UNIVERSITY OF CAMBRIDGE

THE ROLE OF BRAZIL IN THE INTERNATIONAL MONETARY SYSTEM, 1994-2014

LUIZA PERUFFO

Clare College, University of Cambridge

Submitted for the degree of Doctor of Philosophy

September 2016

ABSTRACT

Title: The Role of Brazil in the International Monetary System, 1994-2014

Author: Luiza Peruffo

Abstract: This dissertation is born out of the premise that the 2008 global financial crisis marked a watershed in the history of the international monetary system (IMS), where emerging market and developing countries (EMDs) would become permanently influential actors. In particular, it looks at the experience of Brazil in this context to evaluate this premise. Drawing on in-depth semi-structured interviews with current and former Brazilian policy-makers, this dissertation aims to explain the impact of external constraints on Brazilian economic policy-making from 1994 to 2014 and their role in determining Brazil's position in the IMS. The puzzle is that Brazil has remained an unprivileged player in the power structures of the IMS while its economic power and position with regard to debt and trade varied over the period of analysis. For Brazil there was a particular hope that the aftermath of the 2008 crisis had fundamentally changed Brazil's position in the IMS given the ease with which Brazil traversed the crisis. However, subsequent events have proven this view to be inaccurate, and that while the crisis generated circumstances in which Brazil appeared to have greater influence in the IMS, it did not precipitate any decisive structural change. Whilst Brazil did not change, it was nonetheless able to retain some of the political influence it acquired during the context of the crisis even when its domestic economic performance began to deteriorate substantially and some of the old external constraints re-emerged. The experience of Brazil thus serves to shed light on the understudied role of EMDs in the IMS and helps to better understand which factors can influence a country's monetary power in a hierarchical system.

Brazil is not for beginners.

Tom Jobim

DECLARATION

This dissertation is the result of my own work and includes nothing which is the outcome of work done in collaboration except as declared in the Preface and specified in the text. It is not substantially the same as any that I have submitted or, is being concurrently submitted for a degree or diploma or other qualification at the University of Cambridge or any other University or similar institution except as declared in the Preface and specified in the text. I further state that no substantial part of my dissertation has already been submitted or, is being concurrently submitted for any such degree, diploma or other qualification at the University of Cambridge or any other University of similar institution except as declared in the Preface and specified in the text. It does not exceed the prescribed word limit of 80,000 words for the Degree Committee in the Faculty of Human, Social and Political Science.

Luiza Peruffo

Cambridge, September 2016.

ACKNOWLEDGEMENTS

When I started my PhD, pretty much all I knew was that I wanted to understand the role of Brazil in the international monetary system. I am forever indebted to my supervisor Dr. Helen Thompson, who taught me how to transform an idea into a research project and, most importantly, how to execute it. I am thankful for her patience, guidance and support during the last four years. She was always a better supervisor than I was a PhD student.

I am also obliged to Dr. Pieter Van Houten and to Dr. Kun-Chin Lin, who provided valuable advice and insights at early stages of my research.

My sincere thanks also goes to everyone I interviewed and whose experience made this research possible. Thank you for sharing with me your knowledge about Brazil, for making insightful comments about my research and for challenging me with questions I could not answer at the time. Having the opportunity to meet and discuss my work with such eminent Brazilian personalities was undoubtedly the best part of my research. I hope you approve of the final work.

I am thankful to my professors in the Federal University of Rio Grande do Sul, who encouraged me to pursue my studies in the University of Cambridge and who were always an important source of intellectual support. I am particularly indebted to Dr. André Moreira Cunha, who has been a major professional inspiration for ten years. I know I can always trust and count on him.

I gratefully acknowledge the funding sources that made my PhD possible. I was fully funded by CAPES and the Cambridge Overseas Trust. My fieldwork expenses were funded by the Department of Politics and International Studies at the University of Cambridge.

The best gift I received from Cambridge were the friends I made here. Since my first year I was lucky enough to meet people that made me feel at home even miles away from Brazil. A special thanks to my housemates in 108, the Brazilian community and Clare friends. To Denise, Janaína and Renata, who shared this whole journey with me and were my safe harbor in all times. To Julia, who is one of the most inspiring and caring people I have ever known (and who kindly and efficiently proofread this dissertation). My heart will be forever spread throughout the world.

Warmly thanks to my family for all their love and encouragement. To my dad for making sure I kept my mental sanity amidst the PhD craziness and who is probably the person who enjoys in the most when I succeed. To my mom for always making my life easier and for her unconditional love. To my brother for always reminding me of the truly important things in life and that "worst case scenario you die, so do not worry". To Alexandre, not only for his absolute intellectual and emotional support but especially for tolerating a long distance relationship for four years so that I could pursue my dreams (it must be love).

TABLE OF CONTENTS

LIST OF TABLES AND FIGURES

LIST OF ABBREVIATIONS

ABC	Agência Brasileira de Cooperação (Brazilian Cooperation Agency)
ALBA	Alianza Bolivariana para los Pueblos de Nuestra América (Bolivarian Alliance for the Peoples of Our America)
ANEEL	Agência Nacional de Energia Elétrica (National Agency of Electrical Energy)
ASEAN	Association of Southeast Asian Nations
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BNDES	Banco Nacional de Desenvolvimento Econômico e Social (Brazilian Economic and Social Development Bank)
BRICs	Brazil, Russia, India and China
BRICS	Brazil, Russia, India, China and South Africa
BWIs	Bretton Woods Institutions
BWS	Bretton Woods System
CAN	Comunidad Andina (Andean Community)
CASA	Comunidade Sul-Americana de Nações (South American Community of Nations)
CEBC	Conselho Empresarial Brasil-China (Brazil-China Entrepreneur Committee)
CFF	Compensatory Financing Facility
CMBEU	Comissão Mista Brasil-Estados Unidos (Joint Brazil-United States Commission)
CMN	Conselho Monetário Nacional (National Monetary Council)
CRA	Contingent Reserve Arrangement
EFF	Extended Fund Facility
EMDs	Emerging Market and Developing Countries

FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
FGC	Fundo Garantidor de Crédito (Credit Guarantee Fund)
FIESP	Federação das Indústrias do Estado de São Paulo (Federation of Industries of the State of São Paulo)
FOCEM	Fundo para Convergência Estrutural do Mercosul (Mercosul Structural Convergence Fund)
FONPLATA	Fundo Financeiro para o Desenvolvimento da Bacia do Prata (Financial Fund to the Development of the Rio de la Plata Basin)
FSB	Financial Stability Board
FSF	Financial Stability Forum
FTAA	Free Trade Area of the Americas
GDP	Gross Domestic Product
IADB	Inter-American Development Bank
IBSA	India, Brazil, South Africa
IFIs	International Financial Institutions
IMF	International Monetary Fund
IMS	International Monetary System
IPE	International Political Economy
IPEA	Instituto de Pesquisa Econômica e Aplicada (Institute for Applied Economic Research)
LTCM	Long Term Capital Management
LRF	Lei de Responsabilidade Fiscal (Fiscal Responsibility Law)
Mercosul	Mercado Comum do Sul (Southern Common Market)
NAB	New Arrangements to Borrow
NDB	New Development Bank
NEM	New Economic Matrix
OECD	Organisation for Economic Co-operation and Development
ORTN	Obrigações Reajustáveis do Tesouro Nacional (Adjustable Bonds of the National Treasury)

PAC	Programa de Aceleração do Crescimento (Growth Acceleration Program)
PBoC	People's Bank of China
PSDB	Partido da Social Democracia Brasileira (Brazilian Social Democracy Party)
PT	Partido dos Trabalhadores (Workers' Party)
REER	Real Effective Exchange Rate
SDR	Special Drawing Rights
SML	Sistema de Pagamentos em Moeda Local (Local Currency Payment System)
SUMOC	Superintendência da Moeda e do Crédito (Superintendence of Money and Credit)
SWF	Sovereign Wealth Fund
TPP	Trans-Pacific Partnership
UNASUL	União de Nações Sul-Americanas (Union of South American Nations)
URV	Unidade Real de Valor (Unit of Real Value)
USAID	United States Agency for International Development
WTO	World Trade Organization

INTRODUCTION

The 2008 global financial crisis increased the influence[1] of emerging market and developing countries (EMDs) and in so doing it had a clear impact on the underlying power relations in the international monetary system (IMS). When the crisis broke, EMDs suddenly found themselves in a relatively better situation than developed economies. The improved position of EMDs was the result of the crisis disproportionately affecting developed economies, partly due to it originating in the US, combined with the fact that EMDs were in general more resilient in comparison to previous crises episodes.

As a result of this unprecedented situation, EMDs played an important part in the management of the crisis since they represented a source of financial resources and economic dynamism. US President George Bush recognised this change when he invited the leaders of the G20 countries for a meeting in Washington in November 2008. In September 2009, the G20 officially replaced the G8 as the main international forum for economic cooperation. At the time of the crisis, EMDs' weight spread to other forums, such as the Financial Stability Forum (FSF), which was transformed into the Board (FSB) in April 2009, and the Basel Committee on Banking Supervision (BCBS) in the Bank for International Settlements (BIS). In addition, long-waited reforms in the Bretton Woods Institutions (BWIs) – the World Bank and the International Monetary Fund (IMF) – were approved, increasing the voting power of EMDs at the expense mainly of over-represented European countries.

[1] The concepts of "power," "influence," and "autonomy" are discussed in Chapter 1.

The inclusion of several EMDs in global monetary governance in the wake of the crisis was supported by the international system shifting towards multipolarity. The decade leading up to the global financial crisis witnessed an ever-increasing share of EMDs in global trade, investment and finance. According to a World Bank (2011, p.1) report, EMDs' share in international trade flows went from 30 per cent in 1995 to 45 per cent in 2010. Most importantly, much of this expansion was due to an increase in trade among developing countries. As of 2010, more than one-third of foreign direct investment in developing countries originated from developing countries (World Bank 2011, p.1). EMDs became holders of two thirds of all foreign exchange reserves, in stark contrast to the previous decade when advanced economies held two-thirds (World Bank 2011, p.1). The creation of sovereign wealth funds (SWFs) as well as other pools of capital further added to EMDs' financial power.

The faster recovery of EMDs' economic growth in the face of a US slowdown, triggered by the beginning of the financial crisis in 2007, nurtured the hypothesis that the global economy was decoupling from the US (Bergsten 2008; IMF 2007, chap.4; IMF 2008, chap.1; Dooley & Hutchison 2009). With the bankruptcy of Lehman Brothers in September 2008, however, the crisis turned global and EMDs directly felt its impact, particularly through trade and financial channels. Even so, they began to recover faster and regained their pre-crisis growth levels much earlier than advanced economies, resuscitating the argument that EMDs had gained relative autonomy from their developed peers (Akyüz 2012, pp.4–5). The growing significance of EMDs as engines of global growth was labelled the "new normal" (El-Erian 2009).

Against this background, the crisis unsurprisingly re-launched the debate in the academic literature about the role of EMDs in the IMS, which began from the premise of a large asymmetry between EMDs' economic size and their role in the IMS. As Eichengreen (2011a, pp.121–122) noted "as the world economy becomes more multipolar, its monetary system, logic suggests, should be similarly more multipolar". A multipolar IMS would have meant a better distribution of power across regions, which implied a transformation in global governance away from US-domination and, consequently, a change in the currency landscape. In particular, scholars suggested that the *exorbitant privilege*[2] of the greenback in the IMS would soon be shared with other currencies, particularly the euro and the renminbi (Calleo 2009; Dailami & Masson 2009; Eichengreen 2011a).

A similar statement echoed in international institutions. The World Bank (2011, p.7) reported that "even though the role of emerging markets in international finance is growing, there is a great disparity between their economic size and their role in the international monetary system". By the same token, a discussion paper of the IMF staff pointed out that "the shift to a multipolar IMS would be consistent with ongoing global adjustment" (Maziad et al. 2011, p.19). Both the World Bank and the IMF thus reiterated the conclusions of this academic literature that the future IMS would no longer be dollar dominated. "The most likely scenario for the international monetary system," a World Bank (2011, pp.125–126) report said, "is a multicurrency system centred around the US dollar, the euro, and the renminbi". In similar lines, the IMF staff said "it is possible to envisage a system where the US dollar and euro remain the main global currencies, while a set of regional currencies emerge in different trading blocs or regional financial centers" (Maziad et al. 2011, p.18).

The World Bank and the IMF's reports deemed the shift towards multipolarity as a necessary condition to achieve a better distribution of costs and benefits in the IMS, and so reduce global imbalances (World Bank 2011; Maziad et al. 2011). The unequal share of responsibilities was ultimately associated with the contrast between the international role of the dollar and the role

[2] The term *exorbitant privilege* was coined by Valéry Giscard d'Estaing, Charles de Gaulle's Minister of Economy, to refer to the advantages of the dollar being the key international reserve currency (Eichengreen 2011a, p.4; Cohen 2012, p.17). See Chapter 1 for a discussion of the benefits of issuing an international reserve currency.

of EMDs' currencies, despite their growing presence in the global economy (World Bank 2011, pp.7–8). According to the IMF staff, "the limited role of EM [emerging market] currencies in international transactions stands in sharp contrast to their growing weight in the global economy, which is in itself a source of stress to the functioning of the IMS" (Maziad et al. 2011, p.3).

In this light, international institutions were categorical about the future of the IMS and the role reserved for EMDs. The World Bank (2011, p.7, emphasis added) maintained that "as emerging economies account for an ever-growing share of the global economy and participate more actively in cross-border trade and finance, one sees that their currencies – particularly the renminbi – will *inevitably* play a more important role in the international financial system". This claim was reiterated by the IMF staff, who argued that "it seems likely – if not *inevitable* – that emerging market currencies will account for a larger share of international reserves" (Maziad et al. 2011, p.6, emphasis added). In particular, they highlighted that "key EM currencies with potential for internationalisation are the Brazilian Real, Chinese Renminbi, Indian Rupee, Russian Ruble, and South African Rand" (Maziad et al. 2011, p.10).

Much of the academic literature on the subject equally suggested that there was space for other contenders (besides the euro and the renminbi) to challenge the dollar's supremacy. In one example, Eichengreen (2011a, p.8) argued, "where the Renminbi leads, other emerging market currencies, such as the Indian Rupee and Brazilian Real, could eventually follow". In a similar line, Cohen (Cohen 2009a, p.21) said, "several states around the world today are thought to harbour ambitions to amplify their monetary power – including, most prominently, the four BRIC countries (Brazil, Russia, India, and above all China)". He then suggested these countries could promote the internationalisation of their currencies (Cohen 2009a, p.21).

Politically, this discussion about persistent imbalances in the IMS was put at the centre of the G20 agenda during the French presidency in 2011. President Nicolas Sarkozy (2011) identified the "instability of the international monetary system and commodity price volatility" as one of the challenges to be addressed, recognizing that "we've been living with the instability of the international monetary non-system since 1971". He summarised the French position saying that "the emergence of new economic powers will *inevitably* lead to the emergence of new international currencies" (Sarkozy 2011, emphasis added).

New economic powers were almost always associated with the BRIC countries, which in 2010 officially became BRICS after the inclusion of South Africa. Since the 2008 crisis the BRICS have represented one of the main sources of pressure for reform in the prevailing IMS. First, they revived the idea of increasing the role of IMF's Special Drawing Rights (SDR) as a reserve currency, thus moving away from a dollar-centric IMS. Second, they pushed for reforms in the IMF and the World Bank, increasing their role in global financial governance. The influence they exerted, according to two observers, was going to "make it *impossible* for the United States to successfully resist a reshaping of the international monetary system toward a more multilateral and managed one" (Dailami & Masson 2009, p.14, emphasis added).

These events following the crisis and the reinvigorated academic debate concerning the rise of a multi-currency international system fuelled the idea that the 2008 crisis marked a watershed in the history of the IMS, where EMDs would permanently become more influential actors. However, this shift in the balance of power was to be a temporary one. First, as the global financial contagion was staunched, forums such as the G20 began to lose steam and relevance. Second, as the worst of the crisis passed and the need for financial resources diminished, reforms in the IMF and the World Bank slowed down. Third, already in 2010 international conditions for EMDs began to deteriorate and so did their economic performance. On the one hand, the monetary policies of developed countries to deal with the crisis had negative effects for EMDs, which the Brazilian Finance Minister Guido Mantega dubbed a “currency war” (Wheatley & Garnham 2010). On the other hand, EMDs’ economies further deteriorated with the end of the commodity prices’ boom from 2011 onwards. Thus, the pressure EMDs could exert at the time of the crisis proved dependent on an international context that gradually disappeared.

With the benefit of hindsight, it is clear that the 2008 global financial crisis did not substantially alter the underlying power structures in the IMS in favour of EMDs. At the same time, however, it seems that some of the gains achieved by EMDs during the crisis will be permanent. While the hierarchical core of the system remains the same, the crisis catalysed a rearrangement in the balance of power to recognize the rise of one of the EMDs: China.

The process of including China in global governance did appear to have opened a general window of opportunity for other EMDs to increase their influence. For instance, while EMDs were generally under-represented in the IMF’s quota shares, the major incongruence came from China, which made the reform unavoidable. The 2010 reform made China the third largest shareholder, and also put Brazil, Russia and India among the top ten members of the IMF. To that extent, the pressure for including China in the IMS benefited other under-represented, but less powerful, EMDs.

At the same time, China benefited from the association with other EMDs to legitimise its agenda of becoming a significant player in international monetary affairs. The launch of the New Development Bank (NDB) and the Contingent Reserve Arrangement (CRA) with the other BRICS countries in July 2014 are examples of such politically motivated projects. China has also used the EMDs’ general dissatisfaction with the IMS to validate reforms that ultimately increased its own power. For example, one outcome of the debate about the necessity of moving away from a dollar-centric system was the inclusion of the Renminbi in the IMF's SDR basket in December 2015. To that extent, China's ascension as a monetary power leans considerably on the general EMDs' discourse.

China's rise as a key player in international monetary relations has received extensive attention in academic literature (Helleiner & Kirshner 2014; Subramanian 2011). In particular, its ascension as an international creditor (Drezner 2009; Chin & Helleiner 2008) and its government's decision to internationalise the renminbi have been subject to much debate in recent years (Eichengreen 2011b; Prasad & Ye 2012; Cohen 2014).

The close association between China and other EMDs, particularly the other BRICS countries, has sometimes led to misperceptions about the balance of forces in the IMS. Helleiner and Pagliari (2011, p.175) state that "China and other emerging powers within the developing world seized the opportunity of the crisis to demand a greater role in discussions about the future of international financial regulation to match their growing weight in global financial markets". In another example, Dailami and Masson (2009, p.2) claimed the BRICs are one of the three poles of economic power, together with the United States and the Euro area. They argued:

> Backed by rapid economic growth, growing financial clout, and a newfound sense of assertiveness in recent years, the BRICs are a driving force behind an incipient transformation of the international monetary system away from a US-dominated system toward one that is more regionally based and in which developing countries have a major say (Dailami & Masson 2009, p.2).

The problem with this line of analysis is that, without China, the BRICS group cannot be conceived as a threat to the US-dominated IMS. China alone, however, has the economic weight to challenge the system. Therefore, if academic literature is interested in understanding monetary power of other EMDs, research needs to advance toward other EMDs than China.

Other EMDs' monetary power differs from China's power not only because of their lower economic weight but because of the role of their currencies in the IMS hierarchy. Still, EMDs' experience during the 2008 crisis suggests that it is possible for a country to have some influence in the IMS without issuing an international currency. This influence occurs through other channels, such as influencing international institutions like the IMF and the World Bank, shaping the international agenda in forums like the G20 and pressuring for modifications in policy prescriptions. Thus, scholars have to face the challenge of explaining the role of states that have neither the ambition nor have the potential to internationalise their currencies.

The aim of this dissertation is to examine the constraints faced by EMDs in the IMS through the lens of what came before, during and after the 2008 crisis by conducting a case study on one of the largest EMDs other than China: Brazil. Brazil is an interesting case because it fits very well into the inflated claims directed at EMDs during the 2008 crisis. Among EMDs and the BRICS, Brazil received particular attention during the crisis, with the media portraying it as a success story as one of the last countries to enter the crisis and one of the first to come out of it (The Economist 2009). International leaders also recognized Brazil as a key actor in global governance in the aftermath of the crisis: "Who today could imagine solving the problems of the world without Brazil?" asked the President of France Nicolas Sarkozy in December 2008 (quoted in Latin America News 2009). Besides considerable media coverage, worldwide interest in Brazil was also reflected in the launch of a series of books on the "rise of Brazil". A few examples are *Brazil as an economic superpower: understanding Brazil's changing role in the global economy*, edited by Lael Brainard and Leonardo Martinez-Diaz (2009b); *Brazil under Lula: Economy, Politics, and Society under the Worker-President*, edited by Joseph L. Love and Werner Baer (2009); *The New Brazil*, from Riordan Roett (2011); *Starting Over: Brazil since 1985*, from Albert Fishlow (2011); and *Brazil on the Rise: a story of a country transformed* from Larry Rohter (2012).

In this context, Brazil is particularly useful to understand the issues around the non-China EMDs because it is simultaneously distinctive in its monetary history whilst sharing some features with other states, such as dealing with the many constraints imposed by the IMS for EMDs' economic policy-making in general. Accordingly, the question this dissertation aims to answer is: *How have Brazil's policymakers managed Brazilian monetary, financial and exchange rate policies since 1994 in the context of the power structures of the international monetary system?* The main objective of this dissertation is thus to investigate how Brazil's unprivileged position in the IMS has affected the autonomy of Brazilian policy-makers from 1994 to 2014 and how the 2008 crisis fits into this trajectory.

The period of analysis begins in 1994 because that year was a milestone in Brazil's economic history, with the conclusion of the Brady Plan (which restructured Brazil's external debt) and the launch of a new currency, the Real, which put an end to a long period of very high inflation. Implicitly, the start of the analysis in 1994 suggests that before that year Brazil's economic policy was extremely constrained by external factors, with little or no degree of autonomy. It is only after 1994 that the Brazilian government began to have more autonomy to pursue domestic objectives without being permanently constrained by external debt and high inflation.

Nevertheless, the period inaugurated after 1994 for Brazil coincided with the start of an extremely turbulent time for EMDs in general when many of them faced severe financial crisis. After Mexico in 1994, East Asia in 1997 and Russia in 1998, Brazil had its own financial crisis in 1999, which precipitated a fundamental change in its macroeconomic policy framework. The new arrangement became known as the "macroeconomic tripod," which combined inflation targeting, a floating exchange rate and a fiscal policy aimed at maintaining a primary surplus. Despite the unfavourable scenario in the late 1990s, which imposed an additional source of stress for policy-makers, inflation did not return and the Brazilian economy gradually entered into a more promising phase.

This propitious period was invigorated when China took off in 2003. As a result, the terms of trade improved considerably for Brazil, lowering traditional external constraints for economic-policy making. This scenario allowed Brazilian policy-makers to pursue policies like international reserves accumulation, which gradually made the Brazilian economy more robust against external shocks. A landmark in this process was Brazil's repayment of its debt to the IMF in December 2005.

Thereafter, the Brazilian economy entered into a very buoyant period and, against all Brazil's historical odds, performed relatively well during the 2008 financial turmoil. While EMDs in general were less affected than its developed peers, Brazil's resilience was nonetheless remarkable considering the country's experience in previous international crises. Astonishingly, amidst the greatest global financial crisis since 1929, Brazil became a creditor for the IMF in October 2009.

However, after an exceptional GDP growth of 7.5 per cent in 2010, Brazil's performance began to slow. This poor growth was not, however, exclusive to the Brazilian economy, as other EMDs also started to have less impressive economic results. Significantly, some prevalent trends that had existed until 2010 gradually changed, particularly the upward trend of commodity prices. Still, Brazil's poor economic results strongly contrasted with the trajectory it had been pursuing since 2006.

In contrast to what the immediate aftermath of the 2008 crisis might have suggested, the years after 2010 clearly show that Brazil remained an unprivileged player in the power structures of the IMS. This insight raises several questions relating to the place of external constraints in

Brazilian economic-policy making, since on the surface it appeared that the government had acquired a greater level of autonomy, particularly from 2006 onwards.

There is, in fact, a heated debate among economists to determine whether Brazil's improved performance after 2006 was the result of a change in the macroeconomic policy framework, which arguably gave a greater role to more interventionist policies (Barbosa & Souza 2010; Morais & Saad-Filho 2011). This debate raises questions, for instance, about the level of autonomy Brazilian governments have had to pursue domestic objectives. Ultimately, the matter of autonomy – or of the perception of autonomy – can be related to varying degrees of external constraints over time. Put differently, there is an issue of whether Brazil's autonomy is actually dependent on international variables, which then means the government alone has little power.

Moreover, the fact that Brazil's debt settlement with the IMF coincided with an improvement of Brazil's economic performance in the following years also raises the issue about the level of intervention of the IMF in Brazil's policies. In other words, how much were Brazilian policy-makers actually constrained by having an agreement with the Fund and to what extent did the end of the agreement represent a gain of autonomy for Brazil?

In order to understand how Brazilian policy-makers have dealt with the change in the external constraints from 1994 to 2014, a qualitative assessment of their experience is imperative. The dissertation is based on 39 interviews with 37 former and current Brazilian policy-makers[3], totalling approximately 41:30 hours.[4] All interviews were conducted in Portuguese and translated by the author. Interviews lasted on average one hour. The first round of interviews

---

[3] Two participants were interviewed twice.

[4] Some interviews were not recorded (at the request of participants or for other reasons). These interviews are not considered in the statistics.

took place in January-February 2014 and the second round from December 2014 to April 2015. The second round included 5 interviews with Brazilian representatives in the IMF, the World Bank and the Inter-American Development Bank in Washington D.C. A final interview was conducted in September 2015 with the Brazilian former President Fernando Henrique Cardoso (1995-2002).

The participants were mainly current or former policy-makers at the Central Bank of Brazil, Ministry of Finance and Ministry of Foreign Affairs, known as Itamaraty. There were 8 participants from the Central Bank, including 3 former governors and 3 former directors. There were 7 participants from the Ministry of Finance, including 3 former Finance Ministers and 2 directors of International Affairs. There were also 7 participants from Itamaraty, including 1 former Foreign Minister, 1 former Secretary-General for External Relations (Vice-Foreign Minister). Other participants associated with the government were from the Institute of Applied Economic Research (IPEA, *Instituto de Pesquisa Econômica e Aplicada*), a Brazilian government-led economy research organization; the Brazilian Economic and Social Development Bank (BNDES, *Banco Nacional de Desenvolvimento Econômico e Social*); the Minister of Planning; and the Foreign Policy Advising to the President of Brazil. Four participants were neither former nor current policy-makers (at the federal level), but renowned Brazilian economists who work in Universities and think tanks (in Brazil and abroad).

At the time of the interviews, 13 participants were policy-makers of the Dilma Rousseff government (2011-present) (plus 5 representatives in Washington D.C.); 17 interviewees were policy-makers during the Lula government (2003-2010); 13 during the Cardoso government (1995-2002); and 10 were from previous governments. From the total of 37 interviewees, 15 are (or were) career members of the government, such as diplomats and analysts at the Central Bank, meaning they are less likely to have a clear political bias.

Each interview was conducted with open-ended questions, questions which varied in subject according to the period that participants were members of the government. While the focus of the interviews was the interviewees' job as policy-makers, many of the interviewees were also interested in discussing "the role of Brazil in the international monetary system". These conversations with senior Brazilian policy-makers, who together form a broad spectrum of professional experiences and ideological perspectives, have proven fundamental to the orchestration of this research and have indicated which topics are especially important to consider when discussing the position of Brazil in the IMS.

The qualitative material obtained through the interviews was supplemented with concurrent quantitative research. The quantitative research collected data about Brazil's economic performance for the period under analysis – including GDP growth, inflation, trade flows, balance of payments, interest and exchange rates. Tracking the record of these indicators allowed me to challenge the perception of Brazilian policy-makers about the position of Brazil in the IMS. In addition, I gathered primary and secondary sources on the events that affected Brazil's position in the IMS from 1994 to 2014. Most of this literature review was conducted in the earliest stages of the research and contributed to identify the major topics to be addressed in the interviews. The literature review also included an investigation of the main personalities on those events and was the guide to select the interviewees. Whenever possible, my preparation for the interviews started by a study of the participant's professional and research background to foresee any ideological bias they might have shown. This triangulation approach was used to increase the credibility and the validity of the results presented in this dissertation.

This dissertation is divided into five chapters. The first chapter reviews the international political economy (IPE) literature on money and power, pointing out an important gap in the theory. Whilst IPE theory recognises the existence of a hierarchy in the IMS, it tends to focus on the top of the pyramid, overlooking in terms of detailed analysis the cases of EMDs. The second chapter offers a historical context for the deeper analysis of Brazil after 1994. It considers the position of Brazil in the IMS from 1944 to 1994 from three perspectives: the relations with the United States; constraints arising from external debt; and constraints rising from inflation. The third chapter covers the period from 1995 until 2005, which corresponds to a consolidation phase of Brazil in the IMS. The fourth chapter covers the years from 2006 to 2010, which were the peak years of Brazil's influence in the IMS. The fifth chapter covers the period from 2011 to 2014, which marked a decrease in Brazil's influence in comparison to the previous period. The final chapter sets out some conclusions.

CHAPTER 1. MONETARY POWER BEYOND INTERNATIONAL CURRENCIES: WHAT IS LEFT FOR EMERGING MARKETS AND DEVELOPMENT ECONOMIES?

1.1 INTRODUCTION

Ever since the US dollar was officially recognised as the key international currency at the Bretton Woods Conference in 1944, its demise has often been predicted. In 1960, the Belgian-American economist Robert Triffin (1957; 1960) warned that the persistent US deficits necessary to maintain the Bretton Woods System (BWS) would eventually undermine confidence in the US dollar. After the US government terminated the dollar's gold convertibility in 1971, Charles Kindleberger deemed it to be the end of the dollar era. At the end of the 20th century, the launch of the euro – the first credible alternative reserve currency to the dollar – again rekindled ideas about the imminent erosion of the dollar-centric international monetary order (Chinn & Frankel 2007). Most recently, the 2008 global crisis precipitated a new wave of predictions about the inevitable fall of the dollar and scholars continue to bet as to whether the dollar will have to share its dominance with not only the euro, but also the renminbi in the near future (Eichengreen 2011a; Cohen 2009b; Cohen 2009a; Helleiner & Kirshner 2009a; Prasad & Ye 2012; World Bank 2011; Angeloni et al. 2011).

The reason why the dollar's demise has been the subject of so much scrutiny and consideration is because the ability to issue the key international reserve currency is one of the main sources of power in the international system. As Cohen (2004, p.xii) makes clear, "though seemingly technical in nature, the management of money in fact is anything but neutral in its implications for the distribution of wealth and power across the globe". In other words, the existence of a key currency in the international monetary system (IMS) means that not all currencies are equal. If the power of states is partly determined by the currencies they issue, clearly states enjoy different levels of monetary power. There exists a hierarchy between states rooted in the nature of the currencies they issue.

While the existence of a hierarchy in the IMS has long been recognised (Kindleberger 1970; Gilpin 1987; Strange 1994; Andrews 2006), the reasons for its change (or lack thereof) over time are still the subject of study and debate (Andrews 2006; Cohen 2015; Kirshner 1995). Indeed, the debate over the dollar's future is a principal example of how the relations between money and power are yet unclear. While leading scholars maintain that for the foreseeable future the dollar will, in Cohen's (2015, p.244) words, "remain supreme," just a few years ago several scholars also highlighted the existence of potential challengers, such as the euro and the renminbi, envisaging the possibility of a multipolar currency system (Cohen 2009a; Calleo 2009; Dailami & Masson 2009; Eichengreen 2011a; Angeloni et al. 2011; World Bank 2011).

The idea of a multipolar currency system gained impetus during the 2008 crisis when scholars and international institutions predicted not only the dollar's demise but also an increased participation of emerging markets and developing countries (EMDs) in the IMS (World Bank 2011; Maziad et al. 2011; Dailami & Masson 2009). While some specialists discussed the possibility of using EMDs currencies more widely (Maziad et al. 2011; World Bank 2011), the debate about the participation of EMDs in the IMS was mingled with – and somewhat more focused on – the issue of reforming global financial governance, particularly regarding the rise of the G20 and the need for reform in the International Monetary Fund (IMF) and the World Bank, the two Bretton Woods Institutions (BWIs) (Helleiner 2010). Discussions concerning the reformation of the BWIs implied increasing the share of EMDs and were largely founded on a narrative that the 2008 crisis was ultimately a failure of major economies and global institutions to identify and address failures in global financial markets (Helleiner & Pagliari 2011, p.183; G20 2008).

According to this narrative, the absence of adequate financial regulation was at the crux of the 2008 crisis (Helleiner & Pagliari 2011; Helleiner 2010; G20 2008). This view is not unfounded as financial deregulation has been identified as having precipitated crises in the recent past. After sticking rigidly to the IMF's prescription of capital account liberalisation, a series of Asian countries faced severe financial crises in the 1990s, which were reproduced shortly after in other EMDs, such as Russia, Brazil and Argentina. Since then EMDs have become more careful in their acceptance of the IMF's recommendations and have resisted liberalising their financial systems. To their delight, these countries were among the least hard-hit by the 2008 crisis and began to recover faster than developed countries (Gallagher 2015; World Bank 2011; Canuto 2010).

The context of the 2008 crisis in fact catalysed EMDs' formal and informal participation in global governance. Following the elevation of the G20 as the main forum for international macroeconomic cooperation in September 2009, thus replacing the G8, EMDs' participation was expanded into several other forums. Furthermore, the crisis prompted the enactment of long-awaited reforms in the BWIs, which resulted in higher participation of EMDs. Although this increase in EMDs' participation in the IMS was only incremental, it was, nevertheless, very significant, particularly from a symbolic perspective.

However, the core of the IMS has essentially remained the same (Cohen 2015; Helleiner 2014). The US persists as the dominant power in the IMS, issuing the key international reserve currency and ruling, through its veto power, the preeminent global financial institution, the IMF. Meanwhile, some of the initiatives that appeared to be inaugurating a new era of global financial governance in the aftermath of the crisis – such as the rise of the G20 – proved to be less transformative than initially thought.

If the interactions between money and power are unclear for the core of the IMS, it seems that they are even more obscure for the rest of it. While much of the discussion around the US' power in the IMS is based on the worldwide influence of the US dollar, this kind of analysis cannot be emulated for EMDs. This may explain why China has been hitherto the preferred case of analysis of EMDs in the IMS, for it is the only EMD that issues a currency with the potential for global use.

The mechanisms enjoyed by other EMDs to influence the IMS, however, remain largely unknown. Apart from China, the vast majority of EMDs is very unlikely to ever issue currencies that will be used internationally. Yet, in the aftermath of the 2008 crisis, EMDs states had some power – unrelated to the international use of their currencies – to exert some kind of influence in the IMS. Thus, EMDs' experience suggests that there are other channels of influence in the IMS than the issuing of an international currency.

In this light, the purpose of this chapter is (i) to discuss in which ways EMDs are constrained by the power structures in the IMS and (ii) to investigate the circumstances that allowed EMDs to have influence in the context of the 2008 crisis, despite being unprivileged players. This chapter begins by discussing the concepts of monetary power and currency hierarchy, highlighting the challenges faced by EMDs. Next, it reviews how the IMS that emerged in 1944 and was renewed in 1973 has both revealed and reinforced American power and how the IMS has constrained EMDs' economic policy-making. It then looks at EMDs' influence in the IMS during the crisis to show (i) how previous studies have generally overlooked the subordinated position of EMDs' currencies and (ii) to make an argument for considering more fully their participation in global financial governance and on their capacity to influence ideas/policy prescriptions. The last section concludes the chapter.

1.2 MONETARY POWER AND CURRENCY HIERARCHY

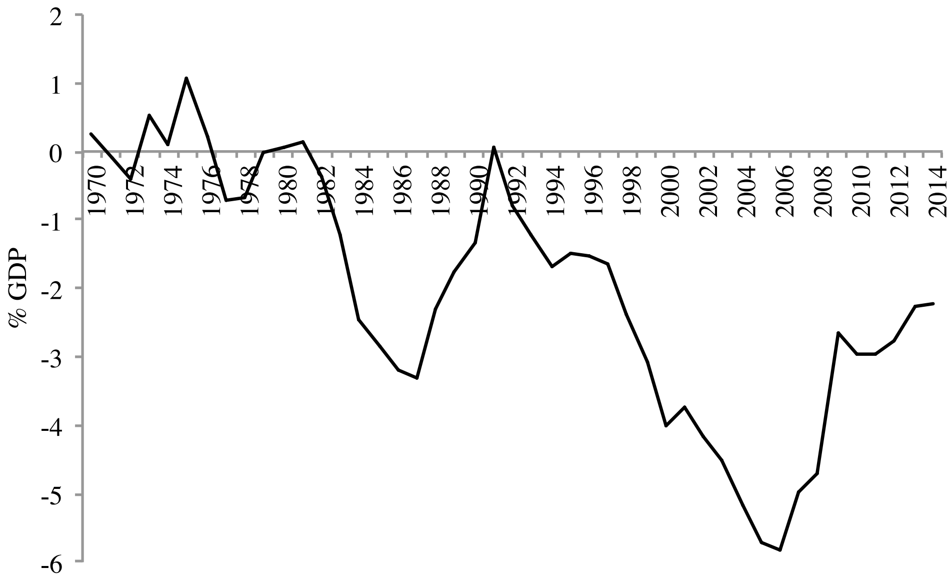
Monetary power happens, in Andrews's words (2006, 8) when "one state's behaviour changes because of its monetary relationship with another state. The ultimate international conflict in monetary relations arises from balance of payment constraints and the need for adjustment. National economies are financially linked through the balance of payments so that the surplus of one country necessitates the deficit of another. For most states, eliminating a trade imbalance involves the subordination of domestic policy to the external adjustment in order to generate a sufficient amount of international money to finance the deficit. Classically, options to mitigate an external imbalance involve the devaluation or depreciation of the domestic currency, the imposition of monetary or fiscal austerity (to reduce domestic demand and, hence, imports) or the establishment of direct controls to limit import volumes or outward flows of capital. Each of these options carry a burden of some kind, economic and/or political. Since no government would willingly subordinate its domestic goals to external adjustment, the foundation of monetary power can be understood as the capacity a state has to avoid adjustment costs when it faces a balance-of-payments' disequilibrium (Cohen 2009a, p.5).

There are two relevant dimensions of monetary power: internal and external (Cohen 2015, pp.54–56). The internal dimension of monetary power refers to *the capacity a state has to isolate itself from external influence or coercion and so formulate and implement its domestic politics*, i.e. the greater capacity the state has, the more it enjoys *autonomy*. The external dimension of monetary power relates to *the capacity of a state to control the behaviour of others*, i.e. the state has a degree of *influence* over other states. As Cohen (2015, p.30) explains, "conceptually, influence and autonomy may be understood as two distinct (albeit interrelated) dimensions of power; … the logical complement of influence is autonomy". While complementary, these dimensions are not inversely correlated. It is possible for a state to have autonomy without having influence; however, it is hard to think that a state could exert much control over other states without some degree of autonomy.

In monetary relations, power is fundamentally related to the notion of autonomy. Since, as Cohen (2015, p.48) noted, “the ultimate foundation of monetary power lies in a capacity to avoid the costs of payments adjustments,” a state is considered powerful insofar as it can isolate itself from external influence or coercion and so formulate and implement its domestic policies (Cohen 2015, p.48). As monetary relations are inherently reciprocal, when a state reaches a degree of operational independence it automatically creates a potential influence.

The most illustrative example of a state that has managed to avoid the burden of external adjustment is the United States. For more than three decades, the US’ current account balance has been in persistent deficit (except for a small surplus registered in 1991) (Figure 1). Saudi Arabia, West Germany and Japan have all financed the US trade deficit in the past. And largely due to China’s current massive dollar holdings, the US has been able to delay adjusting its current account deficit in the present. A deficit in the current account essentially means that total US expenditure – government, enterprises, and individuals – exceeds its income. America’s unmatched capacity to avoid making the external adjustment represents the fact the US enjoys more monetary power than any other state (Chin & Helleiner 2008, pp.92–93; Cohen 2009b, p.29).

FIGURE 1: UNITED STATES' CURRENT ACCOUNT BALANCE (PER CENT OF GDP), 1970-2014



Source: World Development Indicators, World Bank. Elaborated by the author.

America's supreme monetary power is closely linked to the role of the US dollar in the IMS. By adding to the US government's ability to finance its deficits over time, the dollar amplifies America's capacity to delay external adjustment. Put differently, because the dollar is accepted worldwide for public and private transactions, the US government does not need to make the adjustment most states do when they face an external imbalance.

According to Cohen (2015, pp.48–49), there are two ways a state can avoid adjustment costs: by *deflecting* the burden of adjustment on to others; or by *delaying* it. Indeed, instead of generating an external surplus to compensate its deficits, the US government can print money to pay its international obligations (deflect) or issue more external debt (delay) as long as the dollar continues to be accepted as an international currency. This macroeconomic flexibility is known in the literature as the *exorbitant privilege*, a term coined in the 1960s by Valéry Giscard d'Estaing, Charles de Gaulle's Minister of Economy, to refer to the advantages of the dollar being the international reserve currency (Eichengreen 2011a, p.4; Cohen 2012, p.17).

Alongside the exorbitant privilege, other benefits of issuing an international currency include i) reduction of transaction costs for companies and residents; ii) international seigniorage gains; iii) political leverage; and iv) international reputation, or *soft power*[5]. The advantage of lower transactions costs means that companies can expand their businesses abroad at a reduced cost and that residents can use their own money when travelling abroad, warranting a net positive impact to the issuing country. International seigniorage, for its turn, represents a real-resource reward for the issuing country, as explained by Cohen (2012, p.16):

> Since no interest is paid on the cash liabilities of a central bank, holdings of its notes and coins abroad represent the equivalent of an interest-free loan to the issuing country. … The second component, rather more substantial, derives from foreign accumulations of financial claims denominated in the home money, an increase of effective demand for assets. Typically motivated by liquidity considerations, the added demand has the effect of driving the cost of borrowing below what it might be otherwise.

That means whenever non-nationals acquire some amount of national money, either actual cash (bank notes and coins) or financial claims denominated in the domestic money, this generates cross-border seigniorage for the issuing country of an international currency. Eichengreen (2011a, p.3) has put it succinctly: "it costs only a few cents for the Bureau of Engraving and Printing to produce a $100 bill, but other countries have to pony up $100 of actual goods and services in order to obtain one".

Political leverage and international reputation are benefits derived from issuing an international currency that cannot be easily measured. When independence from external influence is achieved, the consequent dependence of other countries gives leverage to the issuer of an international money. According to Cohen (2012), leverage can be exercised directly or indirectly. Direct leverage, which has been named *enforcement* by Kirshner (1995, p.116), "is the manipulation of the rules of the system in order to sanction (or support) member states".

[5] The concept of soft power was coined by Joseph Nye in *Bound to Lead* (1991) and refers to the ability to get what you want through attraction or co-option rather than coercion.

Indirect leverage, or *entrapment* according to Kirshner (1995), works through systemic infrastructure to change material-incentive structures. For instance, as states accumulate foreign reserves, they acquire an interest in the stability and value of that currency, creating a certain affinity between their interests and those of the country issuing the international currency. Finally, an international currency can also endorse intangible forms of influence for its issuer, contributing to a state's international reputation (soft power).

An international currency not only brings the issuing state benefits, but also the potential risks of (i) currency appreciation; (ii) external constraint on monetary autonomy; and (iii) policy responsibility. First, increased international demand can lead to an undesired exchange-rate appreciation. While this overvaluation may be convenient for consumers, enhancing their purchasing power, it can easily jeopardise the competitiveness of a country's exports. Second, the excessive accumulation of liquid foreign liabilities can create an unwelcome external constraint on domestic monetary autonomy. Third, the worldwide envied exorbitant privilege may lead to a burden of policy responsibility, i.e. international monetary leadership may compel a state to change its domestic economic policy to contain a crisis (Cohen 2012, pp.19–20).

While the net balance of issuing an international currency can be positive or negative (Cohen 2015), there is little doubt about the advantages of a state having *monetary monopoly* or *exclusivity* within its borders (Cohen 2004). Having monetary monopoly means that the national currency retains exclusivity in the domestic context, a situation that contrasts when a state *subordinates* or *shares* its monetary sovereignty (Cohen 2004). Subordination here refers to a vertical hierarchy among states, in the form of a bilateral exchange-rate peg or, in its stronger version, a currency board. In its extreme, subordination corresponds to the full adoption of a foreign currency, what is called dollarisation[6]. Sharing represents a horizontal alliance among states. It can be achieved by fixing mutual exchange rates or by replacing existing monies with a joint currency. While intuitively a horizontal alliance may seem better than a vertical one, it requires building a collective governance to manage the money – a challenge that the euro experience has made demonstrably clear.

In light of the pitfalls of both subordination and sharing, states have an incentive to retain their monetary monopoly. There are, moreover, several advantages to monetary exclusivity – benefits that in many ways mirror those associated with issuing an international currency, but at the domestic level, namely: (i) availability of monetary policy instruments for macroeconomic management; (ii) reduction of domestic transactions costs; (iii) seigniorage gains; (iv) political symbol to promote national identity; and (v) independence from external influence or constraint. Except for the reduction of domestic transaction costs, which can be considered a benefit to both the government and societal actors, all of the remaining benefits of monetary sovereignty support the effective power of the government.

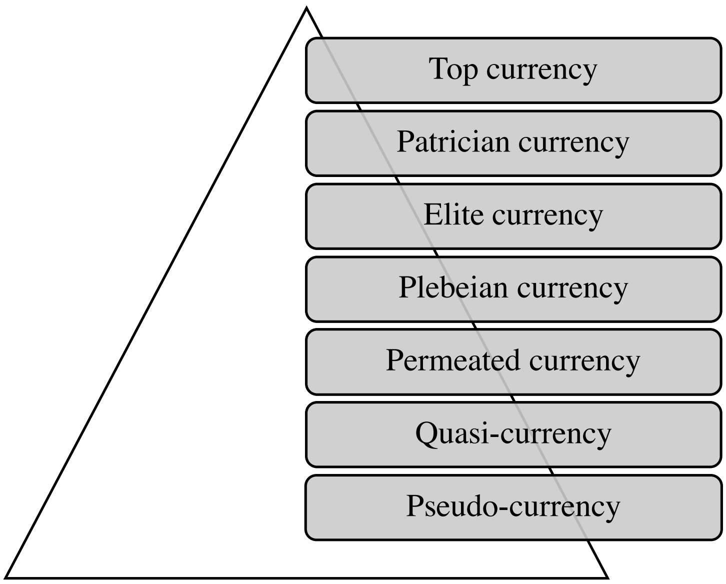
While states have thus many incentives to enforce the use of the domestic currency within their domestic borders, the reality is that domestic currencies are subject to international competition. As a result, a few popular currencies may expand their domains beyond the jurisdiction of the countries that issue them (*currency internationalisation*), but less popular currencies are likely to suffer a direct invasion of traditional territorial domains – partially or totally – consequently weakening their use and influence (*currency substitution*) (Cohen 1998, p.93).

---

[6] Although the term is derived from the use of the US dollar by several economies, the term dollarisation refers to any situation in which a foreign currency replaces the national currency.

The hierarchy of the different currencies around the world has been associated with the image of a pyramid (Cohen 1998; Cohen 2004; Cohen 2015) (Figure 2). According to Cohen (2015, p.16), the currency pyramid is useful because it "is narrow at the peak, where one or a few moneys dominate, and increasingly broad below, reflecting varying degrees of competitive inferiority". Cohen (2015, pp.15–19) defines seven categories of currencies based on the purposes of their international use (medium of exchange, unit of account and store of value by public or private agents) and their international reach (global, regional, little, or none).

FIGURE 2: THE CURRENCY PYRAMID



Source: Cohen 2015, 16.

Following these features of purposes of use and geographic reach, *Top currencies*, which is a term borrowed from Susan Strange's classical typology of international currencies, are "those whose use dominates for most if not all types of cross-border purposes and whose popularity is more or less universal, not limited to any particular geographic region" (Cohen 2004, p.14). This position was occupied exclusively by Britain's pound sterling before World War I, shared between the pound and the dollar during the interwar period, and solely occupied by the greenback since World War II.

Immediately below the Top currencies are the *Patrician currencies*, a group of currencies which have substantial and widespread use for cross-border purposes, but one that are somewhat less dominant and universal. For most observers, today's examples of Patrician currencies probably would be the euro and the yen.

Next are *Elite currencies*, which are "of sufficient attractiveness to qualify for some degree of international use but of insufficient weight to carry much direct influence beyond their own national frontiers" (Cohen 2004, p.15). This group of more peripheral international currencies likely includes the British pound, the Swiss franc and the Australian dollar.

Below the Elite currencies are the *Plebeian currencies* which, while retaining exclusivity in the domestic context, are of little importance abroad. Broadly speaking, Plebeian currencies are issued by smaller developed economies, by some middle-income emerging-market economies and by wealthier oil-exporters.

The three bottom ranks in Cohen's Currency Pyramid are currencies which, besides having no international use, gradually have their domestic terrain invaded by international currencies. Currencies that lose their domestic appeal as a store of value are called *Permeated currencies*. Currencies that are rejected by nationals not only as a store of value but also as a medium of exchange and unit of account are named *Quasi-currencies*, which have a domain more *de jure* than *de facto*. The last rank corresponds to *Pseudo-currencies*, which are currencies that exist in name only – such as the Panamanian Balboa – so that a stronger foreign currency is the favoured legal tender within national borders.

While these categories are very useful to illustrate the existence of a currency hierarchy in the IMS, they are not easy to implement for analytical purposes (Cohen 2015, p.16). Not surprisingly, studies about monetary power have been thus largely constrained to the analysis of countries that issue international currencies (or that have potential to be internationalise), repeatedly addressing the cases of the dollar, the euro and, more recently, the yuan. Despite the interest in EMDs' influence in the IMS following the 2008 crisis, and the suggestion by some that EMDs' currencies might increase their international role, little has been said about the nature of their currencies – i.e. the fact that they occupy a lower position in Cohen's currency pyramid – and the implications of this condition on their monetary power.

Recent studies by the World Bank and the IMF have demonstrated an increase in the international demand for EMDs' currencies (World Bank 2011; Maziad et al. 2011). The economic approach of those studies considers the internationalisation of EMDs' currencies in a broad sense, overlooking the idea that each of the six roles of currency internationalisation involves different benefits and costs for the issuing states (Figure 3).

FIGURE 3: THE ROLES OF INTERNATIONAL MONEY

	Functions		
Level of analysis	Medium of exchange	Unit of account	Store of value
Private	Foreign exchange trading, trade settlement	Trade invoicing	Investment
Official	Intervention	Anchor	Reserve

Source: Cohen 2015, 9.

As Cohen (2015, p.78; 2009a) has pointed out, some roles have a greater impact on states' monetary power than others. He has identified three particular roles as being especially significant: first, the two store-of-value roles, which enable the state to delay or deflect adjustment costs; second, the currency's role in trade invoicing and settlement, which is the link between the two store-of-value roles. What economic studies show, however, is that the demand for EMDs' currencies has increased predominantly in global financial markets (World Bank 2011, p.132; Maziad et al. 2011, pp.6–12). Arguably, these currencies are not working as international currencies since they do not serve as medium of exchange, unit of account or store of value (Prates 2005, p.274). Rather, these currencies function as financial assets, and the increased international demand for EMDs' currencies should actually be seen as a manifestation of their subordinated role in the IMS.

While there seems to be a consensus among specialists that EMDs face different constraints than developed economies, the idea of a currency hierarchy is by no means unanimous. Instead, the greater vulnerability of EMDs is commonly attributed to their institutional weaknesses and poor macroeconomic record, which includes external debt defaults and high inflation. In one seminal example of this perspective, Reinhart, Rogoff and Savastano (2003, p.3) introduce the concept of "debt intolerance" to explain why "many emerging market economies experience overall debt levels that would seem quite manageable by the standards of the advanced industrial economies". In their view, EMDs' restricted access to international capital markets is a symptom rather than a cause of their debt intolerance (Reinhart et al. 2003, p.59). The solution then is to rectify the institutional failings that make a country intolerant to debt, even though the authors recognise that debt intolerance is a condition that can be difficult to shed. Under the surface, Reinhart, Rogoff and Savastano (2003, p.59) seem to be also describing an IMS as somewhat hierarchical and rigid, where the process to "graduate to greater creditworthiness … is seldom fast or easy".

While the importance of sound policies and credible institutions must not be underplayed, EMDs' challenges in the IMS are not restricted to their own faults. The concept of "original sin," introduced by Eichengreen and Hausmann (1999), better encapsulates EMDs' problems. Original sin refers to the inability of a country to borrow from others using its own currency due to the structure of global portfolios and international financial markets (Eichengreen et al. 2007, p.160). This concept of the original sin is based on the costs and returns to portfolio diversification at the global level, which denote a limited appetite of international investors for international currencies. To that extent, Eichengreen et al. (2007, p.160) point out that "emerging market economies are volatile because they find it difficult to denominate their obligations in units that better track their capacity to pay, such as the domestic currency or the domestic consumption basket".

A major consequence of the original sin is the risk of currency mismatches, which correspond to the "differences in the values of the foreign currency-denominated assets and liabilities on the balance sheets of households, firms, the government, and the economy as a whole," as defined by Eichengreen et al. (2007, p.130). If countries with original sin incur a foreign debt, they face a currency mismatch on their national balance sheets, the cost of which is always high, as explained by Eichengreen et al. (2005, pp.27–28):

> Movements in the real exchange rate will then have aggregate wealth effects. This makes the real exchange rate a relevant price in determining the capacity to pay. Since the real exchange rate is quite volatile and it tends to depreciate in bad times, original sin significantly lowers the creditworthiness of a country. Moreover, the wealth effects limit the effectiveness of monetary policy, as expansionary policies may weaken the exchange rate, cause a reduction in net worth and will thus be either less expansionary or even contractionary.

To avoid having currency mismatches, many EMDs have pursued policies of reserve accumulation to insure themselves against potentially disrupting financial consequences. Yet international reserve accumulation is also costly, particularly considering that the yield on reserves is normally lower than the cost of funds.

In addition, the original sin correlates with some other macroeconomic asymmetries that characterise what Ocampo (2001, p.12) has called "incomplete" domestic financial markets.

These are related to the size and depth of developing countries' domestic financial markets, which means they traditionally face higher speculative pressures and are unable to provide long-term financing (this last feature has been referred to as "domestic original sin" by Eichengreen et al. (2005, p.25)). As a result, since EMDs' agents are unable to borrow in their domestic currencies, they are forced to incur foreign-currency denominated debt if they want access to international markets, which is generally necessary given the characteristics of their domestic financial markets.

To that extent, the underlying dynamics behind the currency hierarchy give rise to broader asymmetries in the IMS, which have essentially "centre-periphery" dimensions (Prates 2005, p.281). Since international currencies increase the policy autonomy of the issuing states, these states are less constrained by external conditions to pursue domestic goals while at the same time their policies have a greater impact on the global economy (Prates 2005, p.276). That means global shocks (of economic activity, financial flows, commodity prices and of the exchange rate of major currencies) are largely determined by the policies of centre economies. "These externalities," Ocampo (2001, p.10) argued, "are strongly felt in the developing world, which must adjust to them but lack the degrees of freedom that the ability to supply international currencies provides". There is, thus, a dichotomy between states that are business-cycle and policy "makers" and "takers," closely related to the existence of a currency hierarchy (Ocampo 2001; Prates 2005).

There is nothing perverse about the currency hierarchy and competition in the sense that some currencies are preferred over others. Currency internationalisation, as Cohen points out (2015, p.9), "may be regarded as a quite natural demand response to prevailing market structures and incentives". There is considerable agreement among specialists regarding the features which make currencies attractive outside their borders, and it is clear that only a few currencies are able to meet those requirements. On the economic side, aspects related to (i) the confidence in the money's future value; (ii) well-developed financial markets; and (iii) a broad and large transactional network are the most important features to make a currency internationally demanded. On the political side, domestic considerations about political stability and effective governance as well as international considerations about the issuing country's military capacity are equally relevant. Such economic and political attributes change over time, and that is why "no currency has ever enjoyed a permanent dominance for international use," in Cohen's (2015, p.13) words.

In addition, given the mutually endogenous relationship between currency and power (Cohen 2015, p.132), it seems unlikely that the IMS can evolve to a stage in which, for example, the key international currency is issued by a supranational organisation, so that the exorbitant privilege is enjoyed by no single state. By the same token, most states will resist abdicating from their monetary sovereignty; hence, the IMS will continue to be inherently hierarchical. Consequently, the challenge is how to deal with the consequences of such hierarchy in a context of globalisation and financial integration, or of the "integration between unequal partners," as Ocampo (2001, p.12) stated. As the next section shows, this problem has so far been unsatisfactorily addressed from the perspective of EMDs.

1.3 THE IMS SINCE 1944: AMERICAN HEGEMONY AND CONSTRAINTS FACED BY EMDS

At its most fundamental level, the IMS is the set of written and unwritten rules that governs economic interaction of public and private actors worldwide. It specifies not only the accepted means of payments for international transactions, but also stipulates the institutions and ideas. In Eichengreen's (2008, p.1) words, the IMS is the "glue that binds national economies together," being responsible for ordering and stabilising foreign exchange markets, for encouraging the elimination of balance-of-payments problems, and for providing access to credit in the event of disruptive shocks. In addition, Gilpin (1987) states that an efficient IMS must deal with three technical problems: liquidity creation, adjustment and confidence-building measures. Since the IMS stipulates the nature of international money, the policy instruments that are acceptable to adjust the balance of payments and the legitimacy of national policy objectives, it is clear that every monetary regime generates both costs and benefits for its players (Gilpin 1987; Strange 1994; Block 1977).

The current IMS, for instance, is rooted in the US economic prominence of the post-War period, when the previous monetary regime, the gold standard, was replaced by a new one – one which favoured US interests. Despite having been an international gathering of 44 nations, the Bretton Woods Conference and the international monetary arrangement that resulted from it was essentially the outcome of an Anglo-American battle, also known by its main architects: Britain's John Maynard Keynes and the US' Harry Dexter White (Boughton 2002; Steil 2013). Ultimately, White's plan was accepted with minor changes.

Mirroring White's influence at the Bretton Woods Conference, a major modification of the BWS in comparison to the previous gold standard was the central role assumed by the US dollar, which became the only currency pegged to gold, while most other currencies were pegged to the dollar.[7] In this system of fixed but adjustable exchange rates, central banks supplemented their gold reserves with international reserves holdings, most of which were denominated in dollars. The US could consequently incur deficits equivalent to the amount of dollars that the rest of the world demanded. This amount could be adjusted by the US interest

[7] This highly pro-American idea contrasted with Keynes's desire to create a new world currency, the "bancor," which was going to be issued and controlled by a supranational organisation.

rate, making it more or less expensive to buy dollars. Yet although the US was clearly the main state to benefit under the BWS, its exorbitant privilege was limited by the dollar's fixed value against gold (Isard 2005; Eichengreen 2008).

EMDs had a strong incentive to fully participate in the BWS since they were dependent on international funding, and thus expected to have access to the newly created BWIs, the IMF and the World Bank. The establishment of exchange rate stability, while fundamental to restore international trade in the developed world, created a handful of problems for EMDs. By joining the system of fixed but adjustable exchange rates, EMDs' currencies normally experienced a real exchange rate overvaluation because of the inflation differential with the US. The higher level of inflation in EMDs was, in general, rooted in money creation to finance government expenditures, since other sources of public financing were scarce due to underdeveloped domestic financial markets (which, for its turn, was one of the reasons why EMDs were so eager in having access to international capital).

Economic authorities in EMDs often tried to circumscribe real exchange rate overvaluation by introducing trade and exchange rate controls, but eventually balance of payments crises were unavoidable (Edwards & Santaella 1993, p.408). The sources of these instances of external disequilibrium were twofold: on the one hand, expansionary fiscal policies led to an increase in the demand for tradable goods, augmenting imports; on the other hand, real exchange rate overvaluation decreased the country's exports competitiveness. The result was a worsening in the current account and an erosion of international reserves that sooner or later forced a balance of payments' adjustment.

Furthermore, being traditionally exporters of primary products, EMDs were also more vulnerable to external shocks in terms of trade. According to Eichengreen and Kenen (1994, p.30), developing countries had lobbied for a network of commodity agreements to stabilise the prices of primary products, but ended up agreeing to the foundation of the Compensatory Financing Facility (CFF) within the IMF. The CFF was designed to provide reserve credit to primary-producing countries in case of an unexpected drop in their exports earnings, which can be considered a second best solution since it remedied the consequences of the problem rather than the problem itself. The manner in which the CFF was established is only one example in which EMDs' complaints were in vain. Despite their active role in financial and trade matters, as registered by Eichengreen and Kenen (1994, p.31), their demands were consistently suffocated and their problems were circumscribed in order to avoid disturbing the vitality of the developed world.

In the early 1970s, the end of the dollar-gold system precipitated the breakdown of the BWS. Amidst massive flows from the dollar, the Nixon administration closed the gold window in August 1971, suspending the conversion of dollars to gold. The dynamics of the BWS relied on a very specific political and economic context of the post-war that gradually changed to pressure the basic requirements for its functioning (Eichengreen 2008, chap.4). In particular, the restoration of current account convertibility in Western Europe in 1958 and the rising international capital mobility that resulted from the development of the Euro-markets and other financial innovations added to the change in the political circumstances that challenged the international cooperation behind the Bretton Woods arrangement. On the one hand, West Germany and other industrial countries saw their support for the dollar increasingly at odds with their economic objectives at home, particularly regarding price stability. On the other hand, the US government was having its autonomy circumscribed by the BWS, since its expansionary policies were considered incompatible with pegging the dollar to gold, which triggered the flight from the dollar in the early 1970s. In this context, the US government decided to break its commitment in a unilateral act and simply communicated its decision to the international community, including the IMF (Eichengreen 2008, p.131).

In the post-Bretton Woods system, the dollar remained as the key international currency but it was no longer tied to any real commodity. The suspension of the dollar's convertibility into gold granted the US a greater degree of policy autonomy because it allowed the US to incur recurring current account deficits. This elevated degree of freedom combined with the central position of the US in the IMS added to the instability of the system. The US faced no external constraints to pursue its domestic monetary policy objectives in interest and exchange rates, but the results of these objectives, due to the central role of the US dollar in the IMS, affected the whole world.

An illustrative example of when US domestic priorities distressed the IMS was in the aftermath of the second-oil shock in 1979. Being a net oil importer at that time, the increase of oil prices by OPEC triggered inflationary pressures in the American economy. The US Federal Reserve Board responded by increasing American interest rates to contain the rise in domestic prices. While the primary goal of the US government was to hold inflation, the rise of American interest rates enlarged Latin American external debts, which were denominated in dollars and based on floating interest rates.

