The Brazilian economy: recent developments and future prospects

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The 1980s were years of disruption for the Brazilian economy. Attempts to overcome the negative impacts of the second oil shock in the early years of the decade, by provoking a deep recession, were quickly followed by an inflationary upsurge that was met by traumatic heterodox anti-inflationary measures. The roller-coaster path traced by GDP over the decade led nowhere. When it was over, Brazilians were no better off. Per capita income remained at the level reached in 1980.

From an economic point of view, the 1980s were a lost decade. Unstable domestic conditions and opportunities to obtain better returns from speculative financial operations turned investors away from productive applications of capital. The investment ratio dropped to its lowest since the beginning of the 1970s, hitting bottom in 1984 at a meagre 15 per cent of GDP. And yet, in a well-protected domestic market, the technological gap created by the lack of an adequate level of investment was not perceived as an immediate problem by Brazilian entrepreneurs. In a highly inflationary context, in which consumers had lost any idea of the real value of money, the cost of inefficiency was easily passed on through higher prices.

The country's defaulting on its external debt helped to make things worse. Access to foreign capital was blocked from the mid-1980s and was restored only after a long and difficult period of negotiation that did not end until 1994. Investment from abroad almost disappeared in the late 1980s, recovering to a figure near the $1 billion mark only in the last year of the decade.

The disruptive effects of the unsuccessful attempts to curb inflation almost led to the collapse of the state. Eroded by inflation, tax revenues shrank, bringing the overall tax ratio in the 1980s down to 22 per cent of GDP, almost ten percentage points below the peak of the mid-1970s. The widening gap between expenditures and revenues was filled by the hidden tax of inflation and an increase in the public debt, which, in turn, drained resources from the public services as ever greater sums were required to service the higher government debt. The final blow to the public sector came in the early 1990s, when a disastrous administrative reform, coupled with a demoralizing wage policy for public servants, led to unprecedented levels of inefficiency in public administration and deterioration in performance.

On the social side, things were not as bad. In some respects—housing, sanitation, nutrition and education, for instance—living conditions improved during the 1980s, as a result of previous investment and of an inflation-financed increase in social spending in the second half of that decade. Income distribution, however, became increasingly skewed as inflation, acting as a regressive tax, hit lower earners.

Economically speaking, the 1980s did not end until the first years of the next decade. The administration that took over in 1990 flaunted its promise to kill off inflation at a single stroke, but in spite of making an undreamt—of addition—the confiscation of bank accounts—to the arsenal of past anti-inflationary weapons, the outcome was no better. Involved in a corruption scandal, the government was ousted in a process of impeachment, its departure opening the way for a change of approach and the implementation of a new strategy for achieving stabilization.

The end of this 'long decade' saw the Brazilian economy in a very fragile state. On the domestic front, the public accounts hid a marked structural imbalance. The figures for the consolidated public sector deficit (including federal, state and local government) showed a public sector borrowing requirement (PSBR) of 5 per cent of GDP; yet this in itself, though certainly a poor result, did not reveal the true extent of the problem, since important treasury liabilities—such as those related to housing and rural credit, state enterprises and state and local governments—were not covered by the calculation.

On the external front, decades of protectionism meant that the productive sector was unable to adjust promptly to the shock provided by the opening up of the Brazilian economy to external competition. As this opening up occurred in a period of economic instability and political turmoil, the necessary investment for the structural adjustment needed to equip industry to face competition from abroad did not follow immediately, making it difficult to avoid an undesirable imbalance in the trade accounts. As a consequence of these circumstances, Brazil was suffering both fiscal and foreign imbalances when the first moves to create the 'Real Plan' were put into effect in February 1994.[1] As we shall see, the hidden parts of these imbalances were brought to light in the wake of the monetary stabilization achieved by the 'Plan' and are still the main problems to be overcome in the pursuit of a sustained recovery of economic growth.

[1] The 'Real Plan' acquired its name from the new currency adopted in Brazil as a result of monetary reform implemented in July 1994. This reform was the cornerstone of the policies adopted to bring monetary stabilization to the Brazilian economy. Since its implementation, the 'Plan' achieved its main goal of bringing the inflation rate down to more manageable levels, but other aspects of macroeconomic stability, such as fiscal and external accounts, are still waiting for the conclusion of structural reforms.

