The Limits of Neoliberalism: Business, the State, and Democratic Consolidation in Brazil

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Brazil's *Nova República* (New Republic) began its life with significant challenges left to it as the legacy of military rule. On the economic front, the country suffered from intractable high inflation coupled with sluggish growth. By 1985, inflation ran at over 220%, annual GDP growth rates swung between sharp contractions and low to moderate expansions, while investment as a share of GDP decline from over 20% in 1980 to just over 16%. The government's budget deficit on average between 1981-1984 exceeded 5% of GDP, while foreign indebtedness had climbed to 95 billion $U.S.[1] By the start of the New Republic, business-state relations had also badly frayed.[2] Business criticism began in the late 1970's, but the military government's turn to IMF orthodoxy in 1981 had provoked increasingly sharp attacks. By 1985, those criticism had moved from disgruntlement with government to growing disgruntlement with the role of government. In that context, small groups within both the business community and the government (notably the BNDES) had come to believe that the import-substitution model that Brazil had relied on since the 1930's had run its course. Thus, when José Sarney became the first president of the new democracy, in addition to working to consolidate the new democracy, he faced two complementary, tasks: stabilize the economy and define a new strategy for growth. Those tasks have remained on the agenda of every president that has followed.

By the end of 1996, the Republic's fourth president, Fernando Henrique Cardoso, had successfully stabilized the economy. Cardoso's success came after years of muddling through, with a fair mixture of recession, high inflation, sharp swings in capital flows, and no shortage of chaotic politics and policy uncertainty. As a direct consequence of successful stabilization, Brazil went from a much criticized economic reform laggard to one of the most attractive investment sites in the developing world. The Brazilian economy drew in 9 billion $U.S. in direct foreign investment in 1996, with projections of 16 billion $U.S. for 1997 and over 220 billion $U.S. projected by 2002.[3] Nevertheless, despite Cardoso's successes, the country continued to face concerns over the state's finances and the threats they posed to continued economic growth. Similarly, the government's efforts to promote export-led growth faced significant limitations that pointed to the continued absence of a clear growth strategy.

In what way has the restoration of democracy affected the country's capacity to renew growth? The literature on regime types and growth has concluded rather decisively that there is no consistent relation between regime type and growth.[4] Aside from that conclusion, there is no decisive answer to the question of whether democracy contributes to or hinders stabilization and economic growth. Brazil's experience has tended to confirm the uncertainty of the findings in the general literature: democracy has both hindered and helped.

On the one hand, democracy has significantly complicated the policy-making process and has made stabilization particularly difficult. Members of Congress, motivated by electoral concerns,[5] have steadfastly resisted constitutional reforms central to long-term resolution of what Bresser Pereira calls "the fiscal crisis of the state."[6] Similarly, democracy in Brazil has slowed or limited the country's definition of a new growth strategy. Successive governments have found it hard to define and implement a coherent strategy for renewing growth as complex bargaining over stabilization policies and a variety of compensatory policies has tended to dominate the policy-making process.

On the other hand, democracy in Brazil has played a positive role. First, the occurrence of regular elections has afforded Brazil's leaders repeated opportunities to recast coalitions in support of economic reform. Thus, unlike the military government which became immobilized when it lost its credibility, governments in the New Republic have been able to incrementally push reform by continually rebuilding coalitions behind economic change. Second, the need to continually bargain with social actors has had a positive effect of forcing the government to resort to policies outside of the strict neoliberal framework. As of the mid 1990's, neoliberalism had lost some its luster. Thus, the government's flexible use of policy to offset the costs of reform and maintain political support for the process has contributed to the New Republic's later economic successes.

In turn, the slow muddled progress Brazil has made has helped consolidate democracy. First and foremost, successful stabilization has helped bring economic benefits to new segments of the population, thereby helping to build a stronger constituency for democracy, particularly among the poor, than existed previously. Second, the effects of successive governments' reform strategies have fragmented the business community and weakened the position of those elements within it that might still prefer military intervention.

Thus, as of 1997, the democratic process has helped Brazil stagger towards renewed growth by allowing new governments to overcome policy stalemates by crafting new pro-reform coalitions. This has allowed the New Republic to make awkward, halting progress towards economic reforms. Curiously enough, the country's successes have defied the neoliberal prescription: first by the notable failure of successive Brazilian governments to achieve financial stability; and second because Brazil's success depends on a range of non-neoliberal policies that maintain a central role for the state and domestic market orientation. However, Brazil's democratic process continues to hinder efforts at economic reform by continuing to impede successful financial adjustments and by continuing to divert attention away from defining a coherent strategy for growth. Despite the continued risks to Brazil's economy, the successes of recent years have helped to further consolidate democracy by generating new beneficiaries of economic growth and by fragmenting potential opponents to the regime.

The Sarney Presidency

José Sarney began his presidency with an extraordinarily full agenda and few political mechanisms to effectively address the issues he faced. His agenda included writing a new constitution for the Republic, finding a formula for stabilizing a chronic inflation that had proven very resistant to orthodox austerity measures, finding a new formula for growth that satisfied the increasingly divisive and argumentative business community, and satisfied a wide variety of longings for increased participation in politics and economic benefits. To settle these myriad questions, he could rely on a party system that had begun fragmenting almost immediately, a state policy making structure that could achieve little interministerial coordination and in many instances was thoroughly captured by private interests, and substantial pressure from abroad to meet the country's financial obligations and move towards neoliberal reform, regardless of their consequences for the domestic economy.[7]

It is not surprising, then, that the Sarney presidency seemed to confirm the worst fears that democratic governance is not consistent with the needs of economic growth. By the end of his term, the state's finances had deteriorated from bad to much worse. Inflation rose from 220% per year in 1985 to over 80% per month by 1990.[8] Sarney's stabilization efforts began with heterodox experimentation and moving more and more through the term to orthodox measures. Growth swung sharply between higher rates spurred by consumption booms, followed by sharp contractions. Overall, productive investment fell as firms displayed increasing uncertainty about the state of the economy. The government fared little better on its effort to promote a new growth strategy. The Sarney government's Industrial Policy began very tentative moves towards commercial liberalization and privatization. However, neither move had strong support within the government and private lobbying groups successfully limited their implementation.

