of industrial policy. Industrial policy has been successful, at least in some cases, the cases that we discuss more, the cases that we hear more about. Of course, we do not know much about the failed stories about industrial policy, about what the state has done wrong. We have the good stories of Embraer. We also know the very successful story about sugar cane production and essentially ethanol production. And we also, I think, know that development based on commodities and to some extent commodity dependence is possible provided that you have the right institutions. The Brazilian institutions are strong, but they are still in the process of development. If you read last week's supplement to the *Financial Times* on Brazil, the leading article was very critical of the quality of Brazil. Everything looks bright with the exception of the way Congress functions and to some extent on the relationship between the states and Congress, and that seems to be something that is not as evident today as the good things we know essentially of the Lula Administration that has been able to conduct policies in a very successful way. But underneath that surface, there may be problems with the quality in Brazil, but we know that

development is possible with dependence on commodities, and Brazil is showing that that is the case.

We also heard that another important element for this description about Brazil is the importance of the state. The state has been strong, at least in economic terms, 40 percent of GDP, (inaudible), the development bank, (Spanish). You could go to the 50 percent number, but we still hear stories about state capacities in Brazil, which is not the same as saying that the state is strong. State capacities, for instance, in controlling crime, in reducing problems of drug trafficking. We heard recently in this same auditorium when President Cardoso talked about (inaudible) drops in Brazil, so state capacities to some extent are also an issue that is a challenge for Brazil.

So we have some of the elements for a conversation on whether Brazil is truly a superpower and a superpower that can be successful for a long time in a sustained way and a superpower that can also influence an agenda in the world. Or whether Brazil still has some problems that it has to deal with domestically and that it is going to be hard to really have these external influences in terms of a global agenda. I think this is a tension that is there. I do not think we are going to solve it in one conversation or in one book, but I think that shows pretty much these tensions.

I would like to open up for your comments, your questions, your ideas, and then we will get back to our panelists, including Leonardo if he wants to add a few things from the book. We did not discuss much -- and I hope that someone in the audience asks this question -- about inequality. The issues of inequality are very much still there. To what extent -- that would be one way of putting it -- to what extent can a nation truly become a global superpower with everything that entails when their domestic tensions are still there, especially related to high levels of income and asset concentration.

So these are some of the things that I think we should discuss, but let me now ask you to take the lead. So we have one question here, then you, and then you, and then we will go on this other side. If you could introduce yourselves, and please keep your remarks as short as possible.

QUESTIONER: I am Alexander Door. I am actually in the security area of the OAS, but I am a Brazilian citizen and I must say I am fascinated by the debate here. You know that the thing you are mentioning about the crime and violence now is quite striking in Brazil. In the last twenty-five years, from the early '80s till now, the homicide rate nearly tripled in Brazil, which is really meaningful. I mean, today we are having -- at the end of August, Brazil will have its first national conference on public security, and Brazil today has a sort of hidden civil war in a way.

I mean 45,000 to 48,000 homicides per year, which means in a few days we have what Canada has in a whole year, 600 people killed. So this has to be dealt with, involving civil society, government, training. I mean police have to be well trained, well paid, respected, and not tending to corruption.

But that is another story -- what I would like to mention here is the question of public research in Brazil. I mean you mentioned the Air Force Technological Institute, which gave rise to Embraer. Cenpes with Petrobras was mentioned. There was no reference to a very important institution, which is Cepel, which is the Eletrobras research center, which has been discussing the energy matrix problem of the country for decades now and improving. And there is one case, which (inaudible) mentioned that there is a lot to be done in agriculture to increase productivity. But you remember that our first soy revolution was in the 1970s and in cold states, but are not (inaudible). So EMBRAPA has been researching sugar cane, soy, capital for decades now, and different from Cenpes, which had Petrobras as its main customer, or Cepel, it did not have the foundations at the federal or state level surplus (inaudible) and so on. EMBRAPA was very, very often on the verge of dying, and it had to be supported by Finape. This is just to provoke the debate in the sense that in the United States, the state or the government is necessarily seen as inefficient, although not for the Army or the Armed Forces and so on. That is another story. In the case of Brazil, there is now -- I was reading just over the

weekend that the Lula government is interested in increasing to 1.5 percent of GDP investment in research and development in 2010-2011. So I will stop there, but so security and research, what you think, for the debate? Thank you.

