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BRIC in the Backyard: Brazil's Economic Rise and What it Means for the United States

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In today's increasing globalized world there are several rapidly emerging market success stories that many economic and financial analysts are watching with great anticipation. Brazil is one of these of these geo-political risers and it is perhaps the most underestimated of the so-called BRIC countries. The term BRIC was coined by Jim O'Neill from the Wall Street giant Goldman-Sachs in 2003 and refers to the up and coming economic powerhouse nations around the globe and includes Brazil, Russia, India and China. The story behind Brazil's economic growth is a remarkable tale and has multiple strategic implications for the United States as the two countries struggle to define their future bilateral relationship. The question of what Brazil's rise means for the United States and what are the security implications for the hemisphere are significant.

When Luis Inacio Lula da Silva became the country's first elected "leftist" president in October 2002, many observers expressed deep skepticism that he would honor campaign pledges to pursue disciplined economic policy. Many argued that the former union negotiator would prove to be a Brazilian Hugo Chavez, lavishing cash on social projects to boost his popularity at the expense of economic liberalization.[1] Fortunately for the people of Brazil, as well as the rest of the Western Hemisphere, that premise never came to fruition. Lula aptly demonstrated throughout his presidency that he understood the high stakes economic game he was playing particularly in a volatile global marketplace. Many argue that Lula respected the value of compromise and embraced the necessity of trust to lure of foreign investors to Brazil's promising markets which allowed Brazil to thrive in difficult economic times. He proved himself to be an economic pragmatist, not the Chavez-style ideologue that many analysts speculated he was.[2] During his administration, from 2003-2011, Brazil made significant economic strides and dramatically improved its macroeconomic stability, built foreign reserves, reduced its debt, kept inflation rates under control, and committed to fiscal responsibilities that earned its place in the BRIC community.

Brazil's economy is unquestionably the largest in South America and the country boasts well developed agriculture, mining, manufacturing, and service sectors. Today, Brazil has one of the most advanced industrial sectors in Latin America accounting for roughly one-third of its gross domestic product (GDP). Brazil's diverse industries include automobile and parts manufacturing, machinery and equipment, textiles, shoes, cement, computers, aircraft, and consumer durables.[3] Brazil is a major supplier of commodities and natural resources around the globe. In addition to providing significant contributions in lumber, iron ore, tin, and other natural minerals to the global market, it is a major manufacturer and exporter of petrochemicals. Brazil also has a diverse and sophisticated services industry which includes well developed telecommunications, banking, energy, commerce, and computing sectors. The financial sector is regarded as secure and provides local and international firms with a wide range of financial products. The largest

1. Ian Bremer, "Brazil's Economic Growth Shouldn't Be Overlooked.," October 7, 2007 linked from http://www.realclearpolitics.com/articles/2007/10/brazils_economic_growth_should.html (accessed April 12, 2011)
2. Ibid.
3. U.S. Department of State Home Page, "U.S. Department of State Country Background Notes–Brazil" linked from http://www.state.gov/r/pa/ei/bgn/35640.htm (accessed April 10, 2011)

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financial firms are Brazilian (the two largest banks are government-owned), but U.S. and other foreign firms have an important share of the Brazilian market.[4]

In March of 2011, the Brazilian government announced that it had achieved a major economic milestone. Brazil had achieved an unprecedented economic growth of 7.5% during 2010 – the highest rate since 1986, and the fifth highest out of all the G20 countries. As a result it had overtaken Italy to become the world's fifth largest economy.[5] By the end of 2009, Brazil's economy represented 40 percent of the total GDP of Latin America and the Caribbean, and 55 percent of the GDP of South America alone.[6] The Brazilian economy's solid performance during the 2008 financial crisis and its strong and early recovery, has significantly contributed to the country's emergence as rising global power. Experts forecast that the Brazilian economy is likely to continue to grow in the 4% to 5% range for the next several years, having grown to around $2.2 trillion at the end of 2010.[7] Brazil has dramatically benefitted from a legacy of surging exports, economic growth and social programs enacted under the Lula administration that helped lift tens of millions of Brazilians out of poverty. For the first time in history, an increasing number of Brazilians are now in the lower middle-class, and domestic consumerism has become an important driver of Brazilian growth.[8]

President Dilma Rousseff, a protégé of Lula, took office on January 1, 2011 and seems to be following her predecessor's economic formula regarding economic policies. These measures include sound fiscal management, inflation control, and the continuance of a floating exchange rate. In 2010, rising employment and strong domestic demand pushed inflation to nearly 6%, leading the central bank to boost interest rates and prompted the Rousseff government to announce spending cuts early in 2011. The economic boom and high interest rates have attracted foreign currency inflows that have driven up the value of the currency (the Real) by nearly 40% since the start of 2009. In an effort to limit the appreciation, the government has increased dollar reserves and capital controls. Brazil has benefited greatly from the lowest inflation rates in decades and an expansion of consumer credit which bolstered the purchasing power of Brazilians, both rich and poor.[9] Rising commodity prices throughout the global market have also contributed to Brazil's ability to build a healthy fiscal surplus. A strong current account surplus has earned some US$160 billion for the central bank's coffers. Yields on the country's sovereign debt remain within about 2.2 percentage points of U.S. treasuries, as investors become more confident in Brazil's economic stability.[10]

