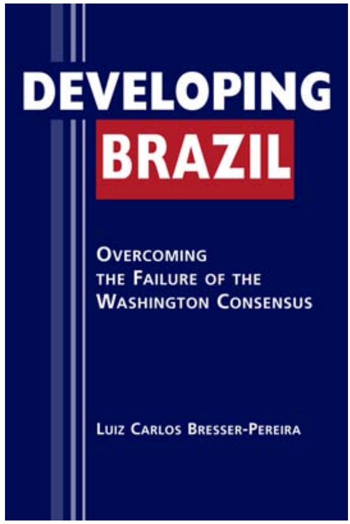
EXCERPTED FROM

# Developing Brazil: Overcoming the Failure of the Washington Consensus

Luiz Carlos Bresser-Pereira





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# Introduction

Brazil in the early twenty-first century is experiencing a time of uncertainty and self-questioning. The country attained democracy in 1985 and has been making a great effort to reduce the radical inequalities that mark its society, but the economy has been nearly stagnant since 1980; although the huge increase in commodity prices has improved growth rates in the early years of the century, overappreciation of the domestic currency makes the future uncertain and optimism unwise. The core political goals of modern societies are security, freedom, well-being, social justice, and protection of the environment, but we do not know how to achieve them. Capitalism is victorious and organizes the surface of the earth with nation-states that compete through their firms, but many forms of capitalism exist, all more or less dynamic, more or less assuring of freedom, more or less fair, and none has a monopoly on the one true path. The hegemonic power, the United States, which at one time—the early 1990s—thought it knew what this true path might be, turned it into the Washington Consensus and into an economic "conventional orthodoxy" that failed to convince a number of Asian countries; those that it did convince lagged behind economically. This is one of the reasons why such hegemony has, since the turn of the century, been experiencing a very deep crisis.

My goal in this book is to better understand the perverse economic reasoning that, inspired by the conventional orthodoxy, prevails in Brazil, notwithstanding that high inflation rates were tamed in 1994 and despite a favorable international economic scenario. My goal is to develop a political argument and a macroeconomic argument to criticize a strategy that rich countries seek to sell to developing countries or (if they get duly indebted) to impose on them using the International Monetary Fund (IMF), the World Bank, and the international financial system as tools. To this end, I attempt to determine why Brazil has not yet attained macroeconomic stability despite the economic policy framework put in place on its behalf. I attempt to determine the coalition of social and political forces that has led Brazilian governments to ignore the Dutch disease (see Chapter 6 for a complete definition) and to accept the policy of growth with foreign savings and other recommendations from the North. And, finally, I propose to lay out the general outlines of a prudent and viable alternative to the macroeconomic policy in place—a new policy that preserves price stability, attains true macroeconomic stability, and enables development to resume—as well as to show the falsehood of the conventional discourse that maintains that the only alternative to the orthodoxy is economic populism: Brazil has shown in the past, and other nations, Asian ones in particular, are showing now, that an alternative does exist. The argument is complex, both politically and macroeconomically, but, if I had to offer an explanation for the quasi stagnation since the early 1980s, I would summarize the political argument as the loss of the idea of nation and the macroeconomic argument as the loss of control over the exchange rate. If I and many others argued in the 1980s that the great problems the country faced were a fiscal crisis of the state coupled with a foreign debt crisis, I now claim that the main political obstacle the country faces is the weakening of the Brazilian nation and that the main economic hurdle is the acceptance of the conventional orthodoxy as the country's macroeconomic policy.

Every power system has its own logic, which becomes more sophisticated as societies progress. Old imperial systems relied on the force of arms; modern ones, such as those represented by advanced countries in the age of global capitalism, prefer ideological hegemony as a means to affirm their interests and to neutralize the competitiveness of middle-income countries such as Brazil.[1] Old empires merely bought the collaboration of subjugated elites in order to exercise imperial domination; modern, and relatively weaker, imperial systems resort to the ideological co-optation of local elites but, to this end, require complex ideological systems such as hegemonic thinking and its application to developing countries: the Washington Consensus and its conventional orthodoxy. To criticize hegemonic thinking, even if limited to the conventional orthodoxy, is by no means a trivial republican endeavor. The rhetoric of hegemonic thinking is always that of perfect rationality, of the identification of its postulates and conclusions with common sense, scientific objectivity, and morality of the day; it is the rhetoric of the sole legitimate option. Hegemonic thinking sees itself as perfect because it finds legitimacy in the economics developed by the world's best universities—its own—and because every empire sees itself as the bringer of enlightenment and civilization, of peace and progress, of freedom and democracy. No matter that all the evidence shows that, on the contrary, the most successful developing countries have accomplished their capitalist revolutions by following a different path; it is irrelevant that those countries that accept hegemonic thinking with docility almost invariably go into a state of quasi stagnation. Although force is always to hand, it is far more important for hegemonic power to impose conventional knowledge or an orthodoxy on the dominated. J. K. Galbraith (1958) coined the term *conventional wisdom,* which has now become part of the English lexicon as a synonym for accepted—and mistaken—truths. This is the kind of truth that the empire transfers to its periphery through the "soft power" of hegemony—a kind of power that many progressive Americans believe superior to the "hard power" of their hawkish peers, heedless of the fact that, right though they may be, this shows that the alternative of not exercising power simply does not exist for the hegemonic power.[2] Words such as *nationalism, developmentalism,* and *capital controls* enter the index of forbidden words (after all, it is not only Catholic orthodoxy that had its *Index Librorum Prohibitorum*), and those who embrace such ideas are termed "outdated" or "populists." This kind of thinking, or language, is presented as naturally as possible, but, according to Edward Said (2003 [1978], p. 321), who criticized hegemonic domination by the West of the Eastern peoples, it is a mythical language. "Mythical language is a discourse and, therefore, cannot help but be systematic; no one discourses freely, no one makes statements without first belonging—in certain cases unconsciously, but always involuntarily—to the ideology and institutions that assure one's existence. The latter are invariably the institutions of an advanced culture dealing with less developed societies, a strong culture encountering a weak one."

The opponent, therefore, is powerful, but this is not to say that developing countries are condemned to eternal subordination. Hegemonic idea systems follow a cyclic pattern of an increasingly short duration. British hegemony lasted a little more than a century, ending in World War I. US hegemony established itself after World War II, reaching its acme in 1989 with the collapse of the Soviet Union, but in 1995—the start of the period analyzed in this book—the neoliberal and globalist wave through which this hegemony expressed itself was already facing internal problems; in the 2000s it is in deep crisis. Hegemonic power is by definition strong but is offset by the real interests of peripheral societies, whose elites often refuse subordination, whether because of patriotic feelings of belonging, or because their real interests lie in their own country, or because only in their own country can they rely on the state as an instrument of collective action, as the states of developed countries are in their own nations. Although hegemonic thinking has encountered substantial hurdles since it assumed a neoliberal form and managed to impose itself on the world circa 1990, it remains dominant in a large number of developing countries. The following years have been marked by deep financial crises affecting "emerging markets" in the 1990s, by the brutal crisis in Argentina in 2001, and by the disaster that was the invasion of Iraq—years that indicate the hegemony's clear decline. As a result, even the traditionally more dependent Latin American countries, which more easily accepted the recommendations of the conventional orthodoxy and suffered the most, have now begun to appreciate the decline of hegemonic thinking and the opportunity this decline affords them to reorganize and formulate national development strategies. Around the world, the North's neoliberal and conservative hegemony is being challenged; the Washington Consensus is contested and severely criticized.

