# A PRAGMATIC APPROACH TO STATE INTERVENTION: THE BRAZILIAN CASE

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This article examines State intervention in the Brazilian economy, in an attempt to elucidate why the State ceased to play a decisive part in the country's development. The primary explanation lies in the cyclical nature of State intervention. In the beginning, intervention tended to be very successful, especially when the country was launching its industrialization phase. Gradually, however, the distortions inherent in intervention without some form of market control began to accumulate, leading the State into fiscal crisis. The current neoliberal wave and its success in advocating privatizations can be understood in these terms. The State had become bloated, not only in Brazil but also in other countries, giving rise in the past 20 years to the need to shrink it and reorganize its finances. In view of these circumstances, the author observes that the pragmatic attitude adopted by East Asian and South-East Asian economists to this problem, i.e., favoring a basic market orientation and fiscal discipline without hesitating to resort to State intervention when necessary, could be very useful.

## Introduction

State intervention is certainly one of the most intensely debated economic and political subjects in this century. There are two reasons for this, one factual, the other ideological As a matter of fact, State intervention in the economy is relevant for the simple reason that governments all over the world, in rich and poor countries, in capitalist and statist countries, are continuously intervening in the market. For ideological reasons, State intervention is important because to favour or oppose some degree of State intervention is a basic criterion for distinguishing the Right from the Left, conservatives from liberals, neoclassical or neoliberal economists from progressive or Keynesian economists.

At certain times limited State intervention becomes a relatively acceptable practice. This clearly occurred in the 1950s and 1960s, when a Keynesian consensus prevailed; in others, as in the last 20 years, the conservative attack on State intervention becomes dominant. Whereas earlier the failures of the market were contrasted with the possibilities of policymaking and planning, now the inverse type of reasoning is the new truth of a "new Right", whose ideas are based in economics and the market, rather than in the political philosophy and ideas about tradition and hierarchy that defined the "old Right" (Bosanquet, 1983).

In macroeconomics the appearance of monetarism in the 1960s and of the "new classical" school based on rational expectations in the 1970s are the best symptoms of this conservative wave. Behind the rise of the new Right in the macroeconomic field we have the collapse of the Keynesian consensus: on the one hand, the State had become too big and inefficient, plagued by a fiscal crisis (O'Connor, 1973); 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. In development economics, the failure of the "big push" industrialization theories, which were behind the dominant import substitution model of industrialization of the 1950s and 1960s, gave rise, in the 1970s, to an export-led, market-oriented theory of growth, whose basic tenets were and continue to be privatization and trade liberalization. The fact that countries which adopted 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 nor hinder the followers of the new credo to use these countries as examples of their ideas. Finally, in comparative economics, the failure of statist economies to maintain the high rates of growth achieved in the 1950s and the 1960s throughout the 1970s and 1980s served as a powerful ideological argument favoring neoliberal theory. The launching of *perestroika* in the Soviet Union and the subsequent breakdown of the communist governments in Eastern Europe were presented as the empirical demonstration of neoliberal ideas. The neoliberal rhetorical strategy was to view support for limited State intervention in the same way as the extreme State control of the economy prevailing in the statist countries.

More recently this neoliberal wave is coming under attack. The insufficiencies of monetarism and rational expectations are becoming manifest. The status of State intervention in economic theory is again changing. The simplistic idea held by the new Right that "the market is good, and government bad" cannot be sustained on theoretical and practical grounds.

Changes in the way that market and State intervention are viewed are related to its recurrent successes and failures. As long as the practice of State intervention is functioning successfully, the theories that support limited intervention are in favour. Yet as soon as they stop working or prove dysfunctional for some reason, the voices of conservatives or neoliberals become louder. In another paper (Bresser-Pereira, 1988b) I discussed the cyclical and ever-changing nature of State intervention. In this paper I will apply the theory to the Brazilian case. In addition, taking Asian economists as a reference point, I will argue in favour of a more pragmatic or dialectical approach to State intervention in market-oriented economies.

## The cyclical character of state intervention

State intervention in modern times has assumed three forms, corresponding to three historical models of development: i) the State as a substitute for the market in the co-ordination of the economy (statist or Soviet model); ii) 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 in this century); and iii) the State as macroeconomic policy-maker, promoter of welfare, microeconomic regulator of the influence business enterprises have on the marker and the environment, fiscal stimulator of technological growth geared toward international competitiveness, and bargaining agent for international trade on behalf of their respective countries (present OECD-countries model) The first historical model of State intervention falls outside the scope of this paper. I will discuss State intervention in Brazil, taking for granted that we are dealing with a capitalist, market-oriented economic system, in transition from the second to the third model of intervention.

