

## **The Rapid Growth Hypothesis. New Arguments.\***

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### **Introduction**

The present paper should be taken as an extension of and supplementation to the original paper: "A Hipótese do Crescimento Rápido e Sustentável"<sup>1</sup>. The original paper's main subjects were: the specificity of the Brazilian "quasi-stagnation" from 1981 to 2003, and the present day experiences of various economies concerning the transition process from quasi-stagnation to rapid and sustained growth.

Further pursuing this issue, the present paper exploits the idea that the aborted growth surges during the period 1981-2003 have accumulated an additional growth potential (beyond that of unused capacity) which cannot be evaluated based on the available data regarding the performance of the economy. It also puts forth the hypothesis that repressed growth during the period of quasi-stagnation tends to spontaneously emerge if stability is assured, but it can be intensified through adequate and specifically-conceived policies. This suggests that the economy could immediately reach a fairly good pace of expansion that might lead it into an effective long-term rapid growth trajectory.

### **Trends Revealed by the Evolution of the Brazilian Economy**

The Brazilian economy's recent history is marked by two clearly differentiated periods. The rupture, or break in trend, occurred around 1980, signaling the transition from the first (1940-1980) to the second period (1981-2003).

During the first period we have the implementation of the productive structure that characterizes, in general terms until today, the Brazilian economy. The construction, in four decades, of a broad and diversified productive structure had as a landmark the

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<sup>1</sup> / Castro, Antonio Barros de – A Hipótese do Crescimento Rápido e Sustentável, em Velloso, João Paulo dos Reis (Org.), Novos Desafios do Desenvolvimento. Cinco Décadas de Questão Social e Crescimento Sustentado, José Olympio Editora. forthcoming.

implementation of the so-called great projects, which were directly or indirectly promoted by public policies or State-owned enterprises<sup>2</sup>.

Even in those ventures which did not involve the implementation of mega-projects or anchor-plants, but merely targeted the introduction, through private capital, of new links in the productive chains, headway was made by means of projects that, quite often, turned out to be greater than the enterprises which were running them<sup>3</sup>. While the new economic tissue was being constituted, the projects (rather than the relative prices) guided, to great extent, the entrepreneurial decisions – that being one of the fundamental characteristics of this first period.

As expected, the projects demanded massive absorption of **new knowledge**. It is important to highlight, however, that this knowledge, in good measure, would come along either incorporated or embedded in the productive processes that were being adopted or in the products whose manufacturing was being introduced. Nevertheless, the “unincorporated” and operational knowledge evolved quite fast as well – otherwise it would not have been possible to set in motion the new machines and equipment. Yet, as in some other contemporary catch-up experiences, not even by far, did the production demand full cognitive command of what was being introduced in the country. Therefore, a second characteristic of this first period consists of the notorious disequilibrium between the operational knowledge and the formal/ scientific knowledge<sup>4</sup>.

The third and last major characteristic to be designated here refers to the economic growth that took place in this period – which includes its pace (7% on average, yearly), its relative regularity and the fact that the expansion was perceived as assured. The latter, i.e., the widely shared belief in the economy’s strong vocation for growing (and in this sense, in the existence of a “growth convention”)<sup>5</sup>, deserves to be specially

<sup>2</sup> / Please refer to Castro, Antonio Barros de, *Renegade Development: Rise and Demise of State-led Development in Brazil*. Org. Smith, William et Al. Transaction Publishers, 1993.

<sup>3</sup> / I owe this last observation to the BNDES economist, Aluysio Asti.

<sup>4</sup> / Amsden, Alice. *The Rise of the Rest: Challenges to the West from Late-Industrializing Economies*, Oxford University Press, 2001. An indirect way to reveal this characteristic can be found in a recently published work, showing that the GDP evolution, from the post-war period to the 1980’s, took place at a much faster pace than that of human capital (measured by a weighted index in which formal education has a significant weight). Please refer to Albuquerque, Roberto Cavalcanti; *A Questão Social no Brasil: Um balanço do Século XX*. in *Novos Desafios do Desenvolvimento*. op. cit.

<sup>5</sup> / Castro, *Renegade Development*, op. cit.

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highlighted. From this perspective, the market risk to be born upon the investments was generically lowered – thus helping to turn growth into a self-fulfilling prophecy.

We will now proceed to the second major trend which extends itself over a 23-year period, from 1981 to 2003<sup>6</sup>.