Finally, business-state relations deteriorated even further. Although private lobbies and sectoral representatives maintained their access to the government, the business community as a whole expressed a great deal of frustration over the constitution, drafted over 1987-1988. Business anger at their perception of the profoundly interventionist character of the document exploded in a range of business protest movements. Both the collapse of the Sarney government's credibility and the rise in hostility of the business community towards government helped produce fertile grounds for Fernando Collor's subsequent reform efforts.

State Finances and Stabilization

Sarney's most visible policy initiatives all came in the area of stabilization. Even before the start of the New Republic, inflation had begun to defy the sophistication of Brazil's indexation mechanisms and their ability to shelter many Brazilians from the worst effects of inflation. The indexation that the military had created in 1967 effectively managed inflation through the 1970's (although at high levels). However, the combination of indexation's inertial effect and the financial disequilirium that stemmed from the debt crisis overwhelmed the system. The risk of rising inflation was that it could (and did) intensify conflict between public sector and the private sector, within the private sector, and between labor and business as each segment of society fought to maintain its share of national income. The result was that combating inflation became Sarney's first priority.

His first, and boldest effort, was the Cruzado Plan, announced February 1986. The plan included a new currency (the Cruzado), a temporary wage and price freeze, and the temporary prohibition of indexation of contracts. The plan also incorporated by fiat an across the board wage hike. The results appeared instantly. Inflation declined from over 20% per month in February to less than 1% per month in March. In addition, the real wage increase given to workers led to a sharp increase in purchasing power. The combination produced a euphoric consumption boom. It was neither a surprise, nor an unintended consequence, that Sarney was a very popular man. Sarney successfully converted his public support into electoral support for the 1986 legislative elections.

Unfortunately, his political manipulation of the plan contributed to its flaws, thereby guaranteeing the collapse of the effort.[9] One of the central problems of the plan was that the price freeze had widely varying effects. Firms that had adjusted prices upwards relatively close to the time of the freeze benefited from the freeze, while those that hadn't lost out significantly. The result was a sharp increase in conflict along supply chains. The wage increase added to the problem by generating inflationary pressure that could not be expressed in official prices and which sharpened the inequality of the freeze's effects among firms. As prices could not reflect inflationary pressure, it tended to appear in supply problems: firms refusing to produce goods unless buyers (either consumers or firms) paid premiums (*agios*); artificial shortages; a host of ways of cheating on the price tables. The government maintained the price freeze through the legislative elections, releasing them finally at the start of 1987. At that point, all the pressed inflation emerged immediately, with the monthly rate rising from 2.5% in November 1986 to 12% by January, 1987.

The government's manipulation of the plan for political purposes added to the general lack of credibility on economic management. Among other issues, some observers expressed concern that the government failed to make serious efforts to address its own fiscal problems.[10] This became particularly apparent as inflation returned, with its significant impact on fiscal revenues and the government's need to adjust its own debt payments to the rate of inflation. For many business observers, it pointed to the government's willingness to impose sacrifice through highly invasive and interventionist practices, yet evade painful decisions that would contribute to financial stability.

The problem for the Sarney government was that it simply lacked the political capacity to reduce its budget deficit. Sarney was locked in expensive bargaining with the Congress, in particular over his efforts to make the presidential term five years rather than four. His party, the PMBD, was splintering continuously as the unified opposition to the military increasingly split along internal cleavages. The result was that the Sarney government could only function by paying out patronage resources and by preserving Congressional access to patronage resources.

This problem manifested itself further in Sarney's subsequent efforts at stabilization. From 1987 to 1989, Sarney's various economy ministers implemented several less ambitious plans, most of which contained some combination of more traditional orthodox elements along with a wage and price freeze, and in one instance a new currency (the Cruzado Novo in the Summer Plan of 1989). Ultimately, all of these plans failed primarily because of the government's inability to make its own fiscal adjustments and because of growing social (especially business) resistance to successive, ineffective wage and price freezes.

Sarney's administration faced two other crucial sources of financial disorder. First, rising budget deficits and high inflation forced the government to maintain high interest rates as a check on inflation. However, high interest rates also contributed to a steady increase in the cost of borrowing and servicing the debt. Similarly, as the government increasingly lost credibility, it was forced to offer higher interest rates with shorter terms of maturity to attract creditors. This dynamic fed on itself, helping Brazil move closer and closer to hyperinflation by the end of Sarney's term in office. Second, the drafting of the new constitution, completed in 1988, exacerbated the state's bad fiscal condition with a range of controversial measures. In addition to protecting the civil service and the national social security system, the constitution also mandated the transfer of over 20% of the Federal government's revenues to the states and municipalities without accompanying spending obligations.[11] Although it took several years for the full effect to appear, the 1988 Constitution helped push Brazil to serious financial disorder by 1989. As inflation rose up towards 80% per month in the wake of the Summer Plan's failure, Sarney's last finance minister, Mailson da Nobrega, observed that Brazil needed surgery, but kept getting just the anesthetic.

