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The delights of dullness

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Brazilians are waiting nervously to see what the world has in store for their fragile economy, but have already done a lot to make their country stronger

VIEWED from a height of 600 metres, it is hard to see how Brazil could ever be poor. Flying in a small plane from Sao Paulo in the south to Bahia in the north, black clouds thick with rain give way to a hot sun, revealing hundreds of green rectangles of sugar cane and circles of coffee below. Further west lie giant areas of pasture for cattle and plains of soyabeans. To the other side, out to sea, a vast oilfield was recently discovered (see box on next page). Beneath the earth lie large deposits of minerals. Yet from the middle of the past decade to the beginning of this, Brazil's economy grew more slowly than that of Haiti.

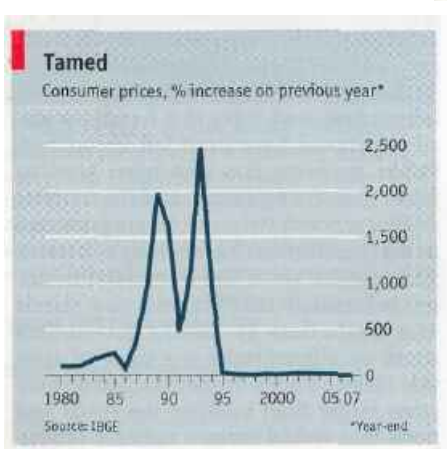
Things look different now. The economy has grown at an average of 4.5% since 2004, the fastest rate for 20 years. President Luiz Inacio Lula da Silva (pictured above, with Sergio Cabral, governor of Rio de Janeiro, to the left, and Sergio Gabrielli, president of the oil company, Petrobras) have reaped the political benefits of this change, which owes much to the efforts of the previous government. In fact, for those excited by economic meltdowns and political turmoil, the place has become rather dull. Last year the stockmarket surged by 44% in local-currency terms and saw a shower of listings. Growth for the economy as a whole sped up to 5.4%.

Compared with Russia, India or China (the three other big emerging economies that Goldman Sachs, an investment bank, grouped together six years ago into the BRICS), that still makes Brazil a deadbeat. Yet the comparison is misleading. Brazil is a much richer country than China or India. Its economy grew by an average of 7% a year from 1940 to 1980, the result of the meeting between capital and a vast labour force that sucked people into cities, where 83% of Brazilians now live.

Brazil enjoys several advantages over the other three. First, the divide between city and countryside is not as threatening as it is in India and China. Second, it has an entrenched multi-party democracy coupled with freedom of expression that helps it to negotiate social change, unlike China and Russia. Third, it exhibits none of the aggressive nationalism that grips the other three from time to time. "I can easily see Brazil's detractors looking back in 20 years' time and saying: 'we called that one wrong'," says John Briscoe of the World Bank in Brasilia.

Brazil is well placed now, because it has dealt with the three main problems that have dogged it since it entered a 20-year slump in 1980. These are inflation, debt and democracy.

Inflation was conquered by the plan for the real in 1994. It has come down from 2,500% in 1993 to around 4.7% now and, apart from a blip in 2003, has been below 10% since 1996 (see chart). This week the central bank raised its benchmark rate by half a percentage point, to 11.75%. Yet that is low by Brazilian standards. Unlike central bankers in the other ERICS, its governor, ▸▸



Henrique Meirelles has an inflation target (set at 4.5%) and the minutes of his meetings are published on the bank's website. "This helps to bring stability, predictability and an extension of the planning environment," he says.

Debt held by the government has fallen to 42.2% GDP {see chart). It should have fallen further, given the way tax receipts have been pouring in. But Brazil no longer surfers from the original sin of emerging markets: the inability to issue debt in the country's own currency. All of its government debt is now denominated in reais rather than dollars. In August, when the real depreciated a little, that debt became less onerous as exporters' extra earnings boosted tax revenues. In the past the opposite would have happened, as the government would have needed more reais to pay back a dollar of debt. And government paper should win an investment-grade rating some time in the next couple of years.