QUESTIONER: Thanks. My name is Richie Harold. I am with BP. And first I want to thank the panel for a fascinating and enlightening discussion so far. And I want to, though, come back to the theme that Mauricio raised at the end, which is the huge income gap in Brazil. You referred to it as "concentration of wealth." It was interesting to me that this only came up in some indirect ways in the presentations. I think Paulo Vieira, you mentioned, really only referred to this when you talked about social transfers at 14 percent of GDP. And what I sort of took out of your comments is that you think that is maybe even too high for Brazil compared to other countries. And then, of course, Jose Guilherme, you mentioned at the end the education question. So my question to you is not a social justice question. Rather – it is fascinating that Brazil over the years has managed to accomplish the growth it has despite, you know, maintaining the shocking difference in the poverty, the crime that was mentioned. So do you conclude then that, except in terms of lost opportunity, you know, the lost opportunity for people who are not contributing to the economy, that it does not really matter? And does that imply, then, that continued impressive growth on the road to superpower,

whatever you call it, is possible without more successful addressing of this problem?

MR. CÁRDENAS: Thank you. A good way of phrasing that question. Here we had another one. And then we will go back to you and then to you.

QUESTIONER: The question is to Dr. Martinez-Diaz. What is the national strategy and goal in dealing with inequality? And you talk about this liberalization. So far, what percentage of the economy has been liberalized? And also, what is the goal of liberalization? And more important, what is the effect of this liberalization on equality? And the last one, what is the effect on national social spending? Thank you.

MR. CÁRDENAS: Let me remind you to introduce yourselves before you ask your question. So we go back to the gentleman in the back, and then to you, sir, here, and then to you.

QUESTIONER: First I would like to congratulate the panelists for all the (inaudible) here in Washington. I am (inaudible), a visiting scholar at Georgetown University's Center for Latin American Studies. My question is about the role played by states and Brazilian economy, but specifically about the role played at the state level, so no central or sub-national government in Brazil try to take the state and just leave the federal out. They have a lot of agencies to focus on trade and (inaudible), probably this at state level could be a source of knowledge



and learning about the state capability. That is my question. How the panelists see the role played by sub-national in Brazil's change in global economy?

MR. CÁRDENAS: Thank you. Thank you very much. Sir?

QUESTIONER: Hi there. I am Saul Eston. I am a Latin American Studies major at Pitzer College. And first of all, I want to say thanks. Probably the best lecture on modern Brazil I have seen. You talked about how Brazil's performance has been based a lot on sound, overall macroeconomic policy, and that, I guess, leads to the implication that micro policy hasn't been as good. So my question is how do we spread more equitably the gains that have been seen recently between the regions, when you know that Brazil is very split between very well off, successful regions, and still very poor, lagging regions economically?

MR. CÁRDENAS: Okay, thank you. The question on inequality keeps coming back. Theresa, I saw you raising a hand. We are going to end with your question for this first round. I am going to ask you to respond to these comments and then we will do another round.

QUESTIONER: I am Theresa (inaudible) Director of the Fiscal Affairs Department in the IMF, and I work on Brazil extensively. First of all, I would like to congratulate the panel for a really excellent presentation and very helpful comments. And also this mixture of macro and micro shot over long term perspectives, which is quite unique. My

question really has to do with the macro prospects for the near term and how they might impact the longer term, not surprising from where I come from. I must say that personally, I am more pessimistic and concerned about what I see as the duration of the public finances in Brazil in the last several months. This is way beyond what can be attributed to purely cyclical developments. I mean, one may be able to attribute largely to cyclical developments the decline in revenue, but this relentless increase in spending in wages, civil service employment, and so on. In looking forward to an election year, how is this going to erode? You know, the long standing statement -- fiscal position of Brazil may create at some point concerns in the market and instigate another crisis, which is something that we were fortunately able to avoid in the last year.

MR. CÁRDENAS: Okay, thank you very much. So let us give the panelists the chance to respond to all these questions. I do not know if you want to start in the same order or should we go in reverse order? Leonardo, do you want to start? Do you want to say a few words?

MR. MARTINEZ-DIAZ: Sure, let me just highlight a couple of points. On the role of social spending and inequality, there is a very useful graph on page 231 in Marcelo Neri's chapter on inequality. And basically his argument and what he tries to show graphically is that the kinds of income transfer programs that Brazil has put in place have had a significant impact on the Gini coefficient, which measures inequality. This

is -- the trend is pretty marked and it is declining over ten years. And what is interesting about it is that the movement takes place after a very long period of very stubbornly high Gini coefficients, some of the highest in the world. He goes on to argue then that, of course, there are as many variables that could explain this. And in his chapter, he does not try to disentangle them through econometric analysis, but he does reference others who have and finds evidence to suggest that these programs are indeed working. What he is saying though -- and this goes to the broader concern here about the quality of public spending -- is that if you really are going to have these kinds of programs, they need to be quantifiable and they need to be measurable. Here at Brookings, two years ago, we had Santiago Levy who was one of the architects of a similar kind of Bolsa Familia program, but in Mexico. And for him, one of the critical elements that made that program a success was that econometrically and quantitatively they were able to really show performance, and therefore to create a degree of accountability, at least political accountability for results.