Growth Policy

A wide array of commentators had observed by 1985 that Brazil had to modify, at the very least, its economic growth strategy. For example, a minority group within the BNDES had noted that Brazil's rapid growth during the 1970's had led to a growing split in the market between more modern and backwards sectors. Modern sectors had made some effort to keep pace with global changes and had some experience with foreign trade. Backwards sectors had neither. These officials recommended a "competitive integration" with the international economy, i.e. a selective and gradual process of commercial liberalization with an eye to promoting competitive improvements throughout the economy. According to this view, import substitution industrialization had run its course.[12]

Comparable views had begun to emerge in the business community, ranging from stronger endorsements of neoliberalism, as expressed by the Liberal Institutes, founded first in Rio then later São Paulo, to calls for industrial policy similar to the minority BNDES position, as expressed, for example, by groups like Abimaq (Associação Brasileira da Indústria de Máquinas e Equipamentos). Business views tended to share with the minority BNDES a sense that global changes required some efforts at commercial liberalization to insure that Brazilian industries remained competitive. Business views tended to also express the belief that the state had lost its capacity to effectively lead the growth process. Thus, while few business groups bought into the neoliberal rhetoric sweeping the region, most did believe that some scaling back of the government's role was necessary.[13]

Unfortunately, the Constitution and stabilization dominated the government's agenda throughout the entire period. As a result, the Sarney administration's several efforts to develop an economic growth strategy were quite limited in their scope. Chief among those efforts were a very limited beginning to privatization, a limited move towards reducing import tariffs, and some failed efforts at improving policy-making coordination. The government's political weakness exacerbated the difficulty of the situation, so although Sarney did propose a change in industrial policy proposal, his government was unable to overcome the intense resistance by private lobbies.

The combination of failed stabilization and very limited changes in economic policy directions meant that the economy deteriorated throughout the period 1985-1989. Real investments declined as a percent of GDP, production in key sectors, such as automobiles, declined as firms increasingly sought higher and higher margins on smaller volumes, tax revenues fell (through inflation, declining production, and increasing evasion), and overall the competitive position of the economy declined.

Business and the State

Business relations with the state began the New Republic in poor shape and deteriorated over the ensuing four years. What began as business criticism of the military government's orthodox stabilization measures rapidly turned into a much more generalized critique of the role of the state in the Brazilian economy. Business criticism focused on the deterioration of the state's finances and the impact that had on the state as a regulator, promoter, and consumer. By 1989, the business community's anger over the role of the state led to growing calls for "modernization;" a word with various meanings all pointing towards a neoliberal or neoliberalizing project.[14] Thus, as of the 1989 elections, the business community had become available for a neoliberal program on pragmatic, not ideological grounds.

Business peoples' pragmatic concerns flowed out of the consequences of the state's ever worsening financial condition and the series of failed efforts at stabilization. Although business people, like the middle and upper class in general, historically have been able to profit from high inflation through financial speculation, they have not been able to protect their productive assets. Firms increasingly found themselves making money off their financial assets and by charging ever higher margins on constantly shrinking margins. However, business leaders explicitly complained that that was not a viable long term strategy for growth.

Moreover, the breakdown of the state's finances produced problems in other key areas of the state's role in the economy. First, the disappearance of financing meant that the state increasingly had to choose how to spend its dwindling resources. This revealed how deeply politicized the Brazilian market was, and revealed as well sharp differences in political privileges. Sectors and firms that the government continued to favor or sectors and firms that maintained good relations with crucial government agencies continued to obtain benefits while others lost them. As a consequence, business' political organizations began to call more aggressively for an end to corruption in government practices and an end to government favoritism in the use of public finances. For many business people, this complaint took the form of growing calls for "democratization."

This resentment towards politicized use of public finances manifested itself as resentment towards the government's political manipulation of regulation. The Brazilian state interacted with the private sector through an array of regulatory agencies that had become colonized by private interests and as a result produced sharp conflicts within the business community and between the business community and the state. Those agencies included, among others, CIP (the Interministerial Price Council), the CDI (Industrial Development

Council), and Cacex (Council for Foreign Commerce).[15] Thus, in a time of general economic hardship, the politicization of regulatory areas like price controls and foreign commerce controls sharply increased business resentment of the state. The state's role as consumer also aggravated business hostility as increasingly state purchases declined and/or the state increasingly defaulted on payments to suppliers or made payments very late.

However, the issue that probably aggravated business-state relations the most was the passage of the 1988 Constitution. While the 1988 Constitution contained many errors from the business perspective, several articles were simply intolerable. The initial draft of the Constitution, prepared in 1987 reflected populist and anti-authoritarian influences, the successful lobbying of organized labor groups, as well as the failure of business to make any effort to influence the process. Thus, the business community decried the initial document as unrealistic, excessively interventionist, and anti-capitalist. In response, several leading business organizations banded together to try and finance a centrist lobby in the Congress as a block against the initial draft.[16] While many observers credit business efforts with substantial revisions in the final round, the business community itself saw both their efforts and the final draft as a failure. In particular, business lobbyists and allies were unable to remove many of the articles they resisted the most, including much of the detailed labor laws that added significantly to payroll costs (if not take home pay), the measures that transferred revenues from the federal government to the states and municipalities without accompanying spending obligations, restrictions on the legal limit for real interest rates, as well as an elaborate detailing of social rights including generous social security entitlements and civil service protections.

In response to the combination of the collapse of the state's finances, the failure of stabilization efforts, the passage of what business people considered a dangerously flawed constitution, and the breakdown of the state's role in the economy, business people turned towards anti-state programs as a solution to their concrete, day-to-day problems. In 1989, the answer appeared to be neoliberalism. By 1990, they had their wish.

The Collor Presidency

The 1989 election turned on two cleavages in society. On the one hand, it reflected a conventional left-right split. On the left, Luis Inacio Lula da Silva presented a relatively straight-forward socializing agenda that explicitly appealed to his working class base. Opposing Lula were a series of candidates, all of whom embraced some elements of the neoliberal line. At the polar opposite to Lula, Fernando Collor de Mello campaigned on a "modernizing" rhetoric with explicit neoliberal content, particularly on his calls for streamlining the state. On the other hand, however, the election also pitted system outsiders, notably Lula and Collor, against the insiders, such as Mario Covas (PSDB), and Guilherme Afif (PFL). Many Brazilians preferred the newcomers, particularly lower income Brazilians who had suffered the most from inflation and the corruption inherent in Brazilian politics. As the first, round of voting approached, it was clear that the newcomers, Lula and Collor, would emerge victorious. Brazilian business people had initially preferred the more moderate "insider" candidates to Collor, who explicitly presented himself as an outsider against the corruption of the system. However, they opted for Fernando Collor when it became clear that he was the only choice against Lula's socialism. Collor's intense "modernizing," but anti-elitist campaign ultimately proved effective when Collor defeated the leftist Lula among low income and low education voters.