This book, by focusing on Brazil and the period during which conventional orthodoxy was prevalent there (1995–2006), seeks, on the one hand, to contribute to changing the country's economic policy and, on the other, to stand as a critique of the set of diagnoses and policies by means of which the North's hegemony is exercised. Criticism of imperial systems has always been fundamental in late countries' efforts to attain higher levels, to catch up. In the nineteenth century the English hegemony did not prevent France, the United States, Germany, and Japan from developing. The Great Depression of the 1930s created an opportunity for Latin American countries, and particularly Brazil, to find a path to industrialization and development. The end of colonialism after World War II created the opportunity for Asian countries such as South Korea, Taiwan, Thailand, Malaysia, and, later on, China and India to attain high economic growth rates.[3] In Latin America, the great foreign debt crisis of the 1980s disorganized the region's nations, cut short their national revolutions, and led them, beginning in 1990, to surrender to the conventional orthodoxy. As a consequence, countries lost importance and contented themselves with much lower growth rates. In Brazil, after 1995 the conventional orthodoxy implemented a macroeconomic policy based on soft fiscal policy, high interest rates, and a noncompetitive exchange rate;[4] this would be an orthodox policy. Meanwhile the dynamic

Asian countries adopted the opposite policy, namely, the macroeconomic tripod that I understand to characterize new developmentalism: hard fiscal adjustment, moderate interest rates, and competitive exchange rates. If we leave aside the claim that in practical terms the conventional orthodoxy is soft in fiscal terms (I discuss this in Chapter 4), the strange thing is that the high interest rates–noncompetitive exchange rate binomial is the opposite not only of new developmentalism but also of the good, "orthodox" practices of rich countries' central banks and finance ministries; macroeconomic orthodoxy in rich countries is one thing, in developing countries, another. This fact, besides showing the difference between using a national development strategy and using an imported strategy, also shows a well-known imperial use: "make what I say, not what I do." The failure of the conventional orthodoxy's policies and the success of Asian national strategies, however, have created a new opportunity for Latin American countries, especially Brazil: an opportunity to rebuild themselves as nations and to resume formulating a national development strategy, that is, new developmentalism. This book is essentially about Brazil, but it includes the dynamic Asian countries because it makes repeated reference to their new developmentalism. On the other hand, I believe that the ideas discussed in this book will be helpful to many other developing countries that, like Brazil, were unable to frame a serious and workable alternative to the conventional orthodoxy—the alternative that I call new developmentalism.

## Method

In this book I employ the historical-deductive method, which takes an observation of an economic reality and, based on the determination of patterns and trends, attempts to generalize from it and build a theoretical model. This was the method that Adam Smith and Karl Marx used to understand the fundamental economic transformation that was the capitalist revolution and that John Maynard Keynes adopted for the world economy after World War I to formulate the first macroeconomic monetary economy model. The assumption is that the purpose of economics is not merely to provide a toolbox but to formulate models for concrete economic systems. When the great classical economists analyzed the capitalist revolution, the economic system they sought to model was exceedingly broad; when Keynes and Michael Kalecki originally formulated macroeconomics, their subject was more restricted, but still broad; when I, in this book, attempt to understand the macroeconomics of stagnation that has prevailed in Brazil since 1995, I am focusing on a more constrained economic system, but since I am simultaneously analyzing and criticizing the reasoning of the conventional orthodoxy in terms of macroeconomics, the scope again expands.

Macroeconomics lies at the heart of economics; it is the branch of economics that shows how economic systems work based on the behavior of the fundamental economic aggregates—income or product, investment, savings, consumption, public revenues and expenditures, or domestic revenues and expenditures—plus the five macroeconomic prices: profit rate, wage rate, inflation rate, interest rate, and exchange rate. Macroeconomics, therefore, is an empirical science with a historically observable subject, so that the appropriate method for approaching it is the historical-deductive method. This method differs from the hypothetical-deductive method used by neoclassical economists and used fundamentally in microeconomics, although the neoclassical authors tirelessly attempt to apply it to substantive areas of economics such as macroeconomics and the theory of economic development. The hypothetical-deductive method, based as it is on a hypothetical *homo economicus,* facilitates making economics more "accurate"—as accurate, in extremis, as mathematics, which, as a methodological rather than a substantive science, legitimately uses the method. Thus developed, microeconomics is useful if treated as a methodological aspect of economics, as is the case with game theory or econometrics. Analysis of concrete economic systems, however, can be performed only with the historical-deductive method, which does use hypothetical-deductive tools, but only to arrive at models for the system under examination (Bresser-Pereira 2005d). Making economic theory means developing models for real economic systems and then testing them, insofar as it is possible, through empirical, econometric research. The models thus obtained are open-ended ones that provide a modest description of open systems such as real economic systems. Mathematics, a methodological science devoid of subject and based purely on logical assumptions, may have closed models; substantive sciences, working as they do with empirical subjects, may develop simple models of great explanatory power, but such models will necessarily be open-ended and, therefore, modest about their claims to truth.

Adopting this method clearly frames me as a Keynesian rather than a neoclassical economist. And what kind of Keynesian economist am I? Post-Keynesian, neo-Keynesian, new Keynesian? I choose not to tie myself to this or that thread, as the reality to hand—the Brazilian economy—is very different from that with which these schools concern themselves. What matters is to believe that all of macroeconomics will be forever Keynesian, because it was founded by Keynes; but no form of macroeconomics can be Keynesian alone, because it is a historical discipline that, faced with new facts or with ever-present structural or institutional changes, must be constantly updated, revised, rethought. Adopting an empirical-deductive, rather than hypothetical-deductive, method implies that the truth criterion for economics is not mainly logical consistency (this is the criterion that applies to the methodological sciences), but empirical verification. Still, as such verification is not always easy or feasible, and as the ultimate goal of science is to guide human action, a second criterion of validity for economics is the pragmatic forecasting ability of its models. If, for example, a model showing that an economic policy based on loose fiscal adjustment, high interest rates, and volatile exchange rates tends to produce low economic growth is confirmed in practice—as has been the case in Brazil—such a model will be correct. Another example: if the same model predicts that inflation will not spin out of control if interest rates drop to civilized levels, and such a prediction is borne out when rates are lowered, the model will be likewise confirmed. A final example: when, based on the theory of inflation inertia, we argued that a stabilization plan as powerful as was the Collor Plan in fiscal and monetary terms would be unable to eliminate inflation because it failed to adopt a strategy to neutralize inflation inertia, and this forecast was borne out—then the theory of inertial inflation is confirmed as true.[5] For all this, I reject the "consistentialism" implied in neoclassical economics and its attempt to reduce macroeconomics to a closed system by assuming rational expectations. Since economics is the science of markets, the two central laws according to which markets operate—the law of supply and demand and the tendency of profit rates to equalize when relative prices are in equilibrium—must never be cast aside in the name of the voluntarism arising from the role in which statists cast planning or, as neoclassical economists put it, of expectations and "credibility."

