

MACROECONOMIC POLICY AND REAL GLOBALISATION MAINLY IN THE LAST QUARTER OF THE 20TH CENTURY*

Joanílio Rodolpho Teixeira*

Department of Economics

University of Brasilia (UnB)

Rodolfo Marcílio Teixeira

Department of Sociology

University of Brasilia (UnB)

ABSTRACT

It is not unfair to say that economic liberalism in its most perverse form – the Washington Consensus – captured the imagination of policy makers in Latin America from the late 80's to the end of the century. Economists and politicians became renowned in their celebration of the market mechanism as the mirror of new modernity. In this context, growth, distribution and social justice were not the real target of economic policy, although essential components of the political speech. Our study, based on the post-Keynesian tradition, points out the main problems associated with macroeconomic policy and globalisation, generating additional valuable insights for those concerned with resource creation and equity in Brazil and other developing countries.

Key words: Liberalisation; Globalisation; Washington Consensus; Brazil; Crises

JEL Classification: E 12, F 02, O 11, P 17.

RESUMO

Não é injusto dizer que o liberalismo econômico em sua forma mais perversa capturou a imaginação dos 'policy makers' na América Latina do final da década de 1980 até o término do século. Economistas e políticos tornaram-se renomados em sua celebração dos mecanismos de mercado como um espelho da nova modernidade. Neste contexto, crescimento, distribuição e justiça social não eram os verdadeiros alvos da política econômica, embora fossem componentes essenciais do discurso político. Nosso estudo, baseado na tradição pós-Keynesiana, aponta para os principais problemas associados à política macroeconômica e a globalização, gerando valiosas considerações para aqueles preocupados com a criação de recursos e a equidade no Brasil e outros países em desenvolvimento.

Palavras-chave: Liberalização; Globalização; Consenso de Washington; Brasil; Crises

Classificação JEL: E 12, F 02, O 11, P 17.

* Direct all correspondence to the first author and he thanks CNPq for support. E-mail: joanilioteixeira@hotmail.com. The second author would like to thank CAPES for support. E-mail: rodolfoteixeira@yahoo.com.br.

I. INTRODUCTION

It is a commonplace to refer to Brazil as a country involved in seemingly diverse phenomena: high and sustained structural inflation, dismal income distribution, unbalanced growth, institutional violence, poor environmental concern, rent-seeking speculation, wasted natural resources. These are old and well established characteristics of this gigantic nation, full of colour, of high expectations in the 50's, fragile economic miracle in the 60's and early 70's, also an amazing paradox in the last quarter of the century.

The autarchic tradition of this economy, its regional disparities, unequal sharing of growth outcome are well reported in current literature, as well as its recent relative success to curb inflation. It is also well praised its conquest of political democratization without passing for the painful process of institutional extremisms many others Latin Americans had to face during a long period of authoritarian regimes.

Concerning the stabilisation of its finances, however, the price to pay may seem considerable in terms of quasi-economic stagnation, unemployment and human suffering. The nation must tackle many issues such as disguised unemployment, poverty, land reform, increasing violence, informal market, distributive justice and equity, duality between a fairly developed nucleus of production and a backward bureaucracy.

Some would mention Brazil as a country where macroeconomic policies often jump to near extremes. It is easy to identify periods in which the country wanted to fully integrate itself into the international market, counterbalanced by frequent calls for self-sufficiency and the need to strengthen the State control of important sectors of the economy. Most actions taken both by democratic and dictatorial governments, in the last half century, have rarely been internally consistent with economic development in the sense of tackling, simultaneously, the targets of sustainable growth, fair income (and wealth) distribution, as well as stability. Our socio-economic policies tend to work like a frictional pendulum dominated by confronting experiments and obstacles – the conflict between the need to change and the powerful opposition of those privileged by the current state of affairs.

The country has experienced peculiar waves of optimism and pessimism, often wishing to create a new national identity and rejecting the notion that it should simply imitate the pattern and behaviour of advanced economies. Many of the mistakes perpetrated

by policy makers stem from a belief in the power of simplistic theories, and we should be aware of lessons to be learned from them.

By the end of the century the nation became conscious that the forces of globalisation would relentlessly involve our economy and institutions more and more deeply in the hands of international finance. The process of economic liberalisation had an adverse impact on output (hence employment), since the experiment was driven by organisations without much care for our peculiarities. Needless to say, ordinary people were suspicious that this quick integration in the world of high finances would involve dangerous swings backs and great leap forward, without new institutions to regulate their activities (regulation and monitoring). We are not a small open economy of the text-books. The role of both State and market needs to be carefully defined.

To the architects of liberalisation some of our weaknesses are too obvious: the nation's fiscal federalism stimulates conflicting rather than co-operative behaviour, none economic policy fits well all the states and regions; we have enormous regional disparities, excessive market rigidities and over-zealous bureaucracy. They simply reiterate their faith that we need to follow the path of orthodox stabilisation and structural adjustments. This would be the way to reconciling "internal balance" with "external balance". Naturally, these are simplistic beliefs.

Actually there is no single solution to the many obstacles. Neither a unique cause to blame, but a set of complex historical circumstances leading to almost inevitable mistakes in macroeconomic policies. We have seen a number of profound failures of neo-liberal extremisms in many developing countries. It is sage to question frequent recommendations of international and domestic experts on liberalisation. Perhaps we should add that international finances tend to show a double standard when dealing with an industrial country and an emerging economy,¹ as pointed out by Krugman (1997).

It seems naive to let the market to manage, without controls, our economies and institutions. The reason seems to be straightforward: i) one has to be rather careful in making simple comparison between success and failure in development strategies

¹ For example, in post-Maastrich Europe, public companies that are independent of their treasures are not included in the calculations of the public-sector deficit (or surplus). However, just the contrary occurs in South America where, after IMF guidance, state companies that are independent of their treasuries are included in the calculation of public accounts. It would seem that the Fund adopts two different economic theories: one for north of equator and another for south.

generally; ii) it is necessary to understand the complex institutional conditions of many countries. Both involve subtleties that a number of researchers have missed.

