Is Copacabana Still the 'Little Princess of the Sea'?

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Introductory remarks

When in 1947 the poet João de Barro wrote that Copacabana beach in Rio de Janeiro was nothing less than the 'Little Princess of the Sea', the likes of Pelé and Garrincha were still eleven years away, and Fittipaldi, Piquet and Senna, even farther away in time. Brazil had not yet made any impact on international football nor formula one. In fact, the country was only known internationally, if at all, for its brand of coffee. However, Copacabana in the 1940s and 1950s was already setting the trend in fashion and culture, with celebrities up and down its famous broadwalk, as simply immortalised by João de Barro in his majestic, or even royal, description of the beach.

Since then Brazil has become an eventful place indeed; football, formula one, military dictatorship, growth, political transition, democracy, populism, hyperinflations, no growth, stabilisation, growth again, a sociologist as president, then a former shoeshine boy as president, and obviously high inequality at the background.[1]

No doubt the above illustrates that, for better or worse, some change has taken place in Brazil. Well, but this should not come as a surprise. According to Acemoglu (2009), in his landmark textbook, economic growth implies changes; new technologies will substitute old ones, there will be social tensions, with winners and losers, however overall there is growth, which is supposed to be good for the majority. Has Copacabana changed at all? Or is it still the 'Little Princess of the Sea' with its immutable royal *status quo?*

Copacabana has changed, as well as Brazil. The country has been growing somehow consistently for the last ten years or so. It is not like looking at the US nor UK incomes per capita with their long-run increase in economic welfare since the industrial revolution. However, the country has now surpassed its own GDP per capita of the early 1980s, therefore fully recovering from the 'lost decade'. As for Copacabana, it has changed a lot too, it does not set the trend in fashion anymore, one would have to go to Ipanema for that, and the *A* celebrities do not stroll in the famous broadwalk as it was their own private catwalk. Nevertheless, an emerging middle class, direct descendants of the poor, somehow obese (Brazilians are not known for their politically correctness), wearing fake D&G sunglasses and other colourful garments, not to mention the heavy intake of burgers with cold beer, are now enjoying what Copacabana has to offer. A change has indeed happened, and hopefully for good.

The remainder of this article deals firstly with how inflation and public debt have behaved from the 1980s onwards, and also with some monetary and fiscal policies issues. Change has happened there too, from extreme macroeconomic instability and somehow lose and irresponsible monetary and fiscal policies, to stability and economic pragmatism. Secondly, we take a look at trade openness and financial development, two variables that illustrate how much change has occurred in a once closed and inefficient society to a more open, competitive, and consequently market-oriented one. Thirdly, we examine how economic growth and inequality have been evolving over time, and the good news is that with consistent growth, which tends to trickle down, inequality can only go one way, and that is downwards. Finally, we offer some concluding remarks in which we highlight the importance of not only keeping up with the current good work, but also to start, once and for all, investing in infrastructure, so that the lack of it does not become an impediment for growth and prosperity in the very near future.

Inflation and debt

Brazil (and also a number of other South American countries), had been known for presenting poor

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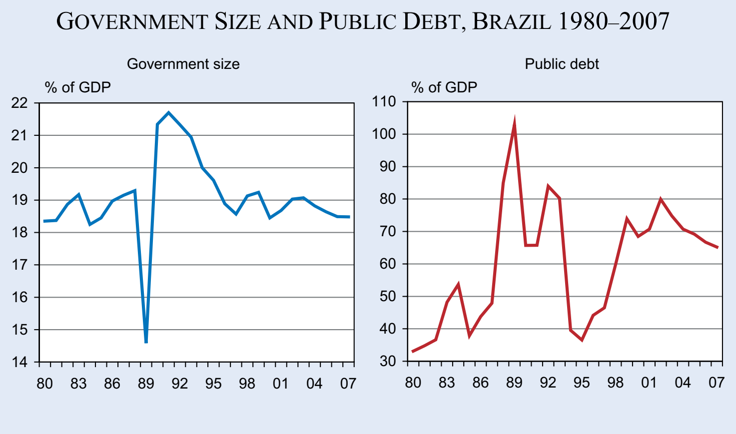
[1] Not to mention that Brazil has just elected its first woman president, Dilma Rousseff.

macroeconomic performance, in particular, but not exclusively, in terms of high inflation rates in the 1980s and first half of the 1990s.[2] In times that some would criticise the implementation of prudent and responsible monetary and fiscal policies in developing countries, it is always worth recalling that inflation in Brazil reached a staggering 82 percent *per month* in March 1990, and then 2,489 percent in 1993. In this respect Brazil was indeed unique in South America at the time, it presented not only one, but two hyperinflationary bursts!