Democracy, which has a more interrupted history in Brazil than in India, was only really consolidated with the election of President Lula. Before he came to power, there was alarm among the maid-owning classes that Lula—who had learnt all about inequality as a child selling peanuts on the streets of Sao Paulo, and whose first wife died in childbirth in a shoddy hospital-would undo the privatisations carried out by his predecessor and zealously redistribute land and other property. "Before the Workers' Party came to power, people were afraid of us," the president admitted in a recent speech. "And they were right."

In power, President Lula has governed with moderation. He has kept most of the achievements of the previous government and added a few of his own. Chief among these is the increased scope of Bolsn *Familia*, a programme of cash transfers that benefits iim poor families, rewarding them if their children go to school and get vaccinated. It is surprisingly well administered for a programme of its size and complexity. Brazil's government is advising India's on how to replace its rural food subsidies with something similar. As a reward, the government and its allies are attacked every day in the press for being useless or corrupt, which is encouraging too.

It is true that the pension entitlements, labour laws and taxes that handicap Brazil's economy have been left untouched. Public spending has also been growing faster than the economy, and the number of civil servants (whose jobs are protected in the constitution) has risen by a massive 70,000 since 2002. The number of ministers in President Lula's cabinet now stands at a world-class 35. Brazil's government sucks up almost twice the share of GDP that Mexico's does. Money is spent on pensions rather than building the roads and ports that would make it richer. Unfortunately the public sector is so large and the poorer states so over-represented in congress that trying to change any of this can appear impossible. And yet this profligacy has helped to entrench stability.

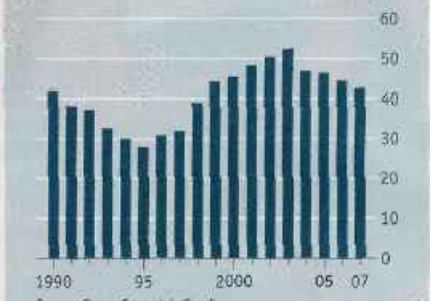
For while the government has been keeping the Workers' Party and its congressional allies happy by spraying money around, Brazil has been changing. In the past two years alone, according to a recent Observador Brasil/Ipsos survey, 23m Brazilians have left social classes D and E and joined class c, whose distinctive markings are a rented apartment, a car and some new gadgets. Employment in the formal sector is up and wages have risen too.

This, combined with Bolsa Rmiilia, has made a dent on inequality, the most persistent symptom of Brazil's failure. The country has long been used as the example of where not to be on the Gini co-efficient-a scale for income inequality where one means one person has all the country's income and zero means everybody has an equal share. Between 1996 and 2006 Brazil's score has headed down from 0.6 to 0.56, even as much of the rest of the world was travelling the opposite way.

A sense that Brazil is becoming a little more equal makes for a healthier kind of capitalism, in which the people buzzing around above Sao Paulo in helicopters attract less opprobrium. Brazil's billionaires appear on magazine covers and are celebrated for their skill rather than lampooned for their greed, which is new. In turn, "young entrepreneurs are realising that you don't have to be born rich or have political connections to raise capital," says Antonio Bonchristiano of GP Investments, a private-equity firm, "I do not see the same thing happening in Mexico, nor in Argentina," he adds.

Lula's legacy

Public debt, % of GDP



Source: Banco Central do Brasil.

Oil

More bounty

Could Brazil become as big an oil power as it is an agricultural one?

OF ALL the commodities Brazil exports, oil has long been an afterthought. Its oil reserves were reckoned to be relatively modest: about 12 billion barrels at the beginning of 2007, according to BP, or about 1% of the world's total. But last year, Petrobras, Brazil's partly state-owned oil firm, announced the world's biggest oil discovery since 2000: the Tupi field, which it hopes will produce between 5 billion and 8 billion barrels. Now the head of Brazil's National Petroleum Agency (ANP) says another nearby discovery might hold as much as 33 billion barrels, which would make it the third-largest field ever found. That alone would be enough to raise Brazil to eighth position in the global oil rankings—if these estimates are correct.