True to his word, Collor pursued a modernizing, somewhat neoliberal program as well as an outright attack on the system. His eventual impeachment in December 1992 on corruption charges has tended to cloud his record as president. However, Collor accomplished a great deal in his two years as president. Moving very rapidly from his inauguration in 1990, Collor implemented a commercial liberalization, a substantial deregulation, initiated a more aggressive privatization program, and completed a partial fiscal adjustment. Aside from the corruption that brought down his government, Collor's most serious problem was his inability to decisively address Brazil's fiscal crisis, and through it inflation. That inability rested on Congressional resistance and the weakness of Brazil's political institutions, not corruption.

State Finances and Inflation

Fernando Collor's inauguration in March 1990 left him facing a serious problem with inflation. By his inauguration, the Sarney government's failures left Brazil with spiraling inflation that had exceeded 80% per month. Most analysts agreed that Brazil was facing hyper inflation, if it was not experiencing it already. In any event, it was clear that even Brazil's sophisticated indexation system could not adjust prices fast enough to keep pace with inflation.

To counter it, Collor passed the most interventionist and draconian stabilization plan in Brazilian history. The plan included the freezing of 80% of the nation's savings, the introduction of a new currency, a temporary wage and price freeze, a substantial tax increase and a one time tax levy on all financial transactions, and a series of measures designed to rein in government expenditures. Those measures included firing up to 100 000 federal government employees, ending free housing for government employees, and rounding up and auctioning the sizable fleet of cars made available to politicians in Brasília. Along with his drastic anti-inflation plan, Collor also set in motion a sweeping process of deregulation (especially in the areas affecting foreign commerce), significantly streamlined the administration, initiated a privatization program, and introduced a schedule for gradual reduction of import tariffs.

The initial reaction to Collor was mixed. For the most part, members of Congress and other elite figures expressed dismay at Collor's dramatic anti-elite rhetoric and authoritarian tactics.[17] However, both public and business reactions were initially quite positive. Collor's tactics forced the Congress on the offensive and resulted in little resistance to the flood of executive decrees issued in the first three months. His stabilization plan brought inflation from 84% per month in February 1990 to an average rate below 10% per month through December 1990. Low levels of inflation boosted both business and public support in general.[18]

However, as shocking and sweeping as Collor's reforms were, they left unresolved the fundamental fiscal problems enshrined in the Constitution. The fiscal deficit declined from 8% of GDP in 1989 to a surplus of 1% in 1990 based on Collor's set of reforms and the suspension of monetary correction of the debt. Collor still faced the difficult task of mobilizing his popular support for reform against a Congress with strong connections to a series of well-organized groups with vested interests in preserving the Constitution's commitment to fiscal chaos.

Collor's strategy focused on using limited patronage spending to influence the October 1990 legislative elections in the hope of building a pro-reform coalition. However, the elections returned traditional, patronage dependent political elites rather than either Collor supporters or foes. Collor's defeat in October 1990 coupled with resurgent inflation (particularly since 80% of the frozen savings had returned into circulation by June of 1990) forced Collor to shift his tack on stabilization. Through early 1991, Collor moved from a slight correction on the 1990 Collor Plan through to a conventional monetarist tight money solution. His new Economy Minister, Marcilio Marques Moreira, brought a significant measure of credibility to the position, but his IMF style orthodoxy imposed a deep recession on the country while containing inflation at 25% per month.

Collor's last effort on inflation came at the end of 1991 as he sought to push through a massive Constitutional reform package, labeled the *emendão*, addressing the vital areas of fiscal concern: administrative reform, civil service reform, and fiscal reform. However, Collor's efforts became bogged down in complex negotiations involving demands for Cabinet posts, support for a plebiscite on parliamentarism, rolling over state level debt, business demands for tax relief, labor demands for increases in wages, and Congressional demands for more patronage spending. Despite Collor's corruption, his administration was marked by a singular refusal to play traditional patronage politics, and rather than make compromises that would have severe fiscal implications, Collor stood back as Congress scuttled his package.[19] He did however manage to secure a tax increase which helped him secure an IMF stand-by agreement in 1991.

As a consequence of his failure to press for constitutional reforms, Collor's economic program consisted of a series of significant reforms in the area of foreign commerce, combined with a strict austerity program and inflation of 25% per month. Although Collor was able to leave his successors, Itamar Franco and Fernando Henrique Cardoso, a legacy of relative fiscal balance, he left the fundamental issues of stabilization, resolving the fiscal crisis, and renewing growth unresolved.

Growth Policy

Unlike Sarney, Collor's government produced a much more coherent plan for renewing economic growth. Much like Sarney, any efforts at promoting growth took a distant back seat to the problems of stabilization. Some of Collor's measures did have rapid effect. First, Collor's introduction of a schedule for gradual reduction of tariffs over the period 1990 to 1994 genuinely opened the economy to foreign competition. Second, Collor's deregulation process effectively and dramatically removed a host of legal and bureaucratic controls of foreign commerce. Thus, by the end of 1990, not only was it cheaper to import products, but the logistics of importing products had become radically simplified. These changes extended to a series of administrative reforms that sharply weakened bureaucratic oversight of the process. For example, Collor's replacement of CACEX with the new Department of Foreign Commerce, Decoct, involved a significant down-sizing of the administrative staff, removal of an array of interventionist mechanisms (particularly discretionary controls over the issuance of export/import licenses), and the removal of the department from the Bank of Brazil, which historically had had tremendous influence in the bureaucracy and Congress and which had had its own well-defined agenda.