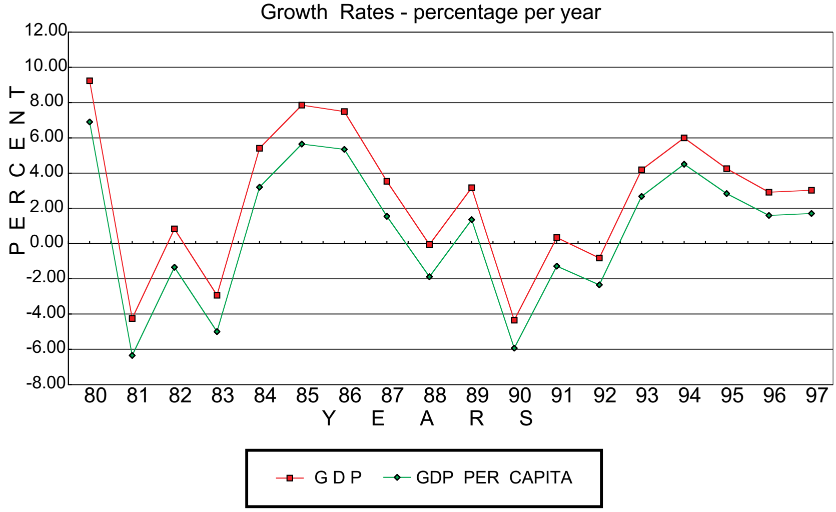
Recent developments

By the time the Real Plan reached its third anniversary, there were many reasons for its commemoration. To the surprise of many, inflation had been reined in. From an annual rate approaching 5,500 per cent at the time the plan was launched it dropped down very fast: to 15 per cent in the first year, 9.2 per cent in the second and 7.8 per cent in the third. By the end of 1997, it was below 6 per cent. A whole generation of Brazilians—anyone much under 60—have never before experienced such a situation.

It is particularly striking that stabilization was achieved without provoking recession. Initially, the rise in poor people's purchasing power generated by the disappearance of the inflationary tax led to a rise in domestic demand for basic goods met by an immediate response through increasing utilization of idle capacity. At the same time, middle-class consumers, fearing that stable prices for durable goods—cars, electronics, domestic appliances—could not last for long, rushed to buy brand-new items to replace the old ones. Thus, despite the high interest rate that was maintained during the period, GDP grew at high rates during the second half of 1994 and the first quarter of the following year. In this period, unemployment remained stable while the wage bill and the income of non-salaried workers showed significant gains.

The trajectory of the economy (Figure 1), shows the ups and downs that dominated the economic picture in the past 17 years. The fall in the rate of GDP growth in the first two years that followed the implementation of the 'Real Plan' reflects the care the government took in seeking to avoid the risk of out of control inflation. Signs of excessive overheating, spotted in the first quarter of 1995, and again at the end of 1996, were followed quickly by a tightening in monetary policy in order to reduce the rate of economic growth.

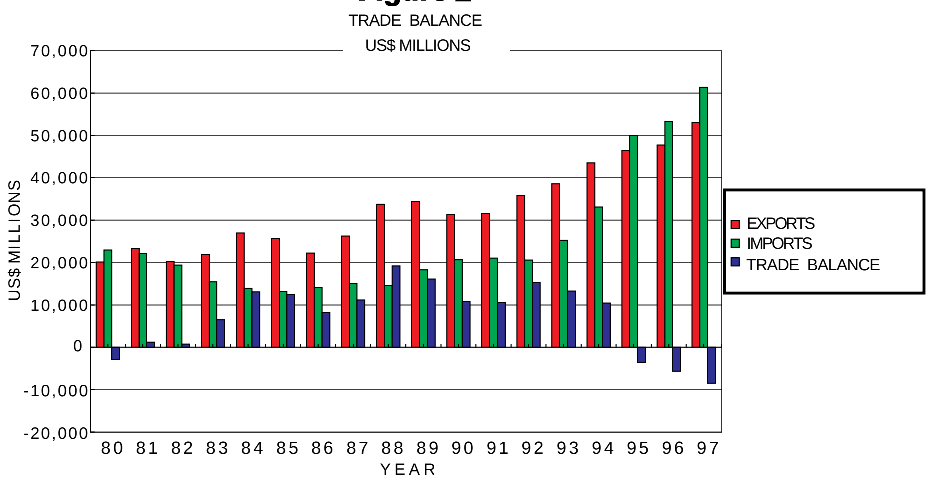
Figure 1
GDP
Growth Rates - percentage per year



