Economic growth in Brazil under the presidency of Fernando Henrique Cardoso (1995-2002): a heterodox perspective

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Resumo:

Esse artigo estuda os padrões de crescimento econômico do Brasil durante o experimento neoliberal dos governos de Fernando Henrique Cardoso (1995-2002) seguindo a visão do crescimento liderado pela demanda. Com esse propósito, este texto se concentra no estudo dos componentes da demanda agregada e analisa de forma separada os dois mandatos de Fernando Henrique Cardoso (1995-98 e 1999-2002), levando em conta o fato que uma política macroeconômica diferente é associada a cada período. O artigo estabelece que a economia brasileira cresceu a taxas maiores durante os anos nos quais a demanda interna liderou a economia, especialmente através do consumo e do investimento. O trabalho ainda mostra que houve uma serie de crises durante o período que afetaram negativamente as taxas de crescimento econômico.

Palavras-chave: Fernando Henrique Cardoso; crescimento liderado pela demanda, economia brasileira.

Abstract:

This article examines Brazil´s economic growth patterns during the neoliberal experiment of Fernando Henrique Cardoso´s governments (1995-2002) from a demand-led growth perspective. For this purpose, it focuses on aggregate demand components and separately analyzes Fernando Henrique Cardoso´s two terms (1995-98 and 1999-2002), taking into account that there was a different macroeconomic policy in each of these two terms. The article concludes that Brazil´s economy grew at higher rates in the years wherein domestic demand drove the economy, notably household consumption and investment. Moreover, it shows that there was a series of crises within the period, which affected economic growth rates.

Keywords: Fernando Henrique Cardoso; demand-led growth; Brazilian economy.

Área temática:

Introduction

In 2016, there was a shift in Brazil´s developmental model with the impeachment of the center-left-wing Labor Party´s president Dilma Rousseff and the ascent of center-right wing vice-president Michel Temer. The new president´s economic agenda meant a resurgence of a neoliberal strategy in Brazil. Accordingly, Temer´s government (2016-18) reformed labor market regulations, introduced radical austerity rules and embraced the idea that Brazil should increase its economic openness and resume a privatization program. Although Temer economic results were very poor, the

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election of now president Jair Bolsonaro in 2018 meant the continuation of Temer´s economic policies. Whilst Bolsonaro is usually regarded as a populist extreme-right politician, his Finance Minister Paulo Guedes is a fierce supporter of a neoliberal agenda. Brazilian policy-makers current enthusiasm with neoliberal policies calls for a new look at the country´s experience in the 1990s.

During the 1990s, Brazil – alongside most Latin American countries – adopted a neoliberal agenda based on privatizations, trade openness, attracting foreign direct investment and the partial dismantlement of developmental institutions. The outcome was a higher integration to the world economy through foreign investment and international finance but with a disappointing rate of economic growth. This was especially the case under the presidency of Fernando Henrique Cardoso (1995-2002). It is possible to divide Cardoso's eight years as president in two phases. The first phase is Cardoso's first term (1995-1998) wherein there was a macroeconomic regime based on a semi-fixed overvalued exchange rate regime, very high average real interest rates and deteriorating fiscal conditions. The second phase was the second term (1999-2002), in which the macroeconomic regime consisted on the so-called tripod: inflation targets, flexible exchange rate and primary fiscal surpluses. Regardless of the phase, there were low inflation rates during Cardoso's government, but also modest economic growth rates, high unemployment rates and lack of structural change.

More than fifteen years after the end of Cardoso´s government, it is time for a balanced new look on its legacy, especially in a context wherein neoliberalism re-emerged in Brazil and in Latin America. In this context, the aim of this paper is to provide an analytical overview of Cardoso years' from a demand-led growth perspective, with a special interest in the modest economic growth rates. For this purpose, it bases the analysis of Brazil´s economic growth performance during Cardoso years on the behavior of aggregate demand GDP components alongside the period, combining them with some remarks regarding structural change.

The contribution of the paper is twofold. Firstly, it provides an updated analysis of Cardoso years in English. The literature on Cardoso years has been relatively scarce in recent years, especially the literature in English on the subject. On the one hand, there are some too general overviews of the period in sorts of handbooks on Brazil´s economic History. This is for instance the case of Baer (2013) and Fishlow (2011), which have chapters on Cardoso years. In a different perspective, Saad-Filho and Morais (2018) analyze the period from a Political Economy perspective based on what they call *Systems of Accumulation*. On the other hand, there are papers dealing with some specific issues, like for instance Ferraz et al. (2003) on industrial policy and trade openness and Amann and Baer (2002) on poverty and redistribution. As previously noted, most of these papers are now old. Furthermore, some of them do not specifically target FHC´s years in power.

A second contribution of the paper is to focus on the aggregate demand components. Analysis of Brazil´s economy during Fernando Henrique Cardoso´s (FHC) government based on aggregate

demand components are rare even in Portuguese[3]. Most of the work has concentrated on supply-side factors or just aggregate GDP growth data. An economic analysis of the period in English, centered on the demand-side components of economic growth, providing some remarks on structural change and taking into account the two different macroeconomic regimes is still missing. It is even more the case taken into account that there are some recent work – like for instance Orair (2016) data on Brazil´s public investment and state-owned enterprises investment – that shed new light on the performance of aggregate demand components[4]. Hence, the paper fills a gap in the existing literature.

I –The early 1990s and the rise of neoliberalism in Brazil

Neoliberalism can mean different things depending on who is writing. There are multiple interpretations and definitions. In general, neoliberalism derives from the idea of a *primacy of markets*. Accordingly, neoliberal governments tend to defend private ownership and foster competition within the economy. This usually results in an agenda based on privatizations, reduction in the size of the state (by means for instance of cuts on welfare expenses and abolishment of industrial policies), trade openness and financial openness.

In any case, "neoliberal governance has been moulded to reflect local, social, political and cultural practices, national institutions and social and labour movements as well as global ideas, meaning that there are geographically distinct forms of neoliberalism" (Grugel & Riggirozzi, 2018: 548). In the United States and the United Kingdom, the ascent of neoliberalism in the late 1970s and early 1980s was very much a reaction to the 1970s *stagflation* process and to the rise in trade unions bargaining power during the Golden Age. In any case, it was a shift in the internal balance of power and came with the electoral victories of Ronald Reagan and Margaret Thatcher. Latin American shift to neoliberalism was partly due to outside pressure[5]. But, as Medeiros (2013: 229) wrote:

> "The crisis of the developmental state was similar to the end of the Keynesian national welfare state in industrialised countries. If the latter was associated with the end of the subordination of monetary and fiscal policy to full employment, the former crisis was

3 Serrano (1998) is one of the few exceptions. In any case, he only deals with FHC´s first term. Freitas and Dweck (2013) do provide a demand-led perspective on Brazil´s growth in English. However, the aim of their work is to develop an empirical (demand-led) growth accounting methodology to examine Brazil´s economic growth in the long period 1970-2015. As a result, their work does not discuss in detail any specific period.

4 Public sector investment data is not directly available, meaning that obtaining them involves combining different databases and sometimes estimating to compensate the absence of data.

5 "Neoliberalism was introduced in the United States as the result of a new political coalition between big business and small and medium-sized enterprises, which by 1980 had effectively isolated organized labor politically. In Brazil, the institutions of regulated capitalism were created by a developmental state whose demise was precipitated by an abrupt change in external conditions, resulting in the foreign debt crisis of the 1980s. As in the United States, neoliberalism in Brazil was largely the result of a political coalition, formed over the course of the 1980s, that unified (to a large extent) the various segments of the dominant classes." (Medeiros & Trebat, 2021: 410)

> connected with the end of the subordination of fiscal and monetary policy to industrial development" (Medeiros, 2013: 229)

As Amann and Baer (2002: 945) observe, the debt crisis of the 1980s and the desperate need of capital flows made Latin American countries extremely vulnerable to the demands and pressures of multilateral institutions and major industrial countries.

In this context, John Williamson (1989) observed that multilateral institutions in Washington d.C and the US government somewhat mutually agreed on a package of reforms and policies, labeled the *Washington Consensus*, that Latin American countries should pursue to foster economic growth and solve their macroeconomic problems. In most of the cases, Latin America´s option for neoliberalism meant the adoption of the so-called *Washington Consensus* (1989) or some variant of it. In other words, the economic policy, and reforms of the Washington Consensus (WC) were neoliberalism´s incarnation in Latin America. Among the most important measures of the WC, there were: "1) attack on inflation; 2) privatization of state-owned enterprises; 3) trade liberalization; 4) prevalence of market interest rates; 5) Opening to most sectors to foreign competition and substantially decreasing the controls over actions of foreign capital" (Williamson, 1993 *apud* Ammann & Baer, 2002: 946).