The exorbitant privilege the US government has enjoyed because of the key international role of its currency is only one way in which the organisation of the IMS meets American interests. Besides assigning a central role to the US dollar, the Bretton Woods Conference also established the creation of two international financial institutions: the IMF and the World Bank. The IMF was founded to promote and monitor international economic policies as well as to provide short-term financial assistance to meet temporary balance of payments needs. The World Bank, by contrast, was designed to finance economic reconstruction and development. Both institutions are organised through a quota system and, unsurprisingly, the US holds the largest share in each.

American influence in the BWIs, particularly in the IMF, occurs not only through formal channels – such as voting and procedures – but also through informal rules that allow the US to set the agenda and control certain outcomes (Stone 2011, p.13). Stone (2011, p.55) shows how informal governance practices that "centralize decision making authority, limit effective participation and restrict the flow of information" have allowed the US to exert a decisive influence over the IMF (see also Copelovitch 2010). Other factors, such as the fact that the BWIs are located in the US capital, also add to the US's tremendous organisational advantage over other countries.

The US has been able to exert influence in the IMS further through the diffusion of ideas and policy prescriptions. In money matters, ideas are particularly important because of their distinctive relationship with "market sentiment," as noted by Kirshner (2003, p.13), and "the overwhelming influence of that sentiment on the ability to practice macroeconomic policy". In other words, while certain policies may be possible from an economic theory perspective, they will only be sustainable if market actors judge them as "credible". The perception of credible policies, for its turn, changes over time and seems to be driven more by political than economic reasons. For instance, while there is no clear evidence that free capital flows is the best policy option[8], the IMF's recommendation changed in the late 1990s from capital controls to the elimination of capital controls (Kirshner 2003, p.6; Gallagher 2015, pp.69–70; Fritz & Prates 2013, pp.3–4). Hence, pursuing financial liberalisation became a way for states to create policy credibility, signalling to the market that they were pursuing the "right" policies.

Despite some changes from the original BWS, the core of the prevailing IMS has remained the same: its focal point has remained firmly centred on the US and the use of the dollar. Once

[8] "The competing argument," as well noted by Kirshner (2003, p.5, footnote 3), "is not that capital flows are bad but rather that completely deregulated capital would lead to a suboptimally high level of flows".

established, the IMS is very rigid and network externalities work in favour of the dominant power. In Cohen's (2015, p.132) words, "currency internationalization does influence state power; state power does influence currency internationalization," in a mutually endogenous relationship. In the case of the current IMS, leading scholars have recognised that the key role of the US dollar "has both reflected and reinforced America's global prominence" (Helleiner & Kirshner 2009b, p.1). Furthermore, US monetary power is reinforced by a system largely dominated by American ideas and international institutions where the US has veto power, both of which contribute to the IMS' inertia.

The US power in the IMS contrasts with the power of other countries for which the global monetary arrangement was given. EMDs in particular have historically faced high external constraints not only because of the nature of their currencies (as discussed in the previous section), but also for being international debtors rather than creditors, particularly in the BWIs. Besides having to deal with the disadvantages of issuing non-international currencies, EMDs have often had to subordinate to the BWIs' policy prescriptions in order to obtain the international resources on which they depended. To be sure, they needed to follow a certain set of "desired" macroeconomic policies not only to receive loans from the BWIs but also to be able to attract private international capital flows.

Adhering to these mainstream policy recommendations, however, proved to be self-defeating for many EMDs in the late 1990s. After sticking rigidly to the so-called Washington Consensus[9], many EMDs faced severe financial crises in the late 1990s. Disappointed by the response of global financial institutions and in the absence of perspectives for substantial

[9] The term Washington Consensus was coined by John Williamson in 1989 and originally referred to a set of 10 economic policy prescriptions agreed by Washington-based institutions (including not only the IMF and the World Bank but also the US government) to Latin American countries. The set of policies included trade liberalisation, privatisation and deregulation. Subsequently, the term has been widely (and wrongly) used as a synonym with "neoliberalism" and "market fundamentalism" (Williamson 2004; Williamson 2000).

reforms to reduce the instability within the IMS, most EMDs, particularly in Asia, started policies of international reserve accumulation as a self-insurance balance of payments strategy (Aizenman et al. 2004; Rodrik 2006). In 2008, EMDs accounted for some 65 per cent of global reserves, against only 28 per cent in 1990 (Aizenman et al. 2010, p.1).

Self-insurance policies also aimed to reduce dependence on the BWIs. EMDs gradually reduced their exposure to debt denominated in foreign currency by improving their debt profiles and paying-off their debts with the IMF. Further, they created and deepened mechanisms of monetary and financial regional cooperation. Following Asia's example, where the ten[10] members of the Association of Southeast Asian Nations (ASEAN) plus China, Korea and Japan (ASEAN+3) launched the Chiang Mai Initiative in 2000, South American countries began to invest in their own mechanisms for monetary and financial cooperation, such as the Mercosul Structural Convergence Fund (FOCEM, *Fundo para Convergência Estrutural do Mercosul*) (2005), the Local Currency Payment System in Mercosul (SML, *Sistema de Pagamentos em Moeda Local*) (2008) and the Banco del Sur (2009).

The ability to pursue these self-insurance policies was made possible by a particular set of international economic conditions. China's integration into the global economy led to a boom in commodity prices since the early 2000s which has mostly benefited EMDs, which traditionally are commodity exporters. The commodity run up represented an improvement in terms of trade for EMDs and, hence, translated into lowered external constraints. Moreover, the commodity boom was coupled with a moment of abundant international liquidity caused by America's loose monetary policy. A considerable part of these resources was directed to EMDs, which offered higher rates of return than their developed peers. Such favourable

[10] The ten ASEAN members are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

international conditions helped EMDs to reduce their exposure to debt denominated in foreign currency and accumulate international reserves so that these countries were less vulnerable to external shocks when the 2008 crisis erupted.

As a result of these policies, the interval between the EMDs' crises in the late 1990s and the 2008 global financial crisis corresponded with a period when EMDs relatively reduced their dependence on global financial institutions and increased their autonomy in terms of economic policy-making. This enlarged autonomy served to lessen the relative power of the US as it represented a decrease in EMDs' dependence. While this unprecedented greater degree of autonomy was welcome, it did not change the underlying power relations of the IMS rooted in the currency hierarchy previously discussed. As the next section shows, studies on EMDs' influence in the IMS during and immediately following the 2008 crisis have generally overlooked the continued subordinated position of EMDs' currencies, focusing instead on their participation in global financial governance and on their capacity to influence ideas/policy prescriptions.

1.4 EMDS' INFLUENCE IN THE IMS DURING THE 2008 CRISIS: HOUSE OF CARDS

The 2008 global financial crisis differed from other crisis episodes in two principal ways. First, EMDs were much less vulnerable to external shocks than they had been previously (Canuto 2010, p.40; Canuto & Giugale 2010, p.9; Helleiner & Pagliari 2010). Second and most importantly, the crisis originated in the US financial system (Bordo 2008, p.2; Helleiner 2010). The origins of the crisis were rooted in America's lax financial regulation and supervision, practices which were, for their turn, supported by the principles of financial liberalisation that had been vaunted by the economic mainstream (Helleiner 2010, pp.628–630). Financial deregulation allowed the creation of some financial innovations in the American financial system, which transformed high-risk mortgage assets (now popularly known as subprime) into prime assets. Problems arose when US housing prices began to decline and those high-risk borrowers with adjustable-rate mortgages were unable to refinance their debts. The default of those debts unveiled the existence of *toxic* assets in many American and European financial institutions. Governments bailed out key financial institutions to prevent cascading effects bankruptcies in their financial system, along with large fiscal stimulus packages (Bordo 2008, pp.3–4).

For some observers, the crisis was symptomatic of America's decline, not the least because it represented a failure of the American model of deregulated financial markets (Helleiner & Pagliari 2011, p.183; Helleiner 2010, pp.629–630; James 2010). To be sure, scepticism concerning the continuation of an US financial leadership arose not only because of the crisis but rather as the final straw in an ongoing legitimacy crisis that had started a decade before with the financial crises in EMDs (Helleiner 2010, pp.627–629). The mainstream interpretation for the 1997-8 crisis blamed policy mistakes within developing countries, where the crisis had originated, underplaying the role played by speculative global financial flows (Helleiner 2010, p.628; Helleiner & Pagliari 2011). Yet by the 2008 crisis, these unregulated financial markets were ultimately acknowledged as a source of international instability even by the most enthusiastic supporters of free market finance, such as Alan Greenspan, who was chairman of the US Federal Reserve from 1987 to 2006 (Helleiner 2010, p.628). As noted by Helleiner (2010, p.629):

> In contrast to 1997–8, the epicenter of this crisis was in their markets, generating massive taxpayer bailouts of private financial institutions and severe effects on their economies. These developments provoked strong political pressure within each country to tighten regulation on financial markets, both at home and internationally. When the crisis spread from the transatlantic region to the world economy as a whole, policy-makers elsewhere echoed the criticisms in the core, often reminding British and American policy-makers

of points they had raised after the East Asian crisis.

Due to their former experiences with financial crises, EMDs' financial systems were in general better isolated than those of their developed peers and were less contaminated by toxic assets. With many American and European financial institutions going bankrupt during the crisis, banks located in EMDs climbed in the rank of largest world banks, serving to increase their home governments' influence in international regulatory politics (Helleiner & Pagliari 2011, p.176). In this context, EMDs' reduced vulnerability was translated into greater autonomy, making them increasingly significant actors in global financial markets.

The prospects for a change in the IMS balance of power were further increased because, for the first time, EMDs were part of the solution rather than the problem, i.e. they were creditors in the IMS. In this condition, EMDs were able to fund part of the financial rescue for US and European institutions through their sovereign wealth funds, central banks holding reserves, and state-owned development banks (Helleiner & Pagliari 2011, pp.175–176). This creditor position in the context of the crisis called attention to the EMDs' economic power, and particularly that of China's, while at the same time exposing US financial dependence on foreign support (Helleiner 2010, p.629; Chin & Helleiner 2008, p.88).

The most symbolic representation of EMDs' prominence during the crisis was the elevation of the G20 from a minister gathering to a leaders summit in November 2008, by a request of US President George W. Bush. This recognition of the importance of EMDs subsequently spilled over into other forums. The deliberations under the G20 influenced the expansion of the Basel Committee on Banking Supervision (BCBS) to include Australia, Brazil, China, India, Mexico, Russia and Korea in March 2009. Following the April 2009 G20 summit in London, the

Financial Stability Forum (FSF) was also enlarged to include all members of the G20 that were not members of the FSF, which then became Financial Stability Board (FSB).

The elevation of the G20 propagated EMDs' influence over the BWIs. Following the reform of the IMF's quota and voice in April 2008, in 2010 the Fund agreed (with more than 95 per cent of the total voting power) to enact wide-ranging reforms that increased the participation of EMDs, mostly at the expense of European countries.[11] (The 2010 reform entered in force only in December 2015, after a 5-year delay of the US Congress in ratifying it). The 2010 reform not only placed Brazil, China, India and Russia among the top 10 IMF shareholders, but it also ended the category of appointed Executive Directors hitherto enjoyed by US, Japan, UK, Germany and France. In 2010, the World Bank also approved a reform that gave developing countries more influence, besides agreeing to the first general capital increase (USD 86 billion) for more than 20 years. In 2012, the IMF embraced a new institutional view supporting the use of capital account regulation, therefore echoing EMDs' views.

Being part of the solution, i.e. having economic firepower during the global crisis, gave EMDs the opportunity to put their demands on the table with more power than ever before. In particular, they were successful in pressuring for reforms in the traditional BWIs, not only to increase their quotas but also to influence IMF's recommendations. This unprecedented weight of EMDs in using international cooperation to their interest has been interpreted as a sign of their increased power in the IMS (Gallagher 2015; Helleiner & Pagliari 2011).

According to several scholars, another major sign of EMDs' increased relative power was their capacity to influence a change in the IMF's recommendation for capital account liberalisation, one of the central pillars of the so-called Washington Consensus (Gallagher 2015; Helleiner &

[11] One exception was Spain, for example, whose share rose from 1.68 per cent to 2 per cent in the IMF reform.

Pagliari 2011). The IMF and the international community eventually recognised that easy monetary policies in developed countries, particularly the quantitative easing in the US, were creating negative spillovers for developing economies, which experienced a surge of inflows in the aftermath of the financial meltdown. The Brazilian Finance Minister Guido Mantega identified these excessive capital flows as a "currency war," which besides increasing volatility for EMDs also overvalued their currencies and served to weaken their international competition and their capacity to recover from the crisis. To counteract these spillovers, Brazil and other EMDs developed a series of regulations to mitigate the effects of cross-border financial flows, and these policies were eventually deemed legitimate by the IMF.

Some prominent specialists have perceived this autonomy of some EMDs' authorities to go against the mainstream view and implement domestic regulations to insulate their economies from exogenously determined volatility as a form of power. Helleiner and Pagliari (2011, p.177), for instance, argue that not only has China been reinforcing its "power-as-autonomy" by lessening the dependence of domestic firms on US and European markets, but also other EMDs, such as Brazil and India, have increased their ability to pursue independent regulatory paths. In a similar line, Gallagher states that "changes in global economic governance of capital flows were in part a function of *countervailing monetary power*, whereby at the national level EMDs were able to counter political pressure and sophisticated global capital markets to manage their financial stability between 2009 and 2012" (Gallagher 2015, p.12).

In addition, the strengthening of the BRICS' group and the creation of new international financial institutions (IFIs) reinforced the growing claims about EMDs' monetary power. During the 6th BRICS Summit in Fortaleza, in July 2014, the BRICS states founded two institutions: the New Development Bank (NDB) and the Contingent Reserve Arrangement (CRA). With a focus on funding infrastructure and sustainable development, the NDB's initial authorised capital totalled US$100 billion, with an initial subscribed capital of US$50 billion, which was equally distributed amongst the founding members as were the voting rights. The CRA is a currency reserve pool to provide liquidity in case of balance of payments difficulties, worth US$100 billion. Unlike the equal distribution of the NDB, the CRA is funded 41 per cent by China, 18 per cent from Brazil, India, and Russia, and 5 per cent from South Africa.

The creation of a developing-country alternative to global development finance has been welcomed by most critics of the prevailing IMS (Stiglitz 2014; Griffith-Jones 2014). Born out of resentment over the BWIs, the BRICS' institutions were seen as a way to balance economic and political power in the global economy. These institutions may potentially generate a more balanced view on policy prescriptions in the future, since they will project the perspectives and beliefs of their members in key policy areas, such as macroeconomic policies, economic development and social policies. Moreover, the NDB in particular represents an additional source to supplement funding for infrastructure projects in EMDs, whose current supply falls short of demand, impairing economic growth.

Albeit symbolic, these EMDs' achievements were insufficient to trigger an actual change in the system as the NDB and the CRA have so far failed to occasion a significant departure from an US-centric IMS. This is due to two particular reasons. First, all of the start-up funding for the NDB was in dollars, contrasting with only 10 per cent of the World Bank's paid-in capital for instance (Steil 2014b). Second, big loans from the CRA will be contingent on the IMF's approval and therefore fail to reduce the role of the US dollar and from the traditional BWIs. In Eichengreen's (2014) words, "the CRA is empty symbolism". Thus, despite being based on a critical discourse about the prevailing IMS, the NDB and the CRA did little to overturn the previous balance of power in the currency hierarchy.

If we accept that monetary power is the capacity of a state to avoid the burden of adjustment to external imbalances, a burden which is strictly related to a state's position in the currency hierarchy, it seems that little has changed in the IMS's balance of power in the post-crisis period. Nearly a decade after the 2008 crisis, the dollar remains supreme and there is little threat from other competitors – at least for the moment. As Cohen (2015, p.159) said:

> Were Europe to get a real grip on its prolonged crisis, the euro might yet stage an effective challenge to the dollar; China's RMB might eventually take a place commensurate with the size of the Chinese economy; conceivably, even the currencies of other emerging market economies, such as India or Brazil, could begin to attract international use. The message is simply that none of this has happened *yet*. Loose talk about the shape of the currency system as it presently exists is misleading and a deterrent to serious analysis. Multipolarity is not (yet) the new normal.

To that extent, it should be of no surprise that as international conditions began to change, new external constraints gradually terminated EMDs' previously celebrated economic policy autonomy. There were two main global reversals that impaired economic performance of the developing world. First, in February 2014 the US Federal Reserve began a gradual reduction, or taper, of its policy of buying bonds which it had started after the crisis to boost their economic recovery, known as quantitative easing. This change in American monetary policy triggered a capital outflow from EMDs, which was further reinforced when the Fed announced in December 2015 the first rise in US interest rates since they were brought effectively to zero in 2008. Second, the big boom of commodity prices ended. Prices began to slow down in 2011, but remained at high levels until 2014. Then, oil and metal prices plunged, in part the result of a reduction in Chinese demand, worsening terms of trade for commodity-exporting countries.

These setbacks in the global economy progressively exposed EMDs' weaknesses and recalled expectations around their growing influence. In August 2013 Morgan Stanley dubbed the term "fragile five" (Brazil, Indonesia, South Africa, India and Turkey) to describe currencies that “will face headwinds over the medium term from various factors ranging from high inflation, high Real Effective Exchange Rate (REER), external vulnerability from initial conditions, and vulnerability to further external deterioration based on a heavy reliance on fixed income flows and/or China related risks” (Lord 2013, p.16). Weaker currencies meant increasing constraints to finance EMDs’ current account deficits, at a moment when external funding became costly and scarcer. Once again, much of EMDs’ vulnerability centred around the nature of their currencies and the interrelated fact that, ultimately, they persisted as business-cycle and policy takers.

Symptomatic of EMDs’ loss of prestige was the decline of the G20 as the main forum for international macroeconomic cooperation. From 2011 onwards, the two annual summits held in 2009 (London and Pittsburgh) and 2010 (Toronto and Seoul) gave place to one annual summit, in which multiple topics began to be included on the agenda. In the November 2011 Cannes Summit, the G20 adopted “an ambitious but rather vague agenda,” according to Grevi (2011, pp.1–2), an agenda that was soon left at the sidelines given the spiralling of the Eurozone crisis. As the risk of global financial contagion disappeared and the epicentre of the crisis moved from the US to the EU, the G20 lost its priority on the agenda of developed economies, since the Eurozone crisis had its own management committee, the Troika (formed by the IMF, the European Commission and the European Central Bank). In the developing world, meanwhile, EMDs’ economies struggled to deal with the monetary spillovers of the developed world’s monetary policies. EMDs were left to “twist in the wind,” said Steven Englander, head of currency trading for major industrialised nations at Citigroup Inc. (quoted in Goyal 2014).

In sum, the general assessment about EMDs’ influence in the IMS after the 2008 crisis suggests there are at least two main areas for further research. First, as put forward by Cohen, more attention should be given to the prevailing currency hierarchy and its underlying power relations to avoid further illusions about EMDs' actual monetary power. Second, the debate about monetary power needs to go beyond currency power in order to understand the case of EMDs (China excepted). That means clarifying to what extent EMDs' influence in global financial governance and ideas/policy prescriptions can be considered a sort of monetary power. The case study of Brazil which follows in the next chapters will serve to shed some light on these debates.

1.5 CONCLUSION

The 2008 crisis and its immediate aftermath created a puzzle to understand EMDs' influence in the IMS. Since EMDs were relatively less affected by the crisis than developed economies, many argued that the IMS had been in the midst of a major transformation in which EMDs would have a greater say. Indeed, it was the first time that EMDs were able to influence the agenda of global financial governance and also to confront mainstream ideas. Yet once the worst of the crisis had passed, EMDs' influence began to lose steam. This is not to say that in hindsight EMDs' influence during this period should be considered null and void. In the aftermath of the 2008 crisis, the BRICS group gained relevance, particularly in light of the creation of two new international financial institutions, the NDB and the CRA. Led by EMDs, these new institutions potentially represent a potential threat to the dollar-centric IMS structured around the BWIs. As it soon became evident, however, the new IFIs broke little ground with the previous arrangement, not least because they failed to reduce the dependence on the dollar.

The currency hierarchy must be the starting point for any monetary power analysis because it explains the differences between states in the IMS. As argued in this chapter, a basic distinction among states is whether they issue international or non-international currencies. Issuing an international currency gives a state a series of advantages, particularly helping them to avoid adjustment costs when they face balance of payments disequilibrium (Cohen 2015; Cohen 2009a).

While currency power is central to the analysis of monetary power, it circumscribes the possibilities for understanding the role of states whose currencies are not internationally relevant nor will they be in the foreseeable future. Since only a few currencies are able to meet the requirements for internationalisation, the existing framework to analyse a state's monetary power excludes most countries in the IMS.

This gap in the theory needs to be addressed if academic literature wants to understand the role played by states like Brazil, India, Russia and other EMDs with low prospects of issuing global currencies. While these states will likely never issue an international currency, they nonetheless carried some influence in monetary affairs in the aftermath of the 2008 crisis.

This influence, however, is much less powerful than the influence from states that issue international currencies. To that extent, while currency power should remain central in determining a state's monetary power and the hierarchy in the IMS, monetary power theory needs to advance in order to better qualify the power of states in the base of the currency pyramid.

One way to improve the understanding about the role of EMDs in the IMS is to incorporate formally the role of ideas and global financial institutions in the monetary power analysis. Since the organisation of the IMS concerns not only the accepted means of payments but also the institutions and ideas that govern worldwide interactions, it seems reasonable to consider the latter two features.

As argued in this chapter, part of the inertia working in favour of the status quo system are the institutions and ideas, features that have so far mainly reflected US influence and interests. If changes in terms of currency are of little significance, the same cannot be said about institutions and ideas. While the change in institutions and ideas did not challenge the core of the IMS, many scholars seem to agree that EMDs' influence has nonetheless increased.

In this light, perhaps some distinction between sorts of monetary power could be useful to understand the case of EMDs; such as *hard* and *soft* monetary power, or *economic* and *political* monetary power. In this sense, hard/economic monetary power would be Cohen's definition of monetary power and soft/political monetary power would be the power to influence institutions and ideas in monetary affairs.

The power EMDs had during the crisis to exert influence over institutions and ideas was based on a temporary hard/economic monetary power (in the sense of autonomy). Even when this autonomy faded away, some of the soft/political power acquired during the period of the crisis remained, as is evidenced by the reforms implemented in the BWIs and the creation of the new IFIs under the BRICS. Such differentiation would make it possible to recognise that even without any significant alteration in the IMS hierarchy, EMDs nonetheless increased their influence through other channels than the currency.

CHAPTER 2. THE POSITION OF BRAZIL IN THE IMS FROM 1944 TO 1994: EXTERNAL DEBT, INFLATION AND THE RELATIONS WITH THE UNITED STATES

2.1 INTRODUCTION

The Brazilian economy has changed considerably over the past three decades. In 1986 the rate of annual inflation hit 2,700 per cent and in 1987 the government declared a moratorium on its external obligations, tarnishing Brazil's image among international creditors. The Brazilian government's agreement with the IMF was suspended in 1984 after it had failed six times in less than two years to reach the economic targets agreed with the Fund. Yet by the 2000s Brazil was being hailed as a success story, playing a significant role in the global economy in the aftermath of the 2008 crisis. In the eyes of the international community, Brazil had become an important participant in the IMS and a model of economic policy and development for other states.

Taking this contrast into account, this chapter aims to provide an overview of how external constraints have historically played a major role in the direction of Brazil's economic policies. Many of the topics addressed in this chapter have already been debated extensively in academic literature although unfortunately the greater part of this scholarship is available only in Portuguese. What makes this account of this transformative period distinct is that it analyses the international political economy (IPE) literature on the international monetary system (IMS) to consider the underlying power relations between Brazil and the world's most powerful monetary states. In short, the objective in this chapter is to illustrate how the arrow of power has mainly pointed in one direction: from the IMS to Brazil.

The unprivileged position of Brazil in the IMS was manifested primarily through recurring foreign currency shortages as well as the dependency of both the government and private companies on international funding. The temporary resolution of these problems frequently depended on the direct blessing of the US government or on its indirect support through the Bretton Woods Institutions (BWIs), the IMF and the World Bank, where the US is the major shareholder. In addition, access to credit lines of international private creditors, not only in the US but also in Europe and Japan, was generally conditional on a good relationship with the IMF.

The subordination of domestic priorities to external constraints led to a politicisation of Brazilian relations with international creditors, particularly the IMF. The reason why international monetary and financial problems and domestic politics became so intertwined is because they had a direct impact on the quality of life of the population. The economic policies put in place from the 1980s to the early 1990s to deal with the problems of external debt and inflation precipitated the deepest recession in the recorded economic history of Brazil, which is known as the “lost decade”. Although the reality is more complex, a vast majority of Brazilians associate these economic policies with the IMF’s conditionalities, which has created crucial domestic political constraints on Brazilian governments’ relations with the IMF in Brazil.

The analysis in this chapter terminates in 1994 as this year represented a major turning point for Brazil. First, the external debt restructuring was completed in April 1994 with the issuance of the Brady bonds. Second, the Real Plan was launched in July 1994 and permanently brought down inflation. In the preceding years, in the words of a high-ranked official at the Ministry of

Finance: “when you had to think about inflation 24 hours a day, you had no time to think about [anything else]”.[12]

Understanding Brazil’s past as a polity that traditionally had its economic policy fundamentally conditioned by external problems is essential for conducting a post-1994 analysis. For instance, comprehending the politicisation of Brazil’s relations with the IMF allows us to see the weight of Brazil’s pre-payment of its debt with the Fund in 2005 or, more symbolically, Brazil’s rise a creditor of the Fund in 2009, amidst the world’s more severe global financial crisis. As a former foreign affairs minister said:

> Brazil could have the foreign policy it had [during the Lula government] because somehow we managed … to get rid of three mortgages, or at least two and were trying to get rid of a third. One was the democratic deficit. Brazil had the military government, which of course was a limitation for many things. I think Brazil, for several years, did not even run for the Security Council to avoid problems, it thought it could be refused, etc. Second, was the economic mortgage, the economic instability, inflation at the level that it was withdrew all the country’s credibility. I will not say this argument was expressly used, like “you cannot run for the Security Council because you have inflation”. It was not like that, but it created an image of Brazil as a fragile country. … And the third mortgage, which has not been fully redeemed, but somehow began to be rescued that is the social mortgage, the big social inequality. Brazil had a Gini index among the worse in the world. It is still bad, but improved, and has continuously been improving.[13]

In this light, this chapter reveals in which ways Brazilian economic policy-making was constrained by the IMS from 1944 to 1994. The first section looks at Brazil’s relations with the United States, which consolidated its position as the issuer of the key international reserve currency in the post-war period. The second section addresses Brazil’s historical dependency on international funding, which resulted in a major external debt crisis in the 1980s that was only resolved in the mid-1990s without the IMF’s support. The third section analyses the

[12] Non-attributable interview with a high-ranked official at the Ministry of Finance.

[13] Non-attributable interview with a former foreign affairs minister.

inflation problem and how Brazilian policy-makers overcame it, also without backup from the Fund. The fifth section concludes the chapter.

2.2 INFLUENCE OF THE UNITED STATES OVER BRAZILIAN ECONOMIC POLICY-MAKING

Since the United States' ascent as the main economic and political power in the post-war period, Brazil's relations with the US government have been strategically crucial for Brazil, not least because of the US' direct and indirect power in the IMS. Thus, many economic policy decisions made by the Brazilian government since the establishment of the Bretton Woods System (BWS) in 1944 were designed to accommodate Brazil's position in the system. Being part of the BWS was necessary not only to have access to the resources of the BWIs, but also to receive official assistance from the US government. In addition, being part of the BWS worked as a quality stamp to attract international private capital. The power dynamics of this relationship lay in the fact that in these circumstances the Brazilian government had virtually no choice but to adapt its economic policies to conform to the arrangement designed by the US.

The pressure exerted by the US (and by the IMS that the US designed) on Brazil should not necessarily be conceived as a bad thing. For instance, there is some evidence that Brazil's first embryo of a central bank had its origin in Brazil's participation in the Bretton Woods Conference (Malan 1983; Armijo 1993, p.263). The Superintendence of Money and Credit (SUMOC, *Superintendência da Moeda e do Crédito*) was created in 1945, to work together with the Bank of Brazil and the Treasury as Brazil's monetary authorities. This institutional arrangement lasted until 1964, when the SUMOC was replaced by the Central Bank of Brazil.

At other times, however, the need to fit into the BWS created serious burdens for the Brazilian government. One example was the government's effort to maintain a fixed exchange rate system, a condition Brazil had agreed to when it signed the Articles of Agreement of the IMF in July 1944[14] even though that system began to create an external imbalance for the Brazilian economy as early as June 1947. The external imbalance resulted from the Brazilian currency's appreciation in real terms against the dollar, given the differential between domestic and US inflation. To avoid devaluing the cruzeiro, the Brazilian currency of the time, which would have in theory compromised Brazil's commitment to the BWS,[15] the government introduced several import and foreign exchange controls in July 1947 (Vianna & Villela 2011, p.5).

Even when in practice its commitment to a fixed exchange rate was unsustainable, the Brazilian government maintained the formal commitment to the BWS. Accepting this constraint came with a significant cost: exchange rate controls caused serious distortions in the price system as well as in the orientation of economic activities, encouraged corruption, and gave rise to a dollar black market (Pechman 1983, pp.76–77). Yet despite these drawbacks, Brazilian monetary authorities nonetheless espoused ties to the BWS on the belief that Brazil would benefit from economic support from the US government if they acted according to American rules.

The US government's decision to support Brazil or not, however, was grounded more in domestic reasons rather than in the Brazilian government's actions. For example, the creation of the Joint Brazil-United States Commission (CMBEU, *Comissão Mista Brasil Estados Unidos*), in December 1950, was not a result of lobbying on the part of the Brazilian

[14] The Articles of Agreement of the IMF were promulgated in Brazil in May 1946 (Decreto nº 21.177).

[15] The Brazilian government kept its commitment with a fixed exchange-rate even in the face of several "illegal" devaluations carried out by some European countries during the dollar shortage in the post-war period (Eichengreen 2008, chap.4).

government to gain American support (as it had been doing since the end of the war), but rather of a change in the US' foreign policy priorities which occurred in 1949 (Vianna 1986, pp.194–195).

To be sure, the CMBEU represented not only a major qualitative change in the US' position towards Brazil, but also a possibility for the Brazilian government to finance some key infrastructure projects (Vianna 1986, p.195). The CMBEU began its activities in July 1951 with the aim of designing projects that would be financed by the World Bank and the Export and Import Bank (Eximbank). A substantial by-product of the CMBEU's efforts was the creation of the Brazilian Economic Development Bank (BNDE, *Banco Nacional de Desenvolvimento Econômico*) in 1952.[16]

The end of the CMBEU in July 1953 was also more related to American domestic politics than to actions of the Brazilian government (Neto 1990, p.164). In particular, since the late 1940s, a tension had arisen between the World Bank and the Eximbank regarding the financing of Latin America's development (Vianna 1986, p.199). The Republican victory in the 1952 US election served to increase the leverage of the World Bank over the Eximbank, removing the latter's influence from the field of developing financing. This in turn changed the US position regarding the Third World and soon after it dropped its support of the CMBEU (Vianna 1986, p.207; Abreu 2000, p.13).

Brazil's subordinated position in relation to the US was also manifested in subtle acts of its post-war governments, such as the decision to appoint Ministers of Finance and high ranked officials to the Brazilian economic team that would please US authorities (Vianna 1986, p.195). When Café Filho assumed the presidency in August 1954, for instance, he appointed Eugenio

[16] In 1982, it was renamed to the Brazilian Economic and Social Development Bank (BNDES, *Banco Nacional de Desenvolvimento Econômico e Social*).

Gudin as the Finance Minister, hoping Gudin's international influence would help Brazil to attract international resources (Neto 1990, p.152). Gudin was very well regarded in the international financial community not least because he was a fierce critic of the developmental proposals, which often mistreated international capital.

The developmentalist ideas were broadly associated with the objective of overcoming underdevelopment through state-led industrialisation. These ideas contrasted with the thinking that Brazil should stick to its agricultural vocation and aim to reduce state intervention, a point of view often referred to as liberalism.[17] In the domestic debate, advocates of this latter position associated developmentalist ideas with populism, a matter that has since been subject to debate in the Brazilian literature (Bresser-Pereira 1991; Fonseca 2011). Likewise, advocates of the developmentalist ideas labelled their opponents as submissive or surrenders to international interests ("entreguistas") in contrast to their self-proclaimed nationalist stance. These differing views were at the core of the Brazilian domestic political game and, not surprisingly, affected Brazil's relations with its international creditors. To that extent, Brazil's domestic debate on economic development was integrally associated with its position in the IMS.

Echoing this debate, Brazil's relations with the IMF have been historically surrounded by a myth that the Fund – and behind it the US – wish to subjugate Brazil through the imposition of conditionalities for the release of loans. This idea was inaugurated in 1959, under President Juscelino Kubitschek, who decided to halt negotiations for a loan from the Fund whilst selling domestically the idea that Brazil was breaking with the IMF. Kubitschek's refusal to undertake the Fund's requirements was perceived by the Brazilian people as a declaration of independence from US imperialism, with obvious political dividends (Almeida 2003, p.5). As

[17] To consider two opponent views is a pragmatic way to read a much more complex and endless debate in Brazil (see for example Fonseca 2004; Bresser-Pereira 2006; Bresser-Pereira 1991; Bielschowsky 1988).

this chapter will show, this myth of subjugation repeatedly influenced economic decisions in Brazil.

On certain occasions, it is true that the US government made explicit use of its monetary power to influence economic decisions in Brazil. For instance, in the period preceding the military coup and most notably during the presidency of João Goulart (1961-1964), the US radically changed its conditions for providing external support. Before Goulart took over, in early 1961, the US government had, in the context of the Alliance for Progress, helped Brazil to conclude agreements with European countries and the IMF and had also made a loan to the Brazilian government without conditioning it to an IMF agreement (Loureiro 2014, p.329). After Goulart took office, however, the US government would only offer its financial assistance on the condition that Brazil re-established its relations with the IMF (Loureiro 2014, p.334). This change was grounded in American suspicions of Goulart's links with communists and the fear that his actions could ideologically contaminate Brazil's government and society (Loureiro 2014, p.336).

During the first eight months of Goulart's administration, the US still released – under strict conditions – substantial financial assistance to Brazil. The reason for this more "cooperative approach," as described by Loureiro (2014, p.337) is three-fold: it was due to Goulart's moderate position at the beginning of his government; the fact that Brazil was too important of an asset to the US to be easily dismissed; and because of Goulart's limited power under the parliamentary form of government, a form of government that the US believed was soon to be consolidated with a plebiscite scheduled for early 1965.[18]

[18] João Goulart assumed power after Jânio Quadros resigned in late August 1961. The rise of Goulart displeased not only Washington but also many segments in Brazil, particularly the military, because of Goulart's past as Minister of Labour (June 1953 – February 1954) and his left-wing ideas. In the light of a very delicate political balance, Goulart assumed the presidency under a parliamentary regime – with fewer presidential powers – and a plebiscite was scheduled to decide Brazil's system of government.

By mid-1962, however, when it was clear that Goulart was going to regain his presidential powers,[19] the Kennedy administration changed its approach and used the monetary power of the US to influence the political orientation of the Brazilian government (Loureiro 2014, p.338). Knowing it had the financial resources Brazil needed, the US government opted to strengthen the anti-Goulart forces, rather than directly destabilising Goulart. In one clear example, the US government conditioned its aid on the ban of leftists in government positions (Loureiro 2014, p.339).

By mid-1963, when Goulart dropped his formerly moderate stance, the US government engaged in a clear destabilisation campaign against him. In Loureiro's (2014, p.348) words: "Alliance funds were released only to anti-Goulart forces, particularly state governors, and resources to the federal government were curtailed, except for the rescheduling of a few debts". This increased difficulty in obtaining foreign loans contributed to the already unstable political and economic environment that helped to foster the American-supported coup d'état (Spektor 2010, p.149; Fico 2008, pp.86–88). In March 1964, the US government launched "Operation Brother Sam" which was intended to support the military overthrow of president Goulart that began at dawn on 31 March 1964. As there was no resistance to the coup, the operation was disabled shortly after on 2 April 1964.

After the military took over with the full support of the US, Brazil experienced a great increase in voluntary capital inflows (mostly foreign direct investment) and external loans. From 1964 to 1967 Brazil received significant loans from the US Agency for International Development (USAID) and it became the fourth largest recipient of net external aid, standing only behind India, Pakistan and South Vietnam (Resende 1990, p.219; Hermann 2011b, p.62).

---

[19] The plebiscite to decide Brazil's system of government happened two years before originally scheduled and presidentialism was restored in January 1963.

Brazil's unprivileged position in the IMS was also revealed in moments where the Brazilian economy was affected by cycles determined by US monetary policy. Aside from obvious episodes such as the increase in US interest rates after the second oil price shock, which triggered the external debt crisis in Brazil and in several other Latin American countries, there were also some more subtle circumstances in which Brazil assumed a cycle-taker position.

In this regard, Brazil's large-scale involvement in international financial markets in the late 1960s can be associated with the increase in international liquidity generated by US expansionary policies at that time. The upsurge in the supply of international credit allowed countries like Brazil, which previously had no regular access to international financial markets, to become borrowers on a large and increasing scale (Batista 1987, p.11).

From 1967 to 1973, Brazil's medium- and long-term external debt rose from USD 3.3 billion to USD 12.6 billion, whereas the share of loans from private sources in the total public debt climbed from 26.9 to 64.1 per cent (Batista 1987, p.4). While part of this rapid increase in Brazil's foreign debt was due to a deliberate policy of attracting capital pursued during the government of Castelo Branco, the strong expansion of credit supply in international markets had an equally significant role on capital inflows. Thus, increasing external indebtedness in Brazil at that time cannot, in Batista's (1987, p.11) words, "be seen as an isolated phenomenon or as the result of a fully planned strategy of the Brazilian economic authorities".

US influence over Brazil was not merely through direct assistance and political and economic pressure, but also occurred through indirect channels and in particular through the BWIs. In the words of a former finance minister:

> Because who conducted, for example, the entire external debt crisis was the US Treasury; not the IMF or the World Bank. The US Treasury delegated to the World Bank the structural reforms, etc. and delegated to the IMF the negotiation of the debt. But always,

> and directly, under the Treasury command. [The IMF and the World Bank] did exactly what the Treasury wanted.[20]

At the heart of Brazil's asymmetric relations with the US were Brazil's currency-related problems. On the one hand, issuing a non-international currency meant that Brazil was always subject to foreign currency shortages to close its balance of payments. On the other hand, both the government and the private sector were dependent on international funding. As the most powerful state in the IMS, the US was in a privileged position to help Brazil with its currency issues. Recognising the US' privileged position since the inauguration of the BWS, Brazilian governments often adjusted their economic policies to the interests of the US government to benefit from its support.

2.3 THE OLDEST KIND OF SLAVERY: DEBT

Brazil is a country that was born in debt. After proclaiming independence in September 1822 the new Emperor, Dom Pedro I, found the public coffers empty because his father, Dom João VI, took all the country's metallic reserves with him on his return to Portugal. As if this was not enough, the Portuguese government only agreed to recognise Brazil's independence upon the payment of £2 million, a sum it claimed was an equitable compensation for its loss of territory. The loans that followed to finance the new state and to indemnify Portugal opened a long cycle[21] of Brazilian external debt (Abreu 1999, p.2; Silva 2010, p.49). Brazil has consequently been in a weak position relative to the IMS throughout its history.

[20] Non-attributable interview with a former finance minister.

[21] According to Abreu (1999), the history of Brazil's foreign debt is characterized by the occurrence of two long cycles of debt: the first goes from 1824 to 1943 and the second from mid-1960s until 1994.

While dependence on external capital was long a traditional feature of the Brazilian economy, a major turning point occurred after the first oil shock in 1973. At that time, when the whole world was adjusting to the inflationary consequences of rising oil prices, the Brazilian government decided to maintain a high growth strategy[22] despite being an oil importing country. This strategy was materialised through the Second National Development Plan (II PND), which consisted of an expansive investment program that aimed to increase Brazil's energy capacity and the production of raw materials and capital goods. Leaving aside the heated academic debate on the rationality and on the long-term results of this policy (Bonelli & Malan 1976; Lessa 1978; Castro & Souza 1985; Carneiro 1990; Aguirre & Saddi 1997; Fonseca & Monteiro 2008), the maintenance of a high growth strategy implied an immediate increase in the Brazilian external debt to cover the substantial increase in the current account deficit produced by higher oil prices.

This strategy of growth through the expansion of external debt was possible because of the prevailing high liquidity in international financial markets that resulted from the prevailing petrodollar recycling. In this context, the profile of Brazilian debt underwent a fundamental change. First, the originally predominantly private external debt was replaced by public external debt, a process that became known as "nationalisation" of the external debt (Cavalcanti 1988, p.15; Cruz 1984). On the one hand, this change arose because public enterprises, state governments and various public agencies contributed to much of the foreign borrowing as part of the government's strategy to sustain relatively high growth rates. On the other hand,

[22] Behind the choice of an economic growth policy was the need to legitimise the military regime through rising living standards.

Brazilian law allowed private business enterprises to pay their debts in the local currency to the Central Bank, which then became responsible for the debt.[23]

Second, external debt subject to variable interest rates began to represent more than half of total public external debt. Variable interest rate loans increased from 16.5 to 56.3 per cent from 1971 to 1978 while the share of concessional loans, for example, decreased from 35.8 to 5.9 per cent during the same period (Batista 1987, pp.24–26). As a consequence of these changes, Brazil's external position, particularly for the public sector, became extremely vulnerable to alterations to international conditions.

These external conditions further deteriorated in 1979 with the second oil price shock, a crisis that was further exacerbated when coupled with the sharp increase in international interest rates that resulted from the tightening of US monetary policy. This time, Brazil's external debt immediately increased not only in reaction to higher oil prices but also due to this rise of international interest rates since Brazilian debt was at the time based mainly on floating interest rates. Additionally and in contrast to the first oil shock, it was more difficult for indebted countries in the late 1970s to raise new loans both because international capital was attracted to industrialised countries as a result of the rise in interest rates there, and because international investors reassessed the risk associated with indebted economies, given the increased cost of servicing their debts (Hermann 2011a, p.78).

Despite the adverse conditions that resulted from the second oil shock, the Brazilian government managed to keep financing its balance of payments deficit by contracting new loans until 1982, when Mexico declared a moratorium on its external debt. The Mexican moratorium happened in August, just before the IMF's Annual Meeting scheduled for the first

[23] Due to the need of resources, the Central Bank rolled over the debt instead of paying it off, which contributed to increase the public share of the external debt.

week of September, when private creditors and debtor countries thought a solution was going to be provided. The expectation was however proven wrong, as a Brazilian representative at that meeting related:

> Mexico broke in August 1982, and two or three weeks later was the IMF's meeting in Toronto … And everyone held their breath, because what began to circulate was that it was going to have a way out. Because Citibank was going to break, Barclays was going to break, all the major banks were going to break, so it was going to have a solution. And then, the Secretary of the Treasury, Donald Regan, said more or less the "drop that, I have nothing to do with it". So when the IMF's communiqué came out and there was nothing, not a line credit, not anything, then there was panic.[24]

After Donald Regan frustrated the expectations of private creditors and debtor countries for a way out of the crisis, the inflow of private capitals to developing countries, including Brazil, dropped sharply as they became too risky of an investment. Consequently, the remaining voluntary capital flows that had allowed Brazil to finance its deficit from 1979 to 1982 vanished, prompting a huge external debt crisis. In contrast to the mid-1970s, when the Brazilian government had the chance to choose between different policy options, there was only one option to address Brazil's economic woes: Brazil had to turn to the IMF. In the words of a high member of the Ministry of Finance at that time:

> Minister [of Finance] Galvêas was planning to leave Toronto and inaugurate a subsidiary company of the Bank of Brazil and he cancelled everything and returned to Brazil to manage the crisis. Because the credit lines began to dry up quickly, and we needed a strategy to deal with it. And the strategy was: let's make a deal with the IMF to preserve the minimum of international reserves and begin the negotiations with the banks. That was end of September 1982.[25]

[24] Non-attributable interview with a former finance minister.

[25] Non-attributable interview with a former finance minister.

Despite the urgency for financial resources, the government waited until December 1982 to announce its agreement with the IMF. The reason for the delay was the upcoming elections in November which represented the first opportunity since 1960 for the Congress and the Electoral College to choose a civilian president after two decades of military rule. The government believed that announcing a package deal with the IMF could potentially impair the result of this extremely important election:

> It was fundamental for the government to win the 1982 elections and thus Figueiredo [the then president] vetoed any idea of going to the IMF at that time. And he said to Galvêas [the then Finance Minister] and Delfim [the then Minister of Planning] something like: "find a way!" I do not know the exact words, but it was "no IMF".[26]

The determination of the government to delay announcing its agreement with the IMF until after the elections depleted Brazil's international reserves and worsened the crisis. The Brazilian government only managed to avoid declaring a moratorium in 1982 because it obtained a bridge loan from the US' Treasury, the Bank for International Settlements (BIS) and a number of American commercial banks (Cerqueira 2003, p.25).

After reaching the agreement with the IMF in December 1982 for an Extended Fund Facility (EFF) and formulating a detailed economic program for 1983, the Brazilian representatives requested the commitment of the creditor banks to support on a voluntary basis the financial needs of Brazil. In February 1983, the Brazilian government also reached a formal agreement with the international private banks, which was conditioned to the IMF's EFF agreement (Cerqueira 2003, pp.26–27).

Despite the resources raised in these negotiations, the Central Bank of Brazil began to delay payments in foreign currency as early as February 1983. In July, the Central Bank "centralised"

[26] Non-attributable interview with a former finance minister.

the foreign exchange market to prevent a further depletion of international reserves. By this measure, local debtors deposited local currency into the Central Bank which then scheduled debt payments according to its priority and to the availability of foreign currency. This measure lasted until March 1984 when the previous exchange rate regime was restored (Cerqueira 2003, p.38). As a former finance minister said:

> And then [the government] began to manage a crisis in which the country was bleeding without great chances of reversal, because the crisis was only getting worse, and the country began to adopt defensive strategies. That is when it does, for the first time in the post-war era, the centralization of the exchange rate … and at some point the reserves were exhausted and the government starts to use the Bank of Brazil.[27]

Besides delaying the payments, Brazil also failed to achieve the targets set by the IMF,[28] a failure which led to the IMF and international banks' temporary suspension of issuing new money to Brazil. Between March and July 1983, the Brazilian government only managed to meet its external obligations because it made an incredible effort to earn foreign currency as part of the austerity programme agreed with the IMF in December 1982 (Baer 2013, p.84; Cerqueira 2003, p.33). Then a second round of negotiations began in mid-1983, which resulted in an agreement with the Paris Club, in late 1983, and with the banks, in January 1984, both of which were dependent on the agreement with the IMF that was reviewed in November 1983 (Cerqueira 2003, pp.35–38, 102).

One of the reasons for the persistent insufficiency of resources was the misconception of both the Brazilian government and the creditors about the magnitude of the crisis. According to one close observer at that time:

[27] Non-attributable interview with a former finance minister.

[28] The reasons for that will be discussed in the next section.

> The negotiation also started from an assumption that was proven wrong; that what we lived was a panic, not a structural change. And panic is resolved by super short-term measures. So what is the problem: everyone is crazy because Mexico did not pay, let's sit down and talk, breath for a year, and then the wheel starts spinning again; the idea was that everything would go back to the previous status quo. Thus, what Brazil did was negotiate the 1983 maturities.[29]

Gradually, however, the international perception about the crisis changed, as not only Brazil but many other Latin American countries began to enter into deep economic recessions. To that extent, the debt crisis began to become unsustainable not only from an economic point of view but also from a political one. In June 1984, the ministers of foreign affairs and finance of eleven[30] Latin American countries met in Cartagena and demanded co-responsibility between creditors and debtors to find a solution for the Latin American external debt problem. According to a senior Brazilian diplomat, the Cartagena meeting was "hard fought by Americans; the Americans strongly pressed the Colombian government not to host such a meeting, but Colombia went on".[31] After two other meetings, however, the group dissolved, as Mexico and Chile preferred to negotiate their debt on their own. One senior Brazilian diplomat reflected on this meeting: "it was an interesting, peculiar moment. [Was it] ineffective? That is the question, because you can say that, in a way, that political pressure, although exerted for a short period, contributed to the Baker Plan".[32]

Arguably the stronger source of pressure to change the management of the Latin American debt crisis came from the creditors and through the Baker Plan. The Baker Plan originated from the proposals set forth by the US Secretary of the Treasury James Baker during the IMF annual meeting in Seoul in 1985 to combat the international debt crisis. In a way, the Baker Plan was a three-year delayed response that private creditors and debtor countries had expected after the

[29] Non-attributable interview with a former finance minister.

[30] Argentina, Bolivia, Brazil, Chile, Colombia, Dominican Republic, Ecuador, Mexico, Peru, Uruguay and Venezuela.

[31] Non-attributable interview with a senior diplomat.

[32] Non-attributable interview with a senior diplomat.

Mexican moratorium. The Baker Plan did not end up succeeding, but it represented the recognition by creditor states that something needed to be done about the debt crisis. As a high member of the Ministry of Finance at that time said:

> What experience came to show is that the problem was much more serious. It was a structural imbalance problem in the debtor countries, requiring much deeper structural reforms. And, moreover, [it was necessary to] restore growth. Because as the wheel did not start to spin again, all these countries began to enter into a process of a sharp drop of growth, recession, unemployment; all this was unsustainable in the medium and long term from the political and social point of view. Then entered a new diagnosis: the problem is long-term financing. And then comes the Baker Plan.[33]

Thus, by 1985 both debtor and creditor states were in agreement that there was a serious need to change the approach to tackling the debt crisis.

In the case of Brazil, in 1984, for the first time since 1979, the external constraint somewhat lessened. This was a result both of better international conditions, such as the reduction in international interest rates and a fall in the price of oil, and of domestic reasons, such as the good performance of Brazilian exports that year and a considerable increase in oil domestic production that diminished the burden of oil imports.[34] In addition, Brazil continued deepening contractionary economic policies. Nevertheless, Brazil continued to miss the targets set by the IMF and its debt problem persisted. In the words of a high member of the Ministry of Finance then:

> There began to grow the idea that the problem was of debt overhang; that is, the debt was too large, and you need a strategy to reduce the size of the debts. A parallel with German war reparations was made. And it was something similar: Germany took over war reparations that were incompatible with its capacity to generate current account surpluses, etc.[35]

---

[33] Non-attributable interview with a former finance minister.

[34] This is one crucial point in the debate about the decision made in 1974 of growing under unfavourable conditions. In short, advocates of that decision argue that it paid off when Brazil began to increase its oil production, reversing a previous structural disadvantage.

[35] Non-attributable interview with a former finance minister.

The return of a civilian government in March 1985 added to the difficulty of subordinating domestic policies to the external problem at a time of economic crisis. Despite the slightly better circumstances in 1984, the Brazilian government failed in its efforts to renew its agreement with the Fund. Without the IMF agreement, the third round of negotiations with Brazil's other creditors was impaired. The negotiations with the IMF were supposed to have resumed when the civilian government came to power; however, the new administration embraced a strong anti-IMF rhetoric and refused to accept any agreement that would result in recessionary policies (Bacha 1987, p.22; Cerqueira 2003, p.41).

Remarkably, the Brazilian government managed to continue negotiations with international banks and the Paris Club even without the IMF's support. After a period of interim measures (January 1985-September 1986), a new agreement with the banks was reached in September 1986 (Cerqueira 2003, pp.41–42). Following the completion of this new agreement with the banks, the Paris Club also decided to resume the negotiations with Brazil and an Agreed Minute was signed on January 1987 (Cerqueira 2003, p.103).

In February 1987, however, negotiations with the banks and the Paris Club were interrupted once again with the announcement of a technical moratorium[36] by the Brazilian government. The moratorium had a very negative impact on Brazil's image amongst its international creditors. In particular, Brazil broke the trust of the Bank Advisory Committee and the Paris Club, both of which had agreed to continue negotiations with Brazil despite the lack of the Fund's endorsement. According to a former finance minister who was working in one of the banks affected by the Brazilian moratorium: "I experienced in London the feeling that arose

[36] The technical moratorium meant the unilateral decision to stop paying the interest on medium- and long-term commercial debt, besides the suspension of profits remittance and dividends payments of international companies. All measures were taken for an indefinite period.

against Brazil, even a certain revolt. … The image of Brazil went deeply down; the moratorium was really a shock”.[37]

To be sure, the anti-IMF feeling was often mixed with a general aversion towards international creditors and in particular towards private banks. To an extent, it was the idea – one frequently kindled by the government – that the Brazilian crisis was the result of an international conspiracy to subjugate the country (Almeida 2003, p.8). In the case of the moratorium, a former finance minister remembered: “To give greater solemnity to the moratorium, Sarney [the Brazilian President] treated it as a matter of State, and brought the National Security Council to approve the moratorium. There was a meeting of the National Security Council, looked like the country was going to a war”.[38]

In September 1987, the Finance Minister Luiz Carlos Bresser-Pereira tried to reopen the negotiations with creditors, suggesting for the first time the concept of “securitisation,” an idea which was to be advocated in the Brady Plan two years later. At that time, however, the proposal was considered a “non-starter” by the US Treasury, as reported by The New York Times on 9 September 1987 (Kilborn 1987).

Despite Brazil’s damaged image, negotiations with the Bank Advisory Committee were resumed again in October 1987. According to Cerqueira (2003, p.46), one of the motivations for reopening the dialogue with Brazil was to avoid downgrading Brazil’s debt in American banks’ portfolios. The possible reduction of Brazil’s classification to *value impaired* would mean a loss realisation for the banks who would then have had to increase reserve requirements or write-off the Brazilian asset portfolio (Cerqueira 2003, p.46). Thus in December 1987 the government signed an Interim Finance Agreement whereby 114 creditor banks offered a

[37] Non-attributable interview with a former finance minister.

[38] Non-attributable interview with a former finance minister.

bridge-loan of US$3 billion to help Brazil pay the US$4.5 billion of accrued interest from February to December 1987 (Cerqueira 2003, p.46).

The negotiations eventually resulted in an agreement with the Paris Club in July 1988 and with the banks in September 1988 which effectively ended Brazil's moratorium. Despite this breakthrough, Brazil once again began in late 1988 to fail to make its payments and in July 1989 an "unofficial" or "veiled" moratorium began. Although the Brazilian government was committed to regularising its obligations to its creditors, it argued that the payment could not undermine the goals of financial stabilisation and growth recovery (Cerqueira 2003, p.65). The regularisation began in January 1991 (Cerqueira 2003, p.65).

Meanwhile at the international level, a solution for the debt crisis was devised with the formulation of the Brady Plan, which was developed in early 1989 by the US Secretary of the Treasury Nicholas Brady. The Brady Plan consisted of converting bank loans into new bonds, the so-called Brady bonds, which were then tradable in the market. These bonds were collateralised by US Treasury 30-year-zero-coupon-bonds purchased by the debtor country and normally with the assistance of the IMF. Mexico was in 1989 the first state to restructure its external debt under the Brady Plan, followed by Venezuela in 1990 and Argentina in 1992.

In November 1993, Brazil also reached an agreement with its creditors under the Brady Plan to restructure its debt – although without the IMF's support. The process began in April 1991 when Brazil signed an agreement to regularise its interest due. In July 1992 it reached the main agreement with both the Bank Advisory Committee and the Paris Club and in January 1993 this agreement was forwarded to the international creditor banks. Between January and February 1993, the chief negotiator of the external debt, Pedro Malan, together with other representatives of the Brazilian government ran a road show to present the agreement to the main international financial centres. After the acceptance of creditors in November 1993, the

Brazilian government only needed to buy the US Treasury bonds to serve as collateral for the Brazilian Brady bonds.

The normal practice under the Brady Plan was for countries to first reach an agreement with the IMF and then use part of the money supplied by the IMF to buy the zero-coupon bonds that were specially issued by the US Treasury (Boughton 2012, p.425). Brazil, however, did not have an agreement with the IMF and thus "began quietly (through a leading US-based investment bank) purchasing existing US Treasury zero-coupon bonds in the secondary market using its own dollar reserves," as noted by Boughton (2012, p.425). "We needed two and a half billions of dollars," a Central Bank director at that time said, "we had at least 10 times that in reserves, so why bother making an agreement with the Fund? We bought directly the US Treasury bonds".[39] Under these circumstances, the Brazilian government not only decided to buy the guarantees for the Brady Plan without the IMF but also turned the situation to its political advantage, as a close participant at that time said:

> I think in January [1994] we already had the feeling that we were going to be able to buy everything in the market, easily. So we began to mistreat the IMF … it was opportunistic because we had managed to close the Brady Plan without the support of the IMF, without having the obligation to do the agreement, being able to say that the IMF was against it…[40]

The issuance of the Brazilian *Bradies*[41] occurred in April 1994. The agreements included the transference of the external debt responsibilities from the Central Bank to the Federal government. As a result, the Central Bank became accountable only for the functions of a

[39] Non-attributable interview with a former Central Bank governor.

[40] Non-attributable interview with a former Central Bank governor.

[41] There were seven different bonds: Discount bond; Par bond; Flirb (Front-Loaded Interest Reduction Bond); C-Bond; DCB (Debt-Conversion-Bond); New Money Bond; and EI (Eligible Interest Bond).

typical monetary authority, which represented a major institutional advance (Cerqueira 2003, p.77).

The restructuring of Brazil's external debt, a process that dragged on from 1982 to 1994, typifies the problems associated with having debt denominated in foreign currency. During this period, the external problem took over the domestic agenda in a way that is familiar for states which issue non-international currencies. Essentially, a structural problem exists for Brazil and other EMDs who must adjust their economic policies to obtain enough hard currency to pay their international obligations – a situation that is unknown for countries that issue international currencies.

The debt crisis serves as an interesting case from which to consider the balance of power in the IMS because being a major debtor actually granted Brazil some power.[42] Notably, international private banks had a great interest in regularising Brazil's debt and this interest ended up counterbalancing the IMF's influence. In any case, the IMF's influence on Brazilian economic policy-making was low. Significantly, the agreement with the Fund in 1982 did not alter the path of the economic policies, since the government had started IMF-style policies already in October 1980.

2.4 FIGHTING FOR ITS CURRENCY: BRAZIL'S BATTLE AGAINST INFLATION

Like the country's external debt, inflation was for a long time a central concern of Brazil's economic policy. A major landmark in dealing with inflation took place after the ascent of the military regime in 1964 and the subsequent implementation of a series of economic reforms.

[42] As John Maynard Keynes already said, "if you owe your bank a hundred pounds, you have a problem. But if you owe a million, it has".

Among these reforms was the establishment of the Central Bank of Brazil, as the executor of monetary policy, and the National Monetary Council (CMN, *Conselho Monetário Nacional*), as the responsible agent for the normative and regulative functions of the financial system.[43] In addition, there was substantial improvement in the financing of the government's deficit with the establishment of the first public debt standard instrument, the Adjustable Bonds of the National Treasury (ORTN, *Obrigações Reajustáveis do Tesouro Nacional*). Before 1964 the government was virtually unable to finance itself through the issuance of debt bonds, so that the deficit was recurrently financed by the issue of paper money (Resende 1990, p.218). At the core of these measures was the government's determination to contain inflation, which had reached 94 per cent in 1964.

For the newly formed military regime, however, the goal of containing inflation could not undermine economic growth (Hermann 2011b, pp.52–53; Resende 1982, p.777). Recovering growth rates was the key to "legitimating" the authoritarian regime (especially among enterprises and upper-classes) and, consequently, other objectives of economic policy were subordinated to that end. Thus, the measures to contain inflation could not threaten the economic recovery. The government's plan did not aim to eliminate inflation, but rather to attenuate its acceleration.

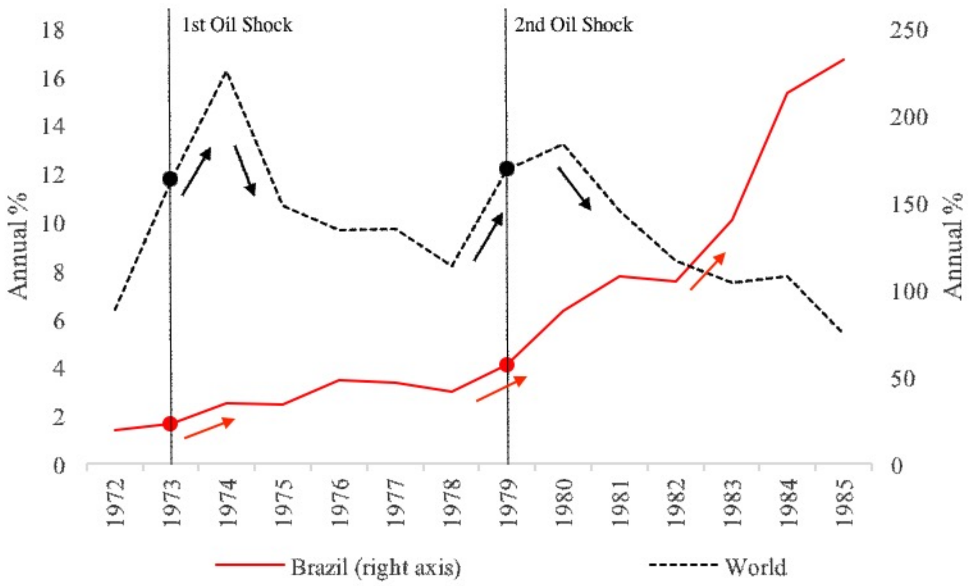
Since the government expected a two-digit inflation rate in the medium term, mechanisms were established in 1964 to protect the real return of assets during the transition period to low inflation (Hermann 2011b, p.58). The primary mechanism to cope with high inflation was

[43] Despite the foundation of the Central Bank as the monetary authority, the Bank of Brazil remained performing monetary-policy related duties, since it had in practice the power to create currency. According to the Central Bank of Brazil, "the Central Bank became the currency issuing bank, but acted according to the needs of the Bank of Brazil. It was also the bank of banks, but was not the sole holder of the financial institutions' deposits because the institutions placed their voluntary reserves in the Bank of Brazil. Besides, the Central Bank was the government's financial agent, in charge of managing the federal public debt, but was not the cashier to the National Treasury, since this was a function of the Bank of Brazil" (Central Bank of Brazil n.d.).

monetary correction whereby the nominal value of assets was indexed to changes in the purchasing power of the national currency. Given the persistence of high levels of inflation, however, the initially temporary measure of monetary correction ended up extending until 1995 and spreading to the various instruments of the economy, such as rent, salaries and the public debt.

