Brazilian Development: This Time for Real?

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Introduction

In the late 1980s a popular Brazilian television comedian presented a skit on his weekly show that consisted of a Brazilian General awaking from a coma he had entered in the heyday of the military regime circa 1975. Anxious to catch-up with the news of the day the general was shocked as the nurses and doctors recounted what was currently happening in the now democratized country. The humor laid in the way current events, which had become mundane from the perspective of viewers, assumed dramatic proportions for the oblivious general. Having lived the day-to-day process of incremental change the viewers came to take the status quo for granted, yet the general was systematically shocked that activities, situations and outcomes that were unthinkable in the past could now have become routine, and that such a striking reversal of fortune could have taken place for key public figures.

If this skit were to be revived today, updated to compare the changes in Brazil from the late-1980s/early-1990s to the present day, it would have plenty of material to astound the new coma-emerging character. This time around the greater contrast would be on economic rather than political issues, but the punch line would still rely on the fact that people who lived through the gradual process of change tend not to perceive the magnitude of the total shift that has taken place. Although almost everyone would agree that Brazil is economically better off today than it was 20 years ago, we suspect that many people would be surprised at the breadth, depth and magnitude of the change when presented with the data. Not only have salient pathologies which once seemed to be ineradicable features of the economy, such as bouts of hyperinflation and external debt, been tamed and beaten, with the country achieving investment grade status in 2008. In addition a wide variety of other not so prominent variables have also undergone dramatic improvement, collectively reinforcing the shift from a dysfunctional to thriving economy.

Even when analysts acknowledge the importance of these changes, there is often skepticism as to whether the data constitute evidence that Brazil has fundamentally and permanently moved towards becoming a developed economy. After all, history is full of examples of countries that seemed to have made the transformation only to slide back down when hit by the next shock. Brazil is a prime example of such past disappointments, having been the fastest growing economy in the world from 1913 to 1980, followed by near-zero rates of growth for the rest of the century (Coatsworth 2007). Also, just like we can point to a list of areas where Brazil improved, we can point to an equally impressive list of things that have not improved or have gotten worse. Corruption scandals of all shapes and sizes continue to pop up periodically; Brazil remains towards the bottom of educational achievement tables, and towards the top of inequality rankings; infrastructure is falling apart; the tax burden is one of the highest in the world; and interest rates cripple domestic investment. These are all real and damning characteristics of the current Brazilian economy and they certainly seem to mitigate the case made by the list of achievements.

Despite the seemingly contradictory evidence we will argue that Brazil is currently undergoing a significant and permanent move towards becoming a developed economy. Confronted with strong evidence for both sides of this issue how can one determine which set of evidence outweighs the other? In this paper we will argue that there is no way to make a definitive assessment based on the evidence at hand. There is no 'smoking gun' or set of evidence that can definitely close the case proving the other side wrong. On their own, none of the achievements reached thus far, impressive as they may be, is incompatible with this being another instance of temporary, short-lived

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growth. Similarly, none of the problems that persist is sufficient to refute the case that the current positive changes will be profound and permanent. Ultimately only time will tell which argument best describes the stage of development Brazil is currently undergoing. Until then the case must be made by putting forth a conceptual argument why the current mix of evidence is compatible with the claim that changes in Brazil will lead to sustainable economic and political openness, and ultimately sustained economic prosperity. The conceptual argument must present an interpretation of the facts and data that passes a *preponderance of evidence* standard, as even *beyond a reasonable doubt* is unlikely to be achieved at this point.

We proceed in the second section by first presenting the evidence for and against the claim that Brazil has undergone deep and sustainable economic and social progress in the past twenty years, leaving it in a propitious position to make a transition to developed-nation status. We argue that although the evidence is necessarily circumstantial, it is consistent with Brazil being on a sustainable trajectory to development. In the third section, in order to provide greater theoretical consistency to our position, we show that the changes over the past twenty years are crucially grounded in a deep process of institutional change that has fundamentally increased open access to economi and political resources. North, Wallis and Weingast (2010) have recently argued that increasing economic and political access is a necessary condition for the transition to an 'Open Access Society' which includes the developed countries in the world. The underlying institutional changes that generate open access have eluded most countries in the world so we will have the burden of presenting evidence that such changes in Brazil are real and sustainably reinforcing. We will make our case based on the combination of virtuous economic and political changes towards greater access to more players and members of society.