Brazil´s neoliberal experience started in the early 1990s under the presidency of Fernando Collor de Mello (1990-92). Collor´s option for a neoliberal agenda was no surprise: during the 1989 presidential election campaign – the first free presidential election in Brazil since 1961 – he openly proposed an economic program based on privatizations and trade openness. He argued that Brazil´s industry was obsolete and inefficient, so that increased competition and private ownership were mandatory to foster investments and modernization. The most remarkable was his criticisms regarding Brazil´s car industry.

As a result, Collor abandoned Brazil´s imports substitution model - which was in place at least since the 1950s – a model strongly based on public investments, public subsidized credit and protectionist policies. Accordingly, Collor´s government launched a privatization program of public enterprises. It did not advance too much because of a variety of reasons, namely some Constitutional constraints to selling domestic assets to foreign investors and the financial crises of several public enterprises. In any case, it privatized CSN (*Companhia Siderúrgica Nacional)*, a public steel company, which was a symbol of Brazil´s state-led development model. Moreover, it also launched a trade openness program. It eliminated several quantitative trade barriers and introduced a progressive imports tariffs reduction in several sectors, like for instance capital goods and automobile industry. The average imports tariff fell from 32.2 percent in 1990 to 21.2 percent in 1992 and later to 14.2 percent in 1994 (Castro, 2011: 133-138).

Fernando Henrique Cardoso´s government extended Collor´s agenda targeting the building of a new development model[6]. Cardoso´s deliberately led a move wherein the state would shift its role from a *direct provider of goods and services* – as was the case in the import´s substitution era - into a *regulator*. Privatization and ending monopolies to foster markets were a landmark of the program, resulting in the creation of several regulation agencies, notably in the telecommunications, electric energy and oil sectors. Economic openness would trigger competition and efficiency and the attraction of Foreign Direct Investment (FDI) would induce a technology upgrade in Brazil´s industry. Traditional industrial policies focused on specific winners or aimed at *picking winners* were abandoned.

José Roberto Mendonça de Barros and Lídia Goldenstein (1997) - two leading figures in Cardoso´s economic policy team during his first term (1995-1998)[7] - made some of these points clear in a 1997 article. According to them, economic openness was mandatory due to the technological, financial, and commercial revolution the world was experiencing. They argued that there were four driving forces during Cardoso´s government: 1) economic openness; 2) privatization; 3) economic stabilization; 4) a new wave of foreign direct investment. The combination of them was breaking the old development model from the 1950s to the 1990s – based on the *tripod* state-owned enterprises, national private family-based enterprises and multinationals – and giving rise to a new development model (Mendonça de Barros & Goldenstein, 1997: 11).

Gustavo Franco, another key figure among Cardoso´s first term economic policymakers[8], also emphasized the importance of economic openness. Franco (1998) suggested the leading role of transnational companies in an era of globalization, defending the growing importance of foreign direct investment to economic development. During the 1980s, Brazil lost many chances of attracting FDI due to macroeconomic instability and protectionist local policies. Hence, economic openness was necessary to foster FDI and thus increase economic growth. More precisely, he argued that economic openness would positively affect the country´s technological dynamics, thus accelerating productivity growth and economic growth (Franco 1998: 122-25). In fact, Franco argued that productivity growth stemming from private investment was the key of this new economic development model. As a result, economic development was due to private investors´ *confidence* instead of state´s planning, as was the case during the import´s substitution era (Franco 1998: 143).

[6] Fernando Collor left office in 1992 due to a corruption scandal that led to his impeachment. The vice-president Itamar Franco replaced him and completed Collor´s mandate. Fernando Henrique Cardoso came to power after winning in the first round of the 1994 presidential elections.

[7] José Roberto Mendonça de Barros was *Economic Policy Secretary* in the Finance Ministry, meaning the number two in the Finance Ministry. Lídia Goldenstein was advisor at BNDES, Brazil´s National Development´s Bank.

8 Gustavo Franco was first Director of Exchange Rate Policy of Brazil´s central bank (1995-97) and then Governor of Brazil´s central bank (1997-99).

In any case, whilst the liberalization and privatization agenda was important in Cardoso´s years, the priority was macroeconomic stabilization. Brazil spent a long period with very high inflation, especially during the 1980s and early 1990s. Annual inflation rates – based on IPCA, a consumer price index calculated by Brazil´s official statistics bureau (IBGE) – were above 300 percent every year from 1986 to 1993, reaching 2,477 percent in 1993. Throughout this period, there were several stabilization plans that failed until the *Plano Real* ('Real Plan'*)* (1994) finally achieved the goal of price stability. By the way, the plan´s success was crucial to Fernando Henrique Cardoso´s win in the 1994 Presidential Elections since Cardoso was the Finance Minister that led the team that formulated the 'Real Plan'. Keeping inflation under control was also central to Cardoso´s second win in the 1998 Presidential Elections.

Alongside Cardoso´s years, the development model remained the same. In fact, one can argue that the development model was part of the stabilization agenda in the sense that growing competition stemming from economic openness - and the increased efficiency that would allegedly result from privatizations – were regarded as tenets for price stability[9]. Nevertheless, there were two different macroeconomic regimes during Cardoso's years, coinciding precisely with his first and second terms. Taking into account Brazil´s inflation standards during the 1980s and early 1990s, inflation rates were under control in both Cardoso´s terms: in the first term, the average inflation rate was 9.71 percent, whereas in the second term it was 8.78 percent. However, figure 1 shows that there are some interesting qualitative differences between the two phases regarding economic growth. It suggests that aggregate *domestic demand* drove economic growth during the first term, whereas *external demand* became much more important during the second term.

Figure 1 – Average growth rates (%) during FHC´s presidency (1995-2002)

	FHC I (1995-1998)	FHC II (1999-2002)	FHC (1995-2002)
GDP	2.5	2.3	2.4
Household consumption	3.6	1.7	2.6
Public consumption	1.0	2.3	1.6
Investment	4.3	-2.0	1.2
Exports	3.4	9.0	6.2
Imports	12.7	-3.7	4.5

Source: IBGE for all GDP data and for GDP components in the period 1996-2002. For data of GDP components in 1995, the source was banco Sidra *apud* Giambiagi et. al. (2011)

[9] Franco (1998) argues that when fiscal and monetary fundamentals become sound, the stabilization agenda and the development agenda become one. Mendonça de Barros and Goldenstein (1997) propose that economic stabilization was part of a process that was imposing a new development model for Brazil. Gesner Oliveira - an economist closely associated to Brazil´s Social Democratic Party (PSDB), Cardoso´s party - argued that structural reforms, namely a State reform and opening the economy, was a part of the stabilization plan. In the Brazilian case, they would be the fourth stage of the Real Plan (Oliveira, 1996: 75-76).

The fact that average GDP growth rates were very similar in both periods (2.5 percent and 2.3 percent) may seem that it was indifferent if the economy domestic demand or external demand drives the economy. However, these data call for a closer look at both regimes and periods.

II – The first term of Fernando Henrique Cardoso (1995-1998)

When it comes to FHC´s first government, a starting point is the 'Real Plan'. The plan consisted of three phases. The first (1993) was a fiscal adjustment, which ended being a minor part of the plan. De-indexation was the pillar of the second phase, which was the most important and creative part of the plan. Alongside the period of high inflation rates, Brazil developed a system of widespread indexation. Eliminating this indexation system was mandatory for the plan to succeed[10]. The Real Plan policy-makers developed then an ingenious mechanism to eliminate indexation based on the launch of a unit of account (URV) and efforts to" make it the sole index for all indexation provisions" (Franco, 2000: 10). The second phase (March 1994 to June 1994) consisted of transition period wherein the official national currency (*Cruzeiro Real*) kept circulating and the URV should become this overall index. The final stage of the second phase was the new currency launch, which occurred on 1 July 1994. As Franco (2000) explains, on this day "the URV was issued as a full currency and its name was changed to *real*" (Franco, 2000: 10).

The third phase was all about introducing a nominal anchor to prices after the launch of the new currency. This phase was very much a trial-and-error pragmatic process. At first, there was an awkward combination of monetary targets and a fixed exchange rate on a 1:1 conversion rate with the dollar. In reality, the exchange rate was (downwards) flexible. There was a rapid and strong appreciation of the nominal exchange rate thanks to the massive inflow of capitals following the launching of the new currency. As a result, the exchange rate fell to 0.84 *reais* per dollar, a 21 percent real devaluation from June 1994 to September 1994. Furthermore, the central bank failed to meet the monetary targets, a very likely result taken into account the re-monetization of the economy that usually follows a stabilization plan.