My general contention is that some degree of State intervention is necessary to run capitalist countries. Without it economic growth and social well-being will suffer. The market is by far the best co-coordinator of the economy, and yet it is not able to allocate resources and guarantee growth in an optimal way. On the other hand, the market is a very poor institution for achieving income distribution. That is why the neoliberals' radical stand against State intervention is essentially ideological. This does not mean, however, that their position is simply incorrect. On the contrary, their views may be quite functional. Their constant contention that State intervention, in trying to cope with the insufficiencies of market co-ordination of the economy, finally provokes worse distortions should not be too readily dismissed.

In practical terms State intervention in a given sector of the economy tends initially to be effective, i.e., tends to correct the coordinative insufficiencies of the market; however, since public officials seldom know when to stop the intervention process, it eventually ends up being inefficient. Regulations became casuistic, the protection offered to certain industries ceases to be transitory – as it should always be – and tends to became permanent, State expenditures and

State tax reductions tend to increase at a higher rate than State revenues, public deficit and public debt increase and the threat of a fiscal crisis becomes increasingly present.[1]

If State intervention were not necessary and efficient in its early stages, it would not occur with such frequency. It is always possible to explain State intervention as an irrational result of interest-group pressures striving for same kind of protection, but the resulting government policies are just one type of State intervention. Even if we acknowledge, following Mancur Olson's suggestion (1975, 1982), that organizations which represent large groups are less effective in producing public goads than small interest groups, the fact is that most Stare regulations are oriented to the general interest rather than to particular or sectoral ones. This was a clear advance of modern democracies, which should not be dismissed by conservative though.

To say that State intervention is, in principle, efficient or inefficient makes no sense. State intervention may be efficient or inefficient, necessary or unnecessary, should be reduced or increased, depending on each specific situation. In general terms, State intervention will be necessary and efficient in the initial phase of the intervention cycle, whereas it will became excessive and inefficient in its final phase. In this phase the State probably will already be inflated and will have became increasingly unable to act, given the interests of external (lobbying) and internal (technobureaucratic) constituencies that led the State into fiscal troubles if nor into fiscal crisis.

## The Brazilian case

In the Brazilian case the cyclical and changing character of State intervention is quite clear. In the past, from the 1930s to the 1970s, the State performed a decisive role in promoting economic growth; in the 1980s, given the fiscal crisis, the State lost its capacity to promote economic growth and became a basic obstacle to it.[2]

Some economists and political scientists in Brazil, who previously supported State intervention for the protection of local industry and the creation and development of State-owned enterprises in those sectors where private capitalists were unable or unwilling to invest, today favour trade liberalization and privatization. This does not mean that they have become conservative. It only means that Brazil is in a different phase of the State intervention cycle – one where it is necessary to reduce, streamline and tighten the State organization in order 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.

Between the 1930s and the 1970s the pattern of State intervention in Brazil was permanently changing, but was effective in promoting economic development. Data on the growth of the gross domestic product in this period demonstrate this quite clearly. In the 1930s the State began a long-term and initially successful industrial policy of import substitution. In the 1940s and the 1950s State-owned enterprises were established in the basic sectors of the economy: steel, oil, electrical power and transportation.

The 1960s represented a period of transition and fiscal adjustment, but the change in industrial policy was quite limited. The basic innovation of the technobureaucratic and authoritarian government that came to power at that time was a clear export-oriented policy. The objective was to export manufactured goods. But the protection of local industry, a basic characteristic of import-substitution industrialization, was maintained. And direct investment by the State was resumed, as it nationalized the telephone industry and completed the nationalization of the electrical power industry.

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[1] The classical analysis of the tendency of modern capitalist economies to fall into a fiscal crisis was made by James O'Connor (1973).

[2] The literature concerning State intervention in Brazil is quite extensive. See, for instance, Wilson Suzigan (1976, 1988), Luciano Martins (1985), Peter Evans (1979), Fernando Rezende da Silva (1972).

Finally, the 1970s were the years of the economic miracle (1968-1978) and the years of the Second National Plan of Development 1974-1979 (II PND). This plan was characterized by the promotion of a new wave of import substitution in the basic sectors of the economy (steel, non-ferrous 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 the years when Brazil acquired its huge international debt and began the process of State domestic debt.

During these 50 years we may distinguish two cycles. The first came to an end in the mid-1960s, when the military government resulting from the 1964 military 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 was submitted to a fiscal macroeconomic adjustment and to structural reforms (indexation system, tax reform, financial reform, housing financial system reform) that re-established the State's capacity to promote forced savings and to channel them to direct State investments or to subsidized private investments. The second cycle is not yet complete, given that the country has not yet been able to overcome the fiscal and economic crisis of the 1980s.

