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Mass Democracy: The Real Reason That Brazil Ended Inflation?

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Summary. — "Populism" and expanded democratic participation often have been painted as the enemy of sane macroeconomics. Yet Brazil's experience suggests possibly *benign implications of stable mass democracy for national economic management* in developing countries. Prior to 1930, agrarian elites ruled Brazil. As political participation gradually expanded, policymakers elaborated the regulatory framework of import-substituting industrialization (ISI). ISI not only generated strong growth but also chronically high and volatile inflation, with costs falling most heavily on the disenfranchised a poor majority. The advent of mass democracy in the mid-1980s gave the poor a political voice for the first time, and plausibly was the crucial cause for the demise of hyperinflation a decade later.
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1. INTRODUCTION

What are the implications of a political regime shift to competitive mass democracy for accomplishing difficult, market-oriented, economic reforms? How do freewheeling elections with universal suffrage, active lobbying by special interests, and proliferating political parties affect the ability of political incumbents to build a coalition for collective belt tightening? One standard answer is that technocratic, *politically insulated policymaking* is superior to *chaotic populism* for accomplishing the fiscal retrenchment that seems to be an essential element of shrinking trade and budget deficits, bringing down inflation, and rationalizing public spending (Gasiorowski, 2000; Geddes, 1994; Haggard & Kaufman, 1995). This essay instead argues that *expanding political participation*, in the context of genuinely *competitive politics*, may improve policy in a country that has had a history of macroeconomic excess. The poor and lower classes may hold stronger preferences than do elite and middle-income groups for a stable macroeconomic environment. Brazil's experience with ending inflation provides an illustration.

2. BRAZILIAN MACROECONOMIC OUTCOMES SINCE THE 1930s

Table 1 summarizes three stylized facts: (1) Brazilian inflation was high for many decades, from the early 1940s through the early 1980s. One might even evaluate Brazil's modest deflation in the early 1930s and low inflation in the late 1930s as comparatively high, given the deep worldwide depression during these years, and the Brazilian economy's dependence on coffee exports, and thus its integration with global markets. Economic growth was also strong from the 1930s through 1980s. (2) Inflation exploded in the late 1980s, while growth crashed. (3) In 1994–95, after a decade of false starts,

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Table 1. *Three periods of Brazilian macroeconomic outcomes*

Period description and years	Mean annual inflation	Mean annual growth
Mostly high inflation, high growth		
1930–34	−3.5	3.4
1935–39	4.2	5.3
1940–44	32.4	3.5
1945–49	10.5	6.9
1950–54	15.6	6.3
1955–59	19.1	8.2
1960–64	55.7	4.9
1965–69	33.9	6.5
1970–74	22.7	11.4
1975–79	44.5	6.3
1980–84	130.0	0.8
Hyperinflation, low growth		
1985–89	707.4	4.5
1990–94	1100.4	1.4
Stabilization, low growth		
1995–99	19.1	2.2
2000–03	9.7	1.2

Sources: 1930–84 from de Paiva Abreu (1990, pp. 398–408); 1985–89 from Baer (1995, pp. 383, 393); 1990–99 from Amann and Baer (2000); and 2000–03 from World Bank (2004).

Brazilian policymakers finally implemented a stabilization plan that worked. Unfortunately, since 1990, growth also has been low—a point I return to below.

(a) *The conventional wisdom*

The standard interpretation attributes the *long history of inflation* to Brazilian political, social, and/or economic regulatory institutions that were those of a "weak state." Thus, the government's inability to control price rises has been credited to a variety of factors, including assertive social actors, often with monopoly or oligopoly control in their domains, opposed only by a politically precarious and fragmented central state (Baer, 1991; Hirschman, 1981); a tradition of clientelistic politics dominated by regionally powerful landowning families to whom progressive social change is inimical (Geddes, 1994; Hagopian, 1996); a plethora of mutually contradictory economic regulations, policies, and institutions (Syvrud, 1974; Tyler, 1983; Weyland, 1996); expansionary central banking and monetary institutions arising out of a perennially bankrupt state's need for financing (Maxfield, 1998); and/or inherited electoral rules that collectively magnify the policy influence of narrow special interests at the expense of policymaking oriented to serving the collective, "public" good (Ames, 2001; Geddes, 1994; Mainwaring, 1999). A common theme in these otherwise diverse analyses is that politicians and senior economic policymakers would like to control rampant inflation, but cannot.

The conventional wisdom attributes the *explosion of inflation in the late 1980s* to the return of civilian rule and democracy in 1985, which added yet another layer of social actors making spending demands of an already overburdened central government. The general argument is that democratization, while normatively desirable, worsened the preexisting problem of a weak state unable to stand up to powerful societal interests (Weyland, 1996). After 1985, no new means of fiscal control appeared, but several additional claimants on public resources—including newly enfranchised voters and newly independent state-level politicians—exercised their influence in ways that worsened the central government's fiscal position, generating first triple and then quadruple digit annual inflation. When decentralized, freewheeling political democracy was combined with Brazil's unfortunate institutional inheritance, the new set of structurally generated incentives to politicians became even more ominous for sound national fiscal and financial management.