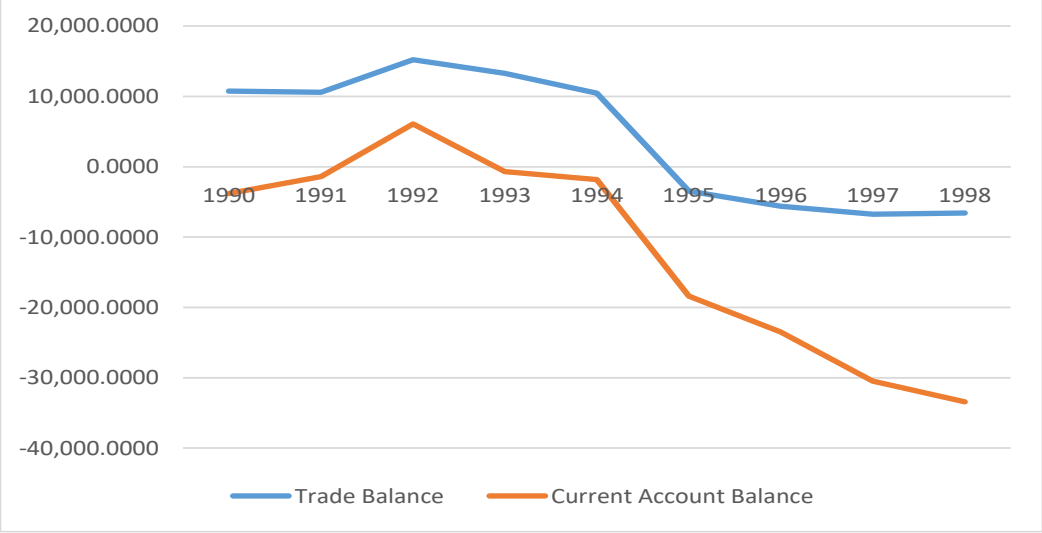
From September 1994 on, the central bank abandoned the monetary targets and Brazil moved to an actual exchange rate anchor taking into account that the nominal exchange rate remained almost stable around 0.84 *reais* per dollar in the following months. In any case, the real exchange rate kept appreciating: there was an almost 30 percent real appreciation of the new currency from June 1994 to January 1995. In the face of the contagion from Mexican peso crisis of December 1994 (the so-

10 The absence of a successful de-indexation process would prevent a relative-price neutrality transition to stability, meaning the existence of winners and losers from the stabilization program. As losers would most likely try to recover their real income loses, their claims for readjustments could jeopardize the stabilization program (Franco, 2000: 9).

called *Tequila effect*), the central bank induced a 5 percent devaluation of the exchange rate in March 1995 and introduced a targets zone regime. It started to intervene in the exchange rate market on a daily basis, establishing in practice a mini-target zone inside the larger target zone. On October 1995, the central bank further turned the exchange rate system flexible by successively dislocating upwards the upper band and lower band of the target zones, meaning a continuous average 0.6 percent monthly devaluation of the exchange rate from this point on (Modenesi, 2005). In any case, this move only slightly reverted the initial 30 percent appreciation of the new currency: the prevailing real exchange rate in December 1998 was still more than 20 percent appreciated compared to the real exchange rate before the implementation of the stabilization plan.

The over-appreciation of the national currency combined with trade openness explain much of the performance of Brazil´s exports and imports during the period 1995-1998. In fact, Brazil had huge trade surpluses in the first years of the 1990s, which rapidly turned into trade deficits in the second semester of 1994, shortly after the launching of the new currency and its sharp appreciation. These trade deficits continued throughout the four years of the first term, leading to increasing current account deficits (see figure 2). The trade deficits occurred despite the terms of trade increase alongside the period: according to data from the United Nations Conference on Trade (UNCTAD), Brazil´s terms of trade increased 13.2 percent from 1994 to 1998.

Figure 2 – Trade and Current Account Balances (1990-98)



Source: Ipeadata

Due to the recurrent and increasing current account deficits, Brazil´s central bank had to keep nominal interest rates at very high levels in order to attract foreign capital, especially after episodes of *sudden stops* in capital flows, which were frequent in this period. Besides the *Tequila effect* from late 1994 and early 1995, there were other episodes of this kind in the second semester of 1997 during the Asian crisis and in the second semester of 1998 following the Russian crisis. Due to these trade and current account deficits and the attraction of foreign capital, there was an increase in the country´s

external vulnerability during the period of FHC´s first term. Indicators of external liquidity crisis – like short-term external debt as a share of international reserves - and of external solvency crisis – like for instance current account balance as a share of exports and net external debt as a share of exports – show the increase in Brazil´s external vulnerability in the period[11]. In fact, short-term external debt as a share of international reserves did not show an explosive trend from 1994 to 1998. On the contrary, it fell from 0.74 at the end of the fourth quarter of 1994 to 0.70 at the end of the fourth quarter of 1997 and then to 0.59 at the end of the fourth quarter of 1998, when Brazil was already under a speculative attack. However, this fall from 1997 to 1998 was probably due to the capital outflows in third and fourth quarters of 1998, following the Russian currency crises of August 1998. Moreover, a 0.70 ratio means that the short-term external debt– which is a type of debt that can very fast turn into a capital flight – represented 70 percent of the country´s total international reserves. In other words, a ratio of 070 shows vulnerability, which was the case at the end of the previous year to Brazil´s 1998 currency crisis. In any case, Brazil´s vulnerability during FHC´s first term is clear when one looks at two other indicators: current account balance as a share of exports and net external debt as a share of exports. The current account balance as a share of exports exploded, rising from -0.04 in 1994 to -0.65 in 1998. Finally, the indicator net external debt as a share of exports increased from 2.0 in 1994 to 3.6 in 1998. In other words, an increase equal to 80 percent in the first term of FHC´s government.

In sum, an over-appreciated real exchange rate and very high nominal and real interest rates were two major aspects of Brazil´s macroeconomic regime in the first term of FHC´s government. In the face of a growing external vulnerability and an increasing volatility in the international capital markets in the second half of the 1990s, the strategy of raising the interest rates to prevent a currency crisis - which worked from 1994 to 1997 - was insufficient to contain the massive speculative attack against the Brazilian currency following the Russian crisis in the second semester of 1998. After months losing international reserves, Brazilian policy-makers decided to abandon the targets zone system and let the currency float at the beginning of the year 1999.

The high interest rates alongside FHC´s first term affected household consumption. After an initial consumption boom in the second semester of 1994 after inflation rates sharply fell with the launch of Real – a common feature in stabilization plans – the interest rates hike in the context of *Tequila* effect negatively affected household consumption (Serrano, 1998). This was a common pattern during the period 1995-98: every time there was a *sudden stop*, the central bank aggressively raised the interest rates, affecting household consumption in the following quarters. Although household consumption grew at reasonable rates during the period 1995-1998, it had an erratic stop-

[11] See Medeiros & Serrano (2001) for a detailed discussion on some of these indexes.

and-go performance. For instance, there was a period without any relevant external shock from the second semester of 1995 until the third quarter of 1997, leading to a process of falling interest rates. During this stability gap, household consumption grew at relatively high rates, especially during most of the period 1996-97. Following the huge interest rate rise in the face of the Asian crisis, household consumption fell (quarter in comparison to the same quarter in the former year) in three consecutive quarters – from the fourth quarter of 1997 to the second quarter of 1998[12]. After remaining stagnant in third quarter of 1998, household consumption experienced a sequence of four quarters of fall after the central bank once again aggressively increased interest rates in response to the massive speculative attack against the Brazilian Real following the Russian crisis[13] (see Annex 1).

The above discussion suggests that there was an external constraint to the expansion of domestic demand (Serrano, 1998). In a context of low and stable interest rates, credit-driven household consumption increase could have been much more significant, meaning higher household consumption growth rates and higher GDP growth rates[14]. In fact, Carneiro (2002) observed that the high costs of borrowing increased delinquency levels. Accordingly, Brazil´s central bank data show that delinquency levels increased from 2.8 percent (as a share of GDP) to 9.2 in 1995. After falling to rates around 6.5 percent and 7 percent in 1996 and 1997, they increased again to 9.5 in 1998. He argues that high interest rates and delinquency levels constrained household consumption growth (Carneiro, 2002: 382-3).

