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The Cycles of the State

The crisis of the state approach is a tool for understanding the economic crisis in Latin America in the 1980s and the modest recovery in the 1990s. This theoretical tool, however, gains full explanatory power only if one adds the hypothesis of a cyclical pattern of state intervention. According to this hypothesis, throughout the world the state grew too much from the 1930s to the 1970s. The neoliberal critique was a reaction to this growth, which became increasingly distorted. Since the 1980s market-oriented reforms of the state—particularly privatization, deregulation, and trade liberalization—have reduced the state apparatus. Yet if the process is intrinsically cyclical, once the crisis has purged the state, new forms of regulation will soon relate the state and the market, and the state will again expand.

On certain occasions limited state intervention becomes an acceptable political practice. This was clearly the case from the 1930s to the 1960s, when a Keynesian consensus prevailed. At other times, as during the past twenty years, the conservative attack on state intervention predominates. After the economic depression of the 1930s, the failures of the market were contrasted with the advantages of policymaking and planning. Today the inverse type of reasoning seems to represent the truth for a neoliberal "new right," whose ideas are based on economic theory and the market rather than on political philosophy and the ideas about tradition and hierarchy that defined the "old right." Yet there are signs that this conservative wave is waning. An ideological downturn seems to be a real possibility.

In macroeconomics, the monetarism that surfaced in the 1960s and the "new classical" school based on rational expectations, which appeared in the 1970s, are the clearest manifestations of the conservative wave. What caused the rise of the new right in macroeconomic theory was the collapse of the Keynesian consensus. On the one hand, the state had become too large and inefficient and was plagued by a fiscal crisis; on the other, standard Keynesian economic policies, based on the assumption of chronic insufficiency of demand, failed to cope with rising unemployment and increasing rates of inflation that became stagflation. In development economics, the failure of the "big push" industrialization theories, which were behind the dominant import substitution model of industrialization in the 1950s and 1960s, gave rise in the 1970s to an export-led, market-oriented theory of growth, whose basic tenets were privatization and trade liberalization. The fact that countries adopting the export-led strategy, such as Korea and Taiwan, did so in combination with aggressive industrial policies rather than leaving the fate of the economy to the market did not hinder the followers of the new credo from using these countries as examples of their liberal neo-ideas. Finally, in comparative economics, the failure of statist economies during the 1970s and 1980s to maintain the high rates of growth achieved in the 1950s and 1960s served as a powerful ideological argument favoring the neoliberal approach. The subsequent collapse of communism was proffered as evidence of the triumph of neoliberal ideas. The fact that in the Soviet Union and Eastern Europe an extreme form of statism had been adopted was forgotten. The conservative strategy was to put support for limited state intervention and extreme state control of the economy in the same basket.

More recently this neoliberal wave has been coming under attack. The inadequacies of monetarism and rational expectations are becoming manifest. The status of state intervention in economic theory is again rising, although modestly, as the new international trade theory (Paul Krugman) and the new endogenous growth theory (Paul Rommer) provide new paths for mainstream economics. The simplistic idea held by the new right that market failures may exist but are always less damaging than government failures seems correct, but it cannot be sustained on theoretical or practical grounds.

Changes in the way market and state intervention is viewed are related to the recurrent successes and failures of such intervention. As long as state intervention is successful, theories that support limited intervention are in favor. When intervention ceases to be effective, the voices of conservatives and neoliberals become louder. This is a symptom of the cyclical and ever-changing nature of state intervention. In this chapter, after a review of the complementary roles of the market and the state in contemporary capitalism—a fascinating example of bureaucratic influence and market orientation—I apply the theory of the cycles of the state to the Brazilian case.

The state and the market are at the center of the recent upheavals throughout the world. It is very difficult to understand these events if we do not have a theory to explain the relationship between these two institutions. There are different interpretations of what the role of the state has been and what role it can still play on the economic level. Yet in recent years those on the right and on the left have criticized state action.

Neoliberals contend that collective action is impossible, that the state is necessarily inefficient because it is a hostage to private interests, that its protection discourages work, and that it tends to favor pressure groups. They also believe efficiency is synonymous with the market, that state failures are worse than market failures, and that it is better to live with market failures than to try to correct them using the state. Thus they propose, unrealistically, the minimal state as their basic policy objective.