Neoclassical macroeconomics often exaggerates the role of expectations, accusing them of running against the second law in particular. A good example lies in the disastrous attempts to stabilize inflation by coordinating expectations, as was tried in the Southern Cone of Latin America at the turn of the 1970s and into the 1980s, using the exchange rate as a coordination instrument (Diaz-Alejandro 1991 [1981]). Another example can be found in neoclassical economists' and the conventional orthodoxy's insistence on explaining high inflation as simply an expectations-related problem that could be overcome by means of the government's commitment to strict monetary and fiscal policies, instead of understanding that inflation inertia was characterized by a permanent distributive conflict due to lagging price adjustments on the part of actors who were therefore constantly pushing relative prices into and out of equilibrium.[6] The radical use of the "rational expectations" assumption and of the concept of "credibility" lies at the root of serious mistakes in macroeconomic theory and policy. Expectations and credibility are crucial to markets' behavior, and there is always rationality in them, but the expectations of economic actors are not so rational as to "correspond to the true model," as intended by the radical theory of rational expectations. For economic and social life to flourish and for economic policymakers to be effective, trust must be omnipresent. This trust, however, springs not from an acknowledgment of the appropriate model and the strict observance of rules, but from the mutual understanding of all—an understanding that requires theorists and policymakers to be prudent and modest, as well as able to discern what is new—to understand the structural change that institutional change and, therefore, economic policy change requires.[7]

The economic system I analyze here is well defined. It is the macroeconomic system that has prevailed in Brazil since the Real Plan of 1994 achieved price stability. An economic system is defined not only by its capitalist nature or its openness to international competition within the framework of globalization, not only by the ratios of wages, profits, and interest through which income is distributed, and not only by the technological variables that condition growth and distribution; it is also defined by the institutions and economic policies it may adopt: by its degree of capital account openness, that is, by whether it accepts involvement in financial globalization (not to be confused with trade globalization); by whether the selected fiscal regime is loose; by its short-term interest rates and foreign exchange policies, which it may seek to manage or to leave to the devices of the markets; and by the political coalitions that support this or that policy. The economic system addressed here is that of countries, such as Brazil, that compete within the framework of global capitalism and, notwithstanding, adopt the recommendations of, or yield to the pressures that come from, the North—the conventional orthodoxy—thereby adopting the competition's advice. Contrasted to them are the dynamic economic systems of Asian countries that follow their own economic policy counsel. The economic system I examine here, therefore, is not an abstraction but a concrete economic, social, and political reality that demands definition in terms of a specific model.

This book is on the area of *development macroeconomics* because its basic tenets are employment and growth, and the basic variables and policies it discusses are macroeconomic ones. I will be using this latter term synonymously with *economic development*—that is, a process of structural transformations in economy and society that lead to better standards of living through the accumulation of capital and the incorporation of technical progress in production—and reserve the term *development,* on its own, to signify the end result of economic, social, political, and environmental development, that is, development as regards the four major objectives of modern societies: well-being, social justice, freedom, and environmental protection. Income growth in a country that finds oil reserves and remains dependent on this product is neither growth nor economic development because its structures, cultures, and institutions—the three dimensions on which a society can be analyzed—remain almost unchanged. Economic development, however, is not always just, does not always take place democratically, and does not always preserve the environment. For equal opportunities, freedom, and respect of nature to be present, there must be social development, political development, and sustainable development.

## The Conventional Orthodoxy and New Developmentalism

This book springs from a basic question: why has neither the price stability attained in 1994 nor world prosperity in recent years been enough to lead Brazil to macroeconomic stability and resumed economic growth? Since 1980, Brazil's economy has remained macroeconomically unstable, with low growth and high unemployment. The growth rate of income per capita, which was 4 percent a year between 1950 and 1980, fell to less than 1 percent at one point. In 1994 the Real Plan finally overcame the high inflation that had ravaged the country for 14 years, but the long-awaited resumption of development never came. After 2002, a structural external shock, caused by growing worldwide prosperity, added to two large devaluations of the Brazilian currency and doubled Brazil's exports, but even so, the country failed to show satisfactory growth. This prolonged quasi stagnation of the Brazilian economy led me to write this book. If the Brazilian economy were healthy—if the main macroeconomic indicators pointed toward stability and if the economy were growing at a reasonable pace—we might concern ourselves with long-term reforms capable of contributing to gradually making Brazil a more prosperous, just, and, perhaps, happier society. Alas, this is not the case. Although no country grew as fast as Brazil between 1930 and 1980, since 1980, or since 1994, it has been among the slowest growing of countries.[8]

In this book I offer an explanation of the chronic quasi stagnation of the Brazilian economy. The Brazilian economy fails to grow because it is caught in a trap of high interest rates and an uncompetitive exchange rate that keeps savings and investment rates depressed—a trap that economic policy reinforces instead of identifying and overcoming. Why do these mistakes occur? Naturally, there is an issue of incompetence, there are obstacles to true fiscal adjustment, and there are domestic vested interests in maintaining a high interest rate and an uncompetitive exchange rate, but the main reason is that, in 1995, after 15 years of crisis and no national development strategy, the country's macroeconomic policy was fully subordinated to the dictums of the Washington Consensus: the country's economic "strategy" came to be determined abroad. Never have Brazil's economic policymakers received as many compliments from Washington and New York as they have since 1995. The underlying rationale of the conventional orthodoxy, however, is not resumed development, nor even macroeconomic stability, but serving the commercial and financial interests of advanced countries and, therefore, neutralizing the capacity of middle-income countries such as Brazil, which are regarded as competitors and a threat because of their cheap labor. I will probably be called a "conspiracy theorist" or an "outdated nationalist" for this statement, but it stems from the very nature of globalization, characterized by generalized economic competition between nation-states. In this ever fiercer competition, middle-income countries pose an objective threat to advanced countries, owing mainly to their cheap labor. The threat hangs mainly over the working class and the middle class (whether professional, or wage-earning, or business), who are directly affected by competition from developing countries; this is why US workers opposed the admission of Mexico into the North American Free Trade Agreement (NAFTA); on the other hand, the interests of large multinationals and their executives and shareholders are not so clear, because some stand to gain while others may lose. Since, however, these countries are democracies and politicians play a strategic role, hegemonic thinking and the policies it generates represent the average of national interests; it is this thinking, expressed in the conventional orthodoxy, that regards middle-income countries such as Brazil as threats.[9] In the medium term this is a mistake, as advanced countries will end up benefiting from the greater economic development of all countries;

but, in the short term, the stagnation of wages in rich countries is related to the growing competition from countries with cheap labor.