A different variable - which surely affected household consumption - was the fall of the wage share (as a share of GDP) during FHC´s first term. According to Saboia and Hallak Neto (2014), the wage share fell from 42.6 in 1995 to 42.5 in 1996 and then 41.3 in 1997, after which it increased to 42.0 in 1998. An increase in the *capital share* (gross operational surplus) was the counterpart of this process[15]. They argue that these results were due to effects in the labor market of the combination of a restrictive monetary policy and the rise in imports stemming from the over-appreciated real exchange rate and trade openness. Accordingly, there was an increase in unemployment rates, a rise

[12] Brazil´s central bank increased the (annual) short-term interest rate from 19 percent to 40 percent in late October 1997. It then reached 46 percent at the end of November. Inflation rate accumulated in 12 months (consumer price index) was 5.3 percent in November 1997.

[13] In early September 1998, Brazil´s central bank again raised the (annual) short-term interest rate from around 19 percent to 40 percent. Inflation rate accumulated in 12 months (consumer price index) was 2.6 percent in August 1998.

[14] Another aspect was the banking crisis that followed the stabilization plan. Throughout the years of high inflation, an important part of the revenues of several important Brazilian banks was due to financial gains stemming from the high inflation rates (*floating*). In a context of low inflation rates after the stabilization plan, these revenues were gone and some banks were on the brink of bankruptcy. There was a huge program in 1995 to deal with the problem, resulting in the de-nationalization of some big banks in Brazil.

[15] Saboia and Hallak Neto (2014) calculate the functional distribution of income from Brazil´s National Accounts (distribution and use of income). Accordingly, they calculate its four components, namely the wage share, the gross operational surplus, the mixed wage-capital share and the (net of subsidies) taxes on domestic products and imports.

in the relative importance of informal jobs in the labor market[16] and shrinking wages. (Saboia & Hallak Neto, 2014: 150-52; 163).

The remaining GDP components are public consumption and investment. Public consumption grew at a modest rate (1 percent), whereas investment had a much more impressive performance (4.3 percent). Regarding public consumption, this small contribution to GDP growth rates happened all along a period of growing fiscal deficits. Average nominal fiscal deficits (as a share of GDP) grew from 0.4 in the period 1991-1994 to 5.2 in the period 1995-98, whereas primary fiscal (as a share of GDP) balance moved from a 2.9 percent surplus in the first period to a 0.2 deficit in the second (Giambiagi et al., 1999: 28). The poor contribution of public consumption to GDP in a context of increasing fiscal deficits shows that looking at nominal and/or primary balances does not tell much on the fiscal policy contribution and orientation as regards economic growth.

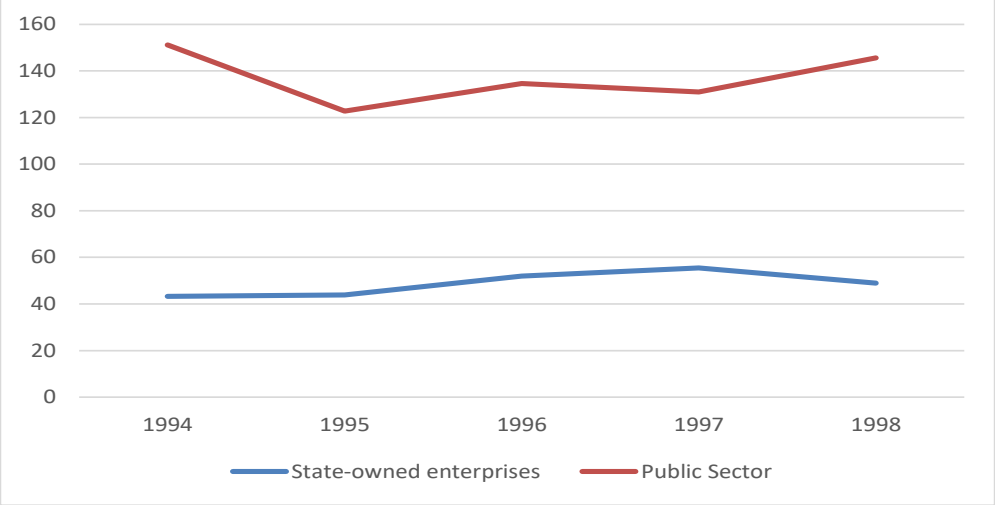
When it comes to investment, Carneiro (2002, p. 341) observes that there were only two short-lived (six months) investment cycles in the period - namely in 1995 and 1997. In any case, investment was the demand component with the best record within the period. In this context, there are some interesting details regarding investment. According to Orair (2016), public investments average yearly real growth rate during 1994-98 was - 0.9 percent, meaning that it had a negative contribution to economic growth. However, federal state-owned enterprises investments – a component of public investments – grew 3.1 percent during the same period (Orair, 2016: 16). This may sound puzzling taking into account the firm commitment of the government to a privatization program. In fact, the determination to privatize is the very reason for the increase in federal state–owned companies' investment. Besides the opening and privatization of some companies in the electric sector, the two major state-owned companies privatized during FHC´s first term were *Companhia Vale do Rio Doce* (1997) – one of the world's largest mining companies and another symbol of the state-led development era – and *Telebrás* (1998), Brazil´s telecommunications company. There were huge investments in telecommunications prior to the privatization process (Carneiro, 2002: 350). The likely reason was to modernize it in order to increase the attractiveness of Telebrás to potential buyers.

In any case, figure 3 shows that public investment fell during the two investment cycles of 1995 and 1997, despite the continuous increase of state-owned enterprises investment from 1995 to 1997. This was due to the negative behavior of the other components of public investment and to the small share of state-owned enterprises investment, which represented close to 35 percent of overall public sector investment and slightly less than 1.5 percent of GDP at the end of 1995 (Orair, 2016: 1-16). However, more importantly, the fall of public investment in 1995 and 1997 suggests that private investment was responsible for the two investment cycles during FHC´s first government.

[16] Formal jobs decreased throughout almost all of the period 1995-98. The sole exception was the year 1995 wherein they grew 0.6 percent. Job creation in the period was mostly due to informal jobs increase (Giambiagi et al., 1999: 34).

This may sound intriguing because the other components of demand had modest growth rates within the period, suggesting the lack of a demand-push for induced investment. Private investment is normally an induced component, meaning that it reacts to increases in other (autonomous) demand components. In fact, there were indeed effects of other demand components on private investment in the period. For instance, there was a sequence of five quarters of falling investment (quarter against the former quarter) – starting in the second quarter of 1998 – showing the impact on investment´s trend from the external crisis and its effects on interest rates and household consumption. As public investment grew in 1998, this negative trend was due to private investment (see Annex 2). However, private investment cycles in the period 1995-98 were the result of a very specific context in the 1990s - which has its roots in the instability of the 1980s – and not to a demand push.

Figure 3: Public investment (1994-98)



Source: author´s own elaboration based on Orair (2016). Data in 2005 billion *reais*, converted by GDP´s implicit deflator.

In the face of very high inflation and external debt, the 1980s were a period heavily unfavorable to investment in Brazil. As Serrano (1998) observes, state-owned enterprises and the public sector were under a financial crisis, which led them to cut their investments. Furthermore, state agencies – which were crucial in the import´s substitution era - lost in general their capacity to plan and promote industrial strategies. Credit was scarce due to high inflation and the financial sector concentrated almost entirely in the indexed public bonds market. Exports were the only dynamic component of demand but - as exports represent a small share of GDP in Brazil - they were not capable to foster higher economic growth rates. In such a context, domestic firms faced a low capacity to import and were reluctant to increase their productive capacity. The result was the lack of investment and a growing industrial obsolescence (Serrano, 1998: 18; 24). In particular, as Castro (2001) suggests, domestic firms did not incorporate the innovations that spread around the developed world in the 1980s.

In the face of economic openness in the 1990s, domestic firms started to adjust. In the first phase of the process (1989-1994) – wherein tariffs were falling and quantitative controls removed but inflation rates were still extremely high – firms adopted some management techniques – like Just-in-Time – started to acquire ISO certificates and made internal readjustments by sometimes downsizing and closing the inefficient plants and reducing the workforce. In sum, there was a *strategic repositioning of firms*. In any case, in a very unstable context of high and volatile inflation, investments in new machinery kept modest (Castro, 2001).

After the stabilization plan in 1994, a new phase started and investments in new machinery resumed (Castro, 2001). In a context of price stability, foreign currency availability and a stable and over-appreciated exchange rate, domestic firms – facing also increased competition due to economic openness – firms were eager to modernize by means of acquiring state-of-the art machinery. A stable and over-appreciated exchange rate – in a context of decreased protectionism – was particularly important in this process. As a result, imports of capital goods grew (in *quantum*) at an average 36 percent every year from 1994 to 1998.