In opposition to the first, the second period is marked by the absence of great projects, Carajás being an important exception. Despite the scarce changes, during this period, in the overall structure of the productive framework, intense changes were introduced within the companies and in their relationship with the markets. As it is well known, these were driven by the opening of the economy and by certain consequences resulting from the stabilization achieved by the Real Plan. In concrete terms, companies changed their management and work organization, the basket of supplied products (which implies, as a rule, changes in productive processes) and, not rarely, changes in their equity structure<sup>7</sup>.

The most important implication of the aforesaid is the radical change observed in the economy's evolutionary pattern. Fundamentally, capital accumulation and, particularly, the implementation of new projects were no longer the axes around which the economy evolved.

During this second period, the economy admittedly presented, as per official indicators, a disappointing performance, growing on average around 2% yearly – that is, just slightly over the population growth. There were, however, in the midst of this quasi-stagnation, brief (although sometimes vigorous) growth surges, followed by relapses of comparable magnitude. On the other hand, the efficiency with which the firms operated indisputably advanced – resulting in steady productivity growth<sup>8</sup> (and job elimination), as well as improvement in the marketed products. However, two exceptions must be made regarding the above mentioned.

Firstly, the pointed out transformations did not occur in the sectors in which Brazil enjoyed significant comparative advantages (such as in the steel and the pulp and

<sup>6</sup> This long period covers sub-periods, which were characterized by the author in “A Hipótese do Crescimento Rápido e Sustentado”. Please refer to *Novos Desafios*, op. cit.

<sup>7</sup> Castro, Antonio Barros de, “A Reestruturação da Indústria Brasileira nos Anos 90: Uma Interpretação.”, *Revista de Economia Política*, jul/set de 2001. Ferraz, J. Carlos; Kupfer, David e Looty, Mariana. *Competitividad Industrial en Brasil: 10 años después de la Liberación*, Revista de la CEPAL, abril de 2004.

<sup>8</sup> Labor productivity growth during the nineties was extremely fast, varying yearly between a minimum of 5% (measured by the National Accounts) and a maximum of 8% (measured by the PIM/IBGE).

paper sectors)<sup>9</sup>, nor did they happen in the gigantic plants inherited from the first period (like Camaçari). Moreover, in the second half of the 1990's, some new large plants started to appear – altering the economic geography rather than the industry's sectoral structure.

The peculiar combination of mediocre results, in terms of average annual growth, and intense transformation in the microeconomic tissue (but not in the economy's productive structure as a whole) tremendously hampers the work of any analyst. Not only because low growth did not at all mean stagnation<sup>10</sup> but, also, because the available statistical indicators, focused on measuring aggregated results (macroeconomic or sectoral), could hardly grasp, adequately, the effects of the current changes. This is quite understandable as these changes occurred, above all, within the companies, in their inter-relationships and spatial distribution.

A striking characteristic of the second period, that must also be highlighted, is the growing awareness regarding the peculiar vulnerability to which the Brazilian economy became subjected. It is quite true that, although the Brazilian economy has been burdened with problems; nevertheless, it has shown itself capable of remarkable recoveries or, even, short-lived booms. But it also became obvious that these movements would not sustain themselves. Consequently, redoubled care had to be taken by firms and consumers when interpreting the economy's situation and perspectives. It was a matter of taking advantage of the comebacks, without giving too much credit to market dimensions that they might suggest. Neither could one easily embark upon foreseen opportunities merely based on the increasing knowledge that could be acquired through the operation of plants and relationships with the market (we will come back to this point later).

In summary, everything takes place as if the environment required that markets be evaluated providing a margin for misleading data - which also results in a parsimonious utilization of the learning brought about by changes in the production and distribution of goods. In doing so, quite possibly, it might be possible to restrain the damage caused by the frequent mismatch between supply and demand. Though this type of conduct might

<sup>9</sup> / Coutinho, Luciano e Ferraz, João Carlos (coordenadores), Estudo da Competitividade Industrial da Indústria Brasileira. MCT-Editora da Unicamp, 1994.

<sup>10</sup> / For a brief comparison between the modernization undertaken in the 1990's and the glorious period of the Brazilian industrialization, please refer to Castro, Antonio Barros de, El Segundo Catch-up Brasileño: Características y Limitaciones. Revista de la Cepal, 90, August 2003.

make less frustrating, or harmful, an environment that was inextricably subject to demand strokes, it was not less true that it also reduced the chances of making the most of given opportunities. In other words, it restrains the production capacity adherence to the stormy evolution of demand – thus, giving up the exploitation of opportunities for they might be misleading.