In accordance with a pattern common to many developing countries, after 1990 the Brazilian economic authorities—with a brief interregnum during the Itamar Franco administration, which included the formulation of the Real Plan—adopted the reforms prescribed by the Washington Consensus and the accompanying monetary policy—one based on high interest rates and an appreciated exchange rate. The same happened in every Latin American country that, having accepted the recommendations of the conventional orthodoxy, relinquished control over its exchange rate by accepting the policy of open foreign accounts and the growth with foreign savings put forward by Washington and New York. The sole exception was Chile, which did the right thing by liberalizing its economy and turning toward exports but also imposed controls on capitals inflows and was thereby able to manage its exchange rate. Not by chance, Chile was the only Latin American country to report satisfactory growth. The orthodoxy's inadequacy as regards resuming economic development, however, soon made itself felt. The second country to adopt it—Mexico—faced a balance-of-payments crisis as early as 1994, and, as the country most committed to the conventional orthodoxy, remains semistagnant to this day. Later, in 1998, Brazil's number came up. But the crisis that indelibly marked the failure of the Washington Consensus was Argentina's, where President Carlos Menem had fully adopted every recommendation—and been commended for it. Like Argentina, Brazil is an example of the disaster of mindless adoption of the conventional orthodoxy by a developing country. Asian countries brought about their capitalist revolutions without implementing certain key conventional orthodoxy recommendations—particularly those regarding open capital accounts and the policy of growth with foreign savings—whereas Brazil, like almost all Latin American countries, subordinated itself to the orthodoxy and to the local interests of nonproductive, or rentier, capital, lagging behind the massive international competition that characterizes today's global capitalism. Several studies show the baleful outcome of the application of the Washington Consensus to Latin America. A recent one (Berr and Combarnous 2007, pp. 536–537) uses factor analysis to examine the impact of these reforms on 23 Latin American and Caribbean countries from 1990 to 2003 and concludes that "an engagement in the process of reforms is not accompanied by significantly stronger growth or a significantly reduced poverty or inequality." In addition, "the 'good students' failed to reach better results than the rest in terms of economic growth." In Asia, several countries that held their ground in the face of the conventional orthodoxy, such as South Korea, Thailand, Indonesia, and Malaysia, also made the same mistake in the early 1990s and endured the crisis of 1997, whereas at the same time, and faced with the same constraints, other countries in Eastern Asia, particularly China, India, and Taiwan, retained control over their exchange rates, preventing them from appreciating, and continued to grow. In more general terms, at the level of reform, while Latin American countries indiscriminately accepted every liberalizing reform, interrupting their national revolutions, letting their nations became disorganized, and losing cohesion and autonomy, Asian countries were more prudent: they accepted certain reforms that were compatible with the higher income levels they had attained but preserved their national autonomy—their national development strategies.

After all the crises, one Latin American country seems to have learned its lesson. The case in point is Argentina, which since 2003 has attained economic growth rates almost on a par with China's. The policy that has been in place since the crisis of 2001, with controlled public accounts, low interest rates, and a managed exchange rate (thanks to those interest rates and to the taxation of commodity exports that, by exploiting abundant natural resources, can cause malignant exchange appreciation), indicates that Argentina is treading a new-developmentalist path. It is still too soon to be sure of its success. Inflation rates close to 12 percent a year in 2006 are a problem whose solution—price controls—is not sustainable in the medium run. The Argentine authorities, however, have been fiscally responsible and are putting up a strong resistance to the pressures of the International Monetary Fund—and, therefore, of the conventional orthodoxy—to appreciate the exchange rate and thereby control inflation. This control will have to be achieved by other means, through a temporarily higher interest rate and more stringent fiscal adjustment—measures compatible with new developmentalism.

Developmentalism was the name given to the national strategy that Latin American countries in general and Brazil in particular adopted between 1930 and 1980. In this period, and especially between 1930 and 1960, many Latin Americans were firmly set on nation building and on finally endowing their formally independent states with national societies equipped with basic solidarity when it came to international competition. But the weakening caused by the crisis of the 1980s, combined with the hegemonic force of the ideological wave that began in the United States in the 1970s and with the internal prevalence of an ideological cycle that I call the Democracy and Justice Cycle, brought the national revolution in Latin American countries to a halt or to a new dependency.

Local elites, who stopped thinking with their own heads, took the advice of, and yielded to the pressures from, the North, and their countries, deprived of their national development strategies, saw development stop in its tracks. The conventional orthodoxy, which replaced national developmentalism, had not been internally formulated and failed to reflect national concerns and interests, but instead reflected the vision and objectives of rich countries. Furthermore, as is typical of neoliberal ideology, it assumed that the market could coordinate everything automatically and proposed that the state should dispense with the economic role it had always played in developed countries: that of supplementing the market's coordination in order to promote economic development and equity. I have been a systematic critic of the macroeconomics of stagnation that the conventional orthodoxy proposes because it is based on a mistaken agenda—it still regards inflation as the main problem in the Brazilian economy—and, mainly, because it fails to produce the macroeconomic stability that is expected of it. Instead, because of the high interest rates and the appreciated exchange rate, the conventional orthodoxy keeps the country in permanent semistagnation, besides rendering it prone to recurring balance-of-payments crises such as those that occurred in 1998 and 2002 and that will occur again in time, depending on what happens to the world's economy, as a result of the brutal appreciation of the real in recent years. I have also criticized the loss of a sense of nationhood and the lack of a national development strategy. But my criticism is aimed not just at the prevailing conventional wisdom but especially at the prevailing conventional wisdom that complains of excessive fiscal adjustment, suggests that the country should again turn to its domestic market, advocates higher public spending to foster effective demand, and irresponsibly proposes "renegotiating" domestic and foreign debt. The national macroeconomic stabilization and development strategy I advance in this book—the new-developmentalist strategy—involves, first, more—not less—stringent fiscal adjustment, has as its main goal lower short-term interest rates (today's real disease in the Brazilian economy), and advocates managing the exchange rate in such a manner as to keep inflation under control and sustain the Brazilian economy's competitiveness. New developmentalism is a national development strategy that has been gradually defining itself in Latin America as the region's countries see the failure of the Washington Consensus to promote growth and its socially inequitable nature, which favors only the wealthy and the more educated strata of professional middle classes while imposing losses on middle-class business owners, professionals, and the poor. New developmentalism replaces its forerunner—a national development strategy that was enormously successful in promoting Brazil's economic development between 1930 and 1980 and then fell into a severe crisis in the midst of which it degenerated into economic populism.[10] New developmentalism, as a reflection of the much more advanced condition of the Brazilian economy today as compared with the 1930s, is not protectionist but export-led, and, although it stresses the importance of industrial policy, sees more relevance in macroeconomic policy and does not cast the state in an important role as a producer of goods and services.

As we will see throughout this book, however, the differences that truly matter today are those between the prevalent Washington Consensus and the emerging new developmentalism. In a nutshell, whereas the conventional orthodoxy proposes growth with foreign savings and open capital accounts, new developmentalism advocates financing investment with domestic savings and maintaining control over the exchange rate to prevent artificial wage gains (foreign exchange populism); whereas the conventional orthodoxy loosely defines fiscal adjustment in terms of a greater primary surplus, new developmentalism defines it more strictly in terms of lower public deficits and bigger public savings; whereas the conventional orthodoxy understands that the exchange rate is nonmanageable and imposes strict limitations on the management of the only instrument it deems to have available—the short-term interest rate—new developmentalism embraces the possibility of and the need for managing both rates as much as possible; whereas the conventional orthodoxy sees the lack of market-oriented reforms as the root cause of Brazil's quasi stagnation (when it even concedes the existence of such a stagnation), new developmentalism, although in favor of reforms to strengthen the state and the market, argues that the main cause of this quasi stagnation is today's macroeconomic policy. This policy, based on a high interest rate and on an appreciated exchange rate, fails to create the necessary demand for the capital accumulation rate to attain the levels needed to resume economic development. If we bear in mind that aggregate demand is essentially dependent on investment, the high interest rate, mistakenly justified as a requirement to keep inflation under control, in addition to imposing high financial costs on the state, hampers both private and public investment; an appreciated exchange rate, on the other hand, arising as it does from the government's inability to neutralize the Dutch disease[11] and from its acceptance of the policy of growth with foreign savings, discourages exports of goods with high per capita value added and, therefore, investment.