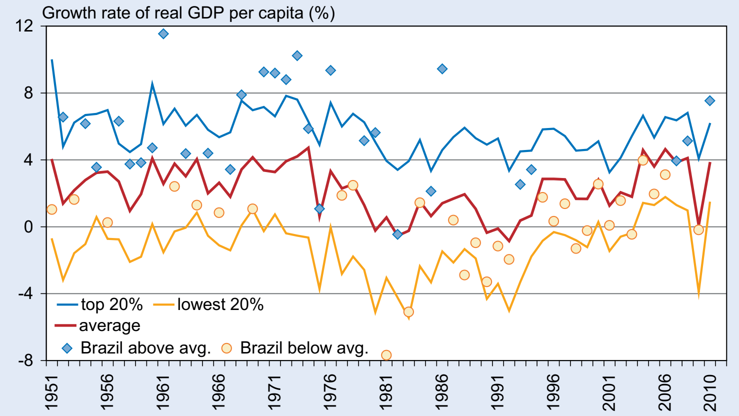
Economic changes from the 1980s to 2011

Few people would disagree with the assertion that the Brazilian economy is currently undergoing a very positive period. But that is not the issue that we address. The essential question is whether this recent performance is merely a temporary stretch of good results, similar to that which several other emerging economies are currently experiencing, or whether it is part of a more profound process of change, and part of a fundamental transformation of the country towards a higher stage of development. Although the scope and magnitude of the changes in the last twenty years have been dramatic, similar spurts have happened before and subsequently been reversed, leading to natural skepticism that this time will be for real. Figure 1 shows the growth rate of GDP per capita in Brazil from 1950 to 2007 relative to the average of 124 other countries. The middle line shows the (unweighted) average of the other countries and the lower and upper lines show the top and bottom 20th percentile. The Brazilian rate of growth is shown as diamonds when it is above the world average and as circles when it is below.

In the thirty years prior to 1980, Brazil's rate of economic growth exceeded the world average in 21 years (eleven times above the top 20th percentile) and fell below the average only nine years. After 1980 it was below the average in 22 years and above it in only 8 years. The positive results during the early period fostered a confidence and belief amongst Brazilians that a country so well endowed with land, natural resources, climate, geography and a potentially large internal market could only be destined for greatness. But the reversal in the second period eroded that belief, both among experts and the Brazilian public. The long line of failures and setbacks produced a profound skepticism that the recent good news may not be sustainable. In this section we will first present evi-

Figure 1

BRAZILIAN GDP PER CAPITA GROWTH RELATVE TO THE REST OF THE WORLD



Sources: Data for 1950–2007 from Heston, Summers and Aten (2009), constant 2005 prices (RGRGDPCH); data for 2008–2010 from IMF (2010).

dence on the positive and negative aspects the Brazilian ledger of development. In the final section we provide an argument for our belief that the changes since 1994 a real and fundamental. Our focus initially is on economic variables and outcomes, with political and institutional variables left for the fourth section as they are part of our explanation for why the economic changes are well-grounded.

The first point to note is that by looking at GDP figures alone there is nothing in the recent performance of the Brazilian economy to suggest that there is anything special going on. Since 1995, GDP growth has been below the world average in 13 years and above it in only 3 years. It is true that the high growth years have been recent: 2007, 2008 and 2010, and also that forecasts are for high rates of growth in the upcoming years (IMF 2010). But it is still a rather lackluster performance for a country we claim to be transitioning to a higher stage of development. So why has Brazil been attracting so much attention lately? Why is it now, along with China and India, expected to be a major source of world economic growth in the coming decades ushering, by some accounts, the start of a new world order? Why have predictions of the type that it "could be one of the world's five biggest economies by the middle of this century" (*The Economist,* 14 November 2009, 3) reemerged decades after similar predictions failed so blatantly?

In order to answer these questions we present the most conspicuous evidence for the case that the transformation in Brazil is sustainable and real. The idea is not to give a fully integrated account that explains the evidence in detail and weighs the different interpretations. It is instead to provide a barrage of evidence that together reinforce each other so that their simultaneous occurrence reduces the probability that, in such a scenario, that claim could be wrong. Subsequently a different set of evidence, which sometimes includes the same data used before but with different interpretations, will be provided so as to consider the counterargument that current economic growth in Brazil is fragile and cannot be sustained.