To avoid misunderstanding, we should stress that most Brazilians subscribe the view that the State needs to play a major role in economic and financial decisions. They tend to hope that governments' actions can protect the country against the uncertainties and pervasive nature of irresponsible globalisation. On the other hand this belief is somewhat idiosyncratic, since our governments are often blamed for the poor outcomes of their economic and social policies. Brazil has been involved in insensitive forms of financial manipulation, making possible unheard-of profits and interest rate for both domestic and foreign speculators. Furthermore, money switches quickly from a once highly value sector to another, in the same way as it moves from country to country, despite of the attempts to bring up a "favourable climate" for investors.

Some would try to make a clear distinction between capital investments and the speculative ones. It happens that in this period of fierce globalisation and the prevalence of the Washington consensus, the extreme form of liberalisation, international finance follows two paths that often cross each other. One is that of multinational corporations engaged in acquiring and creating enterprises, extending their influence but rarely expanding employment. The other path is that of international funds channelled to emerging economies in search of fast and high returns, without any concern for the recipient's stability.

In virtually all major industrial nations, a major component of wealth and income inequality is the prevailing increase of revenue at the top of the income pyramid. This is mainly due to financial innovations, scarcely connected with the economic performance of the real economy. The group of riches and super-riches, both absolutely and proportionally, has expanded considerably their share in income and wealth.

The same happened in Brazil, despite the near stagnation in income per capita in the 80's and 90's. The personal and functional income distribution ranked the country among the most unfair in the world. The significant diffusion of labour-saving technologies, the unprecedented scale and speed of structural changes, the need to re-allocate workers in lower wage activities changed the fates of many, unable to protect themselves. Employment in dynamic and well paid sectors declined and the social burden of daily existence has been

a continuous trial for too many families, where economic decisions tended to “dissoudre dans la mondialisation”.

The liberal economic policies imposed to the Brazilian authorities (and people) – the Washington consensus – omitted some perplexing components of our fragile socio-economic reality, but enriched the portfolio of a social strata whose profile is easy to identify. To the groups of profiteers, the globalisation is a true miracle to be worshiped. To the others, unprivileged, it is a purgative – short-tempered machinery, alien to boundaries and basic needs. More than anything else, some would argue, governments in developing countries are not, anymore, the main responsible for real decisions on macroeconomic policies.

The above interpretation of the outcomes of globalisation is perhaps too critical and, certainly, it does not fit into any of the Procrustean bed of the prevailing orthodoxy. Despite difference in emphasis, it seems to be fair to say that economic neo-liberalism is mainly concerned with the motivations of an “assemblée de copropriétaires”, celebrating the market mechanism as the mirror of modernity. We should highlight some advantages of fair competition as well as the grave danger of unquestioning reliance on market forces. Naturally, Brazil needs a modern structure, capable to adapt to changes in social aims, in technology and fair integration into the global economic system. This requires a flexible structure, where both the forces of the market and the State play an acceptable role. As pointed out by Bhaduri & Nayyar (1996:14):

“there is no historical case of successful late industrialization, either in the nineteenth or in the twentieth century, which did not depend upon State support in the form of promotion or protection of domestic industry”.

We add that, since market forces are concerned with economic results, the State is, or should be, the main responsible, in breadth and depth, for equity and social justice.

Very sensitive individuals may argue in favour of being somewhat more cynical or even sceptical about this kind of co-operation, given the declining tendency of the State to influence real affairs. They would mention that it would broaden our horizons to understand that equity and justice are only rhetorical elements in the world of globalisation. Actually, monetary policy, banking control, labour relations, industrial organization, deregulation, privatisation, and many other jargons, only emerges, domestically, as some part of an

illusion. The core of macroeconomic policy is defined abroad, they would point out. This critique, we argue, goes too far.

In this paper we are mainly concerned with some problems of the globalisation in Brazil, especially those associated to internal and external imbalances, structural change and macroeconomic policy in the last quarter of the 20th Century. The core of our approach is the essential difference between resource utilisation and resource creation. It is the desire to accumulate, in the sense of creating resources, and the ability to finance accumulation that is central to the behaviour of a capitalist economy. Unfortunately, the level of abstraction adopted here precludes such detailed analysis. On the other hand we emphasize the “inner connections” amongst the social classes and some of the mechanisms of the economic dynamics which act through the factors affecting the global process of economic development.