Brazil's economic development is now essentially dependent on the demand for investment, not on the supply of skilled labor. Even though education and scientific and technological development remain as national priorities on the supply side, the fact of the matter is that Brazil has vast idle human resources. The high unemployment rates and the mass migration of middle-class Brazilians to wealthy countries are evidence of this. Brazil's economic development depends, in the short and medium run, on a lower interest rate and a competitive exchange rate capable of stimulating investment. Demand is ensured, essentially, by investment or capital accumulation, which, in addition to expanding worker productivity on the supply side, is, on the demand side, the determinant of employment levels. This is why a satisfactory difference between the expected profit rate and the market interest rate—the determinant of growth—is so important to the growth process. Demand, however, is further determined by consumption, which depends mainly on wages, and on exports, which vary based mainly on the exchange rate. This is why the wage rate or average wage, whose growth is the manifestation of economic development on the supply side, is also important on the demand side. And this is why the exchange rate is a central macroeconomic price in the historic development process.[12]

My alternative to the orthodox and conventional economic policy is not the equally conventional Keynesianism that proposes increasing public expenditures and thereby fostering aggregate demand. There is certainly a need to stimulate aggregate demand through export-oriented investment, which will eventually stimulate foreign trade–oriented investment. The policy of stimulating demand through public or budget deficits makes sense only in a non-full-employment economy whose public sector is in fiscal equilibrium. Otherwise, such a move would be easily confused with fiscal populism; if a government with high indebtedness levels becomes involved in an expansive fiscal policy, the economic players' expectations of a potential failure of the state would make the investments promoted by public spending uneconomic. Likewise, with a highly indebted public sector, an indiscriminate rise of the interest rates does not contribute to lowering inflation, as rational economic actors foreseeing a state failure caused by interest (it was caused by expenditures in the former case) protect themselves by not reducing their margins.

In the 1990s, Brazilian society, convinced as it was of being in the less-than-zero-sum game of high inflation, managed to rally and developed a strategy to fight high and inertial inflation; it now needs a similar strategy to counter the trap of high interest rates and uncompetitive exchange rates. To do this, however, Brazil will need to be able to again rely on a nation, and this nation must use the state as its instrument par excellence for collective action and, thus, to formulate a national development strategy—an international competition strategy; only then will the Brazilian economy be able to increase public expenditures and private investments and, through growth greater than that of advanced countries, converge toward their development levels.

## The Conventional Orthodoxy Defined

Brazil's inability to attain macroeconomic stability and resume growth is related to the capture of the state by a powerful political coalition that is not truly interested in the country's economic development: a coalition that coexists with government's fiscal populism and in practical terms supports foreign exchange populism because it has an interest in a relatively appreciated exchange rate. This coalition is made up of rentiers and the financial system that benefit from high interest rates and of multinational enterprises and rich countries' interests represented by the multilateral agencies that benefit from an overvalued local currency; the neoliberal discourse that it uses materializes in the stabilization and growth strategy that I call the "conventional orthodoxy." I have repeatedly made reference to this strategy—or more precisely, "anti-strategy"; the time has come to define it. The conventional orthodoxy is the set of diagnoses and recommendations emanating from Washington—more specifically, from the US Treasury, from the International Monetary Fund, and from the World Bank—and directed to developing countries. In its current guise, it has manifested itself since the 1980s through what has become known as the Consensus of Washington. This consensus, as expressed by John Williamson (1990), consisted of a series of principles that preached fiscal adjustment and market-oriented reforms or what was also referred to as "structural adjustment." In some chapters, I draw a distinction between the First and Second Consensuses of Washington to highlight the fact that the former is chiefly concerned with the current account and the fiscal adjustment that became necessary as a result of the great foreign debt crisis of the 1980s; the latter, which has been prevalent since the early 1990s, supports open capital accounts and growth with foreign savings, which implies a disregard of current account adjustment. Although the term *Consensus of Washington* remains in use and today has a clear meaning related to the neoliberal ideology, I also speak of the "conventional orthodoxy" because it is a more general expression and also because its failure to bring about growth made the relative "consensus" that existed in the 1990s disappear.

The ten reforms Williamson originally enumerated did not necessarily imply neoliberalism. It is quite possible to favor fiscal adjustment, or trade openness, or the privatization of competitive industries without aiming to reduce the state to a minimum. But in the form in which it was practiced around the world, it was certainly neoliberal and globalist—and this is precisely the ideological definition of the conventional orthodoxy. It is neoliberal insofar as it has a clear pro-market bias that weakens the state apparatus and preaches that most developing countries could benefit from fiscal adjustment and market-oriented reforms, especially greater trade and financial openness. It is globalist because it assumes that increased interdependency among nation-states implies a loss of their relevance: a thesis of particular interest to advanced countries, whose citizens are inevitably nationalist—so uniformly nationalistic that they do not need the adjective to define themselves. It is globalist because, within the generalized competition framework that defines globalized capitalism, the conventional orthodoxy ignores the fact that a country will be hard put to grow unless it can rely on a national development strategy: each nation-state must not allow its nation and its state to weaken, under penalty of paralyzed development. It is based on neoclassical economics but is not to be confused with it because it is not theoretical, but overtly ideological and oriented toward institutional reforms and economic policies. Although the dominant neoclassical economics is based in universities, particularly US ones, the conventional orthodoxy has its roots mainly in Washington, home to the US Treasury and the two supposedly international agencies that are in fact subordinate to the US Treasury, namely, the International Monetary Fund and the World Bank, the former concerned with macroeconomic policy, the latter with development. Its secondary wellspring is New York, the headquarters or center of major international banks and multinational companies. This is why we can say that the conventional orthodoxy is the set of diagnoses and policies meant for developing countries and originating in Washington and New York. The conventional orthodoxy changes over time, but, since the United States became hegemonic, it has expressed its ideological hegemony over the rest of the world at the level of economic ideas. This hegemony represents itself as "benevolent" when it is in fact the arm and mouth of neoimperialism—the imperialism without (formal) colonies that established itself under the aegis of the United States and other rich countries following the end of the classic colonial system, immediately after World War II.

The conventional orthodoxy, as it has been applied in Brazil since the 1990s, says four different things: first, that the country's major problem is the lack of microeconomic reforms to allow the market to freely operate; second, that even after the end of high and inertial inflation in 1994, controlling inflation continues to be the main economic policy objective; third, that in order to exert this control, interest rates will inevitably remain high owing to sovereign risk and to fiscal issues; fourth, that "development is a competition among countries for foreign savings" and that the implicit current account deficits and the appreciation of the exchange rate caused by capital inflows are no cause for concern.

Usually the adjective "orthodox" is applied to macroeconomic policies: orthodox policies usually have a neoclassical foundation and are opposed either to Keynesian macroeconomics or to populist policies. If we ignore the latter, a macroeconomic policy is orthodox if it gives full priority to the control of inflation; it is Keynesian if it combines the control of inflation with economic growth. Both approaches, however, know that moderate interest rates and a competitive exchange rate are also objectives to be achieved. Perhaps the orthodox are less adamant than the Keynesians in this matter, but, for instance, during the times of high growth in Japan, we had a classical combination of an orthodox finance ministry with a developmentalist Ministry of International Trade and Industry (MITI), in which the orthodox macroeconomic policy was based on fiscal adjustment, moderate interest rates, and a competitive exchange rate. The "conventional orthodoxy" that is being adopted by many developing countries, including Brazil, however, is orthodox only because of the priority given to the control of inflation. In the three other variables, it adopts the opposite values: soft fiscal adjustment, high interest rates, and an uncompetitive exchange rate. Thus, the conventional orthodoxy is *an orthodoxy for developing countries.* We can discuss whether it is really soft or not in terms of fiscal policy, because the economists involved maintain a strong rhetoric of austerity, whereas Keynesians admit budget deficits in special circumstances. I discuss this matter in Chapter 4. There is no doubt, however, about the macroeconomic trap: high interest rates and an uncompetitive exchange rate. There is no doubt, either, as to the other two issues that I will discuss in this book and that are related to the uncompetitive exchange rate: the conventional orthodoxy proposes a policy of growth with foreign savings that usually does not increase the investment and the growth rates, but appreciates the currency and increases domestic consumption besides increasing the foreign debt, and ignores the Dutch disease that makes the national currency overvalued and uncompetitive. I discuss the latter two issues in Chapter 5. Besides a chronic macroeconomic instability, the consequences are insufficient effective demand, lack of export-oriented investment opportunities, and a low investment rate, which prevent developing countries from *catching up*—from gradually achieving the income levels of the rich countries.