As a result, the rate reached 3 per cent in 1996–7, down from its peak of 1994. However, the monthly figures of the past three years indicate that a less negative appraisal of the effect of monetary stabilization on growth would be more appropriate: between July 1994 and December 1997, the economy grew by 12,3 per cent, allowing for a 7.3 per cent rise in per capita income.

Exposed without any kind of shelter to foreign competition since the very beginning of the 1980s the Brazilian economy, benefiting from stable prices and sustained growth, albeit at low levels, began to suffer from increasing trade deficits. Consumers and producers alike enthusiastically grasped the opportunity to buy more fashionable goods and more keenly priced equipment, pushing up imports at a rate far higher than the rate of growth in exports, which were hindered by low productivity and higher domestic costs of production (e.g. infrastructure inefficiencies, the tax burden and labour leg-

Figure 2



islation, among other factors), and by the central role played by foreign exchange policy in monetary stabilization. Consequently, a widening gap in the trade accounts became apparent (Figure 2).

Unfortunately, the success of the 'Real Plan' in bringing about a rapid fall in inflation also posed a threat to the fiscal accounts. The rigidities created by the 1988 constitution, in respect of the rights of civil servants—including pensioners—as well as the privileged conditions for retirement under the general social security system, were revealed in all their distorting effects when the inflationary clouds disappeared. When inflation was high, the wages of public servants, who are protected from dismissal by the constitution, were rapidly eroded, allowing for an immediate reduction in public spending and in the public deficit—and a similar erosion occurred in social security benefits. With price stability, the wage bill of the public sector is no longer falling, and so long as employees cannot be dismissed, the deficit can be reduced only through painful cuts in other current expenditures, often leading to further deterioration in badly needed social services, or through a rise in revenues. This situation will not be easy to change, given the particularities of the Brazilian federation (states and municipalities have a great deal of autonomy in taxation and public spending) and the stringent conditions for amending the constitution (three-fifths of votes in two separate rounds in the Lower House and in the Senate).

Proposals for amending the constitution, aimed at removing the privileges of civil servants, together with measures for cuts to the generous social security legislation, were presented to Congress in 1995. Both proposals underwent substantial legislative change and the proposed cuts to acquired rights to social security payments were watered down. The final version of the public administration reform, however, approved by the Congress in February 1998, would, if wholly implemented, allow for a reduction of personnel in the federal, state and local governments, possibly amounting to 1.17 per cent of GDP over the next five years as a result of the flexibility introduced to the rules applied for the dismissal and remuneration of the civil servants.[2]

With regard to social security, change has been much more difficult to accomplish. After very tough negotiations, the final version of social security reform maintains the present rules regarding the remuneration of retired public servants, but sets the minimum age of retirement for men of 60 and for women who are new entrants to the labour force at 55 years. For other women, a transitional formula is established. The modifications in the social security system introduced by Congress do not remove all the undesirable privileges, but they are nevertheless a beginning. If the Lower House does not modify what was approved by the Senate in February 1998, the minor changes which have been introduced will produce a growth rate of 0.5 per cent of GDP.[3]

In spite of the constraint on growth imposed by the imbalances in the external and fiscal accounts, social indicators showed significant signs of improvement. The unemployment rate remained within the 5–6 per cent range, suggesting that the jobs destroyed in some sectors of manufacturing industry that were going through a forced restructuring process to survive competition were matched by other ones created in the service sector. There is also evidence of a sharp increase in manufacturing productivity: exactly how sharp is a matter of some debate, but some accounts point to an annual rise of as much as 8.2 per cent over the last six years. Incomes of wage-earners and of non-salaried