The progressive indexation of all contracts and transactions worked reasonably well to deal with an average annual inflation rate of 21 per cent from 1968 to 1973, when the oil shock which began in October of that year quadrupled the price of petroleum. The effect of the oil shock was a general increase in world inflation in 1974, but in the case of Brazil this increase in inflation was perpetuated because of its indexation mechanisms (Figure 4). Despite the government's monetary and fiscal tightening, inflation continued to accelerate in the following years and with the second oil price shock in 1979 Brazilian inflation catapulted from 56.5 per cent that year to 107 per cent in 1981.

FIGURE 4: WORLD AND BRAZIL INFLATION, GDP DEFLATOR, 1972-1985



Source: World Bank, World Development Indicators. Elaborated by the author.

Two years before resorting to the IMF, the government began in October 1980 to implement very contractionary monetary and fiscal policies. Thus, the agreement with the Fund in late 1982 did not really change the path of economic policies. The problem was that Brazil constantly failed to meet the targets set by the IMF, which were set in nominal terms. Consequently, even if the government made a real fiscal deficit reduction, it failed to meet the nominal target. In the words of a former finance minister:

> It was nominal, so it was impossible, impossible; and the impossibility was in the terms of the agreement. Because Brazil was in an inflationary process, which was not fully understood then, but there was a notion that the inertia was causing inflation, and that the inflation level changed at every shock, that inflation was always increasing … That is why we had to, every trimester, renegotiate targets, and in some cases ask for waiver.[44]

In the 24 months following the 1982 agreement, the Brazilian government submitted seven letters of intent to the IMF to renegotiate terms, which served to increase the negative perception of the IMF in Brazilian society. As the Brazilian government could not achieve the targets set by the agreement, there was a feeling of a constant monitoring of the economy by the Fund at the time of its worst recession. As a former foreign affairs minister remembered: "even the liftmen in the public buildings knew who Ana Maria Jul was,"[45] who was the person responsible to the IMF to verify if the government was complying with its agreement. In the same light, a former finance minister summarised: "the IMF was seen as the number one public enemy".[46]

This anti-IMF feeling in Brazilian society was fuelled by an incorrect assumption about the level of the Fund's intervention in domestic decisions. As the former Finance Minister and

[44] Non-attributable interview with a former finance minister.

[45] Non-attributable interview with a former foreign affairs minister.

[46] Non-attributable interview with a former finance minister.

Planning Delfim Netto said: “I wrote seven letters in collusion with the IMF: I pretended I was going to concede and they pretended they were going to accept, which actually shows an understanding of the difficulties. I mean, they could ask for [certain things], but they knew I was not going to do”.[47] According to several interviewees, the IMF was many times used as a scapegoat to justify the implementation of contractionist policies. In the words of one former Central Bank director:

> Having worked [at the Fund] and then having worked as authority in Brazil, I think that the Fund served many times as an excuse for the authorities to do what they need to do; but they do not want to have the responsibility… the IMF provides a service to take the blame of making an adjustment that is generally unpopular.[48]

While politically convenient in the short term, this strategy was ultimately counterproductive, as a former policy maker observed:

> Politically it is quite tempting you say “I am doing this not because I want to, but because the IMF is demanding”. This may work politically in the short term to safeguard the government from a populist viewpoint … but it has a negative effect since the capacity to implement an adjustment program diminishes, because the reaction of the population is different. One thing is the government say to the country: “look, we need to make this adjustment”. Another thing [is to say]: “look, I have to enforce this here because the IMF is demanding”. Then the population resists to this external, alien element, which impairs the adjustment.[49]

In January 1985 the seventh letter was not approved because the government had failed, again, to meet the targets stipulated in the sixth letter, established for the last trimester of 1984. Negotiations were then interrupted until the first civilian government after 21 years of the military regime assumed office in March 1985.

---

[47] Interview with Antônio Delfim Netto.

[48] Non-attributable interview with a former Central Bank director.

[49] Non-attributable interview.

The new democratic government continued to use the IMF's negative perception as a piece in the domestic political game. The new government took office under a very unstable equilibrium after the unexpected death of the candidate directly elected by the Congress, Tancredo Neves, and the rise of the vice president, José Sarney, who had been a supporter of the military regime. Facing economic crisis and rising inflation, Sarney used the anti-IMF rhetoric to gather popular support. As a former finance minister related: "the Central Bank suspended the cars for the IMF staff; there were things like 'you do not rule here anymore'".[50]

In addition, the ascension of Brazil's democratic regime marked a change in the government's approach towards inflation. On the one hand, the ineffectiveness of the IMF-style policies to reduce inflation helped strengthen the view that Brazilian inflation was not the result of overheating demand but rather of monetary correction mechanisms that perpetuated inflation over time. In other words, inflation had become *inertial* because most contracts had indexation clauses that restored their real value after fixed intervals of time. Regarding the nature of the Brazilian inflation, a former finance minister said: "the idea that inertia was the preponderant cause of Brazilian inflation was not accepted in the IMF, nor [in Brazil] as well. This idea only matured really in 1985, more or less".[51] On the other hand, as noted by a former finance minister, inflation also became a political matter under the democratic regime:

> [High] inflation began to threaten the survival of governments in a democratic regime; gradually, the Brazilian society was becoming intolerant towards inflation. Thus, solving the problem of inflation was not only an economic problem, it was a political problem, a social problem. … Everyone accepted that inflation was a terrible tax for the poor. The problem was what to do...[52]

There were two concurrent proposals to deal with Brazil's *inertial* inflation. One was the proposal of Chico Lopes, which involved basically freezing prices, and the other was the

[50] Non-attributable interview with a former finance minister.

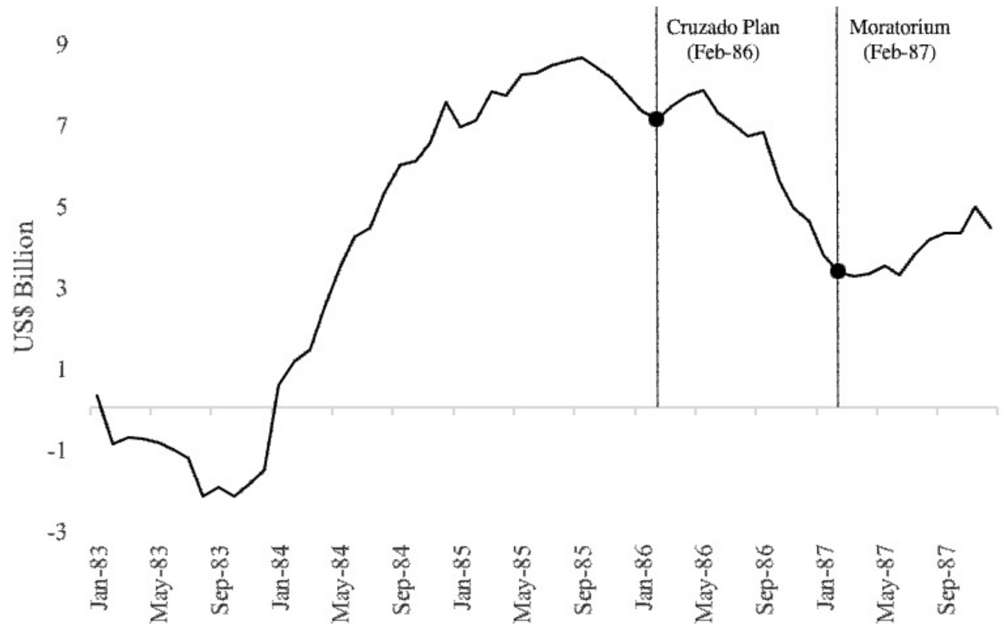
[51] Non-attributable interview with a former finance minister.

[52] Non-attributable interview with a former finance minister.

proposal of Persio Arida and André Lara Resende, known as *Larida* proposal, which was later used as the basis for the Real Plan.

In February 1986 the government launched the Cruzado Plan, based on the proposal of Chico Lopes. According to a former finance minister, Lopes' proposal "had enormous advantages over the other: first, everyone knew how to execute it".[53] Immediately after its implementation, the Cruzado Plan successfully lowered inflation, giving the population a real gain in purchasing power. The consequent increase in domestic demand coupled with an overvalued exchange rate (which was part of the Plan) led already in 1986 to a trade deficit. Since 1984, trade surpluses had helped enable Brazil to maintain a comfortable level of international reserves, but after the Cruzado Plan Brazil experienced an exhaustion of its international reserves (Figure 5).

FIGURE 5: INTERNATIONAL RESERVES, US$ BILLION, 1983-1987



Source: Central Bank of Brazil. Elaborated by the author.

[53] Non-attributable interview with a former finance minister.

Arguably Brazil could have circumvented the situation with a loan from the IMF, but since the Brazilian government was not willing to resort to the IMF's assistance, it decided instead to declare a moratorium on payments. The initial success of the Cruzado Plan had increased the government's popular support, but then its popularity decreased again as inflation returned. Resorting to the IMF was not politically viable, as it would have further decreased the government's popularity. Instead the government decided to use the anti-IMF feeling in its favour. As a former finance minister said, there was an idea inside the government that:

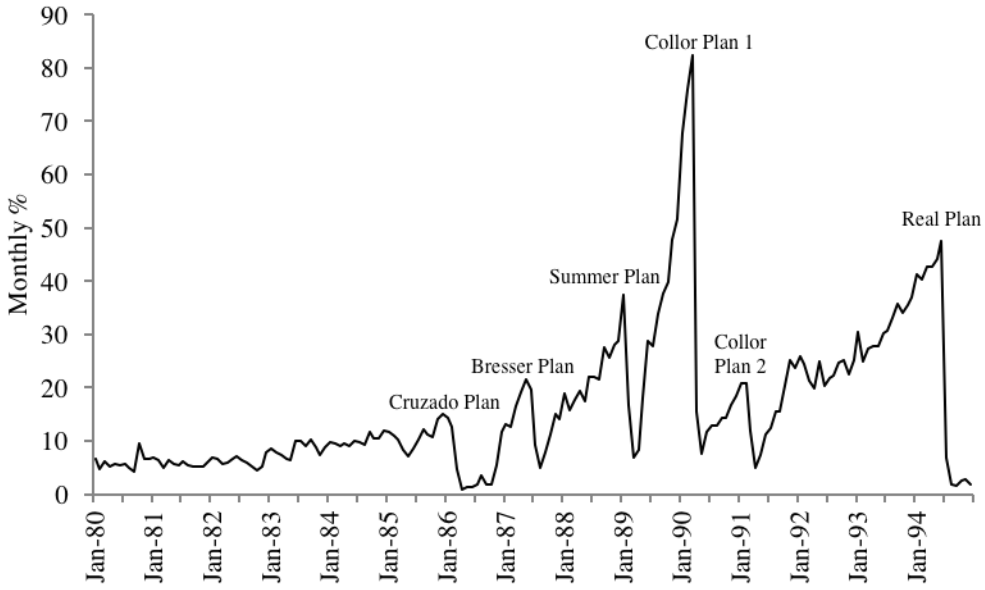
> The moratorium would mobilize society in support of Sarney, who had reached 80 per cent of popularity with the Cruzado Plan and was down again. So it was a way of Dilson Funaro, the Finance Minister, to apologize in a way… And there were a lot of people in the government saying, "let's run over them, we will beat these guys up and we are going to gain popularity".[54]

After the initial success of the Cruzado Plan, inflation rose to an even higher level. During the following years, four other unsuccessful attempts to address Brazil's economic situation ensued: the Bresser Plan in June 1987; the Summer Plan in January 1989; the Collor Plan 1 in April 1990; and the Collor Plan 2 in February 1992 (Figure 6). These plans became known as "heterodox shocks" because they challenged the orthodox logic of the IMF. Although each of these plans had their own specificities, they shared among their main characteristics de-indexation, with sudden withdrawal or amendment of existing rules of indexation, and the price freeze, which constituted a genuine shock in the economy. As noted by a former finance minister, these heterodox shocks became increasingly ineffective: "the programs following the Cruzado, they had their reasons, but they were less and less able to produce effects, because

[54] Non-attributable interview with a former finance minister.

the failure of the Cruzado Plan generated defensive strategies. I mean, it was enough to smell a price freeze for companies to begin to adjust".[55]

FIGURE 6: INFLATION AND HETERODOX PLANS, MONTHLY RATES, 1980-1994



Source: IPEADATA. Elaborated by the author.

After the failure of the Collor Plan 2, the domestic political situation changed again when President Fernando Collor was impeached for corruption and his vice president, Itamar Franco, took office in late 1992. From October 1992 to May 1993 Brazil had three Ministers of Finance, until President Itamar appointed his Foreign Affairs Minister, Fernando Henrique Cardoso, as the new minister. Cardoso put together a team of economists[56] to formulate another plan to control inflation. This was the Real Plan.

[55] Non-attributable interview with a former finance minister.

[56] The team was formed by Persio Arida, André Lara Resende, Gustavo Franco, Pedro Malan, Edmar Bacha and Winston Fritsch, plus Clóvis Carvalho who was not an economist and worked as the manager of the meetings.

The elaboration of the Real Plan overlapped with the negotiations for the Brady Plan and ultimately impaired the implementation of the Brady Plan through its normal IMF-assisted path, as explained in the previous section. As a close participant at that time said:

> The final rite of the Brady Plan mixed with the Real Plan. According to the Brady Plan's rite, the IMF compromised to do a stand-by agreement with Brazil, where it would lend us the money to buy the US Treasury bonds that served as collateral for the agreement … But suddenly the national agenda overlaps with that because then we were making a stabilization plan, so the conversation with the IMF adds with the conversation about the Real. We went to talk with them, and they said: "look, we read the news and know you are preparing something; well, then let's talk about the thing". And then of course the conversation about finalizing the Brady Plan became a conversation with the IMF about the Real Plan.[57]

Up until that point, the IMF had backed all the other frustrated stabilisation plans and thus it was very sceptical about the Real Plan (IEO 2003, p.121). According to one participant who helped devise the Real Plan:

> The IMF wanted extraordinary things; they wanted a primary surplus, which was impossible to achieve. We had just approved a constitutional reform to eliminate 20 per cent of expenditures; that for the IMF was still not enough. It was not enough primarily because they did not believe, because that plan looked like magic. … And the political situation was extremely fragile: Itamar was a nationalist, traditional populist. The IMF was very afraid… how long was Fernando Henrique going to last? … I do not know if they did not understand or if they had orders, I think they had a determination not to support the government, not to support this adventure. They had supported too much; this thing here was not going to work. No one thought it would work.[58]

In any case, essentially there was not much disagreement between the Fund and the Brazilian monetary authorities at that time about what had to be done in terms of economies policies. As a member of the team that designed the Real Plan said:

[57] Non-attributable interview with a former Central Bank governor.

[58] Non-attributable interview.

> There has never been much disagreement about what to do. We knew that we had to make the fiscal adjustment, all that. The reason why we did not do [the agreement] at that time I think it was a combination of resentment of the IMF, a past of bitterness… and from our side we realized that we did not need it, and that actually it was good not to do it. Although if we had done, there would not have been any harm. But it was better not to do it. We were not obligated [to the conditionalities], and the Real was not associated to the Washington Consensus, IMF, etc. so from the point of view of the internal marketing of the program was better.[59]

Even if there were disagreements, the IMF's conditionalities were mostly restricted to general targets so that it was up to the Brazilian government the decision of where to make expenditure cuts. As noted by a Central Bank official:

> The IMF did not order to cut health resources … The IMF said: "you have to have a surplus of 'x'". Then the government deliberated about how it was going to meet the surplus: "I will cut the money from contractors or I will cut health? … I will cut from health, it is easier." Everyone complained? "It was the IMF that told me I had to cut!"[60]

This adds to the point that the actual level of interference of the IMF in domestic politics was exaggerated. In a similar statement, a participant in the elaboration of the Real Plan said:

> The IMF could not care less; they wanted the bottom line. What should be cut was the government's problem. Actually it was little intervention, they should have intervened more to say, "I want you to cut current expenses". The IMF never had this attitude, let's say, pro-growth. An adjustment with growth implied cutting current expenditures, which is much harder to do because these expenditures, in general, besides having very strong internal interest groups behind, also have very strong constitutional moorings. … So the problem was that, I think, the IMF had little concern with the content of the cuts, and the countries, forced to cut, cut where they could, and these cuts in Brazil were very harmful. The Brazilian government invested 5 to 7 per cent of GDP, and began to invest 1 per cent of GDP due to the cuts made along this process of adjustment. And this was the main problem.[61]

[59] Non-attributable interview with a former Central Bank governor.

[60] Non-attributable interview with an official at the Central Bank.

[61] Non-attributable interview.

Ironically, the IMF did not support the plan that permanently curbed the level of Brazilian inflation. Unlike the previous heterodox plans, the Real Plan had no price freezing and all steps were announced to the public in advance, engendering wide popular support. The Real Plan was essentially a three-stage procedure. The first phase began in June 1993 with the Immediate Action Programme and centred on the settlement of public accounts. The second phase started in March 1994 with the introduction of the Unit of Real Value (URV, *Unidade Real de Valor*), a unit of account which temporarily coexisted with the domestic currency, the cruzeiro real. During this phase, prices were converted to the new unit of account which was in turn tied to the US dollar on a one-to-one basis and daily readjusted to the domestic currency. Thus, the cruzeiro real was still used as a medium of exchange, but not as a unit of account. In the third phase, which began in July 1994, the URV was replaced by the new currency, the real, which was disassociated from the previous inflationary inertia.

Since 1994, inflation has not been a problem for Brazilians in the same way that it had been before the launch of the Real Plan. As argued here, by the mid-1980s inflation was not merely an economic problem, but also a political and social one, with consequences that principally affected the lower sections of society. Moreover, the fight against inflation involved a considerable dose of nationalism, not only because of the symbolic weight of recovering the national currency but also because of the dramatic and contentious path that preceded the eventual triumph of the Real Plan. As shown here, the successful strategy had to first reject external solutions and go on to the develop a novel formula, based on the particularities of the Brazilian economy. Moreover, the Real Plan was executed with no support from the IMF, a fact that has unsurprisingly contributed to the idea that Brazil’s battle with inflation was a national victory. On this matter, Fernando Henrique Cardoso, who led the stabilisation plan and was dubbed the "father" of the Real, said: "we accomplished the Real Plan not because of the international support, but because of the local support here".[62]

The success of the Real Plan served to guarantee Cardoso's election as President of Brazil in October 1994. When the presidential campaign began in May 1994, the PT's candidate Lula was the favourite in the polls with 42 per cent against Cardoso's 16 per cent, according to a Datafolha survey (1994, 2). By August, a month after the new currency had been launched, a new survey indicated 36 per cent of the voting population favoured Cardoso and only 29 per cent favoured Lula. By October the gap in voting percentage had increased further, with Cardoso securing 48 per cent and Lula only 22 per cent (Datafolha 1994, 2).

Cardoso's election clearly reflected how important an issue the inflation problem had been and, as time would show, would continue to be, for the Brazilian people. His election also marked the beginning of a new phase for Brazil, one in which the Brazilian government was for the first time no longer tied to the external debt and inflation problems.

2.5 CONCLUSION

This chapter discussed the ways in which Brazilian economic policy-making was historically constrained by external conditions, examining in detail the period from 1944 to 1994. Throughout these years, there was a permanent subordination of domestic objectives to external problems, a feature which served to characterise Brazil's position as an unprivileged country in the IMS with little or no degree of autonomy, to use Cohen's monetary power definition. Indeed, the capacity of Brazilian monetary authorities to choose economic policies or to have any amount of autonomy was fundamentally affected by external conditions. Thus

[62] Interview with Fernando Henrique Cardoso.

the strategies pursued in 1974 (of opting for a growth strategy while the rest of the world was adjusting to the new oil prices) and in 1994 (of buying the guarantees for the Brady Plan without the IMF) were only feasible because the international conditions were favourable.

At a macro level, Brazil was permanently constrained by its asymmetric relationship with the US – asymmetric here not necessarily indicating a relation of conflict but rather a relation among unequal states. Brazil was less powerful relative to the US to the extent that it depended on the US infinitely more than the US relied on it. This dependence in turn translated into Brazil's necessity to fit into the BWS.

Brazil's subordination ultimately rested on currency-related constraints. For reasons that are beyond the scope of this research, since its origins Brazil had a weak or, one could say, incomplete domestic financial system, and it is from this reality that Brazil's problems with external debt and inflation arose. On top of having to deal with the constraints of not issuing an international currency, moreover, Brazil had problems which are characteristic of the basis of Cohen's currency pyramid, when the domestic currency suffers competition from other currencies at the domestic level. Brazil was never dollarised and, unlike other Latin American countries, the Brazilian currency preserved its functions of money, not least because of the mechanisms of indexation. In any case, the high levels of inflation created unwelcome disturbances in the economy.

To that extent, 1994 was a milestone in Brazil's economic history. First, the Real Plan consolidated Brazil's monetary monopoly or exclusivity. Second, the Brady Plan added to Brazil's monetary power by eliminating a major external constraint to which domestic objectives had been subordinated since 1982. By becoming less constrained by inflationary and external debt problems, Brazil had a gain of autonomy to manage its economic policies from 1994 onwards and, thus, had more power. Therefore, its gain of power laid in reducing its dependence, rather than increasing its influence over others. While this was a major change, Brazil persisted as a subordinated country in the IMS to the extent that it continued to face the problems associated with issuing a non-international currency.

In addition, Brazil's experience from 1944 to 1994 identifies channels other than an international currency that can be used as a source of influence in the IMS. Even though the arrow of power pointed in only one direction, Brazil sometimes managed to reduce the relative power of the status quo through the use of diplomacy. This was clear, for example, when Brazil persuaded private banks and the Paris Club to continue their negotiations even after the IMF suspended its agreement with Brazil in 1984.

Diplomacy, which in the case of monetary relations is closely associated with trust, was also a fundamental element for the success of the Real and Brady Plans. As a high member of the government during the elaboration those Plans revealed:

> What matters is to have trust. Of course when the currency is under control confidence increases, but if the currency is under control and the negotiators do not trust each other, it does not work. We did not have anything organized, yet we were moving in the right direction, and people trusted.[63]

Such credibility is engendered basically by domestic coherence. As a very influential Brazilian politician said: "The basic issue is internal. When you lose the internal credibility, it reflects outside. You have to win first here, try to maintain the credibility here; the rest is a response to what is happening here".[64]

Above all is domestic politics. The Brazilian experience showed that whenever necessary politicians would sacrifice their international reputation to stay afloat in the domestic political game. Even an unprivileged economy in the IMS like Brazil in the 1980s, the government's

[63] Non-attributable interview.

[64] Non-attributable interview.

decision-making will be subordinated to domestic politics. The main example of this tendency was Brazil's moratorium in February 1987 in order to avoid resorting to the IMF's assistance. In the words of a former finance minister:

> [There] was the interruption to the access to the international capital market. Practically everything stopped. And Brazil's image was very damaged. It took time to rebuild. Because Brazil ignored at that time [the costs of this decision], for political reasons, even ideological I would say, ideological in the sense of a prejudice against banks.[65]

The evidence that even a state in a weak position puts domestic politics over external goals adds to the debate about the responsibilities of the US as the issuer of the key international currency. In particular, it seems unreasonable to expect that a powerful state like the US would ever consider to subordinate its domestic problems to external ones. The difference is that the US monetary authorities have more autonomy and that American economic policies have a worldwide impact, but the logic behind the decision-making is very similar in the sense of prioritising domestic politics.

In the case of Brazil, the IMF was an important piece of the domestic political game, not least because of the population's negative opinion of the Fund. Consequently, while breaking with the Fund tended to increase a government's popularity, resorting to the Fund in times of need had a negative impact as it could be seen as a surrender to external interests. This association distorted the reasoning behind what was supposed to be a technical decision, based on the economic need of external support, and transformed it into a piece of the domestic political game, sometimes with negative economic consequences, as the moratorium episode in 1987 exemplified. In contrast to popular perception, however, the evidence presented here suggests that Brazil actually had relative autonomy from the IMF.

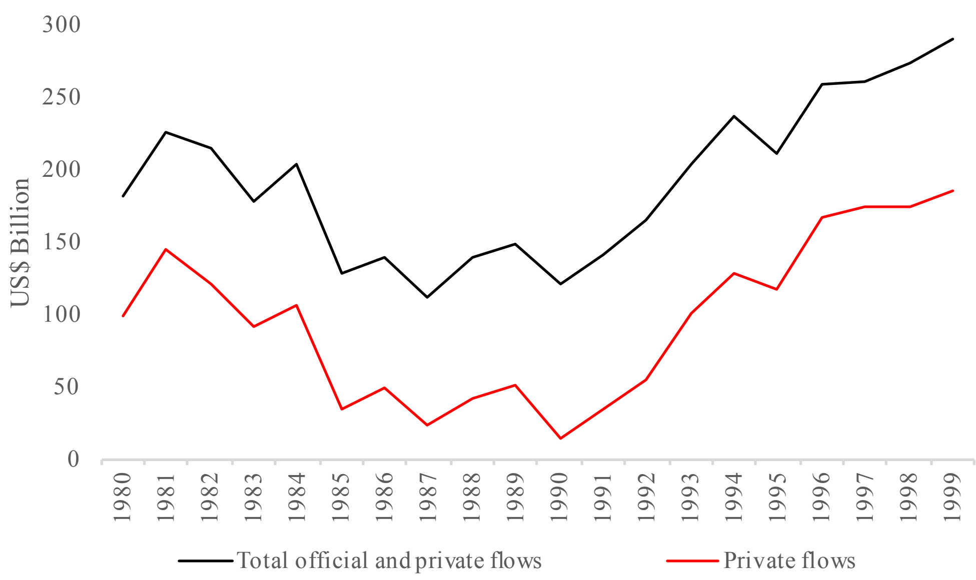
[65] Non-attributable interview with a former finance minister.

CHAPTER 3. CRISES AND CONSOLIDATION (1995 – 2005)

3.1 INTRODUCTION

With the integration of global financial markets in the 1990s, the world economy went through a profound transformation (Summers 2000; Isard 2005). Following the lead of several high-income countries which gradually liberalised their financial markets during the 1980s, a number of developing country states implemented rapid financial liberalisation in the late 1980s and early 1990s (Isard 2005, pp.54–65; Eichengreen 2008, pp.178–183). This process of financial liberalisation triggered a new cycle of capital flows to developing countries, which had dropped considerably after the 1982 Mexican moratorium. As shown in Figure 7, official and private capital flows to developing countries rose sharply in the 1990s.

FIGURE 7: TOTAL OFFICIAL AND PRIVATE FLOWS TO DEVELOPING COUNTRIES, US$ BILLION, 1980-1982



Source: OECD (2016), Total official and private flows (indicators). Elaborated by the author.

Financial liberalisation and deregulation, however, increased the vulnerability of emerging economies and ultimately provoked a series of currency crises from the mid-1990s until the early 2000s (Kose et al. 2006). Part of the problem that led to the crises was that although some resources came into the form of Foreign Direct Investment (FDI), there was a huge inflow of short-term capital which had been attracted by fairly liberalised capital accounts and relatively higher interest rates. At the same time, most developing economy-states had adopted fixed or pegged exchange rates to the US dollar either as part of their export-led growth strategies, as was the case in East Asia, or to help to control inflation, as was common among Latin American economies, including Brazil. As a result, if investors foresaw the possibility of devaluation and/or feared that the government would lack sufficient foreign reserves, they quickly withdrew their capital from the threatened economy, which in general resulted in a self-fulfilling prophecy that obligated governments to devalue their currencies. Particularly in Latin America, another part of the problem was that the massive inflow of international capital allowed governments to postpone dealing with structural problems, such as high-income gaps, low productivity, low international competitiveness and weak public institutions (Naím 1995, p.46).

The first of the mid-1990 to early 2000s currency crises broke out in Mexico in December 1994. Earlier that year, the US Federal Reserve had augmented interest rates and thus decreased international portfolio investors' demand for emerging markets' stocks and bonds (Naím 1995, p.51). The expectation of higher yields in the US combined with the uneasiness surrounding Mexico's political scandals and assassinations that year led to a huge capital flight from Mexico, the then second largest beneficiary of investments to emerging markets, just after China (Naím 1995, p.51). Like most other developing countries at that time, Mexico was committed to a fixed exchange rate. While Mexico's monetary authorities at first resisted devaluing the peso, the furious selling of Mexico's currency left no choice but for the Mexican Central Bank to allow the peso to float in December 1994.

The East Asian crisis that followed the Mexican peso crisis surprised most observers not least because it occurred in economies with apparently good macroeconomic fundamentals and that had hitherto experienced high rates of growth (Noble & Ravenhill 2000, p.1; Isard 2005, p.122). The crisis erupted in Thailand in July 1997, when the Bank of Thailand ran out of foreign reserves. Observing a decline in Thailand's exports, investors began to doubt whether the government would be able to maintain the fixed exchange rate between the Thai baht and the US dollar. Capital flew out as domestic and foreign investors feared a decline in the dollar value of their investments and the possibility that there would be insufficient foreign reserves to meet all claims. Thailand was forced to let the baht float and to resort to the IMF, whose rescue package imposed several conditionalities on Thailand's financial system, and eventually triggered a stock market collapse (Noble & Ravenhill 2000, pp.2–3). After Thailand's breakdown, other economies with similar characteristics became targets of speculative attacks: Indonesia, the Philippines, Malaysia, and South Korea were all to suffer similar crises. Following the devastation of these economies, there was a further round of contagion through trade with negative effects on the whole globe.

The global economic slowdown triggered by the Asian financial crisis resulted in a sluggish demand for crude oil, causing a sharp reduction in its price, which in turn decreased Russian foreign reserves. This external shock combined with other vulnerabilities of the Russian economy, such as a high fixed exchange rate between the ruble and foreign currencies and a persistent fiscal deficit, led to the 1998 Russian financial crisis. In August 1998, the Russian government devalued the ruble, defaulted on domestic debt and declared a moratorium on foreign debt.

After the Asian and the Russian crises, international investors became more risk-averse to emerging market exposure, which led to rising interest rates in these countries. The effects of such crises were soon felt in Brazil, where a US$ 41.5 billion IMF package in November 1998 was not enough to prevent a financial crisis and the abandonment of the fixed exchange rate system in January 1999.

The financial crises in emerging market economies in the second half of the 1990s exposed the instability of the international monetary and financial system and also the incapacity of the IMF to deal adequately with new challenges on a global scale. This scenario revived the debate about the necessity of reforming the prevalent monetary and financial system and developing a stronger structure for global capitalism (Garten 1999).

From the developed countries' point of view, the emerging markets' crises in the 1990s revealed that those states were big enough to interfere in developed countries' financial markets. In this context, the G7 finance ministers decided that it was time to include key emerging economies in global economic management efforts. In late 1999, the G20 forum of finance ministers and central bank governors was established, adding 12 new members – Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, and Turkey – to the original G7 members – Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States – plus the European Union. The idea behind the new forum was to strengthen the dialogue among developed- and emerging-economy states within the framework of the Bretton Woods' institutional system in order to promote international financial stability.

From the emerging-markets states' point of view, the crises in the 1990s made clear the inability of the IMF to respond to their needs. First, the volume of resources provided by the IMF proved insufficient to avoid capital flight and exchange rate instability. Second, the conditionalities imposed by the Fund were considered extremely severe, such as policies of recessive macroeconomic adjustment and structural reforms.

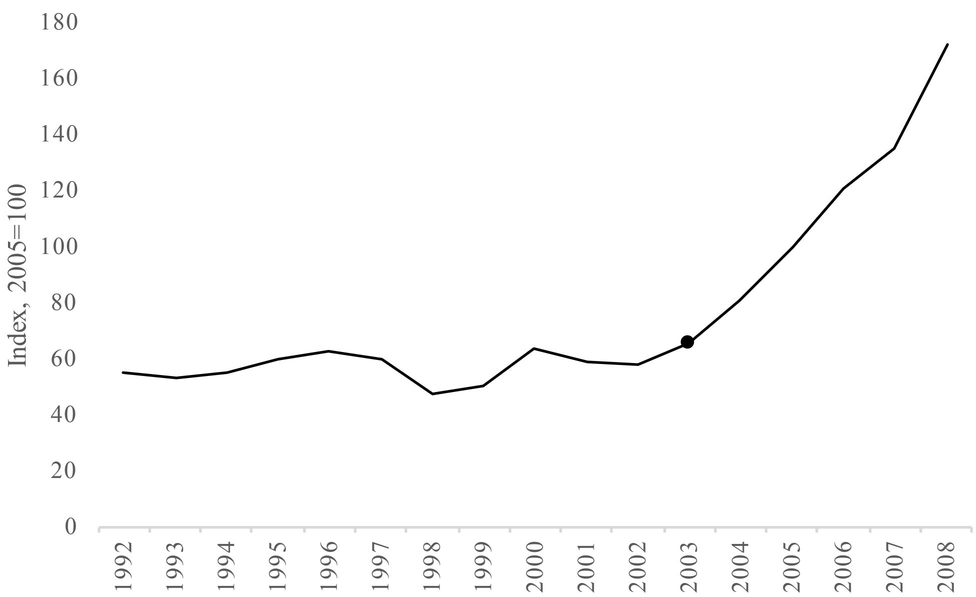
The IMF's failures to deal with emerging markets' financial crises in the 1990s opened up space for regional initiatives of monetary and financial cooperation and, at the same time, added pressure to reform the Bretton Woods Institutions (BWIs). In particular, the growing weight of East Asia in the global economy and its ability to cause worldwide damage to it called attention to the region's underrepresentation in the IMF and other key institutions. This notion of a democracy deficit also reached the World Trade Organization (WTO). In the course of the Doha Round, which began in 2001, developing-country states resisted the US-EU agricultural proposal. In August 2003, during the Cancun Meeting, a document signed by twenty states offered an alternative framework on agriculture to the proposal of the US-EU. These twenty states became known as Group of 20, which allegedly negotiated on behalf of the developing world.

Simultaneously, emerging-market states began to accumulate foreign reserves as a strategy to protect themselves against further currency attacks. As Martin Feldstein (1999, p.1) advised in early 1999, "liquidity is the key to self-protection". In fact, countries with higher international liquidity, such as China and Taiwan, were less susceptible to speculative attacks against their currencies during the crises of the 1990s. The accumulation of foreign reserves by emerging-market states began to outline a new dynamic in the international monetary and financial system, which Dooley et al. (2004) called Bretton Woods II.

In this context, a unique symbiosis developed between the United States and China, where China became an increasingly important creditor of the US. The dynamic behind this relationship was that the United States had become the main importer of Chinese goods, transferring dollars to China. These dollars were acquired by the Bank of China to accumulate reserves and avoid currency appreciation, which could hamper Chinese exports. China's large currency reserves were then channelled into US Treasury bonds, financing a rising American budget deficit.

These trends of the global economy became clearer after 2003 and inaugurated a new global economic dynamic that would last until the 2008 financial crisis. This transformation was largely rooted in China's economic take off and its spill over into the major commodities markets, particularly oil, as well as into other emerging market economies, particularly the commodity producers (The Economist 2004; The Economist 2003; IMF 2004, chap.1 and 2; UNCTAD 2005, chap.3; Prates 2007, pp.335–341). Figure 8 below shows the increase in commodity prices since the early 2000s.

FIGURE 8: COMMODITY PRICE INDEX, 2005=100, 1992-2008



Source: IMF, World Economic Outlook. Elaborated by the author.

Against the backdrop of these transformations to the global economy, this chapter analyses how Brazilian policy-makers dealt with the emerging markets' financial crises and considers the consequences of China's rise on the Brazilian economy. The first section examines the first years of the Real Plan until the Russian crisis spilled over into the Brazilian economy, placing it in the eye of the financial hurricane. The second section discusses Brazil's negotiations with the IMF to receive its November 1998 rescue package and how this package was insufficient to contain international pressure on the exchange rate, which was devalued in January 1999. The third section analyses the last crisis Brazil went through during this period, which was triggered by the ascension of the leftist candidate Lula in the October 2002 Presidential elections and then turns to the effects of the rise of China on the Brazilian economy. The fourth section looks at Brazil's external influence over this period. The final section concludes the chapter.

3.2 SMOOTH SAILING ON ROUGH SEAS (1995 TO 1998)

The year of 1995 began with several economic uncertainties for Brazil. As argued in chapter 2, the first years following the Real Plan and Cardoso's election must be understood within a political and economic domestic context where maintaining price stability was of highest priority. When Cardoso's government took power on 1 January 1995, half a year after the introduction of the new currency, many remained sceptic about the success of the Real Plan, not least because the five previous attempts at bringing down inflation had failed. Added to this suspicion was the fact that inflation did not drop in the first year of the plan and the Brazilian economy was clearly overheated. At the international level, the Mexican crisis came as a warning for Brazil of the likely negative effects of currency devaluation on inflation. In this context, the government's highest priority was to secure the Real Plan's success.

One of the main pillars for keeping inflation down was the exchange rate policy inaugurated in July 1994 and which lasted until January 1999, when Brazil suffered a speculative attack against its currency along similar lines to that which happened to Mexico in 1994. In essence, this policy consisted of maintaining an overvalued exchange rate, which worked as a nominal anchor to control inflation. In practice, however, there were some changes to the exchange rate policy management over this period. The system started with a float and, quite unexpectedly, the real appreciated, even surpassing the value of the dollar (Franco 2000, p.36). In September 1994, the exchange rate reached the lowest admissible level fixated by the Central Bank, at R$0.83 to the dollar (Franco 2000, p.38). In December, after the Mexican crisis, the trend reversed and the exchange rate began to depreciate too quickly. Fearing the effects of a depreciation, the Central Bank established a ceiling for the exchange rate at R$0.86 to the dollar (Franco 2000, p.38). Gradually the system evolved to “crawling minibands” (Franco 2000, p.40), similar to the Chilean regime.[66] In the words of one Central Bank governor:

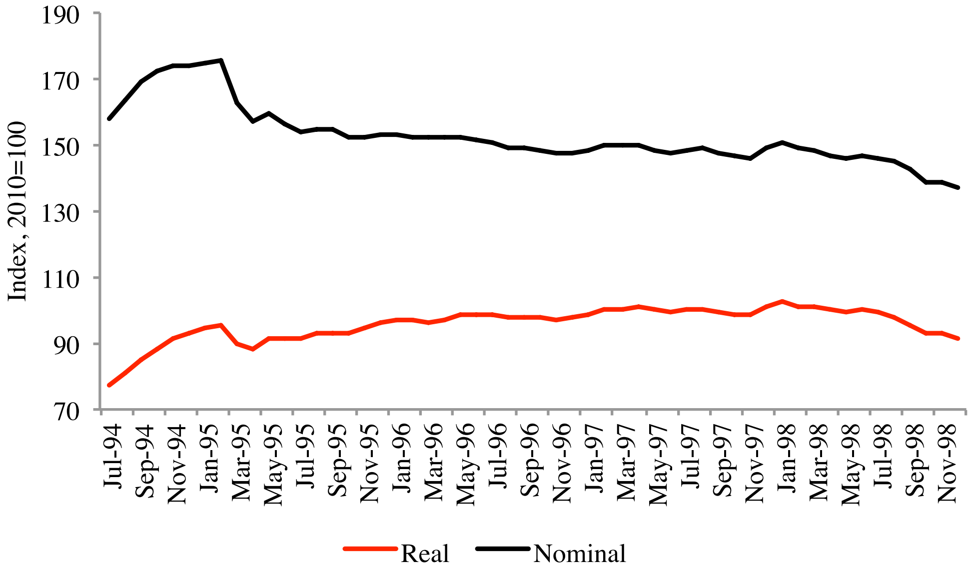
> [The Central Bank] adopted a floating [exchange rate] policy of the real but within certain parameters, which meant in practice the operation of a fixed exchange rate regime rather than a floating [one], but there was a slide, the exchange rate was gradually depreciating. … [The system] was still very focused on the issue of anchoring the inflation, that is, using the external sector as element for reducing inflationary pressures.[67]

Despite the periodic devaluation of the bands, which meant a nominal devaluation of the exchange rate, over time the real exchange rate was actually appreciating. As Figure 9 below shows, from the launch of the real in July 1994 until February 1995 both the nominal and the real exchange rates appreciated, to then depreciate until April that year. From then onwards, however, the nominal exchange rate slowly depreciated and the real exchange rate appreciated because of the differential between domestic and foreign inflation.

[66] The ceiling was made official in March 1995, but the Central Bank initiated intraband interventions only in June 1995. For a detailed explanation of this period, see Franco (2000, pp.37–40).

[67] Non-attributable interview with a former Central Bank governor.

FIGURE 9: NOMINAL AND REAL EXCHANGE RATES, 2010=100, 1994-1998



Source: BIS. Elaborated by the author.

While the strategy of sustaining an overvalued exchange rate was effective to deal with inflation, it created an external imbalance due to consecutive trade deficits and the difficulties of financing the overall current account deficit. Although the Central Bank recognised the problems created by the overvalued currency, it was deemed necessary to control inflation, as related by a former Central Bank governor:

> It was a process of stabilization, a process of consolidation of the [Real] plan. So we knew, we intuit, that at some point we had to move from fixed exchange rates to a floating exchange rate regime. And the floating exchange rate has some advantages, but at that moment the debate was quite complex due to the risks that a floating exchange rate could bring to the inflation at that initial moment.[68]

On the one hand, the deficits in the trade balance were the result of a dramatic increase in imports that followed the Real Plan (associated with a greater purchasing power of the

[68] Non-attributable interview with a former Central Bank governor.

population and an overvalued exchange rate) combined with unimpressive exports results. On the other hand, the current account deficit was financed by capital inflows, mainly in the form of FDI, which increased from US$2.6 billions in 1994 to US$26.1 billions in 1998 (Franco 2000, p.28). The resulting larger payments of interests, profits and dividends produced an increasing deficit in the services and income balance. Hence, the current account went from a surplus of 0.3 per cent of GDP between 1991-1993 to a deficit of 4.5 per cent of GDP in 1998 (Franco 2000, p.28).

The current account deficit had to be compensated with a surplus in the financial account, which was achieved mainly through the maintenance of prohibitive interest rates. In addition, the privatisation process that had begun under President Collor was broadened substantially under Cardoso, contributing to increased capital inflows and at the same time helping the government to deal with its fiscal problems, which was another main issue at that time. As explained by a Central Bank governor:

> We realized that due to the differential of domestic inflation to foreign inflation that over time our currency was appreciating in real terms, which of course would lead to a certain external imbalance. In the beginning [it was possible to] finance [the disequilibrium], due to large inflows of foreign capital, direct investment, etc. At that time there was a lot of foreign capital inflow due to privatizations. So there were no balance of payments' problems at the beginning.[69]

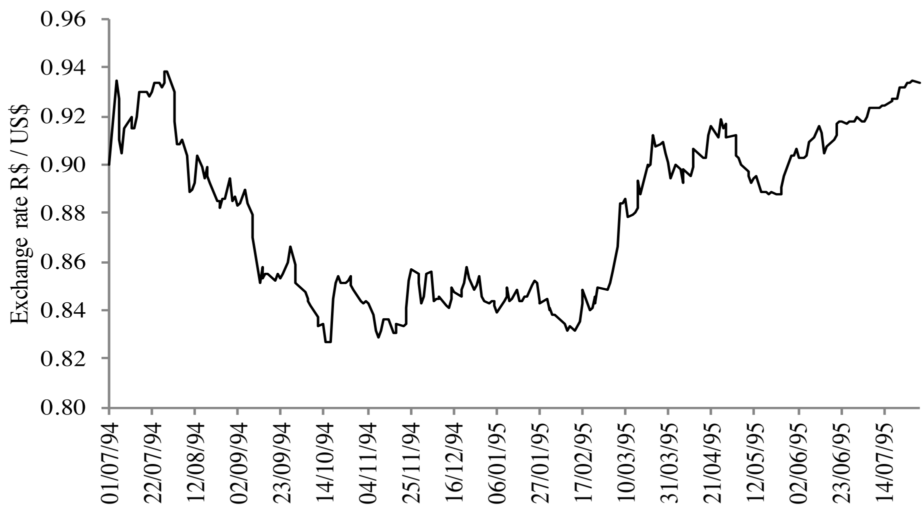
The other imbalance that this approach engendered was in the fiscal situation of the government, particularly due to the high interest rates applied to attract international capital inflows. The government used the credibility acquired through the Real Plan to finance its deficit by raising funds in the domestic and international markets by promising to make the necessary expenditure and revenue adjustments gradually. In addition, due to reasons that will

[69] Non-attributable interview with a former Central Bank governor.

be discussed later in this section, the government also failed to implement badly needed fiscal reforms, such as the reduction in expenditures on personnel, the reform of the civil service pension system and of the social security system (Giambiagi 2011, p.172; Baer 2013, pp.131–135). In any case, as long as international capital inflow levels were maintained, both the trade balance deficit and the fiscal disequilibrium were sustainable, although very expensive.

Amidst this delicate domestic situation, where the fear that inflation would return justified the acceptance of the imbalances created by an overvalued exchange rate, the Mexican crisis broke out. In the immediate aftermath of the Mexican crisis, there was practically no visible impact of the *tequila effect* on the Brazilian currency, as noted by a Central Bank director at that time: "Brazil was more important within the asset class of emerging economies, and there was such a good thing happening with Brazil that the Mexican crisis impacted much more in other emerging than in [Brazil]".[70] In fact, as Figure 10 shows, it was not until March 1995 that the currency began to depreciate.

FIGURE 10: EXCHANGE RATE R$ / US$, DAILY VALUES, 1994-1995



Source: Central Bank of Brazil. Elaborated by the author.

[70] Non-attributable interview with a former Central Bank governor.

The speculative scenario that followed prompted the adoption of a ceiling for the exchange rate in March 1995 to prevent excessive depreciation which could endanger stabilisation. Other than this adjustment in the exchange rate regime, which was accompanied by an increase in interest rates, the *tequila effect* on the Brazilian economy was relatively small.

Two years later the international economy was hit by the Asian crisis, and the Real became again a target of international speculators. Then the main concern for the Central Bank was still the negative effects that could be brought by a sudden devaluation of the exchange rate. As a Central Bank director at that time said:

> [The Asian crisis] had a double impact: one on the exchange flow, which was not so great, [and another] on financial flows, which if we have done nothing would have had a quite big devaluing [effect] in the currency, which at that time we did not want to. Inflation was falling below 5 per cent per annum exactly at that moment, so to allow a devaluation of 40, 50 per cent, I do not know how big it was going to be, it was crazy. … Then there was a pressure on our reserves, which is normal during crises, but the biggest pressure came from the derivatives.[71]

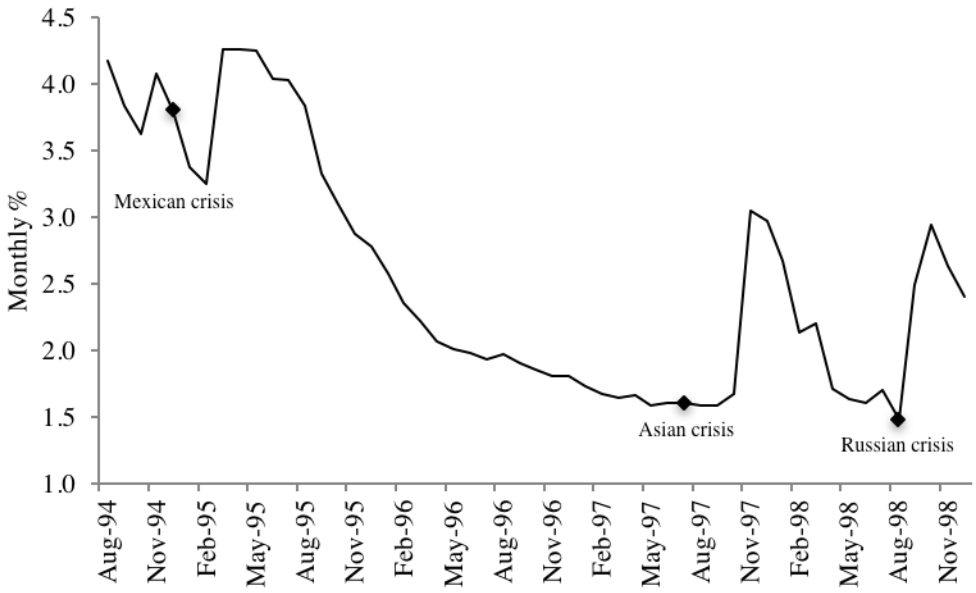
As in the Mexican crisis, the primary impact of the Asian crisis was an increase of speculative pressure on the national currency, which caused the Central Bank to tighten monetary policy so as to discourage capital outflows. As a Central Bank governor said: "to beat down these speculative attacks, the Central Bank had to raise interest rates, it had to impose a really much stronger monetary policy".[72] As Figure 11 illustrates, every time there was an external shock the Central Bank had to respond with extremely high interest rates in order to defend its currency and to prevent the devaluation that could potentially bring inflation back, as had happened in Mexico. In annualised terms, Brazil's interest rate increased from 19 per cent in

[71] Non-attributable interview with a former Central Bank governor.

[72] Non-attributable interview with a former Central Bank governor.

to 45 per cent in late October 1997 (which is the increase of 1.5 per cent to 3.2 per cent represented in Figure 11 in monthly terms).

FIGURE 11: INTEREST RATE (SELIC), MONTHLY PER CENT, 1994-1998



Source: Central Bank of Brazil. Elaborated by the author.

Fortunately, the Brazilian currency was once again able to survive the speculative attack. Amidst the Asian turmoil, Brazil issued in the US market a 30-year bond, the Global 2027, which was then the longest maturity ever issued for a Brazilian government bond (Pedras 2010, p.68). Moreover, Brazil also exchanged securities for the first time, which allowed US$2.2 billion in Bradies to be repurchased (Pedras 2010, p.68). On top of these efforts, by April 1998 the Central Bank had accumulated a record of U$74 billion in international reserves. Embodying Brazil's performance, the then Central Bank governor, Gustavo Franco, was elected the central banker of the year by the British magazine *Euromoney*. As he said:

> What we did [during the Asian crisis] was an overwhelming victory against the speculative attack, and that may have given us a sense of self-sufficiency somewhat exaggerated. Well, from our side, the Central Bank was very secure about the management of these instruments of intervention in the exchange market. We also

> increased interest rates, then we lowered, thus we had total freedom to practice this kind of action.[73]

While Brazil withstood the Mexican and Asian crises, the government was unable to tackle its fiscal imbalance during those years. This was due to an interplay of economic and political factors. First, the fiscal situation was aggravated by the maintenance of high interest rates that, as explained earlier, were necessary to attract international capital flows and so sustain the exchange rate, which was a central element in controlling inflation. As this section showed, during this period there was little space to lower interest rates, since the real was continuously targeted by international speculators.

Second, the delay in the fiscal reform was also the result of a deep division within the Brazilian Congress, which refused to accept reforms that could restrict the fiscal autonomy of the states and municipalities or that could negatively affect conditions of employment in the public sector (Baer 2013, p.135). As the end of the government grew near, the Congress increased its advantage over Cardoso, who was investing a good deal of his political capital to secure a constitutional amendment authorising re-election already in the October 1998 elections. Indeed, the constitutional amendment, which depended on Congress' approval, would allow Cardoso to run for re-election. In this context, the Congress used its leverage over the president to reduce the scope and pace of fiscal reform (Baer 2013, p.136).

Third, because there was much less uncertainty regarding the success of the Real Plan in tackling inflation than in previous years, it became politically harder to justify an economic policy that resulted in high unemployment and low economic growth. In other words, the absolute and unquestionable commitment of the government to price stability that marked the

[73] Interview with Gustavo Franco.

beginning of the Real Plan gradually faded away as the Brazilian economy emerged unscathed from the speculative attacks against its currency. At the same time, other concurrent priorities began to emerge, particularly when Cardoso envisioned the possibility of being re-elected. As a Central Bank governor at that time put forward:

> We went until there with a bad fiscal situation, and the [Asian] crisis came, we renewed the promises to fix the fiscal situation, showed the measures, used a cumulative credibility, operated very well in the markets, did everything right. The only thing that happened is that three months after the crisis … we in the economic area noticed that the fiscal figures were even worse than before … I think the President was very, exceedingly, tranquil with our ability to deal with crises, so he was not as diligent with the fiscal situation as he promised, and should have been. So when the Russian crisis came, just afterwards, then it caught us flat-footed, then it was cruel.[74]

As the next section will show, in contrast to the Mexican and Asian crises, the Russian crisis, which broke out in August 1998, resulted in an almost complete termination of capital flows to emerging markets, particularly ones like Brazil with visible and chronic problems. The shortage of international capital was worsened by the international bailout of the Long Term Capital Management (LTCM) hedge fund management firm in September that year. This time the attack was much stronger and radically reduced the policy options available to the Brazilian government.

3.3 FASTEN YOUR SEATBELTS: THE REAL CRISIS (1998-2001)

After the Russian collapse, Brazil became the centre of speculative attacks. The attack in Brazil came mainly through the C-bonds, the most liquid bond issued by Brazil in international markets that is used as a measure for risk premium. The C-bond risk premium rose from 600

[74] Non-attributable interview with a former Central Bank governor.

basis points in July to more than a thousand in August, reaching 1,403 on August 27 (Figure 12). These bonds were negotiated internationally and therefore were beyond the reach of the Central Bank. As a Central Bank governor at that time said: “for us it soon became clear that the Russian crisis was much more serious, much deeper. It was going to affect us much more, it was going to require more effort, etc., and then we had a credibility deficit, something that we never had until then”.[75] The credibility deficit occurred because the government had failed in implementing the so-called *Pacote 51* in response to the Asian crisis, which was supposed to substantially decrease government spending and so reduce the fiscal deficit.

FIGURE 12: C-BOND SPREAD, DAILY VALUES, 1997-1999

Source: Ipeadata. Elaborated by the author.

In this context, raising interest rates to discourage capital outflows became ineffective and increasingly unsustainable as interest rates levels came close to 50 per cent in annualised terms by September 1998. Thus, to avoid a currency devaluation, and the negative inflationary effects

[75] Non-attributable interview with a former Central Bank governor.

it would engender, the Cardoso government turned once again to the IMF. As a Central Bank governor at that time stated:

> Fernando Henrique brought everyone together one day at the Palácio [do Planalto, the official workplace of the President of Brazil], a secret meeting, to say "we are going to make an agreement with the IMF, because it is a way to borrow a credibility that we dissipated, and at the same time it is going to obligate us to make the fiscal 'homework' that we did not do".[76]

With the October 1998 elections looming, Cardoso made a speech announcing his decision to negotiate with the IMF. According to a close observer:

> It was a difficult decision, because then Fernando Henrique had to change his mind and say "the campaign is going to be different: instead of campaigning for [growth], my campaign is going to be 'I know how to deal with crises,'" which was what elected him at that time. So there were unthinkable things during the election period, like increasing interest rates and such. It was really a crisis. [There were] some days that we lost a billion and half of reserves, some days even more; a lot of nervousness in the market, but he showed a very tranquil face.[77]

As indicated in Brazil's Letter of Intent to the IMF in November 1998, the program with the Fund was of a "preventive nature" (IMF 1998, p.1) and was intended to restore the country's credibility and to reduce the risk-aversion problem due to deep uncertainties in the financial international markets at that time. The IMF announced a US$41.5 billion rescue package for Brazil, which combined a stand-by credit of the Fund of about US$18 billion, US$4.5 billion from the World Bank and a similar amount from the Inter-American Development Bank, plus loans from 20 countries under the New Arrangements to Borrow (NAB) that amounted to US$14.5 billion, of which the US contributed the largest sum of US$5 billion. As explained by

[76] Non-attributable interview with a former Central Bank governor.

[77] Non-attributable interview with a former Central Bank governor.

a former Central Bank governor, the program required the cooperation of the international community, since the package approved largely exceeded Brazil's access to IMF financing:

> The IMF is not a bank, it is an organization that when it needs to lend money through a stand-by agreement, it goes until 5 times the quota. I think Brazil's quota was US$3 billion so the IMF could automatically lend some US$15 billion … but we wanted to make a US$40 billion package, so to make the US$40 billion package the IMF used a supplementary facility that had been created during the Asian crisis … The agreement required many meetings, like one to one, and there was a great deal of goodwill. … In general, the agreement was a very nice experiment of organization, of international cooperation led by the IMF, everyone was happy with the program.[78]

In fact, compared to the rescue packages that had been offered to the Asian countries, the Brazilian package had much better conditions. As a close observer noted: "the Fund never did here what it did in other countries [referring mainly to Asian countries], those absurd conditionalities… a country like Brazil does not have to accept these things, and we were not in such a desperate situation as well".[79] Another reason why the package was considered favourably from Brazil's perspective was the convergence of ideas about what was necessary between Brazilian policy-makers and the IMF's staff. As a Central Bank governor noted:

> I think it is good when you make an international agreement where the other party wants you to do something that is in your own interest, and that you would like to do anyway. So in this aspect, it was a very good agreement for us; we did not feel obligated to do anything we would not have done ourselves. And I remember very well all of us [the economic team] in the audience with the Senate saying this; every time that the national sovereignty discourse came, I said "I do not have any problems in doing an international agreement that obligates me to do something I was going to do anyway".[80]

[78] Non-attributable interview with a former Central Bank governor.

[79] Non-attributable interview.

[80] Non-attributable interview with a former Central Bank governor.

Finally, there was a soft power element that allowed Brazil to reach a favourable agreement, which was the good relationship between Cardoso and Clinton. As Cardoso said:

> I must also say that actually we reached the 1998 agreement because Clinton supported it. I have until today a very strong relationship with Clinton. … The order of command is so: the Fund has its independence, but the American Treasury has a very overbearing part there, very large, predominant. … I spoke with Clinton when they started to ask a lot, to raise interest rates and such. I said "Bill, I cannot do that, I have just been elected, it will look like I am fooling the people" … Clinton was understanding, and his finance ministers as well, … Obviously it was not unconditional, … but when you have political trust it is easier for you to get a more positive negotiation.[81]

By mid-December 1998, the Brazilian Congress had approved about two thirds of the fiscal adjustment provided in the IMF's program. Despite the economic stagnation, inflation had finally been beaten down, allowing the dismantling of the mechanisms created to deal with those astronomical inflation levels. As explained by a former Central Bank governor: "Brazil truly deindexed from 1997 to 1998, when inflation fell lower than 2 per cent; … it detoxified people's minds. That was very important, we perceived on a daily basis people getting rid of the annoyance that was to deal with inflation".[82]

Nevertheless, the following months were marked by economic and political turbulence that impaired the hitherto fairly positive expectations about Brazil's economy. Led by the state Governor of Minas Gerais Itamar Franco, the newly elected governors of opposition parties declared a moratorium on the service payments on the debt owed by the states, including Rio Grande do Sul and Rio de Janeiro. This was followed by the Congress' rejection of the government's pension reform proposals, increasing the distrust about the government's commitment to fiscal adjustment. Meanwhile, the current account deficit kept mounting, intensifying the internal debate about the future path of the exchange rate policy. As argued in the previous section, there was a relative consensus amongst Brazilian policy-makers that the

---

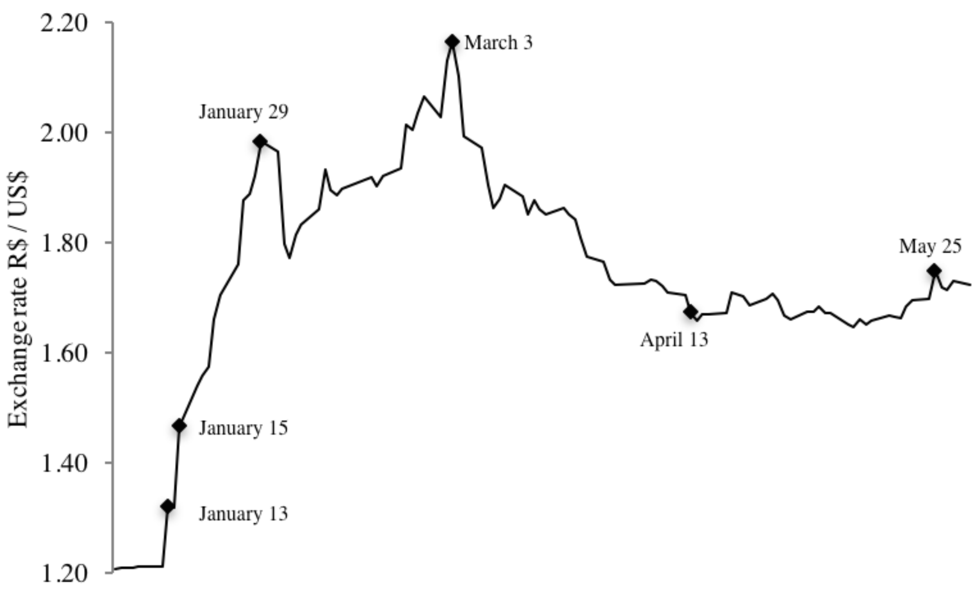
[81] Interview with Fernando Henrique Cardoso.

[82] Non-attributable interview with a former Central Bank governor.

currency was overvalued and that they should eventually adopt a floating system, but significant disagreement remained about how to make a smooth transition.

In early January 1999, President Cardoso decided to support the proposal headed by Francisco (Chico) Lopes which intended to allow a speedier devaluation of the real by raising the currency ceiling faster than the currency floor. The new exchange rate policy was formally announced on January 13, and on that first day of the new band system the exchange rate already reached its ceiling, representing a devaluation of 9 per cent. The band system lasted for another 24 hours until it became unsustainable and the Central Bank, this time with absolutely no alternatives, allowed the real to float (Figure 13).

FIGURE 13: EXCHANGE RATE R$ / US$, DAILY VALUES, 1998-1999



Source: Central Bank of Brazil. Elaborated by the author.

The devaluation of the currency was immediately followed by a substantial increase in interest rates, because the new Central Bank governor, Armínio Fraga, feared that the Brazilian economy could follow the Mexican path. In his own words:

> [In Mexico] there was an overshooting in the exchange rate and Mexican inflation skyrocketed, reaching almost 50 per cent in the intra-year or even more. We had a huge fear that in our case this was going to re-index [the economy]. I mean, it is a country with a very strong history of inflation and this is somewhat built into the behaviour of companies and of people, and in the end this was going to be the end of the Real Plan, so we did everything for that not to happen. … Opinion polls about inflation expectations suggested something between 20 and 50 per cent, and we knew that any two digits number was going to prejudice us a lot. So there was the formation of the inflation targeting system, with the floating exchange rate, and so on.[83]

To that extent, the abrupt raise in interest rates must be placed within the context of an economy that had just very recently disentangled from persistent high inflation, and the fear expressed by monetary authorities of the return of high inflation was real given the Mexican experience. Also, the increase in interest rates was not the only response of the government towards the crisis. As noted by a former Central Bank governor: "since 1998, Brazil had been finally making the fiscal adjustment, and there was all this work of building trust, not only to help to cover the balance of payments needs, but also to change the risk perception associated with Brazil at that moment".[84]

Rebuilding international confidence was essential since the main inflationary element affecting the Brazilian economy was the exchange rate, which was in turn connected to the balance of payments, in particular to the capital account, where fluctuations happen much faster than in the current account. The first step was to re-design Brazil's program with the IMF, adapting its terms to address the new reality of a floating exchange rate and inflation targets. Following the rapprochement with the Fund, the Brazilian economic team also invested in strengthening its ties with the rest of the international community. As the Central Bank governor then related:

> Even before I was approved [by the Senate] for the Central Bank, I went to Washington along with Amaury Bier, who was the executive secretary in the Ministry of Finance,

[83] Interview with Armínio Fraga.