In sum, Brazil´s investment rise in the first FHC´s government was very much a modernization effort after a backward period in the 1980s. In other words, it was a late catching-up process that happened when firms took advantage of some specific circumstances of the period, notably a stable and over-appreciated currency. In any case, as Carneiro (2002) observed, the increased importance of imported capital goods reduced the capacity of autonomous demand increases to foster higher economic growth rates (Carneiro, 2002: 343). In other words, the boom in the imports of capital goods had a negative consequence in the sense that it increased the *leaking* of autonomous demand impulses.

Finally, one last remark consists of looking at the dynamics of growth in each of the years within the period 1995-98. In this sense, whilst it is true that domestic demand was in general the driving force during FHC first term, figure 4 shows that the year 1998 was different from the previous years.

Figure 4 – GDP (%) growth rates (1995-1998)

	1995	**1996**	**1997**	**1998**
GDP	4.2	2.2	3.4	0.3
Household consumption	8.6	3.4	3.0	(-) 0.6
Public consumption	1.4	(-) 1.8	1.2	3.2
Investment	7.3	1.5	8.7	(-) 0.3
Exports	(-) 2.0	(-) 0.4	11.0	4.9
Imports	30.7	5.6	14.6	(-) 0.1

IBGE for all GDP data and for GDP components in the period 1996-2002. For data of GDP components in 1995, the source was banco Sidra *apud* Giambiagi et. al. (2011)

From 1995 to 1997, investment and household consumption were the main drivers of economic growth. As previously noted, there were two short investment cycles in 1995 and 1997.

Moreover, these two investment cycles were due to private sector investment taking into account the poor performance of public sector investment in both cases. Household consumption had a more regular behavior. In 1995, the Brazilian economy grew thanks to both investment (7.3 percent) and household consumption (3.4 percent). In 1996, household consumption was the main driver (3.4 percent). In 1997, investment (8.7 percent) and household consumption were again the driving forces. This was all along a process of industrial modernization in a context of over-appreciated exchange rate, economic openness and relative industrial backwardness after a decade of instability in the 1980s.

Nevertheless, there was a different pattern in the year 1998. In this year, the most important factors fostering growth were public consumption (3.2 percent growth) and net exports thanks to a 4.9 percent exports growth and a 0.1 fall in imports. The reasons for this change were the following. Firstly, the increase in public consumption is probably due to electoral reasons since there were Presidential Elections in October 1998 and governments are likely to raise expenses in such a situation to increase their reelection chances. Regarding net exports, the remarkable aspect was imports fall. In the former year, exports grew 11 percent, but imports grew even faster (14.6 percent). Taking into account that the real exchange rate was still over-appreciated, the reason for this result regarding imports was the collapse of the other domestic demand components in 1998. In fact, investment fell 0.3 percent, whereas household consumption fell 0.6 percent in a context of external crisis – that started in the second semester of 1997, reduced in the first semester of 1998 and strongly resumed in the second semester of 1998 - that led to high and increasing interest rates. Not surprisingly, GDP growth was close to zero (0.3 percent) in 1998.

III – The second term of Fernando Henrique Cardoso (1999-2002)

Despite the contagion effects of the Russian currency crisis in the second half of 1998, Brazilians reelected Fernando Henrique Cardoso in the first round of the October 1998 Presidential elections. In any case, the speculative attack against the Brazilian Real did not vanish. After months under attack and continuously losing international reserves, the monetary authority abandoned the targets zone exchange rate system in January 1999 and let the nominal exchange rate float. There was a 57 percent real devaluation from December 1998 to February 1999. Still in the first semester of 1999, the government implemented an inflation targets regime.

Brazil´s based its inflation targets regime on the following lines: 1) the inflation index of reference is IPCA (*Índice de Preços ao Consumidor Amplo*), a consumer price index calculated by IBGE (Instituto Brasileiro de Geografia e Estatística) , Brazil's official statistics bureau; 2) the targets include a tolerance band of 2 percent upwards and downwards; 3) the National Monetary Council

(CMN, *Conselho Monetário Nacional*) sets the target and the tolerance one year and a half in advance; 4) the central bank does not need to keep IPCA´s 12 months accumulated inflation rate within the band all the time: it just needs to be within the tolerance band at the end of the year; 5) in case the central bank fails to meet the tolerance band at the end of the year, the institution´s Governor has to write a letter to the Finance Minister explaining the reasons why the central bank did not succeed in its target and the measures it implemented to revert the situation as soon as possible (Bogdanski et al., 2000: 11; Barbosa-Filho, 2009: 140-141 *apud* Bastian & Soihet, 2012).

Brazil´s central bank was successful regarding the targets in 1999 and 2000 and unsuccessful in 2001 and 2002. In 2002, the sharp nominal exchange rate depreciation affected inflation rates so much that it was necessary to adjust the targets for 2003 and 2004. In any case, inflation rates fell in the years following 2004 and the inflation targets system is still in use in Brazil nowadays (Bastian & Soihet, 2012: 92-3).

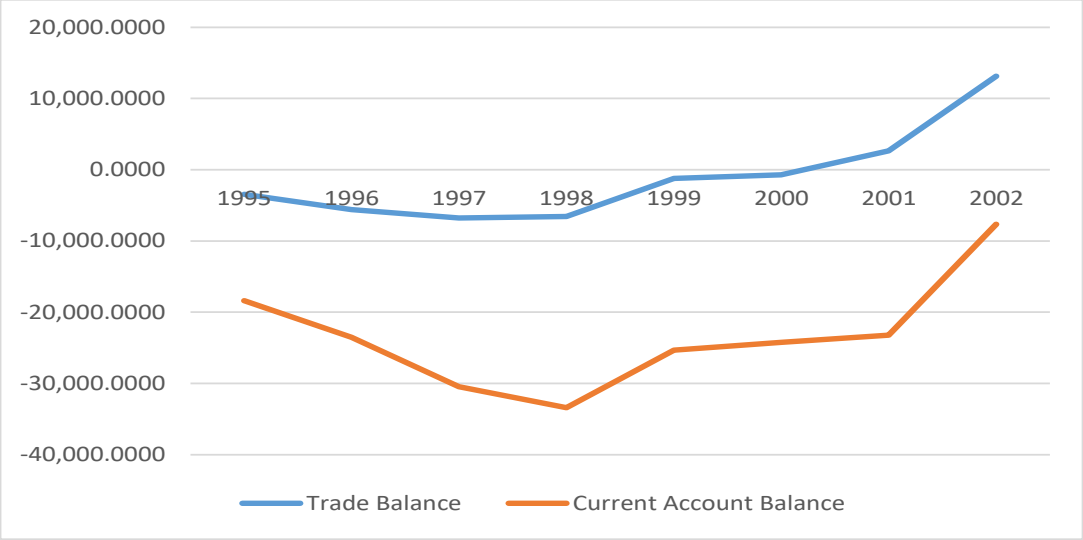
The final piece of the new macroeconomic regime was the introduction of fiscal rules, namely targets for the fiscal primary surplus as a share of GDP. In fact, these rules had been previously agreed with the International Monetary Fund in December 1998 when Brazilian policy-makers – in a desperate attempt to defend the targets zone system – negotiated a Stand-By agreement with the Fund. The Fiscal Responsability Law – established in 2000 – complemented Brazil´s new fiscal regime by imposing a ban on future refinancing of states and municipalities´ debts (Giambiagi & Ronci, 2004: 4; 24).

Under a floating exchange rate regime and after the initial devaluation of the nominal and real exchange rate, exports and imports dynamics changed. Net exports were growing during FHC´s second term taking into account the impressive average yearly 9.0 exports growth rate and the average yearly 3.7 imports fall (see Figure). This increase is even more impressive taking into account the terms of trade fall during the period: according to UNCTAD´s data, Brazil´s terms of trade fell every year from 1998 and 2002, resulting in a 13.9 percent fall alongside this period (UNCTAD, 2021). In this context, as previously noted, external demand became a much more important trigger of economic growth in FHC´s second term.

