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Is Brazil Mexico Thirty Years On?

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Brazil's rapid development over the past decade was celebrated as evidence of a new world order, but it was not without precedent. Indeed, in many ways Brazil in the 2000s paralleled Mexico's economic rise in the 1970s. Of course, Mexico's economy subsequently crashed during the "lost decade" of the 1980s. Is Brazil on the cusp of a similar fate?

Presidential charisma and a potential oil bonanza made for heady times in Mexico during the 1970s. José López Portillo y Pacheco, President from 1976 to 1982, was keen to cast Mexico as a feisty underdog on the world stage.[1] He played up ties to the Aztec Empire, especially the Aztec god Quetzalcóatl, and the association became all the more evident once the inordinate amount of gold that marked the symbolic height of the Aztecs reappeared from underground.[2]

Black gold made the story of Mexico's ascent credible. In the early 1970s, a series of oil discoveries heightened expectations that Mexico would eventually rival Russia and Saudi Arabia among the world's largest oil producers. Then came the oil shocks of 1973 and 1979, trebling the price of crude, and driving economic growth to almost dizzying levels. Mexico's economy averaged real economic growth of almost 7% a year under López Portillo.

Mexico became not just a regional power, offering, in cahoots with Venezuela, discounted oil to its poorer Latin American neighbors, but very nearly a world power. López Portillo, along with the likes of the Shah of Iran, claimed that economic development would henceforth be divided between countries that had oil and those that did not. Of course, by 1979 the Shah's fortunes had rapidly soured, but many Mexicans saw in the Pope's visit that year reaffirmation that their country was on track toward becoming a rich country.

A *New York Times* headline on July 21, 1981 – "Oil Glut Is Here!" – foreshadowed a drop in oil prices. Mexico's growth prospects quickly dimmed. In response, during his last year in office López Portillo tried to stave off recession by expanding the state's role in the economy. Reportedly without consulting his advisors, López Portillo nationalized Mexico's banking industry in an attempt to get control of inflation and steer investment into choice industries.

As a result, the Mexican state increased its exposure to bank-held mortgages by roughly 75%. The government's reach into the market spooked foreign investors, who hurried

1 George A. Akerlof and Robert J. Shiller, *Animal Spirits: How Human Psychology Drives the Economy, and Why It Matters for Global Capitalism* (Princeton University Press, 2009), p. 53.

2 *Ibid.*

to pull their money out of the country.[3] By the time López Portillo left office in 1982, Mexico's inflation rate hovered around 100%, unemployment was on the rise, and the overvalued peso had made the country a net importer of foodstuffs.
In fact, foreign loans at high-interest rates underwrote Mexico's rapid development. And while very little of the newfound oil had been pumped, López Portillo had borrowed enormous sums from foreign investors based on future revenues. But, as we now know, Mexico possesses less than 2% of the world's oil reserves, a far cry from the figures cited by ebullient Mexican officials in the 1970s. The assumptions behind Mexico's rise, as George Akerlof and Robert Shiller put it in *Animal Spirits*, "turned out to be illusory".[4]
Worse news was yet to come, and it would take another 15 years for Mexico's economy to work through its debt and currency problems. Yet, curiously, López Portillo's escaped largely unscathed, despite his short-term approach to the economy and his administrations disregard for the interplay between foreign money and domestic development. Research by Stephanie Finnel, a PhD candidate at the Wharton School at University of Pennsylvania, concludes that the 1970s marked the apex of economic expectation in modern Mexico.[5]

> There are contrasts between Mexico then and Brazil now. Mexico was under authoritarian rule by the PRI in 1976, while present-day Brazil is a stable democracy. And even though Brazil's inflation has ticked up in recent years it is hard to fathom a return to the hyperinflation experienced in Mexico, or Brazil, a generation ago. However, nationwide giddiness that "God is a Brazilian" owes in large part to a combination of the personal leadership of Lula and oil discoveries in 2007 that promised to make Brazil the world's third-largest oil producer, behind Saudi Arabia and Russia, by 2020. As in López Portillo's Mexico, Lula quickly tried to parlay the oil discovery into greater clout for his country.

