Brazil and the G20: Recent Development Strategy and Strength among "New" Emerging Economies

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Throughout history, the Brazilian economic development strategy was, as in many Latin American countries, coordinated by the state, with large participation of public companies and strong protection of domestic economic activities. Beginning in the 1930s, the process of imports substitution industrialization (ISI) was completely dissolved only in the 1990s, following the opening of the economy, with massive and swift tariff cuts alongside privatizations and the withdrawal of the state from economic production.

At that time, shortly after the start of trade liberalization, the first steps of financial openness were being taken, although at a much more moderate pace than the ones adopted in other emerging economies. Brazil's participation in international trade has grown since then but is still modest, compared to other "new" emerging economies. The Brazilian development, in its turn, has focused primarily on the domestic market where demand saw a major boost since stabilization in 1994.

However, profound changes in Brazil's international economic and political position have been occurring since the 1990s and even more so during the following decade. In the economic field, the improvement in Brazil's external position is largely due to the achievements in its economy, which allowed the country to consolidate its image as a large democracy, with a considerable internal market operating in a more or less stable economic setting.

Brazil's participation in the discussion *fora* of the international monetary and financial order, therefore, should be understood in light of recent changes in its economy and its performance in the global financial crisis, which conferred it much more of the so-called *soft-power*, that is, leveraged its moral and material capabilities, even though Brazilian participation in the world economy is still relatively small. That allowed it to bring forward proposals on economic reforms and a more credible right to be heard.

The objective of this article is to discuss Brazilian participation and its relative importance in the G20, arguing that the country's position and its increasing political weight are the result of the changes in its own economy and of the fast recovery of the large emerging economies from the 2008-2009 crisis. Given the improvement in the Brazilian position, this article proposes to draw some reflections on the Brazilian role in the global monetary and financial agenda.

1. Recent Brazilian Economic Changes

When the international financial crisis began in 2007, the Brazilian economy was amidst an important expansion. More than a decade after the stabilization plan and having dealt with the effects of various economic crises in the emerging economies—including its own—the center-left government was to reap the benefits from years of efforts to consolidate macroeconomic stabilization, intensified by expansionary policies. This favorable environment was also the result of political stability.

Recent Brazilian economic success has been determined not only by occasional, exogenous factors, such as economic growth in industrialized countries and the increase in commodity prices, but also by an institutional factor. Macroeconomic stability was preserved as one of the priorities in government policy from the start of Lula da Silva's first term in 2003. Economic policies, thus, combined with expansion in the world's economy, stimulated investments and foreign capital to increase substantially.

Stable, the Brazilian economy appears to the world to have the potential to be developed. Although Brazil still needed to meet its broad reform agenda, the crisis did not affect it strongly enough to push it from its path to prosperity. The stabilization also brought new challenges to the financial system, which has undergone considerable transformation.

Financial System

The Brazilian financial system has historically been limited by an adverse macroeconomic environment in which chronic inflation acted as an obstacle for credit activities. That setting started to change with stabilization, but the memories of inflation remain among economic agents.

New actors in the form of foreign financial institutions entered the market. During the 2000s a deep restructuring was put in place by a process of concentration among private institutions and sanitation of public ones, especially state banks.

Since then, competition increased. Together with this restructuring within the industry, Brazil in recent years has advanced in the regulation of financial activities. From its creation in 1964, the Central Bank has been responsible for carrying out supervision. Since the 1990s, the Brazilian financial system sought to adjust domestic regulations to the criteria agreed under the Bank for International Settlements (BIS). The country's banking system has been subject to compliance with the rules of prudential regulation. Moreover, the central bank sought to have the institutions observe a lending relationship on equity even more conservative than the rates of Basel.[1]

Thus, conservatism in financial regulation and the relatively small opening of the system to operations with foreign currency ended up acting as a hedge limiting exposure to international fluctuations.

Admittedly, as with any other actor in the global economy, the Brazilian financial institutions were not completely shielded from the effects of the global crisis. However, the composition of the Brazilian financial system and a fairly well-organized financial regulation helped to ensure that the crisis' consequences were somehow short and not very devastating.

The Crisis

The Brazilian government responded to the world recession with a set of strong expansionary measures. As in most countries, the policies were based on traditional ideas. The monetary measures consisted mainly of liquidity expansion through reduction of reserve requirements combined with direct credit growth by public financial institutions. The fiscal policy was composed of the maintenance of the program of public expenses already in place, including an industrial policy and a broad action of tax exemptions which was considerably expanded after the worsening of the crisis. State-owned banks increased their loans, mainly targeting domestic consumption and investment.