Figure 2



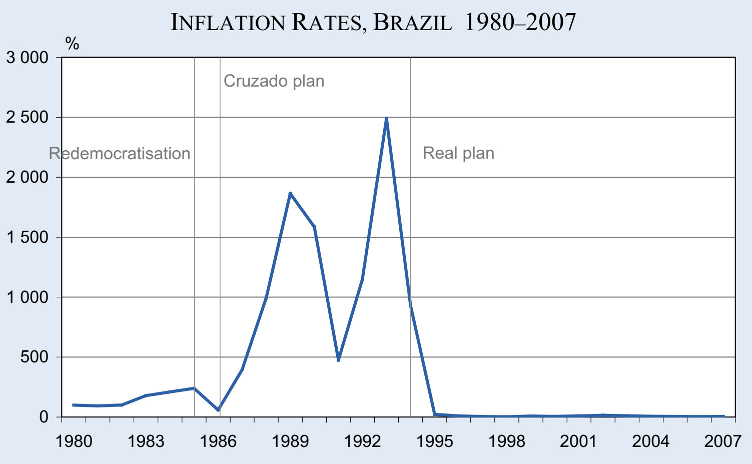
Sources: Penn World Table; International Monetary Fund.

All in all, the Brazilian inflation was persistently high for almost 10 years (from 1985 to 1994), which is perhaps a fine example of a 'delayed stabilisation' (Alesina and Drazen 1991), following the process of political transition that took place between 1985 and 1989.[3] During that time, a number of (heterodox) stabilisation plans were implemented, the populist Cruzado Plan, the Bresser Plan, the hot Verão Plan and the colourful Collor Plan, not to mention the process of redemocratisation itself. Stabilisation came only in July 1994 with the implementation of the (somewhat orthodox) Real Plan, and since then inflation rates have been consistently low in Brazil.

In terms of government size and public debt in general, what can be said is that the share of government in the GDP in 2007 is not much bigger than it used to be in the early 1980s. Many times though, as suggested by Bruno and Easterly (1998), by just taking the averages we end up missing the short-run dynamics of particular processes. In this case, the share of government in the GDP presented a considerable increase in the early 1990s, during the first hyperinflationary burst of 1989/1990 and the on the run up to the second burst of 1993/1994. However, after the stabilisation of 1994 it has returned to its long-run steady state (around 20 percent of the GDP).

Moreover, public debt, after ballooning during the hyperinflationary bursts of the 1980s and early 1990s, was dramatically reduced during the stabilisation, just to increase again during the late 1990s.[4] However, it has seen a slight reduction recently, although it is still much higher than in the early 1980s, which is always a cause for concern. Given its (erratic) nature during the period, government debt still does not seem to have a sort of long-run steady state which to converge to.

Figure 1



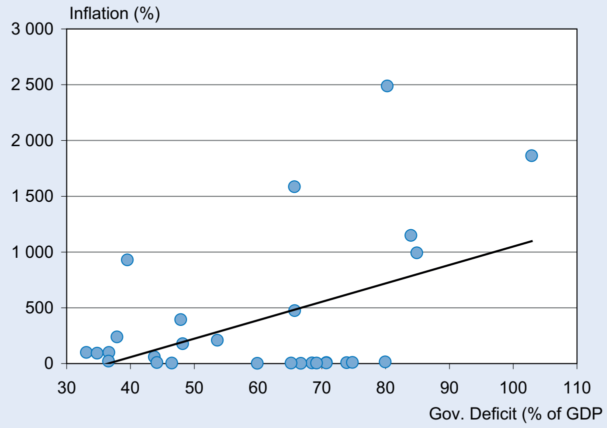
Source: Brazilian Bureau of Census.

Basically Brazil has changed (and is still changing), its institutional framework with regards to monetary and fiscal policies. For

[2] Other countries presenting a similar macroeconomic pattern in South America at the time include: Argentina, Bolivia, Peru and Uruguay.
[3] President Sarney, 1985 to 1989, although a civilian, was not elected by popular vote, but by an electoral college. The election of President Collor by popular vote in 1989 somehow completed the political transition which was initiated in 1985.
[4] In fact, public debt increased sharply from 1985 onwards, which coincides with the beginning of the democratic transition, or with the idea that new democracies incur in higher deficits (Brender and Drazen 2005).

