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The Contradictions of Brazilian Inflation, 1964–1979

THE THEORY OF INERTIAL INFLATION
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Any analysis of Brazilian inflation should begin with the assumption that Brazil is an underdeveloped country whose capitalist market is poorly structured. This is the result both of the domination of key sectors of the economy by cartels of oligopolistic corporations and the existence of an economically strong state that has effective instruments to decisively influence the distribution of the economic surplus.

From this point of view, inflation in Brazil is a way of transferring income from the politically weaker sectors, that is, the workers, as well as from the economically less dynamic sectors, to the economically more dynamic and politically stronger sectors, which dominate the process of capital accumulation. Inflation is a battle between the dominant groups for a larger share of the economic surplus, with losses for the workers, the low- and middle-level managers, and the small- and medium-sized firms in the competitive sectors of the economy.

There is one essential condition that is necessary for carrying out this concentration of income: the possibility for the groups that benefit from inflation to intervene in the market and increase their prices, whenever possible, even more than the other groups. This intervention is made possible in Brazil by two mechanisms: (a) the organization of the oligopolistic corporations into cartels, and (b) the action of the state when it subsidizes the more powerful and dynamic segments of the economy.

In relation to the state, we are led to imagine that its objective is to control inflation, but actually it faces a permanent contradiction: the state attempts to combat inflation while it bows to the inflationary pressures of the groups that control it. As a source of inflation and of transferring income to these groups, the state can: (a) establish subsidies for these dynamic groups and then issue currency (this was the classic inflationary mechanism of the populist period); (b) increase credit at negative interest rates in order to finance these dynamic groups (this was the typical mechanism used between 1967 and 1973); and (c) not control prices, or loosen the controls, to the advantage of the oligopolistic groups (this was the typical policy between 1974 and 1979).

According to this viewpoint, inflation is an economic phenomenon whose political component is essential. Inflation would accelerate in proportion to the aggressiveness of the groups that control the state and to the resistance of the dominated groups. When there is a relative balance of political forces, as in 1962-1963, inflation tends to be explosive. When the capitalist group manages to obtain unlimited domination over the workers, as was the case from 1964 to 1974, inflation tends to be reduced, with the workers paying for the deceleration of inflation with reduced wages. After the elections of 1974, when the workers regained some political weight, inflation began to grow again.

Contrary to what is predicted by orthodox economic theory, but consistent with the theory of inflation based on administered prices, inflation would tend to go up in a descendant phase of the cycle and to go down during an ascendant phase. This is because, when there is a decline, the fight to maintain a relative share in the economic surplus is much greater than during expansion. When production and productivity are growing, it is easier for some of the groups to cope with the losses that come from the policies for stabilizing prices, because, in this case, they lose only in the sense that they do not gain as much.

Implicit in this hypothesis is the assumption that an anti-inflationary policy can only succeed in Brazil when it forces one group to pay for inflation by not allowing it to raise its prices proportionately. In principle, this group has been the workers. It could be the agricultural export sector, as happened in the 1950s, small and medium companies of the traditional capitalist sectors that produce basic consumer goods, as happened after 1964, or finally public servants and lower-level military officers (or rather the low- and middle-level governmental technobureaucrats, as has happened various times).

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The highest rates recorded for Brazilian inflation before the upsurge of the 1980s were between 1963 and 1966, reaching a peak of 91.9 percent in 1964.[1] For 1963, we can see a correlation between the high inflation rate and the political and economic disorganization of that period. However, we cannot do the same for the following years, during the Castelo Branco government, when an orthodox anti- inflationary policy was adopted based on a mistaken (demand pull) diagnosis of the basic causes of infation at that time. The costs of the restrictive monetary and fiscal policies were high in terms of unemployment and of a reduction of the growth rates. The results, in terms of deceleration of inflation, can be explained by the severe cut in real wages rather than by the orthodox economic policy.

From the moment that Delfim Netto became the minister of the treasury in March 1967, there were changes in the economic policy. Inflation was considered to be cost push, and a policy to stimulate demand and control oligopolistic prices was pursued. The inflation rate continued to fall, going from 38.8 percent to 24.4 percent from 1966 to 1967 (see Table 6.1). Once it stabilized around this rate, the government did not show much concern for reducing it to even lower levels. Beginning in

Table 6.1 Inflation - Annual Rates

Year	FGV(a)	DIEESE(b)
1960	30.5	32.9
1961	47.7	42.2
1962	51.3	62.4
1963	81.3	86.7
1964	91.9	72.9
1965	35.5	53.9
1966	38.8	52.3
1967	24.3	25.9
1968	25.4	26.1
1969	20.2	22.3
1970	19.2	16.5
1971	19.8	24.8
1972	15.5	22.5
1973	15.7	26.7
1974	34.5	35.2
1975	29.2	28.5
1976	46.3	44.2
1977	38.8	39.2
1978	40.83	40.12

December of each year over December of the preceding year.
Source: (a) Getúlio Vargas Foundation (FGV) - General Price Index - Domestic Availability (col. 2)
In: <u>Conjuntura econômica</u>
(b) DIEESE - Cost of Living Index (Inter Union Department of Socio Economic Statistics and Studies - DIEESE).

1967, the national product began to grow again at a considerable rate. Thus, we entered the period of the "Brazilian miracle," during which profits and salaries, as well as private and state accumulation, grew at unprecedented rates while wages stagnated.

In the 1950s, the debate on inflation was between the "monetarists" (actually, neoclassical orthodox economists) who attributed inflation to causes exogenous to the economic system that were reflected in deficits and the issuing of currency, and the structuralists, who saw inflation as a phenomenon inherent in the standard of capital accumulation of that time.[2] These positions are opposites, especially in terms of the measures they recommend for controlling inflation. The orthodox advocate the possibility of eliminating inflation, while the structuralists affirm the need to live with a moderate inflation rate. However, they do agree when they explain inflation in terms of demand. That is, both consider an aggregate demand greater than supply to be the cause of inflation. However, this does not make sense during a period of crisis or economic recession, as was the case from 1962 to 1966.