The ANP, which regulates Brazil's oil industry, was quick to distance itself from the remarks of its boss, Haroldo Lima. He spoke personally, not officially, it said, and reflected past reports in the media. Petrobras and its partners, BG of Britain and Repsol-YPF of Spain, said that they needed more tests to determine exactly how much oil it contained.

But no one dismissed the estimate as preposterous. That, plus the fact that a senior official had given credence to such a dramatic number caused the shares of the three firms to jump, despite the fact that Mr Lima claims he does not even know where the stockmarket is, and certainly did not intend to influence it. At one point, Repsol was up by 14%.

Both Tupi and the field mentioned by Mr Lima, Carioca-Sugar Loaf, lie beneath a thick layer of salt that is some 800km long and 200km wide. José Sérgio Gabrielli, Petrobras's boss, has hinted that there are vast reserves of oil to be found in this "pre-salt" formation. At any rate, Petrobras has struck oil every time it has drilled there. The firm's head of exploration says "there is practically no exploratory risk" in the area. Dilma Rousseff, its chairman, has breathlessly declared that Brazil will soon be on a par with Venezuela or Saudi Arabia.

The government must be thrilled at the prospect of the revenue from the new fields. But they will take many years and huge sums to develop (drilling a single well at Tupi cost $240m). And the extra income may also accentuate many of the weaknesses of the Brazilian economy—including a strong real and an overweening public sector.

> Some of these changes have been underpinned by real improvements in the economy. Productivity per industrial worker rose by 4.2% last year, which supports the idea that increased investment is paying off. And yet most of the change has been due to high prices for the raw materials that Brazil sells to the world. "Commodity prices pay for the party," summarises Candido Bracher of Itau BBA, an investment bank.

Brazil is to commodities what China is to manufactured goods. A large share of the world's beef, orange juice, soyabeans and iron ore comes from the great green elbow. This has been such a good business recently that those Brazilians who used to assert that supplying the world with raw materials would condemn the country to perennial poverty have changed their minds. Edmar Bacha, a distinguished Brazilian economist, reckons that the country has not enjoyed such favourable global conditions (including high commodity prices) since the mid-1960s, when it embarked on a decade as the world's second-fastest-growing large economy.

High commodity prices have given Brazil a large current-account surplus for the past few years. This has helped to push the real up to a value of 100 against the currencies of its trading partners, compared with 68 at a moment of exaggerated weakness back in 2001. A strong real buys more imports, which are now growing so fast that a trade deficit is expected this year, even as exports continue to grow.

Encouragingly, a big slice of these imports has been machinery and other capital goods. Brazil invests a measly 19% of GDP, according to Sergio Vale of MB Associados, but that number is growing fast. Once investment reaches around a quarter of GDP, Brazil should be able to grow consistently by at least 5% a year, rather than straining to get there at the top of a cycle. Mr Vale reckons this ought to happen in about 2015.

A strong real and lower interest rates have boosted the purchasing power of the middle class. Domestic demand was sleepy when consumer credit was unknown and a combination of a weaker currency and high barriers to trade made imports too expensive. All this is changing. In the past two years the stock of consumer credit increased by more than 25% each year. Most stores in shopping malls now offer credit to buy an even bigger TV.

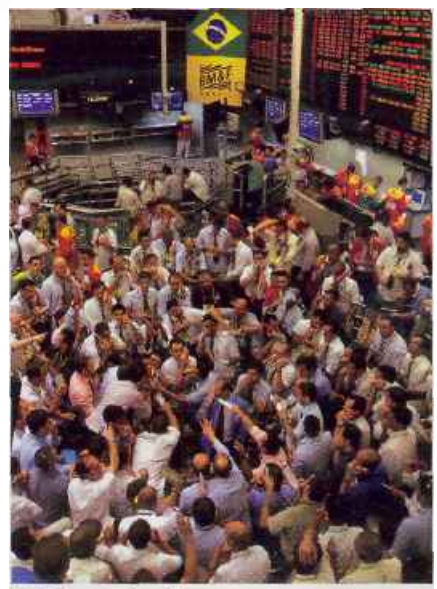
The strong currency has helped the balance sheets of Brazilian companies with international aspirations. According to the Fundacao Dom Cambral, a business school, and Columbia University in New York, Brazilian companies were the second-largest source of foreign direct investment among developing countries in 2006, after China. Brazilian executives tend to put their adventurousness down to an adaptability learnt during the wild inflationary days. "Back then I couldn't predict what the rent on my apartment would be that month," says Alvaro Novls, finance director of Odebrecht, a construction and chemicals firm. "I couldn't even say what a haircut would cost." Building roads in Angola can seem relaxing by comparison.