The modern left also views state intervention as inefficient but not intrinsically so. Those on the left do not say intervention necessarily discourages work but rather that it favors oligopolistic capital. However, the state easily falls victim to inefficiency and private interests that "privatize" the state, turning it into the private property of various pressure groups. It is possible to elicit effective and efficient action from the state, but this requires that the state undergo a permanent process of reform because it lacks an automatic (if imperfect) system of correction like that found in the market. Administering bureaucratic organizations—among which the state is the most important—is a process that constantly needs correcting, that is in permanent need of reform.

When I speak of the state, I am referring only to the state apparatus, the state bureaucratic organization, and the legal system that constitutes it. I am not referring to the nation-state, which is identified with a country or a nation, or to a political regime (e.g., the authoritarian state), much less to an economic system (e.g., the capitalist state). The *state,* in the strict sense in which I am using the term here, is a special kind of bureaucratic organization formed on the one hand by a government, a public bureaucracy, and an armed force, and on the other by a complex legal or constitutional system that has the exclusive power to legislate and levy tributes on the inhabitants of a given geographic area: the nation-state.[1]

The market and the state are the two basic institutions that coordinate any contemporary economic system. In contemporary capitalism the state and the large corporations have a special role in complementing the market's resource allocation mechanism. We find, in the social system we call capitalism, important traits of a statist or a bureaucratic type of society. The economic system is basically coordinated by the market, particularly by the price system. But the state has a major role in regulating and institutionalizing the market. And in the major corporations, as in the state, bureaucrats play an extremely influential role in regulating and coordinating the economy.

If, in abstract terms, capitalism is an economic system coordinated by the market, statism is an economic system in which the state almost completely substitutes for the market in coordinating the economy. Although the demise of the Soviet type of economic system has demonstrated the infeasibility of pure bureaucratism or statism, as was found in Eastern Europe, "pure capitalism," in which small firms would be coordinated only by the market with no participation from the state, is equally infeasible.

In the twentieth century, bureaucratic capitalism has been characterized increasingly by social-democratic regulation of the market. This regulation is carried out by governments through a process of permanent intermediation between capitalists and workers, where the objective is to make the profit rate and investments consistent with an acceptable distribution of income. This intervention is indispensable because in the market for unskilled workers the wage rate of equilibrium is very low (Roemer 1990). This rate is in equilibrium economically because it clears the market, but it is not politically feasible. The welfare state's social-democratic regulation taxes the capitalists and the bureaucrats, the upper and middle classes, to finance the social expenditures that raise the equilibrium wage rate for unskilled workers.[2]

The market is an institution. It does not exist naturally. It is dependent on the laws and regulations issued by the state. Markets can perform their resource allocation role only if there is a strong state to sustain that allocation—and to correct it when the market alone is unable to do so. The state's corrective actions must be very limited because the distortions of an overgrown state are unavoidable. But it is utopian to believe that contemporary capitalism can work without a strong state and without a strong bureaucracy within the state and the large corporations. Contemporary capitalism is highly competitive, market-oriented, and bureaucratic. History demonstrates that an economy coordinated only by bureaucrats and the state is doomed to failure, but history also shows that successful economies controlled exclusively by capitalists and the market are pure fiction. Coordination is always the outcome of the joint operation of the market and state regulations, of the interaction of businesspeople and bureaucrats' decisions.

Thus it makes no sense to define economics as the study of the market and political science as the study of power and the state. In fact, without the state neither capital nor money would exist; therefore, neither production nor large-scale trade would be possible. It is impossible to consider coordinating the economy only with the market or only with the state.

State intervention in modern times has assumed three forms, corresponding to three historical models of development: (1) the state as a substitute for the market in the coordination of the economy (statist or Soviet model); (2) the state as a decisive agent in promoting capital accumulation and technological development (the historical German and Japanese model of industrialization, adopted in varying degrees by most developing countries during this century)—the developmentalist state; and (3) the state as macroeconomic policymaker, promoter of welfare, microeconomic regulator of business enterprises and the environment, fiscal stimulator of technological growth geared toward international competitiveness, and bargaining agent for international trade on behalf of its respective countries (the present OECD model)—the coordinating state. The first historical model of state intervention falls outside the scope of this book. I will discuss state intervention in Brazil, assuming that we are dealing with a capitalist, market-oriented economic system in transition from the second to the third model of intervention.