It is also possible to state that, while in the first phase, as pointed out earlier, the economy grows more than it learns, in the second one, it learns more than it can use. This trend came to be reinforced, in practice, by the acceleration, in the 1980's, of the records achieved in the educational field. Furthermore, it suggested that, if the economy could set itself free from sudden demand suffocations (this being the primary task of macroeconomic policies) and, going even further, if the economy could stimulate the release of perceived, but not exploited, opportunities, its growth trajectory could be shifted upwards.

### Enhancers and Reformers

Quite often, along the second period, the economy's expansive energy would surface. Each comeback, however, was followed, after a shorter or longer time span, by an abrupt deterioration in the economic environment which managed to cancel out the economy's expansive surge<sup>11</sup>.

The growth frustration, though, seems to have acquired a significant stance in the 1999 recovery. This could be, to a certain extent, explained by quantitative reasons. From the first quarter in 1999 to the first quarter in 2001, the Brazilian economy presented an accumulated growth of 8.5% (4.2% yearly). But the ultimate meaning of this traumatic experience is further explained by other reasons.

For some observers, the painfully, but rapidly achieved success in controlling the consequences of the feared mega-devaluation of 1999 led to the conclusion that the stabilization process had passed its definitive test. This conclusion also relied on the fact that, in the second half of 1998, an earnest fiscal adjustment effort had been introduced.

<sup>11</sup> / In "A Hipótese do Crescimento...", op. cit, both, the growing impulse and specificity acquired by the Brazilian economy, as a result of the 23 years of quasi-stagnation, are examined.

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Furthermore, the zest exhibited by the growth momentum was quite impressive: the expansion, lasting approximately 20 months, faced real primary interest rates constantly above 10% yearly, combined with a strict fiscal adjustment effort.

The impression that the economy was facing something new tended to gain strength as some micro-level achievements – beyond everyone's expectations, from both champions and opponents of the 1990's trade liberalization – came to be acknowledged. As matter of fact, even before the devaluation, great part of the industry had been giving out signals that, at least concerning productivity and the struggle for the internal market, the challenges brought by the opening of the economy were being seriously tackled<sup>12</sup>. Bearing this in mind, and after having overcome the intense, but brief, turbulence following the devaluation, it was possible to aim higher. Not only did the new exchange regime offer a reasonable shield against difficulties originating abroad but, also, for the first time in Brazil's modern history, exports could start playing a leading role in GDP growth.

Nevertheless, the swift collapse (between 1<sup>st</sup> and 2<sup>nd</sup> quarters of 2001) of the growth cycle, started after the devaluation, flagrantly contradicted the optimistic hopes raised by the short-lived boom. We will not dwell on this traumatic episode. We should just remember that, in this particular case, the frequently-abused argument of bad fortune should be taken seriously. As the economy was emerging from the quasi chaos brought about by the mega-devaluation, and starting to (surprisingly) grow, Argentina, its second major trade partner, approached a virtual meltdown. At the same time, the NYSE was giving out even more disturbing signals<sup>13</sup> and, as if all these bad news were not enough, in March 2001, it was suddenly announced that an acute energy crisis, unforeseen among non-specialists, was approaching and presaging, at best, a very bleak future.

The cycle aborted in 2001 increased the debate on the state of the economy and how it should be treated, providing arguments to both parties.

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<sup>12</sup> / Castro, Antonio Barros de. O Lado Real do Real: O Debate e Algumas Surpresas, in: Vinte Anos de Política Econômica. Org. Magalhães, João Paulo de Almeida; Mineiro, Ademar & Elias, Luiz Antonio. Contraponto, 1999. See, also, McKinsey Global Institute. Productivity: The Key to an Accelerated Development in Brazil, 1998.

<sup>13</sup> / For a provocative review of the 2001 crisis please refer to Faria, Lauro Vieira. Financial Markets: External Shocks and Policy Responses: The Case of Brazil 2001. Revista de Economia Política, Oct-Dec./2003.

According to the stance henceforth referred to as “enhancers”, it was clear that, after consolidating the monetary stability and the opening of the economy, and having adopted a new macroeconomic policy regime (the so-called tripod composed of severe fiscal policy, floating exchange rate and inflation targets), the economy could resume a sustained growth. The experience undergone after the 1999 devaluation pointed out in that direction; however, it also made obvious the economy’s vulnerability when facing shocks. Hence, the management of the economy demanded a lot of caution. If for no other reasons, because the successive crises in the end of the 1990’s resulted in the public debt’s explosive growth, as well as in the term reduction and dollarization of a high and growing proportion of the total liabilities. Consequently, the floating exchange (a safety net against foreign disturbances) turned into another threat to fiscal solvency<sup>14</sup>. In short, the commitment to fiscal solvency (reached in May 2000 with the Fiscal Responsibility Act<sup>15</sup>) had to be made ostensible.

