Introduction: The Search for a New Interpretation

This book describes the economic crisis that seized Brazil and the rest of Latin America in the 1980s, its political consequences, and the economic reforms that were instituted in the mid-1980s but remain incomplete. This is foremost a book about Brazil, but analysis of the significant changes Latin America underwent from 1982, when the debt crisis broke, until the mid-1990s is present throughout. The crisis of the 1980s was essentially a Latin American crisis; it is impossible to understand this crisis in the context of only one country. Thus I had to study the economies of several Latin American countries, particularly Mexico and Argentina, but my focus is particularly on Brazil, the country I know best.

I speak about interpretations of Brazil and Latin America, corresponding economic development strategies, and corresponding class coalitions and broad political pacts. An interpretation of or approach to the causes of the Latin American crisis has a corresponding development strategy, which can be implemented only if a class coalition is able to informally celebrate an informal political pact to sustain it.

I begin from an interpretation of the Latin American crisis as a crisis of the state and propose that the strategy that will overcome it is market-oriented, but also a pragmatic and social-democratic strategy rather than a neoliberal one. Market orientation and fiscal discipline remain priorities, but the objective is not the minimal state but rather the reconstruction of state capacity and governance. However, in addition to being market-oriented—oriented toward domestic and international competition—reforms will have to carefully consider the national interest. Old-time nationalism—the nationalism that was tied to the import substitution strategy—lost ground in Latin America, but a new form of nationalism, in which the national interest is defended in a case-by-case approach, remains extremely relevant. In Brazil economic reforms were undertaken more slowly because they were consistently not only market-oriented but also Brazil-oriented. They were particularly concerned not with building confidence in Washington and New York but with protecting the national interest and the macroeconomic fundamentals, and they had as their basic objective reforming the state. After all, fiscal adjustment, privitization, and liberalization are essentially state reforms.

My interpretation of the Latin American crisis can be extended to Eastern Europe and, with some caveats, to most developed countries. The 1980s were years of crisis for both Latin America and Eastern Europe. In the developed countries the crisis was less severe, but they, too, have faced a slowdown in economic growth since the early 1970s, and unemployment has emerged as a major problem. In the last twenty years, GDP growth in the OECD countries was half that of the previous twenty years. Brazil and Latin America are just emerging from this crisis, but they are far from achieving sustained growth. In Eastern Europe the transition from statism to capitalism has been extremely painful. In most countries per capita income today is 25 percent below 1989 levels.

Whereas the crisis of the 1930s was a Keynesian crisis, defined by chronic insufficiency of demand, my hypothesis is that the crisis of the 1980s and 1990s is a crisis of the state, of its mode of intervention, and a fiscal crisis.

The collapse of communism was the conclusion of a long-term crisis that started in the 1970s. Many people thought it the triumph of capitalism, but it was only the failure of a radical mode of state intervention that coincided with capitalism's own crisis. The first oil shock, in 1973, was a turning point for the world economy, but there were earlier signs of economic malaise, well expressed in the 1971 suspension of the dollar convertibility. Since that time the growth rates of the developed countries have slowed down, and a neoconservative wave has begun. The United States lost its world economic hegemony. Its growth rates have been particularly unsatisfactory, productivity has increased slowly, the wage rate has stalled, income has become increasingly concentrated, and the number of people below the poverty line has continued to grow.

On the other hand, the United States has retained its military and ideological hegemony. The major U.S. universities are still outstanding centers of excellence. They, together with a decreasing number of other industries, constitute an export industry, attracting students from all over the world. They remain a domineering force in the scientific and ideological realms, having originated the theoretical concepts, the economic and political models that served as a basis for the neoconservative or neoliberal wave that swept the United States and, subsequently, the world. This wave, which in the United States was represented by monetarist macroeconomics, the neoclassical rational expectations school, and the public choice or rational choice school, was, on one hand, a response to the slowdown of the developed economies since the 1970s and to the crisis of the state that was at that slowdown's origin. On the other hand, it signaled the failure of Keynesian economic policy to assure full employment, price stability, and growth.