Obviously there are contrasts between Mexico then and Brazil now. Mexico was under authoritarian rule by the PRI in 1976, while present-day Brazil is a stable democracy. And even though Brazil's inflation has ticked upZsident from 2003 to 2010, and oil discoveries in 2007 that promised to make Brazil the world's third-largest oil producer, behind Saudi Arabia and Russia, by 2020. As in López Portillo's Mexico, Lula quickly tried to parlay the oil discovery into greater clout for his country. He repeatedly promised an end to US and European domination of world affairs, offered cut-rate ethanol to a number of Latin American nations, and forged the Brazilian National Development Bank into an aid program with global reach. For sure, the consequence of all this benevolence and politicking was greater popularity for Lula. But the lasting consequences of his diplomacy are less certain and some moves, such as partnership with Iran, unnecessarily damaged Brazil's long-term foreign policy goals.
Meanwhile, Brazilians were not the only ones excited about their country's seemingly boundless potential; international finance responded in kind. Announcement of the oil discoveries triggered massive foreign investment into Brazil, which increased from US$ 5 billion in 2007 to more than US$ 75 billion in 2012. Perhaps this helped insulate Brazil from the global financial crisis, but it unsettled Brazil in other ways. The onslaught of foreign capital drove up the value of the real, bolstered oil at the expense of other industries, and fueled a credit binge.

3 Roderic Ai Camp, *Politics in Mexico: The Democratic Consolidation* (Oxford University Press, 2007), p. 229.

4 Akerlof and Shiller, *Animal Spirits,* p. 54.

5 Stephanie Finnel, "Once Upon a Time, We Were Prosperous: The Role of Storytelling in Making Mexicans Believe in Their Country's Capacity for Economic Greatness", cited in Akerlof and Shiller, pp. 53-54.

Paradoxically, Brazil's economic policymakers appear all too mindful of the capital influx that roiled countries like Mexico in the 1970s. Fear of "Dutch disease" and "hot money" impelled Brazilian policymakers to more actively manage the economy. For the most part from 2008 to 2012, Brazil's central bank kept lending rates high in order to stay ahead of rising inflation. Predictably, this suppressed domestic small business expansion and it priced many Brazilians out of real estate in places like São Paulo, where the cost of living rivaled that of pricey cities like Paris and San Francisco.

But the central bank – *Banco Central do Brasil* (BCB) – began cutting benchmark lending rates when economic growth slowed in late 2011. The bank has since lopped off more than 5 basis points, but the current rate of 7.25% can't go much lower because inflation, which increased over the second half of 2012 to 5.75%, already exceeds economic growth, which is only about 1%.

The problem here, beyond the clear indication that a slowdown is underway, was that the country's policymakers sacrificed economic growth to tamp down inflation and bolster the welfare state. Hence, Brazil's growth during "the aughts" was only about half the rate of India's, and about a third the rate China enjoyed. As Ruchir Sharma noted in *Foreign Affairs*, Brazil has a demonstrated "tendency to limit its own growth".[6] Unshackling the market could bolster Brazil's petering economy, but it is hard to imagine the state stepping aside.

For much of the past decade, comparison with Mexico has burnished Brazil's image on the world stage. Now the tide is beginning to recede, and while the Mexican economy currently outperforms Brazil's, the more instructive conclusion might be that strong, seemingly providential growth, does not guarantee long-term outcomes. Every decade has its BRICS, but few countries manage to sustain high growth. Brazil's era of easy growth might well be over, government meddling in the market has limited the gains, and policymakers do not

6 Ruchir Sharma, "Bearish on Brazil" (*Foreign Affairs*, Vol. 91, No. 3, May/June 2012), pp. 80-88.

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