[2] The most important aspect of the reform in public administration was the flexibility introduced into legislation concerning the remuneration and conditions for firing public employees. From now on employees who do not perform well, according to certain legal criteria, can be dismissed, as long as the wage bill exceeds 60% of tax revenues, and provided that all those employees who were employed in public administration for less than five years from October 1988 (when the new constitution was enacted) have been fired ahead of those employed before 1988. The amendment also permits a proportional reduction in salaries, based on the number of years in the public service, for those workers who are surplus to administration requirements.

[3] The project for reforming the social security system is expected to receive final approval in the Lower House in June 1998.

Table 1, Gini index of income inequality, 1986–96

Brazil	North[1]	Northeast	Southeast	South	Centre	West
0.602	0.592	0.544	0.653	0.591	0.569	0.577
0.611	0.590	0.586	0.631	0.607	0.577	0.571
0.629	0.556	0.573	0.576	0.628	0.591	0.567
0.647	0.574	0.563	0.619	0.598	0.596	0.611
0.620	0.604	0.587	0.584	0.554	0.616	0.615
0.575	0.629	0.622	0.590	0.581	0.591	0.649
0.603	0.610	0.639	0.589	0.574	0.554	0.660

Source: IBGE

[1]Urban population only

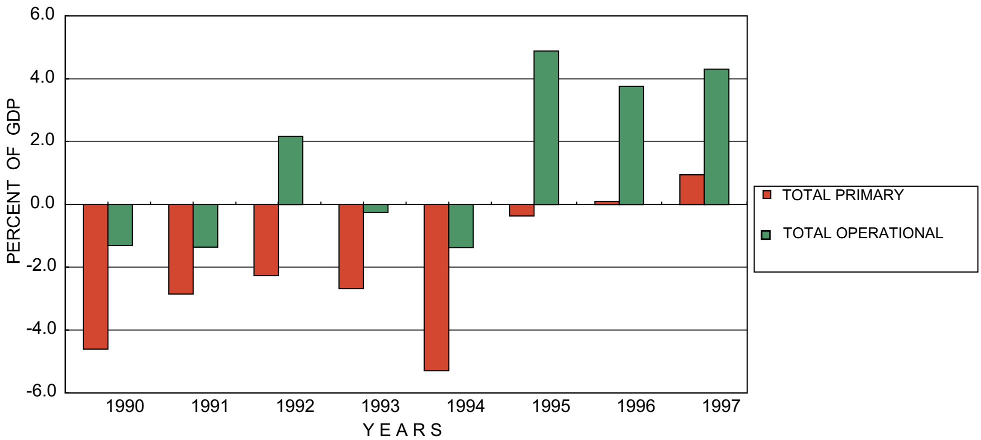
workers have also grown, giving an indirect indication of a rise in pay following the rise in productivity. In fact, labour income in the metropolitan area of São Paulo, the most industrialized region of the country, rose 22 per cent in real terms between 1993 and 1996.

The most important evidence of an improvement in living conditions is provided by the statistics on income distribution. According to estimates made by the Institute for Applied Economic Research (IPEA), people at the bottom of the income scale (the poorest 10 per cent) received an 18 per cent increase in their per capita incomes as a result of the disappearance of the inflationary tax and better opportunities for raising money in activities that are not subject to the exigencies of labour legislation.[4] At the other extreme, the wealthiest (the richest 10 per cent) saw their incomes increase by only 7 per cent. Thus Brazil saw a slight fall in income inequality (of two percentage points in the share of the richest fifth of the population, defined in terms of total family income, from 64.7 per cent in 1994 to 62.4 per cent in 1996) in the immediate post-'Real' era. Needless to say, this improvement was not substantial enough to change the position of Brazil as one of the most unequal, as well as one of the poorest, countries in the world; but it is important in reminding us of one of the worst aspects of high inflation: its disproportionate impact on poor people.