Figure 3

OLS Regression Line between Inflation and Public Deficit, Brazil 1980–2007



Sources: Brazilian Bureau of Census; International Monetray Fund.

instance, on the monetary side the Brazilian Central Bank has not only improved considerably the quality of its technical staff, but has also implemented inflation targeting since 1999.[5] This is a significant step forward in terms of implementing a particular economic institution (more operational independence to the Central Bank to implement particular policies), which was simply unthinkable of back in the 1980s.[6]

On the fiscal side, the Brazilian treasury has also improved the quality of its personnel significantly. More fundamentally though, it has implemented towards the end of the 1990s fiscal responsibility laws at federal and regional levels to considerably constraint the ability of running high public deficits, which in turn tend to have a knock on effect on inflation (Fischer 2005).

Essentially, the above-mentioned institutional framework implemented towards the turn of the century, as simple as it is, has made, without any exaggeration, a huge difference in terms of macroeconomic performance, or alternatively speaking, in controlling the destructive forces of economic populism (high public deficit and high inflation in an unequal country that demands some redistribution), so prevalent during the transition from military rule to a more democratic framework seen in the 1980s and first half of the 1990s in South America in general, and in Brazil in particular (Bittencourt 2010a).

Economic openness and financial development

For all sorts of populist reasons (import-substitution policies, aka protection of particular vested interests), Brazil (and South America in general), has also been known for being a relatively closed and inefficient society.[7] However, the share of exports and imports to GDP has been slowly but surely increasing over time, at least since the early 1990s when President Collor decided to open up the country, in particular to imported luxury cars, but not only, to international competition. Even more important, this process of openness has continued and even furthered with time, with all its (positive) consequences to technological diffusion, international competition and enhanced economic efficiency.

Moreover, foreign direct investment in Brazil has simply ballooned after the stabilisation of 1994, although it has seen a natural drop during the crisis of 2000–2002, just to recover again recently. In addition, during the late 1990s the government implemented some changes to the constitution of 1988 in which the rules for foreign investment were somehow relaxed, not to mention the process of privatisation of public monopolies that took place during the same period, which all facilitated investment of all sorts.

Overall, openness to trade and foreign direct investment have been on the rise during the last ten years or so, and coincidentally enough the sharpest increase in both indicators has taken place since the macroeconomic stabilisation of 1994. This indicates the importance of a stable macroeconomic environment for trade, investment and prosperity in general, and also a degree of political maturity to actually implement particular market-oriented policies which were considered taboo in Brazil during the eventful 1980s.

In terms of financial development, Brazil has also come a long way since the 1980s. In fact, the story is

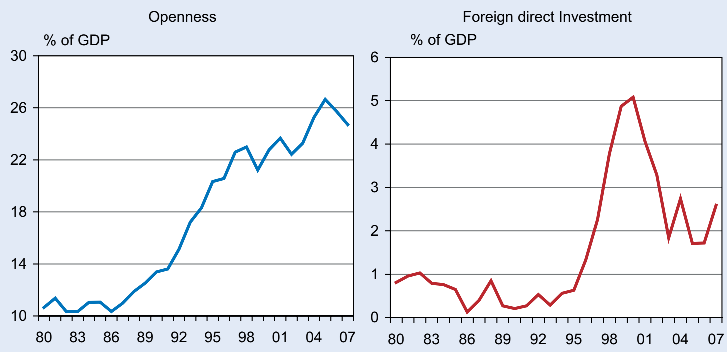
[5] The renovation that the Brazilian civil service has seen recently is quite remarkable, and the Central Bank is no exception, with a research department populated with a number of PhDs in economics from top international schools.

[6] However, Carstens and Jácome (2005) warn that Brazil still has one of the least independent central banks in Latin America, which is always a cause for concern.

[7] It is worth remembering that the import-substitution industrial policy that Brazil implemented in the 1940s was heavily dependant on public monopolies which were insulated from international competition, and also on protection of particular private national interests.

Figure 4

TRADE OPENNESS AND FOREIGN DIRECT INVESTMENT, BRAZIL 1980–2007



Sources: Penn World Table; World Development Indicators.

quite similar to the above. The benchmark measure of financial development, the share of the liquid liabilities to GDP (which we call M2), started from a timid 20 percent of the GDP in the early 1980s to reach a much higher share of roughly 60 percent of the GDP in 2007.[8] Again, it is important to avoid the averages and take a deeper look at what happened during the late 1980s and early 1990s, when M2 presented an erratic behaviour of ups and downs, certainly because of the macroeconomic instability seen at the time. Nevertheless, M2 played an important role during the hyperinflationary bursts in terms of providing the public, at least those with access to financial institutions, with assets which provided even daily indexation and therefore some protection against high inflation.