The changes in exports and imports´ performance allowed for an external adjustment. Trade deficits turned into trade surpluses and the current account deficit significantly fell (see figure 5). External vulnerability indicators improved during FHC´s second term. Net external debt as a share of exports decreased from 3.6 in 1998 to 2.7 in 2002, whereas the current account balance as a share of exports fell from -0.65 in 1998 to -0.13 in 2002. The only indicator that increased was short-term external debt as a share of international reserves, which grew from 0.59 in 1998 to 0.62 in 2002. In any case, the risk of a capital flight is in principle less deleterious in a floating exchange rate system compared to a fixed exchange rate system. Although there is the risk of a fast and huge exchange rate

depreciation in a floating exchange rate system, there is no need to defend a specific peg by selling international reserves and aggressively raising the interest rate.

Figure 5 – Trade and Current Account Balances (1995-2002)



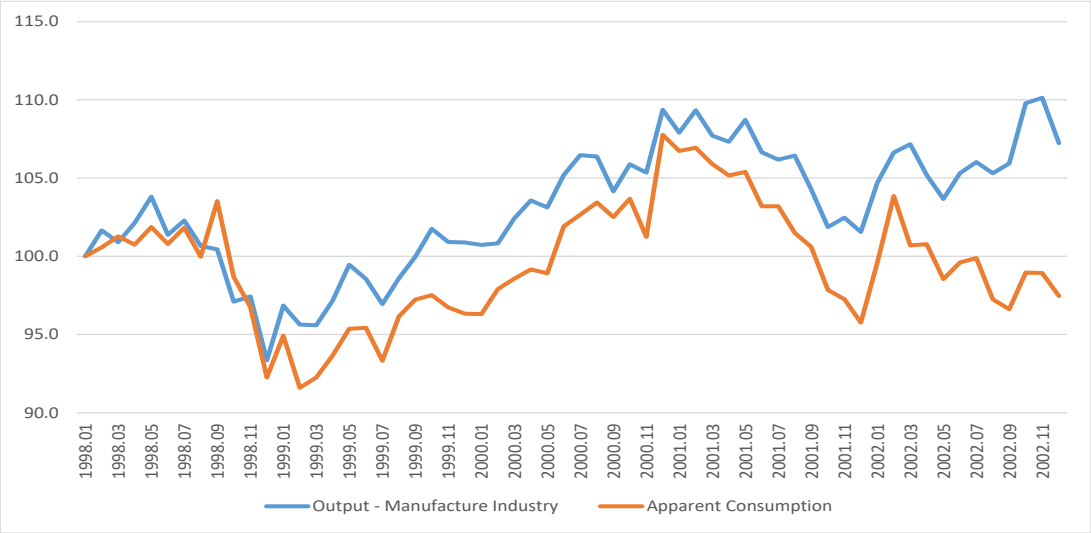
Source: Ipeadata

Another interesting example when it comes to the external adjustment consists on looking at the manufacturing sector after the 1999 devaluation and the change of the macroeconomic regime. For this purpose, we follow what Serrano and Summa (2016) did to analyze this issue for the period 2011-2014. More precisely, we compare the behavior of the indexes of apparent consumption of manufacturing industry and industrial production (both with seasonal adjustment). The apparent consumption of manufacturing industry is the production of industrial goods minus exports of industrial goods plus imports of industrial goods. It equals domestic demand plus the accumulation of inventories. According to Serrano and Summa (2016), as long as one assumes that the accumulation of inventories is small over a longer period, this index can be a good proxy for the evolution of domestic demand for manufactured goods. In case industrial output grows faster than domestic demand – based on this proxy (apparent consumption) and abstracting for inventories - this means that industrial exports are growing faster than industrial imports (Serrano & Summa, 2016: 809).

Figure 6 shows that in 1998 (before the devaluation) both series moved very closely. However, after the 1999 devaluation and during the entire second term of FHC´s government (1999-2002), industrial output grew faster than apparent consumption of industrial goods, meaning that industrial exports grew faster than industrial imports. In other words, industrial net exports grew after the devaluation and the changes in the macroeconomic regime (in general) and in the exchange rate regime (in particular)[17].

17 Unfortunately, the data on apparent consumption of manufacturing industry starts in 1998, meaning that there is no data available to evaluate FHC´s first term.

Figure 6 – Apparent Consumption and manufacturing output (1998-2002)



Source: Ipeadata

In spite of the change in the macroeconomic regime and the external adjustment, FHC´s second term was also a period of instability. For instance, figure 6 also shows the collapse of domestic demand for industrial goods (apparent consumption) in 2001 and again in 2002 after a short recovery. In fact, there were indeed some crisis alongside FHC´s second government, especially in the period 2001-2002. During 2001-2002, Argentina´s economy – one of Brazil´s most important trade partners – was collapsing and under severe speculative attack. In 2002, the potential win of opposing candidate Luis Inácio Lula da Silva in that year´s presidential elections and the misguided monetary policy of Brazil´s Central Bank led to sharp speculative movements in the exchange rate market[18]. In fact, all these events – in different proportions - led to speculation in the exchange rate market. As a result, in the context of the inflation targets regime, there were increases in the nominal and real interest rates due to the pass-through effects on inflation of exchange rate devaluations. In any case, the most problematic event was probably the energy crisis in the year 2001. Due to deficiencies in the sector´s new model stemming from the privatization process[19], Brazilian policy-makers had to impose a program of energy rationing in the first semester of 2001, which obviously had deep impacts on production and consumption.

[18] Brazil´s Central Bank`s Monetary Policy Committee reduced the short-term nominal interest rate target from 18.5 to 18.0 in 18 July 2002 in a context wherein the nominal exchange was already depreciating: from 31 May 2002 to 17 July 2002, there was a 14 percent depreciation. After this reduction, Brazil´s Central Bank`s Monetary Policy Committee did not change the target for the next three months until 15 October 2002, while the nominal exchange rate kept depreciating. There was a 34 percent nominal exchange rate depreciation from 17 July 2002 until 14 October 2002. Inflation rates – consumer´s price index (IPCA) accumulated in 3 months and 6 months - increased continuously from July 2002 to October 2002. Inflation rate consumer´s price index (IPCA) accumulated in 12 months increased from 7.51 percent in July 2002 to 8.45 in October 2002 and then to 12.53 percent in December 2002.

19 Brazilian policy-makers tried to build a new market-oriented model for the sector. They dismantled the former institutions of the state-led model, without building the necessary institutional setting for the new model. As a result, there were insufficient investments, resulting in the energy crisis in 2001.

In this context, household consumption (quarter against the same quarter in the former year) – which had been continuously growing around 3 to 4.7 percent since the fourth quarter of 1999 – had two consecutive falls of 1.8 and 1.9 percent in the third and fourth quarters of 2001. It then only grew in the year 2002, but at a modest 1.8 percent rate (see Annex 1). Regarding household consumption (quarter in comparison to the former quarter), there were very good results in 2000, notably in the second and third quarters. During the crisis period in 2001-2002, there was a huge fall (3.1 percent) in the third quarter of 2001 and two quarters consecutive fall in the third and fourth quarters of 2002 (see Annex 2). The very good performance in the year 2000 happened all along a process of falling short-term nominal interest rates from 45 percent (annual rate) in late March 1999 to 15.8 percent at the end of 2000. The year 2000 was the only one free of crises during FHC´s second term.

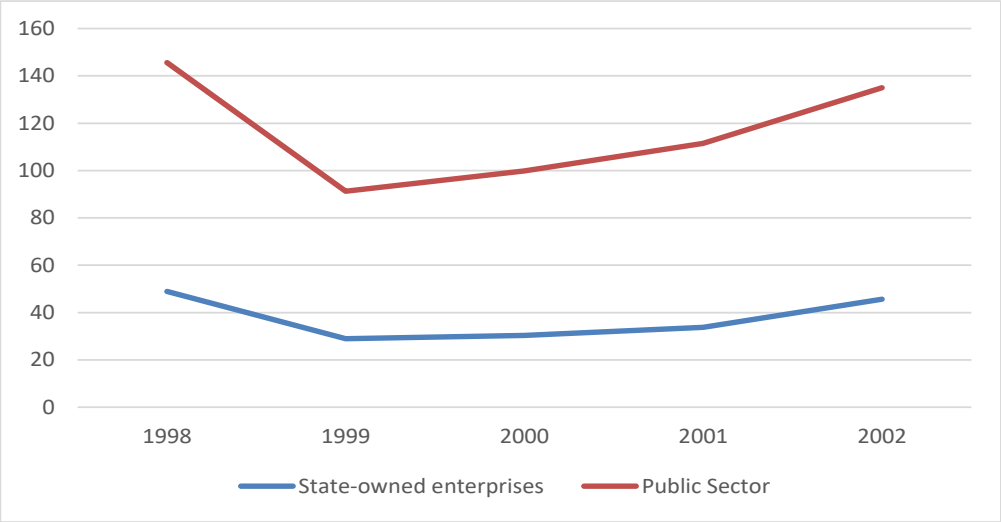
Another factor with negative impacts on household consumption was the wage share, which kept decreasing all along the FHC second term. Moreover, in this case, the fall was higher than in the first term. It fell from 42.0 percent in 1998 to 41.2 in 1999 and then to 40.5 in 2000. After a slight increase to 40.6 in 2001, it fell again to 39.8 in 2002. Hence, there was a 5.2 percent fall from 1998 to 2002 (Saboia & Hallak Neto, 2014: 163).