Although not indifferent to the world's financial turmoil, the Brazilian banking system passed seemingly safe through the crisis. Regulation, concentration and the central bank's policies to restore credit flows restrained the impact of the liquidity crunch. Foreign reserves, likewise, permitted the central bank to defend the national currency in the foreign exchange markets, preventing a destabilizing depreciation.

2. Brazil Facing the International Crisis and the Monetary and Financial Order

The crisis of 2007-09 brought attention to the problems of configuration and reordering of the international monetary system. First and foremost, financial markets regulation in the most developed countries had to be discussed. At the same time, emerging countries gained a broader room and a louder voice in the international arena.

The G20 became the most prominent forum for discussions on the impacts and consequences of the crisis. The crisis was dramatically different from the ones that stimulated the creation of this informal grouping of the world's

[1] As is well known, the Basel Index sets reserve requirements over credit operations. The Brazilian Central Bank has been "conducting" national financial institutions to operate at safer levels than the Basel requirements and so had operated the Banco do Brasil.

largest economies in 1999. The largest emerging economies were less vulnerable, as a result of foreign reserves accumulation and different choices of macroeconomic policies.

Despite the deep depreciation of the US dollar and the huge instability in the Euro zone, the emergence of a multipolar monetary order should not be taken for granted. As Masson and Dailami (2009) argued, emerging countries should play a different role in a new monetary order. According to them, the BRIC countries (Brazil, Russia, India and China—South Africa joined the group only in late 2010), could act to stimulate the decrease of the importance of the US dollar in the global markets. Although China has diversified the composition of its foreign reserves, no consistent signs of rejection of the greenback are evident.

The G20

The G20 has become the main forum for international economic cooperation. So far, however, it has not successfully faced a crucial issue: the huge accumulation of foreign reserves (in US dollars) from countries with high trade surpluses, especially from China. The persistent current account surpluses in emerging countries combined with the ever increasing American twin deficits (budget and trade) were seen as a source of global imbalances. Specifically after the recent crisis, besides China, some other large emerging economies could be involved in a similar arrangement. Thus, in the Toronto Summit, there was a belated call for balance in national accounts. In fact, several tough topics have been in the group's agenda and none have been completely solved yet.

The G20 meetings signalled the possibilities of political reform in the system. Despite the joint efforts of the countries at the peak of the crisis, though, these demonstrations are not very positive yet. Passed the bottom of the trough, the pressures of large international financial groups, which were not heavily regulated, are once again exerted more freely, as seen in the World Economic Forum meeting in Davos in January 2010.

What is more substantive is a search for regulatory measures in order to reduce systemic risk. From an institutional standpoint, the Financial Stability Board came to include new countries, the BRICs among them. But how effective has the participation of emerging economies been in this forum? How loud is their voice? And what are their interests?

Martinez-Diaz (2007) compared the communiqués from the G7, the G20 and G24 as proxies to gauge the extent to which the G20 actually represented the views and demands of the developing countries. The result is astonishing: from 1999 to 2007, that is, prior to the current crisis, the G7's position was reflected in the G20 communiqués twice as frequently as the G24's, and in a third of the cases, countries exercised a "veto" that prevented the group from issuing anything more than a neutral statement. Moreover, those issues in which the G24 agenda was embraced promised modest benefits for developing countries and did not seriously challenge G7 interests.

The 2008 crisis changed this scenario, undeniably. However, it is not yet clear to what extent. In the Pittsburgh Summit, the G20 became the leading forum for international economic coordination, replacing the G7. For the first time in modern history, leading emerging nations have a real chance to shape the evolution of the international monetary system (Dailami and Masson 2009), and the debate around the subject is ever more aroused given the multi-polarity created in the system.

Given the distinct backgrounds of G20 members, the policies proposed will certainly differ, eventually resulting in opposing blocs. This was already seen in the Toronto Summit, where the concerns were over the exit strategies from all the expansionary measures adopted, and fiscal consolidation at the same time as the United States and Europe were still stricken by recession.

Despite all these difficulties, inherent to any form of international cooperation, the G20 has evolved from its creation in 1999, gaining much more influence following the 2008 crisis, and bolstered by the strong economic growth of the emerging economies. The biannual meetings during the recession are a clear example of the importance conferred to economic coordination. As it is, the first "emergency" meeting convened under the Brazilian presidency of the G20, called by President George W. Bush, marked a qualitative change, since the finance ministers' and central banks governors' meeting became a sort of preparation to the gathering of heads of state and government.