However, contrary to some observers' views, Fernando Collor was far from a strict neoliberal. Collor's administration perceived the need for a continued state role in the economy and for a continued promotion of industry. Collor's policy showed in several areas. First, his first Secretary of Planning issued an industrial policy built explicitly on the BNDES idea of competitive integration. The plan laid out a framework, although not specific measures, for identifying and promoting sectors designated as crucial for Brazil's continued growth.[20] Second, the government inaugurated a program to promote quality and productivity, calling on industry's various associations to help in developing programs for disseminating quality standards. Finally, the Collor administration saw measures such as privatization and de-indexation of the economy as key parts of the effort to stimulate competitiveness in the private sector.

Unfortunately, Collor's growth promotion programs never had much impact. Privatization, since 1990, has generated some revenues for the government and has led to increased competitiveness among privatized firms, the positive results are still mostly in the future as of 1997 and certainly had little impact as of 1992. De-indexation under Collor did not succeed, and Collor's industrial policy never advanced beyond the proposal stage. The Brazilian Program for Quality and Productivity did set in motion a significant level of effort among sectoral associations to develop quality programs and disseminate the information across the sectors. Brazilian productivity did improve markedly between 1990 and 1997, although once again, the benefits came mostly after Collor's impeachment.[21]

Business and the State

Business-state relations continued to change under Collor in ways that ultimately tended to support both democratization and a continuation of the economic reform process. Most importantly, Collor's success in beginning commercial liberalization provoked a growing fragmentation within the business community between those firms and sectors better placed to succeed in a liberalized economy and those less likely to succeed. Moreover, the beginning of the reform process effectively broke the status quo that had prevailed up through Sarney. Brazilian firms could no longer profit from financial speculation while resisting changes that they knew were costly but necessary. In short, commercial liberalization made it imperative that businesses support a president that could address the country's fiscal crisis, and thereby reduce the so-called "Brazil cost."[22]

Brazilian business leaders began Collor's term cautiously optimistic. There is no question that Collor's anti-elite rhetoric discomfited them. However, it is also clear that the business community had a fairly clear sense of what a Collor program would look like, and it was one that business leaders from various organizations had endorsed.[23] Even after the sharply interventionist Collor Plan, business support endured. Six months into the Plan, a majority of business people believed that it was working. However, business leaders noted that the country desperately needed a long-term resolution of the country's fiscal problems and a definition of a strategic vision for growth.

Despite his rhetoric, the Collor administration did try to work with portions of the business community to address long term problems. In particular, Collor seemed to prefer to work with some of the protest movements that had emerged in he 1980's against the corporatist structure, especially the Federation of Industry of the State of São Paulo (Fiesp). Thus, he attempted to negotiate social pacts with the PNBE (National Thought of the Business Bases),[24] a small business revolt from Fiesp, as well as IEDI (the Institute for the Study of Industrial Development), a big business protest against Fiesp. He tried to bring these groups as well as Fiesp into negotiations around the *emendão* , and successfully garnered at least Fiesp and IEDI support.

By the end of 1991, he had effectively lost business support. The failure of the *emendão* , combined with the resurgence of inflation, the tax hike of December 1991, and the continued pressure of commercial liberalization turned his last supporters into overt opponents. The PNBE participated in a candle light vigil against commercial liberalization, IEDI began buckram negotiations that led Marcilio Marques Moreira to accuse them of being the principal enemies of modernization, and Fiesp held an election for the Federation's presidency in which opposition to Collor's policy figured as one of the central planks of both contending candidates.

Business resistance to the continuation of the commercial liberalization process manifested itself in calls for industrial policy. Leading business groups, such as PNBE, IEDI, Fiesp, and sectoral associations such as Abdib and Abimaq, expressed support for the principle of liberalization but observed that Brazilian firms needed supportive conditions (i.e. stable prices, low cost financing, renewed infrastructure investment, etc.) if plant-level adjustments were going to work. They also needed a clear strategy from the government that identified policy priorities and directions.

However, by Collor's impeachment, the business community had changed in character. First, certain sectors had begun to see free trade as relatively unthreatening and potentially beneficial. These included strong sectors, such as pulp and paper, consumer durables producers operating primarily out of the Manaus Free Trade Zone (organized in the association Eletros), new firms emerging in the import-export sector, especially automobile importers, as well as some MNC's that could easily substitute local production for imports and for whom access to capital on the international market substantially reduced the "Brazil Cost."

Second, once the process of commercial liberalization had begun, it became even more urgent that the government complete its fiscal reforms. Both substantial survey and interview evidence points to relatively strong support for commercial liberalization at the beginning of the process in 1990.[25] The reason was quite simple: a large majority of business people surveyed believed that the timetable for liberalization was sufficiently gradual to allow for successful competitive adjustments. However, competitive adjustments depended on addressing the "Brazil Cost:" uncompetitive tax system that penalized production, a high cost of capital, high payroll costs coupled with very low take home pay, declining infrastructure, not to mention the corrosive impact of inflation. Collor had successfully liberalized the economy, but had failed utterly to address the Brazil cost. As a consequence, Brazilian firms by 1992 faced an environment in which import competition was emerging while they were left relatively incapable of responding. Brazilian firms needed one (or both) of two options: either support a president who could complete the process, or return to protectionism. In Collor's elected successor, Fernando Henrique Cardoso, they got a bit of both.

The Cardoso Presidency

Fernando Henrique Cardoso emerged as the logical presidential candidate for the 1994 elections during the interim presidency of Itamar Franco. Franco's presidency accomplished little. Franco was deeply ambivalent about the reform process, and as a consequence abandoned orthodoxy, slowed privatization, and ultimately made little effort to actively pursue any strategy. In that context, the economy began to grow again as both inflation and indexation returned. Despite the widely recognized need to do away with both features of Brazilian political economy, Brazilian actors at least knew how to take advantage of the short-term opportunities that the situation offered. Businesses put off long-term adjustment efforts in the face of tremendous policy uncertainty. Finally, in early 1993, with inflation rising precipitously again, Franco appointed Fernando Henrique Cardoso as Finance Minister, and essentially turned over the reins of government to him.

