

# Post-Covid Brazil and the new government: Economy and foreign policy

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Academic editor: M. Sheresheva | Received 31 December 2022 | Accepted 19 February 2023 | Published 31 March 2023

**Citation:** Carvalho, C.E., Massaroli de Melo, T., & Daldegan, W. (2023). Post-Covid Brazil and the new government: Economy and foreign policy. In: Iqbal BA (Ed.) COVID-19: Its Impact on BRICS Economies. *BRICS Journal of Economics*, 4(1), 97–116. <https://doi.org/10.3897/brics-econ.4.e99448>

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## Abstract

The Brazilian economy has more continuity than ruptures in the end of the pandemic as well over former Bolsonaro's government closure. Positive economic indicators since 2021 were followed by a further slowdown at the end of 2022, keeping the pattern of weak growth moments in the midst of a near stagnation trend. The export of goods based on natural resources remains a positive factor as in the previous decades, though with the same problems of low leverage capacity of productivity diffusion to other sectors. The public sector faces great difficulties when trying to promote growth and modernization because of fiscal rigidity aggravated by mandatory expenses and varied resistance to cutting spending and redirecting expenses caused by conflicts that are hard to coordinate. After a brief presentation of the economic indicators at the end of 2022, the paper highlights three elements that condition the economic policy in the post-Covid Brazil: the rigidity of fiscal framework; export industry performance and deindustrialization; resumption of the foreign policy that will allow the country to benefit from the international scenario.

## Keywords

Brazil economic scenario; fiscal framework; deindustrialization and reprimarization; low productivity; foreign policy.

**JEL:** O10, O14, O23, O24.

## 1. Introduction

Brazil that emerges from the pandemic, after the government of Jair Bolsonaro (2018-2022) shows more continuity than disruption, given the complex processes that had been worsening in previous years and become even more challenging during his mandate. The new government of Luiz Inácio Lula da Silva inherits this difficult situation, with a minority in Congress, broad and complex alliances, and lack of clear proposals for resolving the main problems, at least considering what was announced before the inauguration. The willingness and ability to reverse the inherited trends will be crucial.

The economy is better than expected in the face of the impacts of the pandemic. At the end of 2022, the unemployment rate dropped to 8.1%, well below the rate of almost 15% in the worst moments of the pandemic and also below the average level of 12% reported from 2016 to 2020 (IBGE, 2023). This significant recovery of employment, however, according to the still preliminary data, has been followed by more precarious working conditions and lower income. In 2021 the country's GDP grew by 4.6%, recovering from the fall of 3.9% during the previous year under the impact of the pandemic, and may have grown 3% in 2022 (IPEA, 2022). However, signs of deceleration at the end of the year suggest the return of the economy to lacklustre performance. According to the figures of the Brazilian Central Bank, in 2023 the growth rate is likely to be only 0.8% (BCB, 2023).

The exchange rate dropped from 3.7 per dollar in January 2019, the beginning of Bolsonaro term, to 5.1 per dollar in March 2020, the outbreak of Covid-19 pandemic turmoil, and to 5.9 per dollar in May, pressured by domestic problems, especially the fiscal difficulties and worries about inflation. In the second half of the year, Brazilian currency appreciated at some moments, but, given the continued instability, remained in the range between 4.6 and 5.3 per dollar. This rate persisted until the presidential polls in October 2022, despite the good balance of payments and the comfortable amount of foreign exchange reserves, around 370 billion dollars. With those favorable numbers, it could be expected that the Brazilian exchange rate should be at a higher level, maybe around 4.8 per dollar. The initial reaction to the leftist candidate Luis Inácio Lula da Silva triumph was favorable and the exchange rate rose slightly, to 5.04 per dollar. However, some declarations of the elected president a few days later, considered hostile by the markets, brought back the currency to 5.47 per dollar, and up again at the same interval.

Since the severe crisis of the early 1980s and until that moment, the Brazilian economy had not repeated the pattern of the twentieth century, with rapid crises and long cycles of growth. In the recent period the so-called "chicken flight" prevailed, in which short periods of inconsistent growth were followed by disarranged landings without serious injuries, that is, brief downturns without crises or deep recessions.

The causes of mediocre growth are controversial, currents of opinion diverge in treating the elements of the picture, especially in determining what is cause and what is effect. (De Conti; Van Noije; Welle, 2020; Grigoryev; Starodubtseva, 2021)

Productivity growth has been very low for a long time. Between 1996 and 2020, labour productivity in Brazilian industry, measured by the value of industrial transformation per worker, had been falling at the rate of 0.2% a year.

The strong growth of exports of goods based on natural resources generated significant results in foreign trade and expanded income and employment in some regions of the country. Despite its own progress, however, the sector producing these goods could not induce other branches to increase productivity and apply advanced technology.

Brazil's industry is having great difficulty in incorporating new technology and advancing technological frontiers, which could allow it to compete with imported goods. The trend towards deindustrialization has been a permanent concern for many years; it has not been reversed by the policies that put much emphasis on this issue, neither in the second term of the Lula administration (2007-2010) nor in the first term of Dilma Rousseff (2011-2014).

In these years, the good performance of the economy, despite the serious international crisis, expanded income and employment, but with the so-called "leak of demand", increasing imports of manufactured goods.