At the beginning of the 1960s, we first saw the phenomenon of the coexistence of inflation with economic recession in Brazil. This phenomenon would also occur at the end of the decade in the central countries and then be called stagflation. It was observed in Ignácio Rangel's pioneering book *A inflação Brasileira* (1963). He noted that there was a decisive cost component in Brazilian inflation. Corporations were contantly being threatened by their idle capacity and overproduction, which was caused by the unbalanced distribution of income in Brazil and especially by lack of effective demand because of the exclusion of almost the whole rural sector from the market. They were taking advantage of their oligopolistic position in the market and raising their prices autonomously, that is, without any previous increase in demand. Because the demand curve faced by the corporations as a group was inelastic, price increases implied a relatively small reduction in the amount sold. Thus, the corporations caused inflation to accelerate by increasing their markups and prices as a way to defend their profits. Therefore, we were faced with administered or cost inflation, which is perfectly compatible with recession.

However, Ignácio Rangel's analysis had few repercussions. The orthodox economists of the Castelo Branco government ignored it completely. They dealt with inflation in terms of demand and, while they called their policy "gradualist," they adopted drastic measures for reducing consumption, real wages, the working capital of the corporations, and the government deficit. Naturally, the result of all this was a recession. However, faced with pressure from business and from the middle class, they soon relaxed controls. This happened in the second semester of 1965, when the taxes for durable consumer goods were temporarily reduced. Perhaps because of this, its policy could be called "gradualist."

It was a patchy gradualism. The orthodox economic policy, copied from North American and British economic text books, had much less effect than expected, while at the same time the economy began to stagnate. Moreover, this stagnation provoked a large trade surplus in 1965 and 1966 because the industrial sector did not feel stimulated to import machines and raw materials. Ironically enough, the financing of this surplus fed back into inflation. In other words, orthodox anti-inflationary policy provoked a recession, because it led to a reduction in the demand for imports and, concomitantly, to a surplus in the balance of trade. The need to finance this surplus, that is, to buy the foreign exchange credits of the exporters, led the state to print more currency, thus sanctioning the current level of inflation.

Before Delfim Netto became treasury minister in 1967, he made a study of Brazilian inflation. He took a position different from that of the monetarists, explaining it with four variables that are independent of each other: the state deficit, wage readjustments, exchange devaluations, and the inflation of the previous year.[3] Of these, the two cost components for explaining inflation are wage readjustments and the exchange devaluation, which were not given much importance in this book.

However, when he was named as minister in 1967, he was faced with inflation and recession at the same time. In spite of being a mostly orthodox economist, he did not hesitate to emphasize the cost component in Brazilian inflation and adopted a similar diagnosis to the one elaborated by Rangel. Thus, he relaxed the credit restrictions that had been imposed earlier and went on to control the inflationary process through administrative price controls. The Interministerial Price Council (CIP) was created to carry out this task.

His acceptance of the concept of administered inflation was clear. The government even stated it in its own development program (*Programa Estratégico de Desenvolvimento*) in July 1967: "In this latest phase, inflation has continued, in spite of a retraction in demand, because of the influence of certain costs, the increase in interest rates, the increase in average prices resulting from lower sales, and the reaction to expectations."

As a result of this analysis, the government changed its strategy for fighting inflation, clearly subordinating it to the greater objective of promoting the accumulation of capital. When inflation has a cost component, it is basically functioning as a defense mechanism for the monopolistic or oligopolistic corporations against a retraction in demand. Therefore, it was necessary to stimulate demand and to stimulate economic activity. This was done by a more liberal credit policy for the private sector, stimulating investment, and by an increase in the salaries of the technobureaucrats, and stimulating consumption, especially of durable goods.

Although the government did not present large budget deficits, it continued to increase the levels of credit and to issue currency to avoid an economic recession. The nominal increase in the money supply contributed to maintaining inflation at a annual rate of around 20 percent.

On the other hand, since administered inflation is based on autonomous price increases that do not reflect an increase in demand, it depends on the dominance of oligopolistic or monopolistic markets. In these markets, competition does not function. This explains the great emphasis the government gave to the CIP. Instead of controlling prices at the retail level, which was totally inefficient, the CIP went to the source of the high prices and initially began by controlling the prices of the 350 largest Brazilian corporations, a number which increased over the years. In other words, the CIP began to control the prices of the oligopolistic and monopolistic corporations in Brazil. When dealing with a reduced number of corporations, administrative control is feasible. In this way, the CIP became a powerful instrument for controlling inflation. Setting the banks' interest rates can be included in the same line of action, since interests on circulating capital are costs, and banks in Brazil form an oligopoly.

In this way, the anti-inflationary policy between 1967 and 1973 had little to do with that of the previous government. It was a policy of living with inflation that was maintained at acceptable levels through the administrative control of prices and the systematic attempt to cut the workers' wages. The emphasis was put on the growth rate of the system and on increasing exports. As long as inflation provoked a reduction in wages, a moderate inflation rate particularly favored the process of accumulation.

At the beginning of the 1970s, the economy was in full expansion and could no longer count on idle capacity. The rate of capital accumulation increased at the same time that the growing salaries of the technobureaucrats stimulated the consumption of luxury industrial goods. In 1973, the pressures from an aggregate demand greater than supply were already felt. The acceleration of the inflation rate received a new impulse from an external supply shock: the increase in the prices of oil and other imported products.[4]

Because of the relatively high inflationary pressures, at the beginning of 1974 the new minister of the treasury, Mário Henrique Simonsen, decided to adopt a policy of violent credit restriction, thus returning to a diagnosis of demand inflation.

