

# The main determinants of economic growth in Brazil between 2003 and 2010: exports or domestic market?

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## Resumen

Se ha trabajado ya en investigaciones sobre las políticas económicas que utilizó el gobierno de Lula da Silva en Brasil con sus respectivos resultados macroeconómicos. Se piensa que el Mercado de consumo masivo (enfocado al Mercado interno) y el boom de los bienes de consumo fueron importantes para explicar la ventaja para el crecimiento económico del país en ese período. Este artículo se pregunta cuál de los dos aspectos fue el más relevante para explicar el crecimiento del PIB entre 2003 y 2010. Tomando la revisión bibliográfica con un método inductivo de investigación a partir del promedio de crecimiento real de cada componente del PIB en este período, buscamos validar o refutar la hipótesis de que el modelo del Mercado masivo de consumo en Brasil fue el principal determinante del crecimiento económico del país durante el gobierno de Lula.

**Palabras claves:** Gobierno de Lula, Políticas macroeconómicas, Boom de bienes de consumo.

## Resumo

Diversos trabalhos acadêmicos procuram dissertar sobre as políticas econômicas empregadas pelo governo Lula e seus respectivos resultados macroeconômicos. Considera-se que o mercado de consumo de massas (voltado para atender o mercado interno) e o boom das commodities foram importantes para explicar as taxas médias de crescimento econômico do país no referido período. Este artigo questiona, qual dos dois aspectos foi o mais importante para explicar o crescimento do PIB entre os anos de 2003 e 2010. A partir de revisão bibliográfica usando o método indutivo de pesquisa, com base na taxa de crescimento real de cada componente do PIB entre 2003 e 2010, pretende-se validar ou refutar a hipótese de que o modelo de mercado de consumo de massas brasileiro foi o principal determinante do crescimento do país durante o governo Lula.

**Palavras-chave:** Governo Lula. Políticas macroeconômicas. Boom de commodities. Taxa de crescimento. Componentes. PIB.

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## Abstract

Several works seek to discuss the economic policies employed by Lula's government and their respective macroeconomic results. It is considered that the mass consumer market (focused in serving the domestic market) and the commodity boom were important to explain the country's average economic growth rates in the period. This paper wonders which of the two aspects was the most relevant to explain GDP growth between 2003 and 2010? Stem from a literature review using the inductive search method, oriented by the real growth rate of each GDP component in the midst of 2003 and 2010, this paper intends to validate or refute the hypothesis that the Brazilian mass-market consumer model was the main determinant of the country's growth during Lula's government.

**Key words:** Lula's Government. Macroeconomic policies. Commodity Boom

## Introduction

This paper analyzes the economic aspects related to the Brazilian export boom and economic policy decisions between 2003 and 2010. The increase in international demand for domestic commodities has caused a significant capital inflow in the country and an intense expansion of the domestic market. Therefore, it is extremely important to understand the economic consequences, especially for the domestic market, which had an additional reason to grow, resulting from the real wage gains promoted.

There is a theoretical gap in the analysis within the expressive expansion of the domestic market as a positive consequence or as an opportunity afforded by the expansion of commodity exports. Some papers discuss policies to reduce social inequality (SERRANO & SUMMA, 2015; CARVALHO & RUGITSKY, 2015); and the commodity boom separately, few studies establish some kind of connection between the two factors.

This paper was based on the inductive search method, oriented by the study of the real growth rate of each GDP component in the middle of 2003 and 2010. The research hypothesis is that the main impetus for the increase in the average rate of GDP growth in the period came from the domestic market. Thus, the expansion of the commodity market was important, but not determinant to explain the average growth rates observed in the Brazilian GDP in the period.

Therefore, this topic was explored with extreme importance to understand the events that took place in the years following the second term of the Lula administration. For that, the article was structured in four sessions, besides

the introduction and the conclusions. The first discussed in broad outline the macroeconomic policy implemented over the years. The second section focused on the economic policies adopted: monetary, fiscal, exchange and income policies. The third section studied international trade and the commodity boom, linking this movement with real growth rates for each component of GDP. Finally, the last section presented which of the two factors weighed more: the commodity boom or the dynamism of the domestic market.

## 1. Lula's Brazilian macroeconomic model: 'new'; 'social'; 'neo'development.

In order to reduce inflation, an economic problem that generated impoverishment and redistribution of income in favor of the wealthier classes, in 1994, the country adopted the Real Plan. Thus, the period between 1990 and the early 2000s was marked by a highly restrictive monetary policy (MODENESI & MODENESI, 2015) fixed-exchange rules, Asian crisis, capital flight, intense reduction of international reserves, Russia's moratorium, Brazilian exports loss of competitiveness, rising unemployment rate, low economic growth, agreement with the International Monetary Fund (IMF), exchange rate crisis, adoption of a system of inflation targets, high interest rates, Argentina's crisis, slowing of world economies, energy crisis, increased vulnerability of the Brazilian economy, difficulties in maintaining inflation targets, new agreement with the IMF.

After 1999, with the implementation of the macroeconomic tripod, changes were made in the exchange rate regime, but this structure of economic policy did not allow the country's GDP to grow, because the economic external vulnerability and the public sector financial fragility were not overcome (FILGUEIRAS, 2004). In this period, the inflationary reduction was not enough to contain the country's growing fragility (MERCADANTE, 2010). In 2002, the uncertainty associated with the proximity of the presidential elections coupled with the external uncertainties and the consequences of the fall in the investment rate led to the deterioration of inflationary expectations (OLIVEIRA & TUROLLA, 2003).