## The crisis of the 1980s

The crisis of the 1980s, defined by stagnation of per capita income and extraordinarily high rates of inflation,[3] was the result of a series of errors made by the government, particularly at the end of the 1970s, combined with adverse changes in the international economy (second oil shock, interest shock and recession in the United States) in1979. Between 1967 (a date that could be chosen as the first year of the new expansive cycle) and 1973, State intervention was successful in promoting economic growth. The mistakes began in 1974 and became very serious in 1979.

In 1974, just after the 1973 oil shock that led most industrialized countries to introduce severe adjustment processes, the Brazilian government decided to engage in an ambitious programme of economic development. My personal views about the II PND have changed over time. I was initially critical of it as being overly ambitious. I became favorable to it after Barros de Castro and Souza's analysis (1985) demonstrated that this plan was effective in consolidating a strong industrial infrastructure and in warranting a structural trade surplus for the country. Recently I have again become more critical of this plan. The decision to grow by taking advantage of the enormous supply of foreign loans at very low interest rates was quite understandable, although risky. But the decision to use this money primarily for investment in capital-intensive import-substitution industries was a mistake, just as it was a mistake to maintain a high degree of protection for local industry. That would have been the right moment to use the foreign loans my increase the international competitiveness of Brazilian industry. It would have been the time to move towards an export-oriented and technology-intensive model of growth, while beginning to liberalize foreign trade gradually.

Meanwhile, Korea was making quite similar mistakes, becoming externally indebted in order to invest in import-substitution basic input industries (Koo and Nan, 1989). But at that time, Korea was also oriented to export and starting a process of trade liberalization that fostered its basically exported industrialization model. And in 1979, precisely the year Brazil was engaging in a new – and short-lived – populist "miracle", the Korea government was able to correct its industrial policy while promoting a rigorous fiscal adjustments, which led to a 5% reduction in the gross domestic product.

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[3] I have made two broad analyses of this crisis, one emphasizing its fiscal aspects and its foreign debt origins (1989a) and another which seeks to build a macroeconomic model out of it (1989b).

In Brazil the "growth cum debt" strategy of State intervention turned into a disaster in 1979, when the three above-mentioned external shocks hit its fragile – because already highly indebted – economy. At the time there was no other alternative but to adjust. However, the military government decided to do precisely the apposite. It held down the exchange rate, made the domestic interest rate negative and increased wages and consumption. The consequences of this populist yet conservative economic policy were disastrous. The foreign debt/export ratio, which at the beginning of 1979 had already reached a dangerous 2-to-1 relationship, had increased two years later to 3-to-1. In 1979 a strong adjustment policy would have counterbalanced the indebtedness policies of the Second National Plan of Development. Two years later, adjustment alone was not enough; it became self-defeating. Now fiscal adjustment had to be combined with some form of debt reduction (see Bresser-Pereira, 1988 and 1989b).

After the populist policies of 1979-1980, efforts to adjust the economy, from 1981 to 1984 and from 1987 to the present, became ineffective. Their only consequence was to reduce the investment rate and worsen the fiscal crisis. Between these two periods we had a new cycle of populist policies, beginning in 1985 with the New Republic and ending in 1986 with the disaster of the Cruzado Plan[4]

## Paralysis of the State

In the 1980s, the basic consequence of the economic crisis was the paralysis of the State with regard to long-term economic policy. With the fiscal crisis and its basic consequences — acceleration of inflation and stagnation of the economy – the State became increasingly unable to define and implement long-term objectives. And nothing is more important for developing countries than an effective overall strategy of economic development.

Such a deep economic crisis as that of the 1980s is a clear signal that the old strategy of economic development is exhausted. The fiscal crisis is an indication that the model intervention in Brazil is exhausted as well. In other words, if crises are always signals of illness and an opportunity for change, it is clear today in Brazil that the form of State intervention that was crucial to the extraordinary pace of industrialization between the 1930s and the 1970s must now undergo a complete overhaul.

This crisis is also a signal that, more than the model of State intervention, it is the model of society in Brazil that is exhausted. Brazilian society is characterized by a very high degree of income concentration. As long as the country was developing quickly, income concentration was nor a major problem. But once that development stopped, it became a major source of continuous and worsening social conflict – a conflict that underlies the public deficit and the acceleration of inflation.

