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Neoliberalism, Democracy, and Development Policy in Brazil

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This paper offers a political economy analysis of the two systems of accumulation in the postwar Brazilian economy: import-substituting industrialisation (ISI) and new liberalism, and the industrial policies associated with them. The transition between these two systems of accumulation from the early 1980s to the mid-1990s is reviewed in the light of the country's key macroeconomic indicators and the political developments which have determined the choice and implementation of economic policy in each period. It is argued that, despite their significant achievements, both ISI and new liberalism were implemented unevenly and inconsistently, and that their shortcomings can be analysed at two levels: internal micro- and macro-economic limitations preventing these development strategies from achieving their stated aims, and external limitations imposed by social conflicts during each period of time. The paper concludes, first, that industrial policies are closely associated with specific state structures, economic constraints, and political configurations which can be analysed only concretely (there can be no general theory of industrial policy, and there is no 'optimum path' of accumulation under late development). Second, each system of accumulation is limited by a distinctive set of historically specific economic and political constraints, which set limits to its potential development. Third, and precisely for these reasons, industrial policy is irreducibly political and context-specific.

Keywords: *Brazil, Import Substitution, Inflation, Neoliberalism, Democracy*

Introduction

This paper offers a political economy analysis of the two systems of accumulation in the postwar Brazilian economy: import-substituting industrialisation (ISI) and new liberalism, and the industrial policies associated with them.[1] The shift across systems of accumulation has been associated with significant changes in the role, structure, and economic policies of the Brazilian state. The first section examines the case of ISI, departing from a review of conventional assessments of this system of accumulation and, subsequently, offering an alternative interpretation of the economic and political structures underpinning this development strategy. This section also considers the limitations of ISI and the reasons for its terminal crisis in the eighties.

The second section focuses on the political transition to new liberalism, that is, the shift from military rule to democracy. It is argued that this political transition was functionally articulated with the economic transition to neoliberal policies as examined in the third section. This section departs from a conceptual review of neoliberal economic policies and reviews their implementation in Brazil since the nineties, highlighting the significance of the real stabilisation plan. Studied in detail are the shortcomings and limitations of new liberalism, a system of accumulation defined through four main features: *neoliberal economic policies, microeconomic integration of domestic capital into transnational circuits, a decisive role for finance in economic policy-making*, and *political democracy*. This paper concludes that both ISI and new liberalism achieved significant successes in terms of economic development. However, both strategies were implemented unevenly and somewhat inconsistently. These shortcomings can be analysed at two levels: internal micro- and macro-economic limitations preventing these development strategies from achieving their stated aims, and the external limitations imposed by social conflicts during each period of time.

More generally, the paper argues that industrial policies are closely associated with specific state structures, economic constraints, and political configurations which can be analysed only concretely. Consequently, there can be no general theory of industrial policy, and there is no 'optimum path' of accumulation under late development. Each system of accumulation is limited by a distinctive

[1] The system of accumulation is determined by the economic structures and institutional arrangements that typify the process of capital accumulation in a specific region in a certain period of time (Fine and Rustomjee, 1996). This is a relatively concrete concept, with no direct relationship with relatively abstract concepts such as mode of regulation (Aglietta, 1979; Boyer, 1990).

set of historically specific economic and political constraints, which set limits to its potential development. These are examined in detail in the two Brazilian cases in this paper. Finally, and for these reasons, it is concluded that industrial policies are irreducibly political and context-specific.

ISI and Its Limitations

This section reviews the political economy of ISI in Latin America, and in Brazil specifically, and the industrial policies associated with this development strategy. It explains the conventional interpretations and critiques of this system of accumulation and offers an alternative interpretation of ISI and its economic limitations.

Conventional Interpretations of ISI

ISI is often presented as the 'typical' Latin American economic policy, and Brazil was a model case of ISI between 1930 and 1980. ISI is generally viewed as a spontaneous response to three severely adverse external shocks experienced by most Latin American countries in succession: the two world wars and the Great Depression. These shocks led to drastic reductions in export revenues and foreign financial inflows as the result of price or quantity constraints, and to large fiscal deficits because a significant part of the state revenues relied on import tariffs.

The balance of payments and the fiscal deficit could not be financed externally under these circumstances, but sharp exchange rate devaluations and rapid monetary expansion helped to preserve the level of domestic income despite the falling import capacity. This 'proto-Keynesian' policy response helped to alleviate the impact of the external crises and supported local demand for goods and services which, in turn, fuelled the expansion of domestic manufacturing capacity. The initial response to the external shocks was later supported by providing targeted support to the manufacturing and infrastructure sectors. These policies, often called 'populist' by mainstream economists, or 'developmentalist' by their structuralist rivals, were justified by the strategic imperative to industrialise and modernise primary export-dependent economies and reduce their vulnerability to fluctuations in international trade and in the price of their key exports.

Rapid manufacturing growth targeting import reduction, unsupported by significant export growth or diversification, inevitably reduced the degree of trade openness of most Latin American economies, including Brazil. In other words, abundance of natural resources, scarcity of foreign exchange, and ISI pushed Latin American economies towards self-sufficiency which, in turn, bred economic stagnation either because of technical inefficiencies and rent-seeking behaviour (for the mainstream) or because the narrowness of the internal market limited the scope of domestic production (for the structuralists).

More specifically, ISI has been criticised from a neoclassical perspective for five main reasons. First, this strategy is biased against primary production, and it prevents specialisation according to comparative advantage. This leads to resource misallocation, rent-seeking behaviour, and therefore, to low economic growth rates in the medium term. Second, ISI creates an inefficient industrial sector which tends to be monopolised, over-diversified, unable to achieve economies of scale (with firms suffering from chronic excess capacity), and internationally uncompetitive. Consequently, the domestic industry, including local subsidiaries of transnational corporations (TNCs), needs indefinite protection. Third, ISI leads to the over-expansion of state and public sector employment, which fosters fiscal deficits and increases the vulnerability of the state to populist pressures for greater welfare expenditures and higher civil service wages. Fourth, ISI tends to be based on excessively capital-intensive foreign technology, given the large endowment of unskilled labour in the region. Therefore, the manufacturing industry creates only a limited number of jobs despite its stimulation of rural-urban migration, thus exacerbating the problem of urban unemployment. Fifth, ISI concentrates income, because it transfers resources from agriculture to the urban economy, although most of the population is rural and poor. In contrast, structuralist and dependency writers have criticised ISI primarily on two grounds. First, ISI increased rather than reduced the degree of economic dependence of these economies because of the enhanced technological, cultural, and financial subordination through industrialisation with imported capital and technology. Second, ISI created new patterns of inequality, fostering the concentration of income and wealth in societies that were already highly unequal. This was partly the natural outcome of the development of an urban middle-class among a large, poor, and relatively unchanging countryside and partly the outcome of deliberate policies geared toward the creation of a stratum of urban consumers able and willing to purchase domestically produced durable consumer goods.