[84] Non-attributable interview with a former Central Bank governor.

> and we spoke with the IMF, with the American Treasury, to rebuild the basis of trust … We restructured the agreement, we got the American support, … and then it took off. Then we travelled the world to speak with the banks, to show our balance of payments, that we did not need too much rolling from them, that it was a problem that could be solved. … It was an effort of coordinating expectations … so we did this comprehensive work with three groups traveling to Asia, Europe, and the United States, making several presentations for banks, investors, saying "look, this is our problem, this is what we are doing, this are the reforms we are proposing and executing, and it has everything to succeed". And it worked; it was almost as by magic. [After] that raise in the interest rates, which was the biggest, the last one, the interest curve spectacularly inverted, and then we knew that the thing was going well.[85]

These efforts on the part of the Brazilian government did indeed prevent the return of inflation, and from early 1999 the Brazilian economy began resuming its growth. The government succeeded in improving the fiscal situation, which began with the partial approval of the social security reform in December 1998, and later with the approval of the Fiscal Responsibility Law (LRF, *Lei de Responsabilidade Fiscal*) in May 2000, which represented a budget constraint to all levels of government. The LRF together with the floating exchange rate policy and the inflation-targeting regime formed what became later known as the macroeconomic tripod.

In addition to the adoption of the macroeconomic tripod and the reconciliation with the international community, another element that helped Brazil to overcome the 1999 crisis was the reforms made to the Brazilian financial system during the so-called first phase of the Real Plan. In the words of a Central Bank governor at that time:

> When Brazil came out of the 1999 crisis, it was left in a much better situation than other countries because there was no financial crisis. In fact, we took advantage during [the period preceding the 1999 crisis] to modify the financial regulation and strengthened the financial system, taking out its weakest points so that there was no strong spill over from the exchange rate crisis to a financial crisis.[86]

[85] Interview with Armínio Fraga.

[86] Non-attributable interview with a former Central Bank governor.

Indeed, the Brazilian economy underwent a deep reorganisation of its banking and financial system at that time, including a reorganisation of federal public finances, mainly of states and of public banks. In particular, there were three concurrent programs: PROES, which was essentially a program of privatisations of state banks, but also included the resolution of the states' domestic debts; PROEF, which was a program of recapitalisation of federal banks, and also the privatisation of some, such as the Banco Meridional; and the PROER, which included the consolidation of some big banks, such as the Bamerindus, as well as the restructuring of prudential rules and the creation of the Credit Guarantee Fund (FGC, *Fundo Garantidor de Crédito*). Together these reforms amassed to transform Brazil into a more robust economy, as a respected researcher at the government observed:

> After the Real Plan it was necessary to restructure the Brazilian banking and financial system: the PROER and PROES. Since then Brazil has a set of rules for operation of the banking system that goes beyond the Basel agreement. … This is very important because it gave an image of seriousness and of potential control of the monetary authority in terms of standardization and supervision that only a few countries have.[87]

The resumption of growth was again interrupted by a combination of crises in 2001. Beginning with the events of September 11 that year, the Brazilian economy was affected by the general increase in global risk aversion and doubts over the pace of global growth. In December that year, the Argentinean government declared default on its foreign debt. Such a turbulent external environment was then coupled with a serious domestic energy crisis and the government was forced to ration the energy supply both to the general population and to companies.[88] As noted by a former Central Bank governor at that time, the Brazilian economy resisted the turbulence relatively well:

[87] Non-attributable interview.

[88] This episode would be remembered as the *Apagão* (blackout).

> This [Argentinean] crisis disturbed us, but it did not come alone: the drama was that it came together with the energy crisis, September 11, global recession, global crisis, it was a very bad period. And it caught us, but at that moment we were better prepared, things were going well, inflation expectations had been converging … then [inflation] expectations took off a bit because there was an impact in the exchange rate, and also because of the energy crisis. But it was a mini-crisis.[89]

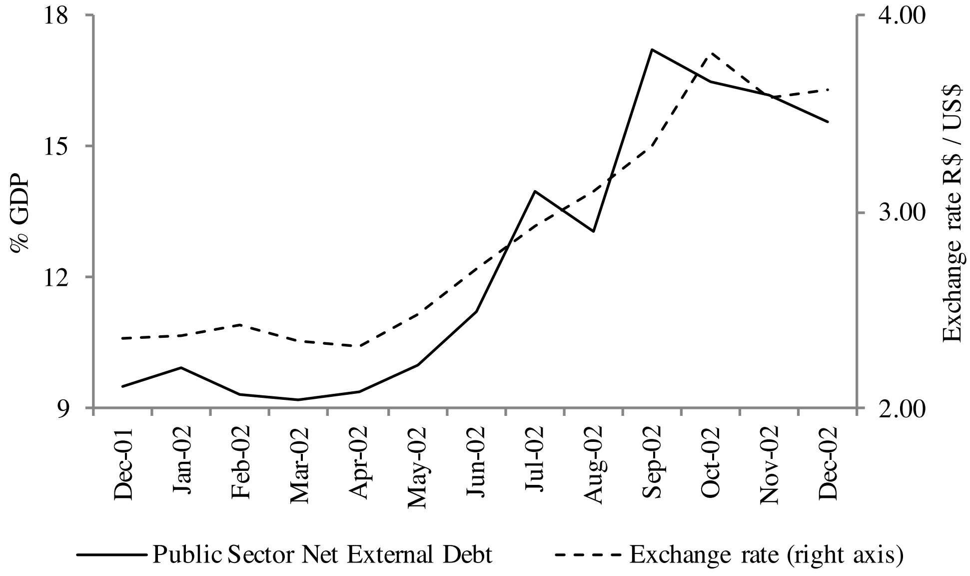
The greatest test, however, came during the Presidential elections in 2002 in light of the possible ascension of the leftist candidate Luiz Inácio Lula da Silva. Lula had been running as the Workers' Party (PT, *Partido dos Trabalhadores*) candidate ever since the first democratic elections for president after the end of the military regime in 1989 and was consistently the second most voted candidate in every election since then. Hitherto his electoral campaigns had been marked by the defence of a socialist economy, by criticising the Real Plan and by the motto "get out IMF". As the next section will show, Lula's ascension in the polls triggered a general crisis of confidence as many people feared that his election could discontinue Cardoso's economic policies.

3.4 TAILWINDS FROM CHINA AND ECONOMIC EMPOWERMENT (2002-2005)

In 2002 Brazil's economic position remained fragile. The public debt was considerable and increasing, and the current account deficit remained substantial even four years after the adoption of the floating exchange rate. At the time, much of the foreign and domestic debt was indexed to the dollar so that the depreciation of the currency had an immediate impact on the public debt (Figure 14).

[89] Non-attributable interview with a former Central Bank governor.

FIGURE 14: PUBLIC SECTOR NET EXTERNAL DEBT AND EXCHANGE RATE R$/US$, MONTHLY VALUES, DECEMBER 2001-DECEMBER 2002



Source: Central Bank of Brazil. Elaborated by the author.

Under such suboptimal economic circumstances, the PT's candidate Lula began to ascend in the polls for the upcoming October 2002 presidential elections, augmenting uncertainty over an already delicate equilibrium, as explained by a former Central Bank director:

> Then, the big question people had at that time was this, "look, will step into power a president who in the past criticized the debt, who criticized the fiscal policy to maintain the solvency of the debt, and who advocated increasing spending". Right or wrong, this was the perception people had from Lula … so you start to do the maths, you see, "well, with the dollar at R$4, or nearly that, Brazil needs to generate a primary surplus of 4 per cent of GDP to prevent the debt to explode. As this will not happen, the debt will explode, there will be a default, and Brazil will break". Simplifying, this is the logic. Now, the original weakness lay in the fact that [the Brazilian government] could not allow the exchange rate to depreciate much because the government had a weak external position.[90]

It was a typical case of a self-fulfilling prophecy, where the fear of Brazil's default triggered capital outflows, reinforcing the real's weakness, which in turn augmented the public debt that

[90] Non-attributable interview with a former Central Bank director.

increased the fear of default. Economic agents dreaded that a leftist candidate would discontinue Cardoso's economic policies and instead assume higher public spending and inflation, a decision which could lead to another Brazilian default. The financial market's anxiety regarding Lula was embodied, for instance, in the "Lulameter," a mathematical model developed by Goldman Sachs in June 2002 to quantify the probability of a Lula victory through the behaviour of prices in currency markets (Goldman Sachs 2002, pp.10–12).

As the 2002 election approached, Lula kept rising in the polls and the exchange rate increasingly depreciated, augmenting the risk of a default. As a Central Bank governor at that time said:

> If Lula won and followed the PT program, Brazil would explode, so there was this well-founded fear about what was there in the party program. And then what happened, as time passed, the fear was gaining ground, was growing, and we began to feel pressure on the exchange rate … in July it was already clear to us that this was a totally explosive situation and that something had to be done, and that the most important response was not in our hands, because people used to say to us, "all right, we know that you are competent, but you will not be here, so I do not want to be stuck in here, in this very uncertain environment, in fact more than uncertain, dangerous". The expectation was very realistic and it was correct.[91]

In contrast to previous crisis episodes, the central bank's and the government's hands were this time tied in dealing with the source of pressure on the exchange rate as it was outside its or the government's control. In that situation, the Central Bank, together with the Ministry of Finance, led a political response to the 2002 crisis. They began by opening a dialogue with the presidential candidates, particularly Lula, to make them aware of Brazil's fragile economic situation. Next, the Cardoso government signed a new stand-by agreement with the IMF in

[91] Non-attributable interview with a former Central Bank governor.

September in an attempt to borrow the IMF's credibility, and hence hold the currency's value. In the words of a former Central Bank governor:

> So the exchange rate was depreciating, we did what we could, raising interest rates and so, but [we felt] a bit helpless in the face of a problem that needed to be fixed in its origin. So our response, our strategy to manage this crisis was totally different from the others, and it was political. We started talking with the candidates to bring them to reality, which was nothing good. So that is how it evolved, with a lot of backstage conversations, and at one point it was decided to make a new agreement with the IMF, which we designed in such a way that 80 per cent of the money was going to be disbursed to the new government, so it was a carrot for those who came [to power].[92]

The strategy to contain the crisis was embraced by all of the presidential candidates, including PT's Lula. Throughout the 2002 campaign, Lula had already changed his tone in comparison to his previous campaigns, adopting a less radical image with regard to economic policy. Then in June 2002 the PT launched a document named "Letter to the Brazilian people" (*carta ao povo brasileiro*), which stated that an eventual Lula government would honour all Brazilian debts and financial obligations in an attempt to decrease market uncertainties. The Letter had limited impact, however, on reversing negatives expectations and the real kept depreciating. According to a former Central Bank governor, it was only in September, after the approval of the IMF agreement and when the PT started its television campaign, adopting a conciliatory tone, that prospects turned around:

> I talked with them to show, "look, this is what is happening, it is a problem of expectations," and especially for the PT I said, "it is in your hands, if you show some common sense things will calm down". In June the Letter to the Brazilian People had been released, but it did not have much impact if you look at the market, but it was already the beginning of change. And then when Lula, who was already leading more in September, began to talk, then it started to calm down.[93]

[92] Non-attributable interview with a former Central Bank governor.

[93] Non-attributable interview with a former Central Bank governor.

Indeed, after reaching its peak crisis in September-October, the exchange rate remained stable and then gradually began to recover its value (Figure 15). Despite this recovery, the situation was very tense, as described by a former Central Bank governor:

> At that time, we used to say to people, "Lula is not a revolutionary, he is a union leader; a pragmatic man … he will not explode". But people did not believe: "you are saying this because you are there, you want to survive". It was a very dramatic situation, because the Brazilian government could not roll over the internal debt beyond November that year. Brazil had not only lost access to the international market, which had obviously lost, but also lost access to the domestic market: Brazilians did not want to roll over the debt with maturity later than the end of the year. So it was dramatic. But fortunately, with the answer Lula himself gave, things began to calm down. I mean, it was very clear at that time that the crisis was caused by them, and settled predominantly by them, with our help.[94]

FIGURE 15: EXCHANGE RATE R$/US$, DAILY VALUES, 2002

Source: Central Bank of Brazil. Elaborated by the author.

One of the factors that contributed to calming down the markets regarding Lula's economic policy was the nomination of his economic team. As a former Central Bank governor said:

[94] Non-attributable interview with a former Central Bank governor.

"when Palocci [Antonio Palocci, Finance Minister from July 2003 to March 2006] appeared was the landmark, because Palocci was a man mostly unknown and it was clear that he had a very good sense, that he really would not sponsor any adventure"[95] (see also Spektor 2014). Then, after being elected, Lula named as central bank governor the former President of FleetBoston's Corporate and Global Bank, Henrique Meirelles, alongside several economists linked to the Getúlio Vargas Foundation in Rio de Janeiro – a well-known conservative centre – to key positions in the Ministry of Finance and the Central Bank. As noted by Armínio Fraga:

> They were very wise in the transition. In the Central Bank only I left, [all directors] stayed. Then later they were gradually replaced. … Meirelles was someone who also brought feet on the ground, had international experience, did a great job, surrounded himself very well.[96]

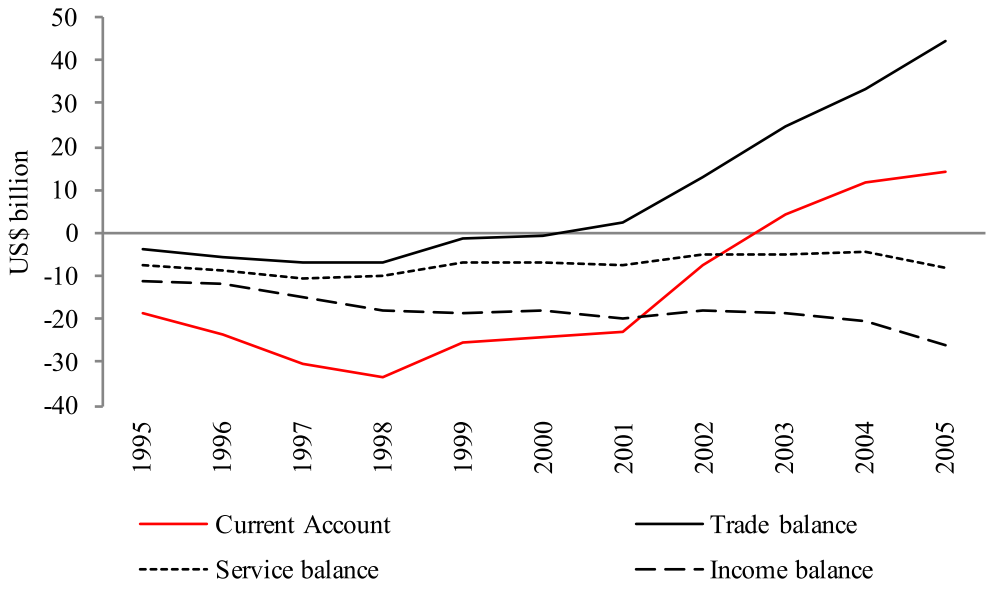
Indeed, the first years of the Lula government were marked by the maintenance of Cardoso's macroeconomic policy framework, the macroeconomic tripod. Lula went in fact further than keeping Cardoso's policies; he reinforced them. His new economic team announced inflation targets of 8.5 and 5.5 per cent for 2003 and 2004, respectively, suggesting a narrower monetary policy. The new government raised interest rates from 25 per cent to 26.5 per cent in the first quarter of 2003 and increased the target for the primary surplus from 3.75 per cent of GDP to 4.25 per cent in 2003, which was to be maintained between 2004-2006. To achieve such targets, Lula announced a cut in public spending, delaying his promise for increasing social expenditures.

The Lula government, however, faced a different external predicament than that of Cardoso's. The economic rise of China combined with a higher international liquidity in the early 2000s

[95] Non-attributable interview with a former Central Bank governor.
[96] Interview with Armínio Fraga.

lessened Brazil's traditional external vulnerabilities and marked the beginning of a less unstable international environment which lasted until the eruption of the 2008 crisis. Remarkably from 2003 onwards, Brazil reversed its historical deficit in the current account and began to accumulate surpluses (Figure 16).

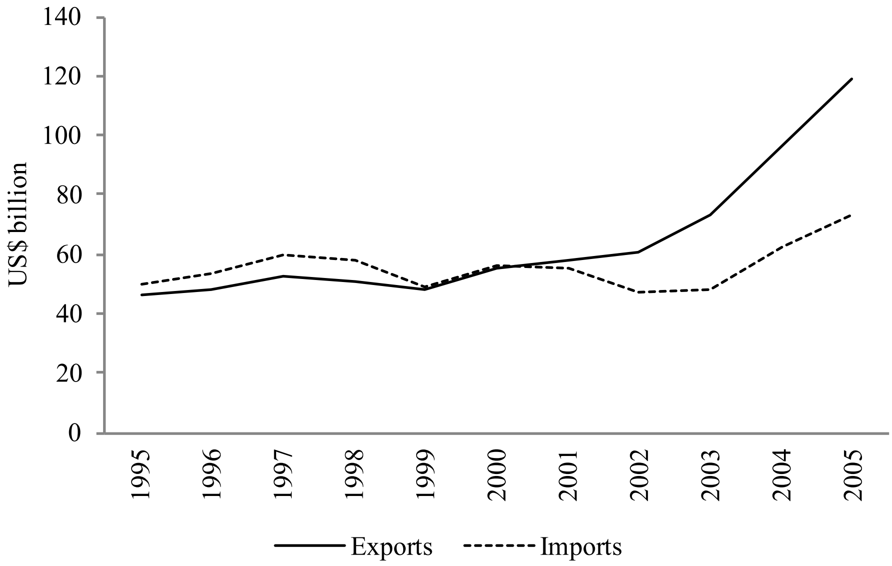
FIGURE 16: BRAZILIAN CURRENT ACCOUNT, 1995-2005



Source: Central Bank of Brazil. Elaborated by the author.

The current account surpluses were principally a reflection of an increase in the value of exports (Figure 17), which, for its turn, could be traced back to the rise of China and its demand for commodities. Exports had been rising since the 1999 devaluation, from US$48 billion to US$60 billion in 2002. In 2003, Brazilian exports jumped to US$73.1 billion and reached US$118.3 billion in 2005. Despite the simultaneous increase in the value of imports, from US$48.3 billion in 2003 to 73.5 billion in 2005, the trade balance surplus swelled from US$24.8 billion to US$44.7 billion. In 2003 the trade balance was for the first time large enough to compensate the current account deficit, which closed that year with a surplus of US$4.2 billion. By 2005, the current account surplus had grown to US$14 billion.

FIGURE 17: BRAZILIAN EXPORTS AND IMPORTS, 1995-2005



Source: Ministry of Development, Industry and Foreign Trade (MDIC). Elaborated by the author.

China's rise and the resumption of capital flows into Brazil also allowed the Central Bank to gradually restore Brazilian foreign reserves. As a former Central Bank director noticed: "the fact is that the emergence of China, China's entry into the international trade flow, benefited [Brazil] greatly in terms of positive terms of trade, etc. It gave Brazil the opportunity to conduct similar policies [of those in Asia] of reserve accumulation".[97] Brazil's motivation for reserve accumulation was not as grounded in anti-IMF action as it had been for Asian countries, not least because Brazil's experience with the Fund had been much less traumatic as argued earlier in this chapter. In the words a former Central Bank director:

> What happened to several countries that faced crises was that they adopted the policies of the IMF; they ended up coming out from the crises, but swearing they would never return to the IMF. … Countries, particularly in Asia, decided they did not want to return to the IMF, and decided to practice aggressive policies of international reserve accumulation in order to, on the one hand, maintain their undervalued currencies to stimulate industry and, on the other hand, get rid of the risk of having to resort to the IMF. At the same time, regional reserve accumulation agreements were also developed; the Chiang Mai agreement is part of this idea. In the Brazilian case, there was no such

[97] Non-attributable interview with a former Central Bank director.

anti-IMF action, so concatenated, so coordinated. I think it was never, from the political point of view, an issue as relevant here in Brazil.[98]

For Brazil, the idea of accumulating reserves was instead more grounded in the idea of building a more robust economy. As noted by a Central Bank director at that time, Brazilian policy-makers, in contrast to their East Asian counterparts, "had no desire to hold the exchange rate, to prevent it to appreciate. … [Instead] there was a perception that it was necessary to accumulate reserves and that reserve accumulation was going to have an important role in reducing the country's risk, as in fact has happened".[99] To that extent, at the time the motivation to accumulate international reserves was mainly to create the image of a sounder economy, as a former Central Bank director at that time remarked:

> When I entered in the Central Bank, there was already a discussion about rebuilding reserves. There was a perception that the level of Brazil's international reserves was inadequate. In total I think [Brazil] had about 40 [billions of dollars], but from these 40 about 25 [billions of dollars] was money from the IMF. In theory, the money was there, but it was not our money. It served to give an impression of solidity. Perhaps if the situation was bad [Brazil] could withdraw, but in theory it was not money to withdraw. So we felt that there was a need. Already in 2003 the National Treasury initiated a process of buying dollars.[100]

Under these more propitious conditions, where Brazil had no risk in the balance of payments and there was a good volume of reserves, the technical area of the Central Bank presented in 2005 a proposal to anticipate the payment to the Fund, which was due in 2007.[101] The proposition of paying the IMF two years ahead of schedule was financially reasoned, since Brazil was accessing the international market already in similar conditions to the ones stipulated by the Fund agreement. Moreover, the early payment to the Fund would be seen as

[98] Non-attributable interview with a former Central Bank director.

[99] Non-attributable interview with a former Central Bank director.

[100] Non-attributable interview with a former Central Bank director.

[101] Non-attributable interview with an official at the Central Bank.

a step forward in Brazil's strategy to signal its growing economic resilience. Such signal only made sense because it was financially grounded, as explained by a high-ranked official at the Central Bank:

> In the end, with the falling costs to access the international market, [Brazil] was already raising resources at even more favourable conditions than the ones with the Fund … But the decision was not strictly financial. It is obvious that if [Brazil] still was raising [funds] at a much higher level than what [Brazil] was paying to the Fund, then the signal would look more like a bravado rather than a rational decision. So it only makes sense at the moment when these rates meet; it does not need to be cheaper: if you are raising near to the Fund's rate then it starts to make sense. You say, "look, our situation has improved so much that we have access to the international market, and we have conditions to pay our debt with the Fund," and it was more in that direction, to send a signal about the strength of Brazil's economic conditions than a signal against the Fund.[102]

Clearly paying the IMF ahead of schedule had assumed a political meaning and had become a symbolic act. In the words of a close observer:

> [Paying the Fund] has a political impact, of course it has. You stop being a debtor of the IMF. And when you are no longer a debtor of the IMF, you do not have to submit to evaluation programs, which is when the IMF may tell you to do something, or you have the famous intention letters, which marked the Brazilian economy from the 1980s to the 1990s. So we submit only to the Article IV, which is the annual assessment that [the Fund] carries out in the economies. … So it is different, when you are in a program of the Fund, the Fund comes to tell you what to do, what you should do, so you change your relation with the Fund [when you paid the debt].[103]

Put differently, while the payment to the Fund had political significance, it only worked because it was economically grounded. As observed by a high-ranked official at the Central Bank: "it was clear that if there was a significant cost differential between what Brazil was raising and what it was paying for the Fund, the signal would not have that strength".[104]

---

[102] Non-attributable interview with a high-ranked official at the Central Bank.

[103] Non-attributable interview with an official at the Central Bank.

[104] Non-attributable interview with a high-ranked official at the Central Bank.

In sum, the external predicament encountered by the Lula government was much more favourable than the one experienced by Cardoso. In the context of China's rise, Brazil's external constraints were reduced, allowing for the reversal of its current account deficits in 2003 and the accumulation of international reserves. This in turn enabled the government to anticipate its payment to the IMF in 2005, two years ahead of schedule. In the words of a high-ranked official at the Central Bank:

> In 2003, [there is] already a scenario in which this structural component around China begins to prevail, affecting commodity prices, and improving the conditions for emerging [economies] in general. Then you start making the adjustment, creating the conditions to resume growth in 2004, 2005 in a stronger way. At the moment when [Brazil] starts to grow in a more consistent way, the *real* stabilizes and begins appreciating, [Brazil starts] to be able to accumulate reserves, the access to the market [improves] … So then Brazil begins to have conditions to build its own defences and then the issue of the prepayment to the Fund entered on the agenda, as an additional element; not to avoid the Fund's interference, because there was none, [Brazil] was already in a situation where the program was over, and it was only paying [not drawing]. It was more in the sense to issue a positive sign and say, "look, our situation is so good that we are settling our debt with the Fund".[105]

Rather than fulfilling the fears that had led to the 2002 crisis, the ascension of Lula as president in 2003 marked a continuity of the policies inaugurated by Cardoso in 1999. Presumably, the endurance of the macroeconomic tripod displeased some of Lula's supporters, who had expected a change with a left-wing candidate in power. As the next section will discuss, the Lula government compensated for its continuity in macroeconomic policy by pursuing a more leftist foreign policy.

[105] Non-attributable interview with a high-ranked official at the Central Bank.

3.5 A RISING POWER: BRAZIL’S EXTERNAL INFLUENCE (1995 – 2005)

The late 1990s and early 2000s marked the time in which emerging market economies had begun to stand out as increasingly relevant players in the global economy. In 1996, Chase, Hill and Kennedy (1996, p.3) called the attention to the *pivotal states*, i.e. states that “could not only determinate the fate of its region but also affect international stability”. These were Brazil, Mexico, Algeria, Egypt, South Africa, Turkey, India, Pakistan and Indonesia. Around the same time, Jeffrey Garten (1996) elaborated his work on *big emerging markets*, or *BEMs*, where he identified ten emerging players in the world economy: Mexico, Brazil, Argentina, South Africa, Poland, Turkey, India, South Korea, the Chinese Economic Area (which includes China and Taiwan) and Indonesia (together with its close trading neighbours such as Thailand, Malaysia, and Singapore). In November 2001, Goldman Sachs economist Jim O’Neill (2001) created the acronym BRIC (Brazil, Russia, India and China) to refer to some of the larger emerging market economies and that consistently put forward good economic prospects when compared to the G7 economies. Two years later, another Goldman Sachs’ report forecast that Brazil would be among the world’s five largest economies by 2050 (Wilson & Purushothaman 2003).

As one of the largest emerging economies, Brazil benefited from this general international perception that emerging markets were increasingly important and deserved inclusion in international financial forums. In 1996 the Central Bank of Brazil was among the eight central banks to be included in the first membership enlargement of the Bank for International Settlements (BIS). Later in 1999, Brazil was also among the countries invited to integrate the G20 forum, which emerged as an informal group of finance ministers and central bank governors of 19 countries and the European Union at the suggestion of the G7 finance ministers after the Asian crisis. As observed by a former Central Bank governor:

> Brazil has been, in this whole process, a strong, a very present interlocutor. For example, in my time, I remember we participated informally in the Basel committee in the beginning. At some point, we were invited – along with other emerging countries, China, India, etc. – to enter the BIS. So Brazil became a shareholder of the BIS … and from there followed an integration process, a greater participation of Brazil, both in terms of supervision and in terms of discussing monetary issues in general. And this also serves for the IMF and such, so we improved.[106]

With the inauguration of a less turbulent period in the international economy after 2003 – a period which coincided with the beginning of the Lula government – Brazil had more autonomy to pursue foreign policy objectives. For many scholars, Lula's ascension in 2003 marked an increase in Brazil's external influence (Hurrell 2010; Sotero 2010; Dauvergne & Farias 2012; Vizentini 2005). Hurrell (2010, p.60), for example, stated that Brazil's foreign policy during the Lula governments was marked by "a new international self-confidence; a determination to forge a bolder and more innovative foreign policy; and a clear sense that Brazil's time has come," and that "building on President Lula's extraordinary personal popularity, the country's continued economic stability, and its increased international activism and assertiveness Brazil has undoubtedly acquired a new global prominence". Sotero (2010, p.72), meanwhile, acknowledged that "at the root of [Brazil's] rise is 15 years of continuity of sound macroeconomic policies and, in particular, the 1999 decision of float its currency, the real, which exposed Brazilian companies to the global market forces at a momentum when they were prepared to engage an expanding world economy". While he gave some credit to Cardoso's tenure – "President Cardoso set Brazil in a new direction in regional affairs, in order to assert the country's autonomy while pushing for integration with its immediate neighbours" (Sotero 2010, p.75) – he made clear that the transformation occurred with Lula (Sotero 2010, p.75). By the same token, Dauvergne and Farias (2012, p.907) also recognised the importance

[106] Non-attributable interview with a former Central Bank governor.

of the Cardoso government when they said that "President Lula's placing of development at the centre of both domestic and foreign policies should not, however, be seen as a rupture with Fernando Henrique Cardoso's presidency (1995-2002), particularly when compared to his last years". But like Sotero (2010) they also focused the change on Lula: "Lula took a different approach, however, highlighting how asymmetric international structures were impeding development, as well as positioning Brazil firmly as a developing – and emerging – economy" (Dauvergne & Farias 2012, p.907).

Conceivably, one of the reasons why Brazil increased its external influence over the years between 2003 and 2010 was because Lula made foreign policy one of the main pillars of his government. Since foreign policy was important to him, he insisted on giving speeches in international forums himself, and only occasionally sent his foreign affairs minister to talk on his behalf – a decision which contributed to Brazil's increased visibility. Drawing on his previous experience of several years as a union leader and taking advantage of his friendly personality and charisma, Lula proved to be a great speaker and a skilful negotiator. A good example of Lula's versatility and ability to engage different interests was in January 2003 when, just after being elected, he attended and spoke at both the World Social Forum in Porto Alegre and the World Economic Forum in Davos.

Nonetheless, the changed international environment was crucial, particularly in respect from 2003 onwards to China's engagement with the global economy and the subsequent reduction of external constraints for Brazil. Moreover, the continuity of the macroeconomic policy by the Lula government contributed to improved Brazil's external image, as noted by a former Central Bank governor:

> Then with Lula, I would say that there was continuity, and this was the great novelty. Because until Lula came, it was always thought: "[Brazil] is going well with Fernando Henrique, but one day PT will win and will break the country". So if you are making a

> strategic analysis of whether to [invest] in Brazil in the long term, 50 years, 100 years, you say "I have some scenarios here where I am going to lose everything". And then when Lula arrives and demonstrates good sense, as he did, put together a good team, that, from the uncertainty point of view, [represented] a huge gain for Brazil.[107]

In this respect, another close observer noted: "the Real Plan was very important [for Brazil's external influence], but as important was the continuity of economic policy, at least in the first term of Lula, which gave a considerable aura of seriousness and of respectability".[108] This is in line with the view of Brainard and Martinez-Diaz (2009a, p.2) who have argued that "Brazil status among the world's rising economic powers emanates from an auspicious conjuncture of external forces and internal strengths". According to these scholars, along with historically high commodity prices, Brazil has also benefitted from its "sustained commitment to sound macroeconomic policies" (Brainard & Martinez-Diaz 2009a, pp.2–3). In the same line, Trinkunas (2014, p.11) said "it was only after the successful policies of the Fernando Henrique Cardoso administration (1995-2002) laid the foundations for economic and political consolidation at home that Brazil was able to resume its rise". Thus, Roett (2011, p.107) is wrong to say that "despite the best of intentions, the Cardoso administration limped to an end in 2002. It would take the new government of Lula and the PT to initiate a new round of reforms after 2002 that would finally transform Brazil into a modern nation". When Lula took power in 2003, he benefited from a favourable external scenario and from the stabilisation achieved by Cardoso in the previous period.

Despite the role Cardoso's macroeconomic policies had played in the stabilisation of the Brazilian economy, the continuation of these policies displeased a good deal of PT supporters who had expected a change with the election of Lula's leftist regime. In a context where Lula

---

[107] Non-attributable interview with a former Central Bank governor.

[108] Non-attributable interview.

was less constrained by the external environment, his government chose to pump up Brazil's foreign policy to compensate for the continuity in the economic area. As noticed by a high ranked official at Itamaraty:

> Because Lula basically followed the same economic policy as Cardoso, a place where they actually gave to the left of the party was foreign policy. So then came a discourse directed to the regional sphere and to the support of these schemes in Venezuela and others.[109]

While Lula's foreign policy was not a complete rupture with Cardoso's foreign policy, there was nonetheless a reorientation and change of discourse, which became all the more visible during Lula's second term as president. As noted by a former Central Bank director: "there were some changes of priority, which became clear afterwards, resurrecting a bit that Third World issue, Brazil connects with things like the Bolivarian league, and such".[110] Specifically, Lula's foreign policy did not disregard Brazil's relations with the US and the other major powers, but it put South America and other Southern states as Brazil's top priorities.

This orientation was not a complete rupture from the past for the Cardoso government had also chosen South America as a foreign policy priority. In Cardoso's first presidential term the focus was placed more on the relatively new sub-regional bloc Mercosul (a customs union between Argentina, Brazil, Paraguay and Uruguay established in 1991), but during his second term, the regional concept was expanded to include relations with the rest of the region as well (Malamud 2011, p.6). According to Vizentini (2005, p.386), widening the integration process to include all South America was a way to overcome Mercosul's crisis, a crisis that had been triggered by the devaluation of the Brazilian currency in 1999 and which affected the economic balance

[109] Non-attributable interview with a high ranked diplomat.

[110] Non-attributable interview with a former Central Bank director.

between Brazil and Argentina. For Argentina the way out of the crisis was to increase its ties with the US and to agree to the Free Trade Area of the Americas (FTAA), a platform that had been under negotiation since 1994. In this context, Cardoso called the 1st South American meeting in 2000, which marked the beginning of change in terms of foreign policy. Brazil's position of privileging Mercosul and the other South American countries at the expense of the FTAA was in line with what Brazil pursued in a more emphatic way during the Lula government in terms of rejecting the American umbrella for regional matters.

A main feature that differentiated Lula's government from Cardoso's was the absence of greater external constraints not only for Brazil but also for the other South American countries, which facilitated regional integration (Fiori 2011, p.9; Carvalho et al. 2009, p.124). Furthermore, at the time when Lula ascended as President of Brazil, several left-wing presidents took power in other South American states (Hugo Chávez in Venezuela, Néstor Kirchner in Argentina, Tabaré Vázquez in Uruguay, Evo Morales in Bolivia) so that there was a political convergence in the region that contributed to a better dialogue. In Castañeda's (2006, p.29) words "starting with Hugo Chávez's victory in Venezuela … a wave of leaders, parties, and movements generically labelled 'leftist' have swept into power in one Latin American country after another". This alteration in the political leanings created a political convergence in South America that favoured regional integration and developmentalist projects.

Thus, the beginning of the Lula government coincided with a resumption of regional integration in South America in which Brazil played a major role as one of the main contributors to the regional initiatives. For instance, Brazil contributed 70 per cent of the total amount annually designated to Mercosul Structural Convergence Fund (FOCEM, *Fundo para Convergência Estrutural do Mercosul*) (by comparison Argentina gives 27 per cent, Uruguay gives 2 per cent, and Paraguay gives 1 per cent). In the Financial Fund to the Development of the Rio de la Plata Basin (FONPLATA, *Fundo Financeiro para o Desenvolvimento da Bacia do Prata*), Brazil, together with Argentina, held one-third of the quotas, with the remaining third equally divided between Bolivia, Paraguay and Uruguay. In the Inter-American Development Bank (IADB), which is not owned by developing countries,[111] Brazil held, along with Argentina, the second largest number of shares (10.75 per cent) following the US (30 per cent). In addition, in 2003 BNDES officially included regional integration as one of its goals, expanding its operations in South America (BNDES 2004, p.1).[112]

The rise in oil prices that began in 2003 contributed to the ascension of another major player in South America's regional integration: Venezuela. Under Hugo Chávez's presidency, Venezuela's interest in regional integration had a clear anti-American tone. In 2004, for example, together with Cuba, Venezuela launched the Bolivarian Alliance for the Peoples of Our America (ALBA, *Alianza Bolivariana para los Pueblos de Nuestra América*)[113] as an alternative to the US' proposal for the FTAA. Under ALBA, Chávez began to conduct several initiatives with Latin American countries, most of them involving oil, such as Petrocaribe, to subsidise oil exports to the Caribbean countries, and Petrosur, a regional confederation of state-owned oil companies. As a high ranked diplomat observed:

> A country that develops a program like PetroCaribe, which is obviously a mechanism that demonstrates leadership and allows the exercise of influence, because you sell oil below market price and with that you make other countries dependent on your interests, obviously had a leading political aspiration. The creation of ALBA is also a political demonstration of leadership … [the problem] is that the Venezuelan model is viable in Venezuela and in some other countries; in others there is no condition to succeed.[114]

[111] The expression "bank owned by developing countries" (*bancos de propiedad de países en desarrollo*) is used by Ocampo (2006, p.15) to refer to multilateral development banks that do not have the capital of industrialised countries.

[112] One limitation for the expansion of its regional activities however is that BNDES can only fund Brazilian companies or branches of multinational companies established in Brazil.

[113] At the moment, the following countries have joined ALBA: Bolivia (2006), Nicaragua (2007), Dominica (2008), St. Vincent and the Grenadines (2009), Ecuador (2009), Antigua and Barbuda (2009), Saint Lucia (2013).

[114] Non-attributable interview with a high-ranked diplomat.

Venezuela also began to act as an alternative creditor, loaning US$2.5 billion to Argentina and enabling that country to pay off its debt with the IMF in December 2005. In addition, Venezuela provided financial support to Bolivia and Cuba in the following years (Carvalho et al. 2009, p.125). Moreover, Chávez pursued a diplomatic battle with the United States by deepening Venezuela's bilateral relations with countries such as Cuba, Russia, Syria and Iran.

In this context of a leftist shift in South America, of lower external constraints, and of likely compensating for the continuity in the macroeconomic area, Brazil's foreign policy bended to support some of Hugo Chávez's initiatives. As described by a high-ranked official at the Central Bank:

> Brazil has never aligned with a Bolivarian line, as Venezuela, Ecuador, Bolivia, nor has never been so close to that line as Argentina, … [but] this behaviour [of Venezuela and Argentina] ended up making that the initiatives of articulation in the regional sphere gained a bias somehow antagonist to multilateral institutions.[115]

Brazil and Venezuela rapprochement started in 2004 when the two main regional integration projects, Mercosul and the Andean Community (CAN, *Comunidad Andina*) (formed by Bolivia, Colombia, Ecuador, Peru and Venezuela), met to announce their intention to unite their integration efforts into a single project, then-named South American Community of Nations (CASA, *Comunidade Sul-Americana de Nações*). In 2006 Venezuela left CAN to apply for a membership of Mercosul. According to a high-member of the government, Venezuela's decision signalled Brazil's hegemony in the region: "why [Venezuela] wanted to enter in Mercosul? Because Brazil is in Mercosul … Mercosul is a project to Venezuela more

[115] Non-attributable interview with a high ranked official at the Central Bank.

strategic than economic-commercial; … is to be sheltered under Brazil's umbrella".[116] Nevertheless, as the next years unfolded, this perspective was to be challenged.

In sum, from 1995 to 2005 Brazil benefitted from an ongoing transformation in the global economy, where EMDs became increasingly important players in the IMS and were gradually included in international financial forums such as the BIS and the G20. The global environment that emerged in 2003 with China's economic rise further increased Brazil's external influence. Facing lower external constraints, the Lula government had more freedom to pursue its foreign policy objectives, which did not represent a rupture with the Cardoso government but rather a change in Brazil's priorities. On the one hand, this change was a way to counterbalance Lula's decision to continue Cardoso's macroeconomic policies; on the other hand, it was also part of a regional political context that favoured initiatives of regional integration and rejected the US leadership.

3.6 CONCLUSION

The decade after the implementation of the Real Plan tested Brazil's newly acquired price stability, when a series of currency crises broke out in emergent market economies and spilled speculative pressures over other emerging markets' currencies. As this chapter has shown, the Brazilian economy suffered every time there was a financial turbulence due to the fragile state of its external position. In the words of a former Central Bank director: "Brazil was a country that had a high deficit in the current account, had limited international reserves, so it was a country that was always vulnerable to contagions. So whenever there was international nervousness Brazil was affected in some way".[117] Most significantly, the Brazilian currency

[116] Non-attributable interview.

[117] Non-attributable interview with a former Central Bank director.

became a target of speculative attacks in the aftermath of the Russian crisis, forcing devaluation and the adoption of a floating exchange rate regime.

Despite all the international and domestic turbulences that occurred during the period analysed in this chapter, the Real Plan survived and succeeded: by 2005 Brazil was recognised as a less vulnerable economy, as one of the fastest growing emerging markets and as an increasingly important global player. The ghost of inflation was finally behind Brazil and its external debt was no longer a strong source of vulnerability. As well as settling its debt with the IMF, the Brazilian government also reduced its exposure to external debt. Equally important, from 2003 onwards Brazil began to accumulate current account surpluses, reducing its balance of payments' vulnerability. In addition, the trade surpluses and positive net inflows of foreign direct investments at this time allowed the beginning of a reserve accumulation process, which contributed to the image of Brazil as a robust economy.

This unprecedented resilient condition of the Brazilian economy was, at least to a certain extent, part of a broader global context where emerging market economies were in general becoming stronger and more important economic actors. While it is striking that Brazil's external influence increased from 2003 onwards, this change needs to be placed within the global dynamics prevailing at that time. At this chapter discussed, Brazilian policy-makers were since 1994 working towards a more resilient economy. Yet it seems to be the change in the global scenario, rather than this shift in domestic politics, that allowed the Brazilian economy to take off and the Brazilian government's economic reputation to improve. As this chapter has argued, there was no significant disruption in the macroeconomic policies pursued by Cardoso and Lula, so Brazil's rise should be conceived more as a result of an external change. This idea fits with the conception of Brazil being a subordinated economy in the IMS, and therefore being much more a business cycle "taker" than "maker".

This chapter has also attempted to further demystify Brazil's relation with the IMF. First, it is wrong to suggest that the IMF imposed policies on Brazilian policy-makers, at least with regard to the experience of 1998. As a former Central Bank governor said, "having dealt with the IMF, I know they are conservatives, but I casually worked in a government that, since the first day we had to deal with the IMF, we had the same thinking about public finances, about balance of payments, about taxation".[118] Second, Brazil did not repay the IMF to get rid of the Fund's influence, but rather to send a signal to international markets and other states about its economic resilience.

The rise of China and the subsequent escalation of commodity prices would favour Brazil's economic performance even more clearly after 2005. Most of this international dynamic went on until 2010, being temporarily interrupted by the 2008 global financial crisis. As the next chapter will show, having built solid economic fundamentals since 1994, Brazil further increased its external influence from 2006 to 2010.

[118] Non-attributable interview with a former Central Bank governor.

CHAPTER 4. THE FUTURE ARRIVES: BRAZIL AS THE LAND OF THE PRESENT (2006-2010)

Brazil – fortunately one of the last countries to be hit by the crisis – is now one of the first to emerge from it.

There is no magic in what we did. We simply kept our financial system from being contaminated by the virus of speculation. We cut back our external vulnerability as we turned from debtors into international creditors. Along with other countries, we decided to contribute resources for the IMF to loan money to poor countries, free of unacceptable conditionalities imposed in the past.

Above all, however, both before and after the crisis broke out we implemented anti-cyclical policies. We intensified our social policies, particularly income-transfer programs. We raised wages above inflation rates. We used fiscal measures to stimulate consumption and keep the economy moving.

We have now emerged from the brief recession. Our economy has regained its impetus and shows promise for 2010. Foreign trade is recovering vitality, the labour market is doing amazingly well and macro-economic equilibrium has been preserved, at no cost to the victories of our people's movements.

What Brazil and others have shown is that, at times of crisis, we must still carry out bold social and development programs.

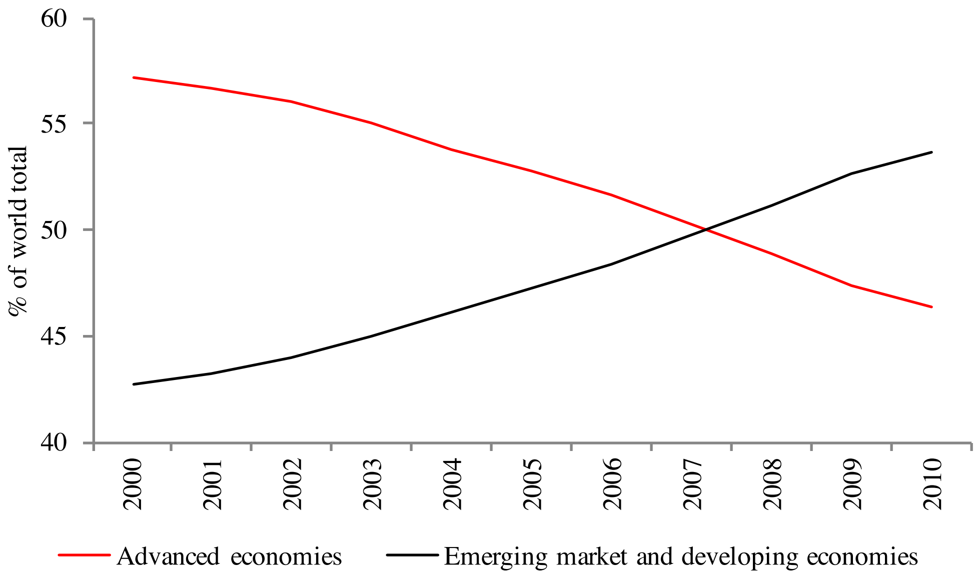
Yet I hold no illusions that we might solve our problems alone, within our own borders. Because the global economy is interdependent, we are obliged to intervene across national borders and must therefore re-found the world economic order.

(President Luiz Inácio Lula da Silva, Brazilian Statement at the General Assembly of the United Nations, 2009)

4.1 INTRODUCTION

This chapter covers the years from 2006 to 2010, a period of turbulence and uncertainty in the global economy which was characterised by the economic rise of new players that challenged the existing order dominated by the United States and other developed economies (Ikenberry 2008; Wade 2011; Subramanian 2011). The increase in the relative economic size of emerging market and developing countries (EMDs), or "the South," gained notoriety in 2008, as the share of emerging market and developing economies' GDP (measured at purchasing-power-parity, PPP) exceeded that of advanced economies as shown in Figure 18.

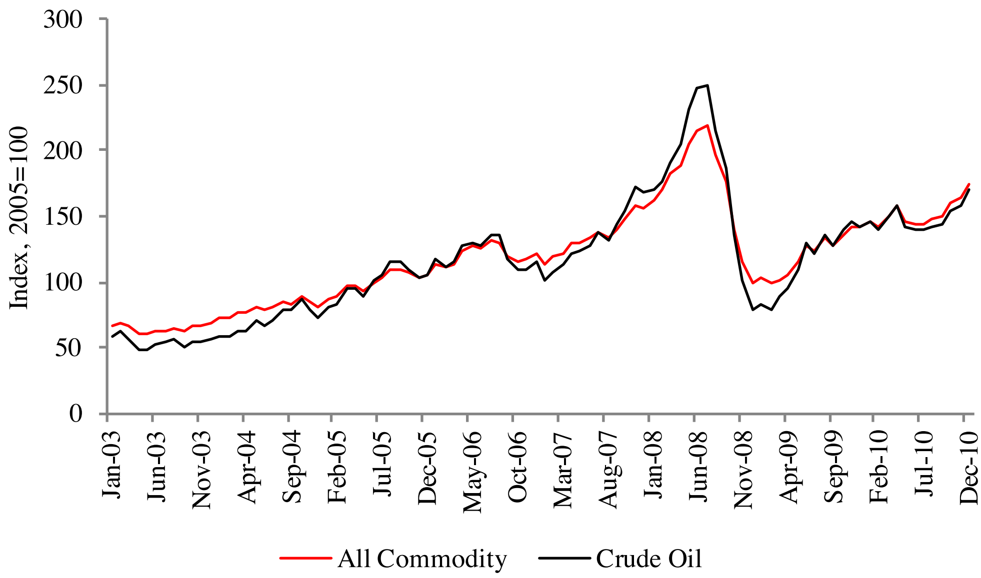
FIGURE 18: ADVANCED AND EMERGING MARKET AND DEVELOPING ECONOMIES' GDP BASED ON PPP, SHARE OF WORLD TOTAL, 2000-2010



Source: IMF World Economic Outlook Database, October 2015. Elaborated by the author.

The 2008 crisis magnified the rise of multipolarity as EMDs proved to be more resilient than the developed world in addressing the economic instability that stemmed from the crisis (Kose & Prasad 2010). Given that most EMDs are commodity-exporting countries, much of EMDs' greater resilience to the crisis can be explained by the external environment resulting from China's huge demand for commodities, one that began in early 2000s. As Figure 19 illustrates below, commodity prices increased substantially during the 2006-2008 period. The upward trend was interrupted during the 2008 crisis, but already began to show signs of recovery in mid-2009. Consequently, while the 2008 meltdown obviously represented a tremendous external shock for EMDs, they could still rely on relatively high commodity prices to lessen the external constraints brought upon them by the crisis and resume growth faster than their developed peers.

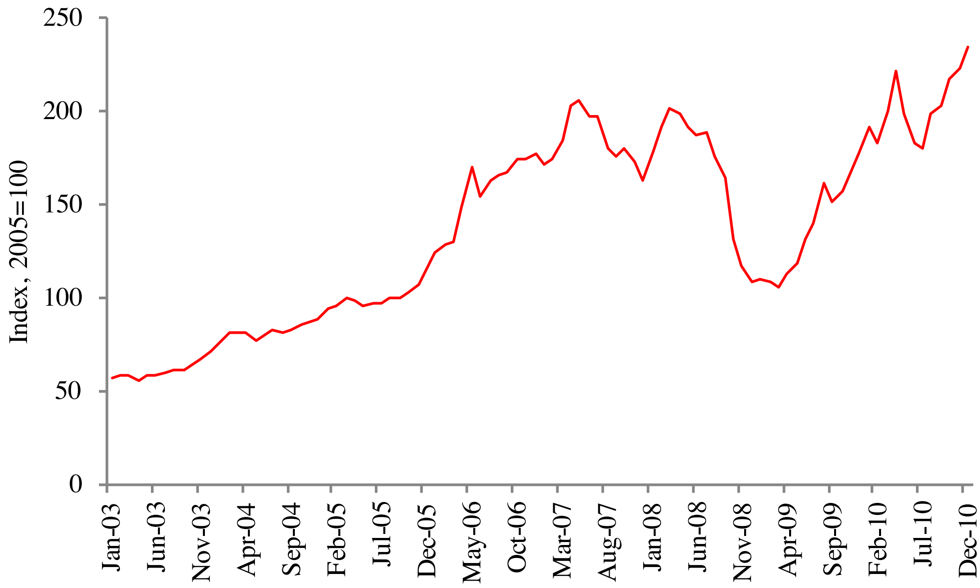
FIGURE 19: ALL COMMODITY AND CRUDE OIL PRICE INDEX, 2005=100, 2003-2010



Source: IMF Primary Commodity Prices. Elaborated by the author.

As one of the biggest commodity-exporting countries, Brazil profited massively from the beneficial cycle in terms of trade triggered by China’s rise, for it served to increase the country’s global influence. China’s huge demand for commodities lessened Brazil’s traditional external constraints in the balance of payments and made it possible for Brazil to accumulate substantial international reserves. After the crisis, the rapid recovery of commodity prices was central in enabling Brazil to rebound from the crisis. As Figure 20 shows, the price of metals had already recovered their pre-crisis level by mid-2010 and continued on an upward trajectory.

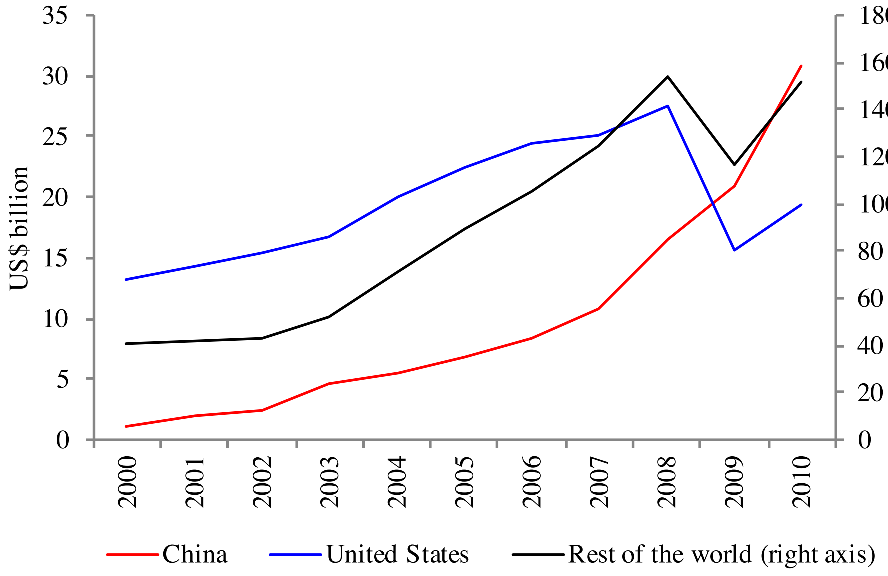
FIGURE 20: METALS PRICE INDEX, 2005=100, 2003-2010



Source: IMF Primary Commodity Prices. Elaborated by the author.

The period covered by this chapter also marks China's displacement of the United States as Brazil's main trade partner, a change that occurred in 2009. That year, the trade flow between Brazil and China was US$36.9 billion, against US$35.6 billion with the United States. Between 2000 and 2010, Brazilian exports to China increased almost thirty-fold (Figure 21). Even when Brazilian exports to the US and the rest of the world dropped in 2008-2009 due to the crisis, those to China continued rising.

FIGURE 21: BRAZILIAN EXPORTS TO CHINA, THE UNITED STATES AND THE REST OF THE WORLD, 2000-2010



Source: MDIC/AliceWeb. Elaborated by the author.

This international scenario that favoured commodity-exporting countries like Brazil overlapped with an alleged alteration of Brazil's economic policies. Part of the academic literature and some policy-makers sustain that there was a change in macroeconomic policies from 2006 onwards, a change that has been identified as responsible for Brazil's relatively better performance during and in the immediate aftermath of the crisis (until 2010) (Barbosa & Souza 2010; Morais & Saad-Filho 2011). This change was mostly associated with fiscal and monetary stimulus measures, into cash-transfer programs and an increase in public investment, usually associated with developmentalist policies.

Brazil's economic performance was used to the political advantage of a group within the government who propagated an oversimplification of the economic debate: "the fundamental strategic option to bet on growth, rather than radicalizing the uncertain proposal of contractionist fiscal adjustments, based on neoliberal canons, ended up being validated based on immediate results"[119] (Barbosa & Souza 2010, p.31). By focusing on the government's role to explain Brazil's performance, this perspective considerably underplayed the place of external constraints imposed by the IMS to countries like Brazil.

The aim of this chapter is to put in perspective the argument which attributes Brazil's economic performance from 2006 to 2010 to an alteration in the government's policies. It highlights, instead, the role played by the international conditions of rising commodity prices and high international liquidity. In addition, this chapter contends that there was in fact little evidence of a significant policy alteration in 2006. While the Lula government after 2006 increased public spending, the former priorities of achieving a primary surplus and inflation control remained constant, even during the 2008 crisis. In this context, this chapter argues that the external environment was fundamental to Brazil's relative economic success.

The reasons for Brazil's sound performance aside, an important consequence of the country's relative economic success was a greater external influence. Being largely unconstrained in its economic policy-making, the Brazilian government enjoyed the freedom and plentiful resources to pursue its foreign policy objectives, which mainly revolved around intensifying its relations with South American and African countries. After 2008, and in the context of the general increase of EMD's role in global financial governance, Brazil further expanded its international influence, benefiting from the elevation of the G20 in September 2009 as well as from the IMF's and World Bank's reform packages.

This chapter is divided into five sections. The first section presents the empirical data that challenges the alleged change in Brazil's macroeconomic policies in 2006. The second section discusses the international repercussions of good domestic results from 2006 to 2008,

[119] Author's translation from the original in Portuguese: "a opção estratégica fundamental em apostar no crescimento, ao invés de radicalizar a incerta proposta do ajuste fiscal contracionista, baseada nos cânones neoliberais, terminou sendo validada com base em resultados imediatos".

particularly in relation to reducing inequality and poverty, and how Brazilian diplomacy used those results to promote its image and influence worldwide. The third section shows how Brazilian policy makers dealt with the constraints imposed by the 2008 crisis. The fourth section explores the implications of the crisis in relation to the role played by developing countries in general and Brazil in particular in the IMS. The fifth section concludes the chapter.

4.2 BRAZIL'S RISE: DOMESTIC CHANGE OR COMMODITY BOOM? (2006-2008)

By 2006, the Brazilian economy had considerably reduced its external vulnerability as the international scenario inaugurated in 2003 allowed the government to gradually reduce the external constraints for Brazilian economic policy-making. From 2003 onwards Brazil began to accumulate unprecedented surpluses in the current account and an increasing amount of international reserves. As Brazil's access to the international capital markets gradually improved, the government anticipated the payment to the IMF in December 2005 (refer to chapter 3).

The payment to the IMF practically overlapped with an important change within the government's economic team, with the replacement of Finance Minister Antonio Palocci by Guido Mantega in March 2006. The significance of this alternation lies in the fact that Palocci and Mantega are associated with opposing views: respectively, a pro-market approach and a more interventionist, or "developmentalist," approach (Barbosa & Souza 2010). Palocci's replacement prompted the departure of other members of the economic team aligned with the pro-market approach, such as Murilo Portugal, the then Deputy Finance Minister, and Joaquim Levy, the then Treasury Secretary. As a result, it seems accurate to say that there was an inflection within the economic team towards the "developmentalist" ideas.

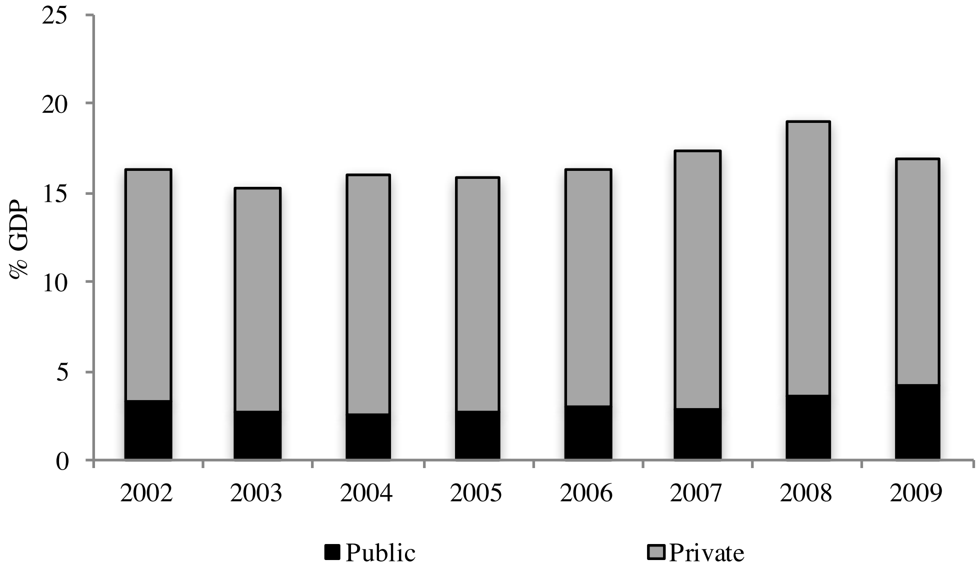
The years following the end of the IMF agreement and the change within the government until the eruption of the global crisis in September 2008, were marked by a sequence of unprecedented achievements including economic growth, rising investment rates and economic stability. In 2006, Brazil became for the first time a liquid capital exporter as its foreign reserves surpassed its foreign debt. In addition, in 2006 Brazil's outward FDI flows outgrew its inward FDI,[120] making Brazil the second largest outward investor among developing countries that year, after only Hong Kong (FDC-CPII 2007). Further, Petrobras announced the discovery of new oil reserves under the pre-salt layer. Likely in consequence of this discovery, Brazil achieved a surplus in its oil derivatives and commercial balance, an excess which the government claimed marked Brazil's energy-self-sufficiency.[121]

In 2007 Brazil's economic growth jumped to 6 per cent, from 4 per cent in 2006, reaching 5 per cent in 2008 in spite of the global crisis. In January 2007 the government launched the Growth Acceleration Program (PAC, *Programa de Aceleração do Crescimento)*, a major agenda of economic policymaking and investment projects with the aim to accelerate economic growth in Brazil. The PAC involved investments of some R$500 billion between 2007 and 2010 in the areas of transport, energy, sanitation and hydric resources. As a result, total investment increased from 16.4 per cent of GDP in 2006 to 16.9 in 2009, peaking at 19.1 per cent in 2008, according to data of the Ministry of Finance (Ministério da Fazenda 2010, p.21). In the same period, public investment increased from 3 per cent to 4.3 per cent (Figure 22).

[120] Brazilian outward FDI figures must be analysed with caution, as it is hard to differentiate authentic FDI from purely financial investment under the guise of FDI (Lima & Barros 2013, p.653; Campanario et al. 2013, p.658). In 2007, more than two thirds of total FDI went to tax havens (Lima & Barros 2013, p.653).

[121] In Sennes and Narciso's (2009, pp.33–34) words: "The actual case is that though Brazil produces an oil volume similar to what it needs for its internal consumption, its production (mainly of heavy oil) has a quality that is not entirely compatible with the country's refineries, as they are made to refine light oil. Brazil exports part of the heavy oil it produces and completes the refinery mix with imported light oil and its derivatives".

FIGURE 22: PUBLIC AND PRIVATE INVESTMENT, % OF GDP, 2002-2009



Source: Ministério da Fazenda (2010, 21). Elaborated by the author.