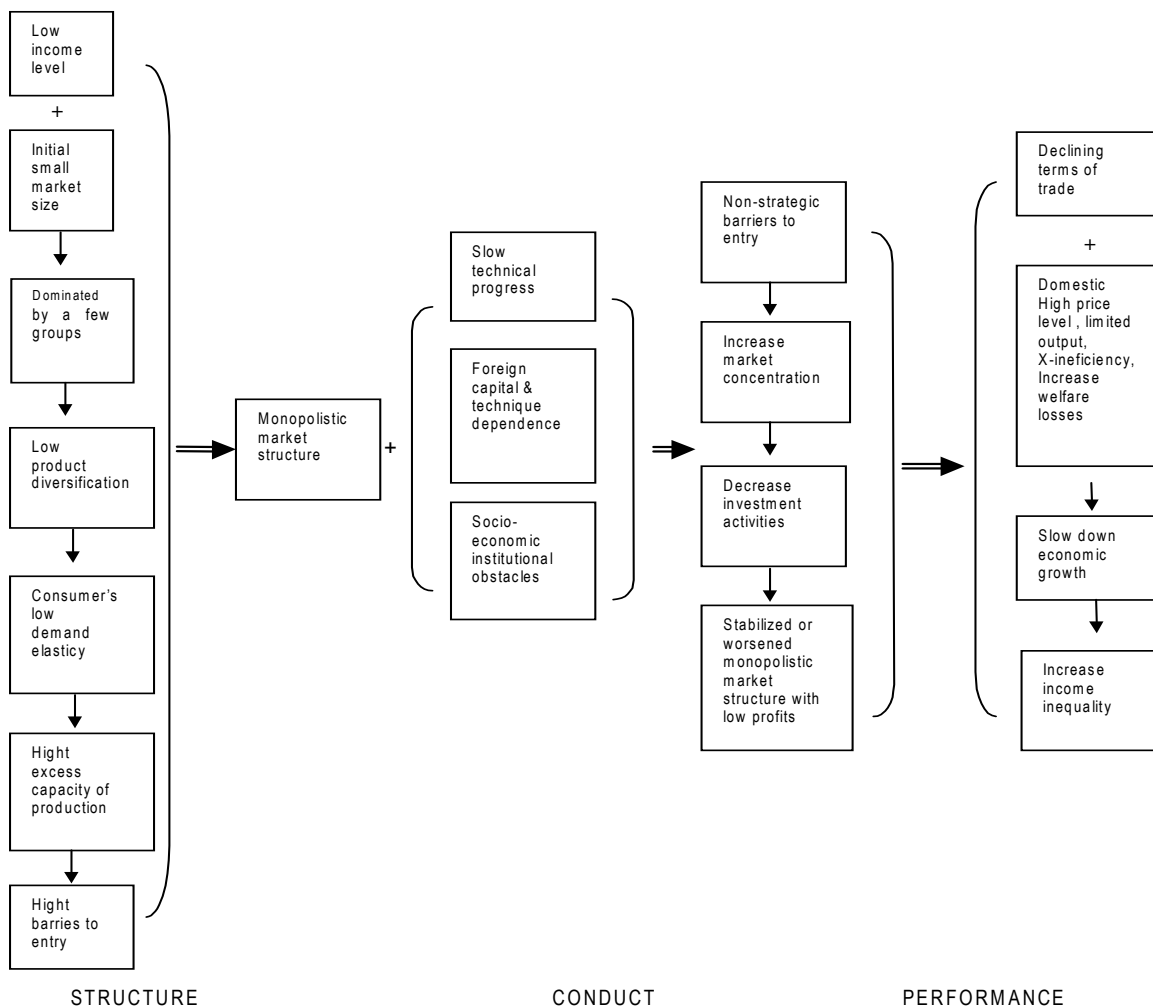
After this introduction, in section II we give an overview of the main issues. Section III deals mainly with the last quarter of century performance of the Brazilian economy, the scenery of instability and the country’s diving into the quicksand of the Washington consensus. Section IV concludes. Among other things we point out that a fair macroeconomic policy to attain sustainable economic development should be concerned with structural change and economic dynamics according to post-Keynesian lines. We hope some of these issues may also help to understand part of the drama in many other countries.

II. DEVELOPMENT IN DEPENDENT ECONOMY

As a historical and social concept, development is, by nature, an open-ended, disequilibrium path. Backwardness is a notion difficult to express but easy to recognise. Development does not yield itself to be encapsulated in simple formulas due to its multidimensionality and complexity. Despite this, here we present a framework of analysis which, we hope, may accommodate interesting insights.

The Brazilian economy of the 50’s can be characterized in terms of its market structure, agents conduct and actual performance typical of a dependent less developed country. According to the dominant view of that time, its structural setting had the features indicated in figure 1, whose content is self-explanatory.

Fig. 1. Market structure, Conduct and Performance in the Dependent LDCs.

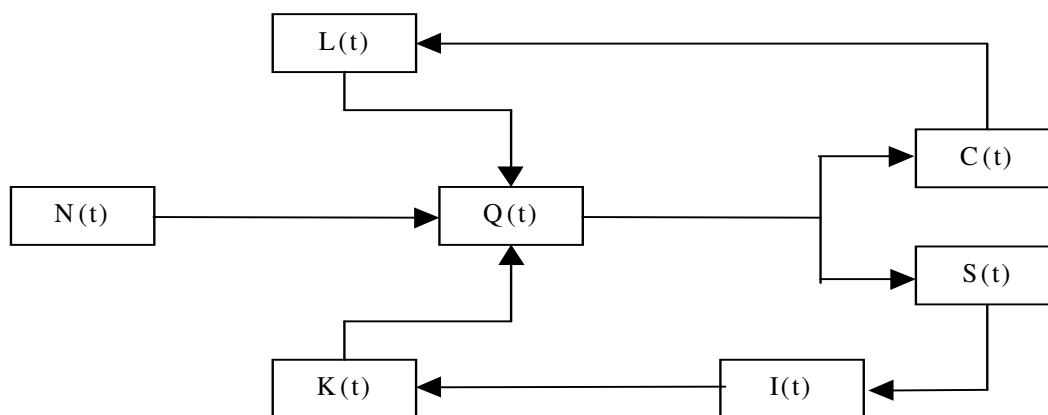


Some would add that Brazil was immersed in the “vicious circle of poverty”: a low income per capita (Y/P) implies a low saving per capita (S/P), leading to a low investment per capita (I/P), and a reduced capital per capita (K/P), implying in the recurrent trap of low income per capita. Others would substitute workers for population in the denominators, but this would not change our fate of a mere developing country.

To change our circumstance it would become necessary to create a “promising circle of accumulation”. The naive view of the growth process in a closed economy where government plays a minor role is underlined in figure 2. Given the stocks of natural resources (N), labour (L) and capital (K), as well as the flows of output (Q), consumption

(C), savings (S) and investment (I), the dynamics of the one sector (aggregated) model has the following basic structure:

Fig. 2. Scheme of the Growth Process



A simple interpretation of such scheme indicates that given the inputs N, L and K, a production function, $Q(t) = f[N(t), L(t), K(t)]$, would provide the links between resources and output. Needless to say that $Q(t) = C(t) + S(t)$ and $K(t+1) = K(t) + I(t)$, neglecting depreciation.

Notice that the scheme above does not involve finance and it is mainly concerned with production and expenditure. It suggests, somewhat, that a monetary economy can be analysed as it were a barter economy. Another interpretation would indicate that money is neutral. This version does not highlights the all-pervasive nature of the latter. Post-Keynesians would argue that in a credit economy the money supply is endogenous. It is seem to accommodate itself to the needs of trade, so that there is a reversal of direction of causality between money and expenditure as well as between saving and investment. Furthermore, the figure 2 does not contain any reference to classes distinctions and income (or wealth) distribution.