These insights are insufficient for a balanced assessment of the experience of ISI in Brazil. An alternative interpretation is outlined below, which offers the possibility of reinterpreting the key merits and shortcomings of ISI and assessing the transition to new liberalism.

An Alternative Interpretation of ISI

ISI is a system of accumulation based on the sequenced expansion of the manufacturing industry, with the primary objective of replacing imports.[2] Manufacturing expansion usually departs from internalisation of the production of non-durable consumer goods (e.g., processed foods, beverages, tobacco products, and cotton textiles). It later deepens to include the production of durable consumer goods (especially household appliances and automobile assembly), simple chemical and pharmaceutical products (e.g., oil refining products and certain pharmaceutical products), and non-metallic minerals (especially cement). In the larger countries including Brazil, ISI can reach a third stage when the manufacturing structure becomes 'complete' (in the structuralist jargon). This includes production of steel, capital goods (e.g., industrial machin-

Table 1. Brazil: Distribution of Value Added in Manufacturing Industry, 1919-59

	1919	1939	1949	1959
Consumer goods	80.2	69.7	61.9	46.6
Textile	24.4	22.0	19.7	12.0
Clothing	7.3	4.8	4.3	3.6
Food	32.9	23.6	20.6	16.4
Other	15.6	19.3	17.3	14.6
Consumer durables	1.8	2.5	2.5	5.0
Intermediate goods	16.5	22.9	30.4	37.3
Metallurgy	3.8	7.6	9.4	11.8
Non-metallic minerals	2.8	4.3	6.5	6.1
Chemical	0.8	4.2	4.7	8.3
Wood	5.7	3.2	4.2	3.2
Other	3.4	3.6	5.6	7.9
Capital goods	1.5	4.9	5.2	11.1
Mechanical	0.1	1.3	2.1	3.4
Electrical	0.0	0.3	0.8	1.0
Transport equipment	1.4	3.3	2.2	6.7

Source: Abreu, Bevilacqua and Pinho (2000: 163).

[2] Import-substituting industrialisation is assessed by Bruton (1981, 1998) and Gereffi and Wyman (1990). For an overview of ISI in Latin America, see Bulmer-Thomas (2003), FitzGerald (2000), Tavares (1975), and Thorp (1992). The Brazilian case is reviewed by Baer (1995), Furtado (1972), Hewitt (1992), and Lessa (1964).

Table 2. Brazil: GDP Shares (%), 1910-80

	Agriculture	Manufacturing	Services
1910	35.8	14.0	50.2
1920	31.9	17.1	50.9
1930	30.6	16.5	52.9
1940	25.0	20.8	54.2
1950	24.3	24.1	51.6
1960	17.8	32.2	50.0
1970	11.5	35.8	52.6
1980	10.1	40.9	48.9

Source: Abreu, Bevilacqua and Pinho (2000: 162).

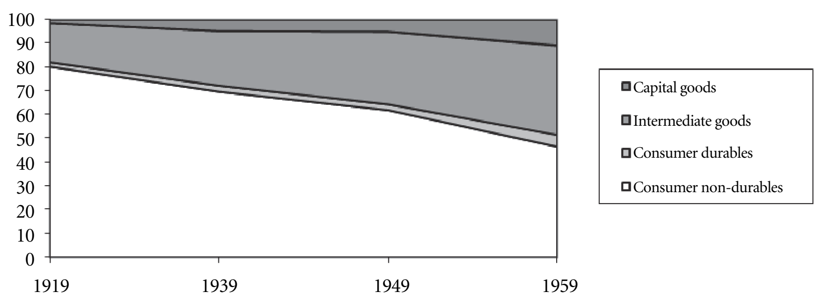

Figure 1. Brazil: Distribution of Value Added in Manufacturing Industry, 1919-59.

Source: Table 1.

ery and electric motors), and technologically complex goods such as electronic machines, shipbuilding, and aircraft design and assembly (see Tables 1 and 2; Figure 1). This gradual 'deepening' of the manufacturing base is accompanied by backward, forward, and horizontal linkages between established firms. As a result of these processes, primary exports were no longer the driving force of the Brazilian economy in the 1950s (see Bulmer-Thomas, 2003). Brazil, the world's largest coffee exporter in the early twentieth century, offers a particularly striking example of these processes: agriculture declined from 36% of GDP in 1910 to only 10% in 1980, while manufacturing increased from 14% to 41% of GDP (Abreu, Bevilacqua, and Pinho, 2000: 162).

The extent of these structural shifts varied greatly. For example, Brazil and Mexico advanced further than Argentina, Peru, and Venezuela (not to speak of Ecuador, Honduras, and Paraguay) for several reasons, including market size, government policies, and the degree of social consensus around the strategy of industrialisation.

Although ISI often starts spontaneously, experiences in Brazil and elsewhere show that its continuing success requires activist industrial, financial, and trade policies, and state provisions (or, alternatively, state incentives for private provisions) of finance and infrastructure, especially electricity generation, water and sanitation, transport facilities, oil extraction and refining, health, education and training, and other requirements for manufacturing growth. The expansion of the bureaucratic apparatus of the state is also essential, because industrial expansion requires not only suitable policies, but also law enforcement, labour control, regulation of social conflicts, and so on.

Brazilian ISI was associated with a specific structure of property relations (or a 'macroeconomic division of labour') and a peculiar mode of competition. Briefly, the production of non-durable goods was predominantly undertaken by relatively small family firms owned by domestic capitalists, which would sometimes grow but rarely change their ownership structure. In contrast, durable and capital goods were typically produced, respectively, by foreign TNCs and domestic oligopolistic firms. Finally, infrastructure and basic goods (steel, electricity, telecoms, oil, gas, air, road, rail and port links, and so on) were generally supplied by state-owned enterprises (SOEs), and state-owned banks played an important role in the provision of credit, especially for industrial development and economic diversification (Auty, 1991; Moreira, 1991; Nembhard, 1996).