Hence, the first meeting (Washington Summit) kept a "particular focus on ensuring financial stability and supporting global growth", while also acknowledging that "the current financial crisis is largely a result of excessive risk taking and faulty risk management practices in financial markets, inconsistent macroeconomic policies, which gave rise to domestic and external imbalances, as well as deficiencies in financial regulation and supervision in some advanced countries". Consequently, "financial institutions [should] also bear their responsibility for the turmoil and should do their part to overcome it including by recognizing losses, improving disclosure and strengthening their governance and risk management practices." It is interesting to notice the continuity of this theme as the liquidity crisis evolved to a solvency one. The emphasis in the subsequent London Summit was on the reinforcement of international institutions, namely the IMF and other regional development banks, in an attempt to assure enough credit to the market. Likewise, it reaffirmed the commitment of the group to liberal thinking, through the call for open markets, but tempered by the need for closer regulation.

In Pittsburgh, the emerging countries agenda gained prominence. As already mentioned, in this summit the G20 was recognized as the main forum for economic coordination. The worry with exit strategies was already present, as was acknowledged the need for different policies according to each country's conditions. The following summit, in Toronto, highlighted the divergences amongst the parties: "while the growth is returning, the recovery is uneven". As the countries gathered, in addition to the financial crisis, the debt crisis in Europe added to the worries of the leading economies. As production remained sluggish on both sides of the Atlantic, the necessary fiscal consolidation should be brought about through "growth friendly" measures. In addition, it was the moment to solve the trade imbalances, that is, the undervalued Yuan and the lax American monetary policy leading to the "currency wars", as called by the Brazilian finance minister, the major theme in the Seoul Summit. The results of this last meeting, as currently observed, were not very encouraging in solving the foreign exchange issue.

As stated by Dailami and Masson, notwithstanding, like the G7, the G20 also lacks legitimacy. Although it comprised almost three-quarters of all global output and more than half the quotas in the Bretton Woods institutions, middle-size and small countries are not part of it. It is more representative, for sure, but it is far from a universal institution.

Brazil and the "Big" Emerging Countries in the G20

The prominence of Brazilian participation in the discussion of a new global monetary and financial system is undeniable. But what would be the most direct Brazilian interests? It is hard to list a precise agenda, although certainly a lower US dollar hegemony would be a way to pulverize the exchange risk and diversify opportunities for gains in international transactions. However, excessive US dollar depreciation is not desirable, since international reserves are concentrated in that currency. With regard to financial regulation, Brazil has built a financial governance system that has granted some safety during the financial crisis. Maintaining or expanding the deregulation of global markets would not be a choice.

It is clear now that a new regulatory framework will not come from an international conference but instead will be shaped according to the unfolding of the global economy in the near future. Brazil has built a more secure and stable international position. Its relative importance among emerging markets was strengthened and the country seems to avoid open confrontation with the more industrialized and large emerging countries.

Although it is in the middle of this boiling cauldron, Brazil, surprisingly, has no definite strategy for the G20 (Barbosa and Mendes 2010). This behaviour, at first sight somewhat reckless, reflects, actually, a well-thought approach. More pragmatically than many other actors in the international system, Brazil has been waiting for the big powers to disclose their positions, thus avoiding previous alignments with any specific country, including the BRICs. Even though some demands are shared, such as the reforms of the Bretton Woods Institutions, the acronym created by Jim O'Neill (from Goldman Sachs) covers an extremely divergent set of economies. Some of these can be exemplified by the distinctions of the banking sectors in the different countries, Brazil's being the most sophisticated, and the identification of the deeper roots of the crisis, which are not only different among the emerging countries, but also between these and the developed ones.

Along these discussions, Brazil was very aligned to the overall agenda, exercising a considerable role in turning the G20 into the main economic forum instead of the G7. Some controversies emerged as the debate reached stricter regulations of the banking sector, involving further taxing. Brazil complained, as well, regarding the overvaluation of its currency as a consequence of the weak dollar, this time with little, if any, result. The main triumph of the Brazilian participation in the G20 and of the group was the remodelling, even if only an incremental one, of the Bretton Woods institutions. The moderate position adopted by the government, which did not apply the North-South divide during the negotiations, resulted in the Brazilian presence in the Financial Stability Board and the Basel Committee (Barbosa and Mendes 2010).

Throughout 2010, the exchange rate volatility was a factor of great concern to developing countries. The Brazilian currency was the most appreciated since the crisis, which inspired the Minister of Finance, Guido Mantega, to use the term "currency war". The G20 Seoul meeting put this issue at the core of the agenda. As in previous meetings, no formal agreement was established. Still, the formal document drafted at the meeting acknowledged the dispute and called for foreign countries to avoid establishing "competitive devaluations". The text recognizes the right of developing countries, like Brazil, to adopt emergency policies to mitigate the effects of devaluations in the currencies of other countries and suggests the adoption of floating exchange rates as the best system.