However, there is also an issue that comes up all the time. Marcelo raises it here as does Santiago Levy in his book on (Spanish), which is that there is an enormous temptation to use these programs to target specific political constituencies, particularly during electoral cycles. This was mentioned here before. And therefore when you put some of the

studies together, sometimes it is not surprising to find that some pockets that perhaps are not the poorest or the most in need of these kinds of payments also happen to have very high rates of cash transfers. And when you look at some of the politics that underlie that and the patterns of party affiliations, it suddenly begins to make sense why, so there is a political party component. How do you insulate these programs from that kind of politicization? Quite difficult, but some of the, I think, transparency and some of the analyses that try to reveal who was getting what can be helpful.

Finally I would add another point from Motta's chapter, which is about the need to constantly reevaluate these programs and to remember that these programs always create political constituencies that make old programs very difficult to phase out. This is true for all of bureaucracy, but it is especially true for these kinds of cash transfer programs. And what he argues in his chapter is that we need to keep the good stuff, the best stuff of Bolsa Familia, and try to quietly put the others to bed, if you will.

MR. CÁRDENAS: Thank you, Leonardo. Paulo?

MR. VIEIRA DA CUNHA: Yes, thanks for the comments. I will make three comments. I will not talk about Brazil as a superpower, only say that perhaps it is one of the fortunate legacies of Brazil that its imperial traditions are long gone. And so, one of the amazing things, I

think, someone once told me that Brazil's one of the countries that has the largest number of borders. It borders I do not know how many countries and seems to do quite well.

MR. CÁRDENAS: And peaceful borders.

MR. VIEIRA DA CUNHA: On the 14 percent of GDP and the sole debate on the fiscal side of the safety net. Okay, the issue -- there was a very interesting paper that was written very early in the Lula Administration under the Palasi ministry. It was written by (inaudible) who is an absolutely outstanding economist. And that is really, I think, a must-read kind of paper for policy in Brazil. And in that paper what they did -- and this is the Marcelo Neri and that whole group (inaudible) from where (inaudible) came. They did a pretty serious analysis of the incidence of all of these programs by income class. And what happens is that in Brazil, which is not uncommon internationally, the pension system, the social security system, is so grossly inequitable and it is so hugely inefficient and large, that it wipes out -- now I do not know, this was done some years ago, so you would have to do an update, but that is where the real problem is. I mean, Bolsa Familia is actually a very small program, very, very small program. It is about 1.5 percent of GDP. There are a host of other programs, I mean a huge amount. I think in there they listed something like over forty transference programs that existed at the time in Brazil, and these were at the federal level. There are some at the state

level and at the municipal level. So once you begin to add all of these things up, the whole question is what is the efficiency of all of these transfers? And who are they hitting? And not surprisingly, given the origins of the Brazilian state, most of this stuff really goes to the middle class. And in part it is seen by the middle class as a way of saying, well we do not get -- we cannot use any of the public services because they are too bad, so we get some of these transfers. All right. So that, I think, is the issue, but can the state continue to afford them. That would be my thinking.

On the question of the state's programs and the state-led developments and the federation, I think that is a very, very important issue. Very, very important, because Brazil is huge, of course, a lot of the public spending is done at the local level. That is where you would get the better feel for the kind of programs, you can do better oversight. The issue is that the Brazilian Fiscal Federation has brought many problems, and the past history of very active fiscal federalism in Brazil has been dreadful. There has been several bailouts of all kinds of programs, not only in agriculture of which it benefits the large farmers who are all represented in the Senate. I mean the largest number of landowners in Brazil is congregated in the Brazilian Congress. It is just a statistical fact. It is a fact. So that is an issue that has to be dealt with in the political

system. It is how do you take advantage of that, you know, which is a good thing to do, the main thing in some sort of fiscal discipline.