In other words, the devaluation and the substantial adjustments made on the fiscal front had withdrawn the economy from the precipice’s verge, turning sustained growth into a real possibility. Nevertheless, the consolidation of this new framework required much prudence and an incessant improvement of the business environment. It would also be advisable, supposedly, that local institutions drew closer to international benchmarks. After all, the turbulence, under which the economy remained exposed for so many years, had left as an inheritance not only a stressful climate (and a notorious volatility as to expectations), but, also, a deep-rooted suspicion regarding anything that is local or country-specific.

Notwithstanding, the improvement front, according to some of its advocates, should go beyond the above-mentioned suggestions. The floating exchange rate could be discreetly monitored (in order to soften or restrain speculative moves), while the inflation targeting system, perhaps, could be somehow eased – as long as it does not compromise its ability to coordinate expectations. Moreover, the vigorous growth phases could be

<sup>14</sup> / The dollar-linked share of the total amount of the public debt (including swap operations) reached 50% in June 2002 and remained above this threshold until February 2003. It should be noticed, however, that in November 2004 the same share, adjusted as per exchange rate, was reduced to 25%.

<sup>15</sup> / Regarding the conditions wherein the new fiscal institutions are constructed, including the Fiscal Responsibility Act, please refer to: Políticas e Reformas Fiscais no Brasil Recente, Loureiro, Maria Rita & Abrúcio, Fernando; Revista de Economia Política, Jan-Mar/2004.

used to start introducing counter-cyclical fiscal policies – thus abandoning the public policies’ pro-cyclical behavior, which dates back to, at least, the so-called Tequila crisis (1994/95).

Two features should still be added to the enhancers’ point of view that we are hereby characterizing.

Firstly, the emphasis on the improvement of the macroeconomic management and on the implementation of microeconomic-oriented mini-reforms reflected an incremental approach. And the same attitude should have been extended to the institutional field: rather than new parameters or changes in the economic policy regime, alterations should be made, one step at a time, so as to unravel the economic players’ behavior<sup>16</sup>.

Moreover, it is worth noting their attitude towards the growth process itself – and here one can perceive the existence of divergences among the enhancers. In order to understand this, it is better to start from the premise that they all pursue an inflationary neutral growth, i.e. one that does not generate inflationary pressures. However, on this issue, the most prudent or conservative enhancers come into difficulties. This is so because, for them, the limits to growth (here understood as an expansion pace that preserves stability), should be deduced from the observation of past occurrences. In other words, they will try to determine the ideal growth rates through statistical methods or through the adjustment of production functions, in the light of previous experience. Yet, this drifts away from the very essence of the enhancers’ viewpoint, whose target is not to just overcome the past, but also to make it different and better. There are further difficulties regarding the idea – highlighted in the first part of this paper – that, in the Brazilian case, the past comprises two different trends and, as we shall see later on, a new rupture in trend might be under way<sup>17</sup>.

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<sup>16</sup> \ A broader presentation of the position referred here as “Enhancing” can be found in the Ministry of Finance document: “Consolidando a Estabilidade Macroeconômica”, November 2004, whose scope, as it can be easily verified, goes way beyond the themes that are directly related with the consolidation of stability.

<sup>17</sup> \ Being fundamentally guided by past trends, without bearing in mind recent transformations, may help explaining forecasting errors regarding the economy’s expected behavior. A likely and important case would be the Central Bank estimate of a 3.5% growth rate for the Brazilian economy in 2004 (Relatório de Inflação, Dec. 2003).

The notoriously conservative position<sup>18</sup>, which has just been evoked, finds resistance, within its own ranks, from those enhancers who believe that it is possible to identify market failures and to correct them through active policies. This implies that “Enhancing” can be made compatible with the adoption of industrial policies intended to disseminate or strengthen innovative conducts. To do so, it is simply a matter of acknowledging that, quite often, enterprises cannot reap all the innovation-derived advantages – a valid proposition for any type of market economy.

Let us now turn to the positions that differ from that of the “enhancers”, just quickly summarized here. Their common characteristic is the belief that, without deep reforms, the Brazilian economy will not be able to achieve a sustainable growth. In short, the economy’s problems would reside in its own structure, or in the so-called economic policy model – and not in the management of the economic policy. The long stagnation, the economy’s successive collapses and troubles, such as the chronically high interest rates, are pointed out, under this perspective, as being some of the systemic difficulties to be surmounted through reforms. International experience (comparisons with well-succeeded cases like Chile and Korea, as well as with other countries subject to recurrent crises) is frequently invoked by supporters of this position to reinforce the need for deep changes.