All this happened within a context of economic stability and the maintenance of the macroeconomic tripod previously discussed in chapter 3. On the one hand, the primary surplus averaged 2.3 per cent of GDP in 2006-2008, slightly lower than the average of 2.5 per cent in 2003-2005. On the other hand, the Central Bank continued to reduce interest rates while keeping inflation even below the target of 4.5 per cent. The Selic rate fell from 19.5 in late September 2005 to 11.25 in September 2007. In 2006 and 2007 the inflation rate was, respectively, 3.14 and 4.46, according to central bank data.

Not surprisingly, this outstanding performance of the Brazilian economy was used by the government for its own political advantage. The official discourse suggested that, first, having the agreement with the IMF had constrained the government's autonomy to increase investment and, second, that paying the IMF was a political decision. As the then-secretary of economic policy of the Ministry of Finance, Nelson Barbosa, and his assessor, José Antonio Pereira de Souza wrote, "the payment to the IMF reflected a moment of intensification and decision in the debate on the directions of economic policy of the Lula government"[122] (Barbosa & Souza 2010, p.8).

Second, official discourse attributed Brazil's great economic results to the rise of the "developmentalist" ideas within the government. In the words of Barbosa and Souza (2010, p.14), "as the Lula government opted more clearly for a developmentalist economic policy, there was a substantial acceleration in economic growth".[123] This option towards developmentalist policies was described as an "inflection" rather than a change of paradigm in the macroeconomic framework, since the macroeconomic tripod remained unaltered (Morais & Saad-Filho 2011, p.520). The diagnosis that an inflection, or the adoption of an "hybrid paradigm," towards developmentalism unlocked economic growth was endorsed by part of the academic literature (Morais & Saad-Filho 2011, pp.516, 521).

Taking into account the politicisation of Brazil's relations with the IMF and the association of the pro-market approach with the US dominance that were discussed in chapters 2 and 3, the government's claim had a substantial political appeal. As one very influential Brazilian economist and former policy-maker said, after Brazil no longer needed the IMF's resources, "[the government] took a political advantage … because there were some ill-informed people [in Brazil] that thought this was a heroic deed".[124] Securing popular support was fundamental for the Lula government as his first term in office grew to a close and he planned to run for re-election in the October 2006 elections. While Lula had great popular approval, his government had just been hit by a big corruption scandal in mid-2005, an episode that is known in Brazil

[122] Author's translation from the original in Portuguese: "O pagamento ao FMI refletiu um momento de acirramento e de decisão no debate sobre os rumos da política econômica do governo Lula".

[123] Author's translation from the original in Portuguese: "À medida que o governo Lula optou mais claramente por uma política econômica desenvolvimentista, ocorreu uma aceleração substancial no crescimento econômico do país".

[124] Non-attributable interview.

as the *mensalão* scandal. In fact, it was this corruption scandal that had prompted the dismissal of Palocci from the Ministry of Finance. Thus, the change in the economic team was not really influenced by external events, such as the payment to the IMF; rather, it was rooted in domestic political circumstances.

Moreover, as argued in previous chapters, the level of intervention of the IMF was generally overstated by the government, so that the end of the agreement in 2005 did not represent an actual increase in the government's autonomy. The capacity of the government to increase public investment after 2006 can be explained, instead, as a result of a long-term macroeconomic process, where external constraints were gradually reduced due to an ongoing change in the global economy and to several domestic policies that strengthened the Brazilian economy. In the words of a former high-ranked policy-maker:

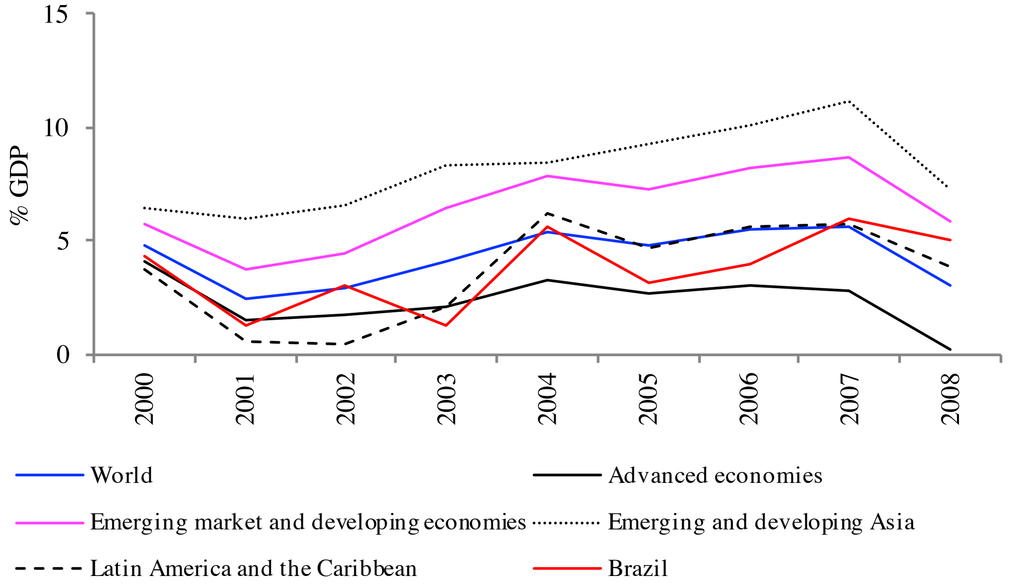
> It is true that all the process of fiscal contention that resulted from that agreement [with the IMF], of the crisis and of the debt deal, hurt a lot investments; the investment rate fell a lot. And from 2004/2005, coinciding with the end of the agreement there was again an increase in the investment rate. But much less because Brazil won freedom and more because Brazil, first, was able to re-enter in the international capital market, to borrow again, and [second], because of the commodity boom, which created an attention to Brazil at that time. I do not see to what extent having or not the IMF here has implicated, you know, it was more the circumstances of the international economy than anything else.[125]

Furthermore, the interpretation of cause and consequence, where an inflection towards developmentalist policies generated greater economic growth, is at least debatable simply on the premise that the world in general and EMDs in particular were growing at high rates at the time. In 2006, Brazil's GDP was of 4 per cent, higher than 3.1 per cent in 2005, but lower than the world average of 5.5 per cent, EMDs of 8.1 and even Latin America of 5.6 per cent (Figure

[125] Non-attributable interview.

23). In 2007 and 2008, Brazil's GDP surpassed the world and Latin America's growth rates, but still lagged behind EMDs' average GDP of 8.6 and 5.8 per cent, respectively. Brazil's performance was even less impressive when taking into account the average growth of GDP in emerging and developing Asia: 10.1 per cent in 2006, 11.1 per cent in 2007 and 7.2 per cent in 2008.

FIGURE 23: GDP GROWTH (PER CENT), GROUP COUNTRIES AND BRAZIL, 2000-2008



Source: IMF, World Economic Outlook Database, April 2015. Elaborated by the author.

Besides, in 2006 there was no rupture with the core of the "neoliberal" macroeconomic framework, represented by the tripod. The continuation of the pro-market approach was embodied in the Central Bank governor, Henrique Meirelles, who remained in office during Lula's two tenures. Meirelles was politically very strong within the government, since he had been elected Federal Deputy by the Brazilian Social Democracy Party (PSDB, *Partido da Social Democracia Brasileira*) with a substantial vote count in the October 2002 elections, but never took office as he was appointed as Central Bank governor. Interviews with former Central Bank directors at that time indicate that Meirelles acted as a minister during the Lula government and did not subordinate himself to the Finance Minister, particularly after the replacement of Palocci by Mantega. As a former Central Bank director said: "Guido continued with the policy … maybe he had the will, but he did not have the political conditions for changing [macroeconomic policy]".[126]

In this light, the monetary and exchange rate policies are illustrative of the absence of a great modification in the government's priorities. The downward trend in the interest rates that began in September 2005 and lasted until April 2008 must be seen in a context where the inflation rate was meeting the target (Table 1).

TABLE 1: INFLATION AND INFLATION TARGET, 2006-2010

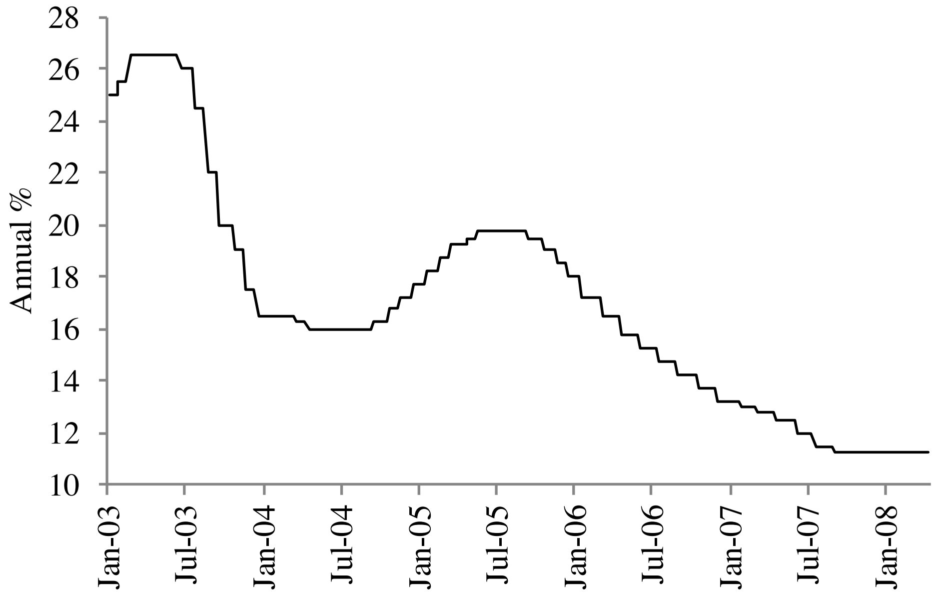
Year	Target (%)	Tolerance Intervals (p.p.)	Upper and Lower Limits (%)	Actual inflation (IPCA, % p. a.)
2006	4.5	2	2.5 - 6.5	3.14
2007	4.5	2	2.5 - 6.5	4.46
2008	4.5	2	2.5 - 6.5	5.90
2009	4.5	2	2.5 - 6.5	4.31
2010	4.5	2	2.5 - 6.5	5.91

Source: Central Bank of Brazil. Elaborated by the author.

Aside from the fact that the interest rate began to decrease before the alleged changed within the government, the Central Bank had already gone through another cycle of lowering interest rates earlier in Lula's first term (Figure 24). Brazil's interest rates were among the highest in the world and there is little disagreement among scholars and policy-makers that they should have been lower. The main difference in view between "neoliberals" and "developmentalists" with regard to monetary policy is the level of inflation rate that can be tolerated, the former defending a lower rate than the latter.

[126] Non-attributable interview with a former Central Bank director.

FIGURE 24: INTEREST RATES (SELIC), 2003-2008

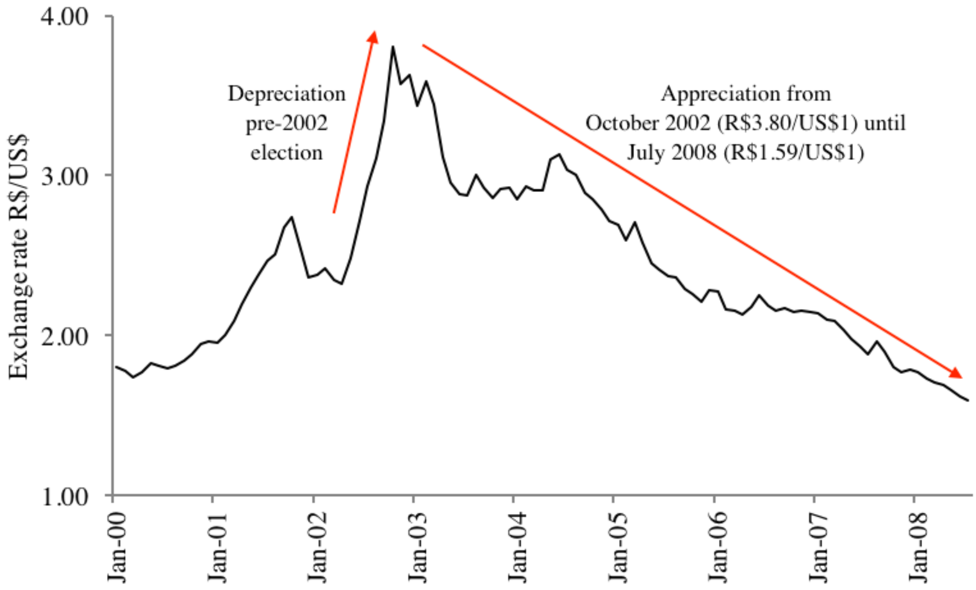


Source: Central Bank of Brazil, Boletim, Seção mercado financeiro e de capitais (BCB Boletim/M. Finan.). Elaborated by the author.

In addition, contrary to its Asian peers, the Brazilian government did not adhere to an export-led growth development strategy, letting the exchange rate appreciate in response to strong dollar inflows (Figure 25). While the Central Bank intervened in the foreign exchange market, it did not prevent the overall trend of an appreciation of the real. This excessive exchange rate appreciation was strongly criticised by advocates of the developmentalists' policies, all of whom claimed it was harming Brazilian exports, particularly those of manufactured goods (Morais & Saad-Filho 2011, p.523). One former finance minister referred to the overvalued currency as exchange rate populism, as it increased real wages and controlled inflation: "Lula let the exchange rate appreciate in an absolutely scandalous way; for him it was marvellous, [it was pure] populism, everyone was happy, but for the country…"[127] If anything the currency appreciation leaned more towards a pro-market approach than a developmentalist one.

[127] Non-attributable interview with a former finance minister.

FIGURE 25: EXCHANGE RATE R$/US$, 2000-2010



Source: Central Bank of Brazil, Boletim, Seção Balanço de Pagamentos (BCB Boletim/BP). Elaborated by the author.

In sum, the period 2006-2008 represented a remarkable phase for the Brazilian economy, one characterised by macroeconomic stability and an improvement of social indicators. There was a significant alteration to the government's economic team, yet this change did not alter the core of the macroeconomic framework in place since 1999. While economic growth increased, it was nevertheless lower than Brazil's EMDs peers. To that extent, it seems reasonable to argue that the external environment inaugurated in 2003 had a great influence on Brazil's performance during 2006-2008. Before analysing the impacts of the global crisis on the Brazilian economy, the next section shows how the good performance of the Brazilian economy, particularly its success in tackling inequality, was key for promoting Brazil's worldwide image.

4.3 THE SUPERPOWER REHEARSAL (2006-2008)

As discussed in chapter 3, foreign policy was an essential pillar of the Lula government. The priority given to foreign policy was reflected in the augmented budget of the Ministry of External Relations, Itamaraty, which increased from R$1 billion in 2003 to R$1.7 billion in 2008. Moreover, between 2003 and 2007, Brazil opened 15 embassies in African countries,[128] reflecting the pivotal role the continent played in Brazil's political and diplomatic agenda. From 2003 to 2008, President Lula travelled annually to Africa,[129] announcing cooperation programmes with African countries and forgiving the public debts countries like Cape Verde, Gabon and Mozambique had with Brazil.

Likewise, Brazilian resources directed towards international cooperation more than doubled from 2005 to 2009, from US$158.1 million to US$362.2 million (Figure 26), according to data gathered by the Institute for Applied Economic Research (IPEA, *Instituto de Pesquisa Econômica Aplicada*) and the Brazilian Cooperation Agency (ABC, *Agência Brasileira de Cooperação*) (Cintra 2010, p.19).[130] During this time, the share of resources destined for humanitarian assistance soared from 0.3 per cent of the total to 12 per cent, and those directed to technical cooperation also rose from 7.2 per cent to 13.5 per cent (Cintra 2010, p.19). In absolute terms, Brazil augmented its contribution to international organisations and regional banks from US$123.1 million in 2005 to US$ 247.5 in 2009 (Cintra 2010, p.19). The resources

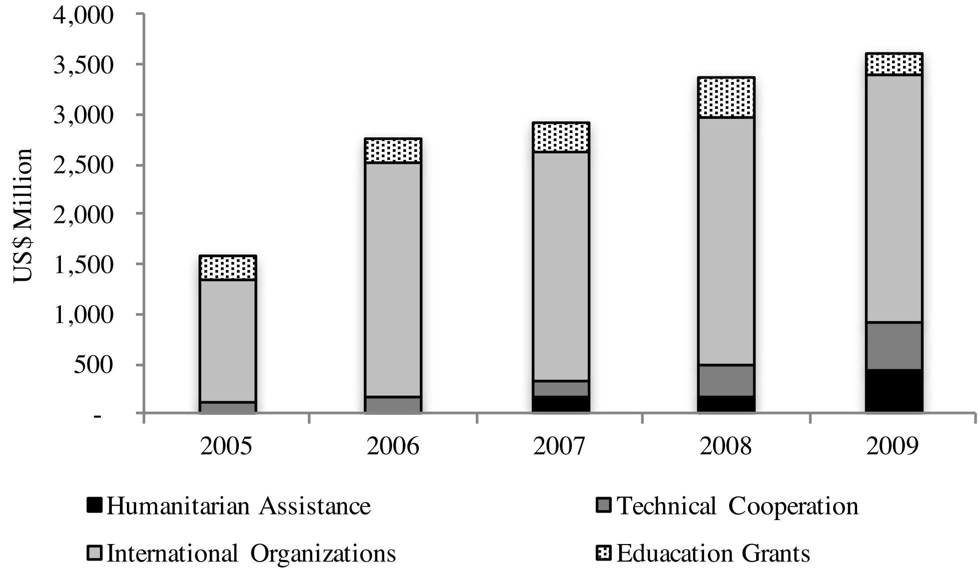
[128] Those were Sao Tome and Principe (2003); Ethiopia (2004); Benin (2005); Cameroon (2005); Equatorial Guinea (2005); Sudan (2005); Tanzania (2005); Togo (2005); Botswana (2006); Guinea (2006); Zambia (2006); Burkina Faso (2007); Democratic Republic of the Congo (2007); Mali (2007); and Mauritania (2007).

[129] In November 2003, Lula visited San Tome and Principe, Angola, Mozambique, Namibia, and South Africa; in June 2004, San Tome and Principe, Gabon, Cape Verde; in April 2005, Cameroon, Nigeria, Ghana, Guinea Bissau, and Senegal; in February 2006, Algeria, Benin, Botswana, and South Africa; in 2007, Burkina Faso, Congo Brazzaville, Angola and South Africa; in 2008, Mozambique.

[130] This was the first survey done by the Brazilian government to know how much Brazil spent on international cooperation, denoting how being a donor was new to Brazil.

expended for international cooperation were mainly allotted to areas which Brazil deemed as priority regions, i.e. South America and Africa.

FIGURE 26: BRAZILIAN COOPERATION FOR INTERNATIONAL DEVELOPMENT, US$ MILLION, 2005-2009



Source: ABC (2010, 21).

Behind the expanded budget for foreign policy during the Lula government were the international dynamics that emerged from China's economic rise, which allowed Brazil to become less vulnerable to external shocks and to accumulate international reserves. As a high-ranked diplomat observed: "there was a clear link between foreign policy and the commodity boom".[131] Symptomatic of this correspondence was Brazil's debt repayment to the IMF in late 2005, which yielded Brazil a very positive political outcome among its peers. As a high member of the government said:

> No longer depending on the IMF is an important political sign about the reduction of [a country's] external vulnerability. And this has important diplomatic effects, you become

[131] Non-attributable interview with a high-ranked diplomat.

> an actor, as it happened [with Brazil], you overcome the stage of dependence of these bodies and move to the next step which is to propose the reform of these organisms.[132]

While the level of intervention of the Fund in Brazil's economic policies was low before 2005, Brazil occupied the debtor dependent position in international forums. To that extent, the main difference for Brazil after settling its debt with the Fund seems not to be the level of autonomy Brazil had to define economic policies but the potential it had to enhance its place in the international debate. As a Brazilian representative to the World Bank related: "when you are in debt or dependent on the institution, it is much more difficult to act as a shareholder … the feeling of independence and the perception of independence [by others] creates a much more favourable environment to make you a partner in the project".[133]

For example, during the IMF meeting in Singapore in 2006, Brazil refused the proposal of quota and voice reform presented, because its scope was too limited when compared to that which Brazil desired.[134] This kind of attitude is unlikely to come from a country that is utterly dependent on the Fund resources. As a high-ranked official at the Central Bank reported: "the then managing director [Rodrigo] Rato … personally called dozen of finance ministers, dozens of developing countries to try to ensure the necessary amount of votes to pass the reform in the format he was presenting".[135] According to him, there was an incipient reaction led by Brazil, which did not actually threaten the reform from being approved, "but the process was a bit shattered, shaking that structure of the Fund, of preserving a command extremely focused on developed countries, European countries, etc.".[136] While there was no political momentum to

[132] Non-attributable interview.
[133] Non-attributable interview with a Brazilian representative at the World Bank.
[134] Non-attributable interview with a high-ranked official at the Central Bank.
[135] Non-attributable interview with a high-ranked official at the Central Bank.
[136] Non-attributable interview with a high-ranked official at the Central Bank.

alter the prevailing global monetary and financial architecture until the 2008 crisis, the change in Brazil's assertiveness after paying off the IMF debt is nonetheless meaningful.

Brazil's economic performance engendered a transformation not only in its self-confidence but also in its international reception. For instance, Brazil's cooperation in social polices was soon sought by both developing and developed countries,[137] as many were increasingly interested in emulating Brazil's experience in their own cooperation programmes and in establishing triangular cooperation with Brazil.[138] It seems that the principal point which differentiated Brazil's economic rise from that of the other developing economies was having something to offer to the developed world: "the social side of Lula's policies [increased] Brazil's international soft power, because it created an appeal to [the Brazilian] model,"[139] said a former Foreign Minister.

Indeed, Brazil's economy did not mirror that of China or India, which astonished the world with their outstanding economic growth rates; rather, it was an economy whose growth appeared based on a commitment to addressing inequality issues.[140] As Brazilian policy-makers prioritised the reduction of inequality and poverty, "Brazil began to communicate to

---

[137] The main Brazilian partners for triangular cooperation were Japan, United States, Germany, France, Canada, Argentina and Spain (Cintra 2010, p.34).

[138] Non-attributable interview with a high-ranked diplomat.

[139] Non-attributable interview with a former foreign affairs minister.

[140] Poverty fell by 51.9 per cent during the Lula government (Neri 2011, p.13), meaning that Brazil accomplished the first Millennium Development Goal to *reduce by half the proportion of the population living in extreme poverty* almost ten years in advance (Barros et al. 2010, pp.134–135). In comparison, during Cardoso's government, poverty fell by 31.9 per cent (Neri 2011, p.13). Between 2001 and 2009, while Brazil's average per capita income rose by 23.5 per cent, per capita income from the poorest 10 per cent rose by 69.08 per cent (the richest 10 per cent rose by 12.8 per cent) (Neri 2011, p.14). Significantly, figures show an inequality reduction in gender (women's income rose by 38 per cent), race (black and *pardos*' income increased by 43.1 per cent and 48.5 per cent respectively, against white's income increase of 20.1 per cent) and region (per capita income in the poorer Northeast rose by 41.8 per cent against 15.8 per cent in richer Southeast) (Neri 2011, p.15). Brazil's success in reducing income inequality is largely attributed to the result of social policies, notably the conditional cash transfer programme Bolsa Família, which was scaled up by three times during the Lula government to include 11 million households (Neri 2011; Barros et al. 2010). In 2013, Bolsa Família won the 1st Award for Outstanding Achievement in Social Security, granted by the International Social Security Association.

the world that there was a qualitative change in Brazil's development project,"[141] one Brazilian representative at the World Bank said. Another member of the government stated along similar lines that Brazil showed "there [was] no insuperable inconsistency between having sound macroeconomic control and, within that context, doing very concrete measures of social inclusion".[142] As a Brazilian representative at the World Bank declared: "Brazil went on from being a 'problem country' to being seen as a 'solution country'".[143] The fact that Brazil carried out these solutions under a democratic regime only served to further enhance its credentials within the international community.

At the World Bank, for example, Brazil's rapid economic growth and commitment to social inclusion lent weight and prominence to its influence within that institution. As a former Brazilian representative there commented: "I felt there was a curiosity and at the same time a deference in relation to Brazil … in determining the standards to where other economies should go".[144] The recognition of Brazilian leadership in this area became clear in 2013 when the World Bank announced the creation of a knowledge hub of poverty and inequality in Brazil. When launching this initiative, the World Bank President Jim Yong Kim said: "Brazil has demonstrated that solid economic policies coupled with social responsibility are not only possible but desirable. And that growing while at the same time reducing inequality is an attainable goal" (Kim 2013).

Also mirroring such change was the Organisation for Economic Co-operation and Development's (OECD) Council Resolution in May 2007, which proposed an enhanced engagement with Brazil, China, India, Indonesia and South Africa (OECD 2007). Although

[141] Non-attributable interview with a former Brazilian representative to the World Bank.
[142] Non-attributable interview.
[143] Non-attributable interview with a former Brazilian representative to the World Bank.
[144] Non-attributable interview.

there was not a formal invitation for Brazil to integrate into OECD, the interest of the developed world in building ties with Brazil and other large emerging market countries was novel.

Despite the positives resulting from the fact that Brazil was no longer a debtor country, Brazilian diplomacy began to face some dilemmas. As one Brazilian diplomat confessed: "it was much easier to do foreign policy before; Brazil's external situation was much more complicated, but the speech was much easier … Nowadays Brazil can no longer have the tiny country speech; Brazil no longer fits in this".[145] Indeed, Brazil has always enjoyed acting as the bridge between the developing and the developed countries; it always had the option of being the first of the developing countries or the last of the developed. Thus, Brazil was very reluctant to join the OECD not least because it "would be very difficult [to the Brazilian diplomacy] to be a member of the OECD and at the same time be active in the G77,"[146] as a high-ranked diplomat said.[147]

Moreover, Brazil's hesitancy in making the transition from "third world" discourse to enter into the "rich-country club" was also grounded in domestic political reasons. As a high-ranked diplomat noticed, "in a PSDB government, we would have been [in the OECD] for a long time".[148] Along similar lines, a former high-ranked policy-maker said: "what Brazil cannot define is the strategy about what to do; and then I think the problem is basically the government's ideology, from the PT, which continues with this third-worldism".[149] Since the beginning of the Lula government in 2003, foreign policy had been used to counterweight the government's continuity of macroeconomic policies (chapter 3), meaning that an alliance with the United States and other developed countries was off the table. Instead, Brazil invested in

---

[145] Non-attributable interview with a high-ranked Brazilian diplomat.

[146] Non-attributable interview with a high-ranked Brazilian diplomat.

[147] The Group of 77 is the largest intergovernmental organisation of developing countries in the United Nations.

[148] Non-attributable interview with a high-ranked Brazilian diplomat.

[149] Non-attributable interview.

strengthening political ties with the developing world, particularly with its South American neighbours.

Brazil's engagement with the rest of South America brought to light one of its diplomatic dilemmas, namely regarding Brazil's leadership role in South America integration. Indeed, the government hesitated in taking the lead in the integration process, as a high-ranked diplomat said:

> If Brazil wants to be a leader and exercise that leadership; it has to take more risks … There is a fear in some branches of the government that leadership might be interpreted as imperialism. The other side, the [neighbour] countries, they expect Brazil to exercise that leadership, expect Brazil to be more benign, to have a more strategic view … without having a hegemonic political ambition.[150]

His frustration was somewhat confirmed by an interview with a high-ranked policy-maker of the Lula and Dilma's governments:

> In the region we have to be careful: leadership you do not need to announce; leadership comes from recognition. If you keep "banging the drums" [*batendo o bumbo*] … you create resistance. Our economic, political weight is so disproportional in the region that you do not need to say that Brazil is the leader, this is evident.[151]

The view that being the biggest economy in South America is a sufficient condition for regional leadership is far from a unanimous position. To begin with, Brazil is the largest economy in South America but is not the richest. In terms of GDP per capita and human development, Argentina, Chile and Uruguay rank consistently higher than Brazil, with Mexico and Venezuela sporadically exceeding it as well, depending on oil prices. Hence, there is considerable resistance in Brazilian society to accept the remittance of financial support from Brazil to regional mechanisms (Malamud 2011, p.5). In the words of a high-ranked diplomat:

[150] Non-attributable interview with a high-ranked diplomat

[151] Non-attributable interview.

> The Brazilian society, the Congress, still does not understand the importance of Brazil's role in the region and to the regional mechanisms; the expectation of the neighbouring countries to receive support from the Brazilian government. There is always a questioning, "these recourses should be used to build schools, ports in Brazil". … There is a lack of knowledge at the technical level, but above all a reservation, a resistance to Brazil make financial contributions [for other countries]. Why? Because people still do not see this as something positive and, going deeper in this issue, they do not understand that a Brazilian leadership entails responsibilities and also involves financial contributions.[152]

Furthermore, while Brazil is the largest economy in South America and is amongst the world's largest economies, it lacks commercial relevance. In comparison to other large emerging markets, such as India and China, the size of Brazil's exports and imports is very small (Table 2). Brazil's share in global merchandise exports is 1.29 per cent, against 1.66 per cent of India and 11.74 per cent of China. The figures for global merchandise imports are similar, where Brazil accounts for 1.33 per cent against 2.47 per cent of India and 10.32 of China. More importantly, Brazil is not present in the international value chains, since commodities represent most of its global trade, with an upward trend (Cunha 2011; Cunha et al. 2012). Manufactures represent only 35.1 per cent of Brazil's exports, while in India they account for 59.4 per cent and in China 94.0 per cent of total exports. In sum, Brazil is a relatively closed economy, with a very low trade to GDP ratio of 25.5 when compared to the figures of China and India, 51.9 and 54.2 respectively (WTO 2014).

[152] Non-attributable interview with a high-ranked diplomat.

TABLE 2: MERCHANDISE AND COMMERCIAL SERVICES TRADE

		Brazil	India	China
Merchandise Trade	**Share in world total exports**	**1.29**	**1.66**	**11.74**
	Agricultural products	37.4	15.0	3.2
	Fuels and mining products	24.2	25.5	2.7
	Manufactures	35.1	59.4	94.0
	Share in world total imports	**1.33**	**2.47**	**10.32**
	Agricultural products	5.9	5.2	8.5
	Fuels and mining products	21.7	45.4	27.9
	Manufactures	72.3	38.8	58.2
Commercial Services Trade	**Share in world total exports**	**0.81**	**3.25**	**4.41**
	Share in world total imports	**1.90**	**2.84**	**7.52**

Source: WTO, 2014. Trade Profiles, data from 2013. Elaborated by the author.

Being a closed economy is problematic for a country that has ambitions to become an influential player in monetary affairs. On this matter, a former Central Bank governor commented: "there is no point in trying to be important in the monetary world if you are not in the commercial world".[153] Brazil's commercial insulation has impaired, for instance, Brazil's quota in the IMF, since the quota formula takes countries' trade openness into account. As noted by a former Central Bank director:

> Brazil has a chronic problem in the quota negotiation with the IMF; that is, historically, the country's share in world trade has been important to determine the quota; the country's degree of openness is decisive. Brazil is a country relatively closed to trade. So suddenly [Brazil] is a country with an economy considerably larger than the Mexican economy, but that might end up with a smaller share than Mexico because we are more closed. In theory, that means our economy is less exposed to the external sector and therefore needs less support.[154]

Considering the case of Brazil's relations with its South American neighbours, a former Central Bank director said:

> It is not a matter of size; we are a very closed economy. … if you want to be a reserve currency you need to have size and to offer your currency to other countries: either lending to other countries, which is [not possible] for Brazil, or having commercial deficit with these countries, and Brazil is small in the international trade … so how could anyone have *reais*?

[153] Non-attributable interview with a former Central Bank governor.

[154] Non-attributable interview with a former Central Bank director.

From 2006 to 2008, Brazil held commercial surpluses with all South American countries except Bolivia (Table 3). As well observed by a high-ranked diplomat, "how do we want to promote regional integration this way? How do you develop complementary economic relations if we only export and do not import?"[155]

TABLE 3: BRAZIL TRADE BALANCE WITH SOUTH AMERICAN COUNTRIES, US$ FOB, 2006-2008

	2006	2007	2008
Argentina	3.686.329.292	4.012.699.656	4.347.179.409
Bolivia	-746.626.199	-750.433.169	-1.722.312.812
Chile	1.047.281.964	802.312.533	840.112.012
Colombia	1.891.980.055	1.911.875.979	1.465.838.938
Ecuador	847.104.599	631.444.346	835.383.982
Paraguay	937.739.517	1.214.070.864	1.830.044.102
Peru	721.392.616	644.849.098	1.342.617.950
Uruguay	394.372.825	502.053.613	625.972.799
Venezuela	2.973.871.037	4.378.015.391	4.611.415.280

Source: MDIC/Aliceweb. Elaborated by the author.

Significantly, Brazil's position stood in a stark contrast to that of China's, which held deficits with most countries in the region. As noted by one official at the Central Bank:

> What is the difference between Brazil and China? China can have swap agreements with any Latin American country it wants to. Why? Because China holds deficits with all Latin American countries, so what happens: if the country does not pay you, you do not pay. China is hedged on that. And Latin America and the Caribbean are the regions where the Brazilian economy holds the biggest surpluses, in terms of export of goods with technology and value added. And it is nowadays the only place to where Brazil is able to export manufactures and services.[156]

The contrasting positions of Brazil and China in South America were recognised by the government, as a high-ranked policy-maker said:

> We need to create conditions to incorporate the neighbours … in this commercial matter, [Brazil] might need to make some political options; create mechanisms to import from neighbours will make our attractiveness to them [higher], counterbalancing the magnetism they have from China and other countries. And this you do not only with economic theory, you do with politics.[157]

[155] Non-attributable interview with a high-ranked diplomat.

[156] Non-attributable interview with an official at the Central Bank.

[157] Non-attributable interview.

Failing to build commercial ties with the region, the Brazilian government's actions concentrated instead on creating a superstructure of agreements. The most important one was probably the Constitutive Treaty of the Union of South American Nations (UNASUL, *União de Nações Sul-Americanas*), signed in May 2008, which completed the integration started in 2004 between the Andean Community and the Mercosul nations. Amongst the greatest ambitions of UNASUL was the constitution of a monetary fund and lending institution, the Bank of the South – an idea that had been launched by Hugo Chávez in his electoral campaign in 1998. Venezuela gained support of Argentina and a first memorandum of understanding was signed in February 2007, when Bolivia and Ecuador also became members. Brazil and other UNASUL members, however, remained reluctant to join the Bank of the South (Carvalho et al. 2009, p.115). In May 2007 Brazil agreed to join the project; however, according to Carvalho et al. (2009, p.115) Brazil convinced the other members to resume the negotiations from the beginning, which meant revising Chávez's original project. The agreement to establish the Bank of the South was finally signed in September 2009 by the governments of Argentina, Bolivia, Brazil, Ecuador, Paraguay, Uruguay and Venezuela – missing therefore the other five members of UNASUL (Chile, Colombia, Guyana, Peru and Suriname) – and has not yet started its operations.

During the negotiations, Brazil and Venezuela held conflicting positions on several important matters for the Bank (Carvalho et al. 2009, p.116). The Brazilian position prevailed in some important aspects such as the establishment of the Bank of the South as a development bank to finance infrastructure projects, which contrasted with Venezuela's desire for a lender of last resort to replace the IMF. Brazil also managed to limit the bank's activities to South America, preventing any possibility that Venezuela could eventually use the bank to support its extra-regional allies, such as Cuba and Nicaragua. However, the headquarters were established in Caracas, and not in Montevideo as Brazil had preferred. Venezuela also won a victory with regards to the Bank's voting system, which was established according to the principle of one country, one vote. At the heart of the disagreements was the more radical position of Venezuela against the Washington-based institutions, as noticed by a Central Bank official who participated in the debate:

> Because behind the Bank of the South there is a speech of Venezuela, of Ecuador, of rejecting the IADB. … There was a meeting in which Brazil proposed to reinforce the actions of [South American countries] in the IADB, articulate more, and the answer was: "no, these Washington institutions are dominated by imperialism, we do not want them, we want to replace them". … Before creating a new [bank], why not make the Fonplata operate?[158]

Besides the UNASUL and the Bank of the South, there were a series of other regional mechanisms inaugurated around the same time, such as the Mercosul Structural Convergence Fund (FOCEM, *Fundo para Convergência Estrutural do Mercosul*), which initiated its operations in January 2007, and the Local Currency Payment System (SML, *Sistema de Pagamentos em Moeda Local*) between Brazil and Argentina, in operation since October 2008. The proliferation of these arrangements, however, did not match the economic capacity of the region. There was simply "too much smoke and not enough fire," as a high-ranked official at the Central Bank said (see also Malamud 2011, p.8). According to him, South American regional initiatives could only become more successful if they ran in parallel with the work of the IMF, the World Bank and the IADB, rather than if they tried to substitute them:

> This is not a matter of ideological nature; it is an extremely pragmatic issue: you have no power here to try to build an alternative to dispute with what is already established and operating in the region … There is no way [South America] can create a mechanism of international reserves that is effectively able to protect the countries from an external shock, for a very simple reason: the most part of the region's reserves belongs to only one country, and this country needs these reserves … So the initiatives here at the regional level have to be adjusted somewhat to this reality, perhaps we can have a less

[158] Non-attributable interview with an official at the Central Bank.

> grandiloquent project, more down-to-earth, more effective from the point of view of promoting economic integration. But for that you have to get down from the podium…[159]

In a critical view, a high-ranked official at the World Bank compared the South American integration experience with the Asian one:

> The Asian let the economic relations increase … and then they created the superstructure; whereas in the case of South America, we create great diplomatic treaties without having at the base the interested economic clusters to support [integration]. This is a very mistaken view … to think that the world is formed by great treaties, [as if] first you make a treaty and then come the merchants, [it is the opposite].[160]

Thus, despite being the largest economy in South America, Brazil failed to transform its structural resources into effective regional leadership (Malamud 2011). Economically, the commercial ties with its neighbours were weak. Instead, South American countries – Brazil included – were becoming increasingly dependent on trade with China. Politically, Lula's foreign policy orientation made it more difficult to moderate Venezuela's influence in regional arrangements, which progressively assumed a political nature. As a respected researcher at the government in this topic said:

> One of the great problems of Brazilian diplomacy is this lack of leadership perspective. Brazil does not have a project, [Brazil does not know] to what we negotiate, there is no direction, there is no project, and I think this is the great problem of integration here in South America, it depends on Brazil and Brazil does not have this perspective, it does not have well defined why it wants closer ties with its neighbours… destiny, geography, etc. but it does not go much further than that.[161]

In sum, as a result of Brazil's sounder economy, the Brazilian government could increase the amount of resources destined for foreign policy, which were targeted mainly at cooperating

[159] Non-attributable interview with a high-ranked official at the Central Bank.

[160] Non-attributable interview with a high-ranked official at the World Bank.

[161] Non-attributable interview.

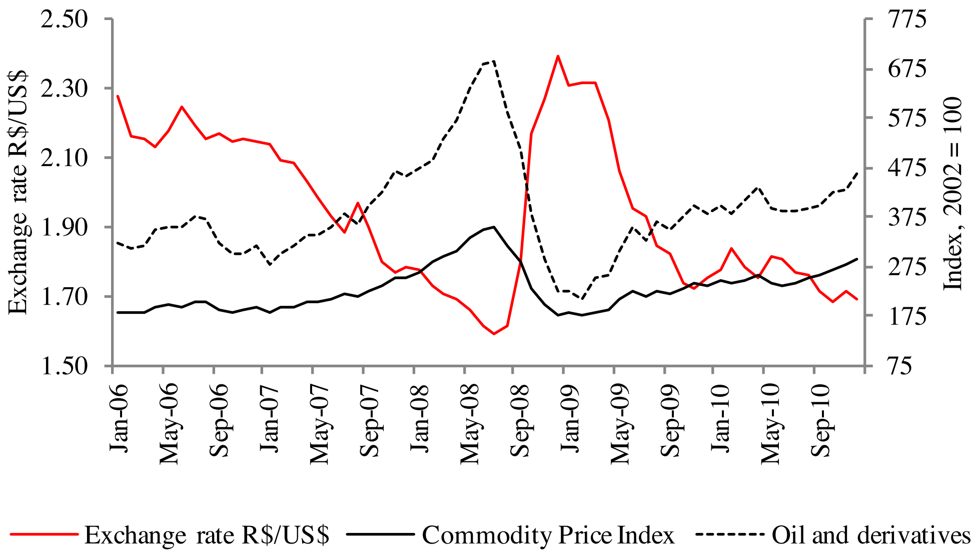
with South American and African countries. Moreover, the social initiatives of Lula's economic policy further augmented Brazil's international soft power as it created a development model that caught the attention of the developed world. However, while the Brazilian economy was no longer financially dependent on developed countries, the government had difficulty in behaving as an independent state, one that was prepared to assume the costs of leadership. Before Brazil could solve these dilemmas, the 2008 financial crisis broke out and interrupted the scenario that had favoured a greater regional integration.

4.4 THE LAND OF THE FUTURE'S DEBUT (2008-2010)

The bankruptcy of Lehman Brothers in September 2008 changed the hitherto favourable conditions enjoyed by the Brazilian economy, conditions that had been only marginally affected by the subprime crisis triggered in the United States in June 2007. One the one hand, the real appreciating trend reversed in July 2008 when it reached its lowest mark of R$1.59/US$1. In August, the exchange rate went down to R$1.61/US$1.00, depreciating even further by that September to R$1.79/US$1.00. Behind the depreciation of the real, was the "flight for safety" triggered by the international crisis, which caused an appreciation of the dollar against most currencies (Cohen 2009b, p.26; Eichengreen 2009, p.55; Akyüz 2012, p.15). In fact, despite being originated in the US financial system, the 2008 crisis did not harm international investors' perception of the US as the safest destiny for their assets.

On the other hand, the strengthening of the dollar led to a drop in commodities prices (Figure 27), which peaked in July 2008 only to fall rapidly until the end of that year. This drop in commodities prices had a negative impact on Brazil's terms of trade, which when combined with the shortage in international liquidity also contributed to the depreciation of the real (Mesquita & Torós 2010, p.7).

FIGURE 27: EXCHANGE RATE, COMMODITY AND OIL PRICES, 2006-2010



Source: IPEA and Central Bank of Brazil. Elaborated by the author.

The effect on the exchange rate was further amplified by the exposure of several Brazilian exporting companies to foreign exchange derivatives (Mesquita & Torós 2010, p.7). As the real began to appreciate in 2003, the revenues of the exporting companies were hampered. Some companies compensated their lower income in the financial market, betting high on the real's appreciation. When the exchange rate depreciated, some large Brazilian companies like Aracruz, Grupo Votorantim and Sadia, were presented with substantial losses. These losses contributed to the erosion of the favourable scenario of high international liquidity and favourable terms of trade, which had prevailed since 2003.

The 2008 crisis differed from all previous external crises Brazil had faced in two main ways. First, the crisis was triggered outside Brazil. In 2008, the shortage of dollar liquidity was not the result of a sudden capital outflow from Brazil, but rather of interbank markets freezing in the United States that reverberated around the world. Second, Brazil was in a much more privileged position than in previous crises to deal with the effects of the crisis thanks to the reforms the Brazilian governments had gradually put in place since 1994, notably in terms of banking and financial regulation, management of the federal public debt and reserve accumulation. In the words of one influential Brazilian economist:

> Unlike what happened in the past, which was a situation where, either because Brazil had a fragile domestic situation that was [prone to contagion] or because investors were specifically attacking Brazil, what used to happen was that there was a capital outflow; the currency devalued, triggering an inflation problem; and at the same time a fiscal problem, because there was no capital inflow … and then you had a balance of payments crisis often together with a fiscal crisis, where you had to make those major adjustment with the help of the IMF. This was the classical way of crisis here. In 2008, this was not what happened.[162]

When the 2008 crisis broke out, the Brazilian financial system turned out to be less contaminated by junk assets than other economies. Since the mid-1990s, Brazil had pursued tighter financial regulation, somewhat against the prevailing mainstream ideas of financial liberalisation and deregulation. As an official at the Central Bank said:

> The clear example is in the 1990s, in the early 2000s, the trend among the world's central banks was to remove the supervision of the financial system. … We suffered a lot of pressure here in the Central Bank. It is not a pressure from an institution, but the pressure from the prevailing ideology, and we resisted a lot. And the fact that in the 2008 crisis the countries that had supervision, regulation within their financial systems managed to respond more quickly to the crisis [helped to] create a new benchmark.[163]

[162] Non-attributable interview.

[163] Non-attributable interview with an official at the Central Bank.

According to Brazilian policy-makers, they knew that Brazil's economic reality – one very prone to financial disturbances – required greater surveillance than the benchmark proposed by developed countries. As noted by a high-ranked official at the Central Bank:

> If on the one hand Brazil took some steps towards [the mainstream] in the 1999 crisis, on the other hand we always maintained a certain autonomy, even during the government of Fernando Henrique, never fully embracing the consensus agenda at the international level. In the Lula government this was even more evident and obviously in the 2008 crisis this deregulation element of the financial sector was very strong, and in Brazil we always had the concern to maintain an effective regulation and supervision… certain elements of our economic structure, which were seen as idiosyncratic or *jabuticabas*[164], were then seen in a more benign way.[165]

For example, the notion of the bank stress test, which came to the fore during the 2008 crisis, had for a long time been part of Brazil's risk management policies. As noted by a former Central Bank governor: "[Other countries] did not have in their risk horizon the market stress; in Brazil we lived under constant stress, so the Brazilian risk management incorporated the stress, not in the methodologically well-organized way as it is today, but the concept existed".[166] In this regard, he said:

> It was a process in which Brazil in fact got ahead. I would say that the idea of a stronger regulation was connected somewhat with the greater understanding we [Brazilian policy-makers] had of the Brazilian problems. That is, we knew we needed to adopt here a stricter regulation than in other countries. We knew that volatility here was higher, that risks here were higher. So that led Brazilian banks to develop certain ways of risk management, or more sophisticated risk management techniques that we saw in other countries, because there you did not have a lot of volatility.[167]

---

[164] Jabuticaba is a Brazilian tree, whose name is commonly used as a pejorative expression to refer to something unique to Brazil.

[165] Non-attributable interview with a high-ranked official at the Central Bank.

[166] Non-attributable interview with a former Central Bank governor.

[167] Non-attributable interview with a former Central Bank governor.

Another *jabuticaba* in the pre-crisis period was the level of reserve requirements determined by the Central Bank, which were considered too high compared to international standards. In the words of a high-ranked official at the Central Bank:

> Our level of reserve requirements [was seen by the mainstream] as an impediment to the development of our financial markets… but at the time of the crisis [the level of reserve requirements] created a leeway for the Central Bank intervention that was very important to prevent bank failures. Obviously, it was also a lock for the degree of leverage [in comparison to] other economies… Thus, on the one hand, our economy was less undermined and, on the other hand, at the moment that [the economy] needed a liquidity injection, you could do this without using public resources; it was resources that were here in the Central Bank and that with one signature you changed the regulation, giving an injection able to target certain segments that were in most need at the time.[168]

The Brazilian economy also went against the mainstream in relation to public banks. The context of the 2008 crisis challenged the view about the usefulness of public banks, since they were a key element in the quick rebound of countries like Brazil, as a respected researcher at the government noticed:

> The fact that in the 1990s and in the 2000s, the relevance of having public banks in Brazil – the Banco do Brasil, Caixa Econômica, particularly BNDES – was very much questioned… with the crisis, this topic sweeps under the carpet: Brazil, like other Latin American and other emerging economies, used its public banks … to provide credit; it changed the credit market in Brazil, the volume of credit went from something like 25 per cent to 50 per cent of GDP in a few years... and Brazil was one of the economies that went through the crisis without major traumas.[169]

A former Central Bank governor likewise recognised the importance of Brazilian public banks in the Central Bank's response towards the crisis:

> I think there was wisdom to avoid many problems; the Central Bank acted as well as BNDES, Banco do Brasil and Caixa Econômica did together. You can even make an analogy with the Fed; [in Brazil] we made a kind of quantative easing as the Fed did, but acting from different institutions. BNDES bailed out institutions which, if they bankrupted, would strongly affect the banking system in a moment of vulnerability. There was a bank run… and the Central Bank involved Banco do Brasil and Caixa

[168] Non-attributable interview with a high-ranked official at the Central Bank.

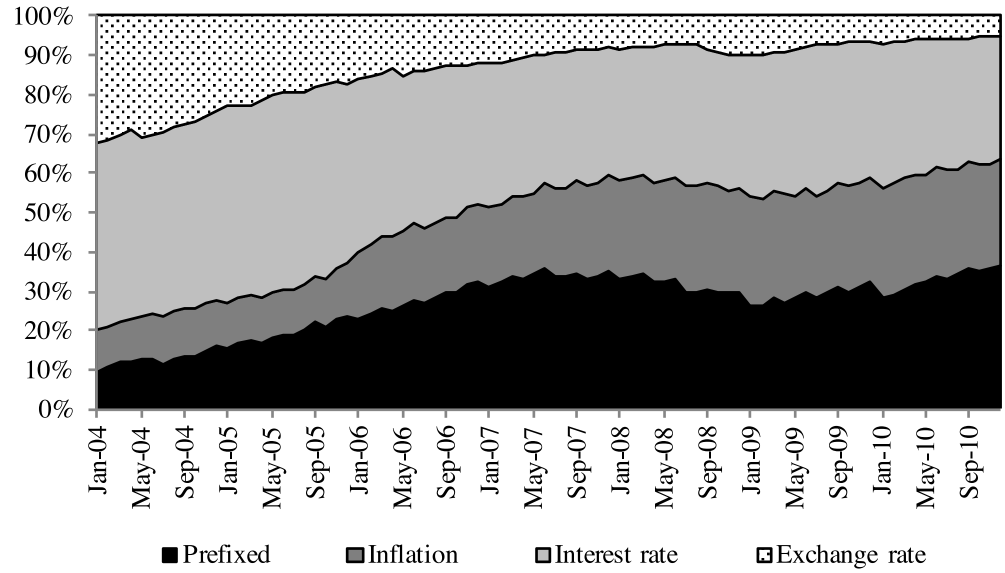
[169] Non-attributable interview.

> Econômica to increase the credit market, which greatly helped the situation of the race against medium-sized banks. We used our equivalent of the FDIC [Federal Deposit Insurance Corporation], the FGC to improve the liquidity situation… Most importantly, the Central Bank and the BNDES acted to make some important acquisitions happen, which prevented some important banks to fail. … Therefore, the Central Bank and other banks acted very firmly to avoid the emergence of a crisis atmosphere and coped very well with the situation.[170]

Another main reform in the years preceding the 2008 crisis concerned the composition of the federal public debt. Traditionally, the federal public debt was predominantly indexed to the interest and exchange rates. In 2004, these figures were 48 per cent and 32 per cent, respectively (Figure 28). Then, in the event of an external shock, the exchange rate devalued and the Central Bank responded by increasing interest rates, which triggered a twofold increase in the net public sector debt as proportion of GDP. In turn, the higher debt as a proportion of GDP was perceived as an increase in the country's risk, which consequently increased the risk premium, reinforcing the real's downward slide. In sum, the debt structure in place in the early 2000s amplified the magnitude of the external shock.

[170] Non-attributable interview with a former Central Bank governor.

FIGURE 28: FEDERAL PUBLIC DEBT COMPOSITION, 2004-2010



Source: National Treasury. Elaborated by the author.

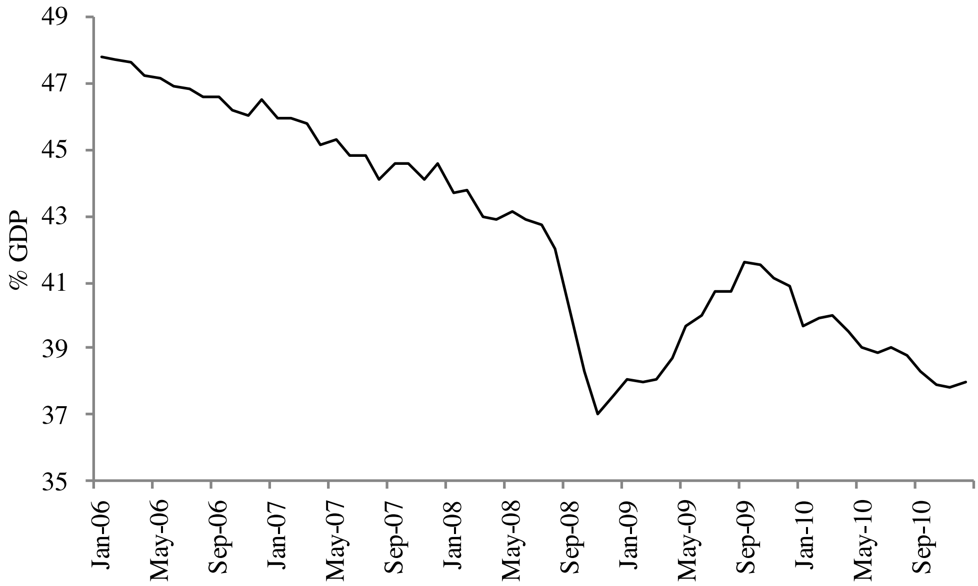
Gradually, the government deliberately changed the composition of the federal public debt, reducing the share of debt indexed to interest and exchange rates and raising the share of debt indexed to inflation or prefixed rates. In September 2008, the federal public debt indexed to inflation and prefixed rates accounted for almost two-thirds of country’s total debt, whereas the debt indexed to the exchange rate accounted for only 8 per cent. In this regard, a very influential politician and former minister reflected:

> When a country’s debt is not in its own currency, it has a different constraint of others; it was the Brazilian case until [not long ago]. Today the Brazilian debt denominated in dollars … is practically irrelevant. [Brazil] overcame this problem, this curse of having debt denominated in foreign currency. The liquidity problem, the default problem, all this is over… I think the Brazilian situation has changed completely; it is a much more solid situation. This does not mean that Brazil has resolved its problems, but I think that the external problem is no longer the key determinant of Brazilian economic policy.[171]

[171] Non-attributable interview.

Consequently, when the exchange rate depreciated in 2008, the opposite from previous crises happened: "the net debt fell instead of rising, then the government could make a counter-cyclical policy,"[172] as a former Central Bank director explained (Figure 29).

FIGURE 29: TOTAL NET PUBLIC SECTOR DEBT, % GDP, 2006-2010



Source: Central Bank of Brazil, Boletim, Seção Finanças Públicas (BCB Boletim/F. Públ.) Elaborated by the author.

In addition, the stockpiles of foreign reserves the Central Bank had been accumulating since the pre-crisis period served to strengthen Brazil's resilience when the crisis broke out. As discussed in chapter 3, China's economic rise created the opportunity for Brazil to initiate a policy of reserve accumulation similar to those pursued by Asian countries. Overall, the strategy of reserve accumulation was driven by the Central Bank's desire to signal to the world Brazil's resilient economy. The first signal of this strength came with Brazil's debt repayment to the IMF in 2005. In retrospect, a former Central Bank director explained Brazil's policy of reserve accumulation as follows:

[172] Non-attributable interview with a former Central Bank director.

> It was initially a policy of shoring up reserves, then we paid with those dollars the IMF loan, and then it was a reserve accumulation policy. … So I think the reserve [accumulation policy] was not so much an act of repudiation of the IMF, but an initiative to perpetuate the positive, but temporary, shock of China.[173]

After paying the IMF, the aim was to build a robust cushion of international reserves as a self-insurance policy. Again, the desire to accumulate reserves was linked to showing off Brazil's resilience. According to a Central Bank director, Brazil's shortage of reserves appeared to be holding Brazil from achieving an investment grade credit rating:

> So by 2004, 2005, 2006, we saw the rating agencies for instance demanding that Brazil implemented comprehensive reforms, even some that were very appropriate, but that we did not see the political environment to do. And we looked and saw countries like Russia, with institutions much more complicated than ours, but that were investment grade. Why? Because Russia had reserves and we had not. So we basically decided to buy the investment grade.[174]

The strategy worked as, amidst the financial meltdown, Standard & Poor's upgraded Brazil's long-term foreign currency sovereign debt to investment grade in April 2008. In early May 2008 *The Economist* (2008) described Standard & Poor's upgrade as a "strong vote of confidence and a milestone in Brazil's economic history, after years of mistrust following the 1987 debt default". In May 2008, Brazil received an upgrade from a second rating agency, Fitch Rating, and in September 2009 from Moody's Investors Service.

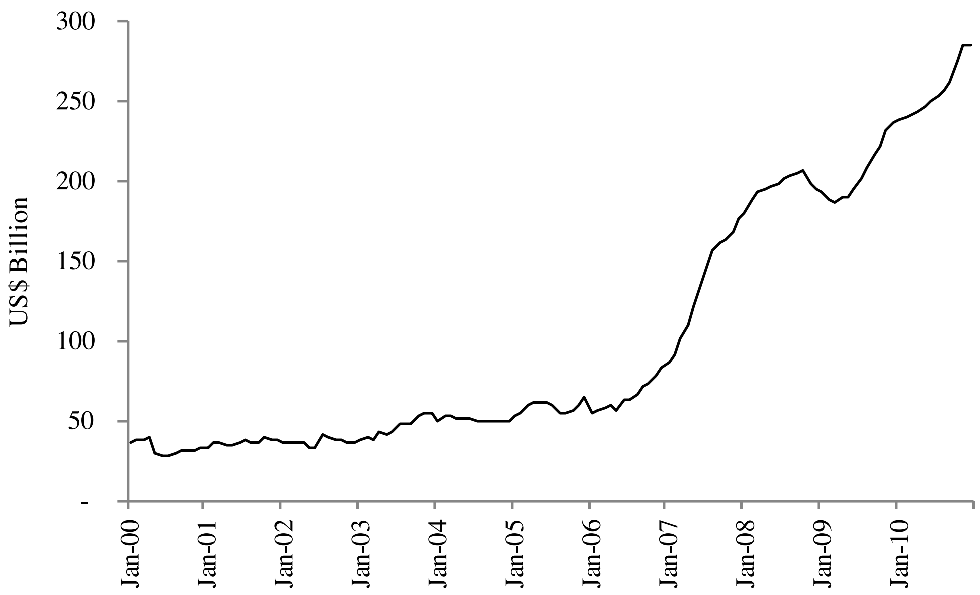
While the Central Bank used some of its reserves during the crisis, it rapidly recovered those expended and soon exceeded its pre-crisis level of accumulation. When the crisis erupted in September 2008, the Central Bank had US$205 billion in international reserves. This amount decreased to US$187 billion in March 2009, when it began to recover, surpassing its pre-crisis

[173] Non-attributable interview with a former Central Bank director.

[174] Non-attributable interview with a former Central Bank director.

level already in August 2009. By December 2010, the Central Bank had US$285 billion accumulated in international reserves (Figure 30).

FIGURE 30: INTERNATIONAL RESERVES, US$ BILLION, 2000-2010



Source: Central Bank of Brazil. Elaborated by the author.

Albeit effective as a self-insurance policy during the crisis, the policy of reserve accumulation was very expensive. It was consequently a controversial policy since the reserves were built in a context of deficit in the current account and of nominal deficits in the public sector. In other words, Brazilian reserves were not the result of a sustained surplus in the economy, whether in its relations with the rest of the world or with the public sector itself; they depended on the capital inflow, an inflow that was larger than the Brazilian economy needed to finance its deficits. Consequently, to buy foreign reserves the government needed to issue domestic debt and pay the high domestic interest rates to maintain it. As a former Central Bank director said:

> I remember many times I had to go to the Senate, representing the Central Bank along with [Henrique] Meirelles [the Central Bank of Brazil's governor from January 2003 to January 2011], and some senators were criticizing us for buying reserves. We always said, insurance is like this: while you do not have the accident, you only see the expense;

> when the accident happens then you start to appreciate the insurance, and it was exactly what happened.[175]

In any case, these policies amassed to build a resilient economy that could weather the external shock of 2008, providing the government enough room to manoeuvre to fight effectively the effects of the international crisis on Brazil. The immediate effect of the crisis was the interruption of international credit lines for Brazilian banks and companies with banks in the US. Consequently, one of the Central Bank's first challenges was to maintain adequate levels of liquidity in dollars and *reais* (Mesquita & Torós 2010, p.18).

In terms of liquidity in foreign currency, already in September 2008 the Central Bank began to use international reserves to established dollar auctions in the spot market and to provide temporary credit facilities to Brazilian exporters (Mesquita & Torós 2010, p.10; Barbosa 2010, p.4). In late October, the Central Bank also started swap operations, whereby the Central Bank bought domestic currency to alleviate the speculative pressures on the real (Mesquita & Torós 2010, pp.11–12; Barbosa 2010, p.4). Soon after, in October 29, the Central Bank of Brazil announced a currency swap agreement with the Fed, which supported the provision of up to US$ 30 billion, with no conditionalities. According to a former Central Bank director, the swap line with the Fed was symbolic of Brazil's progress on the global stage:

> I think there was a big change… the progress Brazil has made in ten years: in 1998, the world was not in crisis, and Brazil was borrowing money from the IMF; in 2008, the world was in a major crisis and Brazil was making currency swaps with the Fed without conditionalities. So I think Brazil has made progress indeed.[176]

[175] Non-attributable interview with a former Central Bank director.

[176] Non-attributable interview with a former Central Bank director.

The Fed selected only three EMDs other than Brazil to conclude swap lines contracts: Mexico, South Korea and Singapore – economies that were considered not only "large and systemically important" but also "fundamentally sound and well managed" (Federal Reserve 2008). The currency swaps with the four EMDs were preceded by the announcement of similar agreements with ten[177] central banks from developed countries since September 18. As a Central Bank director said:

> At that time, the Fed established several currency swap arrangements with other central banks. At a first moment it was only with central banks of developed countries, and then we began to note that although the epicentre of the crisis was far from Brazil, some of our banks, some of our institutions, began to suffer pressure because we were outside the umbrella of the swaps. And then, using the contacts we made in the meetings of the BIS, using the dialogue we had there, we quickly managed to talk to the New York Fed and they made a currency swap with Brazil, without conditionalities; it was money we could use with no need of having any pre-agreed policy with the Fed. … So it was not a loan, it was a swap: if they wanted to use *reais* they had, if we wanted to use dollars, we had US$ 30 billion.[178]

On the surface, it looked like Brazil's Central Bank had had significant influence in securing the swap agreement with the US. As noted by Steil (2014a, p.56), however, the Fed chose the countries for the swaps according to their importance to the US financial system. It is unrealistic to think that Brazil's Central Bank could have obtained the agreement if it had not been in the US' interest. In that year, the Fed rejected swap-line requests from Chile, the Dominican Republic, Indonesia and Peru (Steil 2014a, p.56). The swap lines established during the crisis with Brazil and the other EMDs expired two years after, when the US economy was less vulnerable to external financial volatility, and in 2012 the Fed denied a swap-line to India (Steil 2014a, p.56).