The series of crises during the period 1999-2002 also affected investment. In the context of the currency crisis, investment fell 8.2 percent in 1999. During the 2001-2 crisis, investment (quarter in comparison to the same quarter in the former year) collapsed, falling 7.4 percent in the fourth quarter of 2001, 7.9 in the first quarter of 2002 and 4.3 in the second quarter of 2002 (see Annex 1). Data comparing one quarter with the former quarter, show an extremely negative trend in 2001, taking into account three consecutive falls – from the second quarter of 2001 on – including a huge 5.7 fall in the fourth quarter. Regarding yearly data, investment was stagnant in 2001 (0.4 percent growth rate) and fell 5.2 percent in 2002. It is no surprise that the only positive year was 2000, wherein investment grew 5.0 percent (see forthcoming figure 8).

When it comes to public sector investment, it fell 1.9 percent alongside FHC´s second term. This time it was a general fall, including also state-owned enterprises investment, which fell 1.7 percent in the period (Orair, 2016: 16). Figure 7 shows that the overall fall during FHC´s second term was mostly due to a huge fall in 1999. After it, public sector investment grew every year from 2000 to 2001. Part of the 1999 abrupt fall was a consequence of the privatization of Telebrás in 1998 since it meant the removal from Telebrás' investment from public sector investment statistics in the following year. When excluding Telebrás data state-owned enterprises data for the entire period 1995 to 2002, Orair (2016) shows that public sector investment (*ex* Telebrás) was mostly stable from 1997 to 1999, suggesting that the 1999 fall was to a large extent due to the privatization. However, in the case of overall public sector investment, he shows that there was a huge decrease in 1999, even

excluding Telebrás data for the entire period and controlling for the political cycle. In other words, it shows that there was indeed a significant fall in public investment in the year 1999 (Orair, 2016: 15-16).

Figure 7 – Public investment (1998-2002)



Source: author´s own elaboration based on Orair (2016). Data in 2005 billion *reais*, converted by GDP´s implicit deflator

What was the impact of public investment on overall investment in the period 1999-2002? We will address this issue later (figure 8). In any case, we can anticipate that investment bad performance within the period was mostly the result of the collapses of 1999 and 2002 wherein investment fell 8.2 percent and 5.2 percent, respectively. In 1999, public sector investment fall was part of this overall decrease. In any case, public sector investment grew in 2001 and 2002, suggesting that the overall stagnation of investment in 2001 and the fall in 2002 were both a consequence of private sector investment behavior

A maybe surprising result was the 2.3 percent growth in public consumption, especially in a context of fiscal rules, as was the case in FHC´s second term. In fact, there were primary fiscal surpluses in all years in the period 1999-2002, showing again that primary results do not explain much when it comes to the contribution of fiscal policy to economic growth. In any case, public sector performance was mostly due to a 4.7 percent growth in 2002, in which there were Presidential Elections. In other words, the data of 2002 *inflated* average public sector consumption growth. It is interesting that there was a public sector primary surplus above 3 percent (as a share of GDP) every year during the period 1999-2002, resulting in a 3.6 average primary surplus (as a share of GDP) in the period (Giambiagi & Ronci, 2004: 7-8). Despite the fiscal rules, public consumption had a higher positive influence on GDP growth rates in the second term than in the first term, showing again that the primary balance is not directly relevant as regards the impact of fiscal policy in GDP growth rates.

What about structural change? The development model adopted in the first term did not change in the second term, though the privatization process did not advance much in the second term.

In line with Mendonça de Barros and Goldenstein (1997) expectations, the economy that emerged at the end of FHC´s government was one wherein the public sector and state-owned enterprises reduced their role. Moreover, foreign investment increased its share. There was a massive inflow of FDI during both the first and second terms, especially in the second half of the 1990s: in 1990/95, the inflows of FDI to Brazil represented on average 2.7 percent of the FDI to the entire developing world, but, from 1998 to 2001, it was always above two digits. Privatization, denationalization and economic openness were three major aspects of the period. As previously noted, there was a modernization process following the new economic conditions, especially in the face of exchange rate stability during the first term.

However, there were important limits and caveats in the process. Although pointing out to benefits from the modernization process – especially the adaptation of the traditional sectors, the reaffirmation of the mid-tech mechanical sector and the resistance of Brazil´s national capital goods sector, Castro (2001) criticized the weak investments in non-manufacturing activities, namely R&D, marketing and brand building. Carneiro (2002) observed a disarticulation of intra-sectorial linkages due to the increase in the imports coefficient (Carneiro, 2002: 342). Sarti and Laplane (2002) are even more critical and further explored these issues. Firstly, they observed a great part of the FDI consisted of acquisition of existing domestic companies and not *greenfield* investment, which would necessarily increase economic growth rates. In other words, it meant simply a change in ownership from nationals to foreigners. Secondly, contrary to other periods of internationalization of the Brazilian economy, this time FDI went to the services sector: the inflow to this sector between the years 1996 to 2000 represented 80.3 percent of total FDI. As Sarti and Laplane (2002) argued that branches of foreign firms are more likely to import compared to national firms, the de-nationalization in the services sector simply meant an increase in the imports share without a similar increase in exports. In this context, national firms exported more than foreign firms after the 1999 exchange rate devaluation (Sarti & Laplane, 2002). This new configuration has adverse impacts on growth because it does not foster exports and at the same reduce potential multiplier effects of autonomous demand impulses taking into account the leaking due to the increased import´s share (Carneiro, 2002: 343).

In sum, following the analysis of the previous section, we end by discussing the dynamics of growth in each of the years within the period 1999-2002. In this sense, the dynamics of growth within FHC´s second term was completely different from the first term. Whilst in the first term aggregate domestic demand was the main driver, external demand was the driving force. This was the case in 1999, 2001 and 2002.

Figure 8 – GDP (%) growth rates (1999-2002)

	1999	2000	2001	2002
GDP	0.5	4.4	1.4	3.1
Household consumption	0.3	3.9	0.7	1.8
Public consumption	1.7	-0.2	2.7	4.7
Investment	-8.2	5.0	0.4	-5.2
Exports	5.7	12.9	10.0	7.4
Imports	-15.1	10.8	1.5	-11.8

IBGE for all GDP data and for GDP components in the period 1996-2002. For data of GDP components in 1995, the source was banco Sidra *apud* Giambiagi et. al. (2011)

From 1999 to 2002, net exports were essentially the drivers of economic growth, especially in the years 1999, 2001 and 2002. In some years, public consumption also had a positive contribution. This was notably the case in the year 2002, thus reproducing the same pattern observed in the first term: public consumption grew at higher rates in the year wherein there were Presidential Elections. It is also worth noticing that GDP growth rates were very modest in these years wherein net exports were the driving force of the Brazilian economy. The sole exception was the year 2002 (3.1 GDP growth), which was a year wherein public consumption also grew at relatively high rates. In fact, if one excludes the year 2000 and calculates the average yearly GDP growth rate of the years 1999, 2001 and 2002, the result falls to a 1.7 growth rate. In other words, an average growth rate clearly smaller than the 2.5 growth rate of FHC´s first government, in which domestic demand was the main factor explaining Brazil´s economic growth. This suggests a point made by Serrano (1998): exports can´t be demand´s driving force in a country like Brazil.

Nevertheless, it is worth pointing out that the importance of increasing exports in terms of alleviating the external constraint to economic growth and promoting the external adjustment. There was a sharp improvement in the external vulnerability indexes during the second term and the adoption of a flexible exchange rate gave flexibility to the policy-makers. In fact, the crisis that happened in FHC´s second term were not external crisis in the sense of the first term. Apart from the final crisis of the former regime in early 1999 and some *sudden stops* episodes that led to exchange rate depreciation, crises throughout FHC´s second term were due to very particular reasons like the energy crisis of 2001.