Although we do not intend to fully integrate all the different strands of evidence, we will give the presentation some structure by considering the following perspective: if Brazil is in fact on the path to a higher stage of development, then we should expect to see changes in the past one or two decades in several areas that are essential for growth, especially those where Brazil has traditionally been particularly deficient. One of the main themes in the Brazilian development literature has always been the paradox of why a country that had achieved such impressive economic growth before the mid-1970s was thereafter incapable of recovering that past performance (Bacha and Bonelli 2005; Blyde *et al.* 2008; Hausmann 2008; Pessoa 2006). Scholars in this literature presume that the growth potential is there for Brazil, but that there are different constraints that hold it back. Some constraints are more binding than others and collectively they restrict the growth potential from being realized. We use this perspective as a guide for the presentation of our evidence. For our claim to hold that Brazil is on a positive trajectory we will show that significant progress has been made in those areas traditionally held as causes of Brazilian chronic backwardness. It is not necessary that Brazil has fully solved each of these constraints, but rather that significant strides forward have been made and that further progress is likely to persist. In absolute terms some of these areas might still present significant deficiencies, for example education, but our interest is not so much in the snapshot of the current situation as it is in the likelihood that this problem will be addressed in a timely manner so as not to become a roadblock for growth.

So what are the main constraints and deficiencies that are typically credited with holding back Brazilian economic growth? There is no lack of candidates. Some of the major limitations include: poor human capital, low savings, poor infrastructure, inefficient and excessive taxation, macroeconomic instability, poor business environment, highly concentrated income distribution, rigid labor markets, informality, weak rule of law/property rights, and corruption (Bacha and Bonelli 2005; Blyde *et al.* 2008; Hausmann 2008; Pessoa 2006). The problems appear to be so pervasive, deeply rooted and impervious to past attempts at tackling them, that for many analysts there is a belief that the problems are insurmountable, a belief that is especially strong among those who lived through the process. Our goal is to show evidence that much has changed in recent times and often in quite unexpected ways, and areas. In some policy areas complete turnarounds have taken place and in other areas only initial improvements. Some old flaws and vices that were typically thought to be an inextricable part of the Brazilian way of being and doing things have disappeared or been diluted. Similarly, some surprising new strengths and comparative advantages have emerged. Clearly there are still numerous problems and need for further change. Yet our hope is that the collective weight of the data presented substantially changes the reader's assessment of the probability of our position that a transformation is underway in the Brazilian society.

A good place to start is by noting that the poor performance for most of the 1990s and into the 21st century in terms of rates of GDP growth is not due to a lack of growth opportunities. On the contrary, given that Brazilian interest rates have systematically been among the highest in the world in the past two decades is a consequence of the need to avoid demand from exceeding supply and leading to inflation. Hausmann (2008) argues that it is the lack of savings to fund these repressed investments that is the main 'chain that holds Brazil back', with the implication that changes that increase savings will automatically be reflected in higher growth levels. The view that Brazil is set for a long period of growth relies on the capital constraint being relaxed. Given that public savings in Brazil are negative, increasing the availability of capital requires that foreign capital increases along with domestic savings. At several points in the past Brazil has had access to foreign capital, but never in a sustained manner. In this sense the achievement of 'investment grade' in 2008 is crucially important. It not only provides a weighty confirmation by skittish global financial markets of the main point of this paper but it has also opened the door to considerable new sources of capital inflows. Since 2008 the levels of foreign direct investment have shot up with a record inflow of 48 billion US dollars in 2010, making Brazil the 12th country in the world in terms of stock of foreign direct investment (UNCTAD 2011). Also, by the end of 2010 Brazil had a historical high of over 260 billion US dollars in foreign reserves, more than covering its foreign debt obligations. Such a situation would have been unfathomable a mere 10 years earlier when the excess of foreign debt over reserves reached its record level at 205 billion US dollars. Brazilians, who have typically viewed the foreign debt as one of the greatest symbols of their country's submission to foreign capitalist dominance, have not failed to see the irony in the fact that in 2010 Brazil became for the first time a creditor of the IMF. Similarly, domestic savings have been increasing in Brazil partly due to large increases in export revenues.