The conventional orthodoxy has dominated the country since the early 1990s but has not led to resumed growth. It is uninterested in solving either the problem of the high real short-term interest rate or that of the overvalued exchange rate and ties everything to fiscal adjustment or to overcoming the structural fiscal imbalance, heedless of the fact that a major cause of this maladjustment lies in the absurdly high interest rates themselves and that the problem can be faced only with a simultaneous attack on the interest disease and on fiscal imbalance. As for the interest rate, it confuses short term and long term and understands that the short-term interest rate is endogenous, defined by the market, and, as a result, it feels comfortable accepting stratospheric rates. As for the exchange rate, it understands that it, too, is endogenous and, consistent with its convenient belief that a middle-income country such as Brazil can grow only with foreign savings, accepts that it should remain relatively appreciated. The appreciated exchange rate policy that the conventional orthodoxy adopts is interesting, first, to rich countries fearful of the competition of countries with relatively cheap labor, such as Brazil, and second, to multinationals, which can then transfer more strong currency for the same profits made in reals in the country. The interest rate policy is interesting for domestic and foreign rentiers who live on interest and for the financial industry that collects commissions from rentiers. The disaster that the orthodoxy implied in terms of balance-of-payment crises and low growth for the Latin American countries that adopted it after the late 1980s is now notorious (Frenkel 2003).

## Nation and Globalization

New developmentalism, like the national developmentalism of the 1950s, at once assumes the existence and implies the formation of a true nation capable of formulating an informal, open-ended national development strategy, as is typical of democratic societies whose economies are coordinated by the market. A nation is a society of individuals or households that share a common political fate and organize as a state with sovereignty over a certain territory. A nation, therefore, like the modern state makes sense only within the framework of the nation-state that arises with capitalism. For a nation to share a common political fate, it must, in addition to having a state, strike solidarity bonds among its members and have shared objectives, chief among which, historically, is development. Other objectives, such as freedom and social justice, are also crucially important to nations, but nations arise, like the state and capitalism, with economic development as an intrinsic part of their logic, of their very being. Nations, nation-states, capitalism, and economic development are simultaneous and intrinsically correlated historical phenomena. In its more advanced form—today's globalization—the constitutive economic units of capitalism are not just firms operating internationally, but also, if not chiefly, nation-states or national states. It is not just firms that compete on worldwide markets, as conventional economics would have it; nation-states, too, are key competitors. The main criterion for success for the political rulers of every modern national state is high economic growth relative to that of other countries. Globalization is the stage of capitalism where, for the first time, nation-states span the entire globe and compete economically among themselves through their firms. With globalization, nation-states became more interdependent, but, for this precise reason, more strategic. In order to be able to compete (for competition is the essential relationship that makes them interdependent), they must also cooperate in the construction of an international system of institutions to set the rules of the game nations play. In the competitive process as well as in the cooperative one, each nation-state has a dramatic need for autonomy—an autonomy that hegemony attempts to constrain in order to impose and exert its own domination. Globalization occurs in every realm: commercial, direct investment, financial, technological, and cultural. The commercial globalization derived from trade openness is a competitive opportunity for Brazil given its relatively cheap labor; on the other hand, financial globalization, defined by financial or capital account openness, is not interesting to developing countries because it denies them control over the exchange rate and, therefore, their own national development process.[13]

A nation involves a basic agreement among classes when it comes to competing internationally. Businesspeople, workers, and the professional middle class (including state bureaucrats and intellectuals) may struggle with one another but know that their fate lies in competitive involvement in the world of nation-states. It involves, therefore, a national agreement—a nationalist agreement. A national agreement is the basic social contract that gives rise to a nation and keeps it strong and cohesive; it is the great accord among the social classes of a modern society that enables such a society to become a true nation, that is, a society equipped with a state capable for formulating a national development strategy. The great national agreement, or pact, made in Brazil after 1930 joined together the newborn national industrial bourgeoisie and the bureaucracy, or the new state technicians; these were joined by urban workers and the old oligarchy sectors more attuned to the domestic market, such as the very ranchers from whom Getúlio Vargas sprang. The adversaries were imperialism, represented mainly by British and US interests, and the associated agricultural-exporter oligarchy. The most strategic agreement that can be made in a modern capitalist society is that struck between industrial businesspeople and the state's bureaucracy, including politicians, but such an agreement also involves workers and the middle classes. There will always be domestic opposition, somehow identified with imperialism, or with today's colony-free neoimperialism, and with local collaborator or globalist groups. In globalized capitalism, the latter are the rentiers, who live on high interest rates, and the financial sector, which collects commissions from the rentiers.

A nation is inevitably nationalist, insofar as nationalism is the ideology of the formation of the national state and its permanent reinforcement or consolidation. Nationalism may also be defined, as Ernest Gellner does, as an ideology that pursues the correspondence of nation and state, that is, that wants a state for each nation.[14] This is a good definition, too, but typical of a thinker from Central Europe; it is a definition that exhausts itself as soon as the nation-state forms—when nation and state first coincide on a given territory, formally establishing a "sovereign state." Therefore, it disregards Ernest Renan's celebrated 1882 aphorism: "a nation is an everyday plebiscite."[15] It fails to explain how a nation-state may formally exist without a true nation, as is the case with Latin American countries, which, in the early nineteenth century, were endowed with states owing not only to the patriotic efforts of nationalist groups but also to the good services of Britain with its maneuvers to drive Spain and Portugal out of the region. As a result, these countries saw themselves equipped with states (i.e., with a national law system and an organization to guarantee such system) in the absence of true nations, as they stopped being colonies to become dependent on Britain, France, and, later, the United States. For a nation to truly exist, it is a requirement that the various social classes, notwithstanding the conflicts that set them apart, be joined in national solidarity when it comes to international competition and that they use national criteria to make policy decisions, especially concerning economic policy and institutional reform. In other words, rulers must think with their own minds, instead of dedicating themselves to confidence building, that is, the construction of foreign credibility at the expense of national interests, and all of society must be capable of formulating a national development strategy.