Finally on the question of what is happening on the fiscal side -- yes, I think people are getting very concerned. Even if you adjust for the fact that now Petrobras is not in and you put in, additional spending that has been agreed with the IMF. I mean, most people are forecasting the primary surplus this year at around 1 or 1.2, probably zero next year. That is the consensus in the market. I would say most people think the primary surplus is probably going to vanish or near vanish unless you have a huge recovery in the tax base, which is quite feasible because of the way that the Brazilian -- the buoyancy of the Brazilian tax base, which is a very, very buoyant tax base. So I think this is an issue. I mean -- and, you know, people -- I have done -- I have resuscitated my debt model and everybody is doing that, and we are getting pictures like this. I do not know if you can see, but this is the official forecast for the debt to increase this year and come back next year. But I think this is beginning to be an issue. I mean, people are resuscitating their debt sustainability models and depending where you think the real interest rate -- because real interest rates in Brazil now are very low, at the lowest that people can measure. But they are unlikely to stay that low I think through next year. So this is going to become an issue. Now my sense, my gut feeling here is that, you know, in the Brazilian Congress, it is very hard. If you have it,

you spend it. It is very hard in the Brazilian Congress to argue anything, but if you have money, you should not spend it. But I think that there is a mentality today that if you do not have it, you do not spend it. And so I think that the issue will be maintenance of fiscal discipline. My sense is that that is going to come after the election year. You are going to get another cycle like 2003. You are going to get an adjustment.

MR. MARTINEZ-DIAZ: Thank you, Paulo. Let me add a word to that, which is that in the last three weeks, what we are seeing from Latin America is more and more tax reforms or announcements of tax reforms. The Mexicans are talking about that. Colombia has just formally announced that it will seek a tax bill in the next sessions of Congress. And these reflect the fact that the fiscal stimulus packages that many of these countries introduced are becoming unsustainable from the point of view of the fiscal account. So Brazil, following your discussion, could very easily have to either cut on some of these components of the stimulus bill or also seek additional revenues. And that is, to me, very revealing of the fact that there is still very limited capacity from the point of view of the fiscal sector to implement aggressive stimulus. And if the world economy recovers, that would be great, but if for some reason the world economy produces bad news, it is going to be very hard for the countries in Latin America to really do something to offset that. And I think that Brazil is another example of the same thing.



Jose Guilherme, there were many questions on issues that you can address very eloquently, one of them being the common theme expressing the different ways on the economy.

MR. GUILHERME REIS: Yes, well let me start with the sub-national/regional topic Paulo has mentioned. I think that this was a huge problem, macroeconomic problem, in Brazil. But this was actually also a very successful intervention, policy intervention, that Brazil had in the past year. Constraining credit to sub-national governments, but also restructuring debt and passing legislation like the fiscal responsibility law was very successful. So in this area, what I see in my work today at the Bank, working with some sub-national governments in Brazil, is that you have lots of good experiences right now of governments doing -- combining, you know, sound policies in terms of the fiscal framework, et cetera, and some interesting initiatives in terms of management, of investment programs, et cetera. So -- and this you can see across the political spectrum. It is not one or the other side. But they are very good experiences at the sub-national level in Brazil at this moment.

Of course, (inaudible) are there. I think that some of the programs that were implemented in Brazil recently had a tremendous impact in some of these regions; the Northeast is the best example of Brazil. But still I think that -- then comes the point that Paulo mentioned in

the structure of fiscal expenditure in Brazil, were the programs you had in the past, were not efficient in terms of dealing with these problems.

Finally, the inequality topic. I think that this is a big topic. Leonardo mentioned what Marcelo presented in his paper. It is very clear; the declining trend in inequality this year, poverty is decreasing in Brazil and has been decreasing steadily in the past few years. Inequality started eight or ten years ago, approximately. Brazil put in place increases in minimum wage, the successful transfer mechanism, income transfer mechanism. So a lot has been done and I think that the path is clear. Now, my key question is the one that I refer to in World Bank's language, the inequality of opportunities. This is the key issue. And then comes education, a bit of infrastructure, access to water, sewage, you know, basic things that in Brazil are still very high. And (inaudible) component if you decompose total inequality in Brazil, you clearly find that inequality of what you can address or what you can assess as inequality of opportunities explains a good chunk of total inequality in Brazil. So this is to me the key question to be addressed now.

MR. CÁRDENAS: Thank you very much. We are running a little bit late. We were supposed to end by 3:30. I would like to see if there is any final question or comment because I already offered that we would do another round, but we will have to keep it just to one in case there is. But if there is no additional comment or question, I think it is

about time to end, and to do so with a note of appreciation to our panelists. They did something that is very remarkable, which is basically to read all the chapters in that book and that to me shows a lot of commitment to their work that was put to you. And again, thank you, Leonardo.

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