The Politics of ISI

The uneasy coexistence between populism, nationalism, corporatism, and statism under Brazilian ISI was primarily due to the intense conflicts of interest within the elite,[3] especially between agrarian and urban interests and between manufacturing capital and finance, and between the elite and other social groups, especially the marginalised but increasingly militant urban workers and the emerging urban middle class (Saad-Filho, Iannini and Molinari, 2007; Skidmore, 1973). Stripped of their rich complexity, these conflicts essentially centred around the extent to which resources should be transferred away from the primary export sector, and where they should be allocated—for example,

[3] The elite includes the large and medium-sized capitalists, especially financiers, industrial capitalists (based mainly in São Paulo and Rio de Janeiro), large exporters and traders, the media, landowners and local political chiefs, their intellectual and political proxies, and top civil servants. These fractions of the elite are unrelated to the contrast between domestic and foreign capital, or the conflict between industrial and financial interests.

towards urban industry, infrastructure, or welfare provision (and, within these alternatives, to which sub-sectors, regions, and social groups).

It was widely accepted that extensive state intervention was required at several levels in order to achieve developmental objectives (synthesised into the goal of industrialisation). Economic interventionism was legitimised by a nationalist ideology, according to which the 'nation as a whole' would progress only through industrialisation. In this developmentalist discourse, insufficient industrialisation was associated with backwardness and the political and economic power of the traditional landed elites, which should be overcome through state action that fosters economic 'progress'. The relationship between nationalism, statism, and developmentalism tended to become especially pronounced when private capital lacked the capacity or interest to invest in strategic areas such as oil, steel, electricity generation, or transport links. In these cases, provision often depended on extensive state intervention, either through nationalisation of the industry or through the provision of subsidies for private capital. Management of ensuing conflicts of interest was never unproblematic. Contradictory popular demands, state initiatives, and sectoral pressures were played out in the media, in educational and research institutions, in state institutions, and on the streets, sometimes violently, and the outcomes were contingent on timing, circumstances, and the constellation of forces mobilised on each side. These conflicts were displaced by the 1964 military coup.

Limitations of ISI

Despite its important achievements, ISI was severely limiting across Latin America, and in Brazil specifically. The six most important limitations are described below. *Balance of payments constraint.* This constraint captures the relationship between state economy and the rest of the world, and it is considered by many Keynesian economists to be the most important constraint to growth (McCombie and Thirlwall, 1994). Under ISI, the balance of payments constraint took the form of absolute scarcity of foreign exchange, largely due to the fragility of the export base and lack of reliable access to foreign capital. Currency shortages restricted growth and induced economic volatility because they limited imports, investment, external market access, and the availability of technology for manufacturing development. This constraint was addressed through the cumulative internalisation of production of imported goods, attraction of foreign direct investment (FDI), and foreign borrowing. However, this strategy was limited on two grounds. First, although ISI reduced the demand for imports of finished goods, it increased the demand for imported machines (to produce these goods), oil, and other industrial inputs (see Tavares, 1975). Second, changes in the industrial structure increased the rigidity of the country's import requirements, because fluctuations in import capacity based on the decline of the terms of trade, crop failures, insufficient foreign capital inflows, and so on, would no longer limit the consumption of imported goods as was the case in the past but, instead, hampered domestic production and employment.

It follows that the conventional argument that ISI 'closes' the economy is misplaced. Although Brazilian ISI contributed to a reduction in the export and import coefficients (the former because the economy expanded faster than the export sector, and the latter because import reduction is one of the main goals of ISI), Brazil was always open to—and increasingly dependent upo—foreign capital and loans for balance of payments support, provision of technology, and supply of finance for industrial development, leading to the accumulation of external debt, growing remittances of interests and profits, denationalisation of industry, and increasing dependence on foreign technology.

Fragility and inefficiency of the domestic financial system. The Brazilian financial sector was structurally unsuited for the provision of long-term finance for industrial development (Studart, 1995). This sector developed in order to finance production of export crops, and trading and speculation with primary products, especially coffee, which normally required short loan terms and offered relatively liquid and readily-available collateral. Brazil's banks were generally short-termist and speculative, its financial system was shallow, and its financial institutions were generally unwilling or unable to provide long-term finance to a rapidly expanding manufacturing sector. Consequently, manufacturing investment was funded primarily by FDI, foreign loans, state-owned banks, directed credit, state subsidies, and private firms' own resources. However, this combination of sources of finance is fragile, and it eventually proved to be unsustainable (see below).

Fiscal fragility. The state played a key role in the vertical deepening and horizontal integration of the manufacturing sector. The state influenced production and investment decisions through specialist agencies and institutions, mediated the relationship between domestic and foreign interests, played a key role in strategic technological development, and subsidised capital accumulation through the provision of cheap credit, infrastructure, and inputs. Although activist industrial policies were essential, they were not adequately financed by the tax system. Brazilian ISI was accompanied by fiscal deficits, inflation, and the accumulation of substantial foreign and domestic liabilities of central and local governments.

High inflation. This was typical of ISI for two main reasons (Saad-Filho and Mollo, 2002). On the one hand, social divisions fostered distributive conflicts, with social groups fighting for shares of the national income through higher prices, taxes, and wage demands. On the other hand, inflation was the outcome of the limitations of the financial structures underpinning the process of accumulation, especially fiscal deficits, lack of bank finance, and shallow and speculative stock markets, which compelled firms to rely on price increases to fund investment. This institutional structure facilitated the adoption of rigid mark-up pricing rules by leading firms, which protected their revenue against demand shifts or adverse fluctuations in the level of activity. This may have protected investment in key industries, but it also increased vulnerability of the economy to inflation through distributive conflicts or adverse supply shocks.

High inequality and social tensions. Brazil is one of the most unequal societies in the world in terms of access to income, wealth, and privilege. ISI reinforced these inequalities because it did not create sufficient jobs, wages were permanently compressed by labour abundance and outright repression, and land reform was lacking. Moreover, manufacturing development responded to the existing pattern of demand which was systematically biased towards relatively expensive durable consumer goods produced by transnational corporations employing capital-intensive imported technologies (Furtado, 1972). These social and distributional features limited the domestic market, skewed the structure of demand away from mass-consumed non-durable goods, and frequently blocked an industry from expanding unless income was further concentrated or consumer credit was made available, which often required access to foreign finance. These inequalities have fostered severe social conflicts in Brazil, which reduced the ability of the state to impose co-ordinated industrial policies.