The causes of these problems are the subject of endless controversy. Entrepreneurs and liberal economists (see, for example, Barbosa Filho, 2017) who are more right-wing, blame the unfavourable business environment, inefficient tax structure, excessive bureaucracy, low qualification of workers, high interest rates and financing difficulties, in addition to protectionist barriers that inhibit competition and modernization and accommodate sectors with low technology, little willingness to invest and no risk appetite. Developmental economists, in addition to criticizing high interest rates, attack the long years of exchange rate appreciation and commercial opening of the 1990s, in addition to the retraction of public sector investments and the cut of stimuli to the productive sector. (Carneiro, 2017; Albuquerque, 2019)

The fiscal framework is challenging. The tax burden is very high for middle income areas, in the range of 33% of GDP in recent years (Tesouro Nacional, 2022), but the structure of spending is stiffened by obligations, linkages and the persistent action of interest groups that support state governments in exchange for exemptions and subsidies. And there is also the fiscal complexity of Brazilian federalism.

The pandemic marked the second half of the Bolsonaro government (2019-2022), elected under the banner of drastically reversing the model of development and external insertion. Some relevant institutional changes had been made, such as pension reform, the reform of labour laws and liberalizing the regulatory framework for sanitation, but the difficulties were already increasing in early 2020.

The promises to change the economic model and spur economic recovery with the new agenda did not take off, due to lack of political coordination and feasible projects, various kinds of resistance by bureaucrats and competing groups, and managerial incapacity. The promised fiscal adjustment focused on freezing public sector wages and reducing social spending through policies and instruments for income redistribution, reduction of inequalities, affirmative action, and environmental protection.

The pandemic has had a devastating effect in Brazil. The death toll was one of the highest in the world: 692,000; only the US had more deaths, over 1 million. (WHO, 2022). Social conditions in the country are not exactly favorable, with its gigantic urban agglomerations, precarious housing, and saturated public transport. The large number of informal workers, close to half of the economically active population, dependent on daily earnings without coverage of legal rights, were forced to seek work and income, whatever the circumstances.

Brazil had a large and well-organized public health system, the SUS (Unified Health System), with good universal coverage and recognized tradition in vaccination and in the fight and prevention of epidemics. However, the negationism of the Bolsonaro government nullified these advantages.

In addition to denying the threats of the pandemic and encouraging people to maintain their normal routines, the government refused to coordinate the measures adopted in the states and municipalities, which impaired the local gains in the control of the spread of the disease. The government also resisted adopting income support measures to help the poorest who had lost formal jobs and informal work. Eventually, a program was designed with the amount of approximately USD 40 per month, elevated then by Congress to USD 120.

The poor management in conditions of the pandemic and the successive resignation of two health ministers reinforced the role of governors and Congress, which created a Parliamentary Committee of Inquiry to investigate irregularities and misconduct. Besides this, there was an outbreak of complaints involving members of the government, children of the president and the past of the president as a parliamentarian. The successive requests for the opening of impeachment proceedings were “shelved” by the President of the Chamber of Deputies, a regimental power provided for in the legislation.

Faced with such pressure, the government allied itself with the so-called “Pork-Barrelers” (“Centrão” in Portuguese), a pejorative nickname to designate a large group of parties and parliamentarians who always seek to come to an understanding with the government to promote the local or vested interests and schemes of their own power. In the 2018 election campaign, Bolsonaro and his supporters openly criticized Pork-Barrelers, and, at the beginning of his term, the president tried to establish a direct dialogue with the Congress. In practice, the agreement with the Pork-Barrelers meant handing over broad powers to this group and supporting the interests they represented. The reversal of spending policies has since been enshrined; the government has practically limited itself to cutting expenses where it could to make the amounts demanded by parliament members viable.

In the foreign policy of the early period of Bolsonaro’s presidency there was, indeed, the promised reversal, unprecedented break. The principles of universalism and multilateralism were abandoned in exchange for anti-globalism, anti-communism, and a strongly ideological and religious bias. A policy of rapprochement was implemented with ideologically close governments, i.e. Trump’s government in USA, and governments of Hungary, Poland, Saudi Arabia, while the relations with

neighbouring countries of South America, especially Mercosur, and the Global South, were marginalized.

The exception was the BRICS countries, due to their weight in the Brazilian trade balance and the status that participation in the group reverted to the country. Even so, such relevance did not prevent attacks on China, the country's main trading partner, during the pandemic by the then Chancellor Ernesto Araújo and Flávio Bolsonaro, son of the president, in social networks. The chancellor hinted that the Covid-19 virus was Chinese, amid the urgency of importing supplies and vaccines. In this episode the Ministers of Agriculture and Communications did their best to normalize the relations with China and ensure the supply of vaccines and other items to contain the pandemic.

In parallel, the importance of agribusiness in the export agenda guaranteed the groups involved the influence on foreign policy, whether in the episodes of Chinese embargo on Brazilian beef, or ensuring access to Russian fertilizers. This situation has made Brazilian foreign policy a mix of diffuse interests catalysed by the strong fragmentation in its internal decision-making process. The image of a country that is an adherent to dialogue and promoter of multilateralism, attentive to the regions and welcoming propositions was considerably affected.

The new government faces a complex combination of challenges, to say the least. In the economic area, the persistence of inflation, around 6% per year in 2022 and 10.2% per year in 2021, and the possible slowdown of economic activity can affect the mood of the lower income sectors that had made possible the election of Lula last October. The victory in the second round was very tight, 50.9% against 49.1% for the president seeking re-election. In the first round the centre-right forces won a majority in Congress, including the party that claims to be Bolsonaro's heir, the Liberal Party (PL), now holder of the largest bench in the Congress. They were also able to elect the governors of the three states with the highest political, economic, and demographic weight: São Paulo, Minas Gerais, and Rio de Janeiro.