The increased availability of foreign inflows of capital and domestic savings has already translated into increased economic activity, record low unemployment, and 7.5 percent GDP growth in 2010. To sustain this performance it is necessary that current international circumstances, such as high commodity prices and foreign direct investment availability, remain fairly stable, which seems a reasonable assumption given that there appears to be no inherent limitations on demand for Brazilian exports, especially in the new world order that seems to be emerging with Asia being the leading source of demand.

But will the country be able to continue increasing its supply of goods and services in terms of quantity, quality and innovation in order to satisfy both the foreign and the rapidly growing internal market? Several of the old constraints hold the potential to delay or maybe even derail these ambitions, the most direct of these being a backward agricultural sector, lack of qualified human capital and poor infrastructure. Let us take these in turn to see how they have evolved in the past two decades.

During the 1980s the agricultural sector in Brazil was so highly dysfunctional in so many aspects that few analysts would have predicted the changes that would ensue in the next 20 years. Land reform and rural labor legislation in the 1960s increased the price of labor, and perverse subsidies reduced the cost of mechanization, leading to a productive structure that defied the country's natural factor endowments (Rezende 2006). The upshot was a concentrated and mechanized set of large productive farms co-existing with large under-utilized holdings, and hordes of landless peasants. Low productivity amid much rural poverty prompted an exodus of labor. Weak property rights to land retarded investment and innovation, and impeded tenancy contracts closing one of the most traditional avenues for individual progress in agriculture (Alston and Mueller 2010). Well-intentioned but misguided land reform policy resulted in one of the world's most massive series of land conflicts, spreading violence throughout the countryside and further hindering production and productivity (Alston, Libecap and Mueller 1999 and 2010). The government viewed agriculture not as a leading source of economic growth but rather a supporting sector whose purpose was to provide some inputs that the more modern parts of the economy needed to push the country forward.

This situation led to a standard view into the early 1990s among analysts of Brazilian agriculture that without structural change through land reform and more government involvement in the form of subsidies, purchases and price controls, the sector could not be truly modernized. Years later no such structural change had taken place. The government redistributed a considerable amount of land but in a wasteful manner and without substantively changing the sector; a small proportion of all farms are still responsible for most of the production. In the 1990s the government phased out subsidies and now the government's direct involvement in agriculture is minimal. Yet, under the radar screen and contrary to most prognoses, Brazil has become a major agricultural powerhouse. By 2009 Brazil was a an agricultural superpower in production with the following world rankings in parentheses: sugar (1); coffee (1); orange juice (1); beef (2); soybeans (2); chickens (3); pork (4); corn (4); and cotton (5), as well as a significant producer and exporter of a very large range of other agricultural products.

Brazil also has considerable growth potential in agriculture because it has more available arable land than any other country, part beyond the current agricultural frontier and part in the form of degraded pasture that can be put to more productive uses, all without threatening the Amazon rainforest. Complementing its land endowment, Brazil is one of the best endowed countries in terms of water. On the energy side, biofuels, derived from sugarcane are a major domestic source of energy, and there is still a huge potential export market that is bound to grow as Brazilian ethanol is cheaper and more environmentally friendly than other existing biofuels. Part of the success is due to domestic research and innovation that created more productive procedures and varieties for Brazilian conditions, defying some long established perceptions of what can and cannot be grown in different regions of the country. Given the current endowments of Brazil we are not overly optimistic to imagine that the impressive changes in Brazilian agriculture are only beginning and that agriculture will be a major source of growth for the country in the coming decades.

One objection to our prognosis is that the country´s already deficient infrastructure will significantly raise costs not only for agriculture but for economic activity more generally. A decaying road network, crowded airports, increasingly frequent blackouts, clogged ports and generally overstretched urban infrastructure already hinder the production and movement of goods, services and people. As the rate of economic growth picks up pace these bottlenecks will become an even greater drag on the economy. Given that there has been so little investment in infrastructure in the past two decades, why would one expect this to be forthcoming now? The answer to this question is important because once we have determined what has been the impediment for infrastructure investment in the past we can assess whether it is likely to continue blocking investments in the future. We argue that the current state of infrastructure was a deliberate choice made in the context of trade-offs that have yielded compensating benefits but that the constraints on investment in infrastructure are now less severe and indeed there appears to be a growing consensus that investment in infrastructure should be a priority.