[177] These were the Reserve Bank of Australia, the Bank of Canada, Danmarks Nationalbank, the Bank of England, the European Central Bank, the Bank of Japan, the Reserve Bank of New Zealand, the Norges Bank, the Sveriges Riksbank, and the Swiss National Bank.

[178] Non-attributable interview with a former Central Bank director.

For Brazil, the agreement was nevertheless essential. Its importance did not lie in having access to the US$ 30 billion (actually Brazil had almost seven times that value in international reserves) but rather in the agreement itself. As noted by a Central Bank director at that time:

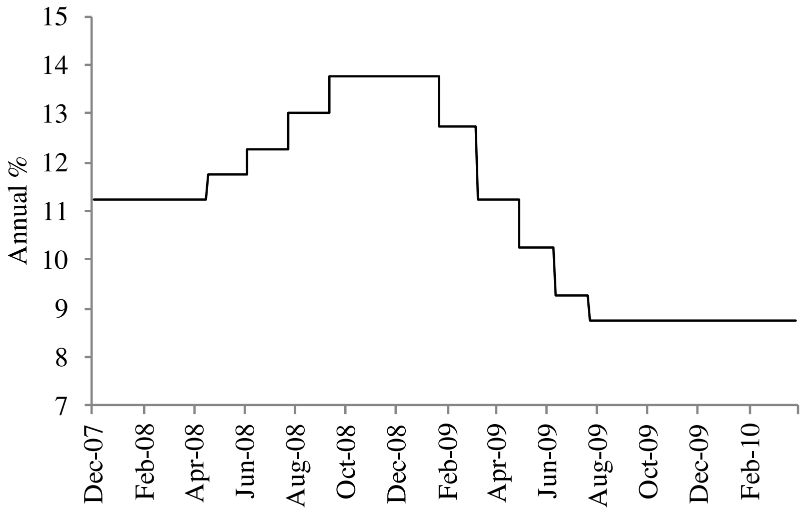
> We actually looked at this currency swap as a signal. We did not need to use that money, we had reserves, we were not even selling many reserves, but we wanted to have this sign that we were part of the core of the international financial system, and we did. So in the end we did not use the money, we did not have any auctions, but the effect we wanted we achieved that was the signalling effect.[179]

In terms of domestic liquidity, one of the main measures used by the Central Bank involved lowering the reserve requirements for domestic banks, which represented an injection of liquidity into the financial system without using fiscal resources. Two other main lines of action were improving rediscount operations and expanding operations with the Brazilian Credit Guarantee Fund (FGC, *Fundo Garantidor de Crédito*) (Mesquita & Torós 2010, p.13).

The provision of liquidity in reais did not undermine the Central Bank's priority of meeting its inflation target (Mesquita & Torós 2010, p.13). The Central Bank tightened monetary policy until the end of 2008 to prevent inflation accelerating (Figure 31), given that when the crisis erupted the Brazilian economy was booming and the subsequent impact of the depreciation in the exchange rate further pressured inflation. The Central Bank feared that a premature cut in interest rates could compromise its credibility on price stability and therefore waited until January 2009 to loosen its policy again when the prospects for the economy had improved (Mesquita & Torós 2010, p.13).

[179] Non-attributable interview with a former Central Bank director.

FIGURE 31: INTEREST RATES (SELIC), DECEMBER 2007-MARCH 2010, ANNUAL PER CENT



Source: Central Bank of Brazil, Boletim, Seção mercado financeiro e de capitais (BCB Boletim/M. Financ.). Elaborated by the author.

Ultimately, the Central Bank's response to the crisis was not an unorthodox one. On the contrary, it was quite conservative, given that the Central Bank kept the stability of prices as its priority, waiting until January 2009 to begin decreasing interest rates. Even so, having fewer economic imbalances when the international crisis erupted allowed the Central Bank to eventually decrease interest rates, instead of raising them as had been the case in previous crises, but it only did so when it judged there to be no threat of accelerating inflation. As one Central Bank director at that time said, the difference in the Central Bank's response in 2008 from that of previous episodes was mainly the more resilient condition of the Brazilian economy that permitted the implementation of counter-cyclical measures:

> [The Central Bank] let the exchange rate depreciate to clear the excesses there were in the local market. We knew that, as the economic fundamentals were good, the exchange rate was going to appreciate afterwards. And then when this began to happen and the inflation expectations began to improve, we began to cut interest rates. So this was an advantage derived from the objective situation of having fewer economic imbalances. …

> I think that the big difference [was not the economic team, but] the policies that allowed us to arrive in 2008 in a better shape, more resistant.[180]

This account further calls into question the government's claim that the alteration of its economic team in 2006 engendered a substantial change in terms of economic policies. In fact, Mesquista and Torós (2010, p.9), both Central Bank directors at the outbreak of the crisis, stated that the management of the crisis avoided breaking with the macroeconomic tripod. To be sure, 2008 was the first time the Brazilian government had the necessary policy space to implement counter-cyclical measures, a policy space that emerged after several reforms in the period preceding the crisis (such as banking and financial regulation, management of the federal public debt profile and accumulation of international reserves) and that was also context dependent. Interviews suggest that, if the economic team had made any difference to the response towards the 2008 crisis, it came from the Central Bank governor, as one influential economist said:

> I think it made a huge difference the fact that the Central Bank governor was someone who had been the president of a large international bank [Meirelles served as the President of BankBoston from 1996 to 1999, and as the President of Global Banking and Financial Services for FleetBoston Financial Corporation from 1999 to 2000], who is someone who truly understands how this system works and what you have to do to unlock the interbank market in a situation like this.[181]

Along with the decrease of the interest rates from January 2009 onwards, the government also increased the domestic credit supply. First, the government increased BNDES available credit, which allowed BNDES to provide special credit facilities for circulating capital, small and medium enterprises and exports (Barbosa 2010, p.5). Second, it extended interest-rate

[180] Non-attributable interview with former Central Bank director.

[181] Non-attributable interview.

subsidised credit to the two largest public commercial banks, Banco do Brasil and Caixa Econômica Federal. According to Barbosa (2010, p.6), these actions combined increased credit supply by the Brazilian public banks by 33 per cent between September 2008 and July 2009, while large private banks increased their credit supply by 9.1 per cent.

On top of monetary and credit supply measures, in September 2008 the government initiated tax exemptions measures and in January 2009 it announced further stimulus measures, including an expansion of the PAC. In March 2009 the government launched a new habitation program, called *Minha Casa, Minha Vida*, in a further attempt to unlock investment. In this context of increased public spending, the primary surplus target was lowered from 3.3 per cent to 2.5 per cent of GDP (Ministério da Fazenda 2010).

Finally, as the Brazilian currency began to appreciate due to a new wave of capital flows which started in the second-quarter of 2009, the Brazilian government introduced measures of capital account regulation (CAR) in October 2009, which included capital control and financial prudential regulation mechanisms (Prates & Paula 2017; Gallagher, Griffith-Jones, et al. 2012). Several academic studies show that while the introduction of those measures were insufficient to contain the appreciation of the Brazilian currency, they had an impact in shifting the composition of capital inflows toward long-term investment and modestly increased Brazilian policy autonomy (Baumann & Gallagher 2012; Prates & Paula 2017; Chamon & Garcia 2016; Klein 2012).

The broad response of the Brazilian government towards the crisis was successful as, after a small recession of 0.2 per cent of GDP in 2009, the Brazilian economy resumed its growth in the second quarter of 2009, peaking at 7.5 per cent in 2010 – Brazil's best performance since 1986. Inflation remained under control (4.3 per cent in 2009 and 5.9 per cent in 2010) and the government achieved a primary fiscal budget of 4.1 per cent of GDP in 2008 and of 2.1 in

2009. Thus, indicators suggested that Brazil had successfully surmounted the negative effects of the international crisis and had resumed growth.

As the height of the crisis passed, however, the government continued to pursue a heavily expansionary fiscal policy. As a former Central Bank director stated:

> But I think that the change really happened in 2010, in late 2009/early 2010, because you already had recovered from the crisis; if you were really countercyclical it was time to start bringing it back. … The government continued with a heavily expansionist policy in 2010 when the economy was already giving signs of overheating: inflation in 2010 was already rising, and in 2011 reached 6.5 per cent. So you had an overheated economy, and despite the signs of an overheated economy [the government] continued with the loose fiscal policy. … Then you notice [an incipient change] in 2010, and the change is crystalized in 2011, then already with Dilma… It was not during the crisis, it was in the post crisis.[182]

Indeed, evidence suggests that there was a clear change from 2011 onwards. As the government believed the Brazilian economy was performing well because of the inflection in its macroeconomic policies in 2006, it embraced "developmentalist" policies more forcefully after 2011. However, from 2011 onwards Brazilian economic performance worsened. Concurrent to this change was that the propitious international conditions that had existed despite the crisis, began to disappear in 2011. This correspondence may suggest that, contrary to the domestic economic policy-focused explanation, the external environment had a more influential effect on Brazil's sound performance during 2006-2010 than has been previously thought.

4.5 BRAZIL IN THE SPOTLIGHT (2008-2010)

Brazil's response towards the 2008 crisis was extensively recognised and lauded around the world. In November 2009 *The Economist* (2009) observed that "Brazil suddenly seems to have

[182] Non-attributable interview with former Central Bank director.

made an entrance onto the world stage," and Brazil was identified as one of the last large economies to enter the crisis and one of the first to emerged from it. In particular, the Central Bank's response towards the crisis, which minimised its effects on the Brazilian economy, promoted international interest in Brazil and, in the words of a close observer, "gave a boost to Brazil".[183] As described by a high-ranked official at the Central Bank:

> [Brazil's performance during the crisis] created a huge interest in the Brazilian economy, books being launched about Brazil, 'new superpower emerging'. … It was very clear, [there was] a big interest about the experience and about what Brazil had to say on what was happening and on how to deal with that situation.[184]

Brazil's performance coupled with the unique context of a crisis that mainly affected the developed world and favoured the ascension of other EMDs served to augment Brazil's external influence. As one influential economist said:

> The emerging [countries] were the flavour of the month at that time; there was a euphoria around the BRICS, Brazil had just been upgraded to investment grade… People talked it was going to be the locomotive of global growth, which was a big mistake, but the fact is that there was this attraction.[185]

The crisis found Brazil chairing the G20, which was upgraded to a leaders' forum in November 2008 and symbolised EMDs' prominence in the aftermath of the crisis. In terms of external influence, the rise of the G20 and Brazil's role in it has actually been regarded a more significant event than the Real Plan for Brazil, as a former high-ranked policy-maker and influential economist acknowledged:

> In terms of power, I think that what recently changed was not the Real Plan, it was the creation of the G20. I think that after the financial crisis and the creation of the G20 there

[183] Non-attributable interview.

[184] Non-attributable interview with a high-ranked Central Bank official.

[185] Non-attributable interview.

> was the idea that the global governance system was going to take into consideration more than in the past the interests of developing countries.[186]

Likewise, Celso Amorim reflected on the importance for Brazil to be part of the G20:

> The fact that Brazil is currently in the G20, this is not measurable. It is what I always say when I talk about the Security Council and the businessmen ask: "why Brazil wants to be part of the Security Council? This is nonsense and so on." And then I tell them: "why the businessmen want to be member of the country club?" To get along with who has power; it is not there that you do business, but you get to know each other, get to know the people in the government. … I am exaggerating to make the picture, but if you are in the G20, if you influence a decision, it is much more likely that your interest will be taken into account.[187]

In April 2009, when the G20 leaders agreed to triple the size of the available resources at the IMF under the New Arrangements to Borrow (NAB), Brazil made the second largest contribution (8,740 million SDR) amongst the new participants (IMF 2011). India and Russia gave contributions of the same amount and China gave the largest one (31,217 million SDR). In the same month, Brazil became a member of the IMF's Financial Transaction Plan, being included in the list of members sufficiently strong enough to finance IMF transactions (IMF 2009). For Brazil, "this was a *sui generis* situation," as the Brazilian representative in the IMF described: "Brazil, who was always a debtor, suddenly found itself in the creditor position. This affected a lot our position, for good".[188] According to him, the Brazilian government capitalised on its role as a creditor of the Fund:

> Lula used to say all the time, in Brazil and outside Brazil, "now we are creditors of the Fund, [it is] totally different from the past when we were not creditors and had to be subordinated to the Fund, when we were debtors". It is a political message. And, in practice, here [in the IMF], the Brazilian seat became more influential.[189]

---

[186] Non-attributable interview with a former Central Bank governor.

[187] Interview with Celso Amorim.

[188] Interview with Paulo Nogueira Batista.

[189] Interview with Paulo Nogueira Batista.

Being one of the biggest EMDs, Brazil was a natural candidate to be invited to join international forums concerned with increasing the representation of EMDs. As a Brazilian economist said:

> What is happening is that other countries have lost their relevance and this axis of relevance moved to countries that today have a stronger geopolitical weight, even though [their] economic advances have not kept the same pace of this new political prominence. I think this has to do with the slight change in the global axis from developed to emerging countries, and then it bends naturally to the major emerging countries; countries of continental proportions like Brazil cannot help but be a country that will join this domain.[190]

After increasing its quota shares from 1.42 per cent to 1.78 per cent in the 2008 IMF Reform, Brazil merited the second largest increment in quota shares (0.53 percentage points), in the 2010 Reform, only behind China's increase of 2.4 percentage points. As a result of this major realignment of quotas shares, Brazil became the tenth largest IMF shareholder. In March 2009, Brazil was included among the new participants of the Basel Committee on Banking and Supervision (BCBS). In the following month, Brazil became member of the Financial Stability Board (FSB), the successor of the Financial Stability Forum (FSF). Concurrently, Brazil was also among the EMDs invited to the BIS' informal meeting on the night before its plenary meetings.[191] As described by a former Central Bank director:

> One of the unwritten rules is that the presidents and directors of the main central banks, which at that time was called G10, they get together on Saturday night. … This G10 was expanded to include Brazil, Mexico, China and South Africa. So this means that the Central Bank of Brazil entered in fact in the group of the main central banks in the world … and I believe we have continued in this group since then.[192]

[190] Non-attributable interview.

[191] Non-attributable interview with a former Central Bank director.

[192] Non-attributable interview with a former Central Bank director.

Moreover, thanks to the particular Brazilian form of diplomacy, Brazil stood out among EMDs in general and from China in particular. As a former Central Bank director noted:

> For example, in these Basel committees, the idea is you make them a permanent dialogue forum; the idea is that people spend time together, talk during a whole day, several times per year, go out for dinner, exchange business card, stay friends, keep in touch, to create a community that at a time of crisis is useful. … That makes most countries maintain a certain stability in their representation on these committees. In the case of the Chinese, every two months changed; you never know who is the person, who is the contact. To China and to the PBoC [People's Bank of China] lack experience; not financial capacity. If they want, they have the means to do, but they lack experience.[193]

Brazilian diplomacy is traditionally very vocal, whereas "Chinese diplomats," a high-ranked diplomat said, "always have been very rigid, always have spoken little English, and always have negotiated on the basis of written text".[194] In informal negotiations such as in the G20, China's diplomatic behaviour hindered it, allowing Brazil, with its more vocal strategies to stand out. In the words of a high-ranked diplomat:

> One of the things that Brazil spoke about first was to enter in the Basel committee, we were the ones to put this one the table. And Brazil traditionally does this; we have had that for many years, since the first UNCTAD. Brazil is very vocal and speaks, and the others sometimes hide behind us. And this demand agenda was not China that opened space.[195]

Thus, Brazilian diplomats skilfully used the country's relatively good domestic response to the crisis to promote Brazil's image and influence internationally.

Furthermore, President Lula's personal style and rhetoric helped put Brazil at the centre of global attention: "there was an economic reason, but also a personal [reason]: president Lula liked this business, Celso Amorim liked [as well]; they travelled and took a lot of initiatives,"[196] one high-ranked diplomat highlighted. In similar lines, a respected Brazilian researcher said:

[193] Non-attributable interview with a former Central Bank director.

[194] Non-attributable interview with a high-ranked diplomat.

[195] Non-attributable interview with a high-ranked diplomat.

[196] Non-attributable interview with a high-ranked diplomat.

"Lula and Amorim surfed well this wave [of the crisis]".[197] In September 2008, for example, Lula declared, "people ask me about the crisis and I answer, 'go ask Bush' … It is his crisis, not mine" (Fidler 2009). Statements such as these yielded President Lula the tag of "the most popular politician on earth" (BBC News 2009) as US President Barack Obama said during the G20 Summit in London in April 2009. At the end of 2009, Lula was named "Man of the Year" by the French newspaper *Le Monde* and the *Financial Times* ranked him among the 50 faces that shaped the 2000s. In January 2010, Lula received an unprecedented award of "Global Statesman" by the World Economic Forum, created to mark the 40th anniversary of the Forum in Davos, Switzerland.

All these circumstances amassed to paint Brazil as a robust and influential player at the world stage. In the words of a former Brazilian Minister:

> I got tired of hearing: "Brazil is not an emerging country. Brazil has already emerged". It is not true, because our social problems are still very large; we have many shortcomings to overcome. But undoubtedly [Brazil] achieved a different international stature. And these internal factors are essential. Nonetheless, the external action was also an important factor to this gain of stature, and I think that by its turn also had a positive reflex domestically, which facilitated capital inflows, several things combined. It is fluid.[198]

While Brazil's domestic economic performance and external political action were important to increase Brazil's global influence, its success was largely context dependent. First, the break out of a major financial crisis in the developed world destabilised the economic and political balance of power in the IMS and made possible the ascension of EMDs. As noted by one influential Brazilian economist:

> This change of the axis, of how a crisis that affects all developed countries and … this perception of the fragility of the developed vis-à-vis the robustness of the emerging. Even

[197] Non-attributable interview.

[198] Non-attributable interview.

> if this robustness is not so robust, this change in the perception really gave a political and geopolitical boost, a voice to these countries that would not have been possible in different circumstances.[199]

Similarly, a former finance minister said: "What happened fundamentally was not a change in Brazil; it was a change in the rich countries, they suffered a very violent crisis".[200] The crisis opened the opportunity for a more serious debate about the necessity of reforming global economic governance in ways that would give EMDs more influence. In the words of a former Brazilian representative at the IMF:

> With the crisis, the voice of emerging countries, including Brazil, grew a lot. The crisis knocked the confidence in the traditional powers, where the crisis originated … because it became clear that many things they said and recommended did not have much ground, so this opened space to countries like Brazil to have more voice. And this happened here in the Fund, but also in the G20.[201]

Second, there was an increased appeal to include China in global economic governance given its economic size. Once the channel was open to incorporate China, it was almost natural to include other rising economies. In the words of a former Central Bank governor:

> I think Brazil has improved. Brazil over the years, after the Real Plan, was gaining more prominence, visibility in international financial forums. It turns out [however] that this process was linked with the perception of developed countries that they needed to involve more the emerging [countries], particularly for a realistic reason of incorporating China. Bringing only China to the debate was not [possible], so this opened a window. The greater financial internationalization itself led to the realization that, if emerging countries are fragile, there might be very negative repercussions on the developed countries' economies, on the developed countries' banking systems.[202]

---

[199] Non-attributable interview.

[200] Non-attributable interview with a former finance minister.

[201] Non-attributable interview.

[202] Non-attributable interview with a former Central Bank governor.

Thus, Brazil's increased external influence in the aftermath of the global crisis must be seen as a combination of a very specific combination of domestic and international circumstances. As one Central Bank official summarised:

> Who believes in astrology would say it was an alignment of the planets: you aligned a crisis that affected mainly the Europeans; a moment in which Brazil had great liquidity; had paid [the IMF]; [and was] articulated with other countries; there was a very important managing director, who was Dominique Strauss-Kahn, who valued the emerging countries, unlike former directors … Dominique Strauss-Kahn gave a lot of strength to these reforms [advocated by EMDs], to a new balance of forces in the Fund to increase the power of the emerging – Brazil, China, India, Colombia, and so on. So all these factors came together, and it was decisive, and yes we changed [our position].[203]

This context, however, gradually faded away and the prestige Brazil had in the immediate aftermath of the crisis was not destined to remain. As noted by one close observer, "Brazil had its peak of prestige, of influence in the international sphere, G20, IMF, etc. I would say, it was the period from 2008 to 2011, more or less".[204]

Significantly, it should be noted that Brazil's rise in influence during the crisis was achieved independently of Brazil's connection with its South American neighbours. Instead, Brazil's rise was connected to the similar circumstances and successes of the other BRICS countries. The regular and informal diplomatic cooperation among Brazil, Russia, India and China that started in 2006, where their foreign ministers met annually at the margins of the United Nations General Assembly, evolved in 2009 to a meeting with the heads-of-state and government. Later in December 2010, South Africa officially became a member nation and the group was renamed BRICS, with the "S" standing for South Africa. Gradually, Brazil's involvement with the BRICS replaced the priority given to South America before.

[203] Non-attributable interview with an official at the Central Bank.

[204] Non-attributable interview.

This change in foreign policy priorities only became clearer later on. Until 2010, Brazil was still relatively engaged in promoting regional integration mechanisms, such as the Bank of the South discussed earlier in this chapter. Likewise, Brazil continued to make an effort to act as a regional leader. In July 2009, for example, Brazil agreed to triple Paraguay's income from the hydroelectric of Itaipu.[205]

The change to the international scene from 2011 onwards reveals the effect external factors had on the image Brazil was able to portray abroad from 2008 to 2010. Put differently, Brazil's international influence proved fragile when international conditions altered. To that extent, the prevailing balance of power in the IMS during the 2008-2010 period that conferred greater political influence on EMDs should be understood as only temporary. As the next chapter will argue, with the exception of China, the crisis did not alter the core of the IMS and EMDs ultimately remained subordinated players.

4.6 CONCLUSION

The fragment of the Brazilian statement at the General Assembly of the United Nations in 2009 quoted at the beginning of this chapter illustrates the surge in Brazil's worldwide influence in the second half of the 2000s, particularly after the global financial crisis of 2008. As this chapter has argued, the Brazilian economy improved its performance from 2006 until the eruption of the 2008 crisis, which coincided with the repayment of the IMF debt and a relevant alteration in the government's economic team. While academics and policy-makers alike have maintained that Brazil's sound macroeconomic results were the consequences of a redirection of economic policies since 2006, Brazil's performance was likely more strongly influenced by

[205] Itaipu was built along Brazil and Paraguay's shared border, and established that Brazil had preference to buy Paraguay's excess capacity.

favourable international conditions of booming commodity prices. At the same time, the Central Bank's response towards the 2008 crisis was an orthodox one. The difference in 2008 was the unprecedented policy space the Brazilian government had to embrace counter-cyclical policies, which was result not of a change in its economic team but rather of a much stronger initial economic position. Brazil's improved position to fight the 2008 crisis, for its turn, was a result of a long term process of reforms and an international context that served to gradually build a more resilient economy.

The reasons for Brazil's improved performance aside, the reduction of external constraints for macroeconomic policies ensured the Brazilian government more freedom to look for external allies and the chance to build its image as a rising power. Additionally, Brazil's unique development model which combined economic growth with income distribution began to draw the world's attention. Ultimately, the 2008 crisis created the momentum for an effective projection of this image. Had the crisis not happened, it is likely that the G20 would not have become the main international forum for monetary cooperation; Brazil would not have been invited to participate in selected groups within the BIS; and there would have been no pressure to accelerate the reform in the IMF and other financial organisations. While this hypothesis cannot be verified, the fact that after the worst of the crisis had passed, the G20 lost its relevance and calls for reform in the IMF reduced (as will be argued in the next chapter) suggests that this argument is in all probability correct.

Both in terms of external influence and domestic economic results, it is clear that international conditions were essential to Brazil's performance. In the words of a close observer, "the fact that you do your homework is certainly not a sufficient condition for you to climb positions of external acceptance; it helps, but is not a sufficient condition".[206] While there was a pressure

[206] Non-attributable interview.

from the economic side to include EMDs, it is remarkable that most changes were called for by developed countries, particularly the US. To be sure, the replacement of the G8 by the G20 undoubtedly carried a lot of meaning; however, the fact that US President George W. Bush had pressed for this change suggests that ultimately developing-country states had little power to alter the architecture of the IMS, regardless of their growing economic weight and their relative resilience toward the crisis.

In spite of the ongoing debate on the origins of the 2008 crisis being rooted in the US and the continued criticism of the US's huge deficits, the US has remained the most influential power in the system. This is clear, for instance, from the swap arrangements the Fed made with other central banks. Then, instead of exercising its influence indirectly through the Bretton Woods Institutions, the US began directly to decide the beneficiaries of the dollar liquidity (Steil 2014a).

The argument that because emerging countries had more economic weight they should also have more political power must be put into perspective in light of the US' continued influence in the IMS. The 2008 crisis confirmed that the IMS is in fact a rigid and hierarchical system. The only state that was actually increasing its monetary influence was China, under the guise of the BRICS. For other EMDs, the crisis represented a circumstance in which they appeared to have greater influence in the IMS; however, it did not precipitate any decisive structural change. Even though Brazil capitalised on some permanent soft power during the crisis, it did not change its position within the IMS.

The international recognition Brazil received from 2006 to 2010 is nonetheless meaningful to understand what happened in the following years, for it somewhat legitimised the "developmentalist" bloc within the government, not least because of Brazil's performance during the crisis. In other words, because the government believed that the better performance was the result of its developmentalist policies, it continued and broadened these policies in the following years, as the next chapter will show.

CHAPTER 5. A NEW BRAZIL? (2011-2014)

5.1 SLEEPING WITH THE ENEMY: THE PARADOX OF BRAZIL'S RELATIONS WITH CHINA

The more rapid economic recovery of emerging market and developing countries (EMDs) relative to their developed peers immediately following the 2008 global financial crisis bolstered the idea of a revised and more balanced IMS, one in which EMDs would play a greater role (Eichengreen 2011a, p.8; Helleiner & Pagliari 2011; World Bank 2011; Maziad et al. 2011; Dailami & Masson 2009; Akyüz 2012). As international conditions began to change, however, this hypothesis was increasingly brought into question and the excitement about EMDs in general – and Brazil in particular – proved to be fleeting and fragile.

Even so, some of Brazil's soft power remained in place long after the short-lived euphoria had disappeared. To begin with, the period 2011-2014 witnessed several instances in which the continuation of Brazil's soft power was evident, such as the election in September 2013 of the Brazilian diplomat Roberto Azevêdo as Director-General of the WTO and the election of Brazil as chair of the United Nations' Peacebuilding Commission in January 2014. Brazil was also chosen to host the FIFA World Cup in July 2014 and the Olympics in August 2016, elections that some observers have suggested were a manifestation of a greater worldwide influence (Grix et al. 2015, p.474).

In addition, Brazil continued to participate in the formal and informal global financial forums it had joined during the height of the crisis and the Central Bank continued to be recognised by its international peers for its competence in dealing with the financial crisis. As a Central Bank official stated, "the Central Bank has become a reference in fighting the crisis, and the demand for cooperation coming to the Central Bank increased drastically".[207] After the crisis, the surge in the demand for international cooperation resulted in the creation of a specific area within the Central Bank.[208] The Central Bank began to promote 'international weeks' of bank inclusion, risk management and regulation, which are attended by other central banks interested in learning Brazil's know-how.[209] Internationally, Brazil also gained a greater role in the international debate, as a renowned economist said:

> Today the Brazilian authorities have a key role in the international debate, for example, in the BIS … Brazil already participated in the 1990s, but nowadays even more. When there was, for example, soon after the crisis, all that revision of the regulatory systems in the world; how countries were going to remodel financial regulation; how the United States was going to do and how this was going to affect the world and so on; when that was still in the process of discussion, Brazil had a very big role and was even used in a way as a reference, considering that we went through several banking crises in the past and we knew more or less what worked and what did not work from the regulatory point of view. … This is a novelty of the last, I would say, five years [2009]; before that Brazil did not have this, it was not on the spotlight so much.[210]

Lastly, Brazilian policy-makers have stated that they could discern a positive difference in their treatment worldwide. In the words of a high-ranked diplomat:

> It may be that from the monetary, economic point of view the changes have not been so deep yet, but I think they are in progress … and to those working with this on a daily basis, we notice a change in the treatment, I have no doubt, I have dealt with these matters for thirty years and I have never seen the American so humble, so humiliated, asking for help, that was what they did.[211]

Also in international forums, a Brazilian representative in the World Bank said:

> Today the power structure in these forums is different from what it was until 2008; it is different, it still is. … Because we have more representation in these forums, people listen

[207] Non-attributable interview with a Central Bank official.

[208] Non-attributable interview with a Central Bank official.

[209] Non-attributable interview with a Central Bank official.

[210] Non-attributable interview.

[211] Non-attributable interview with a high-ranked diplomat.

> to us more, the relationship is different, how much you are heard, how much your proposals gain space in these organisms, in these meetings, I think it has changed a lot.[212]

The vast majority of interviewees related a change in their treatment worldwide and in the deference they received from their international peers, a change that "is not quantitative, it has to be described,"[213] as a senior Brazilian diplomat summarised. As a former foreign minister exemplified:

> I can tell you a bit about the political consequences of this difference. When would, 15 or 20 years ago, someone who was candidate for the post of managing director at the IMF pay a visit to Brazil for support of the Brazilian government? … I think the first visit of Lagarde outside Europe for support was to Brazil. First she needed the support of the Europeans, evident, and then she came to Brazil. Why? That is what I wonder, because it was not because of our quotas, since our voting capacity is limited; it was not because of our economic power in general in Brazil; it was certainly not due to currency [reasons] … of course the size of our economy always weighted, stability obviously helped, but also the capacity of Brazil's influence.[214]

This positive difference in Brazil's treatment was also perceived in the rapport Brazil has maintained with international investors, one that has lasted even as Brazil began again to face strong economic turbulences. As one influential Brazilian economist said:

> I think investors and the whole world in a general way had a huge tolerance for these crazy things we did [referring to the period after 2010], because of the political capital Brazil won in the period subsequent to the crisis. … When you consider previous episodes and compare … no one was tolerant with Brazil … this margin of tolerance only comes after [Brazil] had this very positive visibility; it makes a huge difference."[215]

In sum, the general perception of Brazilian policy-makers and of some external observers is that Brazil was able to maintain a portion of the soft power it acquired in the aftermath of the crisis. In the words of a high ranked official at the Central Bank:

[212] Non-attributable interview.

[213] Non-attributable interview with a high-ranked diplomat.

[214] Non-attributable interview with a former foreign minister.

[215] Non-attributable interview.

> I think Brazil capitalized well that moment in which there was a lot of attention focused on it to strengthen its weight in these discussion forums. This somehow has remained, even if Brazil is out of the spotlight position from the point of view of the markets' specific interests. … Brazil moved a bit forward and not necessarily is moving everything backwards. So it has maintained some of that previous advance, even in a context that is no longer as favourable as before, and it has also used that for its agenda.[216]

Such increased margin of tolerance was convenient as international prospects became less favourable to the Brazilian economy and exposed how, in essence, Brazil persisted as an unprivileged state in the IMS.

Beneath this surface layer of soft power, Brazil's position in the IMS has remained in place even in the face of certain international dynamics that masked ongoing weaknesses within the Brazilian economy and enabled Brazil's superficial success following the 2008 crisis. These dynamics were mainly associated with the consequences of China's economic rise for Brazil, notably in terms of foreign trade (Cunha et al. 2012; Cunha 2011; Jenkins 2012). On the one hand, Chinese demand for commodities bolstered Brazilian exports, reducing Brazil's traditional external vulnerabilities and creating an environment for economic growth. On the other hand, however, China's demand for commodities simultaneously weakened Brazil's external position by undermining the composition of Brazilian exports. Increasingly in its bilateral relations with China, Brazil became a source of natural resources for China and a market for Chinese manufactures (Cunha 2011; Jenkins 2012; Gallagher & Porzecanski 2010, pp.64–69). Brazil's specialisation in natural resources was further reinforced by Chinese competition in third markets, particularly in Latin America, Brazil's main market for manufactures (Cunha et al. 2012; Lélis et al. 2012; Cunha 2011; Jenkins 2012).

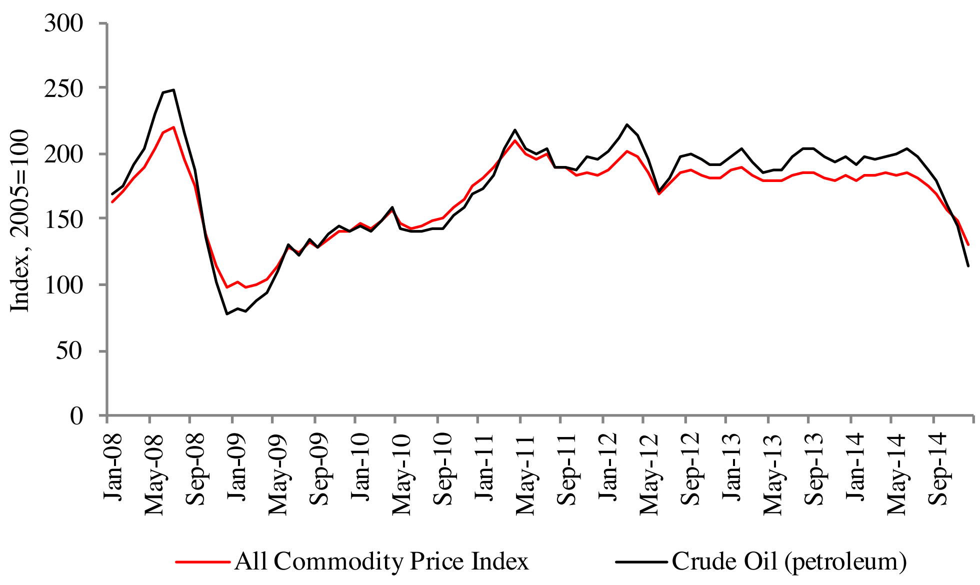
In this sense, China's global expansion has had paradoxical effects on the Brazilian economy. Symbolic of this conflicting relationship was the division in the Brazilian business community

[216] Non-attributable interview with a high-ranked official at the Central Bank.

between the Brazil-China Entrepreneur Committee (CEBC, *Conselho Empresarial Brasil-China*), formed in 2004 to enhance the countries' bilateral relations, and the Federation of Industries of the State of São Paulo (FIESP, *Federação das Indústrias do Estado de São Paulo*), along with other sectoral associations, which demanded greater government support to face Chinese competition (Jenkins 2012, p.23).

From 2011 onwards, the negatives effects of China's rise on the Brazilian economy became increasingly evident. This was mainly due to the reversal in the rise of commodity prices, which had hitherto created more macroeconomic autonomy for Brazilian policy-makers whilst diminishing the issue of the primarisation of exports. As Figure 32 below illustrates, commodity prices peaked in April 2011 and headed downwards until late 2014. A very similar but somewhat more volatile trajectory was followed by oil prices (Figure 32).

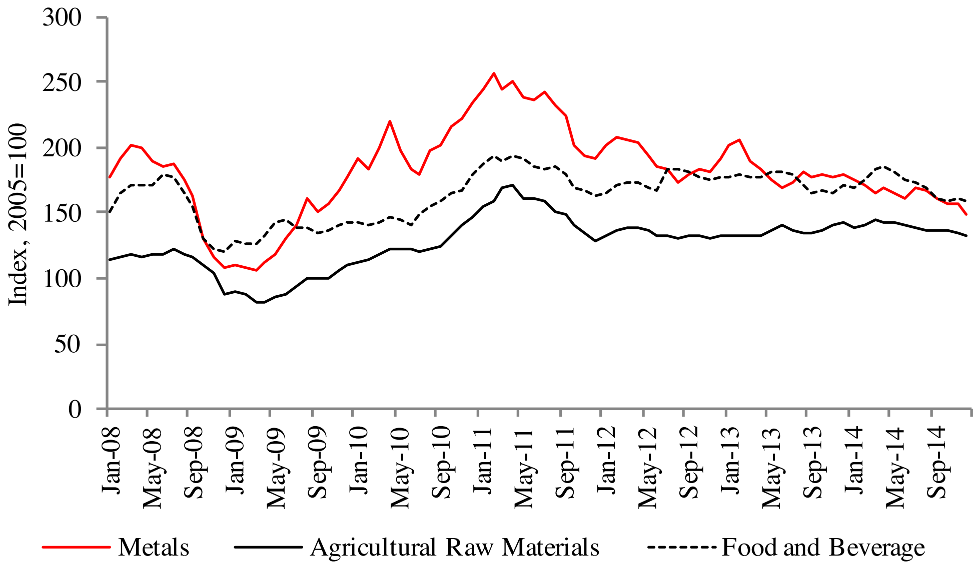
FIGURE 32: ALL COMMODITY PRICE INDEX AND CRUDE OIL, 2005=100, 2008-2014



Source: IMF Primary Commodity Prices. Elaborated by the author.

The Brazilian economy was also affected by metal prices, which similarly to oil were considerably unstable over the post-2011 period (Figure 33). In addition, Brazilian exports were impacted by the prices of agricultural raw materials and food and beverages, although these tended to be less volatile. In each of these cases, however, prices remained relatively high but turned downward from 2011 onwards, causing significant problems for Brazilian economic policy-making.

FIGURE 33: METALS, AGRICULTURAL RAW MATERIALS, AND FOOD & BEVERAGE INDEX PRICES, 2005=100, 2008-2014



Source: IMF Primary Commodity Prices. Elaborated by the author.

In short, the tapering of commodity prices exposed just how much the Brazilian economy was linked to China's rise: "[China] is a big stomach of raw materials where [Brazil] has entered as the periphery of China. … Brazil has engaged exporting commodities. There is the advantage, all agribusiness engages with that, but there is also the impact in the productive structure,"[217] as pointed out by a Brazilian researcher at the government.

As China integrated into the global economy, it transformed the international dynamics for Brazil in three ways: 1) by elevating the price of commodities; 2) by contributing to the

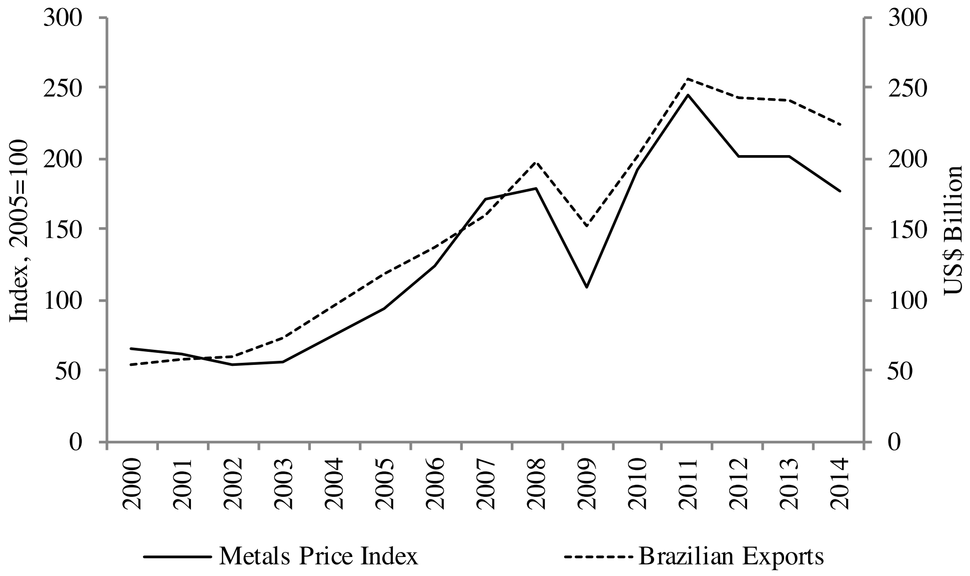
[217] Non-attributable interview.

appreciation of the Brazilian currency; 3) and by fostering competition of manufactured products, mostly in the international market. The combination of (1) and (2) created the context in which the Brazilian economy was less constrained by external factors, as described in the previous chapter. However, when (1) and (2) are pooled with (3), it is clear that China's integration into the global economy undermined Brazilian exports from the mid-2000s onwards. While (1) and (2) were temporary effects, (3) was permanent. When (1) changed, the negative effects of China's rise on Brazil's economic performance surfaced. Brazilian and international economists, however, have long been discussing the risks posed by China's ascension for Brazil and Latin America as well as the possibility of early deindustrialisation, "primarisation" of exports and Dutch disease[218] (Palma 2005; Bresser-Pereira 2010; Cunha et al. 2012; Jenkins 2012).

Commodity prices began to ascend in 2003 and continued to rise until 2011, despite the drop in 2008. Not by coincidence, the performance of the Brazilian exports and the Brazilian currency followed a very similar path, as Figures 34 and 35 illustrate. As commodity prices increased, Brazilian exports soared and Brazil accumulated trade surpluses so that international capital flowed into the country resulting in an appreciation of the domestic currency. While commodity prices were not the only factor behind the trade and capital trends, it is hard to deny their relevance given the connections between them.

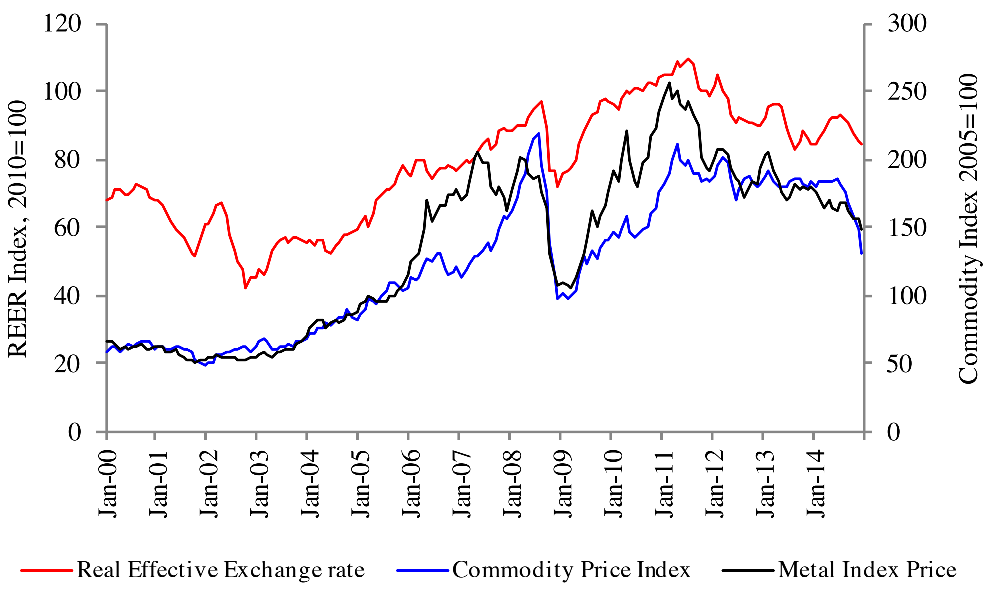
[218] The term Dutch disease was coined by *The Economist* (1977) to refer to the decline of the manufacturing sector in the Netherlands following the discovery of a large natural gas field in 1959. Since then, this concept is commonly used in the economic field to describe a situation where a boom in commodity exports triggers an inflow of foreign currency, leading to an appreciation of the domestic currency and consequently harming exports of other goods, mainly manufactures.

FIGURE 34: BRAZILIAN EXPORTS AND METAL PRICE INDEX, 2000-2014



Source: IMF Primary Commodity Prices (values for January each year) and MDIC/Aliceweb. Elaborated by the author.

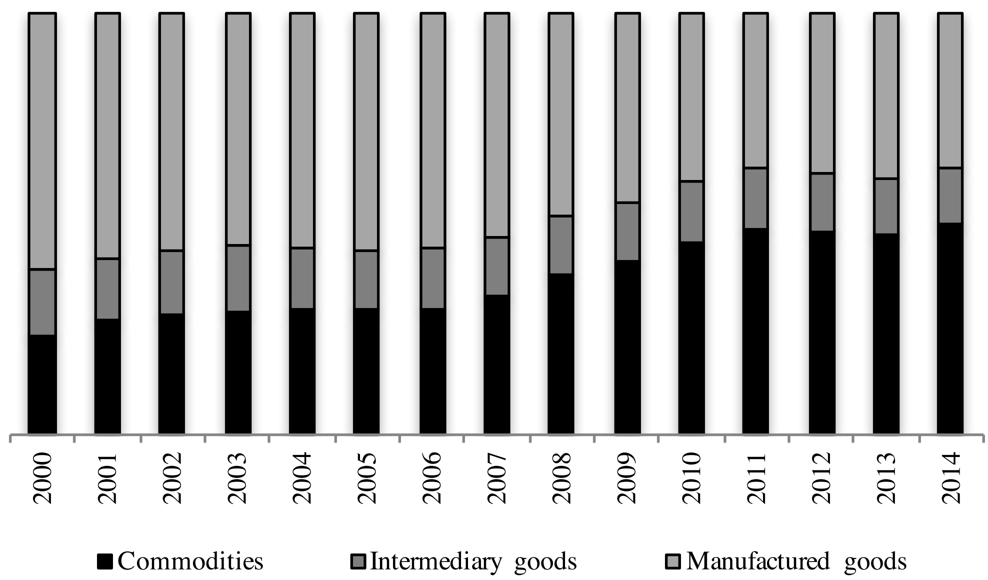
FIGURE 35: BRAZILIAN REAL EFFECTIVE EXCHANGE RATE AND COMMODITY PRICES, 2000-2014



Source: BIS real effective exchange rate and IMF Primary Commodity Prices. Elaborated by the author.

When considered in the context of the growing competition posed by Chinese manufactures, the combination of high commodity prices and an overvalued exchange rate resulted in a negative outcome for the composition of Brazilian exports (Cunha et al. 2012; Jenkins 2012). From a broad perspective, the share of commodities in Brazilian exports grew rapidly from 2000 to 2014 at the expense of manufactured goods (Figure 36). This process was particularly rapid from 2006 to 2011, when the share of commodities increased from 29 per cent to 48 per cent. In 2014 the share of commodities was 49 per cent, against 36 per cent for manufactured goods.

FIGURE 36: COMPOSITION OF BRAZILIAN EXPORTS, 2000-2014



Source: MDIC. Elaborated by the author.

Interestingly enough, until 2006 Brazilian exports were actually headed by two groups of manufactured goods, vehicles and nuclear reactors, which accounted for US$23.3 billion that year (16.9 per cent). In 2007, while vehicles still accounted for the largest share of Brazil's exports, nuclear reactors were overtaken by mineral fuels and ores. In 2008, vehicles and nuclear reactors fell to the third and fifth position, respectively, and export of mineral fuels and ores soon replaced them. More worryingly, since 2011 the exports of vehicles and nuclear reactors fell not only in relative but also in absolute terms, accounting for US$22.5 billion in

2014 (10 per cent) – a percentage far lower than their 2006 level. Figure 37 illustrates this transformation in the composition of Brazilian exports, taking 2014 as the reference year.

FIGURE 37: BRAZILIAN EXPORTS, TOP GROUP OF PRODUCTS, 2003-2014

YEAR	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	
1ST	VEH	▶VEH	▶VEH	▶VEH	▶VEH	▲ORE	▶ORE	▶ORE	▶ORE	▶ORE	▶ORE	▶ORE	ORE Ores, slag and ash
2ND	NUC	▶NUC	▶NUC	▶NUC	▲FUE	▶FUE	▶FUE	▶FUE	▶FUE	▶FUE	▲SEE	▶SEE	SEE Oil seeds and oleaginous fruits; grains; seeds and others
3RD	IRO	▶IRO	▶IRO	▲FUE	▲ORE	▼VEH	▲SEE	▲SUG	▲SEE	▶SEE	▼FUE	▶FUE	FUE Mineral fuels, mineral oils, bituminous substances and mineral waxes
4TH	SEE	▲MEA	▲ORE	▶ORE	▼NUC	▲IRO	▲MEA	▲VEH	▼SUG	▲NUC	▲MEA	▶MEA	MEA Meat and edible meat offals
5TH	FUE	▼SEE	▼MEA	▼IRO	▲MEA	▼NUC	▲SUG	▼MEA	▲NUC	▲MEA	▲VEH	▲NUC	NUC Nuclear reactors, boilers, machinery and mechinical appliances; others
6TH	ORE	▶ORE	▲FUE	▼MEA	▼IRO	▼MEA	▼VEH	▼SEE	▼VEH	▼SUG	▼NUC	▼VEH	VEH Vehicles other than railway or tramway rolling-stock, and parts and acessories
7TH	MEA	▼FUE	▼SEE	▲SUG	▲SEE	▶SEE	▼NUC	▶NUC	▼MEA	▼VEH	▼SUG	▼SUG	SUG Sugars and sugar confectionery
8TH	RES	▶RES	▲SUG	▼SEE	▼SUG	▶SUG	▼IRO	▶IRO	▶IRO	▶IRO	▶IRO	▶IRO	IRO Iron and steel
9TH	SUG	▶SUG	▼RES	▶RES	▶RES	▶RES	▶RES	▶RES	▶RES	▶RES	▶RES	▶RES	RES Residue and waste from the food industries; others

Font colour:
Blue - Primary goods
Red - Secondary goods

Rank positional indicator:
▶ Remained in the same position with respect to the previous year
▲ Moved to a higher position with respect to the previous year
▼ Moved to a lower position with respect to the previous year

Source: MDIC/AliceWeb. Elaborated by the author.

Brazilian exports became increasingly concentrated in fewer products. Looking at the top 10 products exported, for example, their share increased from 27.3 per cent in 2003 to 45.8 per cent in 2011 (and 43.2 in 2014). While in 2003 Brazil's main export product represented 5.9 per cent of total exports, in 2011 it represented 12.4 per cent (Table 4).

TABLE 4: BRAZILIAN EXPORTS, TOP 10 PRODUCTS 2003 AND 2011

	2003			2011		
	Product	US$ million FOB	%	Product	US$ million FOB	%
1	Other soybeans, even crushed	4.287	5.9	Iron ores not agglomerated, and concentrates	31.851	12.4
2	Soybean waste, solid	2.601	3.6	Petroleum oils, crude	21.603	8.4
3	Iron ores not agglomerated, and concentrates	2.282	3.1	Other soybeans, even crushed	16.312	6.4
4	Petroleum oils, crude	2.121	2.9	Cane sugar, in crude	11.548	4.5
5	Autom. with motor explosion,1500<cm3<=300, up to 6 pass	2.077	2.8	Iron ores agglomerated and concentrates	9.965	3.9
6	Chemical wood pulp of n/conif., soda/sulphate, semi/bleac	1.686	2.3	Coffee not roasted or decaffeinated, in grain	7.999	3.1
7	Cane sugar, in crude	1.350	1.8	Soybean waste, solid	5.544	2.2
8	Coffee not roasted or decaffeinated, in grain	1.302	1.8	Chemical wood pulp of n/conif., soda/sulphate, semi/bleac	4.605	1.8
9	Iron ores agglomerated and concentrates	1.173	1.6	Fowls spec.gal.domest.cuts and offal, frozen	4.454	1.7
10	Fowls spec. gal. domest. cuts and offal, frozen	1.092	1.5	Frozen bovine meat, boneless	3.506	1.4
	Total		**27.3**			**45.8**

Source: MDIC/AliceWeb. Elaborated by the author.

Despite such worrying indicators, the government overlooked the concentration of its exports likely because Brazil continued to achieve exports records and these rising exports fuelled recovery from the crisis and simulated economic growth. Despite the fact that Brazilian exports rose and growth improved because commodity prices were high until 2011, the Brazilian government apparently believed that the recovery in economic growth fuelled by exports was driven mainly by the counter-cyclical policies it implemented (Barbosa & Souza 2010, p.22).

Thus, when economic growth began to slow in 2011, the government reinforced and widened the fiscal policies adopted in the wake of the 2008 crisis. As the international scenario had changed, however, when the government applied the same formula different results ensued. In the words of a former Central Bank director: "People today see the government repeating things it did in 2008-09 without success; so they wonder about the quality of the government's diagnosis, if it is right or wrong".[219] The outcome was mounting economic problems that eventually broke out into a political crisis in mid-2013, further aggravating the economic situation.

As result of its economic situation, Brazil's external influence diminished during this period, although this change occurred at a slower pace and to a lesser extent than Brazil's economic influence. After all, China's rise also had paradoxical effects on Brazil in political terms. On the one hand, as China benefited from its partnership with other EMDs, particularly the BRICS, to increase its international influence, Brazil enjoyed the privileges of being its ally. On the other hand, as a result of China's asymmetric economic power in relation to Brazil, it ended up capturing part of Brazil's sphere of influence in the rest of South America.

The aim of this chapter is to argue that the Brazilian government essentially had little power to reverse its domestic economic performance when external circumstances proved less favourable. To do this, the remainder of this chapter is divided into three sections. First, it addresses how Brazilian policy-makers reacted to the revival of higher constraints in the IMS after 2011. Second, it examines how Brazil's external influence was affected by global developments as well as by Brazil's economic condition. The third section concludes the chapter.

[219] Non-attributable interview with a former Central Bank director.

5.2 THE FINAL RECKONING OF BRAZIL'S ECONOMIC SUCCESS

Amidst the ongoing enthusiasm for Brazil, President Dilma Rousseff took office in January 2011. As the Brazilian economy was already showing signs of overheating in 2010, when inflation reached 5.9 per cent, the Dilma government began by adopting measures of fiscal austerity and the Central Bank increased interest rates. However, as economic growth waned, the government launched by the end of 2011 a new economic guideline, which became known as the "New Economic Matrix" (NEM). At its core, the NEM reinforced and widened the fiscal counter-cyclical policies that had been adopted in the wake of the 2008 crisis.

The causes of Brazil's economic deceleration remain the subject of strong debate. Even so, there are two facts on which most observers can agree. The first one is that the government failed to prevent a deterioration in the balance of payments, which weakened the Brazilian economy. This can be ultimately related to the international dynamics that resulted from China's economic rise. The second fact is that the government's actions introduced a high degree of uncertainty from roughly 2011 onwards, which, when combined with the adverse international conditions, worsened the situation of the Brazilian economy.

This section will examine these two accepted facts and will then discuss the subject which scholars and commentators continue to debate – namely, the policy option implemented by the Dilma government to combat economic decline. After adopting counter-cyclical policies to fight the global crisis, the government was unable to return to the tripod framework that had been in place since 1999. Instead, the Dilma government insisted on deepening the measures which they identified as having been responsible for Brazil's recovery from the 2008 crisis. By doing this, however, the government disregarded the role commodity prices had played in Brazil's recuperation and ignored the ways in which the Brazilian economy was tied to international dynamics.

5.2.1 ALL THAT IS SOLID MELTS INTO AIR: THE REVERSAL OF THE INTERNATIONAL SCENARIO

From 2011 onwards, external constraints on Brazil's economic policy-making gradually reappeared. Commodity prices began to slow down in April 2011, a reduction that was partially attributed to a downswing in Chinese growth. Weaker commodity prices lowered economic growth among commodity-exporting EMDs in general and Brazil in particular. The conditions for EMDs were further aggravated by the reduction of capital flows, a decline which can be linked to the change in American monetary policy. In late 2013, the Federal Reserve began to gradually reduce quantitative easing, the bond-buying program it started in 2009 to stimulate economic recovery. Tapering, as the reduction of monthly purchases by the Federal Reserve became known, came to an end in October 2014. In December 2015, the Fed announced the first rise in US interest rates since they were brought to zero in 2008. This transformation in international conditions fundamentally impaired Brazilian economic growth, as noted by a senior Brazilian politician and economist: "the change was really an international one; until 2010 [Brazil] had a tailwind, in 2010-2011 began the headwind, and nowadays the path is much more difficult than it was in the past".[220]

The reappearance of external constraints on Brazilian policy-making was mirrored in the deterioration of the balance of payments. While the change was clearer from 2011 onwards, when the trade balance continuously shrunk, Brazil's balance of payments began presenting signs of increasing vulnerability as early as 2008. In that year, the surplus in the trade balance was not enough to compensate for the deficit in the services and income account for the first time since 2003. Such incapacity was a manifestation of the low dynamism of Brazilian exports which were increasingly dependent on commodities. Nevertheless, amidst a global crisis scenario, which had as strong impact on Brazil's trade as it did for the rest of the world, the

[220] Non-attributable interview.

reduction of exports was perceived as an expected outcome. Then, with the recovery of commodity prices, the problem was postponed again until 2011. From 2011 onwards, however, Brazil's trade balance deteriorated steadily and in 2014 it reached its first deficit since 2000 (Table 5). As commodity prices stopped rising, the value of exports stagnated. The deterioration in the trade balance negatively affected the current account, whose deficits increased continually until 2014.

TABLE 5: BRAZILIAN BALANCE OF PAYMENTS, US$ MILLION, 2008-2014

	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**
Current Account	**-28.192**	**-24.302**	**-47.273**	**-52.473**	**-54.249**	**-81.227**	**-91.288**
Trade Balance	24.836	25.290	20.147	29.793	19.395	2.286	-3.959
Service and Income Balance	-57.252	-52.930	-70.322	-85.251	-76.489	-86.879	-89.251
Current Transfer Balance	4.224	3.338	2.902	2.984	2.846	3.366	1.922
Capital and Financial Account	**29.357**	**71.301**	**99.912**	**112.381**	**70.010**	**74.353**	**98.399**

Source: Central Bank of Brazil. Elaborated by the author.

The balance of payments defined the limits of the improvement of Brazil's condition and exposed the frailties that had been created in the previous years. As observed by a former finance minister: "the balance of payments perhaps is the main demonstration of [the government's] mistakes. … [The government] insisted on a redistributive process using the exchange rate to control inflation, and practically destroyed the industrial sector".[221] In a similar line, a respected Brazilian researcher at the government pointed out that, "it is the policy we have seen in the last 10 years: the emphasis on domestic consumption – imports soar, exports drop, the balance of payments moans".[222] Interviews with current and former policy-makers suggest that there was a fair degree of understanding amongst Brazilian economists that this path of economic policy was gradually being exhausted, because in the words of a

[221] Non-attributable interview with a former finance minister.

[222] Non-attributable interview.

former finance minister: “the terms of trade are slowly decreasing, and this was one of the main factors behind the success of redistributivism during the Lula government”.[223]

With the reversal in international conditions, Brazil’s shortcomings surfaced. During the previous years, the competitiveness of Brazilian industry was harmed not only by the overvalued exchange rate and Chinese competition but also by a lack of investment in infrastructure and a poor industrial policy. In the words of a former finance minister: “the growth reduction is easy to explain, Brazil does not invest in anything; Brazil did not invest in infrastructure during 30 years. Brazil distributed what it has borrowed”.[224] In September 2013, a special report of *The Economist* (2013, p.8) on Brazil observed that two thirds of the PAC’s biggest projects were late and over budget. Thus, despite the government’s intentions, it did not adequately seize on the bonanza period of the commodity boom to invest in infrastructure and overcome one of Brazil’s main weaknesses. In the words of an influential researcher at the government:

> Lula came with a bet, what was the bet: expand the domestic market, making distribution of income, which [the government] called inclusive development, give more income to the poor, increase the minimum wage. Since there was the commodity market, it was possible to use the domestic market to expand and give dynamism to the economy, exports were led by the commodities. And the third part of this process would be infrastructure. So the Lula government manages to do some of that, especially the inclusive development, Bolsa família and all those income distribution programs that engendered enormous transformations in the Brazilian society… but infrastructure does not develop for many reasons, we have not solved the issue of the productive structure and this model is running out.[225]

Thus, one main problem was that the inclusive development did not connect to the productive structure, as the government had planned, because, as one economist noted, “it leaked to

[223] Non-attributable interview with a former finance minister.

[224] Non-attributable interview with a former finance minister.

[225] Non-attributable interview.

China".[226] In short, Brazil was unable to join the technological revolution that was occurring in China and ended up engaging as an exporter of commodities, or in other words, as an actor in China's periphery. As a researcher at the government summarised:

> So [Brazil] did stimulate the domestic market, [Brazil] did made income distribution, [Brazil] did expand the domestic market, but the productive structure did not connect to it as they wanted; it connected to China, where there was a technological revolution of cost reduction happening … so the phenomenon of inclusive development of Lula, of Dilma, is the phenomenon of China.[227]

In addition, the government implemented an industrial policy based on tax exemptions and with little counterpart from industry. This strategy ended up impairing the fiscal side, as a Brazilian economist commented: "with no benefits from the point of view of industry".[228] She added that: "the problem is that the industrial policy was a disaster … and with that [the government] penalized the sector that is the most dynamic; that should be the most dynamic. And with that it accentuated the peripheral trend in the external side [referring to the balance of payments]".[229] As a result, the Brazilian economy remained vulnerable under basically three perspectives: "there is the vulnerability because [Brazil's] currency is not convertible; [Brazil] has a vulnerability because of the composition of its financial account; and there is also a vulnerability due to the composition [Brazil] is imposing on its exports,"[230] as a renowned Brazilian economist summarised.

Brazil's vulnerability was also evident in relation to the effects of the American monetary policy on the economy. After Mantega's currency war alert, Dilma accused developed

[226] Non-attributable interview.
[227] Non-attributable interview.
[228] Non-attributable interview.
[229] Non-attributable interview.
[230] Non-attributable interview.

countries of a “monetary tsunami” in April 2012, referring mainly to the US’ expansionist monetary policy (Talev & Colitt 2012). However, as the US government began to taper its bond-buying program, the tailwinds of easy global financial conditions also gradually came to an end. Thus, the excessive capital flows were replaced by shortage, disturbing Brazil’s economic performance, as a senior diplomat observed:

> [Dilma] coined that expression of the monetary tsunami; now we are concerned with the drought of the tsunami… it is almost contradictory, but it shows our vulnerability from one side and the other. Excess [of international monetary liquidity], which overvalued our currency; and the abrupt, sharp devaluation, which is happening now [early 2014]. Both are a problem, which shows that we still have not reach a situation of equilibrium.[231]

While most Brazilian observers agree that Brazil’s condition has improved relative to the past, there is a general agreement that part of the leverage Brazil had previously held no longer exists. As a former Central Bank governor exemplified:

> If the crisis came today, [Brazil] no longer has the condition to adopt anti-cyclical policies as we had in 2008. In other words, [Brazil] threw away, in my opinion, that capacity, and from now on [Brazil] will have to reconstruct it. I mean, [Brazil] did not completely throw it away because [Brazil] still has a reasonable amount of international reserves. But fiscal policy is greatly compromised.[232]

Brazil’s large stockpiles of international reserves are in general considered one of the remaining strengths from the previous period. Yet the capacity of those reserves to reduce Brazil’s constraints in any significant way is limited. In the words of one economist:

> Reserves are an important aspect in the sense of [Brazil] trying to have some autonomy, or breathing space from the point of view of overcoming cyclical movements. That is good. But in a situation of a real crisis, in two minutes [they are] gone. So it is good

[231] Non-attributable interview with a high-ranked diplomat.

[232] Non-attributable interview with a former Central Bank governor.