As the election of Luiz Inácio Lula da Silva (Lula) from the Partido Trabalhista (PT) was likely, defensive movements erupted in the financial market, leading to severe currency destabilization. In this context, in June 2002, when the elections were still months away, the "Letter to the Brazilian People" was published, in which Lula promised to continue with the economic policy based on the basic pillars generated since 1999, which consisted basically of maintenance of the macroeconomic tripod (WERNECK, 2014).

With Lula's victory in the 2002 presidential elections, the government kept its promise, continuing the economic policies that had been practiced since 1999. In the same year, the Ministry of Finance released the official document entitled "Economic Policy and Structural Reforms" in which a development model was proposed to preserve economic stability but redirecting public spending so that it could reach the social classes that were in need (GIAMBIAGI, 2011).

The great mistrust in the financial market coupled with an inflation rate above 13% and an increase in public indebtedness, triggered in 2002, meant that in 2003 the Lula government had few options to adopt alternative economic policies to orthodoxy (WERNECK, 2014). Policymakers believed that continuing the previous government's economic policy would be the best way to reduce the external vulnerability and the public sector financial fragility - otherwise markets could further disapprove the new government, thereby generating a flight of capital, a currency crisis and even questions about the governability of the president-elect (FILGUEIRAS & PINTO, 2004).

In Carcanholo's vision (2010), this continuity of orthodox policies can be justified by what is called "cursed heritage": serious economic problems, including economic traps and serious structural problems left by the FHC government. For the author, such traps were built through the process of commercial and financial opening, as this process generated an increase in the financial fragility of Brazilian external accounts, which became characterized by a great dependence on external capital flows for closing of the Balance of Payments accounts, amid the instability of the global financial system. In addition, this process intensified the external vulnerability of the Brazilian economy, since it mitigated its ability to withstand possible external shocks.

However, Paulani (2003) sees this continuity of economic policies as a way of guaranteeing the country's "credibility" vis-à-vis the international market, thus making it impossible to adopt policies aimed at growth and increase of employment by the Lula government. Maintaining this "credibility" made it necessary to continue the contractionary monetary policy, the high real interest rate and the tight fiscal adjustment.

On the other side, Werneck (2014) believes that the economic stability - promoted in the years prior to the Lula administration - was the factor that allowed the gains of the worldwide economic expansion and the commodity price boom between 2003 and 2010.

By mid-2005, the destabilization triggered by the exchange of governments had already given way to a promising growth path, coupled with controlled inflation and increasingly strong external accounts. In the second half of 2005, Finance Minister Antonio Palocci and Planning Minister Paulo Bernardo proposed policies to restrain the expansion of primary spending by the Union, which had doubled the GDP growth rate. The ministers intended to implement measures to ensure that the expansion of public spending was lower than the GDP growth rate, so that interest rates and the tax burden could be reduced, as well as allowing the expansion of public investment (WERNECK, 2014).

This proposal for a long-term fiscal adjustment was widely criticized by other ministers and by the Planalto, weakening Palocci's position. As a result, in March 2006, he resigned as Finance Minister and Guido Mantega took office, which meant in practice the abandonment of the fiscal adjustment proposal. The inauguration of Guido Mantega as minister of the Treasury marked a clear change in the government economic discourses (WERNECK, 2014).

Rossi (2015) sees in the rise of Guido Mantega the installation of a certain "flexibility in the macroeconomic tripod" that, according to the author, began to contemplate: i) capitals' control; ii) took into account the supply shocks in the inflation targets calculation; iii) use of a countercyclical fiscal policy. Giambiagi (2011, p. 215) highlights seven elements that allow us to observe the manifestation of this change in the orientation of the economic policies provoked by the exchange of ministers:

- i)** the public spending real change rate rose considerably in the second term of Lula's government;
- ii)** a trend was established for the loosening of primary surpluses;
- iii)** in practice, there was a departure from the fiscal target, as it was subject to a form of "band of tolerance";
- iv)** divergences between the Ministry of Finance and the Central Bank regarding the conduct of monetary policy have become recurrent;
- v)** economic studies to contain the expenditure growth and mitigate the fiscal imbalance were abandoned;
- vi)** the ministries began to seek policies different from those practiced in the FHC government;
- vii)** the role of the National Bank for Economic and Social Development (BNDES) and its importance in the economy widened significantly.

A gradual change of certain guidelines in the economic policy adopted by the Lula government was established. The new team adopted a policy of increased state activism,

based on temporary measures of fiscal and monetary stimulus - with the aim of accelerating growth, such as the expansion of income transfers; the raise of minimum wage and the intensification of public investments (MORAIS & SAAD-FILHO, 2011).

Starting in 2006, in the second term, the Lula government began to follow a new economic policy proposal based on new-developmentalism, mixing heterodox policies with the macroeconomic tripod (floating exchange rate, inflation targets and primary surplus), without, however, breaking with the last ones, establishing, from then on, the hybrid economic policy that characterized this government until 2010 (MORAIS & SAAD-FILHO, 2011). In this way, a development model was implemented that structurally linked income distribution and economic growth policies (SADER, 2013).