State intervention expands and contracts cyclically, and in each new cycle the mode of state intervention changes.[3] When intervention is expanding, the state assumes an increasing role in the coordination of the economic system, the microallocation of resources, the macrodefinition of the level of savings and investments (or of the equilibrium between aggregate demand and supply), and the micro-macro determination of income distribution among social classes and sectors of the economy. Intervention increases because the state is performing a role the market is unable to perform or performs inefficiently. It also increases because the state responds in a fairly effective way to the demands of society.

But as state intervention increases, whether in terms of its share of GDP or of the degree of regulation the economy is subjected to, it begins to become disfunctional. The three basic symptoms indicating that the state's expansion has gone too far are excesses in regulation (which hinder rather than stimulate economic activity), huge public deficits that crowd out private investments, and negative public savings that reduce total savings. This is the point at which the cycle reverts, when state control contracts and market control expands. This is the time for some deregulation and denationalization.

This hypothesis of the cyclical nature of state intervention conflicts with both the static theories, which assume a given level of state intervention as ideal, and the historical theories, which claim there has been a long-term tendency toward the statization of the economy. For neoliberals, the ideal level of state intervention is very low; for statists it is very high; and for pragmatists it is intermediate. Although I am closer to the pragmatists, I would say these three positions are unacceptable as long as they assume a given relation between market and state control as ideal or optimum. My hypothesis is that this ideal relation will necessarily vary historically and according to the cyclical pattern of state intervention just described.

Thus, rather than falling into an endless discussion about a doubtful optimum, I propose that there is a cyclical and ever-changing pattern of state intervention. If I am even minimally successful in demonstrating this hypothesis, I hope the ideological content of the debate over the economic intervention of the state will to some degree be reduced.

There are economic and political limits to the state's growth. Relations between the state and civil society or between the state and the market are not arbitrary. The market and the state are the two mechanisms that are responsible for the coordination of an economy. Although they are not parallel institutions, because the state existed previous to the market and is responsible for its institutionalization and regulation, it is possible to think they fill complementary roles in coordinating the economy. These roles have to be performed in a balanced way. A state that grows too much in relation to the market may cause economic and political problems that, sooner or later, will limit its expansion. In this book I suggest that the state grows cyclically. I propose that, in the same way that in the strictly economic realm there are business cycles and Kondratieff cycles and in the private–public interest alternative there is the Hirschman cycle, in the economic-political realm there are cycles of state intervention.

The present historical process of a relative reduction of the economic role of the state, which started in the mid-1970s, must be viewed as a phase of the cyclical pattern of state intervention. The slowdown of the capitalist economies since that time is, in part, the consequence of the distortions and inefficiencies provoked by the previous growth of the state. As these distortions were perceived by society, they gave rise to the conservative or neoliberal wave. State failures were blamed for all of the major problems that arose, market failures were ignored, and the objective became the minimal state. The proposed instruments for reduction are trade liberalization, privatization and regulation, and market-oriented reforms.

Yet there is no reason to identify market-oriented reforms with neoliberalism; nor should we identify market orientation with market coordination. Japan and the Asian tigers are market-oriented economies—that is, strongly competitive within the country and abroad—but they are not particularly market-coordinated economies—that is, resource allocation is not the exclusive role of the market. On the contrary, in this respect the state plays an important part. Economic reforms that liberalize trade, privatize, and deregulate may merely be sensible economic policy, provided they do not aim at the minimal state, disregard market failures, or ignore the potentialities of collective action. If the pattern of state intervention is cyclical, it tends to change. In each cycle or historical moment it will assume a different form. Following liberalization and privatization, the state will perform new roles—institutionalizing markets, investing in infrastructure and education, stimulating science and technology, protecting the environment, and promoting welfare.