The translation in practical terms of the need for change in the development strategy or in the form of State intervention was reduced (particularly by World Bank economists) to the proposal of "structural reforms" that should be adapted by the developing countries. These reforms have a clear liberalizing intent. They are based on trade liberalization, deregulation and privatization. This is not the appropriate time to discuss these proposals.[5] Although they are sometimes exaggerated in their demand for reduced State regulation and do not always consider the size of the countries, their general orientation is correct. They correspond to a given moment when State intervention, alter a phase of excessive expansive, must now be reduced and its priorities changed.

The three basic strategies used by the Brazilian State for promoting industrialization were i) trade protection; ii) subsidies oriented either to import substitution or to export promotion;

[4] See Jeffrey Sachs (1988) on the populist nature of the Cruzado Plan.

[5] For a critique of the unrealistic nature of radical trade liberalization reforms sponsored by the World Bank, see Jeffrey Sachs (1987).

and iii) direct State investments in public services and basic input industries (electricity, oil, steel, communications, railroads). As these strategies are ceasing to be functional in promoting economic growth, an increasing consensus is emerging for a new strategy that should be based on three fundamental policies: i) elimination of generalized subsidies and incentives; ii) trade liberalization and case-by-case subsidies to technical progress in order to stimulate international competitiveness; and iii) privatization, which will help to solve the fiscal crisis of the State,[6] besides increasing the efficiency of resource allocation.

Given the fact that Brazil is a large country, trade liberalization will be necessarily limited in comparison with smaller countries, but there is no doubt that a substantial degree of liberalization will form an essential part of any future industrial policy. State-owned enterprises had a decisive role in the first phase of industrialization, but now, when efficiency is becoming crucial and the State urgently needs financial resources to balance its accounts, privatization is a natural solution. The elimination of subsidies is essential to overcoming the fiscal crisis, but once stabilization is achieved a new industrial policy where an export orientation is tied to direct and indirect subsidies to technological development will be necessary.

An increasing consensus is being reached in Brazil in relation to the need for these structural reforms. Yet they are not materializing. Why? Several reasons may be listed: the resistance of industrialists, who are afraid to lose subsidies, incentives and administrative and tariff protection, or the resistance of bureaucrats and of the traditional nationalist Left, who insist on defeating State-owned enterprises. But the fundamental reason why little or nothing has been achieved in this area is the public sector's paralysis due to the crisis. The government tries to establish a new long-term industrial and development strategy and makes agreements with the World Bank towards structural reforms, but the results are clearly unsatisfactory. Reforms are not implemented because one of the basic characteristics of an economic crisis, and particularly of a fiscal crisis, is the paralysis of economic policy.

A fiscal crisis means that the State has no funds to finance a new economic policy; that policy-makers have neither the time nor the willingness to formulate and implement the new strategy. If in addition to fiscal crisis there is also a social crisis due to excessive income concentration, the consequence is a legitimacy crisis that permanently threatens the political system and aggravates the State's paralysis.

## Statist and neoliberal responses to the crisis

The question now, after almost 10 years of economic stagnation and high rates of inflation, is how to get out of this crisis. Specifically, what we are discussing in this paper is the rate State intervention plays in overcoming the crisis and in resuming growth.

Neoliberals would respond to these two questions very simply. The crisis is to be overcome by fiscal adjustment. In order to have fiscal adjustment it will be necessary to privatize State-owned enterprises and deregulate the economy, reducing the size of the State apparatus. The objective will be the minimal State, given that "the State serves a double role, that of enforcing constitutional order and that of providing *public goods*" (Buchanan, 1974). Given that they are conservative and generally unable to distinguish old-time nationalism from the national interest, their understanding is that the foreign debt should be fully paid.[7]

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[6] 'It is relevant to note that Ignacio Rangel, one of the outstanding Brazilian economists who helped to formulate the industrialization strategy via protection and direct State investment, has been speaking in favour of privatization of public services in order to promote needed investments in this area since he wrote the "Postface" of the third edition of *A Inflação Brasileira* (1978).

[7] This approach is well represented in Brazil by the weekly columns written by former ministers Roberto Campos and Delfim Neto, in *O Estado de São Paulo* and *Folha de São Paulo,* respectively.

The response that statists or the old Left would give is quite different. They would suggest that to overcome the fiscal crisis it is necessary to increase taxes and reform the State organization and State-owned enterprises, eliminating inefficiencies and fighting corruption, but not reducing the size of the State. On the contrary, it should be increased in order to resume growth and achieve a less unequal distribution of income than the one existing in Brazil. Reduction of the debt should be a condition of repayment.