2

When studying the causes of inflation in Brazil, economists are divided into various camps. In order to analyze this problem, it is first necessary to distinguish between long- and short-term causes.

As for the long-term causes, we should return to the old, but not worn-out, debate between the structuralists and the orthodox, which takes us back to the 1950s. In the 1950s, the neoclassical orthodox economists, who are generically called "monetarists" in Latin America, were not working for the government. They explained inflation very simply. It had one exogenous cause: the demagoguery and administrative incapacity of the Brazilian governments of that time, which incurred constant budget deficits and increased credit as it tried to satisfy all classes and social groups in a populist way. This subsequently provoked the need to finance the budget deficit by a continuous expansion of money.[5]

Meanwhile, the structuralists, who generally occupied government posts, asserted that inflation was an endogenous phenomenon, resulting from the imperfections of markets typical of industrializing countries.[6] These imperfections manifest themselves as bottlenecks in supply. Given a sudden increase in demand or an unexpected fall in the production (supply) of certain goods, prices rise in these sectors. However, contrary to what happens in the advanced capitalist countries, when prices go up in a certain sector of the economy, supply does not respond immediately, either through an increase in internal production or through imports. Thus, the prices of that sector do not immediately return to their previous level, leading the other sectors that use inputs from that sector to raise their own prices so that they will not suffer losses. In this way, a sectorial price increase because of a bottleneck in supply spreads to the whole economy, causing a generalized inflationary process that forces workers to demand readjustments of their wages. At first, there is a variation in relative prices, but as these prices don't return quickly to their initial level, because of the structural deficiencies of the market, the other economic agents are led to increase their prices to defend their income share. Thus, an inflationary process is set off that can only be stopped if some sectors of the economy are prevented from defending themselves. Then these sectors absorb the price increases or, in other words, "pay the bill" for inflation. In Brazil, the propagation or feedback effect is especially significant because it is already institutionalized by the system of indexation or monetary correction of prices, interest rates, exchange rates, and wages. It is true that the monetary correction is not full and complete. If it were, inflation would be absolutely rigidly downwards because no class or sector of the economy would absorb the losses of a stabilization policy.

In these terms, once a sectorial inflationary process is set off, the propagation effect, or the feedback mechanism of inflation, generalizes and maintains inflation at a new and higher level. The economic system is turned into a battlefield on which all try to defend themselves from higher prices by passing on cost increases to prices or, whenever possible, increasing their own prices before their suppliers do.

Once these mechanisms of propagation are started, they tend to become permanent, maintaining the new level of inflation. First, they accelerate the rate of inflation, then they keep it independent of the existence of excess demand. The accelerating effect will be exhausted unless new inflationary shocks occur, either because of the monopoly power of some sectors or the appearance of new structural imbalances between supply and demand in specific sectors of the economy. As long as these new imbalances cannot be corrected immediately, and it takes time for supply to meet demand, we will have a new inflationary acceleration.

The agricultural and import sectors were cited as examples of sectors where bottlenecks in supply tend to initially occur. That is, given the permanent lack of foreign currency, which characterizes underdevelopment, especially during the import substitution phase, the tendency is for their prices to be under constant pressure to rise. Another structural cause of inflation is the political incapacity of the government to raise taxes in proportion to its increase in expenditures, which arise from the state's increasing intervention in the economy to stimulate accumulation.

As for agriculture, some structuralists pointed out the low elasticity of the supply of agricultural products, but the orthodox economists showed econometrically that this was not the case, at least in southern Brazil. In fact, there is no reason for the supply of agricultural products to be inelastic in relation to prices. The hypothesis that the agricultural sector is precapitalistic in Brazil and in the other underdeveloped countries is dubious. It is only in very economically backward areas, such as in certain regions of the northeast of Brazil, that supply does not respond well to price increases. This is mainly the result of a lack of information and, secondarily, of insufficiently developed capitalist relationships of production.[7]

Strictly speaking, for the structuralist theory of inflation, it is not necessary that the supply of agricultural products have low price elasticity. All that is needed is a time lag in the response of supply to an increase in demand. A time lag that is longer than acceptable for the other economic sectors will be enough for the prices of the other sectors to go up as well. The agricultural sector is only one example of a source of structural inflation. Any other sector in which there is a monetary bottleneck in supply can provoke inflation, as long as that time lag is long enough for the propagation effect between a sectorial price increase and the response of supply to set into motion a generalized price increase.[8]

3

The most important aspect in the debate between the monetarists and the structuralists is the question of the endogenous or exogenous character of the money supply. The money supply will be either a cause of inflation or a sanctioning factor, depending on the following alternatives: a money supply decided on by the government, or a money supply resulting from economic forces.

Monetarists consider it to be exogenous because its origins are outside of the dynamics of the economic system and in the area of politics—a decision of the government or of the central bank—as if it were possible to make a clear separation between politics and economics. As a result, they propose an obstinate battle against inflation through rigid restrictions of the money supply and a balanced government budget. When these measures, which are copied from the economic policies of the central countries, are adopted, they are not upheld for long. In the central countries, given that the workers are organized into strong unions, the only way to contain increases in wages during periods of expansion and inflation is by orthodox monetary measures that increase unemployment. But in countries like Brazil, the capitalists do not need this instrument, which is also painful for them, to control wages. That is why fiscal and monetary restrictions tend to be quickly abandoned.