It is noteworthy that the concept of "developmentalism" during the Lula administration has three aspects. The first of those, called 'new-developmentalism', (OREIRO & MARCONI, 2016) calls for the adoption of a development strategy based on: (i) economic growth financed with domestic savings; (ii) manufactured goods exports promotion; (iii) avoiding exchange rate overvaluation in order to steer clear of Dutch disease; (iv) wages growing at the same pace of productivity; (v) fiscal policy used as a way of stabilizing activities levels, as long as it respects the intertemporal public accounts solvency; (vi) adoption of income distribution policies to reduce the intertemporal solvency of public accounts.

The second line of thought, called 'social-developmentalism', believes that macroeconomic policy must be oriented towards countercyclical action, creating a favorable environment for productive investment (ROSSI, 2015). The remarks made for this perspective is that it advocates the use of public investment in state-owned enterprises associated to the public budget expenditure expansion, wage mass growth and credit volume to promote product level expansion. Critics on this issue point out that social-developmentalism do not believe in the effectiveness of macroeconomic price adjustment as a change inducer in the productive structure of the economy (OREIRO & MARCONI, 2016).

The third way is the critic to the developmental proposal, calling it 'neodevelopmentism' (SAMPAIO JR, 2012). This perspective understands that 'neodevelopmentism' is nothing more than the exaltation of growth and the modernization of consumption patterns as an end for itself. That is, the concept would be transmuted into a virtuous capitalist face capable of reconciling growth with equity. However, such a virtuous face is sustained by the reduction of the negative aspects present in the model.

Thus, the conservation of the macroeconomic tripod, which is both the excluding and generator of the inequity.

Thus, during the years studied by this work, macroeconomic policy was steered by a countercyclical orientation guided by a greater prominence of the State in the conduct of expenditures and investments (ROSSI, 2015). Also, this macroeconomic policy promoted wealth transfer actions with real gains on wages. In this scenario, the Bolsa Família program – cash transfer program aimed at families living in poverty and extreme poverty – was widened and real wages grew. Above that, it was released the Growth Acceleration Plan (PAC), a program of infrastructure expansion, especially with investments in energy and transportation, which articulated public investment with the investment of state and private companies and a significant expansion of credit for investments, especially by the public banking sector (MORAIS & SAAD-FILHO, 2011; (WERNECK, 2014).

Fonseca, Cunha and Bichara (2013) point out that the PAC evidenced the resumption by the State of the responsibility for inducing economic growth, since it prioritized sectors and diagnosed bottlenecks for long-term growth. However, Morais and Saad-Filho (2011) they point out that such economic policy measures should be observed as a complement to existing macroeconomic policies, not substitutes.

The changes in macroeconomic policies were important because they provided greater state activism in economic decisions, especially: (i) in the expansion of the mass consumer market, through income transfer programs, the provision of consumer credit and the expansion of the minimum wage; (ii) in stimulating production through public investments in infrastructure and financing; (iii) in support of Brazilian enterprises, with the provision of credit and regulatory incentives for mergers and acquisitions (MORAIS & SAAD-FILHO, 2011). The policies details that form a macroeconomic tripod will be shown in the next session.

## **2. Economic policies between 2003 and 2010**

In January 2003, Lula's government faced a level of public debt corresponding to 55.9% of GDP, with an average GDP growth of 2.1% (1999-2002) and accelerated growth of the unemployment rate. Early on, the new government set a primary surplus target of 4.25% of GDP on its own, surpassing the 3.75% set by the IMF in the previous year (NOVELLI, 2010).

Meanwhile, the recovery of exports produced a trade surplus and in current transactions, which allowed the adoption of a domestic economic policy focused on the

expansion of effective demand, based on the expansion of the credit supply, real increases in the minimum wage and on the expansion of public investments. As of 2006, the significant surpluses presented in the Balance of Payments enabled the provision of a significant amount of reserves in international currencies, thus improving Brazil's position vis-a-vis the external market (LARA, 2012).

In general, throughout its two terms, the Lula government changed the orientation of economic policies, going from a restrictive regime of economic policy (2003-2005), to the "flexibilization of the macroeconomic tripod" after 2006 (ROSSI, 2015). Such a change was only possible as external conditions became more favorable to the country.

In 2008, the crisis highlighted the significant problem of domestic dependence on foreign funding to finance domestic credit supply, which at the time was about 20% (BARBOSA, 2013). At the crisis' peak, there was a reduction of international credit supply, and Brazilian banks contracted domestic credit supply. This contraction, in addition to a depreciation of the exchange rate led to a reduction in the purchasing power of Brazilian families, which, together with the general climate of economic uncertainty, slowed the growth of private consumption. In this context, the government adopted expansionary policies in the fiscal, monetary and credit areas, in a clearly anti-cyclical action.

In 2010, there were already signs of recovery, with GDP growth of 7.5% in relation to 2009, and an average expansion of 5.6% in household consumption. With this, the Lula government started to implement a more restrictive macroeconomic policy, limiting the incentives by the government (BARBOSA, 2013).

### **2.1 Monetary Policy**

In 2003, Brazilian monetary policy was conditioned by the deterioration of expectations and by the liquidity conditions of the international economy. Thus, maintaining the commitment to the inflation target and intensifying the fiscal adjustment policy were essential for the recovery of the economy, reducing uncertainties, ensuring the convergence of market expectations to the inflation target path.