Taken together, these things have created a new enthusiasm for capitalism, a feeling that the stockmarket is not a casino and that being part of the world economy is a good thing, according to Arminio Fraga, now of Gavea Investimentos and formerly governor of the central bank. Brazil's economy is still relatively closed. But many more people now work for companies that import and export things. And those who work for foreign companies generally get better benefits and are paid more. In short, letting the world inhas benefited Brazil.

Don't look now

Yet as the outlook for the world economy is threatened, so too are Brazil's recent accomplishments. So much so that there is a vigorous debate now about how real they actually are. The government believes that the economy is set to grow at today's pace for the next 15-20 years, irrespective of what happens elsewhere. Gloomier observers (and plenty of economists) tend to think that Brazil has just passed a cyclical peak and will shortly head back into its customary torpor.

Those who imagine that Brazil is insulated are wrong. Its economy has long been tied to the rest of the world, even when it was hiding behind high tariff barriers. Within a few years of the Wall Street crash of 1929 Brazil's democracy was replaced by a dictatorship (15 other countries in the region suffered takeovers by either the military or a strongman at that time).



Bidding up Brazil

Its economy slumped in the 19505 with the price of coffee, then its main export. It was hit again in the 19705, when the oil price shot up. Brazil suffered in the wake of the Asian financial crisis and then again when Argentina defaulted on its foreign debt.

Hence America's present malaise is worrying. Brazil still looks like a flop if you strip out the favourable conditions that held in the rest of the world until the end of last year, says Marcello Carvalho, an economist at Morgan Stanley investment bank. From 2004 to 2007 the price of goods it exports to the world increased by an average of 11.5% every year. And yet the economy still grew more slowly than the average in the rest of the world, more slowly than the rest of Latin America, more slowly than Eastern Europe. Mr Carvalho, who has a knack for getting out-of-consensus forecasts right, reckons that, as the skies darken, growth will slump to just 3% in 2009. That would put Brazil back in the category of perennial disappointments.

No big democracies find reform easy when times are good. But small things do change slowly. Both the government and the opposition are talking about the need for tax reform and some modest improvements will eventually come. In Minas Gerais Governor Aecio Neves has managed to make a "management shock" in the public services into his main political selling point. In Sao Paulo Jose Serra's administration is introducing a system in schools that would pay teachers according to the achievements of their pupils. In Rio Sergio Cabral's administration has cut the time needed to register a business from 60 days to under 14. And so on.

Yet incremental change is frustrating. "In Brazil everything is promised and nothing is delivered," laments a businessman who has recently set up an office for a foreign multinational in the south. A state governor promised to renovate the nearby airport if the firm came. Now he has been voted out and the airport is still crumbling. Every month he receives an internal company report sent from Europe and, for some bewildering reason, has to pay tax on it (and always for a different amount). When he complained, the report stopped coming-so he is back to paying every month. Such stories are typical. Yet this company has found a plentiful supply of talented workers and will expand from 20 people two years ago to 400 next year.

How Brazil looks depends on which countries it stands next to in the line-up. True, compared with parts of Latin America, let alone Asia, its economy still seems to be a machine for creating disappointment out of abundance. Its politics are frustrating: corruption is rife in public life, violence widespread, illiteracy normal, poverty stubborn. And yet compared with the Brazil of old, this has the feel of a golden age. That, surely, counts for a lot. ■

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