An orthodox neo-classical interpretation of the scheme assumes the primary resource, the technological transformation possibilities, and the preference structure to be given. The substitution principle is supposed to operate in both commodity and factors markets. Consumers maximise utility, given the set of possibilities, commodities prices and the budget constraints. On the other hand producers maximise profits, given the

transformation possibilities and prices. Assuming perfect competition, well behaved demand and supply relations, price flexibility and given the substitution principle, the system would fully utilize resources in equilibrium. The mechanisms underlying such scheme tends to convert the economic system into a generally interdependent one, and reinforce the role of the rate of interest as equilibrating savings to investment.

According to this set up the economy faces no serious adjustment problems or obstacles in the process of economic growth, provided that a flexible price mechanism is operating. This is an approach that attempts to derive economic outcomes in a decentralised institutional framework. The behaviour of the agents are perceived, essentially, in subjective terms and, as pointed out by Bharadwaj (1983:13): “The microeconomics is left without any macro foundation”.

It is interesting to notice that a number of economists, and even politicians, have the illusion that such scheme applies to both advanced capitalist economies and underdeveloped ones. Actually, this approach does not provide a reasonable explanation for most of the Third World’s chronic condition of quasi-stagnation, without any marked tendency toward sustained growth. Furthermore, this framework deals with production and exchange among economic agents relative to the growth in population over time. Needless to say that we need to differentiate growth from development. The latter is more complex, being growth (accumulation) only one of the components of the process of economic development, the two others (at least) are distribution of income (or wealth) and stability.

We suppose that few economists would dispute the fact that political economy, as a discipline, is basically concerned with two problems which can be conveniently identified as resource utilisation and resource creation. The first problem deals with the explanation of the somewhat mysterious degree of coherence one may, in normal periods, observe to emerge out of the “anarchic” organisation of a decentralised market economy. The other, resource creation, explains how decisions to use resources, to expand investment (accumulation), affects the performance of the economic system in historical rather than logical time.

Resource utilisation assumes in the neo-classical paradigm the dominance of a market clearing process involving either full employment or a natural rate of unemployment, as well as steady state growth. These outcomes require sustained stability

in investment and “happy” financial markets. The focus of such analysis is the concern with the promotion of market competition. Neo-classical economists are supposed to believe that such mechanism will lead to a position of growth, stable equilibrium and maximal utilisation of the disposable resources. Accordingly, resource creation is only the dual result of another set of markets clearing. This standpoint tends to ignore the special problems posed by the necessary transformation of demand for future resources into demand for resources now.

This theoretical environment may lead to tragic outcomes when applied to the analysis of development economics. Neo-classical apparatus is mainly concerned with resource utilisation but the real problem of a developing country is to deal with resource creation, i. e., how to expand investment (thus, accumulation, growth and employment) and how this process is financed. It is important to emphasise that in the process of development, activities such as governmental policies, international finance and foreign trade have to be involved. The existence of a happy combination of these components may well be a necessary but not a sufficient condition to accelerate the rate of economic growth and economic development.

Thirlwall (1994) argues that the effective constraint to long-term steady growth, at a high rate, is the long-run rate of growth of exports, combined with the long-run elasticity of demand for imports in relation to the national income (output). For instance, if such elasticity is 2, a rate of growth of the output equal to 5% implies an expansion of imports of 10%. The complete model takes into account, among other things, the possibility of capital movements to finance possible deficits in current account.

Without going to details of his model, it is important to indicate his main conclusion: in the long-run, the accumulation of deficits in current account expands the debt burden of any country. Therefore it increases the need to pay the debt services, royalties, dividends, etc, thus requiring the creation of an expansionary trade superavit through time.

That is, having accumulated a sustainable debt burden, the economy needs to satisfy an equilibrium condition given by the formula $\Delta GDP \times \varepsilon_m = \frac{\Delta x}{x}$, where on the left we have

the expansion of the output multiplied by the elasticity of imports; on the right hand we have the growth rate of exports.

As we have mentioned before, there is another important missing component in figure 2, the income and wealth distribution, and this is a point that we would like to tackle now. According to an old fashioned interpretation, the central problem of the Brazilian economy was not the stock of natural resources and labour constraint, but the lack of capital. The process of accumulation would require reducing consumption, to increase savings and to accelerate investments, especially in infra-structure.

Ignoring depreciation, assuming that savings are equal to investment, neglecting some Keynesian difficulties and still adopting the framework of a closed economy, the main target of the economic policy may require reducing labour share in national income to provide, via redistribution, the necessary resources to capitalists and to the government. The “rationale” of this approach seems to be straightforward: the propensity to save of the workers is smaller than that of the capitalists and government. Let us concentrate our attention, first, to the case of an economy in which we have two classes and the government plays a minor role in the production process.

According to a distorted theoretical vision of the Post-Keynesian approach, it would be necessary to combine Kaldor’s (1955-56) analysis of growth and income distribution with the simplest version of Harrod-Domar model to determine the “leitmotive” of the economic policy, based on the income concentration².

Income (Y) is divided into wages (W) and profits (Π). Investment (I) is inscribed as equal savings (S), being savings propensities for capitalists (s_c), and workers (s_w) constrained by $1 > s_c > s_w > 0$. Simple algebraic manipulation shows that:

$$I = S = s_c \Pi + s_w W = s_c \Pi + s_w (Y - \Pi) = (s_c - s_w) \Pi + s_w Y$$

$$\therefore \frac{\Pi}{Y} = \left(\frac{1}{s_c - s_w} \right) \left(\frac{I}{Y} \right) - \frac{s_w}{s_c - s_w} \quad (\text{Kaldorian model}).$$

Treating the ratio of investment to output as independent variable, invariant with respect to changes in the two savings propensities, the expression above can be restated as:

² Kaldor deals with the long-run result and full employment. Harrod-Domar’s model is more nearly the requirements for continued growth at full employment that is so alien to developing countries.

$$s = i = (s_c - s_w) \left(\frac{\Pi}{Y} \right) + s_w$$

where i is the participation of investment in national income (I/Y) and s is the average saving ratio (S/Y).