Alston, Melo, Mueller and Pereira (2010) argue that infrastructure has been the prototypical residual policy in Brazil in the past decade. The government goal was first to ensure a fiscal balance which meant suspending expenditures in policy spaces. We argue that the costs imposed by the increasingly subpar infrastructure contributed importantly towards assuring the monetary stability that has been the foundation of the economic and social transformation in Brazil. In short the costs of prior investments in infrastructure costs were, in a sense, 'not worth it'. Now that fiscal and monetary stability are the norm – remember the investment grade status of Brazilian debt – and with Brazil predicted to experience several years of higher rates of growth, this tension between macro-stability and infrastructure may be obsolete. We maintain that the shadow price of infrastructure services and the consolidation of Brazil's fiscal maturity will allow for increased government investment in infrastructure, with the funding partially coming from greater private and foreign investment.

The government has initiated new rules that decouple infrastructure investment from primary surplus accounting. In addition the government elevated greater investment in infrastructure as a central objective through its *Program for Growth Acceleration* and the national development bank (BNDES) has put its weight behind investment in infrastructure. Part of the impetus for greater investment has come in preparation for the World Cup in 2014 and the Olympics in 2016. Our argument is that the circumstances that led to poor infrastructure in the past have changed and that the new government under President Dilma Rousseff has put better infrastructure at the top of her priorities for spending.

Of all the constraints that the Brazilian economy faces, a deficient educational sector leading to a shortage of human capital appears to many analysts as the most severe. Since the end of the 19th century, and continuing to today, Brazil has been below the Latin American literacy average. Better delivery of educational services is clearly a major obstacle for the country's ability to sustain higher rates of growth and a more distinguished role in international affairs. The list of ills that afflict education in Brazil run the gamut: low quality of instruction, weak curriculum, short hours for the school day, absenteeism by students and teachers, poorly paid and motivated teachers, poorly educated and non-involved parents, child labor, and low, erratic and misplaced funding. The title of a volume edited by Birdsall and Sabot (1996) for the Inter-American Development Bank, as well as the title of the first chapter, summarize well the state of Brazilian education in the mid-1990s: *Opportunity Forgone: Education in Brazil* and Chapter 1 – 'Education in Brazil: Playing a Bad Hand Badly'.

The litany of problems and deficiencies in education chronicled by Birdsall, Sabot and other scholars are still present in Brazil today, and the ubiquitous preoccupation with education is certainly warranted. However, what is important for our argument is not the current level of education quality and attainment as much as the direction and pace in which it is heading. Since 1996 the government has initiated major reforms to the educational system along several different fronts, with the result that, despite the doomsayers, there has been significant improvement and a promise of more to come. Our assessment can be seen by contrasting the chapter on Brazil in 1996 by Birdsall and Sabot to a recent OECD (2010) study on 'Strong Performers and Successful Reformers in Education', which included Brazil as a leader in reform. The OECD study stressed that in Brazil coherent and innovative reforms have started addressing the underlying causes of poor education in ways that promise significant long-term changes.

The reforms addressed several different dimensions of the educational system and at several different levels – federal, state and municipal (OECD 2010). Funding, which is constitutionally hardwired, is high by world standards but the productivity of the expenditures has been improved and made more equitable. The government created several new funds to assure resources for different educational purposes: they increased teacher salaries, especially in the poorer regions, and emphasized better training for teachers; government mandated local education councils increased community participation; conditional cash transfers have been extremely successful and have been expanded to cover more than 11 million families, contributing to reduce absenteeism, repetition and child labor; and completion rates have also improved. With school attendance now nearly universal, government has directed efforts to increase the length of the school day and the school year. The government also extended the number of years in the curriculum to 12 years.

Brazil has long had one of the highest returns to education in the world, which is a direct consequence of the unmet demand for human capital. This market signal is clearly perceived by the population which has now found it easier to respond as education availability and quality has improved. At the higher educational level, the number of private universities has increased dramatically as have the number of students in public universities, with both forms of expansion spurred by purposively government created policies. Today Brazil boasts half a million graduates and 10,000 PhDs every year and the number of scientific papers has increased with Brazil's share in the world from 1.7 percent to 2.7 percent since 2002 (*The Economist,* 6 January 2001).