At least until the inauguration, the new government had not shown clear plans for the thornier issues of the economic agenda, such as fiscal situation, resumption of investments, and relations with large capital and financial markets, both domestic and international.

Also in December, the elected government sent to the Congress a proposal for a Constitutional Amendment to exceed legal spending limits, pointing to the emergency in social policies and the need to fulfil campaign promises, especially the expansion of income transfers to the poorest. The proposal was approved, but the process revealed the dependence on agreements with the Pork-Barrelers and the strength of the interest groups represented by these MPs.

In addition to this introduction, the article includes three other sections. The second presents an overview of the economic framework, especially the fiscal framework, which today is in the centre of debates and concerns, including the defence of specific interest groups that wish to maintain their gains and keep their advantages. In the third, an analysis of Brazilian exports is carried out, highlighting the trend

of reprimarization in Brazilian exports, with strong impact of foreign commodity sales to more advanced countries, such as the economies of Europe, USA, and China. The fourth explores the processes going on in the foreign policy and outlines the prospects of their development. The final comments summarize the analyses performed.

## **2. Concerns and hopes of the Brazilian economic scenario**

The fiscal situation is the focus of debates on the country's economic prospects. The supporters of the primacy of balancing the budget and stabilizing public debt has been opposed by the supporters of the priority of meeting social demands and adopting policies for economic growth. In the weeks following the victory at the polls, the then-elected president emphasized the second position, in an emphatic tone (see, for example, Deutsch Welle, 2022), but his finance minister took an intermediate position soon after being appointed to the role.

There is no shortage of reasons to worry about the fiscal imbalance in Brazil, from the prolonged past of high inflation, to the perception that the end of the Bolsonaro government aggravated old problems. The Brazilian trend of the last decades was the expansion of public spending, without prior forecast of revenues, assisted by the flexibility of the tax structure enabling the government to meet progressive or unexpected demands.

On the expenditure side, the trend was increasingly stiffening. The 1988 Constitution enshrined the mandatory allocation of resources, especially for social spending, such as education and health. The end of high inflation in the mid-1990s interrupted the practice, customary until then, of eroding the real value of spending by delaying disbursements, while tax revenues were increasingly indexed to current inflation. With annual inflation in one digit the mechanism lost much of its effectiveness. In the following years, expenses related to parliamentary amendments to the budget law, made mandatory in 2015, grew. Added to this was the continuous creation of subsidies, tax exemptions and special regimes, almost always perpetuated under varied justifications.

From the revenue perspective, the system was balanced by a succession of occasional adjustments, capable of expanding the collection to 33% of GDP on average in recent years, a high level for a country of middling average income. Revenue that came in the range of 25 % of GDP in the final years of high inflation, rose to 27% of GDP in time of stabilization and made a further leap in 2000-2001 to cover government spending by taking on private losses in the severe currency crisis of 1998-1999.

The tax structure has well-known negative characteristics. The emphasis on indirect taxation accentuates the regressive character on income distribution; income tax acts in the same direction, with a maximum rate of 27.5%, widely imposed on low-income classes, with exemptions and special regimes for high and medium high income groups. The difficulties of collection are added to the difficulties of companies to meet

tax obligations. The rules are complicated and often changing. There are several special taxes and fees, with their own regulations.

Moreover, in taxation there are also peculiarities of Brazilian federalism. The main taxes are the ICMS (tax on the circulation of goods and services) and VAT (value added tax) collected by the states, which can impose rules and own rates of their own. The states' ability to legislate on the ICMS is limited by certain rules, but these are in fact loose enough to reduce the coordination capacity by the federal government and lead to the so-called "fiscal war" among the states, in which each one can offer tax reduction to attract investments and companies.

At the third taxation level, municipalities also charge specific taxes, with low collection capacity in most cases. The system is crowned by a complex structure of revenue transfers from the Union to states and municipalities, arbitrated in a complex political game that penetrates into Congress and to a great extent determines the political support gained by federal government.

The taxation and spending system is resilient enough not only to withstand any attempts at making effective changes in its fundamental features, but also to prevent open fiscal crises. Brazil has never experienced a fiscal collapse, steep fall in revenues or repudiation of public debt that have occurred in other Latin American countries. Even during the freeze of financial investments in March 1990, the so-called Collor Plan, the authorities carried out continuous devaluation of public debt by increasing inflation and using discretionary management of projected expenses.

The tightening of the fiscal framework has negative consequences for risk assessments, including the fear that an increase in interest rates for opportunistic reasons may increase the amount of public debt, 74% of the GDP at the end of 2022. This fear ends up putting pressure on interest rates, creating a vicious circle. Between June 2020 and December 2022, the Selic rate rose from 2% per year to 13.75% per year, while the real interest rate rose from 0.2% to only 7.32%.

Brazilian base interest rates set by the country's Central Bank are very high by international standards. In recent years, the average rate has oscillated between 0.2% per year to 7% per year, despite the comfortable foreign exchange position, with foreign reserves of about USD\$ 370 billion. There is always the leftmost economist's argument that the BCB does this to reward rentiers and content the market. In 2012, however, the reduction in real interest rates caused significant currency turbulence and was reverted in a few months. It may have been a diagnostic error of the moment, with the economy showing signs of warming, but the episode left sequelae and made the BC even more cautious.