As Finance Minister, Cardoso led the government as the Congress began a mandated Constitutional review. The 1988 writers of the Constitution had stipulated that a review should take place in 1993 to allow for changes that experience revealed as necessary. However, few members of Congress were prepared to alter the distribution of benefits that the Constitution had conferred on groups like public sector employees, labor unions, the patronage machines established in the country's states and municipalities, as well as a large array of very narrow, special interests that benefited from the distribution of patronage. Rather than vote against reforms that many perceived necessary for the country, they simply did not show, thus denying the government a quorum. Opponents also undermined the process by proposing 17 000 amendments and 12 000 sub-amendments to the Constitution. Ultimately, only 32 amendments were ever read out of committee, of which only six passed. Of the six, two were crucial: the shortening of the presidential term to four years, and the creation of a special fund called the "Social Emergency Fund (FES)."[26]

The Social Emergency Fund recovered roughly $10 billion from transfer payments to the states and municipalities for a period of two years. Thus, rather than a reform to the fiscal system generally, the FES performed an ad hoc fiscal adjustment and left the real reform for later. Nevertheless, it was a crucial short term measure that helped contain fiscal deficits and gave the government breathing room to begin efforts to stabilize the economy. Cardoso lobbied intensely for the measure, even appealing directly to the public and threatening to quit if the Congress didn't approve it.

The measure set the stage for Cardoso's introduction of Brazil's most successful stabilization plan in its history (discussed further below). In the wake of the plan, dubbed the Real Plan, Cardoso announced his candidacy for the 1994 presidential elections. With inflation below 2% per month on the eve of the first round, Cardoso sealed his victory.

Business support for Cardoso was, and to date remains, quite robust. In addition to the renewed threat of Lula, who came in second again, business people saw Cardoso as the most credible solution to the Brazil cost and the resumption of the lagged reform process. With prices stabilized and a credible president, Brazilian firms renewed their adjustment efforts.

As of 1997, the picture remains somewhat ambiguous. Inflation has continued to fall, however, Cardoso has made little progress on addressing the long term fiscal problems. Brazilian debt, public and private, has skyrocketed, while the fiscal deficit has climbed again above 3% of GDP. As a consequence, the Brazil cost has continued to plague Brazilian firms as imports have begun to enter at much more dramatic levels. The business community has further fragmented. Firms with access to foreign capital and importers have done exceedingly well as price stability has brought 14 million people out of poverty into the consumer market. Television, white line goods, cars, fast food (and linked industries such as containers), cement, and meat producers have hit production records. However, firms without the capacity to borrow abroad have faced severe problems and record levels of bankruptcy. Thus, sectors like textiles, toys, machine tools, capital equipment, auto-parts, and electrical and electronics producers have suffered terribly.

Cardoso has maintained support for at least two crucial reasons. First, he maintains a monopoly on credibility for solving the fiscal crisis. Business leaders publicly rallied to Cardoso to support his re-election as the only figure with a plausible chance and a credible commitment to fiscal reforms. Second, Cardoso has also adjusted the commercial liberalization policy and committed state funds as mechanisms of compensation and support for politically vocal and economically hard hit sectors.

State Finances and Inflation

The Real Plan's success hinged on a number of central differences between it and all previous plans. First and foremost, the Cardoso team made credible commitments to keep the plan transparent, predictable, and gradual. The Immediate Action Plan (its formal name) appeared in Congress in December 1993, nearly three months before its actual implementation. Then, in February 1994, the Cardoso team introduced a new index of inflation, the Unit of Real Value, which was pegged to the exchange rate and adjusted daily. The government began adjusting their own contracts according to the URV and encouraged private actors to do the same. The URV had the advantage of an anchor in a stable currency without the potential for external shocks inherent in Argentina's much more radical dollarization plan. The next step of the plan was to convert the URV into a new currency, the Real, in June of 1994. By then, most actors in the economy were quoting their prices with reference to the URV and the adjustment to the Real happened relatively seamlessly. This process stands in stark contrast to the invasiveness of previous stabilization plans and the sharp and unpredictable effect they had on contracts.[27]

The Plan also benefited from the fact that the import reduction schedule had reached its conclusion as the plan went into effect. Thus, even if Brazilian producers felt tempted to speculatively raise their prices, they faced strict pricing discipline from imports. Finally, the plan also benefited from the comparatively healthy state finances as a result of Collor's earlier fiscal adjustment combined with the impact of the FES.[28]

The drawback of the plan is that in the absence of lasting fiscal adjustments, it depended on a combination of a slightly overvalued exchange rate and high real interest rates, both of which lured in foreign investment at very high levels. That meant however, that the government was not free to devalue the Real by any significant measure, nor was it free to substantially reduce interest rates. As a consequence, importers were sharply favored by policy over exporters and local producers, and domestic borrowers were largely shut out of the financial markets. Furthermore, the inflow of foreign capital (which had to be sterilized by issuing public debt paper to protect against inflationary pressure), the rise of government borrowing to offset continued failure to press fiscal reforms, and the high real level of interest rates all combined to sharply increase debt and debt servicing costs.

As of 1997, those problems have not undermined the Plan, although observers have begun to sound warnings that the danger to the Plan is increasing.[29] Brazil continues to maintain very strong reserves due to capital inflows. Moreover, over the period 1994-1997, capital inflows have changed in composition, with private debt and foreign direct investment rising relative to portfolio investment. The former inflows pose far less of a threat to the country's balance of payments than portfolio investment. Imports have surged dramatically, sharply affecting a number of sectors, but also maintaining price discipline. Thus, as of 1997, Brazilian stabilization appears safe.

However, the discussion above points to the need for a resolution of the country's fiscal problems. On that score, the Cardoso government has fared less well. During 1995 and 1996, Cardoso failed repeatedly to get Congressional support for a reform of the Social Welfare System (*Previdencia*), the system out of which both private and public sector pensions are paid and which as of 1996 already faced a $5 billion hole.[30] He finally did secure a vote in the lower house on a dramatically watered down version in 1996. Much like the Social welfare System, Cardoso has made almost no inroads into the civil service, which is another key area for reform, nor into the fiscal system. On both of the latter, Cardoso finally turned in late 1996 to incremental, small measures that could pass as ordinary law, but to date they have had almost no effect.