Data for the most widely used indicator of income inequality—the Gini Index (Table 1)—reaffirm the disproportionate impact of high inflation on the incomes of the underprivileged. Inequality increased steadily in the late 1980s to a peak in 1989 when the country was moving quickly towards hyperinflation. Compared with the index for 1989, the Gini for the first two 'Real Plan'

[4] Independent workers in different areas working on the improvement and conservation of urban dwellings, for instance, were among those who benefited from the opportunities through monetary stabilization. For data on income distribution, see IPEA, *Carta de Conjuntura* 71, March 1997.

Figure 3
PUBLIC SECTOR BORROWING REQUIREMENTS
IN PERCENTAGE OF GDP



years shows an improvement of six percentage points. Not surprisingly, the best results were from the poorest northeast region.

Another important social effect of price stability was the reduction in poverty. Even though work on establishing a more accurate definition of the poverty line is not yet complete, it is not disputed that millions of Brazilians were able to rise above this line.

From the outset, the fragility of the fiscal accounts was seen by many as the Real Plan's weakest point. Hampered by political deadlock in its efforts to push forward the structural reforms necessary to balance the budget, the Brazilian administration turned to measures that would yield marginal gains. A combination of tax increases and spending restraints provided some alleviation of the problem; but the balance of revenues and expenditures (the so-called primary deficit) did not show a significant improvement and the burden of servicing the public debt made it impossible to reduce the PSBR. As Figure 3 shows, the 'operational deficit', calculated by adding interest payments on public debt to the primary result, is still a matter for great concern.[5]

Recent events in Asia have delivered a stark warning that has concentrated minds across Brazilian society. Fears that the impact of the financial crisis on the Brazilian economy could jeopardize the 'Real' prompted a positive public reaction to an emergency package to rescue the 'Real' from imminent danger, enabling the government to get rapid congressional approval for its original proposal with only minor changes. The estimated fiscal gains from this package

[5] The public sector deficit for 1997 was affected by the negative impact of social security and interest payments on the federal accounts and by an increase in the primary deficit of state and local governments.

—20 billion reals—are expected to cover the increase in interest payments on the public debt, severely affected by the sharp rise in the interest rate, and to provide some room to improve the consolidated fiscal accounts of the federal, state and local governments in 1998. The contractionist measures adopted to abort the attack on the 'Real Plan' will lower the expected growth rate for 1998. Their effect was already apparent in 1997, when growth in GDP reached only 3.03 per cent, below the 4 per cent anticipated at the beginning of the year. The forecast for 1998 has improved a little since the figures for retail sales and industrial production in late November and December 1997 fell short of the catastrophe envisaged by some. In the likelihood that no further turbulence will hit Brazil, it is now estimated that the economy could achieve a growth rate of at least 2 per cent by the end of this year.

The slowing down in the pace of economic activity will alleviate pressure on the foreign trade balance by depressing imports, but it is hard to tell by how much. The continuing process of restructuring in the productive sector means that there is no solid basis on which to ground an appraisal of the impact of reduced activity. Certainly, the deficit in the service accounts of the balance of payments is not conducive to optimism in gauging the amount of foreign money that will be needed to finance the external deficit.

On a more positive note, two recent indicators support those who believe in the capability of the Brazilian economy to overcome the present difficulties. The first is the unexpected performance of exports in 1997—an overall increase of 10.5 per cent, led, in the second half of the year, by manufactured goods; the second, the confirmation of a significant increase in investment, which everyone suspected but which was not revealed until more up-to-date information on the import of capital goods made new calculations possible. According to these calculations, the investment ratio rose to 18 per cent of GDP, a level that will enable the economy to move to higher rates of growth.