Lack of policy co-ordination. The Brazilian state could rarely exercise the degree of economic co-ordination essential for the long-term success of ISI. Consequently, ISI was often guided by short-term profitability considerations rather than a long-term vision of the needs of accumulation. New economic sectors would arise, which brought about demographic, sociological, cultural, and political changes, created new interest groups that competed for income, status, and state incentives, and increased the complexity of policy formulation and implementation. State agencies frequently clashed against other agencies with different priorities, and these co-ordination problems were worsened by the extent of TNC penetration and the foreign dependence of the manufacturing sector, especially in finance and technology. These weaknesses help to explain the excessive fragmentation of industry, the fragility of the national system of innovation, and the failure of most firms to compete successfully in international markets, thus perpetuating the balance of payments constraint. The remarkable success stories in the steel, auto, aircraft, and, temporarily, in the defence and telecommunications industries, show what the textile, plastics, toy, wood, beverages, processed food, and other sectors were missing. These limitations help to explain the 'stumbling' character of ISI, the volatility of the economic growth rates, and the reproduction of severe social and economic problems including mass poverty, concentration of income, and insufficient infrastructure provision.

The Crisis of ISI

The limitations outlined in the previous section were due primarily to the *weakness* rather than the 'excessive' strength or size of the state. In brief, the Brazilian state was interventionist, but it was institutionally disarticulated and unable to impose consistent priorities over conflicting interests, especially in the dominant power bloc. This social group generally found detailed planning and large-scale state intervention unacceptable, because they upset the political balance within the elite and sometimes promoted the interests of the poor majority.

The structural constraints and fragilities of ISI and the strongly negative impact of the external shocks of the seventies and early eighties made macroeconomic management extremely difficult in Brazil. These shocks showed that the monetary, financial, fiscal, tax, and exchange rate policies associated with ISI had become incompatible with internal and external balance. The oil shocks and the international debt crisis worsened the balance of payments constraint,

Table 3. Brazil: Annual Inflation Rate (CPI, %)

1970	17	1982	95
1971	21	1983	164
1972	17	1984	179
1973	14	1985	228
1974	33	1986	68
1975	29	1987	367
1976	38	1988	892
1977	41	1989	1,637
1978	40	1990	1,639
1979	67	1991	459
1980	85	1992	1,129
1981	91	1993	2,491

Source: FIPE, www.ipeadata.gov.br

and contributed to the development of an acute fiscal crisis, culminating with a slide towards hyperinflation (see Table 3). Social conflicts intensified, political instability became endemic, and policy shifts were limited by cumulative institutional weaknesses and growing political paralysis. The military government lost its capacity to manage the economy. In the early eighties, it had become widely agreed that political changes were imperative.

The Political Transition to New Liberalism

Between the early seventies and the early nineties, the Brazilian elite gradually convinced themselves that the restoration of economic dynamism would be compatible with the preservation of the existing patterns of exclusion only through the introduction of a new system of accumulation. This system, which can be defined as 'new liberalism', includes four main features: *neoliberal economic policies, the microeconomic integration of domestic capital into transnational circuits* (i.e., denationalisation of firms and their integration into global value chains), *a decisive role for finance in economic policy-making*, and *political democracy*. This section reviews the political aspect of Brazil's transition to new liberalism.

The defining feature of the Brazilian military regime, in power between 1964 and 1985, was its attempt to preserve social exclusion through the combination of economic growth with varying levels of repression. The power of the regime declined gradually after 1974 due to the political exhaustion of the government's heavy-handed approach towards dissent and the economic exhaustion of the regime's growth strategy. The country's foreign debt escalated after the first oil shock, and inflation rose from 20% to 100% in the early eighties. The second oil shock, in 1979-80, triggered a deep economic crisis and the first GDP contraction since 1929. The economy stopped responding to government policies, and the military regime ran out of options.

Military rule finally collapsed due to the emergence of a growing democratic mass movement in 1977-85. Political contestation encompassed a wide range of modalities of struggle, including criticisms of corruption, economic mismanagement, and lack of democracy and political accountability, renewed trade union activities, and mass mobilisation for economic democracy and political freedom. At this stage, a significant change took place within the elite; for the first time since 1930, a consensus emerged around political democracy.[4] This

[4] 'Consensus' refers to a substantial measure of agreement on strategic political projects among

consensus was due to external pressures as well as domestic developments, and it facilitated the democratic transition because it defused the conflicts that might have arisen with the change in political regime (Markoff and Baretta, 1990; Weffort, 1989). For this reason, Brazilian democracy did not emerge on the ruins of the institutions left behind by the dictatorship as was the case in Argentina. Instead, the military commanders of the regime and the country's traditional elites managed to control the democratic transition.

The substance of the elite pact that hijacked the democratic movement was straightforward. In exchange for political freedom, redistribution of economic power was ruled out. Under these limited conditions, the democratic transition established the most open and stable regime in the history of the Republic. For more than 25 years there has been no press censorship, no parties or movements of any significance have been banned, and civil rights are formally guaranteed to a greater extent than in many 'old' democracies. For the first time since the late nineteenth century, the military no longer openly interfere in the political sphere, and the political influence of religious leaders has been curtailed. Finally, right-wing ideology has been demoralised, and no influential organisation claims to be either 'conservative' or on the 'right' (however right-wing their policies and practices may be).

The Economic Transition

Neoliberal economic policies are hegemonic in Brazil as well as the world today (Saad-Filho and Johnston, 2005; Saad-Filho and Morais, 2004). This section reviews the theoretical foundations of these policies, and the transition from economic policies geared toward the promotion of ISI to neoliberal policies in Brazil.