In the present-day scenario, the Central Bank is reluctant to reduce interest rates thus precipitating further devaluations of the exchange rate, which will put additional upward pressure on inflation currently stabilized around 6% per year. Opinions about the nature of inflation in today's Brazil differ greatly. To describe the basic division, leftist economists argue that the inflationary processes are the results of cost pressures brought about primarily by the effects of the war in Ukraine and problems of the Chinese economy; if so, raising interest rates will not produce the required effect

on prices but only cause recession and fall in tax revenues. Liberal economists, tending to the right, insist that inflation has a strong demand component, the result of the broad release of aid to the poorest citizens in the months preceding the election and the normalization of economic activity since mid-2022; they point to the signs indicating that the labour market is overheated thus defending the policy of high interest rates to cool the cost pressures and secure the incomes of the poorest population.

Another problem linked to the fiscal framework is that the strong reduction in available resources has led to the continuous contraction of state investment capacity, which in recent years has been as low as about 1% of GDP. This limitation strongly conditions the terms of divergences on the strategy to resume economic growth on a sustainable basis.

For the leftmost economists, it is the public investment that should stimulate private companies and coordinate re-industrialization. In support of their position, however, they do not indicate where to obtain resources that could trigger the process and so are accused of proposing a public deficit without considering adverse macroeconomic effects that may inhibit private investment. The criticism is answered with the argument that the initial deficit will soon bring in tax revenues while imbalances could be contained by the regulatory state action.

Liberal economists, the right-wingers, call for supply-side policies: deregulation, liberalization, tax system simplification, external openness. They are accused of relying on the market mechanisms that had not worked in other countries, unlike successful East Asian experiences. The answer is that the circumstances are different, that Brazil can attract foreign investments more easily and that the Brazilian state does not have the ability to plan and execute efficient industrial policies, even those easily implementable, as the policy makers are likely to be deflected by powerful pressure groups.

The debate's background does not always explicitly present the complex trajectory of the Brazilian economy since the final years of Lula's second term (2007-2010) and the two terms of Dilma Rousseff (2011-2016). In facing the 2008 global crisis, the Lula government accentuated interventionist policies and achieved great success with the rapid recovery and managed to elect his successor (2010) and re-elect her (2014). The Dilma years were marked by initiatives known as new-developmentalists, accompanied by strong macroeconomic imbalances (rising inflation, external deficits) that led to declining growth and recession that began in 2014.

After the impeachment, the government of Michel Temer, until then vice president, began policies of liberalization, reducing state intervention and attaining fiscal balance, then promoted by the Bolsonaro government. In those years until the beginning of the pandemic (2016-2019), the economy stagnated, which gave the developmentalists arguments to accuse liberal economists of empty promises of growth. In exchange for such accusations, the liberals blamed the inheritance received from the Dilma years. The debate has made little progress, partly because of the political turmoil of the time, partly because of the difficulty of dialogue between economists and political groupings in Brazil.



A truly original aspect of this period is that for the first time the Brazilian economy went through a prolonged crisis without significant interest rate difficulties. Admittedly, this process was greatly favoured by international liquidity conditions, with low interest rates and aggressive expansionary policies of major economies. Still, even with such rosy scenarios the Brazilian economy was not steady.

The optimistic external scenario persists, at least for now, and despite inflationary pressures and high interest rates, international financial conditions are favorable. Brazil seems to be well positioned in the context of intensified geopolitical disputes that were hugely aggravated in 2022 and today show no signs of de-escalation. Despite the domestic problems that the Brazilian specialization in the supply of commodities to the rest of the world has caused, such as the process of reprimarization of the exports, the country may be the destination of foreign investments in search of places more friendly to OECD countries aligned around the US in conflicts with China.

It is indeed true that this benign scenario can be reversed by one of the many potentially explosive processes underway around the world, but at the present moment the new government enjoys these favourable conditions. In the foreground are the policy choices to take advantage of this hitherto very opportune moment.

### **3. Brazilian post-COVID exports and the reprimarization trend**

The reprimarization of the Brazilian exports in the last few years, especially in trade with economies with a higher degree of development, and the early deindustrialization of the country are the two phenomena that have proved difficult to reverse and become a challenge inherited by the new government. In Brazilian exports between 2012 and 2022, among the ten main destinations of agricultural products, considering the average participation of each country in the total export volume, especially notable is the presence of developed economies and economies actively involved in international trade, such as China, United States, Japan, Germany and Netherlands; no Latin American country is part of this list (Table 1).

China is the largest global consumer market for exports of agricultural products; it is also the main destination for Brazilian exports including products of the extractive industry. China's average share of exports of agricultural and extractive industry products in the period of 2012-2022 was 9.0% and 10.1% respectively.

Although the pandemic has impacted exports of Brazilian agricultural products, the recovery in 2022 is evident, together with the growth of participation in total exports (Table 1).

As regards the effects of the pandemic on the Brazilian productive structure, the 2020-2022 data show a significant reduction in the participation of some important partners in the exports of the manufacturing industry. Table 1 shows that the Chinese participation in exports of the Brazilian manufacturing industry fell by 23.6% between 2020 and 2021. Following the same trend, Germany, Canada and Japan decreased their shares by, respectively, 11%, 13% and 4% in the same period.

An important highlight is the increased participation of Latin American countries in trade with Brazil and the rising popularity of Brazilian manufactured goods in the region. Argentina, Chile, Mexico and Paraguay have expanded their purchases, which very different from the trend observed in developed countries. For Mexico and Chile, growth was 10% and 17%, respectively. The pandemic deepened relations with Latin American countries in the trade of higher value-added products, such as those of the manufacturing industry. While developed countries demand from Brazil mainly agricultural and extractive commodities, the trade relations with Latin American countries have shown better conditions for the country to develop industrial policies, in order to increase the production of goods of higher added value.