On the other hand, endogenous structuralist inflation is that which results from the structure and dynamics of the economy itself. It comes from the imperfections of the market that characterize the process of accumulation in a technobureaucratic-capitalist country of the periphery like Brazil. The imperfections of the market are manifested either in sectorial bottlenecks in supply, which cause the acceleration of structural demand inflation, or in an eminently oligopolistic and cartelized economy, which create the conditions for an administered acceleration of inflation. Once reaching a certain level, inflation tends to be maintained at this level through the permanent propagation effect, given the distributive conflict. In order to avoid a liquidity crisis, the money supply should increase at the same rate as inflation.

The more oligopolized the economy, the more important will be the administered component of inflation. Although antitrust legislation formally exists in Brazil, cartels are openly tolerated, and the weight of the administered component is enormous. It becomes even greater when we remember that the state, either directly or through its corporations, also has monopoly power over the market and sizable weight in the country's economy.

Given the endogenous character of inflation, it is clear that curing it is not so simple. It is necessary to attack the bottlenecks, which is a long-term problem, and to avoid as much as possible autonomous or administered price increases, which is a difficult task. As a result, it is necessary to know how to live with inflation. This does not mean that there is any positive correlation between development and inflation, or any negative one, unless it becomes explosive. It does not mean that monetary and fiscal policies should not be used against inflation, as long as they are moderate. It only means that a certain inflation rate acts as a lubricant for the economic system. Since the economy resists recession very much—on one hand, there are no unemployment benefits; on the other, capitalists do not need recession to lower wages, which are already very low—the nominal money supply increases endogenously in order to maintain the level of the real money supply. If the government does not issue currency, the banking system increases its nominal credit supply to its good clients.

4

Although administered inflation is related to the structural imperfections of the market, it differs from the structuralist approach because the accelerating factors are sectorial supply shocks instead of sectorial demand shocks. It is caused by the capacity of corporations and of organized workers to increase profit margins or real wages above the increase in productivity, even if demand is weak. The essential condition for this kind of inflation is the existence of monopolistic power. Then inflation can occur, even during an economic retraction, as happened in Brazil in 1962 and 1966 and in the central countries at the end of the 1960s and in 1974.

This kind of inflation is also known as cost inflation, although this is not a correct name and is marked by strong ideological connotations. It was coined in the central countries and suggests that inflation is caused by an increase in the costs of the corporations. Strictly speaking, there are only two kinds of costs in an economy: wages and profits (profit is a cost within the system). Wages would be the only cost of the corporations that is not determined by them. Thus, this type of inflation would be determined mainly by the actions of the trade unions. If this idea is only partially true for the central countries where the trade unions are strong, in underdeveloped countries like Brazil it is unfounded, given the subordination of the workers' organizations to state control.

By defending their profits during recession and increasing them during prosperity, the oligopolistic corporations autonomously increase their prices, and the banks, which are also oligopolistic, their interest rates. If we consider profit to be a cost, we can adopt the name of cost inflation. In the meantime, administered inflation seems to be a less ambiguous name. When the large corporations have monopoly power, they administer their prices, and thus set off inflation. The state also does this, not only through its corporations, but also by directly setting prices. A tax increase is theoretically anti-inflationary. However, if it is used to increase state expenditures, it becomes inflationary. Increases in the charges for public services also have a very clear inflationary effect.

Intervention by the government to set prices, which in principle are defined by the market, are more significant and paradoxical. The asserted objective of these interventions is to control prices and inflation. There are certain moments, however, when a real wage increase, such as that declared by the Brazilian government in November 1974, just before its defeat in the elections, has a clearly inflationary character. In the same way, the government policy of systematically reducing wages, which was enforced up to that year, was anti-inflationary. Also, the CIP itself, which was created to prevent autonomous price increases, can, at certain times, end up stimulating and sanctioning them.[9] It all depends on the power of the different economic sectors in relation to the state.

When, as in the case of Brazil, inflation has a strong price administration component, there tends to be a clear inverse relation between the growth rate of the economy and the inflation rate. This is a fact that was clearly perceived by Ignácio Rangel, and which has been recently confirmed. In 1962, a process of economic crisis began in Brazil, at the same time in which the inflation rate was going up. Then, between 1967 and 1974, inflation decelerated while the country experienced extraordinary growth rates. When the economy decelerated, between 1975 and 1979, it was accompanied again by a clear acceleration of inflation.

Anti-inflationary policies work better during expansive phases of the cycle for two reasons: because the bottlenecks of the economy are partially overcome, and because, at these moments, it becomes viable to reduce the inflation rate without needing to choose a group to absorb all the costs of an anti-inflationary policy. This is possible as long as the increases in production allow this absorption to occur without resistance from those who suffer the losses, or as long as everyone is benefitting from the increase in productive efficiency.

5

These kinds of inflation are not exclusive. There is no reason for the accelerating causes of inflation to be only structural, Keynesian demand push, or administered. A generalized and persistant increase in prices can easily be determined by a combination of these causes. During prosperity, the first two should be dominant; during a recession, it is administered inflation that should play a more important role. But there is nothing to prevent the occurrence of bottlenecks during a recession. On the other hand, while during prosperity it becomes even easier for the oligopolistic corporations to increase their profits margins, they probably will not do that, as this is behavior typical of firms in the competitive sector. But in special situations, oligopolistic corporations can also increase profit margins during the expansive phase of the economic cycle.

We can mention other secondary causes for the acceleration of inflation. There is imported inflation, when the prices of imported goods rise rapidly. For example, with the increase in the price of oil in 1973, all of the oil-importing countries imported inflation. There are people who talk about psychological inflation, characterized by inflationary expectations, that leads some corporations to increase their prices before the others.