Cardoso's success in securing re-election has led some observers in the press to label him the "steam-roller." Some observers believe that the desire of Members of Congress to secure access to patronage, which Cardoso has use extensively and effectively, will lead them to support reforms now that it looks certain that Cardoso will be president through a second term. That may well prove to be the case. Nevertheless, Brazilian politics is sufficiently volatile that nothing should be taken for granted.

Growth Policy

Like Collor and Sarney, Cardoso has had to sacrifice a well defined growth strategy to the imperative of stabilization related reforms. However, Cardoso has made a number of efforts to promote growth and adjustment that have moved Brazil well out of the conventional view of neoliberal policy. Cardoso's policies have rested on three planks: an industrial policy for the automobile industry; an export promotion policy; and a series of measures that have protected and/or promoted a wide variety of sectors.

The automobile industrial policy emerged in response to the very rapid increase in auto imports through late 1994-early 1995. With imports rising, the Cardoso administration raised tariffs on automobiles to 20% and then in May 1995 to 70%. In turn, they lowered tariffs on parts and machinery to 2%. Firms could then import finished autos at reduced tariffs at dollar values proportionate to dollar values they exported. The reduced tariffs, naturally, only applied to firms producing domestically. The policy has created sharp conflict, particularly with the Japanese and Koreans. However, the government's insistence on maintaining the policy has helped drive the auto industry to record levels of production.

Export promotion, on the other hand, has proven a failure. As it became clear that the Cardoso government would not be able to reform the tax system, and thereby remove the tax component of the Brazil cost, it turned to smaller, non-Constitutional measures. Most important among them were the abolition of the tax on manufacturing (ICMS) for exports and the lowering of the tax on capital goods imports. The Cardoso government predicted that the measures would sharply increase exports. However, the policy simply helped to deepen the fiscal deficit while revealing that Brazil's success, contrary to the prescriptions of the neoliberal model, continued to rest on the attractiveness of the domestic market. Brazil attracted $9 billion in foreign direct investment in 1996, with projections of $16 billion in 1997, and over $200 billion by 2002. However, much of that investment is explicitly targeted to serving the domestic market. As positive as abolition of the ICMS on exports was, it did not sufficiently reduce the Brazil cost to encourage even the most competitive MNC producers to view Brazil as an export platform. As a result, the trade deficit exceeded $5 billion in 1996 after months of government predicted surpluses, and appears to be heading towards a $15 billion deficit in 1997.

Finally, the government has increasingly turned to special credit lines from the BNDES and selective protection as mechanisms to compensate hard hit sectors and promote competitive adjustments. Thus, early in 1995, the government raised import tariffs on 109 products in the consumer electronics and electrical appliances sectors. In 1996, the government accused Asian competitors of dumping in toys, textiles, and apparel, and sharply raised tariffs in all three areas. The quid pro quo was that the protected sectors then had to undertake competitive adjustments in anticipation of later lowering of the tariffs. On the credit side, the government finally responded to business complaints of poor conditions for competitive adjustments, and aggressively reasserted the BNDES role in promoting development. Between late 1996 and early 1997, the BNDES announced several billion dollars worth of new credit lines for micro-enterprises, hard hit sectors (such as consumer electronics, auto-parts, furniture, and textiles), pulp and paper, and most recently large producers (since the earlier much smaller credit lines did not offer sufficient resources for large firms) of capital goods, machinery, auto-parts, and parts and equipment for the soon-to-be-privatized telecommunications sector.

Overall, Brazilian prospects have appeared relatively solid for future growth, but not along neoliberal lines. For one, the Brazilian government continues to run large fiscal deficits and as yet has made only partial steps to correcting it. Despite that, foreign investment, direct and portfolio, has flooded into the country. Moreover, even with price stability and commercial liberalization, the country remains attractive as a domestic market, not as an export platform. Multinational corporations entering Brazil have been seeking out access to a potentially large market. This strongly suggests that Brazilian economic strength in the future depends less on exports than on continuing growth of income and much better income distribution.

Business and the State

Cardoso's relation with the business community has been mixed. On the one hand, surveys and public pronouncements reveal strong support for Cardoso.[31] In interviews, business people expressed the view that the reforms were difficult and that Cardoso's slow pace was understandable, given the difficulties. On the other hand, significant portions of the business community have vocally demanded resolution of the Brazil cost and relief from unfavorable conditions for adjustment. Business associations worked through 1996 to push the government to provide concessions, and business peak associations, most importantly Fiesp, organized very visible political demonstrations calling for a hastening of the reform process. The most visible of those demonstrations was the March on Brasília in May 1996, in which over 2000 Brazilian business people descended en masse on the capitol to press for reforms.

Overall, the business community has fragmented sharply. The reform process has led to a shift in influence from the older industrialist families to the newer business class, including professional executives in large corporations, as well as pension fund managers and securities traders. The most telling symbol of the decline of the old business elite came with the acquisition of Metal Leve by German competitor Mahle. Metal Leve has been one of the most successful, innovative, and competitive Brazilian firms, led by José Mindlin, one of the most influential business leaders in Brazil. As Mindlin faced the prospects of having to expand to face foreign competition from Mahle (which according to Metal Leve representatives was engaged in dumping), Mindlin realized he would have to give up majority ownership in the company. Mindlin sold out to Mahle (and Brazilian rival, Cofap) rather than become a minority shareholder. Both the press and many Brazilian business leaders viewed the sale as a turning point in history.