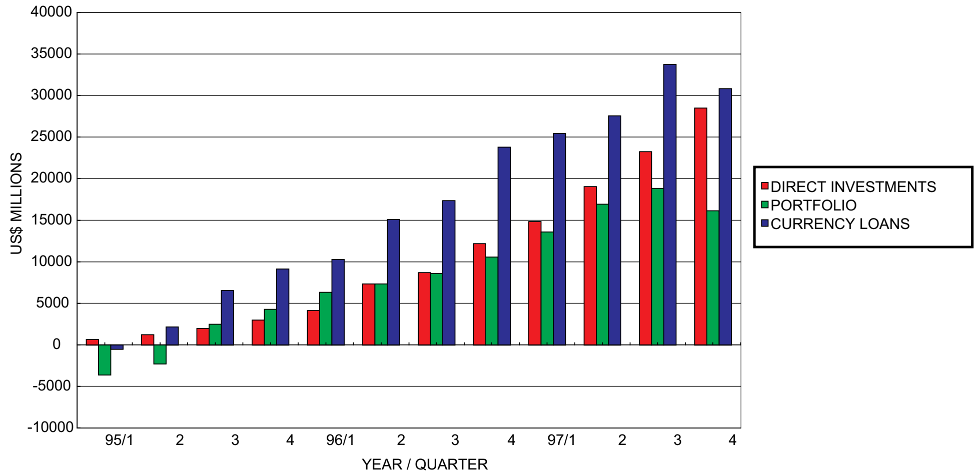
Growth, however, is constrained by a combination of facts that severely limit the scope for reducing the main imbalances. The quicker the fears sparked by the Asian crisis are allayed, the better for the strategy of gradual reduction in interest rates to reconcile the need for external finance with the need to reduce the pressure on the treasury. Also, the recognition of the importance of reinforcing protection in the turbulences in the international financial markets is a strong ally in the campaign to push forward the constitutional reforms, as evidenced by the renewed efforts of Congress to press these reforms.[6]

The apprehension caused by the delay in marshalling enough political support to bring about the institutional reforms is mitigated by other positive signs. Besides the 1997 export performance and the rise in investment, two other factors should be noted. In the matter of external financing, an improve-

[6] As mentioned above, administrative reform was approved in March 1998 and reform of the pension system, approved in the first round in the Lower House in February 1998, is expected to receive final approval not later than June 1998.

Figure 4

BRAZILIAN ACCUMULATED NET INFLOWS OF EXTERNAL RESOURCES



ment in the quality of the capital flowing into the country indicates an increasing belief on the part of foreign investors in the medium- and long-term prospects of the Brazilian economy. The data presented in Figure 4 testify to this. Beginning in 1995, portfolio investment was surpassed by foreign direct investment (FDI) and bank loans, and this trend continues to date. It is now expected that FDI will reach US$20 billion in 1998, covering about two-thirds of the unofficial figure for the external deficit for the year.

Private FDI is also stimulated by the launch of the most important part of the huge Brazilian privatization programme—the sale of the electricity and telecom businesses—and the opening up of the oil business to foreign enterprises. Estimates made before the Asian crisis valued the assets held by the electricity and telecom state enterprises in the vicinity of US$120 billion. Prospects for foreign investment in the oil sector are also bright: according to the new regulatory agency assets worth US$42 billion are now on the market. Taking estimates for the programme as a whole, resources from privatization are expected to provide the federal treasury with funds equivalent to 3.7 per cent of GDP in 1998, plus 2.3 per cent in the following year. These resources can cover about 80 per cent of the PSBR for the next two years and support for the public deficit until structural reforms begin to show results.

The more Brazilian society perceives the benefits of living in a country that gives due importance to the value of its money, the better will be the chances of removing all the institutional barriers in the way of sustaining monetary stability. After three and a half years, politicians are beginning to see the electoral potential of measures in pursuit of this goal. The stability achieved still has to be consolidated, but the positive signals noted above are strong enough to protect those who believe in the future from accusations of unrealistic optimism.

Future prospects

In an attempt to restart discussions on the medium- and long-term prospects of the Brazilian economy, the Institute of Applied Economic Research (IPEA) published a study on this theme in mid-1997. At that time, it envisaged GDP growing at an average rate of 5.6 per cent for the period ending in 2006, at which point the per capita income of the country would be in the region of US$8,000. The turmoil in the financial markets generated by the crisis in southeast Asian countries in the last quarter of 1997 may cast doubts on the likelihood of the scenario materializing. If, as mentioned above, the fear raised by the Asian crisis lends urgency to the completion of constitutional reforms, it might well turn out to be the element that was missing to turn those predicitons into reality.