In any case, the above discussion calls for a closer look on what happened in the year 2000, since in this year the driving forces were different. In 2000, investment and household consumption were the driving forces of the economy, growing respectively 5.0 percent and 3.9 percent. As previously noted, the year 2000 was the only one in FHC´s second term wherein there were no external or internal crisis. As it was a year without shocks, the monetary authority decreased the nominal short-term interest rate throughout the year paving the way for increasing household consumption. In the case of investment, it was worth noting the 9.4 percent growth of public sector investment,

Conclusions

During FHC´s government, there were two different macroeconomic regimes, coinciding with his two terms in office. Aggregate domestic demand components were the driving force in the first term, whereas external demand was the driving force in the second government.

In the first term, there was a macroeconomic regime based on an over-appreciated real exchange rate, which led to imports growing much faster than exports. As a result, the economy had to grow by means of aggregate domestic demand. However, the successive trade and current account deficits led to high interest rates in order to attract foreign capital. This was especially the case in the face of the frequent *sudden stops* in capital flows to Brazil that occurred in the period 1995-98. In the face of external shocks, high and increasing interest rates negatively affected household consumption thus negatively affecting induced private investment. As public sector investment fell during the period and public consumption had a mediocre growth rate, there was no demand component pushing for higher economic growth rates.

In any case, investment was the aggregate demand component with the highest growth rate. Despite the absence of a strong demand push, there were two short-lived cycles of investment thanks to private investment. These two cycles were the result of a modernization process within Brazil´s industrial sector, which was due to very specific circumstances of the 1990s. Hence, there was a very particular process of investment increase unrelated to a strong increase in other components of demand. Secondly, the pattern described above was the case in the period 1995-97. In 1998, net exports and public consumption were the components that grew the most. In a context of external crises in 1998, investment and household consumption fell thus leading to a huge imports fall. Public consumption grew probably thanks to the fact that there were Presidential Elections in 1998.

The exchange rate devaluation in 1999 and the new macroeconomic regime – the so-called *tripod* of inflation targeting, fiscal rules and flexible exchange rates – led to an external adjustment and changed the growth dynamics. Hence, external demand was the driving force in FHC´s second term. However, exports represent a small share of Brazil´s GDP, meaning that the country is unlikely to grow at high rates based on an export-led growth model. As a result, growth rates were very modest in the years in which net exports were the drivers of economic growth (1999, 2001 and 2002). Moreover, despite the new regime and the external adjustment, there were sundry crisis during the period 1999-2002. In particular, an energy crisis in 2001, resulting from the deficiencies of the system that emerged from the privatization program in the first term. This crisis led to a program of energy rationing in 2001 with severe consequences to the economy. Moreover, some of the crises led to a restrictive monetary policy thus affecting household consumption and induced private investment.

The only year without any crises (2000) was not surprisingly the only one wherein the economy grew at higher rates. Unlike the other years of FHC´s second term, in the year 2000 domestic demand (household consumption and investment) was the driver of economic growth. This was all along a process of falling interest rates and increasing household consumption and investment, but this time with growing public sector investment.

In particular, when analyzing economic growth rates, there are at two major conclusions stemming from the combined analysis of both terms: 1) the economy grew at higher rates in the years wherein domestic demand drove the economy, notably household consumption and investment; 2) there was a series of crises within the period, affecting economic growth rates.

In general, when looking at the overall picture, there are after years of very high inflation in the 1980s and early 1990s, FHC government was able to keep inflation under control. However, economic growth rates were mediocre. This was in part due to a series of crises alongside the government, but also due to the government´s own responsibility – like in the energy crisis – and also in its frugal use of public consumption and public investment or in the macroeconomic regime based on an over-appreciated exchange rate in the first term. There was a modernization process within Brazil´s industrial sector, which was a positive aspect of the government. However, it led to an intense process of de-nationalization within Brazil´s economy, with adverse effects for the economy´s growth potential in the future.

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Annex 1- GDP growth (quarter in relation to the same quarter in the former year)

	GDP	Household consumption	Public consumption	Investment	Exports	Imports
1996.I	**-0.6**	-1.2	-3.3	-12.7	4.7	-16.2
1996.II	**1.3**	1.8	-0.2	-4.1	4.5	-6.6
1996.III	**5.6**	5.4	2.8	10.1	-3.6	15.0
1996.IV	**2.3**	6.7	-6.8	13.9	-6.6	31.0
1997.I	**3.4**	7.9	1.2	11.3	-0.5	27.5
1997.II	**4.8**	6.0	-0.8	10.7	14.3	23.8
1997.III	**1.8**	2.1	-5.7	8.5	17.5	15.9
1997.IV	**3.7**	-2.8	11.5	3.6	11.6	-2.0
1998.I	**1.0**	-0.5	1.2	3.5	10.4	7.9
1998.II	**1.5**	-1.1	2.3	2.1	4.8	-2.2
1998.III	**0.4**	0.0	5.4	-1.2	-0.1	-2.1
1998.IV	**-1.4**	-1.3	4.0	-4.9	6.1	-2.4
1999.I	**0.8**	-0.9	0.7	-8.4	-0.1	-17.9
1999.II	**-0.4**	-0.6	1.0	-10.4	-1.0	-15.0
1999.III	**-0.6**	-0.1	1.1	-11.3	3.3	-18.8
1999.IV	**2.2**	3.1	3.9	-5.0	21.8	-8.7
2000.I	**4.4**	3.0	3.6	-0.3	20.7	4.1
2000.II	**4.0**	4.2	1.3	3.9	11.2	7.3
2000.III	**4.6**	4.7	-2.3	6.8	18.6	17.7
2000.IV	**4.6**	4.1	-2.8	8.8	2.7	13.0
2001.I	**3.5**	4.0	1.1	10.2	11.2	24.3
2001.II	**2.3**	3.1	2.2	2.0	13.8	12.8
2001.III	**0.5**	-1.8	3.5	1.2	3.0	-5.2
2001.IV	**-0.5**	-1.9	3.6	-7.4	9.8	-12.5
2002.I	**0.5**	0.2	4.3	-7.9	-4.6	-18.6
2002.II	**2.3**	0.7	4.1	-4.3	-11.1	-16.5
2002.III	**4.2**	2.7	4.2	-0.5	20.1	-8.6
2002.IV	**5.2**	1.6	2.8	7.6	20.9	-9.0

Source: Brazil´s Central Bank

Annex 2- GDP growth (quarter in relation to the former quarter)

	GDP	Household consumption	Public consumption	Investment	Exports	Imports
1996.I						
1996.II	**-0.5**	2.3	1.6	2.2	-2.3	9.4
1996.III	**4.0**	3.0	3.5	3.2	-0.3	7.3
1996.IV	**-1.1**	5.0	-15.0	4.6	5.0	10.7
1997.I	**0.8**	-2.5	13.2	1.2	4.7	0.1
1997.II	**1.0**	0.5	-0.4	0.9	5.8	4.1
1997.III	**1.2**	-0.8	-1.6	1.8	2.8	0.5
1997.IV	**0.7**	0.0	0.7	-0.3	-3.9	-6.2
1998.I	**-2.1**	-0.1	2.4	0.4	5.0	9.6
1998.II	**1.6**	-0.2	0.7	0.7	2.5	-5.5
1998.III	**0.3**	0.4	1.7	-1.6	-3.8	0.8
1998.IV	**-1.2**	-1.4	-0.7	-4.5	0.4	-5.8
1999.I	**-0.1**	0.2	-1.2	-3.2	1.9	-9.2
1999.II	**0.6**	0.2	1.1	-1.9	2.0	-1.4
1999.III	**0.2**	1.0	2.1	-1.9	-1.6	-3.8
1999.IV	**1.5**	1.7	1.9	1.8	16.0	6.9
2000.I	**1.8**	0.1	-1.8	0.5	-2.5	-0.6
2000.II	**0.5**	1.4	-0.9	4.7	2.0	4.6
2000.III	**1.0**	1.6	-1.4	-0.1	8.5	9.3
2000.IV	**1.3**	0.9	1.1	3.2	-1.9	3.4
2001.I	**0.4**	0.0	2.1	1.4	3.6	2.7
2001.II	**-0.4**	0.5	0.3	-1.6	4.2	-3.0
2001.III	**-0.8**	-3.1	0.0	-1.9	-2.8	-7.7
2001.IV	**0.3**	0.8	1.2	-5.7	-2.1	-6.9
2002.I	**1.4**	2.1	2.6	1.5	2.3	-0.5
2002.II	**1.4**	1.1	0.1	2.1	-8.2	-2.6
2002.III	**1.2**	-1.1	0.2	1.7	26.8	-1.2
2002.IV	**1.2**	-0.4	-0.1	1.7	0.4	-4.3

Source: Brazil´s Central Bank