The “reformist” position (which is addressed here fundamentally concerning the resumption of sustainable growth), however, conveys blatantly antagonistic attitudes. On one side, there are those who believe that the revision of the reforms undertaken in the 1990’s, as well as the revision of the present macroeconomic management model, and the reestablishment of certain control mechanisms (especially those concerning free movement of financial flows) are prerequisites for a healthy growth<sup>19</sup>. On the opposing side, there are those who advocate the deepening of pro-market reforms and the minimization of political interferences of any nature<sup>20</sup>.

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<sup>18</sup> \n fact, among the “enhancers”, there are serious discrepancies regarding the pace at which the inflation should be reduced. It must also remain clear that the enhancers’ view , in broad terms, aligns strict critics regarding the management of public policies, particularly in the macroeconomic policy area.

<sup>19</sup> \ Please refer to Mercadante, Aloizio. (Org.) O Brasil Pós-Real: A Política Econômica em Debate. Unicamp, Instituto de Economia, 1998 and A Economia Política da Mudança: Os desafios e os Equívocos do Início do Governo Lula. (Org.) Paula, João Antonio. Autêntica Editora, 2003.

<sup>20</sup> \ The gist of this position can be found in: Arida, Pêrsio; Bacha, Edmar & Lara-Resende, André. High Interest Rate in Brazil: Conjectures on the Jurisdictional Uncertainty. Mimeo, 2004.

Having as backdrop the summarized outline presented in this section, in the following one, we will start discussing the possible extension of the 2004 growth spur.

### **The Release of Growth Potential: Some Remarks**

Many analysts have pointed out the fact that in an economy subject to repeated crises, decisions and knowledge are channeled toward activities perceived as of low risk and, in last instance, focused on guarantying survival<sup>21</sup>. It does not seem to us, however, that the implications of this set of conducts, for a (possible) subsequent growth, have ever been explored. Indeed, in order to at least introduce the idea in the debate, it seems important to make a brief reflection on economic growth, emphasizing its microeconomic foundations.

As an economy begins to count on enterprises that have already accumulated not only material resources but specialized knowledge and capabilities as well, its growth will depend on the exploitation, in a more or less intense and creative manner, of the resources under their control. In such conditions, the relevant principle is the one that views a company as a complex set of resources (once again mentioning that these include knowledge), some of them facing shortages (or bottlenecks); while others available in excess. Concretely, at any given moment, some resources would be fully utilized, or even over-utilized, while others might be underutilized. Growth then becomes, in great measure, the result of adequate removal of bottlenecks and of greater (and better) leftover utilization<sup>22</sup>. This picture obviously differs qualitatively from that, mentioned at the beginning of this paper, in which the investment projects (directly or indirectly coming from the public sphere) surpassed, to a great extent, the capability and, in some cases, the very size of the firms.

Two considerations should be added to the aforementioned.

If growth was already a steadfast process of reutilization of resources and capabilities in the developed countries during the post-war period, this became even more

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<sup>21</sup> \ This theme is extensively treated in Ruiz, Ricardo Machado. *Estratégias Empresarial e Reestruturação Industrial (1980-1992): Um Estudo de Grupos Econômicos*. Unicamp, Instituto de Economia, 1994.

<sup>22</sup> \ The aforementioned comes from Penrose, for whom the growth of a firm depends on new services extraction from the existent resources within. Penrose, Edith. *The Theory of the Growth of the Firm*. Oxford University Press, 1959.

so true today, given the flexibility bestowed by new technologies and the immense potential for product differentiation resulting there from<sup>23</sup>. New possibilities appear, under such conditions, concerning the relation between growth and capital accumulation.

Having the above mentioned in mind, it becomes clear that an economy subjected to repeated demand frustrations may be converted into a very special environment. One of its major characteristics would be that several possibilities of unblocking and of utilization of exceeding capabilities were (and quite possibly continue to be) perceived by companies, despite the lack of proper conditions for their utilization. If this is the case, the widespread notion, by which in the period 1980-2003 companies were predominantly making use of defensive strategies, is rather inaccurate. Indeed, especially in the industrial area, firms have changed intensively throughout this period – and this suggests that they enhanced their capability to reposition themselves in the new market scenario.