To say that state intervention is, in principle, efficient or inefficient makes no sense. State intervention may be efficient or inefficient, necessary or unnecessary, in need of expansion or reduction depending on each specific situation. In general terms, state intervention will be necessary and efficient in the initial phase of the intervention cycle and excessive and inefficient in the final phase. In this phase the state will probably be inflated and will have become increasingly unable to act, given the interests of external (lobbying) and internal (technobureaucratic) constituencies, which lead the state into fiscal trouble if not crisis.

In the Brazilian case the cyclical and changing character of state intervention is fairly clear. From the 1930s to the 1970s the state played a decisive role in promoting economic growth; in the 1980s, given the fiscal crisis, the state lost its capacity to promote economic growth and, in fact, became a basic obstacle to such growth.[4]

Some economists and political scientists in Brazil, who had previously supported state intervention for the protection of local industry and the creation and development of state-owned enterprises in those sectors private capital was unable or unwilling to enter, currently favor trade liberalization and privatization. This does not mean that they have become conservative. It only means Brazil is in a different phase of the state intervention cycle—one in which it is necessary to streamline and tighten the state's structure to overcome the fiscal crisis and create the conditions for a new stage of economic development. In this new phase the state will have a different but necessarily important economic role to play.

Between the 1930s and the 1970s the pattern of state intervention in Brazil changed continually; nevertheless, it was effective in promoting economic development. Data on the growth of GDP during this period demonstrate this. In the 1930s the state began a long-term and initially successful industrial policy of import substitution. In the 1940s and 1950s state-owned enterprises were established in the basic sectors of the economy: steel; oil; electrical power; and transportation.

The 1960s were a period of transition and fiscal adjustment, but changes in industrial policy were quite limited. The basic innovation of the technobureaucratic, authoritarian government was a clear export-oriented policy. The objective was to export manufactured goods. But protection of local industry, a key characteristic of import substitution industrialization, was maintained. And direct investment by the state was resumed; the state nationalized the telephone industry and completed the nationalization of the electrical power industry.

The 1970s were the decade of the economic miracle (1968–1978) and the PND II (1974–1979). This plan was characterized by the promotion of a new wave of import substitution in the basic sectors of the economy (steel, nonferrous metals, oil, petrochemicals) under the direct control of state-owned enterprises, and also by the decision to promote full import substitution in the private, mostly nationally owned capital goods industry. The 1970s were also when Brazil acquired its huge international debt and began to run up a large (state) domestic debt.

During these fifty years we can distinguish two cycles. The first ended in the mid-1960s, when the military government that triumphed in the 1964 coup was able to overcome the fiscal crisis and the recession that followed the excesses of President Kubistchek's Plano de Metas. Between 1964 and 1967 the Brazilian state underwent a fiscal macroeconomic adjustment and structural reforms (an indexation system, tax reform, financial reform, housing–bank system reform) that recovered the state's capacity to promote forced savings and to channel them to direct state investments or subsidized private investments. The second cycle is not yet complete because the country has not yet overcome the fiscal and economic crisis of the 1980s.

The conservative wave that has inundated the world since the 1970s and Brazil since the late 1980s becomes easier to understand if we accept the idea of a cyclical pattern of state intervention. As soon as the state begins to show clear signs that it has grown too much and in a distorted way—the welfare state in the developed countries, the developmental state in the developing countries, and the command state in the statist countries—the opportunity arises for the neoliberal critique of collective action. This critique—particularly the one that came from the public choice school—correctly viewed the public deficit as the outcome of demands from special interest groups. It was unacceptable for its radicalism and conservatism, but it was correct in pointing to the excessive growth of the state and the need for market-oriented reforms.

Furthermore, we can infer that the cyclical upturns of state growth give rise to ideological waves. This seems to be supported by the facts. In the 1930s an upturn gave rise to a successful critique of economic liberalism; in the 1970s state growth led to an also successful (although pessimistic) evaluation of state intervention. One reason the ideological mood changes is that many people tend to adopt the pragmatic approach, which, in my opinion, is the correct thing to do. Technocratic economists exemplify this tendency. In the short run, given that the ongoing economic crisis is essentially a fiscal crisis, pragmatic economists—who in the past had argued in favor of demand-stimulating economic policies—begin to ask for fiscal discipline, for an effective fiscal adjustment that will eliminate the public deficit, and, in extreme cases, for some form of public debt cancellation. However, given that the origin of the fiscal crisis is the foreign debt crisis and that it is practically impossible to eliminate the public deficit while honoring all interests related to that debt, the approach I have been calling social-democratic would demand debt reduction—the securing of a substantial part of the debt. Privatization of as many state-owned enterprises as possible and trade liberalization would be important parts of this type of policy, but the objective—in contrast to that of the neoliberals—would not be the minimal state but the reform of the state so it once again becomes capable of formulating and implementing effective economic policy.