## The pragmatic and dialectical approach

The response that pragmatic and dialectical economists would give is again different. By pragmatic I mean those economist-technocrats who work within the State organization and define economic policy in most countries today. They are nor theoretical economists, nor are they ideological economists.[8] They are practical economists, directly involved in government.

These economist-technocrats have existed for a long time. In Brazil, however, they have come under attack since the 1970s.[9] As a defense mechanism, they have tended to disguise themselves, to make their existence as unnoticed as possible. Thus I was surprised to see, when I participated in an international seminar in Tokyo in the summer of 1989,[10] that most of the Asian economists present were members of their respective governments and defined themselves without embarrassment – on the contrary they seemed quite proud of it - as pragmatic technocrats in opposition to theoretical and ideological economists.[11]

It is well known that the role of the State in the development of the East Asian and South-East Asian countries, starting with Japan and then Korea, Taiwan, Singapore, Malaysia and, more recently, Thailand and Indonesia, was and continues to be very important.[12] During the l980s, while the Latin American countries have stagnated, the East Asian and South-East Asian countries are booming. Whereas per capita income actually decreased in the Latin American countries in this decade, it grew about 4% annually in these Asian countries.

One explanation for this difference in economic performance is that Asian pragmatic economists combine a very strong fiscal discipline with a high degree of State intervention. But their discourse carefully avoids reference to State intervention, while they praise as much as they can their "market-oriented economies". They do believe in a market-oriented economy, but they also believe in and practice a permanent State intervention. A good example of this general attitude is expressed by Seiji Naya:

> "The NIEs 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-fair 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" (1989: 5 and 7).

This oriental economic pragmatism includes a certain degree of pragmatic dissimulation. The members at the capitalist dominant class want to hear that their economies are market-

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8 It should be remembered that it is very difficult to distinguish theoretical from ideological economists

9 This attack on the technobureaucracy was part of the long Brazilian transition to democracy. The alliance between the bourgeosie and the military and civilian technobureaucrats was first broken in Brazil in the mid-1970s. In my book*, O Colapso de uma Aliança de Classes 1979),* I analyzed this political process.

10 "The Tokyo Symposium on the Present and Future of Pacific Basin Economy - A comparison of Asia and Latin America" sponsored by the Institute of Developing Economies, Tokyo, 25-27 July 1989.

11 Actually, some were also very competent theoretical economists.

12 On this point see, among others, Seiji Naya (1989).

oriented, and they say so. In Japan, for instance, government economists insist that the economic role of the public sector is currently a very small one. Only after a lot of questioning will they admit that the Japanese State presently dispenses large sums of money to subsidize technological development. This attitude is not dissimulated, however: it is dialectical. They indeed believe in the benefits of a market-oriented economy and, at the same time, they know full well that the State continues to play a decisive role in economic development and income distribution —a distribution which, by the way, is extremely less unequal in their countries than in Latin America.

The response that pragmatic and dialectical economists would give to the question of how to overcome the Brazilian economic crisis is quite clear. In the short run, given that the economic crisis is essentially a fiscal crisis, they would ask for fiscal discipline, for an effective fiscal adjustment that would eliminate the public deficit. 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 this debt, they would demand debt reduction, which will be achieved only by a combination of negotiations and unilateral measures. In the medium term, they would privatize as many State-owned enterprises as possible and they would begin a process of trade liberalization. But their objective, in contrast with that of the neoliberals, would nor be the "minimal State", but to reform the State so that it once again becomes capable of formulating and implementing effective economic policy.

The new strategy adopted by pragmatic economists would not be based on direct State investment, much less of protection to inefficient import-substitution industries, but rather on the support of technological development to gain international competitiveness. On the other hand, they would support income distribution by increasing spending on education and health in a decentralized way. It is becoming increasingly clear that the high degree of income concentration which exists today in Brazil is a major obstacle to economic growth and price stability, as it permanently feeds a high degree of distributive conflict.

This approach to State intervention and to solving the Brazilian economic crisis is dialectical as well as pragmatic for two reasons: i) because it simultaneously supports a strongly market-oriented economy and State intervention in the critical areas that the market is unable to co-ordinate and ii) because it acknowledges the cyclical nature of State intervention. Sometimes, as at the present moment, it is necessary to reduce the State and reshape it in order to render it more effective (able to implement public policies) and efficient (able to implement these policies at low cost).

But what I am suggesting is a dialectical rather than a pragmatic approach to economics and to State intervention. While rejecting the ideological pitch of neoliberal or statist economists, I am arguing in favour of economic theory and transparency of ideological influences. A dialectical strategy rejects the dissimulation of State intervention as much as the radical affirmation or the radical negation of it which respectively dominates statists' and neoliberals' rhetoric.

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