Metal Leve's fate pointed to the set of exit options rapidly transforming Brazilian businesses. 1994-1996 has witnessed a significant increase in the number of mergers and acquisitions, particularly between Brazilian firms and multinationals. Many Brazilian firms have also become licensed importers of products, either completely abandoning domestic production or simply shifting the line of products produced nationally. Finally, even in the face of rising import competition, the combination of high interest rates and an overvalued exchange rate has offered substantial opportunities for financial speculation. Thus, even if business people may lose their businesses, the current context provides opportunities for protecting family assets.

Overall, portions of the business community have expressed criticism of the government's policies on the exchange rate and interest rates even as many of these critics have noted that Cardoso has had little alternative to maintain low inflation. Similarly, both Paulo Maluf and Delfim Netto have emerged as prominent critics of the Cardoso government and champions of reworking the liberalization process. However, neither has succeeded in drawing overt support away from Cardoso. Most importantly, the possibility of Cardoso's re-election has appeared to offer Cardoso another chance to recast a pro-reform coalition in the 1998 elections with substantial business support again. As in 1994, he has succeeded appearing as the only candidate capable of pushing through the much needed reforms. As long as that appears possible, Cardoso will continue to sustain a pro-reform coalition.

Conclusion

Democracy has had the laudable effect of presenting regular elections that have successfully pulled Brazil out of apparent policy stalemates. From the military to Cardoso, government after government has struggled to push stabilization, sacrificing growth strategy in the struggle. Yet successive elections have allowed successive presidents to reconstruct coalitions in favor of economic reforms and have consequently been able to make incremental steps towards developing a new growth model. That has come despite the possibility that each electoral cycle has presented for crafting new coalitions against the reform process. Certainly since 1990, the reform process's slow advance has generated as much pain as it has gain, particularly in the business community.

The unequal distribution of pain in the business community has intensified a process of fragmentation. The implication for democratic consolidation is that the fragmentation of the business community makes it unlikely that the military could find significant support or alternatively that significant segments would seek out the military. Business' leading organizations have certainly committed themselves to democracy or have withered away. Fiesp's president, Carlos Eduardo Moreira Ferreira, has actively endorsed democracy and explicitly oriented Fiesp towards democratic participation. IEDI has lost its political will, while the PNBE has become oriented towards promoting citizenship.

Democracy has made possible incremental reforms and has generated new constituencies for democracy while weakening potential constituencies for some form of military intervention. However, Brazil's fractious politics and weak political institutions continue to pose a risk to democratic consolidation. To this writing in early 1997, no government in the New Republic has gotten control of the fiscal imbalances inherent in the 1988 Constitution. If Cardoso continues to fail in that area, then the risk of inflation returning and growing balance of payments difficulties will challenge Brazilian democracy and democratic institutions. While I do not wish to predict the future, it would appear that trends to date suggest an actual breakdown of democracy would find only weak support in the business community.

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[1]Data comes from Baer, 1995, pp. 177-182.
[2]Various sources discuss the breakdown of relations between business and the state during the 1980's. These include, Payne, 1994; Kingstone, 1994; Nylen, 1992; as well as Frieden, 1989, pp. 129-132; and Bresser, 1978.
[3]Data comes from Latin American Weekly Reports, various, 1996.
[4]These studies include Haggard and Kaufman, 1995, 1992; and most notably, Remmer, 1986.
[5]See for example, Weyland, 1995, and Kingstone, 1994, and forthcoming.
[6]Bresser has made this case in several publications. for example, see Bresser, Maravall, and Przeworski, 1993; and Bresser, 1996.

[7]A good account of the array of institutional crises Sarney faced is in Sola, 1988.
[8]Baer, op. cit.
[9]This aspect has been discussed widely. For reviews, see Sola, 1988, Baer, 1995, Smith, 1987, Roxborough, Singer, 1987, and Kaufman, 1988.
[10]Discussed in Kingstone, 1994. Also various press reports. The business community was quite vocal about their criticism of the Sarney government.
[11]Discussed in Gall. 1991.
[12]Interviews with former members of the BNDES, 1991-1992. Discussed in Kingstone, 1994.
[13]Discussion of business attitudes and the emergence of business protest movements can be found in Kingstone, 1994, Payne, 1994, and Nylen, 1992.
[14]Discussed in Kingstone, 1994.
[15]Eli Diniz and Renato Boschi, 1987, and Diniz and Lima Jr., 1986 discuss at length the interaction between private interests and government bureaucratic agencies.
[16]Payne, op. cit. p.112-114.
[17]These were noted quite frequently in the press. Also noted by Schneider, 1991.
[18]Evidence for business support comes from a survey conducted by the Estado de São Paulo, May 27, 1990 as well statements from business leaders cited in the Estado through the last week of May.
[19]This view of the Collor administration can be found in both Kingstone, 1994 and Bresser, 1996.
[20]Interestingly, the minority BNDES view that had pushed competitive integration in the early 1980's had converted into the principal vision of the BNDES by the late 1980's. These views appeared in BNDES papers in 1989.
[21]Discussed in Kingstone, unpublished manuscript.
[22]See Kingstone, unpublished manuscript, and Kingstone, 1994.
[23]Fiesp, internal aide memoire no. 177, November 22, 1989.
[24]Payne, op. cit.; Nylen, 1992, Kingstone, 1994, and Diniz and Boschi, 1992, 1990 all discuss the emergence of the PNBE and IEDI.
[25]See Oliveira, 1991; as well as CNI, 1989, 1991.
[26]See Aragão, 1995 for a discussion of the results of the Constitutional review.
[27]Bresser, 1993, discusses the importance of not violating contracts in attempting to promote a stabilization plan.
[28]The basics of the plan are discussed by Oliveira, 1995.
[29]This has included Rudiger Dornbusch's claim that the Real was 40% overvalued in June 1996 which provoked a storm of controversy in Brazil and on Wall Street, but also includes more moderate positions from the Bank of International Settlements, and prominent Brazilian economists such as Edmar Bacha, Andre Lara Resende, and Celso Martone, among others.
[30]Weyland, 1996.
[31]In particular, see Fiesp surveys in Fiesp Notícias, various months through early 1996.

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