The following year, monetary policy was linked to the maintenance of the gains from price stabilization, in a context of international liquidity expansion and higher commodity prices. In 2005, monetary policy continued to maintain a high interest rate to ensure that the IPCA approached the 4.5% annual target rate (BANCO CENTRAL DO BRASIL, 2005), and even so, the IPCA in that year was superior to 5% (MODENESI & MODENESI, 2012).

The declining path of inflation expectations observed in 2006 favored the process of flexibilization Brazilian monetary policy. The evolution of the exchange rate, which favored the domestic competition of marketable goods, together with the accumulation of international reserves and the early redemption of debt securities in foreign currency - which influenced external financing conditions through risk reduction Brazil, allowed the reduction of inflationary levels. Modenesi and Modenesi (2012) say that 2006 was one of the few years in which the IPCA stayed below 5% per year.

At the end of 2007, the intense rise in agricultural prices coupled with the growth in employment, income, credit and government transfers led to the need for a reduction in monetary stimuli, through an increase in the interest rate (SELIC). The following year, the government took a more restrictive stance on the conduct of monetary policy, as the gap between aggregate supply and demand persisted, increasing the risk of inflationary dynamics. Modenesi and Modenesi (2012) highlight the issue of the transmission of monetary policy, since after 1999 the country maintained the highest interest rate in the world, without succeeding in achieving inflation below or at the center of the target specified by the monetary authority.

In 2009, there was a new international economic environment, resulting from the intensification of the global crisis, marked by restrictions in the credit market, high-risk aversion and deterioration of expectations, which, in turn, led to a sharp reduction in domestic activity in Brazil. Therefore, in 2010 the National Monetary Council together with the Central Bank decided to adopt a series of macroprudential measures aimed at improving negotiation instruments, ensuring the stability of the national financial system and credit (BANCO CENTRAL DO BRASIL, 2010).

In general, the expansion of commodity prices in the international markets produced two effects on the Brazilian economy: at the same time that it favored trade balances and in current transactions, it provoked an important inflationary shock. However, this shock did not cause inflation to rise above the target due to high domestic interest rates (MODENESI & MODENESI, 2012), which, in turn, led to a trend of appreciation of the nominal exchange rate (OREIRO & MARCONI, 2016). That is, the exchange rate appreciation was not an unwanted by-product of monetary policy, but the main factor that kept inflation rates within the established targets (LARA, 2012).

Therefore, between 2003 and 2010, the flexible exchange rate regime together with the inflation targeting system allowed the maintenance of high interest differentials in

relation to international rates, in order to attract intense capital flows - which allowed the accumulation of reserves and the nominal appreciation of the exchange rate. The appreciation of the exchange rate was functional for the reduction of inflation levels, generating the collateral effect of deterioration of the productive structure (BRESSER-PEREIRA, 2016).

## 2.2 Fiscal Policy

Orair (2016) divided the Brazilian tax system into three phases. The first phase is from 1999 to 2005, when contractionary measures were adopted, with average primary surpluses of 0.2% of GDP between 1995-1998 averaging 4% of GDP between 1999 and 2005. The second was driven by an expansionary fiscal regime between 2006 and 2010, with an increase in the rate of public investment. Finally, the last phase occurred between 2011 and 2014, when an expansionary fiscal regime was applied based on the expansion of expenses of costing, subsidies and tax relief.

The year 2003 began with the adoption of several restrictive fiscal measures. The primary result target was raised to contain the growth of public debt and reduce the country's insolvency risk. In addition to restrictive monetary policy, fiscal policy had a positive impact on market expectations in relation to economic developments, thus reducing the country's exchange rate and risk premium. Obviously, taking the economy to a growth rate very close to zero. In the following year, the exchange appreciation remained, and the primary result surpassed that of 2003, contributing to the contraction of the net public debt in relation to GDP (BARBOSA, 2013).

In 2005, the primary result rose again, continuing the reduction of public indebtedness. Between 2003 and 2005, the federal government's annual primary result was 2.5%, down from an average of 1.9% between 1999 and 2002. At the end of the year, government debt closure with the IMF a significant improvement in Brazilian external accounts. The end of the Brazilian debt with the IMF was of great political and economic importance, as it marked the beginning of a new phase of the Lula administration, during which Brazil would have more autonomy in the conduct of its economic policy (BARBOSA, 2013), more specifically, fiscal policy.

As Orair (2016) in 2005, the Investment Pilot Project (PPI) was very important for introducing the idea that some investments would need to receive differentiated tax treatment for a virtuous process of self-financing and should therefore be removed from the calculation of the fiscal target. Such a move was crucial for some investments by state-owned companies could be withdrawn from the calculation of the primary surplus, an event that produced

a fiscal space channeled into Public Investment (OREIRO & MARCONI, 2016).

As of 2006, a process of expansion of government investments in infrastructure began, intensified in 2007 with the launch of the PAC. The program included a series of tax exemptions to encourage private investment and the development of the consumer market in the country. In 2008, these exemptions were amplified with the launch of the Productive Development Policy (PDP), whose main objective was to promote long-term competitiveness in the Brazilian economy (MDIC, 2015). In the same year, the government created the Brazilian Sovereign Fund to operate in the foreign exchange market and to construct a countercyclical fiscal policy (BARBOSA, 2013).