> because it signals to the market that you have some power, but even the market knows that it can quickly disappear.[233]

In sum, despite Brazil's relatively quick rebound from the global crisis, it remained essentially a subordinated state in the IMS. As noted by one economist: "from the point of view of escaping from a peripheral situation, [Brazil] did not; in spite of all the rhetoric, it did not".[234] Along a similar line, a researcher at the government commented: "substantively, concretely, nothing has changed; the discourse changed".[235] Despite its persistent unprivileged position, the Brazilian government's official discourse and the policies it adopted suggested the opposite. As will be shown in the next sub-section, the government resisted adapting to the new international reality of higher external constraints, which suggests that it was under some illusion as to Brazil's actual position in the IMS.

5.2.2 WHEN THE RISK OF A WRONG DECISION WAS PREFERABLE TO THE TERROR OF INDECISION

While international conditions became less favourable for EMDs in general as commodity prices reversed their upward trend in mid-2011, Brazil's negative economic results especially stood out among EMDs. As its economic growth did not resume in 2011, the government decided to abandon its short-lived fiscal efforts and instead reinforce the counter-cyclical policies it identified as key to Brazil's post-2008 success through the New Economic Matrix.

In practice, the government began to gradually reject the central tenets of the macroeconomic tripod (inflation target, floating exchange rate, and primary fiscal surplus). This was illustrated

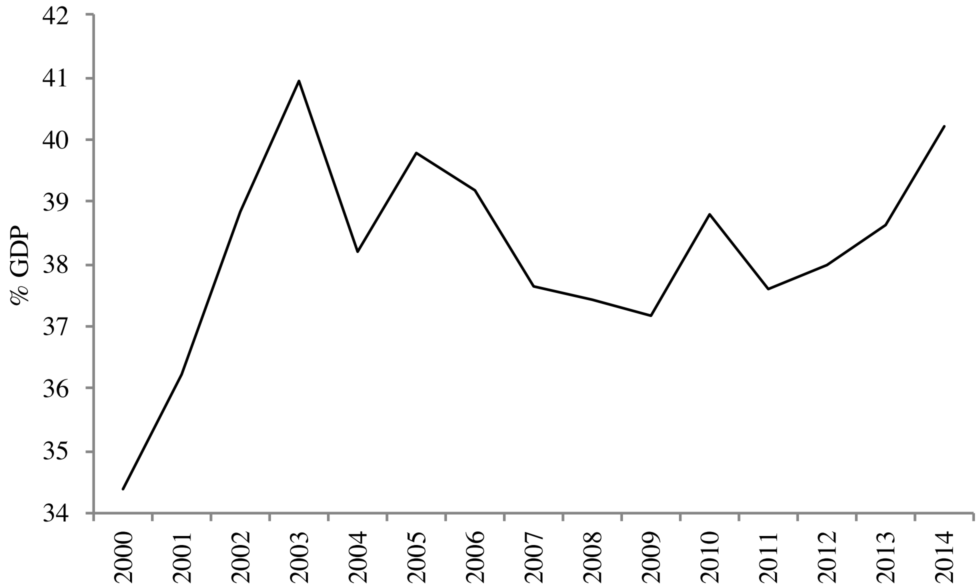
[233] Non-attributable interview.

[234] Non-attributable interview.

[235] Non-attributable interview.

by an increase in government spending (Figure 38) and a higher tolerance towards inflation (Table 6), meaning that the Central Bank was apparently focusing more on preventing inflation from exceeding the ceiling than in meeting the inflation target.

FIGURE 38: GOVERNMENT SPENDING, 2000-2014



Source: IMF, World Outlook Database, October 2015. Elaborated by the author.

TABLE 6: INFLATION AND INFLATION TARGET, 2010-2014

Year	Target (%)	Tolerance Intervals (p.p.)	Upper and Lower Limits (%)	Actual inflation (IPCA, % p. a.)
2010	4.5	2	2.5 - 6.5	5.91
2011	4.5	2	2.5 - 6.5	6.50
2012	4.5	2	2.5 - 6.5	5.84
2013	4.5	2	2.5 - 6.5	5.91
2014	4.5	2	2.5 - 6.5	6.41

Source: Central Bank of Brazil. Elaborated by the author.

Critiques of these economic policies came from both supporters and detractors of the Dilma government, all of whom tended to agree that the lack of clear direction in the economic policies created an environment of uncertainty. For instance, one Brazilian economist who agreed with the government's expansionist policy, said:

> [The government] has an expansionist policy but says that it is not an expansionist policy. They do and they say they are not doing … so from the point of view of forming expectations it is very problematic … At the end you have a very strong heterodoxy in Brazil but that from the point of view of economic policy it has an alter ego of orthodoxy. So it is heterodox, but at the edge gets afraid and pulls back, ending up adopting a policy mix … which disrupts everything, because you cannot be heterodox and orthodox at the same time. … You give signs everywhere and completely confuses agents; I mean, you do not confuse them, agents can see what you are doing, they are seeing you are weak, it is basically that.[236]

Amongst Brazilian economists who disagreed with the course of economic policy, there was consensus that a feeling of insecurity had been created by the government. As one of them said:

> There needs to be a strategy in the macro area; there needs to be a better definition of what is being done with macroeconomic policy in Brazil, and this nowadays is too much in the air. Inflation is high, the fiscal outlook is not terrible but is worse than in other times … I think Brazil gave up some of the commitment with macro stability in the last two or three years [referring to 2012 and 2013].[237]

Some observers have further explained the government's behaviour as a result of a certain arrogance regarding international capital that had developed in the aftermath of the global crisis, perhaps due to the media attention Brazil received as an apparent "case of success" in fighting the crisis. In the words of a senior Brazilian politician: "the government opened every tap, there was a sensation of euphoria. And the world reproduced this [euphoria], with very little critical view".[238] Likewise, a former Central Bank director said: "I think that at the height of euphoria period perhaps the government was contaminated with this vision and began to take actions that generated a bad external impact".[239] He added that, "the government also

[236] Non-attributable interview.
[237] Non-attributable interview.
[238] Non-attributable interview.
[239] Non-attributable interview with a former Central Bank director.

joined the discussion about the concessions in a position that was perhaps a bit unrealistic, because it wanted to force return rates below those prevailing in the international market”.[240]

The Dilma government increased the state’s intervention in investment rules (The Economist 2013, p.2). Petrobras, for example, was brought under greater state control at the end of 2010. First, the Congress approved an onerous regulatory framework making Petrobras the sole operator in the pre-salt fields, with a minimum of 30 per cent share of each project. Second, local content requirements were also sanctioned, which even if they did not add too much to the company’s costs as the government has argued, such a curtailment denoted an increased intervention in the state company. Finally, as oil prices began to climb in 2009, the government prevented Petrobras from passing on the higher international prices, making it sell oil at a subsidised domestic price to prevent inflation accelerating.

Another example of increased government intervention was in the energy sector, where the government tried to reduce the price of energy but ended up bringing a high degree of uncertainty for investments which ironically increased energy prices. The problems began with the launch of the Provisional Measure 579 in September 2012, which allowed the renewal of concession contracts due between 2015 and 2017 for another 30 years, exempting companies from participating in the bidding process. As the proposal entailed the acceptance of a lower tariff from January 2013 onwards, the government offered companies a compensation that supposedly covered the resulting losses for the remaining period (2013-2015). Leaving aside the fact that most companies rejected the compensation value[241] (except for the state-owned Eletrobrás), the whole process was very clumsy and quite counterproductive for the government. For instance, the government asked companies to decide whether they wanted the

[240] Non-attributable interview with a former Central Bank director.

[241] A main issue here was the fact that the initial calculus disregarded the amortisation of investments made by companies before 2000.

renewal of contracts or not before converting the Provisional Measure in Law[242] and defining the new tariff, i.e. before companies could know what were the terms of the new contract.

The complications escalated for the government due to worse-than-expected hydrological conditions in 2013 and 2014 that compromised reservoir levels and, consequently, the supply of hydroelectric power. Given the shortage of energy, distribution companies had to buy from the spot market, where energy prices soared. While distribution companies had to bear the costs of higher energy prices, they could not pass on the price to final consumers, since the price was under government control (and the government wanted to keep inflation down). As a result, distribution companies became highly indebted and had to be rescued by the National Treasury in 2013-2014. To cover the resources lent to distribution companies, the National Agency of Electrical Energy (Aneel, *Agência Nacional de Energia Elétrica*) approved an “extraordinary increase” in the price of electricity in February 2015, which in practice meant an increase of up to 48 per cent (Borba 2015) for final consumers.

Finally, the government also launched new concessions for airports and for the pre-salt exploration (all in partnership with Petrobras) and increased regulations on contracts, augmenting, for instance, local content requirements. However, as the government imposed profit limits below the market expectations, big investors were not interested (The Economist 2013, p.2).

According to some observers, these events amassed to create an environment of uncertainty during the Dilma government and to negatively interfere with Brazil’s growth potential. As one former Central Bank director summarised:

> The dominant view is that [Brazil] is a country that is falling short of its possibilities, more for its own mistakes than because of international circumstances; more for its own

[242] That eventually happened in January 2013.

> options than because of adverse international circumstances … The fact is that the mood, the interest, etc. decreased in recent years, partly because Brazil has had a somewhat hostile position regarding international capital, "I want this capital, I don't want that capital; 'good' cholesterol, 'bad' cholesterol; I'll change the rule, the rule is here, but I can always change," all this has impaired a bit.[243]

In a similar line, a high-ranked official at the World Bank observed:

> This was real, Russian hubris, Brazilian hubris; it was real. And with this hubris came complacency; what happened with Brazil also happened to a great extent in Russia. The quality of governance deteriorated, the excuse for the re-emergence of an entrepreneurial state. … While emerging countries, including the BRICS, managed to resist the crisis well to a large extent because of good economic policies and structural reforms made in the past, since they rested on their laurels and became arrogant, and at the same time lenient, the space they had to respond well to the crisis exhausted promptly, which is the case of Brazil.[244]

Implicit to most critiques regarding the government's economic policies were references to Dilma's political inability (The Economist 2013, p.3). The combination of her centralising management style in an economic situation with a low margin of manoeuvre highly contrasted with Lula's negotiation-oriented approach in favourable economic conditions. In short, while Lula and Dilma belonged to the same political project, the change in government was not innocuous to economic policy-making.

5.2.3 REALITY IS WRONG. DREAMS ARE FOR REAL.

Despite clear signs of a worsening in international conditions, there is no evidence that Brazilian policy-makers realised that this scenario was changing. Indeed, the government's adoption of the NEM presupposed an autonomy that was no longer there. It is interesting to note that the NEM actually put in practice the policies the government believed it had adopted

[243] Non-attributable interview with a former Central Bank director.

[244] Non-attributable interview with a high-ranked official at the World Bank.

in 2006. As argued in chapter 4, despite contemporary discourse, data analysis indicates that there was no clear inflection in the policies adopted at that time. However, since 2010 there were signs of real change in macroeconomic policies as the government began to increasingly intervene in the economy.

The background for this inflection can be found in the "change of paradigm" discourse of international economics that grew in popularity after the 2008 crisis. In short, the global crisis challenged the hitherto predominant neo-liberal view regarding government intervention and financial market regulation, and consequently the post-2008 demanded non-orthodox measures from governments and central banks in the developed world (Helleiner & Pagliari 2011, p.183; Helleiner 2010, pp.627–628; Dailami & Masson 2009, p.8). Nevertheless, "when you transplanted this paradigm shift to Brazil," a former Central Bank governor observed, "it came in a distorted way, because it meant here a license for [the government] to abandon the more orthodox policies, which had been responsible for Brazil's macroeconomic stability, known here as the famous tripod".[245]

This distortion happened because, while the Brazilian economy had been only marginally affected by the crisis, the government acted as if Brazil was in the same situation as advanced economies. As noted by a former Central Bank governor:

> And this started in 2009, when Brazil had indeed to take some short-term counter-cyclical measures, but evidently Brazil was not in a crisis as profound as the United States; we had no financial crisis, we had a temporary external shock; we did not have the same crisis as Europe, as European banks, or the financial crisis that we saw emerging afterwards in the economies of the periphery of the Euro. So we did not have this crisis and we adopted the remedies that were taken in the context of this crisis, so it is something almost corrupt.[246]

[245] Non-attributable interview with a former Central Bank governor.

[246] Non-attributable interview with a former Central Bank governor.

While there is little disagreement among Brazilian economists that the immediate response of the Central Bank towards the global crisis was correct (chapter 4), there is almost a consensus that the government then proceeded to keep its expansionist policies longer than was necessary. In the words of a high-ranked official at the World Bank:

> The Brazilian case, to be honest, is [the outcome] of a change in the international framework and also of a response that was not adequate. … The first anti-cyclical response in Brazil was perfectly adequate. But then to keep repeating the dosage of anti-cyclical policies, believing that it would put the economy back on [a] growth [trajectory], and combining this with the degree of intricacy in state interventionism, driving away private investors? See where we are now.[247]

One probable reason for the maintenance of expansionary policies was the October 2010 election. As a former Central Bank governor commented:

> In 2010 the Central Bank, from my point of view, made several and serious economic policy mistakes. 2010 was an electoral year and it was a year that the government, in my view, the Central Bank made an election cycle policy. 2010 was not a year to make that monetary policy that [the Central Bank] did; it was an extremely loose monetary policy, and this made us completely decouple from the 4.5 per cent inflation target. Since then, Brazil was no longer able to bring inflation back to the target.[248]

In a very similar line, a former Central Bank director stated:

> Brazil exited the crisis very quickly, and the counter-cyclical policies to some extent contributed to that. … I think the turning point is indeed in 2010, late 2009 or early 2010, because then [Brazil] already had recovered from the crisis. If [the policies] were truly counter-cyclical, it was the moment to start bringing them back. … But then you had an election to win.[249]

Dilma's election and the subsequent change in the balance of power within the government's economic team may go far in explaining the change in the direction of economic policy after

[247] Non-attributable interview with a high-ranked official at the World Bank.

[248] Non-attributable interview with a former Central Bank governor.

[249] Non-attributable interview with a former Central Bank director.

2011. To begin with, a former Central Bank director noted: "Dilma was never a big fan of the [economic] model [implemented by Cardoso and continued by Lula]".[250] In contrast to Lula, she had her own ideas about economic policies, being herself an economist. While the non-orthodox side was already more powerful because of her, the replacement of Henrique Meirelles by Alexandre Tombini as the Central Bank governor further increased the disparity in opinions. This substitution represented a subtle but relevant change in the equilibrium of forces within the economic team because Tombini lacked the political strength of Meirelles (chapter 4).

The government's decision to deepen counter-cyclical policies did not generate the results it had expected, and Brazil gradually moved towards another economic crisis. This raised an intense domestic debate of whether the government's diagnosis of the problem and its remedy for it had been correct. The main disagreement was between those who placed the blame on the fiscal effort in 2011 and the revival of the global crisis and therefore believed that the government was right to reinforce counter-cyclical measures, and those who argued that the government rather than the international crisis had been responsible for the market-unfriendly environment and therefore believed that the reversal of the counter-cyclical measures should have happened even before 2011.

Despite the existence of this debate, the government continued to insist on expansionary policies, finding villains – the global crisis, the currency war, the monetary tsunami, or the tapering in the US quantitative easing policies – to blame for its bad economic performance. While it was true that the international reality was worse than previously, Brazil compared itself with other EMDs, many of whom were by this time finding their way back to growth. This was particularly the case for other South American countries, which led them to gradually

[250] Non-attributable interview with a former Central Bank director.

disconnect from the region – and from a potential Brazilian influence – to turn towards China. As the next section shows, Brazil's lower economic autonomy had significant effects for its external influence.

5.3 BRAZIL'S EXTERNAL INFLUENCE: RESTING ON ITS LAURELS

From 2011 onwards it became clearer that Brazil's external influence was to a great extent context dependent. The global financial crisis and its immediate aftermath (2008-2010) represented a unique opportunity for Brazil to increase its international influence, as described in chapter 4. For a brief period of time the failures of developed economies left a power vacuum in the IMS which soon occupied by the big EMDs at the time, including Brazil. Yet as this section demonstrates, the crisis and its aftermath ultimately did not rupture the prevailing system. As will be argued here, in the post-2010 period the IMS has gradually reorganised itself according to its previous power division.

There is, however, one main difference in this arrangement that has emerged from the 2008 crisis: the elevated position of China. All other EMDs have essentially returned to their former positions; the perceived rise of big EMDs like Brazil, Russia, India and South Africa is essentially a misconception arising from their close association with China. Through the BRICS group these states saw an increase of their international influence with the creation of the New Development Bank (NDB) and the Contingent Reserve Arrangement (CRA), yet this was made possible much more because of China's enormous economic power than the individual efforts of the other member states.

This section explains Brazil's external influence as the outcome of paradoxical forces created by China. The first sub-section addresses how Brazilian representatives and policy-makers dealt with the post-crisis scenario, when the euphoria around the participation of EMDs in the IMS began to shrink. The second sub-section shows how China's rising worldwide influence reverberated in South America, where Brazil saw its prestige correspondingly decline. This happened through two channels. First, China emerged as an alternative creditor for states facing major economic problems, including Brazil's main regional allies, Argentina and Venezuela. Second, states in better economic situations, such as Chile, Colombia, and Peru, together with Mexico formed a new trade bloc, the Pacific Alliance, which aimed at furthering trade with Asia, notably China. The emerging result is a fragmented South America that harms Brazil's potential as a regional hegemon. The third sub-section analyses the dynamics within the BRICS group, which was one of the main focuses of the Brazilian foreign policy from 2011 to 2014.

5.3.1 DEVELOPMENTS IN THE GLOBAL FINANCIAL ARCHITECTURE: OLD WINE IN A NEW BOTTLE

The 2008 crisis triggered some important transformations in global economic governance that permanently altered the previous status quo in favour of EMDs in general and of Brazil in particular. Even when the height of the crisis was gone and the momentum to discuss significant reforms in the IMS gradually faded away, EMDs were still able to exert some pressure and to influence certain results. Among EMDs, Brazil played a key role in voicing EMDs' dissatisfactions.

In the BWIs, for example, the increased influence of EMDs was manifested in the World Bank presidential election in 2012 (The Economist 2012; Lowrey 2012), where Brazil joined other EMDs to confront the convention of electing an US candidate. As a Brazilian representative there related:

> Brazil had initiatives with the G11 for the election of the president of the World Bank. It was an election that, of course, everyone knew that the US would end up winning, but it was the first time you had candidates and that you had a platform of discussion which forced the US out of a pattern that was always send someone from the state department or a banker. … I think that from this election onwards, you will never be able to return to the old model, the old policy that was simply put a name there and everyone signed below; this created a pressure for discussion.[251]

Emblematically, Jim Yong Kim is a Korean American, which makes him the first World Bank president to come from a developing country. In addition, his professional background is on health issues in developing countries, rather than on the political or financial sector as was the rule hitherto. The two other contenders were both from the developing world: the Finance Minister of Nigeria Ngozi Okonjo-Iweala and the Colombian Jose Antonio Ocampo. Despite the symbolism surrounding this election, ultimately the US candidate was elected, continuing the long tradition of an US national leading the World Bank.

In the IMF, Brazil's influence was even more remarkable. In July 2013, the *Financial Times* wrote: "Brazil's belligerence has grown since 2009 … since then, Guido Mantega, Brazil's Finance Minister, has emerged as one of the most outspoken critics of the IMF, calling for greater representation of developing countries on the board" (Spiegel 2013). In September 2010, Guido Mantega called global attention to a "currency war" triggered by developed countries, voicing a general concern shared by EMDs (Wheatley & Garnham 2010). Mantega accused developed countries' monetary policies of increasing the volatility of financial markets in the developing world and pressuring the overvaluation of EMDs' currencies, factors which weakened EMDs' ability to be internationally competitive and their capacity to recover from the crisis. In his declarations, Mantega also implicitly referred to China's monetary policy, whose weak currency was also harming the recovery of several EMDs. Brazil's vocal position

[251] Non-attributable interview.

contrasted with some other countries, such as South Korea, who were reluctant to include the currency war issue in the upcoming G20 meeting in November of that year "partly out of fear of offending China, its neighbour and main trading partner," the *Financial Times* wrote (Wheatley & Garnham 2010).

Brazil's currency war concerns were linked to its role in the EMDs' campaign to change the IMF's view on capital controls (Gallagher 2015, p.1). The Fund eventually recognised the negative effects that excessive capital inflows could have on the domestic economy and endorsed a new institutional view on capital controls (IMF 2012). This change has been regarded by some leading specialists in the field as a manifestation of EMDs' power (Gallagher 2015; Helleiner & Pagliari 2011).

In July 2013, Mantega also challenged the IMF's methodology for measuring a nation's gross debt: under IMF standards Brazil's gross debt accounted for 68 per cent of GDP, 10 percentage points more than the Central Bank's 58.7 calculation (Sotto & Parra-Bernal 2013). A respected Brazilian economist reflected on this matter:

> On the issue of the public debt discussion, for example, in the past, in the 1980s, 1990s, the Fund would never have accepted to open this discussion… In fact, the Fund did not accept that very much now either, but received the letter from Mantega with the explanations and so… there is a kind of receptivity to this kind of discussion that there was not in the past; before the Fund would simply say "no, we do this way and that is it". Nowadays they are much more cautious when dealing with Brazil.[252]

Similarly, the Financial Times wrote about this episode saying that: "Brazil's new confidence as a global economic power has also led the country to put increasing pressure on the IMF on issues ranging from the acceptance of capital controls in global markets to even its methodology for calculating debt" (Spiegel 2013).

[252] Non-attributable interview.

Within the IMF, the Brazilian executive director, Paulo Nogueira Batista, also had a fundamental role as a fierce advocate of EMDs' interests and has been described as "one of the most persistent critics of Western dominance in the IMF" (Dettmer & Reiermann 2013). In one famous episode, he abstained to vote in the IMF's rescue package for Greece in July 2013. While Brazil's abstention had no direct impact on the result, "the move was seen as Brazil taking a stand against the IMF in the name of other developing nations," the *Financial Times* wrote in August 2013 (Politi 2013). In the eyes of developing countries, the IMF's extreme focus on the Eurozone crisis was partially due to the European overrepresentation in the Fund: "the euro countries abuse their power within the IMF," Batista said in June 2013 (quoted in Dettmer & Reiermann 2013). Having as a benchmark their past relations with the IMF, EMDs felt there was a difference in the way in which the IMF was approaching the Eurozone crisis and it was Brazil that voiced this concern (Politi 2013).

The issue about influence and quota shares within the IMF was a particularly delicate subject at that time since emerging countries were also disappointed with the US Congress's refusal to ratify the IMF's 2010 reform (Wade & Vestergaard 2015, p.2). Batista led a proposal to decouple the IMF's reform to actualise one element of the reform: the increase and realignment of quota shares (Batista & Torres 2015). The IMF's 2010 reform had two main elements: the quota increase and the change to an all-elected Executive Board. Only the latter part required an amendment of the Articles of Agreement which depended on US congressional approval. To avoid this obstacle, Batista proposed to separate the matters, an alteration which depended only on a simple majority of the IMF's Executive Board and 85 per cent of votes in the Board of Governors. The proposal, however, was silently refused by the US as its Congress ended up approving the 2010 reform in December 2015 (Wade & Vestergaard 2015, p.4).

The delay in implementing the IMF's 2010 reform boosted the BRICS' proposal of creating alternative institutions: "either the institutions and forums adapt to a reality where emerging countries have more weight or they will search their own ways,"[253] a high-ranked Central Bank official said. Similarly, a former foreign minister stated: "look, we have our alternatives here, if you do not agree we will not leave the IMF, but we will dedicate more attention to this [referring to the BRICS institutions]".[254]

In spite of Brazil's efforts, Brazil's image and influence in the IMS gradually shrunk. To begin with, Brazil's economic performance began to deteriorate already in 2011, dismantling the picture of a country that was doing better than the world average: "2010 was a year in which the world grew little and we grew 7.5 per cent; so it is natural that in that context people had more optimism with Brazil. And since then we have grown much less, and less than other countries in the region, and this affected Brazil's image".[255]

Moreover, foreign policy issues in general were downgraded on the list of the Dilma government's priorities, in high contrast to the Lula period. As one Brazilian representative in the IMF said: "The truth is that Brazil has had a much higher concept. I think there is also a foreign policy element, Lula was very interested in international issues".[256] By the same token, a Brazilian representative in the IADB observed: "her interest in international relations is very different from Lula, it is much smaller".[257] The Brazil's executive director position in the IADB, for example, was vacant for more than a year simply because the Dilma government did not appoint anyone to fill the position.[258]

---

[253] Non-attributable interview with a high-ranked official at the Central Bank.
[254] Non-attributable interview.
[255] Non-attributable interview with a former Central Bank director.
[256] Non-attributable interview with a Brazilian representative at the IMF.
[257] Non-attributable interview with a Brazilian representative at the IADB.
[258] Non-attributable interview with a Brazilian representative at the IADB.

For Brazilian diplomats, Dilma's lack of interest in foreign policy matters was further impaired by Brazil's economic and political context. For instance, one high-ranked diplomat related: "you have this conjunction of two inhibiting factors that overlap: lack of money and lack of a greater interest as well".[259] Along very similar lines, a researcher at the government stated:

> Lula went 40 times to Africa, visit I do not know how many countries… If I am not mistaken, Dilma went four or five times. So foreign policy has shrunk and as the Brazilian productive structure is suffering fierce competition, the ability to reverse this in the short-term is low. There was a reversal on two fronts.[260]

Another high-ranked diplomat explained the setbacks in Brazil's foreign influence as follows:

> First, I would say a lower commitment of the executive to move forward with the external agenda. President Lula was much more proactive in foreign affairs than President Dilma is. Second, the party support, Lula had a leadership and a much broader party support than Dilma. Third, the external environment was much more benign to the Brazilian economy, we were in a time of economic expansion and economic growth, not technical recession.[261]

Another problem for some observers was that China dwarfed the importance of Brazil and other EMDs in the global debate: "the BRICS and the G20 would not exist were it not for China,"[262] a former Brazilian finance minister said. According to one influential researcher at the government, Brazil's international influence was largely dependent on China:

> [Brazil's economic growth] allowed the country to change its image, and above all because there was an important leadership that was Lula… This was reversed. If we think of the years of Dilma, as far as I can see in foreign policy, what are the big moves? It is the Bank of the BRICS and the contingency agreement; but these are lead by China.[263]

[259] Non-attributable interview with a high-ranked diplomat.

[260] Non-attributable interview.

[261] Non-attributable interview with a high-ranked diplomat.

[262] Non-attributable interview with a former finance minister.

[263] Non-attributable interview.

Thus, from 2011 onwards a more influential role for EMDs in general and for Brazil in particular became less likely. At the domestic level, the Dilma government had to deal with mounting economic and political difficulties. On top of that, foreign policy was downgraded within her government's priorities. At the international level, the momentum for substantial reforms disappeared, not least because many EMDs began facing their own economic setbacks. Yet despite this curtailed influence, the BRICS group gained impetus and forwarded the proposal of creating alternative institutions, yielding Brazil some global influence.

5.3.2 BRAZIL AND SOUTH AMERICA: ALL ROADS LEAD TO CHINA

The aftermath of 2008 crisis changed the context that had favoured regional cooperation earlier that decade (Fiori 2011, p.9; Carvalho et al. 2009, pp.123–124). Particularly after the fall in commodity prices from 2012 onwards, some South American countries began facing mounting economic problems. Argentina, Brazil and Venezuela's economic growth was in fact worse than the South American average, averaging 1.3 per cent GDP growth against a figure 4.9 per cent for the rest of the region between 2012 to 2014 (Table 7).

TABLE 7: GDP GROWTH IN SOUTH AMERICA, 2012-2014

Country	2012	2013	2014	Average 2012-2014
Argentina	0.8	2.9	0.5	1.4
Bolivia	5.1	6.8	5.5	5.8
Brazil	1.8	2.7	0.1	1.6
Chile	5.5	4.3	1.8	3.8
Colombia	4.0	4.9	4.6	4.5
Ecuador	5.2	4.6	3.8	4.6
Paraguay	-1.2	14.2	4.4	5.8
Peru	6.0	5.8	2.4	4.7
Uruguay	3.3	5.1	3.5	4.0
Venezuela	5.6	1.3	-4.0	1.0

Source: IMF, World Economic Outlook Database, October 2015. Elaborated by the author.

The contrast between the poor economic results of Argentina, Brazil and Venezuela, on the one hand, and the faster growth rates of the rest of the region, on the other, added further obstacles to an already complicated integration process. Under this less favourable scenario, the shortcomings of the Brazilian economic and political regional leadership that were discussed in chapter 4 became even more problematic. Notably, Brazil's lack of economic leverage turned into a higher disadvantage when neighbour countries were in need of financial help and China appeared as an alternative creditor for needed funding in South America. In the words of a high-ranked Brazilian diplomat, "the crisis unfortunately has never helped the integration process … but at the moment that you have China expanding, regional crises create space for the growth of China's presence. And this in the long run is detrimental to our interests".[264]

From 2005 to 2010, Gallagher et al. (2012) estimate that China lent some US$75 billion to Latin American countries. In 2010, China's loan commitments to the region totalled US$37 billion, out-financing the combined figures of the World Bank, the IADB and the US Eximbank for that year (Gallagher, Irwin, et al. 2012, p.1). Brazil has actually been among the main beneficiaries of China's loans, again symbolising the paradoxical relationship between the two countries, as a high-ranked diplomat observed:

> It is an ambiguous relationship in the sense that Brazil is also interested in Chinese capital, of course … so Chinese capital is welcome, [but] we see with concern three things: the increase in exports of Chinese manufactured in our region, displacing Brazilian products; we see with concern the granting of finance, loans to key countries in the region, Argentina, Venezuela, Ecuador; and we also see with concern the over-reliance of those countries [in the Chinese capital]. Because is not just funding, today there is already a dependency. A dependence that is worrying because the Venezuelan government and the Ecuadorian government are getting money in China to be able to run their administrative machines … so this is very worrying.[265]

In the case of Venezuela, China agreed to fund oil-for-loan deals from 2007 onwards that has since helped Venezuela overcome volatility in oil prices. In September 2015, Reuters reported

[264] Non-attributable interview with a high-ranked Brazilian diplomat.

[265] Non-attributable interview with a high-ranked diplomat.

that China had lent some US$50 billion to Venezuela through such agreements since 2007 (Reuters 2015). As observed by a high-ranked Brazilian diplomat, "for the Chinese it is interesting, because this guarantees the supply of oil at a fix price; not at the spot price".[266] For Venezuela, the government could not borrow in the international financial system so it decided to deepen "its exposure to the Chinese financial system, borrowing resources that the Chinese government offers; and it offers in hard currency, dollars, and in yuan as well"[267] (see also Gallagher, Irwin, et al. 2012, pp.14–17).

As for Argentina, the drop in commodity prices after 2011 further exacerbated the deterioration of the Argentinean economy. As a high-ranked Brazilian diplomat related, "there were Argentinean demands to [Brazil] support the creation of credit lines for them, and also of special swaps, but the response was negative because the risk is too high".[268] Economic conditions worsened further in mid-2014, when the US Supreme Court denied Argentina's appeal against NML Capital, a fund that had opted out of the restructured bonds from the country's default in 2001. The Supreme Court, it should be noted, had already denied Argentina's petition for certiorari in October 2013. Reflecting on this problem a high-ranked researcher at the government said:

> Latin America is again abandoned. Last year [referring to 2013] the Argentinians, predicting what is going on now [January 2014], came to Brazil and asked: "can we make a swap reserves? You have US$380 billions, you lend us US$10 billions, and we improve our accounts, we can show that we have dollars". And this was just for the record in the balance of payments, it would still be managed by Brazil; Brazil would not deliver the dollars. Then the Central Bank said, "only if the Argentinians buy Brazilian foreign debt bonds and deposit as collateral". Look, if Argentina is strapped for cash, they will not purchase Brazilian foreign debt bonds… So we promise, and we do not deliver. Then the Chinese came and offered.[269]

---

[266] Non-attributable interview with a high-ranked diplomat.

[267] Non-attributable interview with a high-ranked diplomat.

[268] Non-attributable interview with a high-ranked diplomat.

[269] Non-attributable interview.

With Argentina and Venezuela facing acute economic difficulties, regional integration around UNASUL and Mercosul was impaired, as a Central Bank high-ranked official said: "Argentina and Venezuela are economies that are going through a very complicated situation … so that complicates matters within Mercosul, which was the initial project that Brazil had to strengthen its leadership in the region".[270]

Increasingly, Mercosul became a political project, with little concern for economic integration (Malamud 2011, p.7). In 2012 Venezuela was approved as a full member of Mercosul despite Paraguay's objection, who was temporarily suspended from the block for violating the Democratic Clause of Mercosul.[271] Mercosul's political turn and economic isolation has been viewed as detrimental to Brazil's regional interests, as a former policy-maker observed: "these international agreements are growing and Brazil does participate in hardly any; it is very limited here to Mercosul, and even Mercosul, with the incorporation of Venezuela, has turned into a more political forum than [a block] of economic interest".[272] In a similar perspective, a senior Brazilian economist and former minister said:

> I am convinced that Mercosul was a very interesting measure, particularly from the political point of view. Mercosul overcame a serious problem that we had between the armed forces of Brazil and Argentina … after that, Mercosul has never worked, this is the truth. And today I am afraid because the world is developing in another place. There is a US agreement with Europe; there is a US agreement with Asia; there is China advancing in Africa; the South Atlantic will be a cemetery … Mercosul [will be] disconnected from the world; it will be there, spinning around itself.[273]

Displeased with Mercosul's political turn, some South American states decided to create a new trade bloc, aiming to strengthen trade relations with Asia in general and China in particular.[274]

---

[270] Non-attributable interview with a high-ranked official at the Central Bank.

[271] The impeachment of the then President of Paraguay Fernando Lugo in June 2012 was considered a coup d'état by the neighbouring countries.

[272] Non-attributable interview.

[273] Non-attributable interview.

[274] Chile, Mexico and Peru are also amongst the Trans-Pacific Partnership (TPP) members, a trade agreement approved in October 2015 by twelve Pacific Rim countries, including the United States.

In April 2011 Peru hosted a meeting with Chile, Colombia and Mexico, which resulted in the establishment of the Pacific Alliance in June 2012. In March 2012 the four leaders had met via videoconference in the region's first virtual summit (Oppenheimer 2012), symbolising the new group's pragmatism and trade-driven orientation.

According to a high-ranked official at the Dilma government, "the Pacific Alliance does not itself bring any added value,"[275] because the included states already had free trade agreements among themselves, and Brazil also has trade agreements with them all. According to the official discourse, then, the Brazilian government "has no problem with the Pacific Alliance," not least because "the region without Brazil does not act as region".[276]

Nevertheless, upon further consideration this claim seems disconnected from reality. In the IADB, for instance, as a Brazilian representative there has pointed out, "the Pacific Alliance many times arrives with a closed position; we have observed that they are voting in bloc".[277] Similarly, a high authority in the World Bank summarised the current condition of South America as follows, "the Argentinean President travels to China and signs bilateral agreements with matters that are known afterwards by Itamaraty; not to mention the Pacific Alliance that is going in another direction. Anyway, the reality is that it has changed".[278] The gradual decline of Brazil's influence in South America was also observed by a leading Brazilian politician:

> What happened [in the recent period] was the predominance of the Chavismo, which did not exist [before]; another axis was created, one that Brazil is not part of, which includes Nicaragua, Venezuela, Bolivia, Argentina and Ecuador. And [in this new axis] Brazil is not the leader; Venezuela is. … Brazil lost effective relevance then, and now due to the Pacific Alliance.[279]

[275] Non-attributable interview.

[276] Non-attributable interview.

[277] Non-attributable interview with a high-ranked Brazilian representative at the IADB.

[278] Non-attributable interview with a high-ranked official at the World Bank.

[279] Non-attributable interview.

The rupture of the integration process in South America heightened the dilemmas faced by Brazil's regional strategy (Malamud 2011). As a high-ranked diplomat summarised:

> I would say Brazil is at a crossroads: it can either strengthen its ties with the region or it can decouple from the region. What I mean by decoupling from the region is to search for markets in other continents, to strengthening the relations with the other BRICS, to loosen the Mercosul rules for signing free trade agreements, a diversification of Brazil's markets towards other regions, Africa, Southeast Asia …[280]

In light of the difficulties presented by regional integration, the question remains whether Brazil's global influence even depends on its role as a regional leader (Malamud 2011, p.8; Fiori 2011, p.25; Carvalho et al. 2009, p.132; Hurrell 2000, p.3). The logical argument is that Brazil's global weight increases if Brazil can speak for the region, as a high-ranked researcher at the Brazilian government noted:

> I think this is a dilemma of Brazilian diplomacy, or it should be, if we are big enough to continue to be invited for the banquet, or if future invitations to the banquet assume that you build and consolidate your constituency. I think there is no answer to that, but I tend to assume that without speaking on behalf of a group, with the policy that you have here, and with the indicators that you have here, it is not the same thing.[281]

While many current and former policy-makers agree with this argument, the problem remains that there exist many impediments to Brazil becoming a regional leader. In particular, there is not necessarily a convergence between Brazil's interests and those of its neighbours and, hence, Brazil's interests might be best served acting independently. In the words of a high-ranked Brazilian diplomat:

> The prevailing understanding is that when you strengthen your regional influence, you project yourself stronger globally and become more influential globally. … This is the theory. But theory and practice are not talking, because [Brazil's] action in the G20 …

[280] Non-attributable interview with a high-ranked diplomat.

[281] Non-attributable interview.

> [ends up] very prisoner of interests that are not ours, are Argentinean interests [for example]. Sometimes we end up defending Argentinean interests in the G20 when we could be articulating our interests more forcefully.[282]

Similarly, a Central Bank high official noted that, “the fact is that [Brazil’s] international position goes through deepening its leadership at the regional level, and I think Brazil has pursued this, but in an environment that we do not have to elaborate very much to see it is complicated”.[283] Indeed, there are some major differences in terms of economic policy between Brazil and its neighbours, including domestic policies, the relationship with international financial markets and the treatment of property rights (Carvalho et al. 2009, p.132). The hostility of some neighbour countries towards international markets and the BWIs, for instance, does not align with the Brazilian position. Another important obstacle is Paraguay’s diplomatic relations with Taiwan, which prevents Mercosul signing any agreements with China (Malamud 2011, p.12).

Another major complication is the fact that Brazil’s leadership was never recognised by its neighbours (Malamud 2011, pp.9–10). As a former Central Bank director said:

> So what I could observe [Argentina] was never a country that has supported us a lot, instead always expected much from us. … And Mexico is clearly a country that has the ambition to take the lead in the region, so they resent much of the leading role that Brazil reached during the crisis.[284]

Brazil has also reacted to its lack of regional support. For example, in the 2011 elections for Managing Director of the IMF, Brazil supported the French candidate Christine Lagarde

[282] Non-attributable interview with a high-ranked diplomat.

[283] Non-attributable interview with a high-ranked official at the Central Bank.

[284] Non-attributable interview with a former Central Bank director.

instead of the Mexican Agustín Carstens. Brazil's position was especially symbolic in the context of the Brazil's constant advocacy for a greater role of EMDs in global governance. In 2013, Mexico and Brazil each offered candidates for the Director-General position of the WTO, a contest ultimately won by Brazil and its candidate Roberto Azevêdo.

In sum, the prospect of regional integration and an increase in Brazilian influence in South America decreased considerably from 2011 to 2014. On the one hand, as Argentina and Venezuela began to face mounting economic problems and, as Brazil was in no condition to offer financial support to its neighbours, China took the opportunity to provide assistance. On the other hand, the rest of the region, which was growing at faster rates than the regional average, created a new economic bloc with the aim of increasing trade relations with China. Besides the worsening of international conditions, the weakening possibility of South American integration in the post-2008 crisis can be thus understood as the outcome of a deficient Brazilian leadership and the alternative posed by China.

5.3.3 ALL THAT GLITTERS IS NOT GOLD: THE BRICS

From 2011 to 2014, Brazil gradually detached from regional initiatives and invested more heavily in the BRICS group. As discussed previously in this section, the BRICS group achieved momentum during and in the aftermath of the global crisis because of the member countries' convergent interest in reforming the global monetary and financial architecture. The BRICS states share the desire to reduce the US-dominance of global financial governance, a scenario they believe can be achieved through the reform of the BWIs where they claim they should have a higher quota share. Since their first joint statement in June 2009 (BRIC 2009), the BRIC countries (before the inclusion of South Africa) have advocated for a greater voice and representation in international financial institutions and have welcomed the central role assigned to the G20 in the context of the 2008 crisis.

Moreover, the BRICS deem it necessary to move away from a dollar-centric IMS. Implicitly expressing their dissatisfaction with a dollar-dominated IMS, the BRICS (2011) have explicitly advocated for an increase in the use of the IMF's Special Drawing Rights (SDRs). China has been particularly keen on the proposal for a multilateral alternative to the dollar (Zhou 2009), an idea that was endorsed by the 2009 report of the Stiglitz Commission, convened by the President of the UN General Assembly (Stiglitz et al. 2009, pp.115–116). Russia has been even more categorical in its discomfort with the IMS' dependence on the US dollar, and declared in mid-2009 that it planned to reduce the share of dollar-denominated assets in its international reserves (Eichengreen 2011a, p.135). In 2010, the BRIC (2010) collectively declared their intention to discuss future opportunities for monetary cooperation, including local currency arrangements, further signalling their dissatisfaction with the dollar's key role.

Furthermore, the BRICS countries have also expressed their concern about the growing gap in infrastructure financing in the developing world (Chin 2014, p.367; BRICS 2013). In early 2012, the BRICS (2013) began discussing the possibility of establishing a joint development bank to address the deficit financing in infrastructure and sustainable development faced by EMDs. The discussions resulted in the launch of the NDB in July 2014. On the same occasion, the BRICS created the CRA as an additional line of defence against international financial instability.

The BRICS leveraged their convergent interests for reforming the IMS by acting together in forums such as the IMF: "the existence of the BRICS creates a greater proximity among the members in the discussion of certain issues; so as these issues enter in the BRICS' agenda, it reinforces their action within the Fund,"[285] a high-ranked official at the Central Bank observed. Despite sharing similar interests on many topics, Brazil's agenda in the Fund was not driven by any prior articulation of convergence with the other BRICS members. In the words of a high-ranked official at the Central Bank:

> It is a situation a little different: if a point is being developed and enters in the BRICS' agenda, then you create an articulation of those five countries that will be reflected in the action of their directors in the Fund and, hence, they will have a coordinated position on that matter. However, if a topic comes up in the Fund, it does not need to be articulated first between the BRICS to [Brazil] determine its position… sometimes there will be an alignment of positions that will not necessarily follow the group format, [Brazil] might join other countries, there might be very different interests depending on the subject that is being discussed there.[286]

Indeed, aside from certain topics concerning the reform of the global monetary architecture, there is little convergence among the BRICS' interests. This is reflected even in the group's origins, as a former Brazilian minister has pointed out, "the BRICS is an invention of [Jim] O'Neil [who coined the term BRIC in a paper written for Goldman Sachs in 2001] … There is no connection among these economies, which reveals how myths have a great power. Only because it was the BRICS, when they came up with the PIGS[287] everyone rejected".[288]An influential Brazilian economist summed up the BRICS' trajectory along similar lines:

> This thing of BRICS I think is a serious problem; because it turned out that this thing caught on. It was invented by Goldman Sachs; it turned into a geopolitical initiative, as these things happen without much pertinence to be honest, because these countries have nothing to do with each other. And if you want to say, "but they are BRICS because they are large economies, are countries of continental proportions with huge domestic markets, etc.," then I do not know why South Africa is there. Nothing against South Africa, but it is incongruous; it makes no sense. But this animal was created; it was sold

[285] Non-attributable interview with a high-ranked official at the Central Bank.

[286] Non-attributable interview with a high-ranked official at the Central Bank.

[287] PIGS is the acronym for Portugal, Ireland, Greece, and Spain.

[288] Non-attributable interview with a former finance minister.

> this way, and then naturally the countries began to try to position themselves in a certain way in discussions and debates.[289]

It is paradoxical that one of – if not the – main focuses of attention in terms of Brazil's foreign policy is, in the words of a high-ranked Brazilian diplomat: "a group that [Brazil] did not create: we won it on a silver plate, it already had value in the market when we took it over".[290] This is significant because the group that Brazil had truly meant to engage, the IBSA forum, together with India and South Africa, lost ground to the BRICS. In fact, a high-ranking member of the government has said the inclusion of South Africa in the BRICS was a Chinese initiative, "because there was no African country, and [Brazil] could not veto".[291] Indeed, some officials in the government speculate that, "China did this to empty the IBSA, … [the group] that brings together three democracies".[292] While it is not possible to prove such a Chinese conspiracy existed to put an end to IBSA, one cannot deny that China's interests have ultimately prevailed.

Apart from the odd way in which the BRICS was transformed from a financial acronym to a foreign policy instrument, the BRICS countries in fact have conflicting interests in several areas. In geopolitical terms, there are tensions between China and India as they fight for hegemony in Asia and between Brazil and China as they both seek to increase their presence in Africa. Russia and India, moreover, are strategically concerned with China's rise (Brands 2011, p.39). In terms of agricultural policy, Brazil and India also have conflicting interests, as a former Central Bank governor commented:

> Does China help Brazil in any relevant international trade forum? No. The big protectionist issue that harms Brazil is the agricultural protectionism, where China is not with us, nor India, nor Russia, nor South Africa. No one votes with us on these matters.

[289] Non-attributable interview.

[290] Non-attributable interview with a high-ranked diplomat.

[291] Non-attributable interview.

[292] Non-attributable interview.

> So in this "let us bring the periphery together," they are from different neighbourhoods, with different interests. It is the mountain people and the beach people; there is no convergence.[293]

The BRICS' conflicting agendas are reflective of their different economic and political features. China's development model, for example, is based on investment and exports, while Brazil and India are more focused on their domestic markets. India is competitive in information technology services, but Brazil, South African and Russia are competitive in commodities. Russia in particular relies heavily on oil. Politically, Brazil, India and South Africa are democracies; Russia is still in a transition towards a complete democratic regime; and China is ruled by the Chinese Communist Party. Not surprisingly, the BRICS countries have not only opposing economic interests but also divergent conceptions of governance and legitimacy (Brands 2011, p.39).

At the same time, these divergent interests can be partly attributed to the power imbalance within the group: "at one point, it seemed very relevant to bring together these countries to reform the institutions; more than that is to be naïve, because China has a global weight much heavier than the others,"[294] as noticed by an authority at the World Bank. Illustrative of this difference is that fact that, while all the BRICS countries have to deal with the spillovers of the monetary policies of developed countries and particularly from the US, they do not have a unified proposal for reforming the IMS. Significantly, China's exchange rate policy also represents a discomfort for the other BRICS since its undervalued currency hurts their exports and simultaneously poses a threat for their domestic industries. The group has avoided discussing this matter, however, leaving the US to confront China.

[293] Non-attributable interview with a former Central Bank governor.

[294] Non-attributable interview with a Brazilian representative at the World Bank.

Considering the initial motivation that catalysed the BRICS group – the reform of the IMS – the asymmetry of power within the group is not necessarily a problem. On the one hand, while China was probably powerful enough to create sufficient pressure on its own, its claim to reform the prevailing system became more legitimate when it was supported by other large EMDs. As a high ranked Brazilian diplomat stated, "even though China has a very large weight, what we feel is that they value the forum [referring to the BRICS], that it is useful to their interest in some way, perhaps even to show that they are not isolated, because there is much distrust about China everywhere".[295] On the other hand, the other BRICS states relied on China's economic power to exercise a political pressure that would not have otherwise had the same weight. Thus, in light of the discussions for reforming the IMS, the BRICS association had a win-win outcome: "within the BRICS, [the balance of power] so far has been reasonably balanced, not least because there was any instance where you had to measure forces to decide [a major issue]… the five countries see the BRICS as a relevant cooperation forum,"[296] a high-ranked diplomat observed.

During the creation of the NDB, for example, Brazilian representatives considered that there was a fair equilibrium among the members. In fact, in the important matter of deciding voting power and the value of contributions, China's position was defeated by the other members, as a high-ranked diplomat said:

> China wanted to enforce the idea of different voting weight and share power, of course along with different contributions as well… South Africa, even for the sake of a greater fragility, was slightly willing to accept, but Russia, Brazil and India did not accept that; we made sure that the contributions were equal, at least in the beginning, with equal voting power. Somewhat in return they were very keen to bring the headquarters to Shanghai, and they put up a lot of money. Russia, India and South Africa competed a bit… South Africa ended up taking a regional office. Brazil thought it was not the

[295] Non-attributable interview with a high-ranked diplomat.

[296] Non-attributable interview with a high-ranked diplomat.

> moment to invest a lot of money, build a building, these things are very expensive. So it stayed in Shanghai.[297]

Nevertheless, already in their second Summit in 2010 (BRIC 2010), the BRICS group began to broaden its agenda beyond the reform of the BWIs and the creation of their own alternatives. Under such circumstances, the power asymmetries among the BRICS members became a more obvious disadvantage for Brazil, one of the least powerful states within the group. Brazil is not a permanent member of the United Nations Security Council, of which Russia and China are part, and it is also not a nuclear power, which Russia, China and India are. As noted by Brands (2011, p.39), "as the individual BRIC countries – especially China and India – become more powerful, they will probably become more assertive in pressing their particular national interests". Yet despite these asymmetries, the BRICS remains the only international forum that still yields Brazil some international prestige.

In sum, Brazil's external influence was altered on two fronts from 2011 onwards. First, because of its poorer economic performance, Brazilian foreign policy in general had less visibility and was considered a lower priority even within the government. Second, it was affected by the international trends of i) an environment less propitious for reforms that favoured EMDs in global financial governance and ii) China's ongoing rise. In its turn, China's rise had mixed effects for Brazil's influence as for while Brazil yielded some international prestige through its association with China and the BRICS, it is questionable whether Brazil's relationship with these states in general was in Brazil's best interest. Finally, the combination of Brazil's economic crisis and China's ascent resulted in Brazil's much reduced position of influence in

[297] Non-attributable interview with a high-ranked diplomat.

regional matters, which ultimately can be considered a central factor of Brazil's international influence.

5.4 CONCLUSION

From 2011 to 2014, the international perception about EMDs' increasing influence in the IMS gradually changed. During this period, the relatively better performance of EMDs in comparison to their developed peers was substituted for an economic slowdown in the developing world. Significantly, the previous global economic conditions of rising commodity prices and booming capital flows that had allowed EMDs to rebound quickly from the 2008 crisis began to fade away. Already in 2011 commodity prices began to slow down. Weaker prices, which were partially attributed to the downswing of Chinese growth, lowered economic growth among commodity-exporting EMDs. Then in late 2013, the Federal Reserve began to gradually taper the quantitative easing, which came to an end in October 2014. This change in American monetary policy further served to deteriorate EMDs' economic results.

Setbacks in EMDs' economic performance added to the inertia of reforming the IMS. In contrast to the immediate aftermath of the crisis, when EMDs' economic firepower helped them pressure for IMS reforms, from 2011 onwards this became less apparent. In particular, after 2011 the G20 gradually lost the prestige it had enjoyed at the height of the crisis. As the risk of financial contagion disappeared, developed countries' interest in increasing monetary cooperation shrunk and EMDs' problems with monetary spillovers from the developed world were largely marginalised.

Despite EMDs' more fragile economic situation, there were some permanent advances towards a more multipolar IMS, at least in comparison to the very outdated pre-crisis architecture. First, although limited, the reforms in the BWIs were significant from a symbolic standpoint. Notably, the IMF's 2010 reform put Brazil, Russia, India and China amongst its top ten shareholders. Second, the landscape of global governance was altered in favour of EMDs with the establishment of the NDB and the CRA.

These advances towards a more multipolar IMS were largely related to the need of recognising China's power. China's emergence as a monetary power ended up creating some positive spillovers for EMDs, particularly for the other BRICS countries. For instance, once the window for reform was open in the IMF, it was reasonable to increase the share of countries like Brazil, Russia and India. Yet what made the IMF reform unavoidable was the necessity to increase China's share. China's uniqueness among EMDs became blatant with the inclusion of China's Renminbi in the benchmark SDR currency basket in November 2015. The prevailing idea in the immediate aftermath of the crisis that EMDs were to have a higher influence within the IMS has therefore been replaced by China's actual gain of hard monetary power.

Moreover, the consolidation of China's monetary power can be understood in part as the American capacity to preserve the previous IMS, centred on the dollar and on the BWIs, which the US continues to rule. In other words, the post-crisis IMS has been gradually reorganised from a US standpoint, where China has gained some power and Europe has lost some, but American might has remained supreme. To that extent, the IMS proved to be as rigid as has been described by IPE theory.

Meanwhile, the marginal gain of power by EMDs falls short of the high expectations espoused in the immediate aftermath of the crisis. In this regard the soft and hard monetary power distinction is useful, as it seems that Brazil, along with some other EMDs, made some progress in the former and little or none in the latter. In this regard, a respected economist commented:

> Unequivocally there is greater political and geopolitical prominence of Brazil, while the progress in terms of its economic position did not come along; it came, but one walked faster than the other, this is undoubtedly true. I think this is and is not a contradiction. In normal times, it would be a contradiction, because how could a country gain political prominence without an equivalent economic prominence, how would you accept these two things? But in view of a non-normal context of the global crisis, which we have been living for the past 5 or 6 years, it seems less incongruous to me.[298]

This political or soft power gains, according to several Brazilian policy-makers have endured in post-crisis period, when Brazil began to face strong economic turbulences.

In terms of hard power, however, gains were significant only for China. The Dilma government was unable to reassess Brazil's actual power to its benefit. The government's actions from 2010 onwards suggest that it believed that it had much more power than it actually did. Ultimately this misreading is illustrated by the change in economic policy that took place with the adoption of the New Economic Matrix, which meant a gradual abandonment of the macroeconomic tripod that had been in place since 1999. In other words, the NEM was the crystallisation of the Dilma government's belief that certain economic policies were behind Brazil's success since 2006. By doing this, the government underestimated the influence of the very favourable international scenario EMDs like Brazil had enjoyed. This attitude combined with the worsening of international conditions for EMDs can be identified as key to Brazil's economic deceleration that took place from 2011 onwards.

[298] Non-attributable interview.

CONCLUSION

The fallout of the 2008 crisis generated a puzzle in understanding monetary power. Suddenly, emerging market and developing countries (EMDs) appeared to have increased their global influence even without issuing international currencies. They had been less affected by the onset of the crisis and consequently could become an important part of the crisis management. In addition, EMDs' growing economic weight (share in global GDP, trade, and investments) reinforced the idea that they should have equivalent political might in the international monetary system (IMS). In the context of the crisis, solid macroeconomic fundamentals and a vocal diplomacy appeared to be relevant sources of monetary power and capable of changing the landscape of the IMS. Understanding sources of monetary power other than issuing an international currency was precisely the initial motivation for studying Brazil's position in the IMS.

Brazil's case in particular reveals the complexity of monetary power. While Brazil faces the general constraints associated with states that do not issue international currencies, it has nonetheless a certain level of political influence in global monetary and financial matters. Moreover, Brazil's transformation from a state dominated by problems of external debt and inflation in the 1980s to a rising power in the early 2000s also provided a unique account of how changes in external constraints can affect a state's monetary power.

This final chapter starts by presenting a summary of findings. The second section identifies the analytical implications of this case study of Brazil for the position of EMDs in general in the IMS. The third section discusses what the study's findings on Brazil say about the nature of power in the IMS. The fourth section draws conclusions about the relationship between external constraints and domestic autonomy for Brazil in the context of the IMS. The final section sets out the limitations of these conclusions and suggests further avenues of research.

SUMMARY OF FINDINGS

Chapter 1 set forth the puzzle around the role of EMDs in the IMS in the aftermath of the 2008 crisis. The main contribution of this chapter was to draw attention to a gap in the existing monetary power theory, one that circumscribes the possibilities to understand the role of states whose currencies are not internationally relevant nor will be in the foreseeable future. It highlighted the significance of this gap by connecting it to the short-lived enthusiasm surrounding EMDs. In other words, if currency-related constraints faced by EMDs had been at the centre of the monetary power analysis, the predictions around EMDs' future role in the IMS would have been more realistic. Moreover, a major conclusion of this chapter was that, if academic literature is interested in understanding the role played by states like Brazil and other EMDs, monetary power theory needs to advance in order to incorporate other sources of power than issuing an international currency.

Chapter 2 exposed the extent to which economic policy-making in Brazil was subordinated to currency-related constraints from 1944 to 1994. These were mainly the product of Brazil's incomplete domestic financial system, which was at the origins of the problems of external debt and inflation. In particular, the chapter showed how Brazil's dependence on external capital translated into its need to fit into the Bretton Woods System (BWS) in order to have access to international credit. One major conclusion of this chapter was that even in its weak position Brazil's subordination to the International Monetary Fund (IMF) was limited.

Significantly, both the Brady Plan and the Real Plan were implemented without the Fund's support.

Chapter 3 analysed how Brazilian policy-makers dealt with the currency crises in other emerging markets from the mid-1990s until the early 2000s, and it considered the consequences of China's rise on the Brazilian economy. Brazil's weak external position (deficit in the current account, low level of international reserves and high share of public debt indexed to interest and exchange rates) made the Brazilian currency a target of speculative attacks. Eventually, the 1999 attack forced Brazil to devalue its currency and adopt a floating exchange rate regime. Propitiously, the economic ascent of China after 2003 prompted a change in the external conditions confronting Brazil, creating the opportunity for Brazil to reduce its external vulnerabilities, mainly in terms of balance of payments problems. This beneficial change to Brazil's position (rising level of international reserves and surplus in the current account) occurred in the context of Cardoso's macroeconomic tripod and its continuation under Lula. The domestic tensions resulting from the continuation of this economic stance likely played a key role in establishing Lula's leftist foreign policy.

Chapter 4 challenged the argument which attributes Brazil's sound economic performance from 2006 to 2010 to an alteration in the government's policies. Instead, it argued that the external environment, particularly rising commodity prices and high international liquidity, was fundamental to Brazil's relative economic success. When the 2008 crisis broke out, Brazilian policy-makers had an unprecedented policy space to implement counter-cyclical policies due to its much stronger initial economic position. In addition, the quick rebound of commodity prices in mid-2009 contributed to the recovery of the Brazilian economy. The reasons for Brazil's sound performance aside, this chapter showed how Brazil's relative economic success, particularly during the 2008 crisis, was a source of greater international influence.

Chapter 5 reinforced the argument that the Brazilian government had essentially little power to reverse the downward turn of its domestic economic performance in less favourable external circumstances. Moreover, it highlighted the paradoxical consequences of China's rise for Brazil, the negative side of which became all the more clear after 2011. In particular, the reversal in the rise of commodity prices ended the previous buffer space Brazilian policy-makers had had to pursue domestic objectives and concurrently exposed the problems associated with the primarisation of exports – a subject that had been hitherto disregarded. Strikingly, it showed how Brazil was able to retain some of the political influence it had acquired despite the re-emergence of external constraints on its economic policy making.

CONCLUSIONS ABOUT THE POSITION OF EMDS IN THE IMS IN LIGHT OF BRAZIL'S CASE

The case of Brazil is important to understand some of the underlying dynamics in the IMS and it shows why scholars mistakenly assessed the power of EMDs at the outbreak of the crisis. In the aftermath of the 2008 crisis, Brazil typified big EMDs who failed to fulfil the prophecy of becoming inevitable key players in the global economy. Brazil's quick recovery from the crisis, with a minimum recession in 2009 and a strong recovery in 2010, helped to fuel predictions that EMDs would be the new engines of the global economy. However, as the global scenario began to reverse from 2011 onwards, Brazil and other EMDs were unable to sustain their previous performance. Gradually, the international euphoria surrounding the fate of Brazil and other EMDs disappeared.

Confounding the expectations that the 2008 crisis would mark a watershed in the history of the IMS, the years after the financial meltdown unfolded with little threat to the US' systemic dominance (Kirshner 2014; Cohen 2015; Helleiner 2014). Once the global financial contagion was controlled, the momentum to reform the global monetary architecture faded away. Symbolising this loss of momentum for significant reforms was the fall of the G20's prestige after 2011, when the frequency of summits was reduced to just one meeting a year. The G20's influence was further downgraded by the rebound of the Eurozone crisis, which became the highest priority for European and other developed countries. The Eurozone crisis not only reduced the G20's significance but it also helped to restore the IMF's status quo, where EMDs were still under-represented despite their contribution to expand the IMF's lending capacity through the New Arrangements to Borrow (NAB) in 2009. Consequently, the forum in which EMDs had some voice was weakened whereas the forum in which they do not have one was strengthened, even though they financially contributed to make it stronger.

The centrality of the US dollar in the IMS also remained untouched and, hence, American monetary policy continued to determine the relevant business cycles for EMDs, particularly in terms of exchange rate movements. In the less prosperous period of the global economy following the outbreak of the crisis, American monetary policy sparked outrage among EMDs. Policy-makers in EMDs, particularly in Brazil, first complained about the Fed's quantitative easing policy, calling it a "currency war" as it triggered a huge capital inflow to a number of EMDs. Later, when the Fed announced its intentions of tapering its security purchases in May 2013, and effectively started to do in December that year, EMDs were equally dissatisfied and their economies were negatively affected by capital outflows.

As Eichengreen and Gupta (2013) have shown, having better macroeconomic fundamentals, such as smaller budget deficits, lower public debts, higher levels of international reserves and superior growth rates, did not provide sufficient insulation for EMDs in face of the Fed's policy change. Aizenman et al. (2014) have come to a similar conclusion. Such views are emblematic of EMDs' continued unprivileged position in the IMS, being policy and business cycle takers.

With the benefit of hindsight, it seems clear that EMDs' monetary power was overestimated in the aftermath of the 2008 crisis and the Brazilian experience elucidates why this occurred. Brazil's economic trajectory can be explained in terms of changes to its currency-related constraints over time and by the fact that much of its influence in the IMS was externally determined. First, Brazil's relative economic resilience was to a great extent context dependent. The international dynamics inaugurated with the ascent of China in the early 2000s was fundamental to the reductions of Brazil's external vulnerabilities. The rise in commodity prices was also a central factor behind Brazil's surplus in its current account from 2003 to 2007 and in its accumulation of international reserves. When these international conditions changed, Brazil – and several other EMDs – began to face mounting economic problems. Significantly, from 2011 onwards the Brazilian government was unable to reverse its economic crisis, raising questions about how much autonomy Brazil actually had over its relatively good economic performance in the 2008-2010 period.