This psychological inflation caused by expectations, however, is not exactly a cause for the acceleration of inflation, but rather a euphemism for expressing a very simple fact. No matter what the causes of inflation are—structural, monetary, or administrative—it will always have a basic cause: the struggle by corporations and social groups to increase their share of the surplus. Inflation is the result of a fierce battle for the division of the economic surplus. Those who are capable of increasing their prices more and before the others, those who take the front line in the inflationary process, will certainly be its beneficiaries. Once inflation reaches a given level, it can attribute its maintenance at this level to expectations. But, contrary to what monetarists think, expectations in this case are based on past inflation and thus on the distributive conflict.

This conflict takes place on a broader level between social classes. In the underdeveloped countries, inflation itself is the way in which capitalists reduce the real wages of the workers. They create what their ideologues call "forced savings," but which are really an increase in the corporations' profit rates.

During the import substitution period in Brazil, inflation was also used to transfer income from the exporting sector to the industrial sector, using the exchange rate as an intermediary mechanism. It had been maintained at a fixed rate for long periods, while internal inflation progressed at an accelerated rhythm. This resulted in an artificial valorization of the national currency and a transfer of income from exporters to importers. Later, in the 1970s, when exports received priority, a real devaluation of the cruzeiro became necessary. Although this devaluation did not take place, another way was found to promote exports: by reducing real wages, using the acceleration of inflation. This policy was not necessarily deliberate on the part of government officials, but it reflected the power of the different pressure groups.

It is significant that between the 1950s and the 1970s a curious inversion took place. Inflation was basically an instrument that the capitalists and technobureaucrats used to reduce the workers' wages. However, the official version was something else. Wage increases were considered to be a cause of inflation. Administrative control of wages and of the salaries of the lower-level government employees was defined as the way par excellence to fight inflation. In the meantime, the high salaries of the upper-level technobureaucrats were left free to grow, according to the political power of the technobureaucrats and to their relative scarcity. If we assume that the share of salaries in the income remained constant, then during certain periods, that of profits must have increased as wages were reduced.

Up until the mid-1950s, aside from transferring income from the workers to the capitalists through the lowering of real wages, inflation also transferred income from the exporting sector—the coffee growers—to the industrial sector and to the state itself via the exchange system. At this time, with the progressive exhaustion of the import substitution model at the same time in which the export system entered a crisis, the local industrial bourgeoisie consolidated itself at the top of the dominant class, the multinational manufacturing corporations entered the country en masse, and the *estado cartorial* transformed itself into a state that produces and regulates the economy.[10] Hence a new pattern of accumulation was defined: the underdeveloped industrialized model. In this setting, beginning with the Kubitschek government, inflation played the role of transferring income to the dynamic sectors of the economy, not only through a reduction of real wages, but also through the mechanism of subsidized credits.

This system generalized itself after 1964 when the state became stronger politically. It put together an extraordinary system of fiscal and credit subsidies in order to favor those sectors or activities that were considered as priorities by those who were formulating economic policy. Since they were exempt from monetary correction, the credit subsidies were especially dependent on the inflation rates. Exporters of manufactured goods, big farmers, producers of capital goods and raw materials, supermarkets, and the food industry are among those who received subsidized credits. Bankrupt financial institutions also received them. Personal criteria were added to the impersonal criteria of economic policy. Usually it was the larger corporations in each sector that benefitted the most, as they had the best administrative conditions and more political influence at their disposal.

Because interest rates were fixed in nominal terms, the higher inflation went the lower or more negative was the real rate, and the greater the subsidies. For the beneficiary sectors, the higher the inflation rate went, the better it was. The transfer of surplus to these dynamic or influential sectors was in direct proportion to the inflation rate. In these terms, by waving a magic wand, Brazilian state capitalism changed inflation from a dangerous evil to a political and economic instrument aimed at maximizing the accumulation rate of the sectors that had priority in the economy.

The pressures that were put on the state to maintain an elevated inflation rate did not come only from the need to keep the real money supply stable and from the interests of the industrial sector in maintaining the level of investments of the state at a high level. They also come from the interests of the corporations that were favored by subsidized credits at negative real interest rates. Inflation was thus built into the very logic of the model of industrialized underdevelopment.

Inflation was the result of a strategy of the more dynamic capitalist groups to increase their profits and their rate of accumulation.[11] While the technobureaucrats developed an eminently administrative strategy for increasing their share of the total income, attempting to directly increase their salaries, the capitalists used inflation to reduce the wages of the workers and to neutralize salary increases, and thus to increase their profits.

6

The structural nature of Brazilian inflation has become clearer in recent years. Here we are giving the term "structural" a wider meaning than just that which identifies the causes of inflation with sectorial bottlenecks in the supply of goods. Inflation in Brazil is structural because it is built into and is inherent in the present pattern of accumulation. It is structural because it is the outcome of a permanent distributive conflict. The imperfections in the market and the imbalances of political power between the different social and economic groups tend to accelerate inflation. In order to not lose in the distributive conflict, those who can, automatically pass on cost increases to prices, which rigidly maintains the given level of inflation.

Because the monetary authorities since 1974 did not understand the complex and structural nature of Brazilian inflation, they did not achieve the results they desired with the measures they adopted. Inflation actually recovered its ascending rhythm in 1973 after a long period of decline. At this point, demand inflation and administered inflation joined forces.[12]

The new government, which was installed in 1974, was counting on a minister of the treasury with an orthodox neoclassical orientation, Mário Henrique Simonsen. His position, at least at the beginning of this government, was to not believe in administrative mechanisms for controlling inflation, but rather to prefer the classical mechanisms of fiscal and monetary restrictions. In keeping with this position—which later became more flexible—in the first months of his administration he decided to undertake a policy of restricting credit. As a result, the Brazilian economy underwent a recession during the second half of 1974 and the first half of 1975. It was not a very deep economic crisis, but one in which the inflation rate continued to grow. The liquidity index of the economy fell precipitously until February 1975, when the government, faced with pressure from the corporations, decided to release credit again, mainly by compensatory refinancing. Thus, a phase of large profits for the banks and an acceleration of inflation began. The economic system itself did not react right away. But in the second half of 1975 it had already entered into a new cycle of prosperity. We found ourselves in the midst of a stop-and-go policy.