Countering the critics, China argued that a strong Yuan is not an answer, citing as the main cause of the crisis the lax financial supervision in the developed countries, to which partially agreed Brazil and India, harmed by the over-devaluated Chinese currency and the following trade imbalances (even though Brazil has been accumulating surpluses in the past years, despite the strong Real). All these divergences, amongst emerging powers and the developed ones, lead Dailami and Masson to conclude that "the nascent institutions that have emerged from the current crisis with enhanced powers, in particular the G20 and the Financial Stability Board (formerly the Financial Stability Forum) are not adequate in their current state to serve as permanent *fora* for cooperation in international finance."(pp. 6-7)

A closer look into the Group's communiqués and the Brazilian positions confirm the prevailing opinion that Brazil, indeed, has adopted a quite cautious position. Nonetheless, this stance has slightly changed over recent times, together with the improvement of the Brazilian economic performance and its currency's further appreciation. Table 1 presents the main positions and proposes their classification.

Table 1. Brazil and the G20: Neither Antagonistic, Nor that Protagonist

Summits	G20 Communiqués	Brazilian position
Washington (November 2008)	**Analytical approach. Few propositions** • General statements on financial stability, need to improve supervision and governance of financial institutions • More room to emerging economies in Bretton Woods Institutions	**General plead for emerging economies** • Demands on more prominence to the G20 and developing countries' voice • Bretton Woods institutions
London (April 2009)	**Focus on Multilateral Financial Organizations** • Treble the resources available to the IMF • Strengthen financial and regulatory systems and reform international financial institutions • Increase the credibility and accountability of the institutions	**Cooperative position** • Brazil will collaborate with the IMF through the purchase of bonuses. • Selective policies of international organizations contemplating emerging economies and membership to G20
Pittsburgh (September 2009)	**Focus on potential conflicts among countries** • Economic recovery brings the need to continue coordinated and cooperatives exit strategies • Negative spill-overs from domestic policies over trade and investment should be avoided • No resort to financial protectionism or any measure constraining international capital flows • Modernization of IMF's governance to improve its credibility, legitimacy and efficacy.	**Propositions on regulation and macroeconomic management** • Financial markets regulation • Gradual withdrawal of the economic stimuli. • Exchange rates imbalances brought to the table
Toronto (June 2010)	**Focus on the recovery and design of national policies** • Follow through on existing stimulus plans • Growth-friendly plans to deliver fiscal sustainability, • Surplus economies must reduce reliance on external demand and focus on domestic sources of growth.	**Propositions on macroeconomic policies** • The BRICs are against further taxes on their banking system. • Concerns: withdrawal of the stimuli package, rigidity of the Chinese currency.

Seoul (November 2010)	**Call for coordination. Foreign exchange becomes a key issue** • Fiscal consolidation to ensure recovery and sustainable growth • Stability of financial markets • Flexibility of exchange rate systems (reflecting economic fundamentals and refraining from competitive devaluation)	**Focus on exchange rate policies** • Avoid a currency war • Or capital controls could be imposed, leading to a trade war.

In fact, from the Pittsburgh Summit on, it is possible to identify a louder Brazilian voice on issues related to macroeconomic imbalances—namely exchange rate policies—and on the transition from the stimuli packages in place in the developed economies.

The positions among large emerging economies are also subject to changes over time. Concerning the reform of multilateral financial institutions, there are no important divergences, since they all ask for reform in governance, voice and quotas. But potential conflicts are apparent, primarily between Brazil and India versus China on exchange rate policies. The United States' expansionary monetary policy is also a strong contribution to the challenges imposed on the emerging economies on exchange and financial markets and their impact on domestic economic policy. Naturally, the consequences of this imbalance on external trade affect the whole world.

Concluding Remarks

Internal economic improvements allowed the development of a more assertive foreign policy by the Brazilian government, especially in the last decade. The adoption of a "variable design diplomacy" and the emphasis conferred to symmetric relations, that is, with countries without power surpluses, did not, however, mean the abandonment of pragmatism and the beginning of a reckless behaviour.

The Brazilian stance regarding the international economic institutions is within this framework. Having been one of the beneficiaries of the Bretton Woods system and its later developments, the thirst for change is limited, more related to the current representation of power distribution in the world order than to the logic of market functioning.

The analysis of the communiqués and some public statements by Brazilian authorities indicate, thus, that the country indeed has been adopting a pragmatic approach at the G20. Brazil had no deep confrontation with the developed countries, even concerning controversial topics such as capital controls or the currency exchanges mismatches.

In both aspects, Brazil had short-term interests, not willing to mislead the world's—and the investors'—perceptions about itself and the risk involved in financial operations. Specifically concerning currency appreciation, despite the Finance Minister's loud voice on the problems of a currency war, Brazil did not present effective propositions on the subject.

To a certain degree, Brazil seems to be working on medium and long-term interests. Needless to say, coherently, a plea for more room to the emerging countries is constantly present in Brazilian discourse.

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