Second, Brazil and other EMDs were already relatively resilient economies and claimed the right to greater political influence in global governance before the breakout of the 2008 crisis. In a non-crisis context, however, Brazil's economic weight was insufficient to increase its influence. The crisis created the environment in which it was possible for Brazil to bargain and increase its political power, due to its relatively stronger position at that moment in time. To this extent, Brazil's case suggests that "doing its homework"[299] (becoming a more resilient economy) is a necessary but not a sufficient condition to improve a state's position in the IMS'

[299] This term is borrowed from one interviewee.

hierarchy. Being a robust economy was not enough to change the IMS' status quo; the EMDs' increase in political power only happened when more powerful states temporarily became more vulnerable.

EMDs' limited power was evident in the dynamics of the G20. The G20 leaders' meeting was called by the US, rather than being the outcome of a demand from EMDs. Most significantly, the forum maintained its relevance only insofar as it was pertinent to developed countries. To that extent, while the G20 put big EMDs at the centre of global governance, its rise was not the outcome of EMDs' power. Precisely because of this, EMDs were unable to sustain the G20's relevance once developed countries had lost interest in it.

In sum, the study of Brazil's position in the IMS highlights the importance of currency-related constraints. The argument that the position of a country's currency is central to its position in the IMS is further confirmed by the case of China, the only EMD to changed its relative position in the post-2008 crisis period. Significantly, the currency constraints faced by Brazil and the majority of other EMDs were not entirely applicable to China. Eichengreen and Gupta (2013, p.4) have found that among the BRICS only China's currency did not depreciate after the Fed's tapering talk. China was equally the only economy whose international reserves were augmented after the tapering talk (Eichengreen & Gupta 2013, p.4). Put simply, China faces much lower currency constraints, particularly since the inclusion of the renminbi in the IMF's Special Drawing Rights (SDR) basket in December 2015.

CONCLUSIONS ABOUT THE NATURE OF POWER IN THE IMS IN LIGHT OF BRAZIL'S CASE

The Brazilian experience suggests that there is more to monetary power than issuing an international currency. When asked about the position of Brazil in the IMS, current and former

Brazilian policy-makers instinctively acknowledged that it has changed in the past decades even though Brazil continues to be a subordinated economy. As one influential Brazilian researcher at the government said: "it is very different than it was 15, 20 years ago, undoubtedly… [although] obviously [Brazil] is still an economy that continues to be a secondary economy in the international arena".[300] Another renowned economist tried to explain Brazil's improvement as follows:

> I think what happened in the last 10, 15, 20 years perhaps, is that Brazil achieved greater macroeconomic stability, with everything that happened in the early 2000s – increased participation of Brazil in international trade, the rising commodity prices – and how this has benefited Brazil, Brazil being a big country, with a large consumer market, very attractive for foreign companies and so on… Brazil achieved a role that it not had in the 1980s and 1990s. I think there are countries that transited in this pyramid [of the IMS] and Brazil is one of them.[301]

The accounts of current and former Brazilian policy-makers help shed light on the channels through which a state may increase its influence in the IMS even if it does not issue an international currency. To begin with, many interviewees suggested that having influence in the IMS is considerably subordinated to a country's *position as a creditor or a debtor*. When asked about how Brazil's position in the IMS has changed, most interviewees remembered Brazil's position as a debtor in the 1980s and early 1990s and how that situation constrained the government's economic policy-making. To that extent, the conclusion of the Brady Plan in 1994 had a considerable impact on Brazil's position in the IMS (chapters 2 and 3) and settling its debt with the IMF in 2005 also contributed to an increase in Brazil's influence (chapters 3 and 4). Becoming a creditor of the Fund in 2009, during a major global financial crisis was

[300] Non-attributable interview.
[301] Non-attributable interview.

thus crucially important to Brazil's position in the IMS and imbued with symbolism due to its history as a traditionally debtor state (chapter 4).

Although it represents a significant step forward, the simple change from being a debtor to a creditor status in the IMS does not *per se* increase a state's influence. In the words of a senior official at the World Bank:

> The change of debtor to creditor status makes room for influence. This influence, at the same time, is not mechanical; is not a linear thing. Because both influence and power are not variables that you can quantify and attribute an exact measure… the soft power in institutions is the behaviour combined with money that gives influence… This transition from debtor to creditor influence is not binary: "I am a debtor so I have no influence; I am a creditor, now I have influence". Because [the influence] also depends on the degree, form and agenda brought by the government's country to these institutions.[302]

Similar statements were made in relation to a state's *economic stability and performance*. To be sure, current and former Brazilian policy-makers believe that having good results at home increased Brazil's influence in the IMS. In this regard the Real Plan was recurrently pointed out as vital to transforming Brazil's position into an important player in the IMS (chapters 2 and 3). Moreover, Brazil's economic performance from 2003 to 2010, and particularly from 2008 to 2010, was also frequently mentioned as a factor that contributed to the state's influence (chapters 3 and 4).

Strikingly, Brazil was able to maintain some of the political influence it acquired during the crisis even when its domestic performance began to deteriorate. According to Brazilian policy-makers, their prestige in international forums remained considerably high from 2011 until at least early 2015 (when the last interviews were conducted). They claimed that Brazil wielded considerable influence in the international debate about capital flows regulation and that overall

[302] Non-attributable interview.

Brazil achieved a higher reputation than in the past, particularly because of the Central Bank. In addition, Brazil succeeded in capturing some level of permanent formal influence in the IMS, as is evidenced from its becoming a member of the Financial Stability Board (FSB) (chapter 4). Although the 2010 reform of the IMF was far from ideal from EMDs' perspective, it nonetheless represented a considerable improvement in relation to Brazil's previous position (chapter 4). In the words of a senior Brazilian economist:

> Maybe the results fell short from what we considered great in some areas, but in any case these forums continue. So at least there is still the G20, which continues to meet; in the FSB we managed to get 3 seats, we had none; and we achieved the reforms in the voting power at the IMF and the World Bank.[303]

Considering the deterioration of Brazil's performance from 2011 onwards, the formal structural influence achieved by Brazil in international forums can actually be considered as an instance of Brazil punching above its weight. All of these elements considered, it seems likely that Brazil took advantage of a temporary circumstance to permanently increase its political influence.

To that extent, while having a robust economy was an effective starting point to increasing Brazil's power in the IMS, several Brazilian policy-makers noted that it was not the only factor behind Brazil's improved position after the 2008 crisis. As one senior diplomat noted: "it is not just the economic weight that counts, it is the ability of diplomatic articulation… there are a number of other factors depending on the forum. But undoubtedly the economic stability helped us".[304] Along with its diplomatic capacity, Brazil's representatives, particularly its

[303] Non-attributable interview.

[304] Non-attributable interview with a senior diplomat.

president and foreign affairs minister, were accredited as important sources of the state's global influence. In the words of a former finance minister:

> Brazil's power depends fundamentally on its economic power. But if you have a very competent president and a very good diplomatic corps, which Brazil does, that already gives us a leverage in relation to other countries… Lula was very competent, Fernando Henrique as well, but Lula [was more]. So people can make a difference, and thus the policies they pursue can trigger a change… [Brazil] has somewhat more influence in the IMF, the G20…[305]

These more subjective forms of influence identified by Brazilian policy-makers can be summarised as two sources of power: *diplomatic ability* and *influential leaders*. Diplomatic ability refers to the capacity of influence global matters independently from actual capabilities. For example, while China was economically more powerful than Brazil, it was Brazilian diplomats who put on the table EMDs' demand to enter the Basel committee (chapter 4). Moreover, the fact that Christine Lagarde, the candidate for the post of managing director at the IMF, turned to Brazil for support (chapter 5) was not due to Brazil's voting or economic power but most likely due to Brazil's capacity to influence others. These were concrete circumstances where having more economic power was not necessarily associated with having more political power. Several interviewees referred to this Brazilian ability – or power – as a *vocal diplomacy*, that is, the capacity of Brazilian diplomats to present demands, negotiate autonomously and influence other states' decisions. A comparison was recurrently made with Chinese diplomats, who are much less independent to negotiate on behalf of their government.

The Brazilian experience also demonstrated how having an influential leader can alter a state's power. For instance, Cardoso's personal relationship with US President Clinton influenced the conditions of Brazil's agreement with the IMF in 1998 (chapter 3). In addition, the priority

---

[305] Non-attributable interview with a former finance minister.

given to foreign policy during the Lula government and, hence, Lula's personal engagement with foreign policy issues was often mentioned by Brazilian policy-makers as a fundamental element to Brazil's international influence during his government, most notably in the 2008-2010 period (chapters 3 and 4). Lula's government was often contrasted with the Dilma government's low engagement with foreign policy issues, a period that coincided with the decrease of Brazil's international standing (chapter 5). To that extent, a state's representative can himself or herself influence a state's international power.

Finally, some Brazilian policy-makers associated a state's power in the IMS with its institutions. As one former finance minister said:

> What forms the bargaining power of a country in international negotiations… I am convinced that it is its institutions. I mean, the confidence in a country, if it pays what it owes, this has a lot to do with institutions… Institutions in the broad sense of Douglas North, that is, not only formal institutions, but a much broader set, including the society's beliefs. So if you are negotiating with a society that is anti-liberal, anti-banks and so on, it has a tinge of uncertainty, and this influences the willingness to borrow, the risk premium and so on.[306]

In fact, many interviewees emphasised the importance of the establishment of a democracy in Brazil to the state's international influence. In the sense of beliefs, another institutional evolution mentioned by several interviewees was the development of a society intolerant of inflation. Institutional advances such as these were important for, as Brazilian policy-makers have recognised, they engendered a higher accountability in Brazil. As one former finance minister said: "Brazil created the typical conditions of institutionally developed countries, which is the ability to detect and correct errors… Brazil crossed a line from which there is no return: there will be no more dictatorship, inflation and unsustainable external debt".[307] Thus,

[306] Non-attributable interview with a former finance minister.

[307] Non-attributable interview with a former finance minister.

it is reasonable to assume that having *credible institutions* can also enhance a state's monetary power.

The findings of this research, therefore, suggest that there are five other sources of monetary power other than issuing an international currency: i) creditor position; ii) economic stability and performance; iii) diplomatic ability; iv) influential leaders; and v) credible institutions. These results add to the existing literature that strives to understand EMDs' monetary power. Helleiner and Pagliari (2011, p.176), for instance, acknowledged the existence of a "different kind of 'market power' of a number of emerging-market countries," one that referred to EMDs' influence in the post-crisis global debate about international financial regulation. According to them, EMDs were able to exert *power-as-autonomy* in international regulatory politics (Helleiner & Pagliari 2011, p.177). In another remarkable effort to advance the comprehension of EMDs' monetary power, Gallagher (2015, p.12), coined the concept of *countervailing monetary power* to explain "how *some* EMDs deviated from and countered the structural power of global markets, on the one hand, and the power of industrialized countries in global economic governance institutions that remains pervasive in the world economy today, on the other".

Contributing to the existing literature, the findings of this research indicate that understanding EMDs' monetary power is important for two main reasons. First, in light of Brazil's case, these other sources are important because they are forms of power. The second reason is because these other sources of power, despite being power, are not as strong as currency power. The failure to acknowledge this hierarchy among the different sources of power was likely the key to the erroneous assessment about EMDs' might.

One way to rectify this issue is to consider the existence of hard and soft monetary power. This distinction may help to qualify the case of states that do not issue international currencies (most states) and will allow monetary scholars to incorporate other factors than the currency into monetary power theory while still maintaining currency differences at the centre of the monetary power analysis.

Significantly, this refinement in theory will be useful to explain what was the difference between Brazil's position in the IMS in 1994 versus 2014. Brazil's hard monetary power did not change to the extent that Brazil continued to be unable to delay or deflect disequilibrium in its balance of payments. However, according to Brazilian policy-makers, Brazil's soft monetary power grew. In addition to their account, Brazil increased its participation in global governance both by augmenting its share in the IMF and the World Bank and by joining new forums, which represented a permanent higher influence in global monetary matters.

THE RELATIONSHIP BETWEEN EXTERNAL CONSTRAINTS AND DOMESTIC AUTONOMY FOR BRAZIL IN THE CONTEXT OF THE IMS

The findings of this research suggest that the main external constraints for Brazil's economic policy-making in the context of the IMS were currency-related and that the external influence exerted by international institutions and ideas were easier to isolate. From 1994 to 2002, Brazil suffered several currency attacks, which eventually prompted the abandonment of the exchange rate regime in 1999. From 2003 until the eruption of the 2008 crisis, the Brazilian currency underwent a major appreciation and external constraints lessened. This was the outcome of a transformation in the international economic dynamics (mainly with the integration of China into the global economy) rather than a change in Brazil's domestic policies. While it is true that Brazilian monetary authorities were sufficiently astute in taking the opportunity to reduce Brazil's vulnerabilities, their success was only possible due to the reversal in the external environment. In the words of a former Central Bank governor:

> It is likely that at the bottom no one had a choice; because something else was happening outside the Brazilian control that was entering too much money here, and that maybe it was not us attracting but someone pushing. I think this becomes clearer after 2008, … when the American Treasury needed to sell bonds to have resources to save their banks. More or less half of this effort, the Federal Reserve took over; and the other half was Brazil plus China plus the rest [of EMDs]. … People do not realize that in the end we had no choice. And when [Brazil] faced that dollar mountain on the border, then prior experience paid to say: "let's buy this pile of reserves, it is worthless, it will not yield anything, but we will never have balance of payments problems again". So this is our sovereignty… Ok.[308]

In the aftermath of the crisis, external constraints reappeared. From 2011 to 2014, the Brazilian economy was less vulnerable than it had been until 2003, not least because it had a higher level of international reserves and lower shares of public debt indexed to interest and exchange rates. Brazil remained, however, a subordinated economy in the IMS because the nature of its currency has not changed.

Brazil's currency issue can be associated with other external constraints, such as the one arising from Brazil's condition as a commodity exporting developing country. Being a commodity exporting country means that two key determinants of Brazil's economic performance – capital flows and commodity prices – are largely beyond its control (Akyüz 2012, p.8). As argued in Chapter 5, Brazil's condition as a commodity exporting country was reinforced through currency channels, following China's ascension and its demand for commodities. The resulting overvaluation of Brazil's currency (starting in 2003) undermined the competition of Brazilian manufactures exports. Increased reliance on commodities exports turned out to be a major constraint for economic policy making when commodity prices began to fall in 2011. Being a commodity exporting country is an external constraint in itself as it increases macroeconomic volatility (Calderón & Fuentes 2011, p.2; Calderón & Yeyati 2009; World Bank 2008). The

[308] Non-attributable interview with a former Central Bank governor.

case of Brazil indicates how the currency issue can reinforce such vulnerability, raising external constraints. To that extent, there is a relationship between Brazil's place in the international economy – including its role in the global trade structure, i.e. being a commodity exporting country – and its position in the IMS. For its turn, the structure of the IMS reflects the power division in the international economy, as already pointed out by Kirshner (2003, p.21), Eichengreen (2008; 2011a), Cohen (2015; 2009a), among others.

The miscalculation of Brazil's actual power cost Brazil dearly. Following the euphoria surrounding EMDs in the aftermath of the 2008 crisis, academic literature which attempted to explain Brazil's economic performance gave too much attention to the government's role whilst considerably underplaying the constraints imposed by the IMS. In particular, Brazil's quick rebound from the 2008 crisis has been largely attributed to the countercyclical policies the government implemented in the wake of the financial meltdown (Barbosa 2010; Paula et al. 2015). In one example, Ban (2013, p.299) highlights Brazil's robust economic growth of 7.5 per cent in 2010 to then ask "with what kind of policy regime did get Brazil to this point?" There is a strong argument in the academic literature that the reason why Brazil recovered quickly from the crisis was because the government changed its previous approach and adopted a formula inspired by *new-* or *neo- developmentalism* ideas (Cypher 2015; Ban 2013; Barbosa & Souza 2010).

The findings of this research, however, serve to challenge these assessments about why Brazil responded differently to the 2008 crisis in comparison to previous crises. In all previous crises episodes, Brazilian policy-makers had never had the policy space they had in 2008 to implement counter-cyclical policies. Because of Brazil's lack of autonomy, the toolkit for fighting financial crises always including rising interest rates to avoid capital flight and balance of payment crises. Interviews with Brazilian policy-makers show that the difference in 2008 was more the existence of a policy space for enacting counter-cyclical measures, rather than different ideas within the government that resulted in the country's more successful response. Thus, the argument made by Ban (2013, p.304) that "during the 2009 crisis the Central Bank did not repeat the mistake made after the East Asian crisis, when its increase in interest rates sent the economy into recession" actually ignores the different constraints faced by Brazilian policy-makers in each episode.

The consequences of wrongly assessing Brazil's actual power became evident after 2011. Because the government believed Brazil's economic recovery had been triggered by domestic policies, when the performance began to deteriorate in 2011 it broadened its actions. In particular, the government increased public spending because it believed it had the power to reverse the deleterious effects of external conditions. Nevertheless, the government's actions were unable to reverse the slowdown of the Brazilian economy after 2011. In that context, some scholars stated that Dilma's government did not incorporate enough of the new-developmentalist policy framework and turned attention to the international environment, emphasising several reasons for the slowdown, such as the drop in commodity prices, falling domestic consumption and lower public investments (Cypher 2015, p.635; Paula et al. 2015, p.419).

Certainly there are several reasons associated with Brazil's slowdown from 2011 onwards. Yet it is problematic to attribute Brazil's success to the government's policies in 2008 and then explain Brazil's failure after 2011 through other reasons. While the government's policies were certainly important in bringing Brazil out of the 2008 crisis, their success was linked to a particular set of international conditions. In other words, the government alone had much less power to change Brazil's path than it thought it had, a fact that became clear after 2011.

Rather than relying on explanations that centre on the government's actions, the Brazilian experience can be better understood through the lenses of the international political economy (IPE) literature, with a focus on the dynamics of the IMS and Brazil's place on it. Under the IPE perspective, Brazilian policy-makers have been historically constrained by the external environment and have had little autonomy to deal with domestic problems. The years leading up to the 2008 crisis until 2010 were marked by a reduction of external constraints, which when combined with certain domestic policies, led to a temporary greater degree of autonomy and a better economic performance. Brazil faced a new external predicament, however, when international conditions began to change in 2011. Then the formula that had overcome the 2008 crisis produced different results. However, because the government apparently believed the rebound from the crisis was mainly due to its counter-cyclical policies, it insisted and deepened those policies in the subsequent period. As a result, on top of an unfavourable international scenario, the Brazilian economy declined still further because of the government's actions, which were premised on the Brazilian state having more autonomy than it did.

Despite Brazil's unprivileged position in the IMS, the level of external interference emanating from international institutions and mainstream ideas was limited according to Brazilian policy-makers. To begin with, one of the reasons why the Brazilian economy was less contaminated by toxic assets in the context of the 2008 crisis was because Brazilian policy-makers resisted the mainstream policy prescription of deregulation and liberalisation of financial markets (chapter 4). The notion, for instance, of the stress bank test, which came to the fore of international mainstream during the crisis, was long ago part of Brazil's risk management policies. Likewise, Brazil's high level of reserve requirements were also recognised as a useful tool for central banks in moments of crises. Finally, public banks, whose value had been questioned in previous times, had an important role in reversing the crisis in Brazil. Thus, it seems right to argue that Brazilian policy-makers were considerably autonomous in relation to mainstream ideas.

When asked about the position of Brazil in the IMS, the majority of the interviewees also insisted on the importance of Brazil's relationship with the IMF. Their insistence reveals the importance attached to the Fund and, perhaps, a certain desire of current and former Brazilian policy-makers to demystify the influence of the IMF in Brazil.

In terms of actual constraints for economic policy-making, Brazilian policy-makers asserted that the power of the Fund was limited. Even during the 1980s when Brazil was considerably dependent on the Fund's resources, policy-makers were able to circumvent the Fund's external pressure in favour of domestic priorities. A major example of this was in 1982, when the government waited until after the general elections to announce it was going to resort to the Fund's assistance. To be sure, at that point Brazilian economic policy-making was subordinated to external constraints (mainly because of its exorbitant external debt), but this is different than saying the Fund limited the government's autonomy. To that extent, the IMF should be conceived more as a piece of the domestic political game than as an obstacle to the formulation of "autonomous" economic policies.

According to several current and former Brazilian policy-makers, the idea that the Fund restricted the autonomy of policy-makers is incorrect; rather, on many occasions the IMF was used as a scapegoat to justify unpopular economic policies (see also Almeida 2003, p.2). Their accounts challenge some of the existing academic literature about the IMF's influence in Brazil (Tude & Milani 2013; Gonçalves 2005). In particular, following the payment of Brazil's debt with the Fund in December 2005, some scholars have conjectured about the motivations of the payment as well as its outcome in terms of an increased autonomy for economic policy-making (Tude & Milani 2013; Gonçalves 2005).

The findings of this dissertation reveal that the proposal for settling Brazil's debt with the IMF came from the technical area of the Central Bank and it was not a result of political bravado. After the proposal was presented to President Lula, the payment of the IMF was used to Lula's political leverage, not least because of the high symbolism denoted by Brazil independence from the Fund. Nevertheless, the IMF payment was not politically motivated. Thus, the suggestion of some scholars (Gonçalves 2005, pp.178–179; Tude & Milani 2013, p.91) that the payment of the Fund was a political movement is wrong.

Moreover, interviews with current and former Brazilian policy-makers call into question the idea that settling the IMF debt represented an increase in the government's autonomy to formulate economic policy. In one example, Ban (2013, p.305) argued that the fiscal policy turn after 2006 was possible only when Brazil paid off its debt to the IMF, which was described as "one of the most structural constraints bequeathed on [Brazil] by Cardoso's government". In light of the interviews conducted with Brazilian policy-makers, it is both an exaggeration and a simplification to assume that the continuation of Cardoso's macroeconomic framework by Lula was due to the agreement with the IMF.

While the Fund's actual intervention in Brazil was low, paying off the debt to it represented an increase in Brazil's influence within the institution. According to Brazilian policy-makers, despite its debtor position until December 2005, Brazil always had a certain influence in the IMF. A handful of policy-makers mentioned the key role of Alexandre Kafka in sustaining Brazil's strong diplomatic position in the Fund. Kafka worked for more than three decades as Executive Director, representing Brazil and a group of Latin American nations until 1998, when he retired. Having been Dean of the Board for many years, Kafka's influential personal position somewhat balanced Brazil's vulnerability.

After paying the Fund, however, Brazil changed its relative position, particularly from 2009 onwards when it became a creditor to the IMF. According to Brazilian policy-makers, this transformation had a two-fold significance. On the one hand, Brazilian representatives felt more assertive in presenting their proposals. On the other hand, they sensed a positive difference in their treatment from their international peers, which continued even when Brazil began to face mounting economic problems.

In light of this complex relationship between external constraints and domestic autonomy for Brazil in the context of the IMS, the Brazilian experience makes a strong case in favour of the distinction between hard and soft monetary power. While it was impossible for Brazil to escape the currency-related constraints posed by the IMS's dynamics, Brazilian governments were somewhat successful in isolating the pressure emanating from international institutions and mainstream ideas.

LIMITATIONS OF CONCLUSIONS AND SUGGESTIONS FOR FUTURE RESEARCH

While the case of Brazil serves to enlighten the dynamics of monetary power in the IMS, several questions remain unanswered and new ones have emerged during the course of this research. In the absence of a benchmark to analyse the monetary power of states that do not issue international currencies, the experience of current and former Brazilian policy-makers was the main guide from which to decide the topics incorporated in this research. This approach represents an original effort to advance monetary power theory in respect to EMDs. It gave analytical premium to the real-world constraints faced by policy-makers and thus has the potential to be useful even outside the realm of academia. At the same time, however, there are certain limitations to its utility regarding the case of EMDs in general and of Brazil in particular.

To begin with, this research addressed an extensive period of time and a very broad topic. On the one hand, the period of analysis had to be long so as to enable conclusions to be drawn about the changing place of external constraints in economic policy-making over time. On the other hand, to capture the dynamics between economic and political matters and to place the developments in Brazil into the broader international context, there was little way out of dealing with a substantial amount of literature. To achieve the objective of understanding the position of Brazil in the IMS, there was an inevitable trade-off in terms of the level of discussion of each topic. Despite the efforts to include all of the relevant literature and touch on the most important debates, some topics deserve a deeper discussion. Notably, future research on Brazil could delve deeper into Brazil's response towards the 2008 crisis; on the prospects for regional integration in South America and the place of Brazilian leadership in that project; on Brazil's relations with the IMF; and on the implications of the NDB and the CRA for Brazil's monetary power.

Moreover, the findings of this research are predominantly Brazil-specific and the generalisations made about EMDs should be treated with caution. To advance the comprehension of monetary power and the position of EMDs in the IMS requires further comparative analysis. One particularly interesting area of research would be a comparison between the case of the monetary power of BRICS' states and non-BRICS' states, such as Indonesia, Turkey and Mexico. Judging by the case of Brazil, its association with China was instrumental in maintaining Brazil's influence when domestic economic tensions arose. However, the case of Brazil alone is insufficient to draw conclusions about the actual weight of China in determining the influence of less powerful EMDs.

Furthermore, while this research tried to balance the account of Brazilian policy-makers with economic data, it is substantively a qualitative assessment. A major contribution of this dissertation to academic knowledge was to reveal the experience of policy-makers in relation to monetary power matters. Due to the effort required to collect, transcribe and translate all of the interview material, there was limited time to expend to fully consider quantitative measures about Brazil's monetary power. This research analysed data from some relevant measures of monetary power, such as debt denominated in foreign currency, level of international reserves and share in global trade and investment flows. Yet, there is plenty of room for further quantitative investigations on this matter and they will certainly prove to be instrumental in better understanding the developments of a country's monetary power.

Three areas for future quantitative research must be highlighted. First, even though the Brazilian currency has little prospects to be internationalised, some interviewees noticed that the real has a discernable influence on South America's monetary dynamics. It would be interesting to explore through which channels and to what extent this influence occurs and what implications this has for Brazil's monetary power (potentially shedding light on Brazil's endless dilemma about its regional role). A second interesting area with potential for a more complete quantitative analysis concerns Brazil's participation in international financial institutions (IFIs), particularly in the IMF and in the NDB. Quantitative research on this topic can increase the understanding about the significance of shares and voting power. Finally, while it seems right to affirm there was an improvement in Brazil's soft monetary power, research is needed to quantify this change. The main challenge in addressing soft monetary power is that in all probability it is harder to measure than hard monetary power. For instance, what is the difference between Brazil's and India's soft monetary power? Scholars can measure the increase in the use of a certain currency for international transactions or if a state occupies a creditor/debtor position. Yet, how can we measure, for example, the capacity of a state to influence the international agenda or the importance of having the G20 instead of the G8 as the prime forum for global macroeconomic coordination? Advancing theoretical work to understand other sources of monetary power is far from easy but must be addressed to capture the complexity of these relations.

REFERENCES

Abreu, M. de P., 1999. *Brasil, 1824-1957: Bom ou Mau Pagador?*, Rio de Janeiro.

Abreu, M. de P., 2000. *The Brazilian Economy, 1945-1964*, Rio de Janeiro.

Aguirre, B.M.B. & Saddi, F. da C., 1997. Uma alternativa de interpretação do II PND. *Revista de Economia Política*, 17(4), pp.78–98.

Aizenman, J., Binici, M. & Hutchison, M.M., 2014. *The transmission of Federal Reserve tapering news to emerging financial markets*, NBER Working Paper Series, No 19980

Aizenman, J., Jinjarak, Y. & Park, D., 2010. *International Reserves and Swap Lines: Substitutes or Complements?*, NBER Working Paper Series, No 15804

Aizenman, J., Lee, Y. & Rhee, Y., 2004. *International Reserves Management and Capital Mobility in a Volatile World: Policy Considerations and a Case Study of Korea*, NBER Working Paper Series 10534.

Akyüz, Y., 2012. *The Staggering Rise of the South?*, Background Paper No 1, UNCTAD and South Centre, Geneva.

Almeida, P.R. de, 2003. O Brasil e o FMI de 1944 a 2002: um relacionamento feito de altos e baixos. *Revista História Hoje*, 1(1), pp.1–28.

Andrews, D.M. ed., 2006. *International Monetary Power*, Ithaca: Cornell University Press.

Angeloni, I. et al., 2011. *Global currencies for tomorrow: a European perspective*, Bruegel Blueprint Series/CEPII Research Reports, Brussels.

Armijo, L.E., 1993. Brazilian Politics and Patterns of Financial Regulation, 1945-1991. In S. Haggard, C. H. Lee, & S. Maxfield, eds. *The Politics of Finance in Developing Countries*. Ithaca and London: Cornell University Press, pp. 259–290.

Bacha, E.L., 1987. *Do Acordo Plaza à Moratória Técnica: Os Tortuosos Caminhos da Renegociação da Dívida Externa Brasileira, 1983-1987*, Rio de Janeiro.

Baer, W., 2013. *The Brazilian Economy: Growth & Development* 7th ed., Lynne Rienner.

Ban, C., 2013. Brazil's liberal neo-developmentalism: New paradigm or edited orthodoxy? *Review of International Political Economy*, 20(2), pp.298–331.

Barbosa, N., 2010. Latin America: Counter-Cyclical Policy in Brazil: 2008-09. *Journal of Globalization and Development*, 1(1), p.Article 13.

Barbosa, N. & Souza, J.A.P. de, 2010. A inflexão do governo Lula: política econômica, crescimento e distribuição de renda. In E. Sader & M. A. Garcia, eds. *Brasil entre o Passado e o Futuro*. São Paulo: Boitempo.

Barros, R. et al., 2010. Markets, the State and the Dynamics of Inequality in Brazil. In L. F. López-Calva & N. Lustig, eds. *Declining Inequality in Latin America: A Decade of Progress?*. New York and Washington D.C.: UNDP and Brookings Institution Press, pp. 134–174.

Batista, P.N., 1987. *International Financial Flows to Brazil since the Late 1960s: An Analysis of Debt Expansion and Payments Problems*, Washington, D.C.

Batista, P.N. & Torres, H.T., 2015. How to Reform the IMF Now. *Project Syndicate*.

Baumann, B.A. & Gallagher, K.P., 2012. *Navigating Capital Flows in Brazil and Chile*. Initiative for Policy Dialogue Working Paper Series.

BBC News, 2009. Obama: I love this guy. http://news.bbc.co.uk/1/hi/in_depth/business/2009/g20/7978816.stm

Bergsten, F., 2008. Trade has saved America from recession. *Financial Times*, July 1.

Bielschowsky, R., 1988. *Pensamento econômico brasileiro: o ciclo ideológico do desenvolvimentismo*, Rio de Janeiro: IPEA/INPES.

Block, F.L., 1977. *The Origins of International Economic Disorder: a study of United States International Monetary Policy from World War II to the Present*, Berkeley and Los Angeles: University of California Press.

BNDES, 2004. Informe BNDES No. 187. , pp.1–4.

Bonelli, R. & Malan, P.S., 1976. Os limites do possível: notas sobre balanço de pagamentos e indústria nos anos 70. *Pesquisa e Planejamento Econômico*, 6(2), pp.353–406.

Borba, J., 2015. Tarifaço sobre energia começa semana que vem e aumento chega a 48%. *Folha de São Paulo*.

Bordo, M.D., 2008. *AN HISTORICAL PERSPECTIVE ON THE CRISIS OF 2007-2008*, NBER Working Paper Series, No 14569.

Boughton, J., 2012. Five Fat Years: Recovery from the Debt Crisis, 1990–94. In *Tearing down walls: the International Monetary Fund, 1990-1999*. Washington, D.C.: International Monetary Fund, pp. 411–453.

Boughton, J.M., 2002. *Why White, Not Keynes? Inventing the Postwar International Monetary System*, IMF Working Paper.

Brainard, L. & Martinez-Diaz, L., 2009a. Brazil: The ‘B’ Belongs in the BRICS. In L. Brainard & L. Martinez-Diaz, eds. *Brazil as an Economic Superpower? Understanding Brazil’s Changing Role in the Global Economy*. Washington, D.C.: Brookings Institution Press, pp. 1–13.

Brainard, L. & Martinez-Diaz, L. eds., 2009b. *Brazil as an Economic Superpower? Understanding Brazil’s Changing Role in the Global Economy*, Washington, D.C.: Brookings Institution Press.

Brands, H., 2011. Evaluating Brazilian Grand Strategy under Lula. *Comparative Strategy*, 30(1), pp.28–49.

Bresser-Pereira, L.C. ed., 2010. *Doença holandesa e indústria*, Rio de Janeiro: Editora FGV.

Bresser-Pereira, L.C., 2006. O Novo Desenvolvimentismo e a Ortodoxia Convencional. *São Paulo em Perspectiva*, 20(3), pp.5–24.

Bresser-Pereira, L.C. ed., 1991. *Populismo econômico: ortodoxia, desenvolvimentismo e populismo na América Latina*, São Paulo: Nobel.

BRIC, 2010. 2nd BRIC Summit of Heads of State and Government: Joint Statement.

BRIC, 2009. Joint Statement of the BRIC Countries’ Leaders.

BRICS, 2011. Sanya Declaration.

BRICS, 2013. Statement by BRICS Leaders on the Establishment of the BRICS' Led Development Bank.

Calderón, C. & Fuentes, R., 2011. Chracterizing the Business Cycles of Emerging Economies (Second Version). Documento de Trabajo 371, Santiago, Chile, p.56.

Calderón, C. & Yeyati, E.L., 2009. Zooming in: From Aggregate Volatility to Income

Distribution, Policy Research Working Paper, No 4895.

Calleo, D.P., 2009. Twenty-First Century Geopolitics and the Erosion of the Dollar Order. In E. Helleiner & J. Kirshner, eds. *The Future of the Dollar*. Ithaca: Cornell University Press, pp. 164–190.

Campanario, M. de A., Stal, E. & Silva, M.M. da, 2013. Brazil: Outward FDI and its policy context, 2012. In K. P. Sauvant, P. Mallampally, & G. McAllister, eds. *Inward and Outward FDI country profiles*. New York: Vale Columbia Center on Sustainable International Investment, pp. 658–674.

Canuto, O., 2010. Recoupling or Switchover? Developing Countries in the Global Economy. In O. Canuto & M. Giugale, eds. *The Day After Tomorrow: A Handbook on the Future of Economic Policy in the Developing World*. Washington, D.C.: The World Bank, pp. 31–49.

Canuto, O. & Giugale, M., 2010. Synthesis. In O. Canuto & M. Giugale, eds. *The day after tomorrow : a handbook on the future of economic policy in the developing world*. Washington, D.C.: The World Bank, pp. 1–28.

Carneiro, D.D., 1990. Crise e esperança: 1974-1980. In M. de P. Abreu, ed. *A Ordem do Progresso: Cem Anos de Política Econômica Republicana 1889-1989*. Rio de Janeiro: Elsevier, pp. 295–322.

Carvalho, C.E. et al., 2009. Banco do Sul: A proposta, o contexto, as interrogações e os desafios. *Cadernos PROLAM/USP*, 8(2), pp.113–135.

Castañeda, J.G., 2006. Latin America Left's Turn. *Foreign Affairs*, 85(3), pp.28–43.

Castro, A.B. de & Souza, F.E.P. de, 1985. *A Economia Brasileira em Marcha Forçada*, São Paulo: Paz e terra.

Cavalcanti, C.B., 1988. Transferência de Recursos ao Exterior e Substituição de Dívida Externa por Dívida Interna. , p.95.

Central Bank of Brazil, History of the Central Bank of Brazil. Available at: http://www.bcb.gov.br/pre/historia/historia_bc_en.asp [Accessed July 1, 2016].

Cerqueira, C.A., 2003. *Dívida Externa Brasileira* 2nd ed., Brasília: Banco Central do Brasil.

Chamon, M. & Garcia, M., 2016. Capital controls in Brazil: Effective? *Journal of International Money and Finance*, 61, pp.163–187.

Chase, R.S., Hill, E.B. & Kenedy, P., 1996. Pivotal States and U.S. Strategy. *Foreign Affairs*, 75(1), pp.33–51.

Chin, G. & Helleiner, E., 2008. China as a creditor: a rising financial power? *Journal of International Affairs*, 62(1), pp.87–102.

Chin, G.T., 2014. The BRICS-led Development Bank: Purpose and Politics beyond the G20. *Global Policy*, 5(3), pp.366–373.

Chinn, M. & Frankel, J.A., 2007. Will the Euro Eventually Surpass the Dollar as Leading International Reserve Currency? In Richard H. Clarida, ed. *G7 Current Account Imbalances: Sustainability and Adjustment*. University of Chicago Press, pp. 283–335.

Cintra, M.A.M. ed., 2010. *Cooperação brasileira para o desenvolvimento internacional: 2005-2009*, Brasília: IPEA.

Cohen, B.J., 2015. *Currency Power: understanding monetary rivalry*, New Jersey: Princeton University Press.

Cohen, B., 2014. *Will History Repeat Itself? Lessons for the Yuan*, ABDI Working Paper No 453, Tokyo.

Cohen, B.J., 2012. The Benefits and Costs of and International Currency: Getting the Calculus Right. *Open Economies Review*, 23(1), pp.13–31.

Cohen, B.J., 2009a. Currency and State Power. *Prepared for a conference to honor Stephen D. Krasner, December 4-5*.

Cohen, B.J., 2009b. The Future of Reserve Currencies. *Finance & Development*, 46(3), pp.26–29.

Cohen, B.J., 2004. *The Future of Money*, Princeton: Princeton University Press.

Cohen, B.J., 1998. *The Geography of Money*, Ithaca: Cornell University Press.

Copelovitch, M.S., 2010. *The International Monetary Fund in the Global Economy: Banks, Bonds and Bailouts*, Cambridge, UK: Cambridge University Press.

Cruz, P.D., 1984. *Dívida externa, política econômica: a experiência brasileira nos anos setenta*, São Paulo: Brasiliense.

Cunha, A.M., 2011. A China e o Brasil na nova ordem internacional. *Revista Sociologia e Política*, 19(Suplementar, Dossiê ‘China: desenvolvimento econômico e segurança internacional'), pp.9–29.

Cunha, A.M. et al., 2012. Brazil in the Face of the Chinese Rise: The Risks of Regressive Specialization. *Austral: Brazilian Journal of Strategy & International Relations*, 1(2), pp.129–168.

Cypher, J.M., 2015. Emerging Contradictions of Brazil's Neo-Developmentalism: Precarious Growth, Redistribution, and Deindustrialization. *Journal of Economic Issues*, 49(3), pp.617–648.

Dailami, M. & Masson, P., 2009. *The New Multi-polar International Monetary System*, Washington, D.C.

Dauvergne, P. & Farias, D.B., 2012. The Rise of Brazil as a Global Development Power. *Third World Quarterly*, 33(5), pp.903–917.

Dettmer, M. & Reiermann, C., 2013. Merkel Maligned: IMF Board Attacks Euro Crisis Management. *Spiegel Online International*.

Dooley, M. & Hutchison, M., 2009. Transmission of the U.S. subprime crisis to emerging markets: Evidence on the decoupling–recoupling hypothesis. *Journal of International Money and Finance*, 28(8), pp.1331–1349.

Dooley, M.P., Folkerts-Landau, D. & Garber, P., 2004. *The Revived Bretton Woods System: The Effects of Periphery Intervention and Reserve Management on Interest Rates and Exchange Rates in Center Countries*, NBER Working Paper Series, No 10332.

Drezner, D.W., 2009. Bad Debts: Assessing China's Financial Influence in Great Power Politics. *International Security*, 34(2), pp.7–45.

Edwards, S. & Santaella, J., 1993. Devaluation Controversies in the Developing Countries: Lessons from the Bretton Woods Era. In M. D. Bordo & B. Eichengreen, eds. *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform*. University of Chicago Press, pp. 405–460.

Eichengreen, B., 2014. Banking on the BRICS. *Project Syndicate*. Available at: http://prosyn.org/dvlQVMf [Accessed July 1, 2016].

Eichengreen, B., 2011a. *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*, New York: Oxford University Press.

Eichengreen, B., 2011b. The renminbi as an international currency. *Journal of Policy*

Modeling, 33(5), pp.752–759.

Eichengreen, B., 2009. The Dollar Dilemma - The World's Top Currency Faces Competition. *Foreign Affairs*, 88(5), pp.53–68.

Eichengreen, B., 2008. *Globalizing Capital: a history of the international monetary system* 2nd ed., Princeton: Princeton University Press.

Eichengreen, B. & Gupta, P., 2013. Tapering Talk: The Impact of Expectations of Reduced Federal Reserve Security Purchases on Emerging Markets. *Emerging Markets Review*, 25, pp.1–15.

Eichengreen, B. & Hausmann, R., 1999. *Exchange Rates and Financial Fragility*, NBER Working Paper Series 7418.

Eichengreen, B., Hausmann, R. & Panizza, U., 2007. Currency Mismatches, Debt Intolerance and Original Sin: Why they are not the same and why it matters. In S. Edwards, ed. *Capital Controls and Capital Flows in Emerging Economies: Policies, Practices and Consequences*. University of Chicago Press, pp. 121–169.

Eichengreen, B., Hausmann, R. & Panizza, U., 2005. The Pain of the Original Sin. In B. Eichengreen & R. Hausmann, eds. *Other People's Money: Debt Denomination and Financial Instability in Emerging Market Economies*. Chicago and London: University of Chicago Press, pp. 13–47.

Eichengreen, B. & Kenen, P., 1994. Managing the World Economy under the Bretton Woods System: An Overview. In P. Kenen, ed. *Managing the World Economy: Fifty Years After Bretton Woods*. Washington, D.C.: Institute for International Economics, pp. 3–57.

El-Erian, M.A., 2009. PIMCO Secular Outlook 2009: A New Normal. *PIMCO*.

FDC-CPII, 2007. Brazil's Multinationals Take Off. Fundação Dom Cabral and The Columbia Program on International Investment, Press Release, Nova Lima and New York.

Federal Reserve, 2008. Federal Reserve, Banco Central do Brasil, Banco de Mexico, Bank of Korea, and Monetary Authority of Singapore announce the establishment of temporary reciprocal currency arrangements.

Feldstein, M., 1999. *Self-Protection for Emerging Market Economies*, NBER Working Paper Series, No 6907.

Fico, C., 2008. João Goulart e a 'Operação Brother Sam'. In *O grande irmão: da Operação*

Brother Sam aos anos de chumbo: O governo dos Estados Unidos e a ditadura militar brasileira. Rio de Janeiro: Civilização Brasileira.

Fidler, S., 2009. Going South. *Financial Times*, January 9.

Fiori, J.L., 2011. *Brasil e América do Sul: o desafio da inserção internacional soberana*, Textos para discussão CEPAL - IPEA, No 42, Brasília.

Fishlow, A., 2011. *Starting Over: Brazil since 1985*, Washington, D.C.: Brookings Institution Press.

Fonseca, P.C.D., 2004. Gênese e precursores do desenvolvimentismo no Brasil. *Pesquisa & Debate*, 15(2), pp.225–256.

Fonseca, P.C.D., 2011. O mito do populismo econômico de Vargas. *Revista de Economia Política*, 31(1), pp.56–76.

Fonseca, P.C.D. & Monteiro, S.M.M., 2008. O Estado e suas razões: o II PND. *Revista de Economia Política*, 28(1), pp.28–46.

Franco, G.H.B., 2000. *The Real Plan and the Exchange Rate*, Essays in International Finance, No. 217, Princeton University, Princeton, New Jersey.

Fritz, B. & Prates, D.M., 2013. *The New IMF Approach to Capital Account Management and its Blind Spots: Lessons from Brazil and South Korea*, desiguALdades.net Working Paper Series, No 35, Berlin.

G20, 2008. Declaration of the Summit on Financial Markets and the World Economy.

Gallagher, K.P., 2015. *Ruling Capital: Emerging Markets and the Regulation of Cross-Border Finance*, New York: Cornell University Press.

Gallagher, K.P., Griffith-Jones, S. & Ocampo, J.A., 2012. Capital account regulations for stability and development: A new approach. In *Regulating Global Capital Flows for Long-Run Development*. Boston University/Pardee Centre Task Force Report.

Gallagher, K.P., Irwin, A. & Koleski, K., 2012. *The New Banks in Town: Chinese Finance in Latin America*, Inter-American Dialogue.

Gallagher, K.P. & Porzecanski, R., 2010. *The Dragon in the Room: China & The Future of Latin American Industrialization*, Stanford, California: Stanford University Press.

Garten, J.E., 1999. Lessons for the Next Financial Crisis. *Foreign Affairs*, 78(2), pp.76–92.

Garten, J.E., 1996. The big emerging markets. *The Columbia Journal of World Business*, 31(2), pp.6–31.

Giambiagi, F., 2011. Estabilização, Reformas e Desequilíbrios Macroeconômicos: Os Anos FHC. In F. Giambiagi et al., eds. *Economia Brasileira Contemporânea*. Rio de Janeiro: Elsevier, pp. 165–195.

Gilpin, R., 1987. *The Political Economy of International Relations*, Princeton: Princeton University Press.

Goldman Sachs, 2002. Focus Article: Introducing the 'Lulameter'. *Emerging Markets Strategy*, 2(10), pp.10–12.

Gonçalves, R., 2005. *Economia Política Internacional*, Rio de Janeiro: Elsevier.

Goyal, K., 2014. Rajan Warns of Policy Breakdown as Emerging Markets Fall. *Bloomberg*. Available at: http://www.bloomberg.com/news/articles/2014-01-30/rajan-warns-of-global-policy-breakdown-as-emerging-markets-slide [Accessed July 1, 2016].

Grevi, G., 2011. *The G20 after Cannes: An identity crisis*, Policy Brief, No 105, FRIDE.

Griffith-Jones, S., 2014. *A BRICS Development Bank: A Dream Coming True?*, UNCTAD Discussion Papers, No 215, Geneva.

Grix, J., Brannagan, P.M. & Houlihan, B., 2015. Interrogating States' Soft Power Strategies: A Case Study of Sports Mega-Events in Brazil and the UK, Global Society. *Global Society*, 29(3), pp.463–479.

Helleiner, E., 2010. A Bretton Woods moment? The 2007-2008 crisis and the future of global finance. *International Affairs*, 86(3), pp.619–636.

Helleiner, E., 2014. *The Status Quo Crisis: Global Financial Governance after the 2008 Meltdown*, New York: Oxford University Press.

Helleiner, E. & Kirshner, J. eds., 2009a. *The Future of the Dollar*, Ithaca: Cornell University Press.

Helleiner, E. & Kirshner, J., 2009b. The Future of the Dollar: Whither the Key Currency? In E. Helleiner & J. Kirshner, eds. *The Future of the Dollar*. Ithaca and London: Cornell University Press, pp. 1–23.

Helleiner, E. & Kirshner, J. eds., 2014. *The Great Wall of Money: Power and Politics in China's International Monetary Relations*, New York: Cornell University Press.

Helleiner, E. & Pagliari, S., 2010. Between the storms: patterns in global financial governance, 2001–2007. In G. R. D. Underhill, J. Blom, & D. Mügge, eds. *Global Financial Integration Thirty Years On: From Reform to Crisis*. Cambridge, UK: Cambridge University Press, pp. 42–57.

Helleiner, E. & Pagliari, S., 2011. The End of an Era in International Financial Regulation? A Postcrisis Research Agenda. *International Organization*, 65(Winter), pp.169–200.

Hermann, J., 2011a. Auge e Declínio do Modelo de Crescimento com Endividamento: o II PND e a Crise da Dívida Externa (1974-1984). In F. Giambiagi et al., eds. *Economia Brasileira Contemporânea*. Rio de Janeiro: Elsevier, pp. 73–95.

Hermann, J., 2011b. Reformas, Endividamento Externo e o 'Milagre' Econômico (1964-1973). In F. Giambiagi et al., eds. *Economia Brasileira Contemporânea*. Rio de Janeiro: Elsevier, pp. 49–72.

Hurrell, A., 2010. Brazil and the New Global Order. *Current History*, 109(724), pp.60–66.

Hurrell, A., 2000. Some Reflections on the Role of Intermediate Powers in International Institutions. In A. Hurrell et al., eds. *Paths to Power: Foreign Policy Strategies of Intermediate States*. Woodrow Wilson International Center for Scholars, Latin American Program, pp. 1–10.

IEO, 2003. *The IMF and Recent Capital Account Crises: Indonesia, Korea and Brazil*, Washington, D.C.

Ikenberry, G.J., 2008. The Rise of China and the Future of the West: Can the Liberal System Survive? *Foreign Affairs*, 87(1), pp.23–37.

IMF, 2012. *The Liberalization and Management of Capital Flows - An Institutional View*, Policy Survey Paper.

IMF, 2011. Major Expansion of IMF Borrowing Arrangements Takes Effect, Boosting Resources for Crisis Resolution.

IMF, 2009. *Financing IMF Transactions Quarterly Report*, http://www.imf.org/external/np/tre/ftp/2009/100109.htm

IMF, 2008. *World Economic Outlook: Financial Stress, Downturns and Recoveries*, Washington, D.C.: IMF.

IMF, 2007. *World Economic Outlook: Spillovers and Cycles in the Global Economy*, Washington, D.C.: IMF.

IMF, 2004. *World Economic Outlook*, Washington, D.C.

IMF, 1998. Brazil Letter of Intent, November 13.

Isard, P., 2005. *Globalization and the international financial system: what's wrong and what can be done*, Cambridge, UK: Cambridge University Press.

James, H., 2010. Unlearnt lessons of the Great Depression. *Financial Times*, January 3.

Jenkins, R., 2012. China and Brazil: Economic Impacts of a Growing Relationship. *Journal of Current Chinese Affairs*, 41(1), pp.21–47.

Kilborn, P.T., 1987. Brazil debt plan barred by Baker. *The New York Times*, September 3.

Kim, J.Y., 2013. Statement on a Memorandum of Understanding Signing on Knowledge and Innovation Initiative in Brazil, Speech Transcript.

Kindleberger, C.P., 1970. *Power and money: the politics of international economics and the economics of international politics*, London and Basingstoke: Macmillan and Co LTD.

Kirshner, J., 2014. *American Power After the Financial Crisis*, New York: Cornell University Press.

Kirshner, J., 1995. *Currency and Coercion: The Political Economy of International Monetary Power*, Princeton: Princeton University Press.

Kirshner, J., 2003. The Inescapable Politics of Money. In J. Kirshner, ed. *Monetary Orders: Ambiguous Economics, Ubiquitous Politics*. Ithaca and London: Cornell University Press, pp. 3–24.

Klein, M.W., 2012. *Capital controls: Gates versus walls*, NBER Working Paper Series 18526.

Kose, M.A. et al., 2006. *Financial Globalization: A Reappraisal*, NBER Working Paper Series 12484.

Kose, M.A. & Prasad, E., 2010. *Emerging Markets: Resilience and Growth Amid Global Turmoil*, Washington, D.C.: Brookings Institution Press.

Latin America News, 2009. France's Sarkozy in Brazil. *Latin American regional report: Brazil & Southern Cone*, p.11.

Lélis, M.T.C., Cunha, A.M. & Lima, M.G. de, 2012. Desempeño de las exportaciones de

China y el Brasil hacia América Latina, 1994-2009. *Revista CEPAL*, 106, pp.57–77.

Lessa, C., 1978. *A estratégia de desenvolvimento, 1974/76: sonho e fracasso*. UFRJ.

Lima, L.A. & Barros, O. de, 2013. Brazil: Outward FDI and its policy context, 2009. In K. P. Sauvant, P. Mallampally, & G. McAllister, eds. *Inward and Outward FDI country profiles*. New York: Vale Columbia Center on Sustainable International Investment, pp. 653–657.

Lord, J., 2013. EM Currencies: the Fragile Five. In Morgan Stanley, ed. *FX Pulse*. Morgan Stanley, pp. 15–19.

Loureiro, F.P., 2014. The Alliance For or Against Progress? US–Brazilian Financial Relations in the Early 1960s. *Journal of Latin American Studies*, 46(2), pp.323–351.

Love, J.L. & Baer, W. eds., 2009. *Brazil under Lula: Economy, Politics, and Society under the Worker-President*, New York: Palgrave Macmillan.

Lowrey, A., 2012. U.S. Candidate Is Chosen to Lead the World Bank. *The New York Times*, April 16.

Malamud, A., 2011. A Leader Without Followers? The Growing Divergence Between the Regional and Global Performance of Brazilian Foreign Policy. *Latin American Politics and Society*, 53(3), pp.1–24.

Malan, P., 1983. Verbete: Superintendência da Moeda e do Crédito (SUMOC), Dicionário Histórico-Biográfico Brasileiro, FGV, p.3284.

Maziad, S. et al., 2011. *Internationalization of Emerging Market Currencies: A Balance between Risks and Rewards*, IMF Staff Discussion Note, SDN/11/17, IMF, Washington, D.C.

Mesquita, M. & Torós, M., 2010. *Considerações sobre a Atuação do Banco Central na Crise de 2008*, Trabalhos para Discussão, No 202, Banco Central do Brasil.

Ministério da Fazenda, 2010. *Economia Brasileira em Perspectiva*, Brasília.

Morais, L. & Saad-Filho, A., 2011. Da economia política à política econômica: o novo-desenvolvimentismo e o governo Lula. *Revista de Economia Política*, 31(4), pp.507–527.

Naím, M., 1995. Latin America the Morning After. *Foreign Affairs*, 74(4), pp.45–61.

Neri, M., 2011. *Desigualdade de Renda na Década*, Rio de Janeiro: FGV.

Neto, D.M. de P., 1990. O Interregno Café Filho, 1954-1955. In M. de P. Abreu, ed. *A Ordem do Progresso: Cem Anos de Política Econômica Republicana 1889-1989*. Rio de Janeiro: Elsevier, pp. 151–169.

Noble, G.W. & Ravenhill, J., 2000. Causes and Consequences of the Asian Financial Crisis. In G. W. Noble & J. Ravenhill, eds. *The Asian Financial Crisis and the Architecture of Global Finance*. Cambridge, UK: Cambridge University Press, pp. 1–35.

Nye, J.S., 1991. *Bound to Lead: The Changing Nature of American Power*, New York: Basic Books.

O'Neill, J., 2001. *Building Better Global Economic BRICs*, Global Economics Paper, No 66, Goldman Sachs.

Ocampo, J.A., 2001. *International Asymetries and the Design of the International Financial System*, Santiago, Chile.

Ocampo, J.A., 2006. Regional Financial Cooperation: Experiences and Challenges. In J. A. Ocampo, ed. *Regional Financial Cooperation*. Washington, D.C.: Brookings Institution Press and UN Economic Commission for Latin America and the Caribbean, pp. 1–39.

OECD, 2007. OECD countries launch accession talks with five prospective new members. Available at: http://www.oecd.org/russia/oecdcountrieslaunchaccessiontalkswithfiveprospectivenewmembers.htm [Accessed July 16, 2016].

Oppenheimer, A., 2012. Region's first 'virtual summit' should set the trend. *Miami Herald*, March 7.

Palma, G., 2005. Four Sources of 'De-industrialisation and a New Concept of the 'Dutch Disease'. In J. A. Ocampo, ed. *Beyond reforms: structural dynamics and macroeconomic vulnerability*. Stanford, California: Stanford University Press.

Paula, L.F. de, Modenesi, A. de M. & Pires, M.C.C., 2015. The tale of the contagion of two crises and policy responses in Brazil: a case of (Keynesian) policy coordination? *Journal of Post Keynesian Economics*, 37(3), pp.408–435.

Pechman, C., 1983. *O Mercado Paralelo de Dólares no Brasil*. FGV-RJ.

Pedras, G.B.V., 2010. History of Public Debt in Brazil: 1964 to the Present. In A. C. Silva, L.

O. de Carvalho, & O. L. de Medeiros, eds. *Public Debt: the Brazilian Experience*. Brasília: National Treasury Secretariat, pp. 53–72.

Politi, J., 2013. Brazil sets fresh sparks with IMF over Greek bailout rebuke. *Financial Times*, August 8.

Prasad, E. & Ye, L., 2012. Will the Renminbi Rule? *Finance & Development*, 49(1), pp.26–29.

Prates, D.M., 2007. A alta recente dos preços das commodities. *Revista de Economia Política*, 27(3), pp.323–344.

Prates, D.M., 2005. As Assimetrias do Sistema Monetário e Financeiro Internacional. *Revista de Economia Contemporânea*, 9(2), pp.263–288.

Prates, D.M. & Paula, L.F. de, 2017. Capital account regulation in Brazil: An assessment of the 2009-2013 period. *Brazilian Journal of Political Economy*, 37(1), pp.108–129.

Reinhart, C.M., Rogoff, K.S. & Savastano, M.A., 2003. *Debt Intolerance*, NBER Working Paper Series, No 9908.

Resende, A.L., 1982. A política brasileira de estabiliazação: 1963/68. *Pesquisa e Planejamento Econômico*, 12(3), pp.757–806.

Resende, A.L., 1990. Estabilização e Reforma: 1964-1967. In M. de P. Abreu, ed. *A Ordem do Progresso: Cem Anos de Política Econômica Republicana 1889-1989*. Rio de Janeiro: Elsevier, pp. 213–231.

Reuters, 2015. China signs off on $5 billion loan to boost Venezuela oil output: Maduro. *Reuters*, September 2.

Rodrik, D., 2006. The Social Cost of Foreign Exchange Reserves. *International Economic Journal*, 20(3).

Roett, R., 2011. *The New Brazil*, Washington, D.C.: Brookings Institution Press.

Rohter, L., 2012. *Brazil on the Rise: The Story of a Country Transformed*, New York: Palgrave Macmillan.

Sarkozy, N., 2011. President Sarkozy launches French G20/G8 presidency, Press conference to present the French presidency of the G20 and G8.

Sennes, R.U. & Narciso, T., 2009. Brazil as an International Energy Player. In L. Brainard &

L. Martinez-Diaz, eds. *Brazil as an Economic Superpower? Understanding Brazil's Changing Role in the Global Economy*. Washington, D.C.: Brookings Institution Press, pp. 17–54.

Silva, A.C., 2010. Origin and history of Brazil's public debt up to 1963. In A. C. Silva, L. O. de Carvalho, & O. L. de Medeiros, eds. *Public Debt: the Brazilian Experience*. Brasília: National Treasury Secretariat, pp. 31–52.

Sotero, P., 2010. Brazil's Rising Ambition in a Shifting Global Balance of Power. *Politics*, 30(S1), pp.71–81.

Sotto, A. & Parra-Bernal, G., 2013. Brazil asks IMF to review way it calculates debt. *Reuters*, July 27.

Spektor, M., 2014. *18 dias: Quando Lula e FHC se uniram para conquistar o apoio de Bush*, Rio de Janeiro: Editora Objetiva.

Spektor, M., 2010. Lincoln Gordon (1913-2009), o internacionalismo liberal da Guerra Fria no Brasil. *Política Externa*, 18(4), pp.146–150.

Spiegel, P., 2013. Latin American countries rail against IMF over Greek bailout. *Financial Times*, July 31.

Steil, B., 2014a. Taper Trouble: The international consequences of Fed Policy. *Foreign Affairs*, 93(4), pp.54–61.

Steil, B., 2014b. The Brics Bank is a feeble strike against dollar hegemony. *Financial Times*, October 1.

Steil, B., 2013. *The Battle of Bretton Woods: John Maynard Keynes, Harry Dexter White, and the Making of a New World Order*, Princeton and Oxford: Princeton University Press.

Stiglitz, J., 2014. Nobel Economist Joseph Stiglitz Hails New BRICS Bank Challenging U.S.-Dominated World Bank & IMF. *Democracy Now*.

Stiglitz, J.E. et al., 2009. *Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System*, New York.

Stone, R.W., 2011. *Controlling Institutions: International Organizations and the Global Economy*, Cambridge University Press.

Strange, S., 1994. *State and Markets* 2nd Ed., London: Pinter Publishers.

Subramanian, A., 2011. *Eclipse: Living in the Shadow of China's Economic Dominance*, Washington, D.C.: Peterson Institute for International Economics.

Summers, L.H., 2000. International Financial Crises: Causes, Prevention, and Cures. *The American Economic Review*, 90(2), pp.1–16.

Talev, M. & Colitt, R., 2012. Rousseff Tells Obama Rich Nations' Policies Harm Growth. *Bloomberg*.

The Economist, 2013. Grounded: special report Brazil.

The Economist, 2012. Kim for president.

The Economist, 2009. Brazil Takes Off. November, pp.14–20.

The Economist, 2008. Making the grade: Brazil gets recognition for improved economic management.

The Economist, 2004. The hungry dragon.

The Economist, 2003. A copper-bottomed boom? October 2.

The Economist, 1977. The Dutch Disease.

Triffin, R., 1957. *Europe and the Money Muddle: From Bilateralism to Near-Convertibility, 1947-1956*, Yale University Press.

Triffin, R., 1960. *Gold and the dollar crisis: the future of convertibility*, New Haven: Yale University Press.

Trinkunas, H., 2014. Brazil's Rise: Seeking Influence on Global Governance, Latin America Initiative Foreign Policy at Brookings.

Tude, J.M. & Milani, C.S., 2013. The Brazilian Foreign Policy concerning the International Monetary Fund during the Lula Administration. *Revista Brasileira de Política Internacional*, 56(1), pp.85–103.

UNCTAD, 2005. *Trade and Development Report*, Geneva.

Vianna, S.B., 1986. As relações Brasil-EUA e a política do segundo governo Vargas. *Revista Brasileira de Economia*, 40(3), pp.193–210.

Vianna, S.B. & Villela, A., 2011. O pós-Guerra (1945-1955). In F. Giambiagi et al., eds. *Economia Brasileira Contemporânea: 1945-2010*. Rio de Janeiro: Elsevier, pp. 1–24.

Vizentini, P.F., 2005. De FHC a Lula: uma década de política externa (1995-2005). *Civitas*, 5(2), pp.381–397.

Wade, R.H., 2011. Emerging world order?: from multipolarity to multilateralism in the G20, the World Bank, and the IMF. *Politics & Society*, 39(3), pp.347–377.

Wade, R.H. & Vestergaard, J., 2015. Impasse at the IMF, Bretton Woods Project.

Wheatley, J. & Garnham, P., 2010. Brazil in ‘currency war’ alert. *Financial Times*.

Williamson, J., 2004. A Short History of the Washington Consensus, Paper commissioned by Fundación CIDOB for a conference “From the Washington Consensus towards a new Global Governance,” Barcelona, September 24–25.

Williamson, J., 2000. What Should the World Bank Think About the Washington Consensus? *World Bank Research Observer*, 15(2), pp.251–264.

Wilson, D. & Purushothaman, R., 2003. *Dreaming With BRICs: The Path to 2050*, Global Economics Paper, No 99, Goldman Sachs.

World Bank, 2008. *Country Insurance: Reducing Systemic Vulnerabilities in Latin America and the Caribbean (Report No. 43066-LAC).*

World Bank, 2011. *Global Development Horizons 2011 - Multipolarity: The New Global Economy*, Washington, D.C.

WTO, 2014. Trade Profiles 2014.

Zhou, X., 2009. Reform the International Monetary System.