**Table 1.** Share of destination countries in the total exports by Brazil, Agriculture (2012 - 2022)

Agriculture Countries	Average participation in the period	Growth rate in % (2012 - 2022)	Growth rate in % (2020 - 2021)	Growth rate in % (2021 - 2022)
China	9.0	5.1	-4.0	3.2
Spain	0.7	4.6	10.7	32.7
United States	0.7	-3.4	-1.9	6.1
Netherlands	0.6	1.9	-18.0	-2.6
Germany	0.6	-4.3	-17.7	27.3
Iran	0.6	7.5	-5.0	123.3
Japan	0.6	-2.9	-38.7	85.3
Vietnam	0.5	6.2	-28.8	3.1
South Korea	0.4	-6.5	-30.0	31.9
Thailand	0.4	4.5	4.3	7.2
Extractive Countries	Average participation in the period	Growth rate in % (2012 - 2022)	Growth rate in % (2020 - 2021)	Growth rate in % (2021 - 2022)
China	10.1	7.2	6.8	-32.6
United States	1.5	-4.4	63.6	22.0
India	0.8	-7.9	37.8	-30.7
Japan	0.7	-11.8	56.2	-48.3
Netherlands	0.7	-2.2	45.8	7.5
Chile	0.7	2.3	125.4	28.3
Malaysia	0.6	16.7	25.2	-37.3
Spain	0.6	10.6	-13.3	96.0
South Korea	0.5	1.9	69.4	-19.3
Germany	0.4	-8.3	7.4	-38.2

**Table 1.** Continued

Processing Industry Countries	Average participation in the period	Growth rate in % (2012 - 2022)	Growth rate in % (2020 - 2021)	Growth rate in % (2021 - 2022)
United States	9.6	0.6	3.2	-4.3
Argentina	5.9	-6.4	1.0	9.6
China	4.7	6.7	-23.6	9.7
Netherlands	2.8	-8.7	-0.7	13.8
Mexico	1.7	0.2	10.0	5.2
Chile	1.6	2.5	16.9	1.9
Germany	1.4	-5.0	-10.8	16.8
Canada	1.2	7.5	-13.4	-11.4
Japan	1.2	-4.1	-3.6	2.6
Paraguay	1.2	-2.2	5.6	-3.6

Source: Ministério da Indústria e Comércio do Brasil (MDIC), 2022.

In the manufacturing industry, although the USA and China remain the main destinations for Brazilian exports, among the top ten it is possible to find Latin American countries that, in addition to the geographical proximity to Brazil, also have proximity in terms of competence to produce. In this sense, the development of industrial policies by the new government, which strengthen trade synergies with Latin American neighbours can be a way to take advantage of some opportunities created by the pandemic. Table 1 shows that Argentina, Chile, Mexico and Colombia hold together 10.4% on average of Brazilian exports of the manufacturing industry, bringing them closer to the US block, whose average share in exports of the Brazilian manufacturing industry is 9.6%, considering the period 2012-2022.

Brazil's technical and geographical proximity to the countries of Latin America, especially Mercosur, may be an opportunity for the country to boost industrial production and thereby reverse the harmful trend of falling industrial GDP in the country's added value, a sign of deindustrialization. In economic theory, the process of deindustrialization is not necessarily interpreted as something unwanted, but rather as a consequence of the process of development in advanced countries, marked by the shrinking share of manufacturing industry in GDP and the growing share of services. (Clark, 1957; Sachs and Shatz, 1994; Rowthorn and Ramaswamy, 1999).

In developed economies, the phenomenon of deindustrialization has often been accompanied by expanding industry-related services, such as those responsible for producing information and communication technologies (ICT). Deindustrialization does not thus become an unwanted phenomenon, because as the industry's share of GDP falls, the supply of high value-added services increases. However, in Brazil and some Latin American countries, the effect of the growth of high added value services has not been observed. As the share of manufacturing industry in the GDP is

contracting, its productivity is also falling: the former process began before the economy could reach income levels necessary to sustain a dynamic process of structural change, with high growth in demand for services at the expense of industrial goods (UNCTAD 2003, p. 93). This is because the services sector in Latin American countries has not developed in order to be used by the manufacturing activity, as a factor to promote higher levels of productivity in the industry.

This scenario of low-income growth combined with the loss of industry participation in GDP points to the true character of the hypothesis of premature deindustrialization in Brazil. Between 2010 and 2020, according to UNCTAD data, the value added by the Brazilian industry in relation to GDP fell by 1.63%. The phenomenon of deindustrialization marked Latin America of the period, so that out of the 12 countries whose data are available in the UNCTAD statistics system, 9 showed a decline in the industry's share in GDP. Colombia, Peru and Argentina were the countries with the highest losses of industry participation in GDP between 2010 and 2020, respectively 2.4%, 2.3% and 2.2% per year, measured in terms of average annual percentage change.

It is interesting to note that during the 1970s, a period of heavy investments in infrastructure and creating of the Brazilian industrial park, the industry's share in GDP was around 30%. At the time, Brazil and Argentina were the Latin American countries with the best performance by this indicator. The drop in the value added in Brazil's industry was sharp, especially after the opening of the economy to international commercial trade in 1990. Between 1990 and 1995, the industry's share in GDP fell by the average of 8% per year to 15% in 1995. In 2020, the share of Brazilian industry in GDP was the lowest among Latin American economies (10.0%), higher only to Guyana (4%).