Assuming that there is a given technique represented by a constant (maximum) technical output-capital ratio $\left(\sigma = \frac{Y}{K} \right)$, the Keynesian condition ($S=I$) implies:

$$\theta = \frac{I}{K} = \frac{S}{K} = \frac{sY}{K} = s\sigma \quad (\text{Harrod - Domar model}).$$

Connecting the two models we obtain:

$$\theta = \sigma \left[s_w + (s_c - s_w) \frac{\Pi}{Y} \right]$$

This formula, linking growth to distribution, leads to a straightforward conclusion: ceteris paribus, $\frac{\partial \theta}{\partial (\Pi/Y)} = \sigma(s_c - s_w) > 0$ and $\frac{\partial \theta}{\partial (W/Y)} = -\sigma(s_c - s_w) < 0$, since

$$\frac{\Pi}{Y} + \frac{W}{Y} = 1.$$

This means that there is a trade-off between growth and distribution. Such conflict extends to the Pasinetti's (1962) approach, in which i) workers earnings comprise wages (W) and profits (Π_w); ii) capitalists earn only profits (Π_c), where $\Pi_c + \Pi_w = \Pi$; and iii) worker's savings out of their total income $\left[s_w(W + \Pi_w) \right]$ is a constant fraction. Thus:

$\theta = \sigma(s_w y_w + s_c y_c)$, where $y_c = \frac{\Pi_c}{Y}$ and $y_w = \frac{W + \Pi_w}{Y}$. As $y_c = 1 - y_w$ and $s_c > s_w$, then

$$\frac{\partial \theta}{\partial y_w} < 0 \quad \text{and} \quad \frac{\partial \theta}{\partial y_c} > 0.$$

This shows the conflict between growth and income distribution in a closed economy, without significant governmental participation in the production process. Of course, this approach only deals with inequality between social classes. It is not concerned with both size distribution (personal) and the distribution inside each class, but with the functional income distribution as a block.

The formulation above involves considerable misunderstanding and misinterpretation of Post-Keynesian economics. Within this framework, it is not surprising that growth and distribution involve some trade-off but this issue deserves a close theoretical attention. Araujo and Teixeira (1996) show that the trade-off above can be suppressed when tax policy is allowed to change. However, this result is obtained under the assumption of full-capacity utilisation, in contrast to the so-called neo-Steindlian or stagnationist literature.

Nobody disputes that effective implementation of policies is as important as the choice of strategic policies. However, in few of the developing countries such a programme could be fairly implemented by the government without foreign acceptance. Furthermore, in a capitalist economy the forcing and allocation of the surplus involves the financing of business, government and some aspects of household spending. Therefore, any serious consideration of the resource creation process needs to examine how banking and finance do in fact operate.

Needless to say that any analysis that emphasises resource creation has to focus on investment. Actually, it is impossible to consider effective demand in capitalist societies without examining demand for investment, i. e., how demand becomes effective and the way investment is financed. Being this the case, if aggregate income and output are growing, investment demand in the aggregate requires external financing. As pointed out by Minsky (1983:47):

“An implication of this requirement is that under modern conditions money, as the liability of the banking or financing systems, is a product of the investment process. It is not possible to analyse the determinants of effective demand without considering the behaviour of those institutions in an economy that select and finance investment, and in the process that determines the price level of existing capital assets”.

His concern with endogenous forces, inherent to the functioning of capitalism, is well established. For him instability is a consequence of the financial process.

III. PERFORMANCE OF THE BRAZILIAN ECONOMY

The market structure, socio-economic performance and governmental conduct of Brazil in the second half of the XX century is marked by a strong drive toward industrialization. This was a period of great success compared with the experience of many other dependent economies.

The combination of a strong public sector and incentive to private enterprises generated dramatic changes in output per capita and high levels of employment. However, this success obscures the use of perverse mechanisms, including income concentration to sustain the industrialization process. That was a period of disregard with respect to financial stability and being a capital-receiving country the Brazilian process of imported substitution was somewhat conditioned, but not determined, by its position in global finance. It is a period of increasing external debt, despite the high saving rates of the private and public sector.

Since the workers' rate of saving was less than the capitalists' propensity to save (as well as to the government saving rate), an important instrument of macroeconomic policy was to reduce the workers' share in national income. This process fitted well the ideological motivation of the authoritarian regime that took power in 1964. The period of 1968 to early 1974 was showing an "economic miracle", since the economy was growing at an average rate above 10%. The naive expectation was that by the end of the century Brazil would be a member of the group of rich countries.

However this miracle did not last long. It became increasingly difficult to attain compatibility between internal equilibrium (full employment and price stability) with external equilibrium (sustained current account). The deep petrol crises of the 70's and the debt crisis of 1978 only accelerated the implicit contradictions of the prevailing strategy of "growing the cake and postponing the distribution". The decade of 1980 is characterised by a decrease of the domestic saving, the increase of the deficit in current account and the expansion of public deficit. Particularly relevant was the fact that it was upon the public sector that felt the burden of the domestic adjustment. In the last two decades of the 20th Century the Brazilian economy was not able to sustain a fair growth rate and has faced

increasing internal and external constraints, hindering the capital formation, reducing the rate of growth and increasing the level of unemployment.

It is impossible to consider the performance of the Brazilian economy without mentioning inflation and financial intermediation. For a proper treatment of monetary policy we must, perhaps, address to a very wide range of variables that might be crucially important for analytical purpose. We should recognise, according to Johnston (1985:812):

“all the monetary aggregates; interest rates; the exchange rate, the external account; the current performance and outlook for the economy, including movements in asset prices, inflation, and the outlook for inflation and expectations for inflation”.

It suffices to the purpose of this paper to stress that inflationary expectations, once raised, might prove hard to reduce, despite frequent announcements of new fiscal and monetary measures. The early 70's, in Brazil, was a period of high activity (rate of economic growth) and inflation positive but moderate. However, for many reasons, expectations of future growth in price had been formed. With the dawning of the 70's and the start of a rapid acceleration of inflation, the standard set of tools available to the policy makers did not produce the desirable outcome. The response to such instability of prices was to experiment with different measures, including non-orthodox, and the wage-setting process became much regulated over time. It happens that the Brazilians learned very quickly how to deal with financial intermediation and their expectations did not respond to announcements of the anti-inflation targets. The result was higher inflation, with the exception of short periods of adaptation to new environments.