What is more important than the impressive albeit insufficient results that have been attained so far is the change in governance over education policy. There has long been a consensual recognition of the key role of education, as expressed in the hardwiring of education expenditures in 1988 Constitution. On its own, hardwiring did not ensure that expenditures would be effective. An important change has been the willingness to measure, evaluate and benchmark performance at all different levels, creating accountability and incentives for improvement, effort and innovation. As in most countries, this type of policy was met with initial resistance from teachers, students, parents, unions, and political parties that feared the new burdens and requirements that such a change might impose on their constituents. Nevertheless, as the government pushed through the new policies, earlier opposition subsided. The various evaluation schemes began to be seen as providing valuable feedback that was eventually used not only by policymakers but also by parents and consumers to pressure for better quality of education.

We stress that this change in mentality is important because it creates an environment where improvement is continually sought and incentives start to break the traditional resistance to competition and meritocracy. Long gone are the days in the 1980s when the only ranking of university departments available to students deciding on what to study was the Playboy ranking, published once a year. Today there are indices and rankings for several different levels and dimensions of departments and universities across Brazil. Not only are the rankings used by students but the government has used the rankings to change policy in ways that reward what works and to locate and reform low performers. The new mentality of educational excellence, together with the federal structure of Brazilian education provides an environment where experimentation and innovation are fostered. It is thus the magnitude of the changes in the ways in which government(s) make education policy, more than the actual achievements in terms of measurable statistics that provide our optimism that education will not be a critical constraint to economic growth. Rather we see the advances in education as a crucial input to sustaining growth in the coming years.

However one may choose to define what constitutes an improvement in economic development, at some point it is necessary to have progress in reducing poverty which most likely in turn will reduce income inequality. So even if one accepts our position that changes in the last two decades have surprisingly and fundamentally improved the outlook regarding capital availability, agriculture, infrastructure and education, there may still be some skepticism whether these changes were merely isolated and transient events, or part of a more systemic process of development. In the next section we will show the institutional foundation that connects these changes, but first we show that the changes in poverty in Brazil are quantitatively significant and qualitatively unprecedented.

Poverty rates in Brazil fell by half from 1993 to 2009, declining from 43 percent to 21 percent of the population. Extreme poverty rates fell even further from 20 percent to 7 percent. Though impressive, one could argue that throughout Brazilian history there have been spurts of poverty reductions, and that they have simultaneously taken place in other countries, perhaps driven by high commodity prices. However, a crucial difference this time is that both decreases in inequality and economic growth have produced a decline in poverty (Barros *et al.* 2007). This is much different than the fall in poverty in China which has been accompanied by a significant increase in inequality. The same is true of the recent growth in Russia, and India – rates of inequality have increased, though less than in other developing countries (Bardhan 2009). In Brazil the Gini coefficient of income inequality has been falling nearly every year since 1995, dropping from 0.60 in 1995 to 0.54 in 2009. Though this is still a very high level of concentration, a systematic fall over such a prolonged period is unprecedented in Brazil, a country historically impervious to reductions in wealth and income inequality. The main determinants of this improvement include real increases in the minimum wage, lower wage heterogeneity and various governmental transfer programs, and at a more fundamental level the end of endemic inflation.

Leaving the social and political causes and consequences of these changes for the next section we want to stress here the important economic impact of the incorporation of a massive contingent of consumers into the domestic market. From 2002 to 2010 the class of citizens that earns from 900 US dollars to 3,000 US dollars a month, known in Brazil as the C class, corresponding to about 49 percent of the population, has gone from making 27 percent of all purchases of durable goods to 45 percent (*Folha de São Paulo,* 15 December 2010). This means millions of people making first time purchases of computers, washing machines, refrigerators, automobiles, and other durable goods, along with the purchase of non-durable goods and services such as airline tickets, and restaurant meals. A greater access to credit has fueled much of the consumption. The resulting increase in the extent of the market is much more consequential than the mere expansion which the numbers suggest, as a larger market may stimulate greater productivity and growth potential. The vigorous internal market has already been credited with allowing Brazil to sail smoothly through the recent global depression.

In the pages above we provided evidence of improvement in just a few important aspects of the Brazilian economy and society. We could expand the list considerably. Brazil has recently discovered massive oil reserves that will make it potentially one of the world's top producers. The new phenomenon of a Brazilian transnational company has become a reality with significant increases in foreign/domestic partnerships in recent years. Regulatory governance has improved, not only in infrastructure, but also financial regulation, bankruptcy laws, labor markets, environment and other areas (Correa *et al.* 2007). Informality is declining as is urban violence in most cities. We anticipate that preparation for the World

Cup in 2014 and the Olympics in 2016 will further catalyze change.