In the First World the new conservatism—modern, intellectually sophisticated, pessimistic about humankind, and individualistic—materialized in the neoliberal interpretation. *Neoliberal,* as used here, is not to be confused with *American liberalism*—the form by which the moderate left, the U.S. social democrats, express and define themselves. Neoliberalism is a radical and utopian form of European (and Latin American) liberalism. Neoliberalism brought back and radicalized the old bourgeois liberalism, asking for the absolute rule of the market and a minimum state, which would only protect property rights and enforce contracts.

Neoliberalism emerged in the United States and Europe when, beginning in the 1970s, Keynesian policies proved unable to control the economy; when inflation accelerated, unemployment increased, and growth rates slowed. In Latin America the same economic crisis took place ten years later, in the 1980s, but it was more severe than was realized in the neoliberal interpretation, the "Washington consensus," which became dominant in the region only in the late 1980s. The economic reforms of the neoliberal credo were obviously radical and utopian, but they were correct in their intent. After many years of state expansion, the state had become distorted, the fiscal crisis had paralyzed governments, economies were clearly overprotected and overregulated. A pragmatic synthesis between the old development strategies and the dogmatic neoliberal critique was required.

These reforms took place in Latin America in the shape of fiscal adjustment, trade liberalization, privatization, deregulation—all reforms of the state—and the restructuring of business enterprises. Some of these reforms were well developed and were both Latin America–oriented and market-oriented. Others were designed to build confidence. In the 1990s, following substantial economic reforms that reduced the state apparatus and deregulated the economy, Latin American countries have gradually resumed growth.

The crisis was caused by the excessive and distorted growth of the state: the developmentalist state in the Third World; the communist state in the Second World; and the welfare state in the First World. The potential of the market as a resource-allocating mechanism and as a coordinator of the economy was badly overlooked. The state became too big; although it was apparently too strong, it was increasingly weak, expensive, and inefficient. It was a victim of special interest groups and dominated by fiscal indiscipline or economic populism.

The neoliberal critique points out that the solution to this crisis is to reduce the state, aiming at the minimum state; to destroy not only the communist state but also the developmentalist and even the welfare state. The state would not perform any economic role except to guarantee property rights and the national currency. According to the "rhetoric of reaction" that Hirschman (1991) so strongly denounced, even social functions should be eliminated or reduced, given their "perverse effects." Market failures could occur, but even worse would be government failures.

My reaction to this neoconservative wave was critical, although respectful. It became clear to me that the new conservatism offered a useful critique of the problems the world faces, particularly of the distortions that befell the state; this conservatism, however, provides only a partial solution to the problems, given its ideological and dogmatic nature and its lack of pragmatism. The market is a wonderful mechanism, and I agree that all economic reforms should be market-oriented and even market-biased. By this I mean that we should always start from the assumption that the market will do its job in coordinating the economy. But reforms should not be market-blinded or oriented toward building confidence. They should not transform the market, which is only an institution created by society and regulated by the state, into a sort of myth. They should not assume that confidence building is good per se. Building confidence in Washington or in New York may stimulate investments in the short run. But neither the bureaucrats and politicians in Washington nor the bankers and financial operators in New York can be viewed as depositaries of universal economic rationality, much less as people concerned with the national interests of Latin American countries. In fact, a confidence-building strategy may well be implemented at the expense of national interests and macroeconomic fundamentals, as happened in Salinas's Mexico.

It is a mistake to identify market orientation with market coordination. To be efficient, all economies should be market-oriented. All economic reforms should aim to spur competition. A market-oriented economy is strongly competitive in both domestic and international terms. Even within firms competition is a basic management and motivation principle. But the coordination of an economic system involves more than competition; it also follows from cooperation. And for cooperation to occur at the national and international levels, society needs the supplementary coordinating role of the state. Every economic system includes not one but two coordinating principles or mechanisms: the market and the state. Successful economic systems are usually those that combine, in a balanced and dynamic way, the role of the market and the role of the state. Some European social democracies, as well as Japan and the East Asian countries, are good examples.

Starting from these very broad observations, I come to what I call the "crisis of the state approach." This approach may eventually become a third paradigmatic moment of interpretation of Latin America.