If Brazil is to meet the challenges facing it in economic and social development, it needs to sustain an average growth in GDP in the vicinity of 6 per cent for the next ten years. Demographic shifts have pushed the annual growth rate of the population down to 1.3 per cent (less than half the rate prevailing in the 1970s), but regional and social differences in population behaviour will maintain the pressure on the state to satisfy the demands of people on lower incomes for more and better social services. Moreover, recent demographic projections point to persistently high pressure on the labour market, due to the fact that people who are reaching working age now were born before the spectacular fall in the birth rate from the 1970s onwards. The economically active population is expected to grow at a rate of 2.34 per cent annually up to the year 2005, which means that 1.3 million jobs will be demanded each year just to keep unemployment from rising above its present level.

Changes in the age distribution of the population will shift the pressures on social services on to those orientated towards the low-income elderly, but there are important regional differences to be noted. As social inequalities are regionally differentiated, the expected changes in the age distribution of the population will not occur simultaneously throughout the country. For the poorest regions in the north and northeast, the ageing of the population occurs at a slower pace. Coupled with higher illiteracy rates in these regions, these distinct demographic patterns indicate that the resources needed to eliminate the fundamental causes of inequality and poverty will still be a matter of great concern.

Without sustained economic growth, social challenges cannot be properly met. Universal access to basic education and to essential health services are other preconditions for development. According to the IPEA's estimates, if the 5.6 per cent growth rate contemplated for the Brazilian economy for the next decade is achieved, there will be enough jobs to accommodate the new entrants into the labour market and to bring unemployment down to 4 per cent of the labour force in the year 2005. However, since the supply of skilled labour falls short of demand, given the requisite of increasing productivity, wage differentials between skilled and non-skilled workers would increase by 50 per cent.[7]

Thus, even though a favourable scenario for the labour market could be envisaged in the presence of sustained growth, inequality remains a big problem. It is often argued that the roots of Brazilian inequality lie in the inadequacies of its educational system. Insufficient capacity in the poorer areas and a high degree of inefficiency in the state education sector can be blamed for the bad performance of the Brazilian educational system, in which younger Brazilians receive a mere 5.5 years of schooling, as compared to more than 7.5 years for the country's more important Mercosur partners (Argentina, Uruguay and Paraguay).

The way to reconcile economic growth with less inequality is to give every Brazilian equal oppotunities for social mobility. Besides access to more and better education, other basic social needs must be met. State reform is the answer to this problem. The social policies of the Brazilian government have missed the target—and the question is not one solely of resources. By all accounts, social spending in Brazil has not fared badly in international comparisons. Estimates of federal, state and local expenditures approach 20 per cent of GDP: above the corresponding figures for other Latin American countries.[8] And yet management inefficiencies, vested interests and an absence of focus have not seen this money spent in ways which did not make best use of it.

A good example of the misdirection of spending is provided by the social security system. Special provisions for public servants, including the military, and for members of the judiciary and the legislature, allow for retirement in the early fifties at incomes 20 per cent above the remuneration achieved immediately before retirement. In the public system for private employees early retirement is also the norm for those who are well-positioned in the labour market—employees of state enterprises, multinationals, and some privileged professionals, such as university professors and airline pilots. Not surprisingly, those who retire at an early age are those with better salaries, a situation that perpetuates very unequal access to the benefits of the system. More than 80 per cent of retired workers receive a monthly payment less than three times the legal minimum wage (approximately US$300), but account for only 52 per cent of total payments from the public social security system for private employees. On the other hand, the 10 per cent of pensioners who receive more than five times the legal minimum wage per month get 38 per cent of total payments.[9] As two-thirds of these benefits are financed by a payroll tax, thus shifting the burden on to the population as a whole, this situation amounts to a regressive system that cannot be sustained.

7 *O Brasil na Virada do Milênio* (Brasilia: IPEA, 1997).