Although they have promoted true changes, the supplementary possibilities, opened up by their own transformations, have not been duly exploited. As a result, they have limited or restrained their acquisition of new knowledge and capability. In other terms, the possible chain of changes has often been unduly cut off. Hence, summarizing, hardly ever did they manage to operate under – the usually fertile – demand pressure. In the given situation, even in the well-succeeded cases of change, it was rarely necessary to have, for example, more than one production shift. Recently, the well-succeeded repositioning of numerous companies towards foreign markets has granted an even broader and more important role to the phenomenon of foreseen, but not (yet) adequately explored, opportunities.

The consequences possibly derived from what has been said are far from trivial. To perceive this, it is worth considering the case of an economy that did not go through successive demand suffocations and in which there was no equivalent to a sudden discovery of many new opportunities in foreign markets. In such a (normal) economy capacity utilization, in a given moment, may or may not be considered satisfactory. When utilization is significantly below full level, it is widely accepted that it can be

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<sup>23</sup> \ It is not about cost and scale not mattering any longer. Particularly regarding the increasingly complex and differentiated product base (sometimes referred to as platform) that is being launched in the market, scale is still fundamental. However, it does not prevail as a competitive weapon when it comes to fighting for the consumers' preference.

raised by measures that stimulate effective demand. Under these circumstances, it is very plausible to suppose that a greater degree of capacity of utilization can be reached – and that the resulting growth will be inflationary neutral.

However, the situation is quite different in an economy, as the one in Brazil, at the present stage. In such a scenario, most certainly, even cost reducing opportunities were visualized as possible but were not explored. Hence, as formerly suggested, there is an under-utilization of the very capacity of learning. Beware, though: it is not a low-learning case. As lots of changes took place, these were naturally followed by experimentation and learning. It is due stating, though, that in this particular period the economy learned more than it used, which is the same as saying that it has accumulated quasi-capabilities<sup>24</sup>. From this angle, we are in a situation that is opposed to the one, signaled in the beginning of this article, whereby there was far more utilization than learning.

### **Growth beyond Recovery: Some Conjectures**

The debate on the growth of the Brazilian economy has evolved quickly. Until the middle of 2004, many people continued to deny that the economy was in the midst of a recovery process. However, as this perception about the state of the economy was definitely proved wrong by the released data, many of them moved to a more generic position: the growth process would not be able to sustain itself. Meanwhile, those who had already perceived that the economy was growing (more vigorously so than after the 1999 devaluation)<sup>25</sup>, began to look into new issues.

For one group it was a matter of establishing, in light of available information on the performance of the economy, the pace at which it could grow in a sustainable way. That is to say, it would have to be determined, by using accredited assessment methods,

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<sup>24</sup> \ For an interpretation centered on the capability evolution, please refer to Langlois, Richard. Chandler in a Large Frame: Markets, Transaction Costs and Organizational Form in History. University of Connecticut, mimeo, Jan. 2004. According to this perspective, it should be stressed that the production world has imperfect knowledge and information, which varies from firm to firm, thus limiting the value of blueprints.

<sup>25</sup> \ In the monthly bulletin released by the current economic affairs research group from UFRJ's Economics Institute, especially through the articles written by Caio Prates, one can find a step by step coverage of the last two great resurrections: the one which goes from May/June 1999 until March 2001 and the other that was initiated in the third quarter of 2003.

the GDP potential growth<sup>26</sup>. For a few others, convinced that the rupture under way was introducing new parameters and trends, it was crucial to understand and characterize the main features of the recent and surprising performance of the economy<sup>27</sup>. This is quite understandable: there are uncountable serious mistakes, made here and by foreign observers, on this matter. Undoubtedly, it would be ideal to go beyond the mere interpretation of available data; but here we face huge difficulties. What we might call the repressed growth potential is virtually unknown and, indeed, inaccessible in any precise way. Data on what is going on is also missing, especially on the supposedly-new trends which are spontaneously emerging as the rupture moves on. Furthermore, little is known about the institutions and, above all, about the policies that will backup (or not) the new growth pattern. One of the few things that can hardly be disputed is the fact that this government is decidedly engaged in creating micro-institutions capable of improving the business environment<sup>28</sup>. It is within this context and as a very first approximation that the following reflections should be taken.

So far, the expansion of the economy took place basically through increased utilization of the existing capacity. Presumably, though, capacity is not just being more intensively exploited but, also, it is being recycled according to opportunities that had been perceived in the past but could not be duly exploited. This kind of growth, in which the release of opportunities is strongly present, would also help explain the fact that the demand for machines and equipment (though not the investment in new plants) has been growing at a higher rate than would have been expected at the beginning of a growth cycle. Indeed, the apparent consumption of capital goods grew 14.2% until the third quarter of 2004, over the same period in 2003.