Even more importantly, the share of private credit to GDP, a more sophisticated measure of how active the financial sector is in actually allocating credit to private entrepreneurs, has increased sharply since the 1990s, which somehow highlights once again the importance of achieving a certain level of macroeconomic stability as a pre-condition for financial development (Bittencourt 2011). In addition, the financial deregulation of the 1990s, which introduced a certain degree of competition in the financial market, clearly played a role in creating some incentives for the financial institutions to actually perform their supposed duties.

The above trade openness and financial development deregulation processes that have been taking place in Brazil since stabilisation are important not only because they illustrate environmental and behavioural changes in how particular policies, unthinkable of 25 years ago, are implemented and even accepted by most, but also because some would argue that more open and competitive societies tend to growth faster (Lucas 2009), and also that finance is an important determinant of economic growth (Levine 2005 or Bittencourt 2010b).

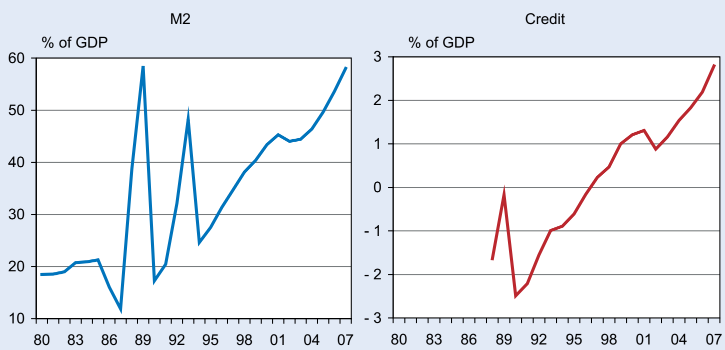
Growth and inequality

In terms of GDP per capita (the main macroeconomic measure for economic welfare), we can guess by now that for obvious reasons during the hyperinflationary bursts of the 1980s and early 1990s income per capita was considerably reduced (Fischer 1993), which in fact constitutes the 'lost decade'. However, income per capita has been experiencing a consistent positive trend since the macroeconomic stabilisation of 1994, which highlights once again the importance of macroeconomic stability (or prudent and responsible macroeconomic policies) in generating a stable, and conducive to growth, environment.

Inequality, a much debated – and somehow perennial – Bra-

Figure 5

FINANCIAL DEVELOPMENT, BRAZIL 1980–2007

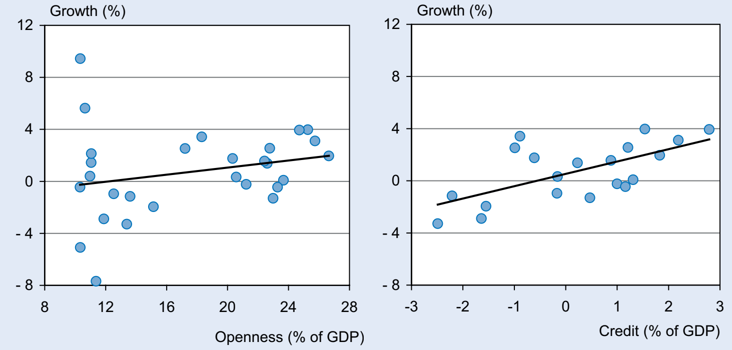


Sources: World Development Indicators; Database on Financial Development and Structure.

[8] For instance, in 2007 the share of the liquid liabilities to GDP in the United States was of 80 percent.

Figure 6

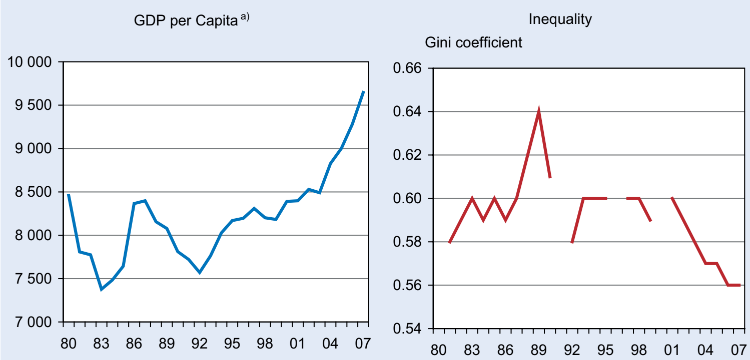
OLS Regression Lines between Growth and Trade Openness and Growth and Private Credit, Brazil 1980–2007



Sources: Penn World Table; World Development Indicators; Database on Financial Development and Structure.