New developmentalism is a manifestation of a moderate nationalism that is reemerging in Brazil after the exhaustion of the society's cycle that I call the Democracy and Justice Cycle (1964– ) and also after the failure of the conventional orthodoxy to promote economic growth. This was the case in Brazil between 1930 and 1960, under the leadership of Brazil's twentieth-century statesman, Getúlio Vargas. In this period, Brazilian society took national decisions on its own behalf and formulated a successful national development strategy. In those 30 years (or 50 if we count the military regime, which, despite a political alliance with the United States against communism, remained nationalist), Brazil changed: from an agricultural country, becoming industrial, moving from a mercantilist to a fully capitalist social formation, transitioning from a semicolonial status to that of a nation. Developmentalism was the name given to the national development strategy and the ideology that drove it. Therefore, the current process of defining new developmentalism is also a resumption of the concept of nation in Brazil and other Latin American countries. This implies a nationalist perspective in the sense that economic policies and institutions are formulated and implemented with national interest as a main driver and with each country's citizens as authors. This nationalism is not meant to endow a nation with a state, but to make the existing state into an effective instrument for collective action by the nation, an instrument that allows modern nations in the early twenty-first century to consistently pursue their political objectives of economic development, social justice, and freedom, in an international framework of peace and collaboration among nations. It implies, therefore, that this nationalism should be liberal, social, and republican, that is, that it should embody the values of modern industrial societies. Unlike liberalism and socialism, with their universal aspirations, nationalism, as Paulo Nogueira Batista Jr. (2006, p. 3) points out, "is not humanism . . . nationalism is a historical phenomenon and not a universal, timeless value."[16] Nationalism is an ideology of national unification and consolidation. It is always a reaction against the empire. Nothing, however, prevents nationalism from being liberal and social, as long as it is each of the two in moderate measure. And nothing prevents it from making a contribution to the ideals of universal peace and solidarity, as nation-states are the political organization principle of the world society; they are entities that compete among themselves, but, for this very reason, must act collectively to establish the institutions charged with regulating this competition.

## Society's Cycles and State Cycles

Although this book is concerned with economic and political developments in Brazil after it was able to end high and inertial inflation in 1994, before ending this Introduction I permit myself to offer a broad view of Brazil in the twentieth century. To better understand the obstacles ahead and the complex relationships between the Brazilian nation and its state as an instrument for collective action, one must focus on the cycles that society and the state underwent in Brazil in the twentieth century—those of society preceding those of the state, the former creating social and ideological consensus, the latter leading to political pacts and control of the state. The model I summarize here is specific to Brazil, but I believe that, with the appropriate adjustments, it could apply to many Latin American countries. At the societal level, in the early twentieth century the Nation and Development Cycle begins with such imposing characters as Silvio Romero, Manoel Bonfim, and Euclides da Cunha; progresses to Alberto Torres, Monteiro Lobato, Oliveira Vianna, and Roberto Simonsen; attains classical status in the works of Gilberto Freyre, Sérgio Buarque de Holanda, Caio Prado Jr., and Barbosa Lima Sobrinho; and becomes fully defined in the 1950s in the thinking of great intellectuals such as Ignácio Rangel, Guerreiro Ramos, and Hélio Jaguaribe at the Instituto Superior de Estudos Brasileiros (Superior Institute of Brazilian Studies; ISEB) and Celso Furtado at the Economic Commission for Latin America and Caribe (ECLAC) of the United Nations.[17] In the early 1960s, with the military coup of 1964, whose roots lie in the increased Cold War tension in Latin America and in the consequent political radicalization brought about by the Cuban Revolution of 1959,[18] this nationalist cycle, which revolves around national identity and industrialization, collapses, as industrial businesspeople who were the "national bourgeoisie"—that is, a capitalist class committed to national interests—and the military, ever a pillar of Brazilian nationalism, afraid of the communist threat, associated themselves with the United States to establish a military regime in Brazil.

At the state level, which lags behind the societal level, the corresponding cycle is reflected in the National-Developmentalist Pact that begins with the *tenentista* movement (lieutenants' movement) and the revolution of 1930 and finds in Getúlio Vargas its main political actor. In this cycle the government successfully leads a national development strategy oriented toward import-substitution industrialization, and Brazil attains the world's highest growth rate. After redemocratization, in 1945, the National-Developmentalist Pact experiences a political crisis that culminates in 1954 with Vargas's suicide, reestablishes itself with the election of Juscelino Kubitschek, and faces a new crisis in 1961 that eventually resolves itself with the military coup of 1964. After that, the National-Developmentalist Pact, which includes industrialists, state bureaucrats, and organized workers, loses the last of these groups and turns into the Bureaucratic-Authoritarian Pact. Yet the national-developmentalist strategy is resumed and survives until the great foreign debt crisis of the 1980s.

This crisis arises at a time when the new social cycle, which I call the Democracy and Justice Cycle, has already taken large steps toward undermining the military regime. The cycle is born among left-wing intellectuals, usually associated with the São Paulo School of Sociology and the theory of associated dependency, who, after the coup of 1964, start leveling criticism at ISEB, which has diagnosed and supported the National-Developmentalist Pact, and rejecting its basic thesis—namely, that a great national accord led by the national bourgeoisie is giving rise to a Brazilian nation and to Brazil's industrial development. The theory of dependency, which becomes hegemonic in Latin America in the 1970s, originates from this rejection. If no national bourgeoisie exists, as the intellectuals mistakenly believe, then the concept of nation is unviable. In its stead, a new consensus forms, no longer based on the ideas of nation and economic development, but on the demand for democracy and social justice. Whereas the Nation and Development Cycle was born out of rejection of foreign dependency, the Democracy and Justice Cycle is based on acceptance of dependency as an inevitable sociological and economic fact. Whereas the nationalist cycle had economic development as its core goal, the new cycle, which corresponds to the theory of associated dependency, assumes that economic development is assured, be it as a result of the dynamic nature of capitalism or through the inflow of foreign capital. Since, according to the new consensual reasoning, continued industrialization is ensured, the two major problems Brazilian society still has to address are overcoming the military authoritarian regime and the country's pervasive and radical inequity.

This view of Brazil gradually becomes prevalent throughout society while the idea of a nation, identified as it is with the military and businesspeople, sinks into oblivion. Politically organized society fails to become a nation oriented toward national autonomy and development to become a civil society focused on the affirmation of civil, political, and social rights. Democracy becomes the core demand, social justice a requirement at once moral and political. After the "April package" of 1977,[19] the struggle for democracy, which has enjoyed the support of workers, the left wing, and important sectors of the middle classes since the coup, gains the additional support of businesspeople, no longer under the threat of communism.[20] A new government pact forms at the political level but remains outside the realm of the state: the 1977 Popular-Democratic Pact. From that year on, because of the bourgeoisie's negative response to President Ernesto Geisel's April package, the bourgeoisie's alliance with the military breaks down. The Democracy and Justice Cycle acquires momentum, becomes prevalent, and, with the "Diretas já" (the national movement demanding direct elections for the presidency), leads the country to democratic transition in 1985. Besides achieving democratic transition, its chief accomplishment is the constitution of 1988. But in the next year, amid the constitutional workings, the Popular-Democratic Pact collapses with the failure of the Cruzado Plan to control high inflation rates and with the ensuing economic crisis. Add to this the inability of the Partido do Movimento Democrático Brasileiro (Brazilian Democratic Movement Party, PMDB)—the political party that represented this pact—to face the crisis, and one can see why the Brazilian society will yield, from 1990 onward, to the neoliberal wave and to global modernity. The ideas of democracy and justice remain but are now joined by those of neoliberal, modernizing reforms. It is difficult to name the political pact that arises from this surrender of society and that controls the state after 1990, as it retains the notions of democracy and justice but adds to them the contradictory proposals of the conventional orthodoxy. I call it the Neoliberal-Dependent Pact, to emphasize its subordination to the North and its economic neoliberal or ultra-liberal character.[21]

The two parties that came to power after PMDB—Partido da Social Democracia Brasileira (Brazilian Social Democracy Party, PSDB) and Partido dos Trabalhadores (Labor Party, PT)—are also the fruit of the Democracy and Justice Cycle, and, therefore, of the waiver of a sense of nation. Democracy has been attained; the task at hand is to attain justice. But how? The three parties agree that it has to be through increased public spending in the social area. And so it is, as proven by the 9 percent increase of social expenditures as a share of gross domestic product (GDP) that occurs after redemocratization. The outcome of this great effort, however, is meager because its underlying assumption—that economic development is ensured—has proven false: growth has lasted for ten years; the economy has been in quasi stagnation since 1980.