8 Figures for social spending in Latin American countries can be found in R. Cominetti and G. Ruiz, *Evolución del gasto público social en América Latína, 1980–1995* (Santiago de Chile: Cuaderno CEPAL – UN Economic Commission for Latin America and the Caribbean, November 1995).

9 The legal minimum wage of 130 reals per month (more or less US$100) sets the floor for any wage in the private and public sector throughout Brazil as well as for social security benefits.

Conclusion

If the turmoil generated by the Asian crisis is now losing its destructive force, the prospects for the Brazilian economy in the near future are not as bad as they may seem from the outside. The contractionist measures adopted in late 1997 will halve GDP growth in 1998 as compared with the figure envisaged in the early months of last year. But so long as the government moves fast to implement the structural reforms, the process of adjustment may gain speed, thus compensating for lower rates of growth in this year and the next with higher rates in the first years of the next millennium.

There are two preconditions for the realization of IPEA's scenario for the next ten years:

- exports should grow at an annual rate above 10 per cent to avoid an unsustainable trajectory for the relationship between external debt and GDP;
- investment should rise steadily over the years towards the level of 24 per cent of GDP reached during the 1970s.

To keep exports growing at 10 per cent in the next ten years will not be an easy task, but it is certainly not impossible. Alongside management of the foreign exchange policy, tax reform and export promotion are the main tools in the government's hands. Tax reform is at the top of every businessman's list of priorities for improving competitiveness in domestic and foreign markets (the exemption of primary and semi-processed goods from the state tax was behind the increase of 13 per cent in the exports of these goods in 1997). Export promotion, through credit, insurance and other measures to enhance productivity and facilitate access to foreign markets, is being intensified to secure this goal.

With regard to investment, recent results, as well as the proclaimed interest of domestic and foreign investors in reaping the profits of the growth potential of the Brazilian economy, provide positive signs. Surveys conducted in Brazil and abroad provide impressive evidence of intentions to invest in the years ahead.[10] Even though these surveys lack scientific foundations and do not give due weight to the fact that some of the declared willingness to invest will not raise productive capacity (taking the form of mergers and acquisitions), or will not materialize at all, the figures are high enough to be taken as an indication that the investment target may not be difficult to reach.

The next two years will be decisive. If the projected scenario is to become reality, efforts to cut public spending and restore credibility in the management of the economy must be sustained. To assess the long-term prospects for success, one has to look ahead. Figures for 1998 cannot be taken as good

[10] A survey conducted by the Brazilian Ministry of Industry and Commerce in 1996 pointed to a declared amount of US$120 billion for intended investments in the manufacturing industry alone up to the year 2000.

guidance for the future, since the structural adjustment will take time to show results. The trajectory of the public sector deficit is highly sensitive to GDP growth when the growth rate reaches levels above 5 per cent, in such a way as to make the ratio of net public sector liabilities to GDP converge faster on stability. The same sensitivity characterizes the ratio of external debt to GDP, which reaches a sustained level as soon as economic growth reaches a higher speed. Growth is the solution; but it is also the problem. To increase growth without jeopardizing the balance of payments requires a reversal of past trends in international trade. Measures that are being taken to meet this end are beginning to show results, even though it is not realistic to expect fast changes in a short time. Hit by the unexpected eruption of the international financial crisis and thwarted by political obstacles to the passage of institutional reforms in Congress, the Brazilian government reaffirmed its belief in the ability of the country to overcome present constraints to build a better future.

High inequality is also a constraint on economic growth. Much of the upsurge in imports of consumer goods that followed the opening up of the Brazilian economy was attributable to the demand by people on middle or high incomes for luxury goods—especially fashionable cars. A reduction in inequality will allow for the expansion of domestic production, thereby diminishing the import requirements per unit of output. Policies to reduce inequalities should focus on three main priorities: improving educational standards; focusing social spending on programmes that promote equal opportunities for social mobility; and reforming public sector administration to improve efficiency in the public services.

By all accounts, Brazil is on the way to overcoming its present difficulties. Political and economic stability is providing favourable circumstances for domestic and foreign investors to tap the opportunities that lie ahead. More investment means higher growth, and higher growth creates the preconditions for reducing poverty and improving income distribution.