An additional component contributing to Brazil's strengthening economy is the fact that trade continues to remain at the forefront of President Rousseff's economic policies. The expanded development of the Brazilian export sector is a main component in the administration's plans to generate future growth for the country. To develop and optimize export opportunities, the government is aggressively pursuing access to foreign markets through assertive, yet pragmatic, trade negotiations. Additionally, Brazil remains a vocal and prominent player in the World Trade Organization's Doha Round negotiations seeking to solidify its position, influence other members and successfully conclude those key discussions.[11] To further increase its international profile (both economically and politically), the Rousseff administration is also seeking expanded trade ties with developing countries, as well as a strengthening of the Common Market of the South – Mercosul (Mercosur in Spanish). Brazil believes that strengthening Mercosur would grant South America better conditions to fight for more balanced and fairer trade with other regions of the

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4. Ibid.
5. "Brazilian Investment Figures 2010," *Free Press Release*, (March 23, 2011) http://www.ft.com/cms/s/0/89ad55ba-45d7-11e0-acd8-00144feab49a.html#axzz1Jz8pW100 (accessed on 10 April 2011)
6. According to International Monetary Fund figures, Brazil's GDP is 54.94 percent of South America's total and 39.6 percent of the total for Latin America and the Caribbean. See IMF, *World Economic Outlook Database*, April 2010, Report for Selected Countries, Gross domestic product, current prices (U.S. dollars).
7. Jim O'Neil, "Brazil is now the 5th Largest Economy. 2 Down 2 to Go" (March 5, 2011) http://www2.goldmansachs.com/gsam/advisors/education/viewpoints_from_chairman/viewpoints-pdfs/brazil_is_now_the_5th_largest_economy.pdf (accessed April 16,2011)
8. U.S. Department of State Home Page, "US Department of State Country Background Notes–Brazil," http://www.state.gov/r/pa/ei/bgn/35640.htm (accessed April 10, 2011)
9. Ibid.
10. Ian Bremer, "Brazils Economic Growth Shouldn't Be Overlooked.," October 7, 2007, http://www.realclearpolitics.com/articles/2007/10/brazils_economic_growth_should.html (accessed April 12, 2011)
11. U.S. Department of State Home Page, "US Department of State Country Background Notes –Brazil," http://www.state.gov/r/pa/ei/bgn/35640.htm (accessed April 10, 2011)

world.[12] In 2008 Mercosur concluded a free trade agreement with Israel, and another arrangement with Egypt was signed in 2010. Mercosur is pursuing free trade negotiations with Mexico and Canada and resumed trade negotiations with the European Union. The trade bloc also plans to launch trilateral free trade negotiations with India and South Africa, building on partial trade liberalization agreements concluded with these countries in 2004.[13] Also contributing to the country's economic surges has been China's swelling demand for Brazilian commodity exports. China has significantly increased its profile as a leading trading partner with Brazil. A significant rise in commodity prices has brought a windfall of fortune to the Brazilian economy in the last two years alone.

Another key component to Brazil economic success is precipitated by the fact that it is generally open to foreign investment. It is the largest recipient of foreign direct investment (FDI) in Latin America, and the United States is traditionally the top foreign investor in Brazil. That too may change in the not so distant future as China's purchases of Brazilian soy, iron ore, and steel in recent years has propelled it to be a principal recipient of Brazil's export strategy and proven to be an important source of increased foreign investment. Since domestic savings are not sufficient to sustain long-term high growth rates, Brazil must continue to attract FDI, especially as the government plans to invest billions of dollars in off-shore oil, nuclear power, and other infrastructure sectors over the next few years. The major international athletic competitions that Brazil will host every year leading up to the 2016 Rio Olympics are also leading the government to invest in roads, airports, sports facilities, and other areas.[14] At present investors are enamored with Brazil. Foreign direct investment for 2010 reached a record $48.5 billion.[15] A 2007 report from the United Nations Conference on Trade and Development revealed that a survey of 192 multinational companies ranked Brazil the fifth most attractive country in the world for investment.[16]

Brazil's economic boon is not without its blemishes. There are a number of weaknesses that still plague the Brazilian government. The country's growth rates remain by far the lowest of the four BRICs, driven by a tax burden of nearly 35 percent of GDP and often painfully slow progress on key economic reforms.[17] The Brazilian government's spending is growing faster than their overall economy. Both the public and private sectors of the Brazilian economy are investing too little causing analysts to question their highly optimistic growth forecasts. Many argue that too much money is being spent on the wrong things. The federal government payrolls are increasing substantially as is social security and pension spending, whereas investment in education and infrastructure are significantly lacking.[18]