I began my work in the context of the first paradigmatic moment: the national-bourgeois and structuralist interpretation of Latin America that originated in the ideas of Raúl Prebisch (1949). Following the economic crisis of the 1960s, I actively participated in formulating a second paradigmatic moment of interpretation of the region: the new dependency theory. Both interpretations can be combined under a more general denomination—the national-developmentalist interpretation—which was the outcome of Latin American structuralism and Keynesianism, both loosely combined with the Marxist and the Weberian traditions. The national-developmentalist interpretation soon became the victim of populism of all sorts. Keynes was supposed to support chronic budget deficits. The argument favoring protection of infant industries led to permanent protectionism. Bureaucratic interests were confused with the interests of labor and the left. Since the 1960s this approach has faced increasing difficulties in its attempt to offer sensible policies to the region, whereas the corresponding industrializing strategy—import substitution—proved to be exhausted. In the early 1980s, when the debt crisis erupted and inflation exploded in Latin America, I became increasingly interested in short-term macroeconomic issues, particularly with inflation and balance-of-payments adjustments. I was turning from structuralism, which was mainly concerned with long-term development strategies, to a more short-term approach in which scarcity and efficient allocation of resources, public savings, and a balanced budget receive full attention, without renouncing my structuralist origins.

On the other hand, the neoliberal approach—although correct when it proposes market-oriented state reforms and fiscal discipline—is dogmatic and lacks pragmatism or operationality. Thus an alternative, some kind of synthesis between the old developmentalism and the new neoliberalism, is required. In broad theoretical terms, the neostructuralist approach may be this alternative. I suggest that perceiving a crisis of the state, the approach I discuss in the next section and throughout the book, provides a new interpretation of the region. This interpretation, or approach, is market-oriented but also Latin America–oriented, and corresponds to a social-democratic and pragmatic development strategy. This book, in addition to analyzing crises and reforms in Brazil, can be thought of as a search for a new interpretation of and new development strategies for Latin America.[1]

The crisis of the state approach is an attempt to synthesize the old paradigms, which reserved a decisive role for the state, and the neoliberal paradigm. It views the crisis of the state as having two aspects: a fiscal crisis and a crisis of the mode of intervention. The fiscal crisis is defined by the loss of public credit. It may also be defined by the fact that a large public debt—coupled with high inflation, chronic public deficits, high domestic interest rates, and decreasing rates of growth—renders explosive expectations that the public debt might increase. The crisis of the mode of intervention is defined by the exhaustion of protectionist forms of intervention and by the multiplication of subsidies and regulations in an economy where rent seeking becomes the norm.

The crisis of the state is the basic cause of the economic crisis in the Third World and Eastern Europe and also of the slowdown affecting the developed countries since the 1970s. The countries able to overcome the crisis were essentially those that conserved (Japan, Germany, Korea, Colombia) or recovered (Chile) fiscal solvency. The choice of this variable to explain the crisis is crucial because it implies that other causes are either ancillary or complementary. The basic cause of the crisis will not be found in excessively capital-intensive (or capital-saving) technological progress nor in the weariness of capital-labor relations based on Taylorist techniques. These two causes, particularly the latter, may help to explain the crisis but do not constitute the essential explanation. Chronic insufficiency of demand, correctly used by Keynes to explain the crisis in the 1930s, is not a good explanation for the present crisis. The collapse of the Keynesian consensus in the 1970s, which economists usually attribute to the failure of the Phillips curve to explain stagflation, was actually caused by the fact that demand management no longer constituted an answer to the problems in economies in which the state had grown too large and faced serious financial problems.

The crisis of the state approach borrows the neoliberal paradigm's market orientation and belief that the functions of the state were severely distorted. It affirms, however, that, if the basic cause of the economic crisis is the crisis of the state, then the state has an important economic role. If other explanations were adopted—if the crisis were associated with, for instance, insufficiency of demand or technological problems, implying an increasing capital-output ratio—other consequences would need to be derived. But if we acknowledge that the crisis of the state is the main explanation, we have no alternative but to admit that the first and primary task is to reform the state, recover its solvency, and redefine its mode of intervention in such a way that the market and the state complement each other, that together they assure an adequate rate of savings and investments, an efficient allocation of resources, and a fair distribution of income.