The new strategy adopted by pragmatic economists does not propose direct state investment, much less protection for inefficient import substitution industries, but rather the support of technological development for international competitiveness. Income distribution through increased expenditures for education and health is also important. It is becoming increasingly plain that the high degree of income concentration in Brazil is a major barrier to economic growth and price stability because it permanently feeds a high level of distributive conflict and reduces the government's legitimacy.

In addition to being pragmatic, this approach to state intervention in Brazil is dialectical: it simultaneously supports a strong market-oriented economy and state intervention in the critical areas the market is unable to coordinate; and it acknowledges the cyclical nature of state intervention. Sometimes, as at present, it is necessary to reduce and reshape the state to render it more effective (able to implement public policies) and efficient (able to implement those policies at low cost).

Technocratic economists all over the world tend to be pragmatic, but those from the Far East seem to be particularly so. I saw this clearly when I took part in an international seminar in Tokyo in summer 1989. At this seminar most of the Asian economists were members of their respective governments, and they defined themselves without embarrassment—on the contrary, they seemed fairly proud—as pragmatic technocrats in opposition to theoretical and ideological economists.[5]

The role the state has played in the development of the East and Southeast Asian countries is well known, starting with Japan and then Korea, Taiwan, Singapore, Malaysia, and, more recently, Thailand and Indonesia.[6] Whereas the Latin American countries are stagnant, the East and Southeast Asian nations are booming. Whereas per capita income in the Latin American countries decreased in the 1980s, it grew about 4 percent annually in the Asian countries.

One explanation for this difference in economic performance is that Asian pragmatic economists combine very strong fiscal discipline with a high degree of state intervention. But their discourse carefully avoids reference to state intervention while strongly praising their market-oriented economies. They believe in a market-oriented economy, but they also believe in and practice permanent state intervention. A good example of this general attitude was expressed by Seiji Naya (1989:5, 7).

> The NIEs [newly industrialized economies] and the ASEAN-4 countries have largely allowed the market to work and have adopted a private sector approach to economic development. . . . This does not mean that they are laissez-faire economies; in fact, governments intervene strongly. . . . In East Asia there is a hierarchical relationship under which the government may directly influence the conduct of private enterprises for the benefit of the public good and in turn is expected to assist and protect them.

This Asian economic pragmatism includes a certain degree of pragmatic dissimulation. The dominant capitalist class wants to hear that Asian economies are market-oriented, and the Asian countries insistently repeat that as fact. In Japan, for instance, government economists say the government's economic role is currently very small. Only after much questioning will they admit that the Japanese state presently dispenses large sums of money to subsidize technological development. Rather than dissimulated, however, this attitude is dialectical. Asians do believe in the benefits of a market-oriented economy, and at the same time they know very well that the state continues to play a decisive role in economic development and income distribution—income distribution that, by the way, is far more equal in their countries than is the case in Latin America.

Technocratic economists have long existed in Brazil. Yet many of them compromised with the authoritarian regime and failed to face the economic crisis when it arose in the late 1970s; thus they have come under attack.[7] As a defense mechanism, they have tended to disguise themselves and to make their existence as inconspicuous as possible. With democratization, they lost power over both the bourgeoisie and the professional politicians. There is no doubt, however, that if the solution to the Brazilian crisis involves the formation of a new and broader political coalition—broader than the one that existed under the bureaucratic-authoritarian regime—this coalition will have to encompass businesspeople, workers, and the private and state bureaucratic class. Fernando Henrique Cardoso's election to the presidency points toward such a coalition and, to a certain extent, signals the new political pact that will probably be formed.