If one asks why U.S. strategic leaders should bet on Brazil as the emerging model of global success as opposed to the other members of the BRIC community, it is easy to argue that its geographical position, its wealth of natural resources and rising importance in the in the hemisphere make Brazil unique. It is easy to reason there are plenty of good arguments to go with Russia, India or China as emerging leaders. All three have solid growth trajectories. All three are increasingly open for business in many sectors and markets. The key that sets Brazil apart is the fact that the nation enjoys important long-term advantages over the other three. China's political future will remain uncertain so long as hundreds of millions of citizens remain marginalized and have few accepted avenues for the redress of a growing list of political, economic and social grievances. India's politics are increasingly dominated by smaller parties with local interests to protect – often at the expense of the country's liberalization and economic growth. Russia continues to be plagued with some of the investment-unfriendly attributes of a classic petro-state.[19] Brazil, on the other hand, has

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12. "Lula da Silva Calls for an Enlarged Mercosur to Better Defend the Region's Interests" *MercoPress South Atlantic News Agency* (December 20, 2010) http://en.mercopress.com/2010/12/20/lula-da-silva-calls-for-an-enlarged-mercosur-to-better-defend-the-region-s-interests (accessed April 18, 2011)
13. U.S. Department of State Home Page, "U.S. Department of State Country Background Notes–Brazil" http://www.state.gov/r/pa/ei/bgn/35640.htm (accessed April 10, 2011)
14. Ibid
15. Andre Soliani, "Brazil FDI Jumped to Record, Covering 2010 Account Gap" (January 25, 2011) http://www.bloomberg.com/news/2011-01-25/brazil-current-account-deficit-was-3-5-billion-in-december.html (accessed on 15 April, 2011)
16. Ian Bremer, "Brazils Economic Growth Shouldn't Be Overlooked.," (October 7, 2007) http://www.realclearpolitics.com/articles/2007/10/brazils_economic_growth_should.html (accessed April 12, 2011)
17. Ibid.
18. "Brazil Takes Off," *The Economist* (November 12, 2009), http://www.economist.com/node/14845197?story_id=14845197 (accessed April 17, 2011)
19. Ian Bremer, "Brazil's Economic Growth Shouldn't Be Overlooked," (October 7, 2007) http://www.realclearpolitics.com/articles/2007/10/brazils_economic_growth_should.html (accessed April 12, 2011)

institutionalized some important political gains. The transformation of the country's political left, a domestic political consensus in favor of disciplined and market-friendly macroeconomic policy, and its stable democratic governance have created a solid foundation for steady and predictable growth over the next several years.[20]

All of these weighty economic revelations can only mean one thing – Brazil's economic rise will undoubtedly have profound changes in United States-Brazilian relations. It is evident that the United States is not the only game in town. Trade with China is booming and Brazilians are encouraged that their time has finally arrived. Brazilians are ready to seize the moment and be recognized as a serious county ready to achieve new advances and demonstrate its seriousness as a new global actor.[21] Relations between the two nations have always been respectful and productive, even with minor policy disagreements from time to time. However, with its new found economic leverage, it is clear that Brazil is no longer deferring to United States policy desires. It is determining its own path in this evolving new world order. Last year in 2010, Brazil's President Lula flexed the country's new found political might and stepped out against the U.S. led policy on Iran, voting against the United Nations resolution against Iran's nuclear program. However, with Brazil's new president, Dilma Rouseeff, initial indications are that the bilateral relationship may be off to a fresh start in 2011. President Rouseeff appears to be distancing herself from her predecessor's rhetoric on the Iranian sanction issue, yet she remains careful not to be perceived as aligning too closely with the United States.

What is apparent is that both counties have significant common interests from which to strengthen their diplomatic and economic relationships. Earlier this year the during a visit from the United States President, Barack Obama, the two countries signed agreements on scientific cooperation and cross recognition of patents. There are business opportunities for U.S. corporations in Brazil that the U.S. government would like to see open up. Brazil is in the market for defense technologies and military aircraft and the Brazilians want to sell more goods in the U.S. commodities market. Americans need Brazil's backing to persuade China to revalue the Yuan and Brazil needs the United States to end its subsidies to corn-ethanol producers and open up the market to Brazil's sugar ethanol.[22] These are but a few of the options for increased cooperation.

Some analysts argue that the United States has been slow to comprehend Brazil's transformation into an economic and political power. Now is the time for the United States to re-calibrate its partnership with Brazil. It must leverage the strengths of its own elements of economic power to forge a strong and lasting partnership with this emerging giant. The United States and Brazil are historically linked politically, economically and, to an ever growing extent, culturally. The United States must intensify its efforts to demonstrate to its southern neighbor that while other countries do have much to offer Brazil, the United States can offer more and is still clearly a partner of choice. Brazil's economic rise should be encouraging for the United States. Now is the time to meet the challenge with the creativeness and ingenuity that has made America stand out as a global leader. Rather than speculate on how to mitigate the challenges regarding a rising Brazil, America's policy makers should recognize them, embrace them, and let them serve as a catalyst to drive U.S. economic and foreign policy with Brazil in a constructive and cooperative manner.

20. Ibid.
21. Larry Rother, *Brazil on the Rise* (New York, Palgrave Macmillan 2010), p. 225.
22. "Flying Down to Rio," *The Economist* (March 19, 2011) p.45.