The Foundations of Neoliberalism

Like all mainstream approaches, neoliberalism at the microeconomic level presumes that, in a decentralised and deregulated economy, free competition leads to full employment equilibrium. Consequently, the market rather than the state should address such economic problems as industrial development, inter-

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social groups which, by virtue of their institutional power and political influence, can implement these projects through state institutions. This concept is related to the Gramscian notion of hegemony. Neither of them presumes unanimity.

national competitivity, and employment creation. By the same token, policy-oriented shifts in relative prices and in allocation of resources should be avoided. At the macroeconomic level, neoliberalism argues that the world economy is characterised by the relentless advance of 'globalisation' (usually defined superficially and imprecisely) and international capital mobility. They offer the possibility of rapid growth through the attraction of foreign capital. However, this strategy can be successful only if domestic policies conform to the short-term interests of the financial markets, which implies that interventionist policies are unfeasible because any policy deemed undesirable or unsustainable by the financial markets would lead to capital flight, balance of payments crisis, and economic collapse. 'Policy credibility' is essential and, in practice, it derives from the preferences of the international financial conglomerates, the US government, and the IMF. In sum, neoliberalism is optimal because it offers the best and the only viable set of economic policies and these policies are viable and optimal because they are in the interests of international capital.

The most important tool of neoliberal policy is the interest rate. Presumably, the 'correct' interest rate can deliver balance of payments equilibrium, low inflation, sustainable levels of investment and consumption and, therefore, high growth rates in the long term (Arestis and Sawyer, 1998). The implementation of neoliberal policies can be analysed from two angles. On the one hand, it generally raises interest rates above their level in an alternative regime where similar objectives would be pursued using a wider set of tools. However, higher interest rates tend to reduce the levels of employment, investment, output, and income relative to what they could be in an alternative scenario, both in the short and in the long run. In this case, long-term unemployment tends to rise because capacity becomes fully utilised, and the balance of payments constraint becomes binding before unemployment declines sufficiently. On the other hand, the neoliberal policies implemented in Brazil and other newly industrialised countries during the 1990s included trade, financial, and capital account liberalisation (see below). They were justified by the need to increase economic efficiency and to eliminate high inflation. However, they require not only that domestic interest rates should rise, but also that they should exceed international rates by a large margin because of the political, currency, and other risks in these countries.

It is impossible to determine the size of the interest rate differential required to attract a given volume of foreign resources due to continuous changes in domestic circumstances and international liquidity. Excessively low margins and low liquidity tend to be associated with insufficient inflows and, potentially, with capital flight and currency devaluation. In contrast, high margins and abundant liquidity are associated with large capital inflows, accumulation of foreign reserves, deflationary pressures, and currency overvaluation. The impact of the interest rate margins on aggregate demand is ambiguous with a potential to shift, because low (high) domestic interest rates can increase (reduce) consumption and investment through the usual Keynesian mechanisms; or they can reduce (increase) because of the combined impact of the international capital movements and the ensuing changes in the exchange rate. Only excessively high interest rate differentials can persist over long periods, but the consequences of chronic conditions may often be even more serious than those of the acute variety. They may include deindustrialisation (because of high financial costs and foreign competition), rapid growth of the domestic public debt (DPD) (if the capital inflows are sterilised), and the creation of a 'casino' atmosphere in which financial strategies steadily shift from hedge towards speculative and, finally, Ponzi finance (Arestis and Glickman, 2002).

Inflation and Stabilisation

It was suggested in the second section that the Brazilian elite converged around the view of ISI having faced three insurmountable problems in the eighties: inefficiency of the financial sector, continuing industrial backwardness, and difficulty to create a dynamic national system of innovation (Laplane and Sarti, 1999: 198). It gradually became accepted that these obstacles could be overcome only if the size of the state was reduced through expenditure cuts, the reform of the fiscal, tax, and social security systems, and privatisation of state enterprises. It was expected that fiscal reforms would reduce inflation, while financial liberalisation would increase domestic savings and investment. Finally, liberalisation of foreign trade and capital inflows, and the resolution of the remaining conflicts with the international financial system, would facilitate the attraction of direct and portfolio investment flows as well as industrial restructuring in those sectors compatible with the country's comparative advantages. Productivity would rise, followed by a structural improvement in the balance of payments (Auty, 1991; Moreira, 1991). In sum, the integration of Brazilian productive and financial capital into transnational conglomerates would drive a virtuous circle of growth that would turn Brazil into a developed economy.

These policy prescriptions were implemented gradually, and increasingly consistently, by successive governments. In 1988, during the Sarney administration, the domestic financial system was reformed and, starting in 1989, international capital flows were liberalised (Studart, 1999). The exchange rate regime was made increasingly flexible in the following years (Banco Central do Brasil, 1993). From 1990, during the Collor administration, Brazil reduced import restrictions incrementally and implemented the resolutions of the Uruguay Round of GATT. The Collor and Franco administrations adopted strongly contractionary monetary policies in order to control inflation, attract foreign capital, and generate exportable surpluses. The Cardoso government fully implemented a neoliberal economic strategy, especially through the Real Plan, and the Lula administration has pursued essentially the same policies introduced by his predecessor.

Between early 1992 and mid-1994, Brazilian inflation increased slowly but relentlessly from under 20% per month to over 40% per month. Inflation control was essential for the political legitimacy and economic viability of the new elite consensus. High inflation was eliminated through the Real Plan (Governo do Brasil, 1993).[5] This stabilisation plan was also used to legitimise the economic transition to neoliberalism.

Five policies underpinned the Real Plan. First, *import liberalisation*: Foreign competition limits the prices domestic firms can charge (otherwise, their markets will be lost to imports). It also limits the workers' wage demands, since pay increases could make local firms uncompetitive. Neoliberals also claim that trade liberalisation forces local firms to compete against 'best practice' foreign producers, which should help to raise productivity across the economy. Unsuccessful producers will close down, and their capital and labour should be deployed more productively elsewhere.