Historically the state's economic role has been constantly changing, but it has always been essential. In addition to guaranteeing property rights and contracts and ameliorating market failures, the state has positive economic roles that are particularly important to economic development. An essential condition is the recovery of public finances, making public savings positive again so they can finance public investment in the infrastructure, in industrial and technological policies, and in new social and environmental protection expenditures. A state that is bankrupt, that does not dispose of public savings, and that is chronically the victim of a public deficit is a weak state. It may be large, but it is also sick. In cases where hyperinflation is nearly reached, the state's government—the top politicians and bureaucrats who directly control the state apparatus—is unable to govern. Public policies become endogenous because the government does not effectively command the fiscal resources required to formulate and implement policies.

According to the crisis of the state approach, the objective, after streamlining the state apparatus, is to create a leaner but stronger, more flexible state. Market-oriented reforms, privatization, deregulation, and trade liberalization, as well as fiscal discipline, monetary reforms, and tight monetary policies, are means to strengthen the state rather than weaken it. One can picture the reformed state as a sleek young tiger, instead of an ailing old elephant.

To understand this approach, how I came to it, and the structure of this book, a short story is in order. In the mid-1980s it became clear to me that the dependency interpretation and the import substitution strategy, which had been useful tools, no longer offered a sensible explanation for the Latin American crisis or effective policies to overcome it. For decades the Brazilian state had been strong and powerful, financing and subsidizing the private sector. But in 1983, just after the Latin American debt crisis erupted, I realized that the state had become poor and increasingly bankrupt, whereas the private sector was now rich and was providing financing for the state.

In the early 1980s Yoshiaki Nakano and I were involved in the analysis of the high and chronic rates of inflation then prevailing in Brazil. We formulated the theory of inertial inflation (see Bresser Pereira and Nakano 1983), which provided an alternative not only to monetarism but also to Keynesianism. Keynes was the most important and creative economist this century has produced, but his ideas on inflation did not explain inertial inflation because they were unable to explain stagflation.

Yet in addition to the macroeconomic view in the theory of inertial inflation, we needed a more structural or microeconomic explanation for the crisis Brazil and Latin America were facing, which had as one of its symptoms inertial inflation. The answer began to form in the mid-1980s, when I read some extremely insightful articles on the state and state-owned corporations written by Rogério Werneck (1983, 1985, 1986). Werneck was already suggesting a crisis of the state, although he did not relate it to the larger Brazilian economic crisis. I was invited to participate in a conference on Latin America at Cambridge University, and I wrote my first paper on the crisis of the state (1987). Chapter 4 of this book is based on that work.

I presented the paper in Cambridge in April 1987. Three weeks later I was invited to become finance minister of Brazil. The long-term economic crisis, which had prevailed since the early 1980s, had been aggravated by an acute economic and financial crisis originating in the Cruzado Plan's collapse. Immediately after taking office, I asked my economic team to formulate a macroeconomic consistency plan, using as their parameters the ideas in my Cambridge paper. The staff did an outstanding job. The Macroeconomic Control Plan was probably the first systematic assessment of the Brazilian fiscal crisis. On the structural or microeconomic level, however, it was clear that the import substitution strategy—that is, the mode of state intervention—had lost functionality, making privatization and particularly trade liberalization urgent. Members of my staff, economists from the World Bank, and Juan Sourrouile—Argentina's minister of the economy at the time—helped me to reach this conclusion. Two months later I made my first trip to the United States as finance minister, met Jeffrey Sachs, and read his work on trade reforms and the debt crisis in Latin America (1987). I learned from Sachs that the debt crisis was essentially a fiscal crisis, which led me to recollect James O'Connor's extraordinary book *The Fiscal Crisis of the State* (1973).

I had learned a great deal from putting all these ideas together and completing an assessment of the Brazilian crisis, but the country had not. A populist mood still fully dominated Brazilian politics, making impossible economic policies aimed at fiscal discipline and market-oriented reforms. I resigned as finance minister in December 1987 and returned to academic life. In the next years I dedicated myself to further developing ideas on Brazil and Latin America that were consistent with the crisis of the state approach. I wrote numerous articles, participated in national and international conferences, talked to people, and followed the new ideas that were emerging. The outcome is this book.

An important factor in developing the crisis of the state approach was my participation in the East-South System Transformations Project, led by Adam Przeworski. In this context I wrote, with Przeworski and José Maria Maravall, *Economic Reforms in New Democracies* (1993), in which I was first able to shape this interpretation. I initially called it "the fiscal crisis approach," but I later realized that it was actually a global crisis of the state; it was not only a fiscal crisis but also a crisis of the mode of intervention. "The crisis of the state approach" is a good name for an interpretation of the crisis rather than an indication of the policies designed to solve it.