In the middle of 1975, we were still in an economic recession. The government continued to try stimulating demand in spite of the eventual acceleration of inflation. The new expansion was only perceived by the economic authorities in January or February 1976. Once more, inflation was immediately diagnosed as being of demand. As a result, new measures were imposed to restrict credit. However, these measures had little effect for one year; this time they did not even manage to control inflation, much less reduce economic activity. Although the index of the real liquidity of the economy began to go down again in January 1976, the large amount of speculation, as verified in the open market, increased the circulation of money and cancelled the monetary restrictions imposed by the government. It was only in the first half of 1977 that the economy began to show signs of cooling off. Industrial production, which according to the FIBGE showed a growth rate of 12.85 percent and 12.33 percent in December 1976 and January 1977, respectively, in relation to the previous twelve months, had already gone down to 8.41 percent and 7.48 percent in May and June 1977, respectively. Meanwhile, until May 1977, the inflation rate continued to rise, undergoing its first reduction only in June. This reduction confirmed itself in July and August when the inflation rate went from a monthly average of above 4 percent to a rate of 1.3 percent (see Table 6.2). This strong reduction in the inflation rate followed a series of heterodox administrative measures, which Simonsen finally took in May 1977. Among these was a freeze in the price of gasoline, a very firm action on the part the CIP, and the limitation of the price increases of the state corporations to 25 percent a year.

All of these facts contribute to making it very clear that there is a strong component of costs, or administered inflation, in Brazilian inflation, notwithstanding the component of demand. Therefore, it is necessary to make clear that demand inflation and administered inflation are compatible. They can both overlap and strengthen each other.

Demand inflation does not occur only because of an excess of money or because of sectorial shortages in supply. There is also Keynesian inflation, which occurs when the real aggregate demand exceeds supply at the peak of an economic cycle. This was probably what happened in Brazil in 1973. There are various reasons for real aggregate demand exceeding supply: (a) large investments made by the government; (b) large investments made by the private sector; (c) optimism and an increase in consumption by consumers. Any of these can cause the economy to warm up and then go on to grow rapidly. As the idle capacity disappears, and as the increase in production does not manage to accompany the increase in demand, profit margins and wages begin to rise in an inflationary manner. From 1974 to 1976, investments by the state continued to sustain a strong expansion of aggregate demand by putting pressure on prices while private investments were falling off. At the beginning of 1977, when the government noticed that the state financial resources, which had been abundant from 1967 to 1973, were beginning to be short at the same time that they were feeding inflation, a big cut in investments was announced. While this cut was sponsored by the ministry of the treasury, it was opposed by the other areas of the government, especially the public corporations. All sorts of pressures were put into action again, in order to sustain the economic activity, profits, and salaries.

Aside from being demand administered, Brazilian inflation in 1976 also had a component that was related to the real wage increases of 1975. These increases were inflationary because the corporations were not, and never are, willing to reduce their profit margins. Wage increases above the increase in productivity can only be absorbed without being inflationary if the corporations reduce their profits.

Because Brazilian inflation is a structural process endogenous to the system, it is dangerous to think that it can be done away with in a short

Table 6.2 Inflation - Monthly Rates

Month	1974		1975		1976		1977		1978	
	FGV(a)	DIEESE(b)	FGV	DIEESE	FGV	DIEESE	FGV	DIEESE	FGV	DIEESE
Jan.	2.77	2.07	2.24	2.63	3.18	4.80	3.66	5.29	2,67	4,33
Feb.	2,69	3.89	2,19	2.18	4.07	5.82	3.24	2,47	3,40	4.11
March	4.53	4.69	1,61	2.39	3,77	3,85	4.07	4,75	3,27	3.57
Apr.	5.25	5.13	1.76	2,85	3,64	4,96	4.08	6,36	3,38	1,62
May	3.47	1,84	2.07	0,72	3,51	2.32	3.58	1,59	3,20	2.68
June	1,88	0.64	2.20	2,83	2,66	0,71	1,97	1.24	3,62	4.07
July	1.23	1.45	2,15	3.45	3.77	2,40	2.10	1.81	2,85	3,42
Aug.	1.21	1,89	2,76	3.66	4,09	4,21	1.27	1,10	2,67	2,40
Sept.	1.80	2,46	2,37	1.93	3.38	2,77	1,80	2.95	2,56	1,59
Oct.	1.38	2.46	2,16	1,71	2.43	2,37	2,69	1,78	2,83	3,01
Nov.	1,55	1,84	2,26	0,35	1.85	1,49	2.62	2,69	2,75	2.26
Dec.	2.29	2,25	2,07	0.66	2,33	1.62	2,11	1,69	1,54	1.21

Sources: (a) Getúlio Vargas Foundation (FGV) - General Price Index, Domestic Availability (col. 2) In: Conjuntura econômica, n° 3, Vol. 30, March, 1976; n° 7, Vol. 31, July, 1977. (b) DIEESE - Cost of Living Index (Interunion Department of Socioeconomic Statistics and Studies - DIEESE, 1977).

period of time. If inflation is structural, the Brazilian economy must live for years with a certain inflation rate. Obviously, however, there is no need for this rate to be 40 percent per annum. Rates of 15 percent to 20 percent are sufficient for making the adjustments in the system.