Second, *exchange rate overvaluation*: It enhances the impact of trade liberalisation on inflation and competitivity. These policies are highly effective against inflation, and they can be very popular with consumers. However, their impact on the balance of payments and on local industry and employment can be devastating. Brazilian goods imports increased from US$20.6 billion to US$50.0 billion between 1992 and 1995. This structural shift was pursued deliberately:

> [T]he logic of the exchange rate policy is to reduce exports, raise imports and the current account deficit and, therefore, make the country import capital again. These [capital] imports and the domestic savings accumulated by the private sector will finance economic growth. (Pedro Malan, Minister of Finance, *Gazeta Mercantil*, 24 October, 1994)

Cheap imports badly harmed the manufacturing industry. In Brazil, the

[5] See also Bacha (1997), Dornbusch (1997), Saad-Filho, Morais and Coelho (1999), and Sachs and Zini (1996).

proportion of manufacturing value added in GDP reached 41% in 1980. By 2001, this ratio had declined to 27%. Manufacturing sector employment fell, with the loss of more than one million jobs between 1989 and 1997, and average real wages declined by 8% between 1994 and 2001 (Bonelli, 1999: 89; Saad-Filho and Mollo, 2006). Third, *domestic financial liberalisation*: It was expected that the deregulation of the financial sector would help to increase savings and the availability of funds for investment. In fact, the opposite happened, and both savings and investment rates declined. The savings rate fell from 28% of GDP in the mid-'80s, to around 20% in the mid-nineties and below 15% in 2001, while investment rates fell from an average of 22.2% of GDP in the eighties, to 18.2% in the nineties, and 16.1% in 2001-06. The inflow of foreign capital may have replaced rather than supplemented domestic savings, financing consumption rather than investment (Bresser-Pereira, 2003). The decline of the investment rate helps to explain the dismal growth rates in Brazil: between 1994 and 1999, Brazil's average annual real GDP growth rate was only 2.6% (3.2% between 1994 and 2008). The economy, on the other hand, expanded on average by 6.4% per annum between 1933 and 1980.

Fourth, *fiscal reforms*: The public sector deficits that, presumably, induced high inflation were addressed. These reforms were largely successful through privatisations, expenditure cuts, and tax increases (Giambiagi, 2007).

Finally, *liberalisation of the capital account of the balance of payments*: This was supposedly essential to attract foreign savings and modern technology.

This policy combination offered a fail-safe strategy to reduce inflation and, simultaneously, lock in the neoliberal reforms. Cheap imports were allowed in, while high interest rates, foreign loans, mass privatisations and TNC takeovers of domestic firms brought the foreign capital that paid for them. Inflation tumbled while consumers gorged in new automobiles, computers, and DVD players, and splashed out in artificially cheap foreign holidays. Consumer goods imports increased from US$606 million to US$8.2 billion between 1985 and 1998. In the same period, foreign travel spending increased from US$441 million to US$5.7 billion. Euphoria reigned supreme; neoliberalism bribed those it had not yet convinced, and it seemed that it could do no wrong.

However, the neoliberal reforms did not resolve the shortcomings of ISI (explained in the section on alternative interpretation of ISI), and they destabilised the balance of payments and the country's productive system. The reforms hollowed out the industrial chains built during ISI and reduced the local content of manufacturing production. Wages and profits declined because of competing imports, the rising share of interest in the national income (due to the financial reforms and the permanently high real interest rates), and the diffi-

Table 4. Brazil: Import Coefficients, 1993 and 1996 (%)

SECTOR	1993	1996
1. Standardised capital goods and electronic goods	29	65-75
2. Chemical inputs, fertilisers, resins	20-26	33-42
3. Auto parts, natural textiles, capital goods made to order, rubber	8-15	20-25
4. Pharmaceuticals, tractors, electric and electronic consumer goods, glass, chemical goods	7-11	13-16
5. Synthetic textiles, petrochemical inputs, cars, food, paper and cardboard	3-6	9-12
6. Beverages, shoes, plastics, dairy products, semi-processed foods	0.7-3	4-8
7. Non-tradable goods (cement, inputs, and others)	0.5-2.5	1-4

Source: Coutinho, Baltar and Camargo (1999: 70).

culty in developing new competitive industries. Structural unemployment mounted. Neoliberalism discarded import substitution and promoted 'production substitution' financed by foreign capital instead.

Industrial Policy and the Restructuring of the Manufacturing Sector

The neoliberal transition introduced into Brazil a new industrial structure based on the microeconomic integration of production and finance into transnational value chains. It was expected that intensified competition would lead to partnerships, mergers, and acquisitions or to the collapse of the inefficient firms, raising average productivity. First, the share of imported manufactured goods increased sharply (see Table 4).

Second, participation of foreign firms in mergers and acquisitions (M&As) and foreign purchases of minority stakes in domestic companies increased significantly. Foreign firms participated in 49.1% of the 3,276 M&As between 1990 and 1999. Both the number of M&As and the degree of foreign involvement increased during this period.[6] The most affected sectors were electric and electronic goods, telecommunications equipment, car parts, and processed foods.

Growing foreign participation contributed to the search for efficiency gains. The new mode of competition was influential at several levels. First, it led to a shift in management techniques towards 'modern' methods and the downsizing of the workforce. Second, rising manufacturing unemployment was rein-

[6] PriceWaterhouse Coopers (*Folha de S. Paulo*, 21 January, 2000, p. 2-1). For similar estimates, see Gonçalves (1999: 138-42).

forced by the introduction of new labour-saving technologies. Third, firms tended to shift their output mix towards simpler products with less value added in order to reap efficiency gains. As a result, manufacturing productivity increased, on average, by 7.6% annually between 1990 and 1997 (Feijó and Carvalho, 1998). Coutinho, Baltar, and Camargo (1999: 66, 73) rightly conclude that:

> [The] avoidance of industrial development policies by the State…strongly contributed to the increasing exposure of domestic industry to imports, especially in high value added sectors and those with high technological content… [T]he explosion of imports rapidly 'hollowed out' the productive chains, and led to a large reduction in intra-industry demand…which sharply reduced the economy's capacity to create jobs… [T]he frantic attempts to cut costs have led to successive rounds of innovation and rationalisation in the productive process that generated strong tensions in the labour market… [This is partly due to the] entry of new competitors and the redefinition of strategic alliances [that] have destabilized the oligopolistic structures inherited from previous decades… The 'modernisation' of [these] oligopolistic structures has ruptured the existing supply chains, led to the entry of new [foreign] suppliers, reduced the degree of verticalisation and increased the import coefficients… [The] higher coefficient of imported inputs and components (and, therefore, the substantially lower value creation in the country) means that the success of efforts to stimulate domestic demand for intermediate goods and employment will tend…to be very modest.