With the advent of the international financial crisis and its consequences, the Lula government adopted a policy to combat the effects of the crisis based on expansionary fiscal, monetary, and credit measures. The upward trajectory of public spending was based on the increase in income transfers (expansion of programs to combat poverty), of public investments (expansion of infrastructure spending) and expenditure on governments account (conducting public tenders and salary readjustment) (BARBOSA, 2013). In addition, at the end of 2008 and early 2009, the government adopted a series of exemptions to prevent a more intense reduction in the level of economic activity and to favor the recovery of consumption and investment more quickly; expanded the supply of loans, mainly through the BNDES, assuming a more active role in the financing of investments (BANCO CENTRAL DO BRASIL, 2010).

At the end of 2010, the end of the second Lula administration's term was marked by the Central Bank's move to reverse the stimulus measures adopted to combat the effects of the international financial crisis, which established a reduction in the growth of primary government spending, a new direction of the economic policy, of more restrictive (BARBOSA, 2013).

## 2.3 Foreign exchange Policy

In the early years of the Lula administration, appreciation of the exchange rate allowed for an unusual combination of accelerating growth and slowing inflation, Bresser (2016) and Oreiro, and Marconi (2016) attributed to this period the productive regression that would affect the economy in the subsequent government. The reduction of the exchange rate coupled with the inflationary contraction has had a favorable impact on the purchasing power of families and companies, thus increasing domestic consumption and investment.

Between 2003 and 2010, the Brazilian currency appreciated at a practically constant rate, with the exception of 2008, as capital flight provoked by the financial crisis

led to the depreciation of the Real. However, the following year, the flow of foreign capital recovered, allowing the resumption of the appreciation of the exchange rate. Between 2003 and 2007, the current account surplus and the substantial financial flows provided a considerable reduction in Brazil's external vulnerability with an increase in the growth rate induced mainly by commodity exports and the expansion of domestic consumption. The two variables that led to GDP growth (exports and expansion of domestic consumption) were broadly aided by the exchange rate, which was kept overvalued in the period. The fall of prices of imported industrial goods and the productive surplus of the primary sector were functional to sustain the mass consumer Market (ROSSI & MELLO, 2017).

The Brazilian real exchange rate showed a 20% reduction between 2006 and 2008, impacting directly on the Balance of Payments. On the one hand, the country's exports continued to grow, pushed by the increase in sales of commodities (ROSSI & MELLO, 2017) state that the country experienced a modernization in the structure of demand that was not accompanied by the productive structure, a problem already diagnosed by Furtado in the 1960s. On the other hand, there was an intense inflow of capital in Brazil, significantly increasing the volume of international reserves, from US\$ 54 billion at the end of 2005 to US\$ 207 billion at the end of 2008. This 'cushion of external liquidity' would be crucial for the country to face the effects of the international financial crisis in 2009 (BARBOSA, 2013). However, the 'liquidity cushion' was also responsible for the productive regression (BRESSER-PEREIRA, 2016; OREIRO & MARCONI, 2016), and the root of the inflation period with a fall in the product experienced during the post-Lula period.

The importance of the accumulation of international reserves was evident when the turmoil caused by the 2008s' international financial crisis began. The 2008s' crisis brought strong pressure on the exchange rate, which depreciated rapidly and intensely at the end of the same year.

However, the monetary authority made the situation relatively smooth. Free from the restrictive conditionalities that are generally imposed by the IMF, economic policy has even been able to adopt a countercyclical policy, seeking to alleviate the effects of the crisis in the central countries on domestic growth (LARA, 2012).

#### 2.4 Income Policy

Public spending on social policies generates an increase in the income guarantee system, whether monetary or non-monetary, functioning as a relevant element in income distribution, which can have a positive effect on aggregate demand, making it possible to create a large internal market consumption. Social policy expands the population productive inclusion, an essential factor for innovation increase and labor productivity, which in turn are decisive for economic growth, besides facilitating the increase of wages and the reduction of poverty (CASTRO, 2012). The Bolsa Família is an example of social policy with wide populational range.

It should be noted that between 2004 and 2005, two small financial reforms were made, which contributed to the expansion of credit in subsequent years. Firstly, a reform of the Bankruptcy Law in 2004, which helped to expand corporate credit. And, secondly, a payroll-deductible loans were the second innovation, which significantly expanded the supply of credit to Brazilian families (BARBOSA, 2013). As of 2005, there was a strong expansion of household consumption in Brazil, especially in those whose main income came from occupations directly or indirectly related to the minimum wage - from R\$ 300.00 in 2005 to R\$ 510.00 in 2010 (MEDEIROS, 2004).

As so, since 2005, economic growth in Brazil, started to be based on the expansion of domestic consumption of private goods and services (see Table 1). Such expansion was only possible due to the interventions which secured the households power of purchase, especially in the lowest levels of income. These interventions were characterized by

**Table 1: Household Final Consumption Expenditure (in R\$ millions): Brazil, 2003-2010**

Year	Household Final Consumption Expenditure (in R\$ millions)	Percentual variation of Household Final Consumption Expenditure (baseline year: 2003)
2003	1.052.759,00	-
2004	1.160.611,00	10%
2005	1.294.230,00	23%
2006	1.428.906,00	36%
2007	1.594.067,00	51%
2008	1.786.840,00	70%
2009	1.979.751,00	88
2010	2.248.623,92	114%

Source: Adapted from IBGE (2015).

policies by (i) the labor market: valuation of the minimum wage and induction to the formalization of employment; (ii) government transfers: rural retirement and social benefits; and, (iii) access to credit - directed rural and real estate, appropriated or derived from income improvement (KERSTENETZKY, 2015). A table showing household final consumption expenditure between 2003 and 2010 can be seen below.