No matter how compelling the evidence that we have shown, it is not sufficient to close the case that Brazil is undergoing a fundamental change in its economic and societal growth trajectory. For each of the areas discussed above counterarguments could be made pointing out the limitations and hazards for the Brazilian economy. Education is still highly deficient, and the current rate of improvement may still be too slow. Income inequality improvements may be just the low hanging fruit. The oil discoveries may be a curse rather than a blessing. Additionally several other points which we have not touched upon might be brought up such as corruption, excessive tax burdens, and social security commitments that will hamper growth. We take these counter-points seriously, but they cannot definitively refute our argument. We have not argued that all improvement has occurred in all policy areas or that all the needed improvement has taken place in the areas that have moved in the right direction. Note that even in highly developed countries there are always underperforming sectors and a myriad of constraints on growth – much of the developed world is awash in debt and many suffer from a skewed demographic profile with too many people leaving the labor force and an insufficient number entering. Furthermore, successful development does not proceed in a smooth monotonic pace, but is rather a highly complex process that moves in fits and starts, waxing and waning on different margins in unpredictable ways. We simply argue that Brazil has witnessed significant and fundamental changes in the past two decades, commencing with the stabilization of the currency in 1994. Although the evidence we have presented is largely circumstantial, the more evidence that points in the same direction the stronger is our inferential chain of reasoning. We maintain that our evidence cannot be simply due to a wave of high commodity prices and there have been underlying fundamental changes in Brazilian society grounded in significant changes in institutions. In the next section we argue that institutional changes are the key reason for believing that the process of economic, political and social development is sustainable.

The institutional underpinnings of Brazil's transformation

Economic performance of the sort that Brazil experienced in recent years can be driven by a series of factors: favorable external circumstances; enlightened leaders; or even by sheer chance. But if these are the root causes of the improvements, the good run will be temporary. For improved performance to be sustained, it is necessary that there be more fundamental structural changes that produce forces and incentives that buttress past achievements and foster future development. One obvious, though elusive, way to achieve sustained development is to establish institutions that produce an environment where: governments and policymakers face incentives and constraints to seek the public good rather than private gain; and where secure property rights and endemic rule of law create conditions for individuals and organizations to invest, transact, innovate and prosper. In this section we argue that Brazil is undergoing such a process of institutional change, and that this has been the most important underlying determinant of the economic and social developments discussed above.

Our claim may seem counterintuitive, given the overwhelming powers of the president in Brazil and that strong presidential powers have not historically been associated with rule of law and democracy in Latin America. Alston and Mueller (2006) show that the Brazilian executive possesses a series of prerogatives, instruments and political currencies that allow the president to set the political agenda and generally get what she wants. Though such powers more often than not lead to outcomes with shades of tyranny and autocracy, in Brazil, accompanying institutions since 1995 have ensured that the powers of the president will generally be used for the common good rather than for personal gain or that of private groups.[1] The greatest manifestation of presidential power being used for the public good has been the unrelenting zeal with which the government has pursued monetary stability. President Cardoso initiated the *Plano Real* as finance minister in 1994 and it pulled the economy out of a history of recurring inflation including a crippling 10 year run of hyperinflation following 1985. Maintaining low inflation requires a level of fiscal discipline that runs counter to any politician's natural instincts as it necessitates policies and decisions that holds enormous upfront costs and delivers only diffuse future benefits. Choosing enlightened leaders

[1] We are aware that this in no small claim and we do not have the space to defend it fully in this paper. For this we refer the reader to Alston, Melo, Mueller and Pereira (2008). Similarly we will not have the space to go into the deeper question of how and why such institutional arrangements emerged, which is the subject of our ongoing research: Alston, Melo, Mueller and Pereira, *Power, Beliefs and Institutions: Development in the Modern World, Brazil – 1960–2010,* book manuscript in progress.

initially may be necessary but it is not sufficient to ensure the sustained required restraint. In Brazil, even the left-wing Workers' Party under President Lula and now President Dilma Rousseff, fully embraced conservative fiscal and monetary policies once they came to power. President Lula was elected in part on a mandate to push social justice through aggressive but unsustainable redistributive powers but he quickly abandoned this agenda in favor of following in the footsteps of Cardoso. This turnabout suggests that there are deeper incentives and constraints influencing the exercise of strong presidential powers.