Therefore, it is now increasingly clear that the Democracy and Justice Cycle has become exhausted. Its core goals—democracy and social justice—remain as valid and necessary as ever, but society is at a loss as to how to proceed given the lack of economic development and increased unemployment. A continued increase of the tax burden to fund social spending is evidently no longer a realistic option. The lackluster presidential elections of 2006 and the absence of genuine public debate are indications of this exhaustion: the political parties originating in the period have been unable to renew their vision for the country. Democracy has been attained, despite its current ethical crisis, but reduced inequality is still a distant prospect. Although income distribution data indicate gains in this area, they are misleading because they are incomplete. As 80 percent of the income that the surveys are based on is labor income, in a country where labor income is no more than a third of the national income, the survey underestimates capital income and, therefore, fails to take account of the fact that, in order to offset increased social expenditures, there has been a brutal increase in transfers in the form of interest from the state to rentiers, that is, to the unproductive members of the wealthy class. The strategy of redistribution via social spending was intrinsically limited. In addition to increased interest payments, it brought about an astronomical tax burden of 37 percent of GDP, and society is no longer willing to accept further tax hikes. It is now clearer than ever that inequality will subside only when economic development resumes and companies again absorb the unlimited supply of labor that characterizes Brazil's underdeveloped and dual economy. If the intellectuals of the Democracy and Justice Cycle were mistaken in their trust in the income-redistributing virtues of social spending, the ideologues of the conventional orthodoxy were even more seriously mistaken in assuming that development would resume as a result of the reforms and policies proposed by rich countries. Brazil must rethink its history during the past century, realizing that its objectives cannot be just democracy and the reduction of social inequality but economic development as well; otherwise it will never overcome its present quasi stagnation. After the two major cycles it has faced, society needs to find a new synthesis reconciling national development with social justice and democracy.

## Notes

1. I refer only to middle-income countries because poor countries are incapable of competing with rich countries.

2. *Soft power* is an expression coined by the US "liberal"—that is, progressive—internationalist Joseph Nye (2002).

3. According to Claudia Trevisan (2006, p. 27), "vigorous growth, stability and national unity make up the tripod that drives the decisions of [China's] rulers, who continue to use state planning strictly, despite economic openness."

4. The conventional economists' tripod is fiscal adjustment, an inflation targeting policy, and a floating exchange rate. As we will see, however, what really characterizes the conventional orthodoxy's macroeconomic policy is high interest rates, an uncompetitive exchange rate, and, surprisingly, soft fiscal adjustment.

5. On the high and inertial inflation that prevailed in Brazil between 1980 and 1994, which is several times referred to in this book but will not be the object of specific analysis, see Bresser-Pereira and Nakano (1987 [1984]); on the several failed attempts to stabilize prices in Brazil, see Bresser-Pereira (1996b, ch. 14); on the 1994 Real Plan, which was successful because it adopted a strategy of inertia neutralization (the Real Value Unit [Unidade Real de Valor; URV), see Arida and Resende (1985 [1984]) and Bresser-Pereira (1994); on the intellectual origins of the theory, see Bresser-Pereira (1996a).

6. One of the most clear-cut cases of the application of rational expectations in connection with fiscal and monetary policy is the letter of intent to the IMF that Brazil signed in 1991, when Fernando Collor de Mello was president and Marcílio Marques Moreira his minister of finance. Inflation was then at 20 percent a month. For a year, very stringent fiscal and monetary policies were in place. The IMF expected that, by the end of 1992, inflation should be at 2 percent per month, but it remained at the same 20 percent.

7. This is how the more competent central bankers manage their countries' economic policies, as exemplified by Alan Blinder (1999), Blinder and Reis (2005), and Aglietta and Borgy (2005). See Le Heron (2003) and Le Heron and Carré (2006) for a theoretical analysis of the problem.

8. Brazil grew more quickly than any other country in gross terms; in per capita terms, Japan grew a little faster because its population was rising more slowly.

9. China and India, where labor is even cheaper, are naturally feared by rich countries, but so is Brazil. This is clearly depicted, for example, in a feature by the Washington correspondent to *Valor* newspaper (November 26, 2006) about the attitude of members of the US Congress toward Brazil. According to Ricardo Balthasar, "American politicians . . . who know something of Brazil regard it essentially as a competitor to be faced and as a threat to the well-being of American workers and farmers."

10. "Political populism"—the practice major political leaders adopt of striking up a direct relationship with the masses—was a permanent feature of old developmentalism. Getúlio Vargas, however, the main representative of this breed, never used "economic populism," that is, spending more than one's revenues, which, as we will see, can be either fiscal or foreign exchange related.

11. I define the Dutch disease in Chapter 6.

12. Oreiro, Nakabashi, and Lemos (2007) provided econometric proof of this thesis; according to their analysis, investments are constrained mainly by the exchange rate, which limits industrial exports.

13. Financial globalization relates to the "financialization" process, that is, the accumulation of financial resources by firms and governments, accompanied by high asset liquidity (Kregel 2004; Coutinho and Belluzzo 2004).

14. Gellner, a Czech philosopher who sought political asylum from communism in Britain, was probably the leading analyst of nationalism in the second half of the twentieth century (see Gellner 1983, 1996 [1993]).

15. Ernest Renan (1993 [1882], p. 55). In the immediately preceding text, Renan says: "A nation is therefore a large-scale solidarity, constituted by the feeling of the sacrifices that one has made in the past and of those that one is

prepared to make in the future. It presupposes a past; it is summarized, however, in the present by a tangible fact, namely, consent, the clearly expressed desire to continue a common life."

16. Batista then adds: "In its extreme form, nationalism is intrinsically adversarial towards the two other great political and economic ideologies of the 19th and 20th centuries: liberalism and socialism."

17. The ISEB was a think tank that existed between 1955 and 1964; it was formed by a group of major nationalist intellectuals that since the early 1950s had developed an original interpretation of Brazil and defined politically the strategy adopted by Getúlio Vargas, "national-developmentalism" (see Toledo, 2005). The beginning of ECLAC was the birth of the structuralist Latin American school that developed an economic rationale for industrialization and state intervention or, in other words, for the national-developmentalist strategy; it had in Raúl Presbisch and Celso Furtado its major intellectuals.

18. Concerning the new historical facts that determined the military coup and the end of Vargas's National-Developmentalist Pact, see chapter 4 of Bresser-Pereira (2003). This chapter has been part of the book since its first edition, published in 1968.

19. The "April package" was a set of measures taken by President Geisel that, for the first time, met with great opposition from sectors of the Brazilian bourgeoisie.

20. The main cause of the political crisis of the early 1960s, resulting in the alliance of industrial businesspeople and the military with the United States and in the coup of 1964, was the Cuban Revolution of 1959, which led to a great radicalization of politics on both the left and the right.

21. Note that I use the word *liberal* in the European and Latin American sense, as meaning, in economic terms, *laissez-faire,* not in the US sense, whereby *liberal* means *progressive.* To avoid confusion I use *neoliberal* instead of *liberal* whenever possible.