The real increase in the minimum wage, increase in formalization and expansion of consumer credit of factors that increased the number of households with sufficient purchasing power to diversify the consumption pattern, considering the urban working mass and the lower middle class. The massification of durable consumer goods, the expansion of private transport, the increase of food outside the home and also the expenditure on services in all income brackets express these transformations (MEDEIROS, 2015).

The inflation growth trend reversal in the mid-2003 allowed the macroeconomic policy to turn to the domestic market, given the consumption importance of the aggregate demand sustained recovery. In 2005, loans to individuals increased 38.4%. In 2006, there was a 23.6% increase in loans to individuals, due to the expansion of personal loan portfolios, which are maintained through payroll loans, which grew 51.9% in the same year (BANCO CENTRAL DO BRASIL, 2005).

According to the 2007 Central Bank Annual Report, maintaining the dynamism of domestic demand as a driver of economic growth was a predominant factor to preserve the sustainability of the national financial system during 2007, even in the face of a volatility in international financial markets. In 2008, loans to individuals rose 23.9% year-on-year, boosted by operations related to vehicle acquisition, personal credit and up-front purchases with credit cards (BANCO CENTRAL DO BRASIL, 2008).

In the second half of 2009, credit expansion was driven by individuals' hiring, mainly through the expansion of payroll loans and financing for vehicle acquisition. This behavior was conditioned by the favorable evolution of labor market indicators and the decline in various types of interest rates. In 2010, the number of individuals increased by 19.2%, standing out the increases of 49.1% and 24.7% in financing for vehicles and personal loans, respectively (BANCO CENTRAL DO BRASIL, 2010). The next session analyses the external scenario and its relation with Brazilian GDP growth between 2003 and 2010.

### **3. The international trade and its impacts over Brazilian GDP growth between 2003 and 2010**

The level of the current account deficit is an important indicator of a country's external vulnerability. The futu-

re prospects for export growth, the deficit in the balance of payments, the possibility of reducing imports and the continuity of external financing are very important for the sustainability of the current account deficit (SANTOS, 2014).

During the period of international boom, the availability of external financing and the terms of trade were favorable towards Brazil, which allowed an increase on the imports volume. The expansion in demand for iron ore, soybeans, meat and pulp, increased Brazilian exports. On the other hand, the country has observed the deterioration of its industrial goods share in total world exports, which Bresser (2016) calls the 'Dutch disease'.

Already between the end of the FHC government and the early years of the Lula government, the external insertion conditions of the Brazilian economy underwent a significant reconfiguration, since the exchange rate promoted new conditions of competitiveness and encouraged exports, together with the beginning of the cycle of growth in commodity prices and in international liquidity (LARA, 2012). The expansion of cheap external funding supply allowed the external adjust to be postponed.

In this period, the appreciation of the currency of many emerging countries, the intense economic slowdown of the central powers and the expansion of China's current account surplus increased the share of peripheral countries with current account deficits. Even with the outbreak of the 2008 international financial crisis, accelerated growth in demand from China and other Asian countries for raw materials and the low interest rate favored Brazil's external accounts (LARA, 2012).

The major problem lies in the fact that the peripheral countries' vulnerability, like in Brazil, tends to increase during periods of international boom. With this, most peripheral countries become vulnerable to occurrences of international cycles reversions (SANTOS, 2012).

External liquidity is characterized by the country's capacity to meet its short-term commitments in foreign currency. Such capacity is defined by the relation between the stock of short-term external debt and the stock of international reserves. The higher this ratio, the worse the liquidity position. Between 2003 and 2010, it showed a practically continuous contraction trend, as the significant growth of the stock of international reserves was not supplanted by periods of intense growth in the stock of short-term foreign public debt. In the first quarter of 2003, the external liquidity indicator was approximately 45% and in the last quarter of 2010 it was around 20% - having presented even lower in some moments in that (LARA, 2012).



The intense accumulation of international reserves between 2005 and 2010 was a determining factor for Brazil to be able to face with relative stability the effects of the 2008 international crisis. Between the end of 2003 and the end of 2010, Brazilian international reserves grew from US \$ 49,254 million to \$ 288,575 million - practically multiplied by six (BANCO CENTRAL DO BRASIL, 2010). The excess of reserves was essential for the overvaluation of the Real, an event that promoted the reprimarization of the export agenda (CARVALHO; CARVALHO, 2011) or Dutch disease (BRESSER-PEREIRA, 2016).

However, the main factor that allowed the maintenance of the high level of international reserves was that the financial opening was matched with a flexible exchange rate, not allowing the recurrence of what happened in the exchange rate crisis of 1999. In addition, in 2008/2009, the sharp drop in commodity prices concomitant to exchange rate attacks was essential if the significant devaluation were not accompanied by an acceleration of inflation (SANTOS, 2014).

On the other hand, the external solvency indicator demonstrates the ability of a country to sustain a growth momentum with accumulation of external liabilities; that is, the ability to pay in the deficit country. This indicator is characterized by the ratio of current account deficit to exports. The higher the ratio, the worse the country's solvency position. This indicator declined between 2003 and 2007, becoming negative thanks to current account surpluses. Even with an increase between 2007 and 2010, the indicator remained lower than it was in early 2002 (LARA, 2012).