The 1980's was a period of sustained and higher inflation rates, too low economic growth and a financial structure where the credit-market conditions played a central role in the propagation of cyclical fluctuations. In general, the persistency of high inflation, rather than the occurrence of high-inflation episodes or hyperinflation, contributes to the difficult in designing and implementing macroeconomic stabilisation programmes. One aspect of the problem is concerned with foreign or domestic currency substitution, since traditional hyperinflation posit that, as the opportunity cost of holding currency increases with inflation, high-inflation episodes coincide with the progressive abandonment of currency in transactions.

In the Brazilian case, however, a high degree of substitutability between liquid monetary assets (currency) and liquid interest-bearing assets in periods of high inflation was such that the latter became, progressively, almost as liquid as standard checkable current accounts. This type of almost perfect cross-asset substitution may then explain why foreign currency substitution and capital flight were negligible in Brazil in periods of high inflation. Instead of foreign currency substitution, financial innovation (cross-asset mobility combined with widespread indexation) prompted a process of domestic currency substitution, by which the demand for money can be shown to be dynamically stable in Brazil, in so far as the share of national wealth held in non-interest-bearing assets hardly changed over time, despite persistent high inflation.

A second aspect of financial innovation in the presence of persistent high inflation is the widespread use of sophisticated formal and informal backward-looking indexation mechanisms to protect financial assets and personal wealth from inflation-related uninsurable risks. As a result of widespread indexation, current and future inflation depend on its past levels, which increase inflationary inertia. Inertial inflation in Brazil was then more likely to come from widespread indexation and not foreign currency substitution (via dollarisation), as in other Latin American countries experiencing high-inflation episodes.

In addition to persistent high inflation, the Brazilian economy was characterised by the absence of a nominal anchor, such as the exchange rate, wages or the money supply to stabilise the underlying price-wage dynamics. The option between either the exchange rate or the money supply to anchor nominal prices depends on the stability of the demand for money, given financial innovation and indexation mechanisms. On the other hand, it also depends on the degree of openness of the economy and the relative importance of indexation in wage contracts based on consumer price inflation and exchange rate movements.

In broad terms, the Brazilian experience with macroeconomic stabilisation programmes can be characterised as follows. During the 1960s, Brazil tried to curb inflation by controlling real wages and implementing formal indexation rules in all markets. In the 1970s, the country experienced massive public investment, as a continuation of the import-substitution process of the previous decade, which created a steady demand injection based on foreign debt-led growth. After the second oil shock and the interest rate

increases on foreign debt in the late 1970s, inflation was hardly manageable. Maxi-devaluations were followed by crawling peg slowdowns which predictably appreciated the official exchange rate. The country went into a recession between 1981 and 1983 and, by 1986, orthodoxy was formally abandoned.

After a period of indecision, the government opted for the non-orthodox strategy in the Cruzado Plan of 1986, freezing prices and wages, and introducing a new currency (Cruzado) after devaluating the official exchange rate. As there was no support for the exchange rate anchor on the fiscal and monetary sides, the first Brazilian heterodox stabilisation attempt soon needed repairs. Three other plans were introduced thereafter (Bresser, 1987; Summer, 1989; and Collor, 1990), but the lack of political support to implement the necessary austerity in the government accounts determined the failure of each one of them. Exchange rate-based anchors were used in the 1980s to tackle inflation unsuccessfully due to lack of fiscal and monetary discipline.

The economic indicators of the 1980s and early 1990s showed sharp increases in insolvencies and bankruptcies, rising real debt burdens, bank failures, financial imbalances among the states of the union and a reduction both in the rates of savings and investments – an outcome that could not continue without limit. As a result, advocacy of a role for liberalization fell for the most part among academic mainstream, financial-market practitioners and a number of politicians, not to mention the voices of the Washington consensus. It is not unfair to say that this extreme form of economic liberalism captured the imagination of policy makers in Latin America as well.

Along with the international Monetary Fund, the World Bank and the USA Treasury became strong advocates of outward orientation. The central notion of such vision was that a return of confidence, in the market. Emphasis was placed on elimination of price distortions, recognition of the power of competitive advantage, privatisation of public enterprises, encouragement of private foreign investment, maintenance of price level and balance of payments stability, international competitiveness, and the target of minimum government.

In conformity with the “orthodox wisdom” of the IFM and the World Bank, the Brazilian government set in motion a process of macro-economic stabilization combined

with fiscal adjustment and structural reform. As pointed out by Bhaduri & Nayyar (1996:31):

“The principal instruments for achieving IMF-style stabilization are fiscal policy of the government (taxation and expenditure in the budget) and the monetary policy of the central bank (interest rates and credit controls).”

Both instruments are applied as brakes to reduce the purchasing power, especially governmental expenditures, under the presumption that it causes monetary expansion and excessive aggregate demand, thus accelerating inflation. This compression of activities is often combined with devaluation in order to improve the balance of payments. Such package of policies was implemented in the framework of the Real Plan, which was the macroeconomic proposal during the run-up to the election of 1993. During its first length of time in office, the government, surprisingly, did not introduce any radical changes in policy, despite the country’s poor outcome in terms of growth, employment and exposure to international finance.

One problem with this kind of view on stabilization programmes is its short-run theoretical basis. Another is the excessive optimistic scenario implicit in this orthodox perspective. Actually, the inflation rate declined substantially in the country, but the cost of stabilization was high in many spheres and did not prevent the financial crises of 1997 and 1998. A number of troubles enlighten some unpleasant dilemmas. Figure 4 show the Brazilian interpretation of the Washington consensus.

A further problem of this so-called consensus is its unreserved commitment with the issue of efficiency in a very traditional way. Their proponents seemed to believe that questions of efficiency, distribution and equity could be completely separated – *hoc opus hic labor est*. As the current literature shows, changing the distribution of income (or wealth) can affect the efficiency of the economy.