This book is divided into four parts. Part 1 deals with conflicting interpretations of Brazil and their respective development strategies. Chapter 2, in which the crisis of the state interpretation is outlined, is the central chapter. The approach to the crisis as a crisis of the state started with an intuition that Brazil and Latin America faced a fiscal crisis connected to the debt crisis and to economic populism. But it was also based on another intuition. I observed that the state's role was changing and that this fact was related to the "cyclical and ever-changing character of state intervention," which is the title of a paper I wrote in 1988. This cyclical process explains how the state, which had performed a strategic role in development between the 1930s and the 1970s, fell into a deep crisis in the 1980s, and why, after that time, fiscal discipline, privatization, and trade liberalization became mandatory. It also explains why the conservative, neoliberal wave was so strong. Chapter 3 summarizes my views on the cyclical character of state intervention and applies those views to Brazil. It is the basic model behind the role and concept of the state I adopt in this book.

Part 2 examines the economic crisis of the 1980s: the historical process that led to the crisis; its perverse macroeconomics; and the debt crisis.

Part 3 is centered on the political dimension of the crisis. All of the chapters in this book have a political as well as an economic dimension, but the four chapters in this part are specifically political. In them I examine the crisis and the renovation of the left, the political obstacles to economic reforms, the contradictory aspects of the short but significative Collor administration, and what I call "the citizenship contradiction": a very large number of citizens with the right to vote in a radically heterogeneous society in which governments face a permanent legitimacy crisis as long as the classical social contract is insufficient, requiring additionally a development-oriented political pact. Brazil is a dual society. Income distribution is extremely uneven. The gap between the elites and the masses is enormous. If a modern society is not only market-oriented, one in which resource allocation is efficient and technological change dynamic, but is also a democratic and socially balanced society, this social gap is a major obstacle to its modernization. Forming a democratic political coalition able to consolidate democracy, reduce economic inequalities, and promote growth becomes extremely difficult.

Finally, Part 4 is an analysis of the economic reforms undertaken in Brazil, particularly since 1987 with the collapse of the Cruzado Plan, that were accelerated in 1990 during the Collor administration and crowned by the Real Plan in 1994, which stabilized prices. Thus this is a book on crisis, but it also addresses the changes and reforms that have been taking place in Brazil since the early 1980s but that have been concealed or shadowed by the prevailing high and inertial inflation. In this part I first discuss the failed attempts to stabilize, proposing that the causes behind the failures were also, but not mainly, political. The incompetence of policymakers, who were unable to understand the abnormal times Brazil and Latin America were experiencing, and particularly the nature of inertial inflation, were also major causes of the failures. Second, I discuss the successful reforms. I conclude with an analysis of the social and political changes in the direction of the formation of a new, development-oriented political pact. In Chapter 16 I discuss the international strategy of Brazil. It is clear to me that the Initiative for the Americas (1991) and NAFTA opened a new phase in Latin American–U.S. relations. These initiatives are a response to the crisis in Latin America but also to the end of U.S. world economic hegemony. In this part of the book I discuss the difference between the old nationalism, tied to the import substitution strategy, and international policy based on national interest. And I propose that economic reforms should not be only market-oriented but also national-oriented—Brazil-oriented, for instance. The alternative is for economic reforms to be oriented toward building confidence, as occurred in Salinas's Mexico. Such confidence, while comforting to Washington and New York, is often precarious and bought at the expense of the reforming country's national interest and macroeconomic fundamentals.

Some sections of this book have been published in other versions, as individual articles; they have been updated and revised in several ways.

For the development of the ideas presented here, my experience as finance minister, my role as a professor of economics at Getúlio Vargas Foundation, São Paulo, and my participation in debates on Latin America and Brazil in many domestic and international seminars were essential. I am indebted to many friends, but I would like to mention four economists—Jeffrey Sachs, Roberto Frenkel, Rogério Werneck, and Yoshiaki Nakano—with whom I wrote Chapters 7 and 13—and two political scientists, Adam Przeworski and José Maria Maravall. To them I indeed owe a great deal.