Although during the 2000s, investment in the Brazilian economy grew as a whole, especially between 2003 and 2008, a period in which the growth rate of investment (4.8% per year) exceeded the evolution of value added (3.2%), the investment made was basically the replacement of depreciated capital and preservation of existing productive capacity, to the detriment of the expansion and diversification of the industrial structure. Although such efforts may be relevant for the modernization of the productive park, there is no evidence of diversification of the industrial structure towards sectors of higher technological density, nor of expansion of production capacity (Bielschowsky et al., 2015; Carvalho and Kupfer, 2011). As a result of this process, export earnings from trade in primary products had grown; a strong pressure of imports of industrial products of high added value had been observed. Still, in the last decade, Brazil's investment rate measured as the proportion of gross fixed capital formation in GDP was among the lowest among Latin American countries. In 2020, Brazil's investment rate was 16%, higher only than that of Argentina (13%) and Bolivia (15%).

The low investment rate in Brazil reinforces the trend towards deindustrialization. In the period between 2010 and 2020, the investment rate in Brazil had been falling at 3.8% per year on average, registering the worst performance among Latin American countries. Although the decrease in investment was a characteristic of all Latin

American countries, in Brazil it was more pronounced. Argentina, Chile and Uruguay, for example, recorded a decrease in the investment rate of, respectively, 2.3%, 0.9% and 2.9% per year.

As can be seen in the presented investment rate table, the fall in the participation of the industry in the GDP and reduction in demand for products of the manufacturing industry by the developed countries means that a major challenge for the Brazilian government in the coming years will involve bringing back the industrial policy of supporting the development of skills and technologies that can be exploited in the economy, especially in trade relations with other countries of Latin America. The analysis of export agenda suggests that there are greater opportunities to sell the products of higher added value in the foreign markets, especially those of Latin America.

Regarding the agricultural sector, it should be pointed out that, although the pandemic has negatively affected Brazilian exports to the major countries of destination, most of which are economies with a higher degree of development, the recovery of the country's export shares in 2022 reveals that, thanks to the consolidation of the sector in the international market, Brazil has competitive advantages in the production of agricultural goods. Thus, an important direction of economic policy in the coming years will be the development of skills necessary to produce and export agricultural products, which in its turn could assist in boosting competitiveness of the production of industrial goods, promote the development of the capital goods and basic inputs sector for agricultural production through policies aiming to encourage technological innovation, with expansion and modernization of the productive park.

#### **4. Brazilian foreign policy prospects after the pandemic**

Historically, Brazil has been recognized for its international role based on the dialogue with partners on all continents, peaceful solutions to problems and multilateral decision-making instruments. The country has been a member of the United Nations (UN) since its foundation. It has actively participated in the negotiations for the creation of the World Trade Organization (WTO). Regionally, it maintained friendly and peaceful relations with its neighbours promoting the multilateral arrangements such as Organization of American States (OAS) and Mercosur. Brazil maintains diplomatic missions on all continents and has no recent history of animosity with any country.

The consistency of this behaviour conferred, over time, the principles of pacifism, universalism, and multilateralism on Brazilian foreign policy. Foreign policy is understood as the way the state projects itself abroad through its relations with other states, or even as the sum of its official relations with other actors in the international system. (Hill, 2003). In the Brazilian case, it is up to its highly professional diplomatic corps as guardians of the national interest on the international arena, to conduct foreign policy facing different partners on numerous themes. The professionalism of diplomacy and its centrality in international issues have led to building an international image

of constancy, commitment, and reliability. Constancy derived from the permanent interest and willingness for dialogue with new or traditional partners. Commitment to agreements made at forums contributes to the intensification of interactions. Reliability arises from the combination of the two previous attributes now reinforced by historical respect for International Law and recognition of the global governance structure.

With all its professionalism, Brazilian foreign policy has features depending on the current governments; it (i) either follows the guidelines issued by each government, (ii) is determined by the decisions of diplomats who, having close links with the government, assume the main functions and positions in the hierarchy of the diplomatic corps, (iii) or determined by the government's policy in the current internal and external context. Throughout the 2000s, Brazilian foreign policy was acquiring distinct features depending on each government, but even so some continuity had been preserved. Respect and centrality in the diplomatic corps and the diversification of international partnerships were maintained.

The ruptures began incisively only in 2019. According to Hermann (1990), subtle changes in foreign policy are common and expected but fundamental changes can generate concern, and these were the changes implemented in the Jair Bolsonaro Government (2019-2022). A highly polarized internal context, where groups had gained space in politics associated with no respect to the hierarchical structure of the diplomatic corps bureaucracy, did not improve the recent Brazilian international position. Decision-making became a process in which individuals, bureaucratic agencies and groups that press for their interests are involved, although these interests characterize the national interest in a biased way. (Hudson, Vore, 1995).

Self-proclaimed as right-wing, liberal in the economy, conservative in customs, and presumably Christian in religion, the Jair Bolsonaro government began to dismantle the principles of traditional Brazilian foreign policy, starting with the appointment of Ernesto Araujo, the first chancellor. Araujo was practically unknown to the diplomatic corps, did not belong to the highest hierarchical diplomatic structure and his appointment to the Ministry of Foreign Affairs (MRE) was not well received even by his peers. (Saraiva, Silva, 2020). With a markedly ideological stance, he quoted the Bible in his first speech and claimed that the diplomatic corps were bound by flawed ideas not consistent with the interests of the population; he then questioned the liberal international order, praising countries with right-wing governments such as Poland and Hungary, making clear the principles that would guide the country's international action since then: religion, anti-communism, anti-globalism and alignment to governments ideologically close to the Jair Bolsonaro's Government. It is interesting that a great effort was made to approach the American government of Donald Trump. Brazil removed the need for visas for American citizens without reciprocal action of the US and expected, in vain, its support and direct involvement in the Brazilian claim to join the Organisation for Economic Co-operation and Development (OECD).