These heavy blows were softened by the expansion of trade within Mercosur and by the transfer of some SOEs to Brazilian capital.[7]

The New Policy Regime

The Brazilian experience shows that the new liberal reforms can secure short-term macroeconomic stability and growth. This is due to two main reasons. First, they are part of the conventional wisdom of the age and embedded in the belief systems of most domestic and international institutions. Therefore,

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[7] See Cano (1999) and Laplane and Sarti (1999: 222-4). '[The] flows of [Brazilian] exports to the Argentine market are concentrated on medium-high and medium-low technological intensity products, which include 70-75% of the sales of Brazilian industrial goods. The participation of these products in Brazilian exports to the rest of the world is less than 40%' (Machado and Markwald, 1997: 197). See also Leal and Silva (2009).

they are 'credible' by definition. Second, if international liquidity is high and interest rates are low, as was the case in the mid-seventies, again in the early nineties, and after the recovery from the 2000-2001 slump, trade and capital account liberalisation seem to abolish the balance of payments constraint. They can attract capital inflows to finance a large trade deficit, allowing consumption, investment, and growth rates to increase rapidly, in a virtuous circle that may last several years. However, if these foreign capital flows decline, as they did in the early eighties, the mid-nineties, 2000-2001, and since mid-2007, countries following neoliberal policies can find themselves in a vulnerable position. The balance of payments constraint can reappear suddenly, either because of the scarcity of foreign exchange or because higher international interest rates push up domestic interest rates, squeezing the economy both internally and externally at the same time.

In Brazil, the crisis of the Real Plan in 1998-99 (Morais, Saad-Filho and Coelho, 1999) led to the introduction of a new macroeconomic policy regime that includes inflation targeting, large fiscal surpluses, and the managed fluctuation of the *real*. The aim of these policies was to preserve low inflation, stabilise the DPD and the exchange rate, and eliminate current account deficit. These policies and goals have also been pursued by the Lula administration.

This policy regime has been partially successful. Devaluations of the *real* in 1999 and in 2002 triggered a temporary inflation bubble, while revaluations of the currency have been associated with declining rate of inflation (see Figure 2; Araujo and Leite, 2009). Although the government's inflation targets have nor-

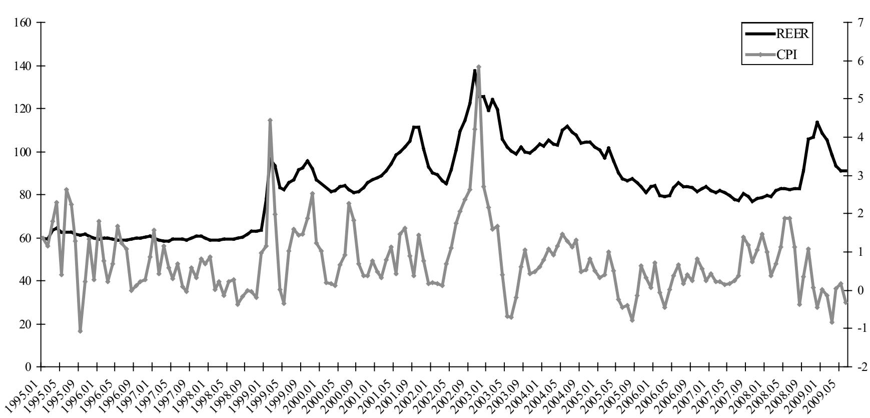

Figure 2. Brazil: Real Effective Exchange Rate (REER) (average 2000 = 100) and Inflation Rate (CPI) (% per month)

Source: Ipeadata.

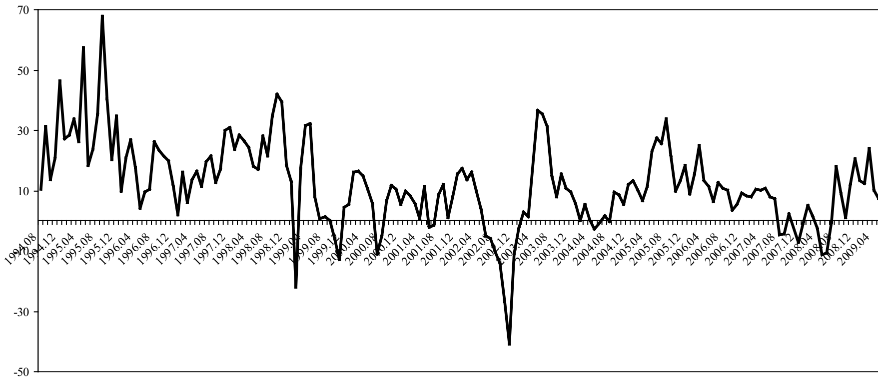

Figure 3. Brazil: Real Overnight Interest Rates (annualised monthly rate, %)
Source: Calculated from Ipeadata.

mally not been achieved, inflation rate is relatively low and stable (Bresser-Pereira, 2003; Lima, Maka, and Mendonça, 2007).

Permanently high real interest rates during the period of the *real* (see Figure 3) are due to the high costs and continuing inefficiencies of the Brazilian financial system as well as the latent conflicts between monetary and fiscal policies under new liberalism. In summary, contractionary monetary policy automatically relaxes the fiscal policy stance because of the growth and high liquidity of the DPD. This leads the government to contract monetary and fiscal policies again in a vicious circle that can gradually increase the financial fragility of the state. This conflict requires permanently high fiscal surpluses (which is politically costly and economically damaging), privatisations (which are largely exhausted) or, more realistically, the reduction of domestic interest rates. However, lower rates can conflict with the balance of payments constraint because they may trigger capital outflows, or they could reduce the demand for public securities, making it harder to finance the public deficit and potentially lead to the monetisation of the DPD. This would trigger a currency collapse, an inflation bubble, or both. However, since the new policy regime automatically blames excess demand for any increase in the rate of inflation (regardless of the level of capacity utilisation or the unemployment rate), inflation stabilisation will *always* require high interest rates and a high fiscal surplus, perpetuating the limitations of the current policy regime.