It is evident, therefore, that the external conditions were exceptionally favorable to the Brazilian economy throughout the Lula government. The improvement in liquidity and solvency indicators may be tied to three combinations of factors: (i) a more competitive exchange rate and resumption of exports; (ii) dynamics of commodity exports, mainly due to prices; (iii) the large availability of external capital, which provided a high dynamism in capital flow (LARA, 2012). The analysis of the Brazilian case allows affirming that items ii and iii were more relevant, after the resumption of exports.

The great complication of this conjuncture was the fact that the Brazilian economy returned to be highly dependent on exports, which were based on primary products, mostly natural resources - leading to a process of reprimarization of Brazilian exports (CARVALHO & CARVALHO, 2011; CUNHA, LELIS & FLIGENSPAN, 2013) or Dutch disease (BRESSER-PEREIRA, 2016). Although underpinned by the dynamism of commodity exports,

the weak performance of industrial exports combined with a vigorous increase in imports caused a reduction in the trade balance, resulting in a return on the current account deficit starting in 2007 - the end of the Lula government. Such fact collaborated with the hypothesis of Rossi, et al., (2017) that the demand's structure was diversified due to imports, without counterpart in the productive sphere.

Between 2008 and 2010, the adjustment variable between the strong growth of domestic demand - 5.6% on average - and the slow GDP growth - 3.3% on average - was the reduction of Brazil's trade balance. Exports of goods and services remained virtually stagnant during this period, at the same time as the volume of exports expanded sharply, with real growth of 9.8% per year, on average - from US \$ 173 billion in 2008, to \$ 182 billion in 2009 (BARBOSA, 2013). In the next subitem, the impact of the commodity boom on GDP growth was discussed.

### **3.1 The impact of the commodity boom on the Brazilian GDP**

The volume of exports expanded strongly after 2002, with the increase in worldwide trade and its output. The reactivation of the worldwide economy from the close relationship of the United States with Asia has led to an increase in the demand for primary products from the Asian economies, raising the price of these products - a fact that was strengthened by the high liquidity situation of the international financial market (BALTAR, 2008).

This increase in prices had direct and indirect impacts on Brazilian exports. The expansion of exports of primary products to Asia and the increase in the value of these exports to Europe, given the price increases, were the immediate effects. On the other hand, the indirect effects occurred due to the increase in the income of other developing countries, which export primary products and import manufactured products that are intensive in Brazilian natural resources (BALTAR, 2008).

In the period between 2004 and 2006, the external scenario was especially favorable to Brazilian exports. In the three-year period, China's demand for two of the most "valuable" products exported by Brazil, soybeans and iron ore, expanded sharply in the context of an intense increase in the price of commodities (ANDERSON, 2011).

**Table 2: Export of goods and services<sup>3</sup> : Brazil, 2003-2010**

Year	Exports (in R\$ 1mi)	Percentage change in exports (base year: 2003)
2003	260,798.30	-
2004	396,381.66	52%
2005	540,805.95	107%
2006	1,025,790.00	293%
2007	755,985.32	190%
2008	663,422.28	154%
2009	780,424.28	199%
2010	656,618	152%

Source: Adapted from IBGE (2015).

Between 2003 and 2005, Brazil reversed the trade deficit and began to enjoy a significant trade surplus - a situation created by the intense growth of world trade. In this way, the intense and upward trend in exports was insufficient to induce a more significant GDP growth. Only with the change in macroeconomic policies, starting in 2006, with a greater incentive to domestic consumption and the expansion of investments (public and private), actions that would leverage the economic growth of the country.

The explosion of commodity exports during the first decade of the 2000s was very important not only for GDP growth, but also for allowing the reduction of external debt, from the huge trade surplus and, consequently, from the expansion of the accumulation of reserves countries. The share of exports in the composition of GDP was reduced due to the increase in domestic consumption, which now represents a large part of the domestic product, which started to have its demand met by imports (ROSSI, 2015), a fact that contributed to the worsening of the external accounts coupled with a process of productive reprimarization (CARVALHO & CARVALHO, 2011; BRESSER-PEREIRA, 2016).

#### 4. Which factor played the main role?

For Lara (2012, p. 24), despite the fact that the improvement of the conditions of external insertion of the Brazilian economy has occurred from exogenous factors, this would not have resulted in an acceleration of economic growth if there were also no changes in domestic economic policy throughout the Lula administration.

On the other hand, Medeiros (2015) states that the easing of external restrictions on Brazilian economy between 1998 and 2002 led to an expansionary economic cycle that remained until 2010, characterized by substantial increases in the growth rate of GDP components. However, due to their weight on income, household consumption has been affirmed as the

main protagonist of the expansion. This expansion of domestic demand, however, was accompanied by high import penetration.

According to Lara (2012), as of 2004, the share of foreign trade in GDP growth has become smaller. As a result, the main contribution to this growth was the domestic market. In 2006, the contribution of the foreign sector became negative and the contribution of the domestic market reached an annual growth of around 8%, until its interruption by the effects of the international financial crisis in the last quarter of 2008.

<sup>3</sup>Data deflated based on the year of 2003.