7

In order to control inflation, it is undoubtedly necessary to adopt the classic means of fiscal and credit restrictions, with moderation, when the demand component is obvious. On the other hand, when the government has a budget deficit while the economy is functioning at almost full capacity, it is necessary to reduce expenditures, or, preferably, to selectively increase taxes. Tax increases have the advantage of being able to be less indiscriminate, thus making a better distribution of the income possible. Aside from this, government investments can be maintained while the consumption of luxuries is cut. Meanwhile, it is necessary to make it clear that, while contractionary monetary and fiscal measures are only justified when there is pressure from demand and an unbalanced budget, administrative price control is necessary under any circumstances in a cartelized economy like that of Brazil.

Certainly, it is theoretically possible to reduce inflation by using only monetary means. Money is the oxygen and lubricant of the economy. If the monetary authorities succeed in reducing the real money supply, prices become stabilized, even if inflation has structural causes or a strong component of administered prices. We know that there is a strong correlation between prices and the money supply. When prices are increasing autonomously and forcing the monetary authorities to increase the nominal money supply, if these authorities were capable of not carrying out this increase, prices would become stabilized. However, this would only be possible through the creation of an enormous liquidity crisis and a strong recession. As long as only the symptoms of inflation are prevented from appearing, rather than the causes being fought, only a serious, permanent recession can contain prices. Underdeveloped countries like Brazil have much less tolerance for recessive monetary policies than the central countries for two reasons: first, because they do not have unemployment insurance, so that large-scale unemployment is catastrophic; second, businessmen do not support the recessive measures because they do not need them to control wages. When inflation threatens to increase in the central countries during the expansive phase of the cycle, the corporations support recessive measures in order to prevent—as the industrial reserve army is eliminated—wages from growing faster than profits. In Brazil, given the existence of massive underemployment, businessmen are not afraid of an increase in wages, and so they do not support the orthodox policies for controlling inflation. On the other hand, the government has neither enough power nor enough real interest to go against the interests of the dominant class. Therefore, anti-inflationary policies have a short life span.

If inflation has administered components, the only logical way to contain it is by controlling prices. The CIP is a system that was intelligently planned, considering that its objective was to control the prices of the products of the oligopolistic corporations. However, since 1974, it has had so many of its functions taken away that it has often been unable to be an effective instrument for controlling prices. It was only in May of 1977, when the monetary authorities seemed to be desperate when faced with the systematic failure of their monetary methods for fighting inflation, that they decided to firmly adopt administrative anti-inflation methods. But in August 1977, when the general price index of the Getúlio Vargas Foundation went down 1.3 percent and the wholesale price index 0.9 percent, the president of the central bank, Paulo Lyra, in keeping with his neoclassical orientation, "named the containment of demand and the cooling off of the economy as the best reasons for anti-inflationary success. However, he recognized the importance of what is considered to be a key factor by various analysts, the rigid control of critical prices."[13]

Actually, what the anti-inflationary economic policy has clearly shown is that orthodox measures for containing credit are effective for reducing the growth rate of the economy, but not for controlling inflation. Pressure from the oligopolistic groups that make up the most dynamic sectors of the economy, as they try to increase their participation in the economic surplus, thwarts the monetary measures. What is more serious, however, is that these sectors could also thwart administrative measures while the government is under their control.

It is at this point that we perceive the political basis of Brazilian inflation. In 1977, the government limited the rate of salary increases of civil servants to 30 percent while inflation was more than 45 percent, and controlled the prices of public corporations. By this action, it seemed to have decided to make the lower- and middle-level state technobureaucrats pay the bill for controlling inflation along with the workers, since that year nominal wage increases were set by the government at rates that were lower than the increase in prices. As new elections would only take place at the end of 1978, this policy did not seem to be risky. As for making the state carry the major part of the burden of the anti-inflationary measures through a reduction in the profits and investments of the public corporations, everything shows that these are the political results of a campaign against the state-run enterprises started by the bourgoeoisie in 1975. Once more, politics and economics are dialectically interrelated, with one instance determining the other and vice versa, but always in keeping with the demands of accumulation of the Brazilian economic system, which is predominantly capitalist.

During the second semester of 1977, the clear reduction in the inflation rate was verified to be a direct result of the administration of the prices of the state corporations by the ministry of the treasury. At the end of 1978, however, the inflation rate started to accelerate again, ending the year with an increase in prices of around 40 percent. This led Minister Mário Henrique Simonsen to give interviews to journalists in which he revealed his perplexity.[14] The experience of the government forces leads one to recognize that fighting inflation is not as simple as it seems, and that its causes are not as exogenous as the monetarist analysis claims. It also makes it clear that political conditioners are inextricably built into the inflationary process. The state's attempt to divide the product into a sum of parts greater than the whole is not exogenous, as the monetarists claim, but is strictly endogenous, as in the structuralist viewpoint.

However, there is one essential component of the administrative character of Brazilian inflation that continues to be ignored: extremely high interest rates. Interest rates in Brazil were very high, and the spread between the rates paid for deposits and those charged for loans is one of the largest in the world.[15] At first, in 1974 when the government adopted a rigid orthodox economic policy, an increase in the interest rates was considered to be beneficial for controlling inflation because it would lead to a reduction in investments. However, as investments are not very sensitive to interest rates, this strategy did not help to control inflation, but only benefitted the banks and rentiers. At the beginning of 1979, when the idea that high interest rates were a fundamentally administrative component of inflation began to spread, people thought that the government would take steps to lower the interest rates. However, nothing has been done, limiting Minister Simonsen to invoke Wicksell's views on the natural rate of interest, emphasizing that "high interest cannot be a focus of cost inflation, but only the rising of the interest rate."[16] He ignored the fact that when a businessman takes out a loan from a banker at a high nominal interest rate, even if it is stable, he has to increase his prices to reduce the real interest rate to limits that are compatible with his profit rate. After all, interest is nothing more than a part of surplus value that the active capitalist pays to the inactive capitalist or rentier, using banks as intermediaries.