Figure 7

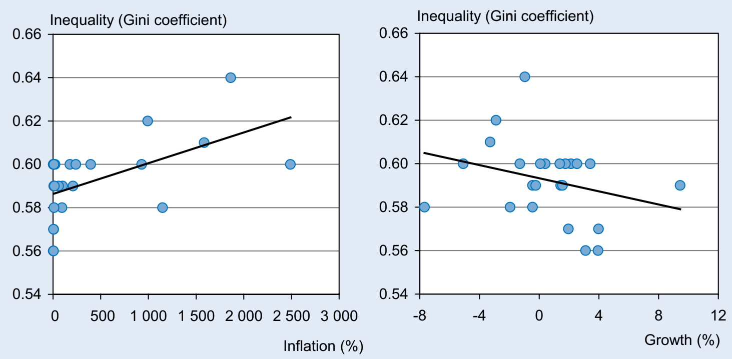
GDP per Capita and Inequality, Brazil 1980–2007



a) Calculated by the GDP per capita in Brazilian real, divided by the real value of GDP per capita in international dollars.
Sources: Penn Table and Brazilian Bureau of Census.

Figure 8

OLS Regression Lines between Inequality and Inflation and Inequality and Growth, Brazil 1980–2007



Sources: Brazilian Bureau of Census; Penn World Table.

zilian problem, has also followed a very natural trend, with sharp increases during the periods of macroeconomic instability (Bittencourt 2009); the poor are certainly the ones at highest risk during hyperinflations for being unable to have access to indexed financial assets which could somehow protect them against the full onslaught of high inflation (via a process of financial adaptation, see Erosa and Ventura 2002). On the other hand, and following the same pos-stabilisation trend of other variables before, inequality, as persistent as it is, has not only initially converged to its long-run steady state (a Gini coefficient of .59), but also decreased to even lower and unprecedented levels.

Ultimately, the macroeconomic stabilisation, and all the institutional reforms implemented, of the 1990s has not only brought down inflation for good, but also presented a real impact on other cyclical and structural variables. The poor, no doubt, had to carry the heavy weight of a decade of high inflation and irresponsible populism. However with stabilisation and particular simple economic reforms such as trade openness, deregulation of financial markets, privatisation and end of inefficient public monopolies, growth picked up again, and coincidentally enough, inequality has been falling to unprecedented levels since then.[9]

The take home message in this particular case is incredibly simple; macroeconomic stability, combined with a certain degree of political maturity, is, to say the least, a necessary condition for economic growth, and growth is still the best and the most equitable policy to reduce inequality (Kuznets 1955).

[9] Some would argue that the new welfare system being implemented in Brazil is also behind the recent reduction in inequality. However, this remains to be seen.

Concluding observations

In this article we have seen how some macroeconomic variables and indicators have been performing in Brazil since the 1980s. Basically, we argue that Brazil has come a long way since the convoluted 1980s and early 1990s, with a number of disruptive events happening before macroeconomic stabilisation was finally achieved in 1994. Moreover, we argue forcibly that macroeconomic stabilisation (and the institutional framework that accompanies it), has been the precondition for increased economic openness and foreign direct investment, financial development, economic growth and much lower inequality.

No less important, the country has also been an example in terms of political maturity, with different political parties alternating in power as in any mature democracy. All the same, economic stabilisation combined with political maturity (which is also a fine example of what causes what), are at the heart of what Brazil has achieved in terms of institutional reforms, economic policies, and obviously better outcomes recently (Acemoglu *et al.* 2008).

However, although Brazil has been on the right track for the last ten years or so, anecdotal evidence suggests that the public infrastructure is crumbling. Those visiting the country recently could not avoid seeing the sorry state of airports, ports and roads in general, not to mention the national grid and the collapse of the Itaipu dam recently. In addition, government consumption has been on the rise for twenty years or so now, and public investment has not really kept with the Joneses (Adrogué *et al.* 2006). All the same, the lack of infrastructure in a country which is displaying growth of the private sector is worrying, since at some point bottlenecks might arise, and it would be a pity to stop the prosperity because of infrastructure glitches.

To conclude, Copacabana, like most modern monarchies, has evolved and adapted for its own survival, and it is now a much more representative place which accommodates a much broader spectrum of the Brazilian population (perhaps a sign of a more equalitarian society), which makes *her*, as immortalised by the Poet, the 'Little Princess of the Sea'.

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