On the other hand, although the capacity utilization level in the basic inputs industry is high enough, and the economy's infrastructure is by large very deteriorated, it

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<sup>26</sup> \ The theoretical foundations of the potential growth models can be found in Jones, Charles. *Introdução à Teoria do Crescimento Econômico*. Ed. Campus, 2000. The usual estimating methods are described in *A summary of Alternative Methods for Estimating Potential GDP*, US Congress. CBO, 2004. A stimulating critical appraisal of this growth vision can be found in Felipe, Jesús. *Total Factor Productivity Growth in East Asia: A Critical Survey*. Studies, April 1999.

<sup>27</sup> \ An effort towards this was made in Castro, Antonio Barros de. *A Hipótese do Crescimento Rápido...*, op. cit.

<sup>28</sup> \ It is worth highlighting, among the most recent changes, the measures aiming at reducing the investment costs, the new Law on Innovation, the new Bankruptcy Law, and the Public-Private Partnership regulation.

is not expected, at the present resumption stage, any great volume of investments in these areas. In the basic inputs sector, which holds strong comparative advantages, because the repression of opportunities simply did not occur. As for infrastructure, its projects are recognizably of long-term maturity and highly sensitive to the uncertainties inherent to the still necessary changes in regulation.

Returning to investment, it is worth pointing out that (in fields other than basic inputs and infrastructure) companies are now frequently determining their investments together with new strategies of market insertion. This certainly differs from what happened in the heroic period of industrialization (1940-1980), when projects, aiming at building the modern industrial structure, had obvious precedence over companies' market strategies.

The second conjecture, practically a corollary to the first, consists in not needing to promote, as from the start of economic growth, a boost in the overall investment amount. After all, as it must be already clear, the growth's initial phase, in this particular environment may be based on the greater and better utilization of pre-existent resources.

Supposing that what has just been said is pertinent, this would imply the existence of a transition period of approximately 2 to 4 years, before falling into the long-run growth pattern. Two additional observations should be introduced here.

During the transition phase of expansion, the relation between investment and growth would be characterized by the prevalence of the second over the first one. That is, basically, growth would promote investment. As to the usual relation, in which investment precedes (or simply determines) growth, this would predominate later on.

It is worth observing that, given the supposed precedence of growth over investment, the short-term must be seen, within this unique context, as strategic. This obviously goes against the customary use of this term. As a rule, the term "strategic" is reserved for the long-term, while the term (and concept of) "tactics" is associated with short-term. Notwithstanding, in this case, the short-term must be understood as strategic – in the sense that it represents a condition for bringing about the rupture and the transition into a new growth trajectory.

As regards the above, it must also be stressed that once could simply not hope for a jump of investment in order to reach a new (and high) growth pattern. This is

understandable: consumption is at present notoriously compressed and should realistically increase at, say, GDP growth rate. On the other hand, neither the present Government nor the general public would accept that the country, yet again, resorted heavily to external savings (current account deficits). In short, only gradually may Brazil set in motion a renewed “growth machine” for this requires reinforcement and adaptation of the financing capacity, intensification of the generation of intangible assets, recovery of engineering, and other. This is, nonetheless, another way of perceiving the decisive importance of utilizing, in the transition to long-term growth, the potential contained in the existing economy.

As these suppositions prove to be right, the economy would be able to make substantial headway by wisely making the most of the hidden potentials. Evidently, support to innovation (of a non-disruptive, or rather, evolutionary nature) could be of great relevance – and this draws to center stage the importance of bringing together private and public interests so as to awaken dormant possibilities within the firms.

The agenda that is being drafted would certainly benefit if two obsessions were overcome. The first one is denying the past and, the second, is “doing the necessary homework” by copying the state of the art abroad.

Regarding the last one, it must be made clear that improvements are always most welcome, provided they take off sand from the wheels of industry, to use an old British expression. The same applies to reforms aimed at making the tax burden lighter and better distributed. However, it does not make any sense to implement reforms whose assimilation could put the resumption at risk – as well as the original transition to sustained growth that, presently, seems to be taking shape.

As it can be gathered from what has been said so far, the Brazilian economy’s present situation can be summarily conceived as the overcoming of a long crisis, to which it has resisted, and somehow adapted itself, and whose cost has already been paid. In other words, the present dynamism (sketched, in pioneer style, in the 1999-2001 aborted cycle) suggests that the trends prevailing since 1980 might have been defeated, though with great difficulty. It is unnecessary to insist that this perspective is frontally opposed to that which believes that the resumption of sustainable growth can only be achieved through the re-foundation of the economy.