One of the key incentives for the president to maintain macro-orthodoxy is a deep understanding by the electorate, acquired through experience, of the evils of inflation and the precedence that this issue must take over other things they may also value highly. This understanding has become engrained in the form of a widely held belief *which* resulted in powerful inducements for presidents since the 1990s, whatever their personal ideologies, to prioritize monetary and fiscal stability. Given the nature of presidential powers, the responsibility for any lapse back to inflation could never be credibly shrugged off by the president, and for the past fifteen years revealed behavior has been exemplary, with some license to following the political business cycle. A second powerful incentive for careful monetary and fiscal policy is the discipline imposed by globalized financial markets that would instantly punish evidence of lax behavior. Although every country is subject to this form of market scrutiny, Brazil is particularly susceptible given its high integration in international financial and goods markets.

In addition to the incentive placed on presidents since the success of the *Plano Real,* political choices are also highly constrained by a series of checks and balances that have evolved in the past few years. The underlying characteristic of these constraints is a belief that arose in reaction to the authoritarian ways of the military dictatorship (1964–1985). This belief rests on an aversion to despotism, exclusion, oppression, censorship, inequality, disenfranchisement and other undemocratic manifestations. This anti-authoritarian and inclusive democratic belief has been the bedrock for many changes that have taken place in Brazil, both at institutional and policy levels, with both desirable as well as regrettable consequences. The Constitution of 1988 epitomized the belief in anti-authoritarianism and inclusion. The constitution enshrined these just and noble aspirations often with no concern for economic reality. One example was the extension of social security benefits to millions of rural workers who had not contributed to its funding, in a rare instance of redistribution towards some of the poorest members of society, yet with a big impact on the fiscal deficit. Whether one approves of any given policy or political choice, our argument is that the beliefs in anti-authoritarianism and inclusion have significantly influenced the general nature of policies and institutions since democratization in 1985.

In particular the beliefs prompted the establishment of checks and balances creating an important network of counterweights to the powers of the executive. The Supreme Court, for example, despite many faults, is highly independent and systematically rules against the president's interest. Similarly there are other organizations such as district attorneys and the Courts of Accounts that have increasingly played the role of watchdog, not only acting directly as veto players but also by providing platforms through which other actors can pursue their rights (Mueller 2010; Melo, Pereira and Figueiredo 2009). The belief in participation, inclusion, transparency and accountability has given rise to numerous institutionalized and informal entry points for different groups to participate in the policymaking process, giving rise to a rich tapestry of social groups, associations, NGOs and other participatory groups in civil society. Similarly, the belief against any form of censorship or lack of transparency contributed to the rise of a highly combative and high quality press. Despite some ownership concentration of media conglomerates and the general low level of education, it is undeniable that the freedom of the press provides a key check on politicians at all levels in Brazil and spurs a healthy debate on public issues. Though democracy is still a relatively new experience for most Brazilians alive today, sufficient elections have been successfully held to uproot the old cynicism born from the crooked political practices of the past. High levels of political competition with frequent and peaceful turnover of those in power including the demise of formerly perennial oligarchic families, provides strong inducements for those in office to pursue the public interest.

As in the previous section, here we have enumerated a series of positive institutional changes that have transpired in Brazil in the past two decades. We posit that the economic and social virtuous changes chronicled in the previous sections resulted from the institutions and beliefs that emerged. Yet here again a skeptic could easily provide a list of wrongdoings, injustice and absurdities from current public life as counterarguments to our claim of virtuous institutional change. For some, a glance at the morning paper is sufficient to show the naivety of our portrayal of Brazilian politics. Yet once again we insist on the point that the evidence is circumstantial on both sides of the ledger but that the preponderance of evidence is consistent with our view. After all, doesn't the morning paper even in highly developed countries stand the hair on one's neck? Especially with current events it is difficult to sort out which events will be consequential and which, despite their current sound and fury will prove irrelevant as time passes (Gavin 2010). In the end only history will prove whether our forecast about the trajectory of Brazilian society is accurate. By developing a logically consistent account of the economic and social changes in Brazil, and their ties to the underlying institutional changes, our goal in this essay was to convince the reader that this time Brazilian development is for real.

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