The economic limitations outlined above help to explain why the Brazilian trade balance reacted slowly after the currency crisis. The trade balance shifted to a surplus only in 2001 and the current account two years later. Trade surplus-

Table 5. Brazil: Balance of Payments (US$ million)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Goods (FOB)	-6,575	-1,199	-698	2,650	13,121	24,794	33,641	44,703	46,457	40,032	24,836
Exports	51,140	48,011	55,086	58,223	60,362	73,084	96,475	118,308	137,807	160,649	197,942
Imports	-57,714	-49,210	-55,783	-55,572	-47,240	-48,290	-62,835	-73,606	-91,351	-120,617	-173,107
Services and income (net)	-28,299	-25,825	-25,048	-27,503	-23,148	-23,483	-25,198	-34,276	-37,120	-42,510	-57,252
Current unilateral transfers	1,458	1,689	1,521	1,638	2,390	2,867	3,236	3,558	4,306	4,029	4,224
CURRENT ACCOUNT	-33,416	-25,335	-24,225	-23,215	-7,637	4,177	11,679	13,985	13,643	1,551	-28,192
CAPITAL AND FINANCIAL ACCOUNT	29,702	17,319	19,326	27,052	8,004	5,111	-7,523	-9,464	16,299	89,086	29,352
Capital account	320	338	273	-36	433	498	372	663	869	756	1,055
Financial account	29,381	16,981	19,053	27,088	7,571	4,613	-7,895	-10,127	15,430	88,330	28,297
Direct investment	26,002	26,888	30,498	24,715	14,108	9,894	8,339	12,550	-9,380	27,518	24,601
Portfolio investments	18,125	3,802	6,955	77	-5,119	5,308	-4,750	4,885	9,081	48,390	1,133
Financial derivatives	-460	-88	-197	-471	-356	-151	-677	-40	41	-710	-312
Other investments	-14,285	-13,620	-18,202	2,767	-1,062	-10,438	-10,806	-27,521	15,688	13,131	2,875
ERRORS AND OMISSIONS	-4,256	194	2,637	-531	-66	-793	-1,912	-201	628	-3,152	1,809
OVERALL BALANCE	-7,970	-7,822	-2,262	3,307	302	8,496	2,244	4,319	30,569	87,484	2,969

Source: Central Bank of Brazil, www.bcb.gov.br es have proven to be sustained (see Table 5). In particular, expansion of Brazilian exports has brought much-needed relief to the balance of payments. However, this has been due largely to favourable market conditions for some of the country's main commodity exports and the excellent performance of the agribusiness sector. This, and the slower growth of manufacturing output and processed exports, has led to the re-primarisation of the Brazilian economy, which is not easily compatible with the creation of quality employment and the improvement of social welfare in a Latin American economy.

Conclusion: The Limitations of New Liberalism

New liberalism includes a hegemonic political settlement (procedural democracy) and a hegemonic set of economic policies and relations (neoliberalism). New liberalism has become the mode of existence of capitalism in Brazil—a system of accumulation—with a specific material basis corresponding to a particular social structure and relationships among domestic capital, foreign capital, and the state.

New liberalism has transferred state capacity to allocate resources intertemporally (the balance between investment and consumption), intersectorally (distribution of investment, employment, and output), and internationally to an increasingly integrated and US-led financial sector. The policy reforms have dismantled the production systems established during ISI and the social structures and patterns of employment that corresponded to them. They have led to the privatisation of the most productive and financial SOEs, and promoted the alliance between foreign and domestic capital at the firm level and the denationalisation of industry and infrastructure. The transnationalisation of production and finance ('globalisation') was, to a large extent, a process of international integration at the firm level that restructured the 'national' system of production at a higher level of productivity and integrated the local elite internationally. The economy has become structurally more dependent on foreign trade, investment, and technology. Brazil's productive base has shifted away from the long-term requirements of national accumulation and towards the short-term imperatives of global accumulation instead.

The Brazilian state has become profoundly depleted in the areas of economic planning, control, and policy implementation. In contrast, state capacity in monetary policy implementation, financial sector regulation, and security has been extended significantly. The financial reforms have embedded private sector interests into the policy-making process through the decisive role of finance in the pricing of government securities, determination of interest rates, and financing of the public sector. The reforms also increased the role of the private financial institutions in the foreign exchange market and, therefore, in the country's relations with the rest of the world.

The neoliberal transition has contributed to the disorganisation of the workforce and to a significant shift in power away from the majority regardless—and, to some extent, because—of the stabilisation of political democracy. Rather than relying on military force, the new liberal consensus has disciplined the working class through contractionary fiscal and monetary policies, higher unemployment and labour turnover, personal debt, and the continuing threat of inflationary or balance of payments crises should the distributive conflicts get out of hand.

At the political level, democracy has become established as the political form of neoliberalism in Brazil. In that country, the neoliberal transition and the democratic transition were mutually reinforcing and, eventually, mutually constituting. They were associated with a shift in the mechanisms of social domination towards a combination of democracy and neoliberalism, which contributed to social fragmentation and the dismantling of the resistance movements which had emerged during the dictatorship. The symbiosis between neoliberalism and procedural democracy operates at three levels. First, the neoliberal economic transition was achieved through, and validated by, democratic means. Second, neoliberal policies support the democratic regime because they fragment the workers through higher unemployment, faster labour turnover, the repression of trade union activities, and the rise of economic insecurity. Under neoliberalism, the repression of working class activities becomes primarily 'economic' rather than 'political', as was the case under the dictatorship. Third, democracy is the best political regime for neoliberalism because it guarantees the stability and predictability of the 'rules of the game', making it more easily managed by the moneyed interests.

In spite of these successes, the new liberal system of accumulation is limited, and the state is less capable of addressing the problems of industrial co-ordination and growth than at any time since 1929. The combination between the unresolved weaknesses of ISI and the flaws of neoliberalism has entrenched economic stagnation and reduced the scope for the implementation of distributive economic and social policies in the country beyond the limited achievements of the social programmes of the Cardoso and Lula administrations (Marques et al., 2009; Paes de Barros et al., 2007).

From the point of view of the majority, the challenge is not simply to elect governments that are programmematically committed to searching for an alternative economic model. After several victories which eventually proved to be largely hollow, it must be admitted that attempts to 'vote away' the neoliberal reforms are bound to fail, for these reforms are not limited to ideology or policy choice. They have acquired a material basis in the transformations that they have wrought onto the economic fabric of Brazil. Transcending neoliberalism will require economic and political changes that can be carried out only through the construction of an alternative system of accumulation. This project will require a systematic dismantling of the material basis of neoliberalism initially through a set of pro-poor and democratic economic policy initiatives, which will support a shift to a model of development that can generate more equal distributions of income, wealth, and power, and higher levels of material welfare (Saad-Filho, 2007). This is the fundamental condition for democracy.

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