Actually, if inflation is a mechanism for transferring income from the workers to the capitalists, and from the "non-priority" sectors to the "priority" sectors of the national economy, it is clear that inflation is useful for the existing pattern of accumulation. However, this is no longer the case when high, increasing real interest rates turn into one of the basic causes of the maintenance and acceleration of inflation. Although investments are not very sensitive to the real interest rate, when it reaches levels as high as those in Brazil, it is obvious that productive capital begins to be affected. On the other hand, a permanent, accelerating rate of inflation threatens social stability and not only hurts the workers, but also, when the productive sectors of the dominant class cannot raise their prices quickly and frequently enough, does not stimulate capital accumulation. On the contrary, it creates problems with international credit and demoralizes the government.

In conclusion, it is not difficult to understand why anti-inflationary economic policy is rarely effective and is always insecure. It reflects the contradictory interests of the Brazilian dominant classes, the imperfections of the market, and the intrinsic contradictions of the pattern of accumulation prevalent in Brazil, which is characterized by industrialized underdevelopment.

March 1980

NOTES

1. For a historical analysis of Brazilian inflation since the middle of the last century, *see* Paulo Neuhaus (1978).

There is a basic bibliography in this book on this subject.

Between 1869 and 1939, annual inflation was less than 5 percent, except for a period during World War I when it went up to 8.5 percent. During the 1940s, it rose to more than 10 percent, and in the period from 1950 to 1976 to 25 percent (296).

2. In Brazil, the expression "monetarists," as it is used by newspapermen and politicians, means the orthodox, neoclassical economists (and eventually Keynesian economists) who attribute inflation to an increase in the supply of money or who recommend restrictive fiscal and monetary policies to control inflation. There is no distinction between Keynesian and *stricto senso* monetarists, who follow Friedman's macroeconomic model, developed in the 1950s and 1960s. Eugenio Gudin, for instance, who was not influenced by Friedman, but mostly by Gottfried Habeler, is usually considered to be the father of the Brazilian monetarist economists.

3. Antonio Delfim Netto, Afonso Celso Pastore, Pedro Cipolari, and Eduardo Pereira de Carvalho (1965).

4. As was definitely shown in 1977, the official indices for inflation for 1973, of around 16 percent, were manipulated by the government by using tabulated prices. The true inflation rate was around 26 percent, which indicates a clear increase in relation to the rate for the previous year.

5. For an interesting exposition of this position, *see* Mário Henrique Simonsen (1969). According to him: "In general terms, the sociopolitical roots of chronic inflation in the underdeveloped countries can be found in the distributive policy of the government. The different social groups show themselves to be unsatisfied with their participation in the national product and, in order to placate them, the government tries to divide the product into a number of parts greater than the whole" (124). Simonsen is an ecletic economist, using orthodox, as well as structuralist, arguments (such as the distributive conflict argument) to develop his own ideas.

6. About structural inflation *see* Juan Noyola (1956), Oswaldo Sunkel (1958), Celso Furtado (1959), Ignácio Rangel (1963), Júlio Oliveira (1964) and Aníbal Pinto (1973, 1978).

7. *See* especially Afonso Celso Pastore (1973).

8. Celso Furtado, in a work that which synthesizes the structuralist position, cites the following internal structural inflationary foci, aside from pressure to increase imports: inelasticity in the supply of agricultural products, inadequacies in the infrastructure, inadequacies in the available human resources on a short term basis, inadequacy of the fiscal structures, and an increase in the financial costs of the corporations (1976).

9. When, at the beginning of 1977, the National Association of Automobile Manufacturers showed its lack of interest in the liberalization of controls that the CIP was proposing, Eduardo Matarazzo Suplicy (1977) commented: "This organism for controlling prices (CIP) has become an administrator of the prices of the oligopolized industries in Brazil for the cartels. The actions of the CIP have been so much in line with the interests of the leading industries that produce final goods that they are afraid of a complete liberalization of prices."

10. *Estado cartorial* is an expression used by some Brazilian political scientists for the traditional Brazilian state which, aside from its classical liberal functions, also gave jobs to the middle class linked to the agrarian exporting oligarchy.

11. Carlos Eduardo Silveira observes that "inflation works in the most general manner to redistribute returns and to favor accumulation in the new dynamic center of the economy" (1974).

12. According to Luiz Antonio de Oliveira Lima, "When, at the beginning of 1973, the economy came close to a full utilization of the productive capacity, corporations with the most market power began to raise their markup" (1977).

13. *Gazeta Mercantil*, 2 September 1977.

14. *See*, among others, a long interview given to *Folha de São Paulo* (1978). This perplexity led Minister Simonsen, after being nominated to the

planning ministry, to present Congress in May 1979 with a report in which the administered components and the structural components of inflation were recognized, although timidly (Mário Henrique Simonsen, 1979). Francisco Lafayette Lopes (1978) developed a formal distinction between monetarists and structuralists, according to which, structuralists would be all of those who admit the existence of the Phillips curve, or, in other words, of an inverse relation between the inflation rate and the unemployment rate. According to this concept, the Brazilian governmental policy was structuralist. This formal distinction is not acceptable, even though it has the virtue of showing that no monetarist economist is able to remain orthodox when faced with the task of governing.

15. According to a survey of world financial markets, published by Morgan Guaranty Trust Company in May 1977, of the twenty-seven principal capitalist countries of the world, Brazil had the largest spread between interest rates given on deposits and those charged for loans: 43.8 percent for deposits and 62.0 percent for loans. In the United States, Great Britain, France, and Germany, the spreads were 1.50 percent, 1.75 percent, 3.75 percent, and 1.50 percent respectively.

16. Mário Henrique Simonsen (1979).