Furthermore, the simplistic view that a country must be single minded concerned with improving its efficiency in production is a very narrow target of economic policy. The socio-economic process is much more complex than a mere preoccupation with increasing productivity and expansion of the income per capita.

To tackle the problem of growth, distribution of income (and wealth) and stability requires institutional reforms, “which go beyond the so-called ‘Washington Consensus’, in

seeking broader goals of development and employing a wide range of instruments in doing so”, as pointed out by Stiglitz (1998:2).³

The followers of such view were essentially committed with bringing down inflation and budget deficits, liberalizing trade, privatizing state-owned enterprises, and “getting the prices right”. Naturally, the opening of markets and broad economic changes brought about by structural reforms and globalization can have powerful effects on social norms. The Washington consensus tend to understand the process of economic development as little more than initially solving a set of difficult technical problems and later removing certain (usually government imposed) barriers. That having been done, they believed, development would simply would come.

Such approach, which emphasizes getting governments out of the way to allow markets to function, is too naive, or ideological, and lacks historical perspective⁴. The Washington consensus emphasizes that there is competition between public and private investment, so that the former “crowds out” the latter. However this theme is rather controversial and we cannot, a priori, discard that public investment is complementary to private investment in so far that, by generating positive externalities, it creates favourable conditions for the latter.

Apart from purely ideological reasons, it is necessary to consider empirical studies on this matter. Actually, as the study of Cruz and Teixeira (1999) shows, the case of the Brazilian economy is very interesting with regard to this dispute. Considering the period 1947 to 1990, they concluded that private investment is indeed crowded out by public investment in the short term. However, in the long-run the cointegration vector coefficients indicate that these two variables complement each other. Some interesting econometric evidence showing the relative importance of public investment are starting to show up in many other countries. Actually, it is difficult to imagine that the development of infrastructure can be attained in lowest-income countries without public investment. The domestic private sector is not strong enough to finance important projects and foreign

³ He also indicates, for instance, that land redistribution “is more than just a matter of economic efficiency, or even equity as measured by a conventional social welfare function. It is part of a broader social and institutional change that is the central component of the second generation of reforms...” (p.10).

⁴ As pointed out by Bruton (1998:926). “The view that an effective market mechanism would appear if governments simply remove itself from the economy was implicit in many formulations even though evidence to support the view was rarely offered”

investors are often scared to respond to some of these opportunities. However, in Latin America there is, to some degree, significant participation of foreign capital, due to historical reasons.

In the same vein the supporters of the Washington consensus tend to see only the positive effects of foreign direct investment (FDI) on the long-run growth rate of the recipient economy. Recent theoretical and empirical research for Brazil lead to the conclusion that, although it can not be affirmed that long term growth rate is not positively affected by FDI, there is some evidence that it only occurs if the recipient country is prepared to receive it. This obviously requires some previous efforts to the recipient economy.⁵ [see Castro and Teixeira (1999)].

In order not to extend this list of criticisms, we add that expansion of investment and of the GNP, as well as improvements in income distribution, only appear at the end (phase II) of fig. 3 [see appendix]. Furthermore, a number of time-series analysis in the period 1947-1995, based on Feldstein-Horioka approach (1980), shows that there is an unidirectional causality from investment to saving in the Brazilian case. Therefore, the main effort of economic policy should be in the direction to accelerate investment. However, the aim is not exactly to attract foreign investors indiscriminately, but to create an internal social and economic environment within which the domestic knowledge-accumulating process would take advantage from the presence of foreign enterprise.

IV. CONCLUSIONS

As already mentioned, the late 80's and early 90's was a period in which Brazil went through a number of unsuccessful stabilisation programmes. In 1994 the government decided to apply a new strategy based on the exchange-rate anchor. The central idea of such approach had two specific features: i) the long-lasting exceptionally high interest rates, and ii) the aim that inflation rates should stood below the rate of increase in exchange rate – the latter is the anchor of the former. These are the essential features of the Real Plan.

⁵ The absorption of FDI with its modern technology requires consideration of some basic historical and sociological conditions, such as values, institutions, entrepreneurship, social incentives, commitment to growth, learning process and other factors that define a society. These characteristics vary extensively among developing countries.

We argue that the Real Plan relied too much in the combination of extremely high rates of interest and an overvalued rate of exchange as nominal anchor to the stabilisation programme. An undesirable outcome of the excessive reliance on an exchange rate anchor, or tight monetary policy when fiscal imbalance are not eliminated in the course of macroeconomic stabilisation, is the likely overvaluation of the domestic currency, which is deemed to have a detrimental impact on the trade balance.

Moreover, fiscal imbalance may impair the sustainability of the exchange rate because excess public spending (and hence domestic absorption) increases the demand for traded goods. An additional undesirable feature of exchange rate-based stabilisation programme is an initial expansion of private consumption, if agents believe the exchange rate regime to be unsustainable in the long-run.

Actually, the profound exchange rate crises of the Brazilian economy in 1998 showed that the proclaimed flexibility and sustainability of the existing policy was a fallacy. Due to the election campaign to re-elect the president, at the end of year, the necessary measures to correct the economic policy were postponed to 1999. Such modification in the exchange regime from almost fixed to a fluctuating one only reinforced the view that the country was using an erroneous policy.

At this point some questions come to the mind of any intelligent person: Why do the administrators of the Washington Consensus deliver the same medicine to each ailing developing country? Is it the case that policies are only introduced if they are in the interests of the domestic oligarchy who will retain wealth and privilege whatever external policies are proposed? Why do orthodox packages of structural adjustment systematically bring about recession, unemployment and further polarization of income and wealth in countries with basically no social safety nets to protect the ordinary people? Why is it that the financial system is so fiercely protected in its speculative operations around the world? Are the conventional policies implemented because it is believed they really overcome crisis in developing countries or they are mainly designed to benefit financial interest in advanced industrial world? Why, in theory, do the financial monarchs support democratic institutions when, in practice, they undermine the democratic process by imposing imprudent policies that hurt the ordinary people and lead to social turmoil and democratic setbacks? Why the adjustment crusade for “internal balance” (fiscal responsibility) and

“external balance”(current account equilibrium) is always pushing for the reduction of real wages? Finally, what should be a fair fiscal stance of developing countries in face of recession or economic downturn?