Universalism, a hallmark of Brazilian foreign policy, was abandoned in favour of seeking ideological allies and constant criticism of governance instruments.

Trump's unsupported approach to the US presidency with the election of President Joe Biden in 2020 and the relationship between Bolsonaro and Viktor Orbán, Hungarian Prime Minister, are good examples. On the other hand, the country closed its diplomatic representations in Africa and the Caribbean in 2020 and criticized the International Criminal Court's decisions in 2021 in connection with crimes involving the violation of human rights in the conflict between Israel and Palestine that reflected the bilateral policy with Israel.

Also, the Jair Bolsonaro Government criticisms of the investigation of attacks on the World Health Organization (WHO) in the midst of the Covid-19 pandemic illustrate the abandonment of the principle of universalism and multilateralism.

Anti-globalist position implies rejection of the policy aimed at defending multilateralism. Throughout the Jair Bolsonaro's governance, Brazil had few contacts with the UN bodies, refused to host international environmental defence forums, reneged on its position as a regional leader by not promoting agreements and partnerships with neighbours, abandoning almost entirely Mercosur. With France, by Emmanuel Macron, the disagreement around the environmental agenda became known to the general public. In this regard, Brazil lost important resources from European countries to combat deforestation and climate change due to the political inability and discrediting data from official agencies that indicated an increase in degraded areas in the Amazon. During the Covid-19 pandemic, Ernesto Araujo even disdained China and suggested that the virus be Chinese in addition to, in another episode, communicated with the Chinese Ambassador in social nets and asked Beijing to put and end to it. This behaviour generated a Chinese demand for apologies and reverberated negatively in the negotiations for the acquisition of inputs and vaccines throughout the pandemic.

The changes proposed by Ernesto Araujo as the head of Brazilian diplomacy did not find support among his peers and motivated a Manifesto of diplomats in 2021, requesting the departure of the Minister of MRE. This situation contributed to the fragmentation of the political decision-making process in Brazil giving power to support groups of the Jair Bolsonaro Government. These groups represent the conservative movement led by the oligarchic elites, the Armed Forces and the Evangelical Church. (Pecequillo, 2021). Casarões (2019) classifies five groups ("5 Bs" in Portuguese: bible, ox - "boi" in Portuguese -, bullet, banks and Bolsonaro's militants): evangelicals, ruralists, military, liberals and anti-globalists. All groups would have strong influence in this state of foreign policy, especially the ruralists and anti-globalists.

The ruralists played a fundamental role in Brazil's international behaviour due to the weight of the agricultural tariff in the country's exports. This well-organized group pressed the country's position at different times to satisfy its interests. Minister of Agriculture Tereza Cristina was also highlighted and acted in several ways: (i) with the Chinese before the embargo on Brazilian beef, between September and November in 2021; (ii) negotiations with the Russians to increase meat exports and guarantee access to fertilizers, also in 2021. The Minister of Agriculture was even called upon, together with her Communications colleague Fábio Faria, to unlock the negotiations

for the acquisition of inputs to produce vaccines, after tensions between the Ernesto Araujo and the Bolsonaro family and the Chinese ambassador in the country. In another episode, in 2022, on the eve of the conflict between Russia and Ukraine, Brazil sent an entourage of ruralist members to President Jair Bolsonaro in order to preserve relations and expand again the access to fertilizers at the expense of a neutral position of the country in the face of escalation of conflict.

The anti-globalists, in turn, had a great impact on the principle of multilateralism traditionally defended by Brazilian diplomacy. Under the ideological bias, they advocated greater alignment with the US of Donald Trump and countries with right-wing rulers such as Poland, Hungary, and Saudi Arabia. Of these, no real and substantive gains for the country followed and such policy was inconsistent with the discourse of defence of freedoms. At the same time, Brazil chose not to value regional partnerships and marginalized MERCOSUR, abandoned UNASUR and maintained distancing from the historical partner Argentina because of political divergences of their presidents. The agreement between MERCOSUR and European Union has not advanced in recent years partly owing to the European partners' perception of the Latin countries' compliance with the provisions of the agreement, especially those related to environmental protection. The environmental protection policy was strongly criticized throughout the period of Jair Bolsonaro government. Deforestation rates had broken records, inspection agencies, such as the Brazilian Institute of the Environment (IBAMA), suffered from low transfers of funds. Norway, Denmark and Germany suspended the funds sent to the Amazon Fund.

While there was a marginalization of the geographical surroundings, Brazil maintained its communication with the BRICS. This cooperation arrangement has served over the years as an instrument of maintaining an expensive status to its members. According to Cooper and Farooq (2015) the BRICS would be responsible for an "exclusive self-selectivity" responsible for characterizing its members as emerging countries and for ensuring a club in which decisions are taken without such limitations as rules and standards. At this point, Daldegan and Carvalho (2022) affirm that precisely this status of the members and the absence of institutionalization gives the BRICS the procedural and dynamic character. The cooperation takes place through processes related to agendas commonly negotiated and arising from the vision that members have of the current international conjuncture while no limitations or constraints of action are established to its members.