Among the problems that growth will face from now on, only one of them will be mentioned here.

Given China's striking rise as a manufacturing power, as a multinational enterprises' platform, and the home of aggressive local companies (many of them belonging to public entities), it must be admitted that several choices that Brazil has made – regarding sectors, technology and products – today seem quite “wrong”. In other words, many choices would not have been made – or would have taken other paths – had we known beforehand that we would have to compete against the Chinese steamroller. Indeed, the emergence of the Chinese economy as “the world's factory” puts at stake one of the trump cards of the Brazilian economy vis a vis the rest of Latin America. We are referring to the fact that Brazil is the only economy that coped with (and took advantage of) the opening to the world market, managing to keep and revitalize a highly-diversified productive structure. Though hardly scratching the surface of this new and fundamental issue, we would, nevertheless, like to add two extra comments.

Having escaped from specialization by sectors and functions (Argentine automobile industry, for example, became merely an assembler), the Brazilian industry today might be forced into the new rescheduling of its competitive strengths. And this time we could hardly escape a deeper product-based specialization<sup>29</sup>. This type of specialization could not have happened during the disordered rush (in pursuit of modernization) promoted by the 1990's opening. Nowadays, however, having preserved, to a great extent, our productive chains (apart from some well-known exceptions), this is a possibility that is already being exploited by different firms. It is a superior kind of specialization widely-adopted among developed economies. It is also a particularly adequate and fertile movement to be enhanced by industrial policies centered on the development of innovation capability. On the other hand, this is one more reason why the investment-led growth should be understood not only as difficult (as mentioned earlier) but also, quite possibly, as inadequate, given the precocious crystallization (as sunk costs) of choices to be subsequently reviewed.

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<sup>29</sup> Exemplifying: regional aircrafts, compact cars, hydro-electric engines, some agricultural machines, ladies' footwear, beachwear fashion design, superior quality towels, alcohol and alcohol-producing equipment, etc.

In short, it cannot be denied that, from the manufacturing viewpoint, Brazil and China are on a collision course. And this leads us to reassure that growth supportive policies must be reinforced by means of direction-shifting policies and, let us say, through advanced capability specialization.

To end this exposition – that by far excelled the initial proposal – I will add a couple of comments on the present government.

It was observed in a previous paper<sup>30</sup> that this government has shown itself capable of carrying on the pragmatism that emerged (but remained limited to certain areas) in the second term of Fernando Henrique Cardoso. Even in the present government, though, what we are calling pragmatic approach, i.e. sensitive to context specificity, certainly did not encompass all areas. The monetary policy, for instance, shows an ostensible rigidity that if, on one side, reflects the caution imposed by this country's inflationary history, on the other, it seems to be ignoring that we are just emerging from a long period of systematic inhibition of initiatives both in private companies and public institutions geared to supporting development.

Notwithstanding the contradiction that has just been pointed out, it is impossible to deny that this government is distinguishably open to negotiations. As a matter of fact, and in accordance with one of the founders of the Workers' Party – PT, this should not surprise anyone since “negotiating is in the DNA” of this government's hegemonic party<sup>31</sup>.

If pragmatism has a solid root sown in the labor union-negotiator experience, it is no less true that the accumulated experience in city management, which is the birthplace of the PT government practices, certainly reinforced the realistic and, arguably, biased approach towards administration. Looking at it from another angle, all of this has helped to abandon the foundational myth that characterized the traditional left. And it is based on this background that the present government, or at least an important part of it, has dedicated itself to gain the confidence of the national entrepreneur. In short, this government, very much like the preceding one, has been cultivating the capital holders'

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<sup>30</sup> \ Castro, A B. “A Hipótese do Crescimento...”, op. cit.

<sup>31</sup> \ Various testimonies could be gathered, all pointing to the same direction. Recently, I had the opportunity to hear, from a well-known industry leader, that entrepreneurs “had a dialog channel with the government that had rarely been matched in the past”.

trust, but the present administration – indisputably helped by the exceptional balance of payments performance – has revealed its particular inclination to listen and cooperate with firms, specially the Brazilian-owned ones. Moreover, the present government has undeniably extended its open attitude towards negotiation to all organized interests and social movements. All this helps forging a truce-like climate between private and public sectors that strongly differs from the one prevailing in the 1990s.