These are points requiring convincing answers. Unfortunately the proponents of Washington Consensus prefer to go about their business without answering outsiders intrusive questions. The country needs sounder fundamentals of economic and social policy to guarantee the necessary conditions for stability, equilibrium, growth and distribution. The new fundamentals may involve a new set of components: i) adequate real rate of interest; ii) inflation rate similar to the main international partners; iii) stable and sustainable budget adjustment to achieve long-run equilibrium; iv) competitive and predictable exchange rate; v) creation of working posts; vi) improved distribution of income and reduction of public discontentment; and vii) to create safety nets to protect the ordinary people.

The points above raise some important considerations. For instance, what do we mean by competitive exchange rate? What is the real exchange rate in equilibrium? Most economists would say that it is the relative price of tradables and non-tradables. This ratio depends on the nominal exchange rate and of the prices of non-tradable goods and services. Naturally, Brazil does not have control on the prices of tradables and there is a straight relationship between the nominal and the real exchange rate. In the long-run the real rate of exchange is an endogenous variable. It should be compatible with economic equilibrium and sustainable growth.

Needless to say that, in some sense, nowadays we are in a global village. International trade, exchange of ideas and gains from international learning are required. This is part of the process of liberalization and globalization and involves a proper appreciation of the institutional infrastructure, gradual transition to a fair outward orientation, a sensible governmental concern with legal structures that enforce, regulation of some economic and financial activities, and so on.

Policy makers should be concerned with structural change and the economic dynamics of prices, production and employment implied by differentiated rates of sectorial productivity, growth and expansion of demand. Macroeconomic policy should be based on a dynamic perception of international economic benefit according to the principle of

comparative productivity change advantage [Pasinetti (1993)] and not the conventional policy recommendation associated with “factor price equalisation” and the static comparative advantage, praised by the Washington Consensus. Accordingly, as pointed out by Pasinetti (1994:274), “in order to obtain the highest possible gains from international trade, a country should specialise in producing those commodities for which it can achieve, over the relevant period of time, the highest rates of growth and productivity”.

To conclude, it is interesting to note that most prominent economic models, including those associated with orthodox adjustment programmes in Latin America have not brought fairness and income distribution to the centre stage. Contrary to the typical orthodox economic policy packages to promote structural adjustment in the Third World, based on the Washington consensus, we should be concerned not simply with the stability and allocation but rather with the creation and better distribution of resources. We need a broad and flexible framework to take care the peculiarities to the Brazilian economy and institutions. It must be said that many difficulties remain to be solved. Their solutions acquire renewed urgency which certainly will raise deeper questions about the wisdom of further acceptance of the medicine “encouraged” by the Washington Consensus.

REFERENCES

- Araujo, J. & Teixeira, J. (1996). “A Post-Keynesian Model of Growth with Distributional Improvements.” *Socio-economic Planning Sciences*, vol. 30, nº 1, pp. 67-76.
- Bhaduri, A. & Nayyar, D. (1996). “The Intelligent Person’s Guide to Liberalization”. New Delhi: Penguin Books.
- Bharadwaj, K. (1983). “On Effective Demand: Certain Recent Critiques”. In “Distribution, Effective Demand and International Economic Relations”. Edited by J. Kregel. London: The Macmillan Press Ltd, pp. 3-34.
- Bruton, H.(1998). “A Reconsideration of Import Substitution”. *Journal of Economic Literature*, vol. XXXVI, June, pp.903-936.
- Cruz, B. & Teixeira, J. (1999). “The Impact of Public Investment on Private Investment in Brazil: 1947-1990.” *CEPAL Review*, nº 67, April, pp. 75-84.

- Castro, E. & Teixeira, J. (1999). “Investimento Direto Estrangeiro, Transferência Tecnológica e Extensões do Modelo Norte-Sul de Wang.” *Revista Brasileira de Economia*, vol. 52, nº 2, Abril-June, pp. 167-181.
- Feldstein, M. & Horioka, C. (1980). “Domestic Saving and International Capital Flows”. *The Economic Journal*, v. 90, n. 358, June, pp. 314-329.
- Johnston, R. (1985). “Monetary Policy – The Changing Environment”. T. A Coghlan Memorial Lecture, reprinted in *Reserve Bank of Australia Bulletin*, June, pp. 807-814.
- Kaldor, N. (1955-56). “Alternative theories of distribution”. *The Review of Economic Studies*, pp. 83-100.
- Krugman, P. (1997). “Latin American’s Swan Song. <http://web.mit.edu/krugman/www/swansong.html>.
- Minsky, H. (1983). “Notes on Effective Demand: Comments on Bharadwaj” in “Distribution, Effective Demand and International Economic Relations”. Edited by J. Kregel. London: The Macmillan Press Ltd, pp. 43-49.
- Pasinetti, L. (1962). “Rate of Profit and Income Distribution in Relation to the Rate of Economic Growth”. *Review of Economic Studies*, vol. XXIX, pp. 267-279.
- Pasinetti, L. (1993). “Structural Economic Dynamics”. Cambridge: Cambridge University Press.
- Pasinetti, L. (1994). “The Structure of Long-Term Developments: Concluding Comments”, in L. Pasinetti and A. Solow (eds). “Economic Growth and the Structure of Long-Term Development”. London: International Economic Association.
- Shackle, G. (1967). “The Years of High Theory.” Cambridge: Cambridge University Press.
- Stiglitz, J. (1998). “Distribution, Efficiency and Voice. Designing the Second Generation of Reforms.” *Proceedings of the International Seminar on Asset Distribution, Poverty and Economic Growth*: The World Bank and the Cabinet of the Minister of Land Reform, with the Support of II CA, Brasilia – DF, Brazil, July 14-17.
- Thirlwall, A. (1994). “Growth and Development.” Fifty edition, London: Macmillan Press Ltd.

APPENDIX

Fig.3 Brazilian Perspective of the Washington Consensus