For Brazil, this format is beneficial because it does not prevent it from building parallel agreements and keeps it close to strategic partners, especially China. Despite the tense moments involving Minister Araujo and the Bolsonaro family, at the height of the pandemic, Brazil has in China its main trading partner. In turn, Brazil is highly vulnerable to fluctuations in the fertilizer trade where Russia is its main supplier. With India and South Africa, the Bolsonaro government adopted pragmatism both in trade affairs and in other agendas. It would be fair to say that although the foreign policy affects more bilateral than multilateral agreements, the BRICS was the main arena of articulation for countries with large economies. Brazil has not been invited to the



meetings of the Davos Economic Forum nor to the G-7 meetings. The G-20, although overshadowed in recent years, no longer has its leaders in Brazil.

The solidity and coherence of Brazilian foreign policy, according to Lopes (2020), was eroded by fragmentation in which groups directly and indirectly affected the formulation of foreign policy plus the inability of the Presidency of the Republic to set the tone for international action. According to Daldegan and Souza (2021), the multiplicity of interests and visions in these groups, the conduct of diplomacy by Ernesto Araujo, the marginalization of multilateralism, together with the leaders of developing countries, added to the unfavourable external context of economic crisis and pandemic leading to the loss of influence of Brazil in the international sphere.

This state of affairs may explain why Jair Bolsonaro was not reelected to the Presidency of Brazil. In the 2022 election, the winner was the former President Luís Inácio Lula da Silva who had ruled the country between 2003 and 2010. With the continuing strong polarization and internal and external economic crises, the context does not seem favourable. Nevertheless, immediately after the election, the elected President declared “Brazil returns to the world” in a clear indication of a new turn in the country’s foreign policy.

The first actions have shown a priority interest in the environmental agenda. Lula was attending the United Nations Conference for the Environment in Egypt, winning Norway’s sympathy and its commitment to resume the transfers to the Amazon Fund. In addition, there are expectations for the revival of negotiations with the neighbouring countries. Alberto Fernández was in Brazil the day after the elections to greet Lula.

The foreign policy of the former Lula government (2003-2010), recognized as active, proud, affirmative, and assertive, was motivated by the impetus of “autonomy for diversification”. (Pecequillo, 2021; Vigevani, Cepaluni, 2007). One cannot be sure that this foreign policy will again prevail, given today’s internal and external context and existing interest groups and bureaucratic structures. However, in light of the previous policies of Lula Bolsonaro, there seems to be reason to believe that the new government’s actions are positive regarding the country’s reintegration into the international community.

## **5. Final comments**

The legacy of the pandemic weighs on the new government, intertwined with old problems and the sequelae of the Bolsonaro period. The good dynamics of GDP and employment since mid-2021 has given way to signs of deceleration at the end of 2022, indicating the persistence of the pattern of weak and short growth cycles followed by deceleration and prolonged stagnation. The rise in inflation, to levels close to 6% per year, led the Central Bank to raising the base short-term interest rate to 13.75% per year. In addition to this attempt to contain domestic prices, the BCB seems to be prioritizing the risks of reducing interest rates and allowing further depreciation of the exchange rate, despite the reserves of USD 370 billion.

The fiscal framework remains even more complex and challenging, taking into account the problems that a center-left government will have to negotiate with the new Congress, dominated by center-right members and considerable weight of Bolsonaro's supporters.

Even before the inauguration, the new government of Luiz Inácio Lula da Silva was able to approve a Constitutional Amendment Proposal (PEC) authorizing additional spending of R\$ 145 billion (approximately USD 30 billion) necessary to cover short-term expenses not foreseen in the budget proposed by the Bolsonaro government and to meet campaign promises, especially the maintenance and expansion of income transfers. In these negotiations, the government set up articulation in Congress involving an important part of Bolsonaro's support base.

Favorable indicators of tax collection and reduction of public debt at the end of 2022 will hardly be maintained. The most likely trend is the persistence of heavy restrictions on investment capacity and reorientation of public spending. Seeking to resume economic growth on a sustainable basis, the new government will have to face the problems of low productivity, difficulties of the industrial sector and insufficient connection of the commodity export sector with the economy.

In the external sector there are possibilities to ensure stability in the midst of internal conflicts. The results of foreign trade should remain positive, with a stable share of lower value-added products such as agricultural commodities and the mineral extractive industry for important partners such as China and the USA. Regarding trade, the main problem to be faced by the next government is the resumption of policies to strengthen the production of industrial products of greater added value, especially trade relations between Brazil and the countries of Latin America, that have proved to be important partners in the trade of products of the processing industry.

Another way of using external resources, besides exports, is through financial accounts, which can be further stimulated by the new guidelines on sensitive issues, especially environmental matters.

In foreign policy the scenario is promising in the short term. The diplomatic corps and the Ministry of Foreign Affairs will have no serious objections to the resumption of Brazil's traditional orientations on the international stage or the main policies pursued in the previous period of President Luiz Inácio Lula da Silva. Moreover, the expectation is positive regarding the regional spectrum, especially MERCOSUR. The vacuum of the recent years can easily be filled by diplomacy open to dialogue and trade with the neighbouring countries. In the global spectrum, Brazil must sustain historic demands for permanent seat in the United Nations Security Council (UNSC) and reforms in the International Monetary Fund (IMF) and the World Bank as articulated by the BRICS.

## **Funds**

The authors thanks Rio Grande do Sul Research Foundation (FAPERGS/ Brazil) for grants N°22/2551-0000605-1 that made possible the development of this research.

## Acknowledgements

The authors are grateful for the valuable comments of the BRICS Journal of Economics anonymous reviewers.

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