**Table 3: Real GDP data disaggregated by components: Brazil, 2003-2010**

GDP Components	GDP at current values (R\$ 1mi)							
	2003	2004	2005	2006	2007	2008	2009	2010
1. Total	1,720,069	2,396,836	3,549,586	7,122,505	5,667,645	4,898,311	7,181,442.7	6,116,339
2. Household expenditure	1,063,141.6	1,443,763.7	2,145,492	4,313,601.8	3,395,771.8	2,927,768.2	4,453,634.5	3,684,051.0
<b>2.1 Share of GDP</b>	<b>61.8%</b>	<b>60.2%</b>	<b>60.4%</b>	<b>60.4%</b>	<b>59.9%</b>	<b>59.8%</b>	<b>62.0%</b>	<b>62.0%</b>
3. Public Administration expenditure	325,414.3	439,038.8	664,586.7	1,342,859.3	1,061,626.3	912,082.5	1,395,514.2	1,162,839.9
<b>3.1 Share of GDP</b>	<b>18.9%</b>	<b>18.3%</b>	<b>18.7%</b>	<b>18.9%</b>	<b>18.7%</b>	<b>18.6%</b>	<b>19.4%</b>	<b>19.0%</b>
4. Gross fixed capital formation	286,738.3	416,677.9	611,081.8	1,231,927.2	1,024,073.3	954,689.1	1,379,227.8	1,259,438.7
<b>4.1 Share of GDP</b>	<b>16.7%</b>	<b>17.4%</b>	<b>17.2%</b>	<b>17.3%</b>	<b>18.1%</b>	<b>19.5%</b>	<b>19.2%</b>	<b>20.6%</b>
5. Stock Variation	6,652.6	15,683.5	7,860.4	55,914.9	108,967.2	113,132.1	-17,934.3	73,665.1
<b>5.1 Share of GDP</b>	<b>0.4%</b>	<b>0.7%</b>	<b>0.2%</b>	<b>0.8%</b>	<b>1.9%</b>	<b>2.3%</b>	<b>-0.2%</b>	<b>1.2%</b>
6. Exportation of goods and services	260,789.3	396,381.7	540,805.9	1,025,790	775,985.3	663,422.3	780,424.3	656,617.8
<b>6.1 Share of GDP</b>	<b>15.2%</b>	<b>16.5%</b>	<b>15.2%</b>	<b>14.4%</b>	<b>13.3%</b>	<b>13.5%</b>	<b>10.9%</b>	<b>10.7%</b>
7. Importation of goods and services (-)	222,675.9	314,664.6	420,241.5	832,779.5	678,779.5	672,783.1	809,424.5	720,273.2
<b>7.1 Share of GDP</b>	<b>12.9%</b>	<b>13.1%</b>	<b>11.8%</b>	<b>11.7%</b>	<b>12.0%</b>	<b>13.7%</b>	<b>11.3%</b>	<b>11.8%</b>

Source: Elaborated from IBGE data

The dynamism of Brazilian exports played a fundamental role for the resumption of economic growth, since it promoted the relaxation of the external restriction (LARA, 2012; ORAIR, 2016). However, Orair (2016) is trenchant when affirming that the positive rate of expansion of the public investments had a very important impact both in the growth of the consumption and the salary mass, and of the expansion of the private investments, both observed in the period. It is noted that the share of Gross Fixed Capital Formation on the GDP grew 1.67% in 2003 to 20.6% in 2010. In absolute terms, the GDP components that grew the most during the period were the Gross Fixed Capital Formation (around 4 times the value of 2003) and imported good (around 4 times the value of 2003). These variables were followed by the consumption expenditure of the Public Administration, with a growth of 3.5 times in the period. While household consumption grew 3.4 times. On the other hand, exports had the lowest growth in the period, around 2.5 times the value of 2003. Thus, it is evident the importance of the expansion of the Gross Formation of Fixed Capital coupled with the increase in the Consumption of Public Administration and Consumption of households to explain the expansion of the average GDP growth rate between 2003 and 2010.

#### **Conclusion**

At first, the Lula government sought to guarantee the credibility of the economic policy in the market and, in this way, it was possible to take advantage of the opportunities arising from the commodities boom, which intensified from 2004 onwards. The improvement of credibility allowed this use to come from the favorable external scenario. Complementarily, the commodity boom was an essential factor as it reduced the external vulnerability, a matter that worried the government until 2003.

Inflation control, the reduction of public sector net indebtedness and the reduction of the vulnerability of the external accounts in the face of international shocks - based on the maintenance of macroeconomic stability - favored the acceleration of economic growth associated with the improvement in social indicators.

Lula administration's success in achieving average rates of GDP growth above previous periods was directly related to the increase in the economy's investment capacity. Both private investment (Gross Fixed Capital Formation) and Public Investment (Public Administration Consumption Expenditure) together with Household Consumption Expenditures were the main causes that explain GDP growth rates between 2003 and 2010.

Another aspect to be highlighted was the loss of export capacity to offer positive stimulus to GDP growth in the pe-

riod in question, since its growth was less than the growth observed in imports, due to the diversification of consumption not served by domestic production.

We understand that if the commodity boom had not occurred, the Lula government would probably not have had the opportunity to promote so many policies focused on expanding the purchasing power of the lower classes and, consequently, on expanding the domestic market. The expansion of the accumulation of international reserves, coupled with the improvement in the indicators of external liquidity and external solvency - succeeded by strong export growth - was essential in changing the economic policy. Therefore, the external dynamics of the country's economy allowed that the actions to boost the domestic market could take effect and promote an increase in the country's GDP between 2003 and 2010.

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