Thus, in 1986, the Congress voted to enfranchise illiterates for the first time in Brazilian history, and also to lower the voting age to 16. Later that year, the newly expanded electorate chose members of Congress, who, along with representatives selected by state legislatures, also were charged with writing a new, democratic Brazilian Constitution. Candidates promised voters, now including numerous poor slum dwellers, better schools, clean water, health care, and a variety of other expensive benefits. Once passed, the new Constitution of 1988, proclaiming that sub-national authorities were closer to the people, transferred a large chunk of federal tax monies to state and municipal governments (Montero, 2000; Sola, 1995). Only in retrospect was it clear that very few federal spending obligations also had been transferred to sub-national governments, with the result being greater patronage opportunities for governors and mayors, but a worsening fiscal deficit at the center.

Following the democratic transition, balloting under Brazil's unusual system of open-list proportional representation created a Congress fragmented among multiple political parties (Mainwaring, 1999; Power, 2000). Despite political party differences, the structure of patronage opportunities available to legislators (who typically needed to dispense favors in order to win reelection) has meant that state governors often have had as much or more claim on the loyalty of individual federal deputies and senators as have the ostensible national party leaders. Consequently, in order for presidents to pass legislation, they have needed to put together issue-by-issue coalitions in which legislators often have been swayed by the opinions of governors (Ames, 2001; Samuels, 2001). Exploiting their newfound political influence, a number of governors, including those of the wealthiest and most powerful states such as São Paulo, boldly ignored warnings of the Finance Ministry and bankrupted their provincial-level public sector commercial and development banks with patronage-driven lending (Montero, 2000). Political decentralization thus has weakened already limp fiscal controls.

Finally, the *successful stabilization of the mid-1990s* usually is understood as a case of acute crisis eventually convincing social actors to cooperate in solving a dilemma of collective action. It is the level of the crisis itself that is argued, ultimately, to have provoked a solution (Alesina & Drazen, 1991; Weyland, 2002). Even Brazil, with its elaborate indexation edifice, could not keep functioning with annual inflation over 1000%. Consequently, the weaker social actors—usually understood to be organized labor, and perhaps the salaried middle class—caved in and moderated their demands, allowing stabilization to occur at the expense of their relative incomes. A variant on this interpretation attributes successful stabilization to the combination of an acute crisis, which inspired normally quarreling social actors to cooperate, and policy learning, as many of the same government technocrats participated in successive heterodox stabilization attempts, incrementally modifying each new plan on the basis of the previous failures (Amann & Baer, 2000; Dornbusch, 1997).

Interestingly, implicit in the analysis attributing stabilization mainly to economic crisis would seem to be the thesis that a tendency toward reproducing crisis-generating levels of macroeconomic disarray still inheres in the overall pattern of Brazilian national political and/or economic institutions. Barring a thoroughgoing overhaul of institutions, therefore, the roller-coaster nature of Brazil's form of national economic management thus would appear to be bound to reassert itself. Analysts vary as to which institutions (the central bank? the electoral system for federal deputies? the economic clauses of the 1988 Constitution?) most need reform.

(b) *An alternative interpretation*

This essay's alternative interpretation concurs that the *long history of inflation* in Brazil reflects the existence of a struggle for shares among societal interests and a weak state, unable or unwilling to solve the collective action problem of sharing out the sacrifices necessary to balance the public budget. Inflation principally resulted from politically motivated subsidies and spending that incumbents engaged in to woo their core partisan constituents. The difference is that I further propose that inflation is *politically sustainable* only so long as its main costs can be pushed off onto groups whose fate is irrelevant to the political fortunes of the incumbent.

I agree with the conventional wisdom that the *explosion of hyperinflation* in the 1980s can be attributed to redemocratization and the sudden surge of accumulated demands on government for additional spending from previously repressed and excluded political actors.

But I have a *different understanding of Brazilian stabilization*. The underlying political logic

that accounts for the success of the *Real* Plan is that redemocratization, and especially the inclusion of the broad masses in the electorate, fundamentally altered the incentives to Brazilian political incumbents. Only after the electoral reforms of 1986, which established universal adult suffrage, did the policy preferences of the median "voter" (more accurately, the median member of the set of relevant political actors) come to resemble those of the median resident of the country.

3. POLITICAL INCLUSION IN THREE MIDDLE SECTOR REGIMES, 1930–84

The period of recurrent high and very high inflation occured during the three political regimes of the middle sectors: mostly authoritarian urban populism (1930–45), postwar democracy (1945–64), and modernizing military authoritarianism (1964–84). Most analysts have stressed *the differences* in the rules governing *political contestation* among these periods, which went from authoritarian, to competitive, to authoritarian. Alternatively, we could focus on *the continuities* in the dimension of *political participation* even while the overt rules of the game have been mutable. The game switches from soccer to basketball, but the same players participate, and the same unchosen players sit forlornly on the sidelines. [1] All three political regimes incorporated as "relevant political actors" (that is, those social groups whose good will national political incumbents need to retain, see Przeworski, 1991) economic elites, including both rural landowners and urban capitalists, plus a heterogeneous middle income group of liberal professionals, white collar workers (often civil servants), and small entrepreneurs and shopkeepers. Brazil's relatively small and privileged formal sector industrial working class is also best understood as a middle sector group—a controversial point that is central to this analysis. None of these three political regimes extended even minimal political representation to the rural poor or the large urban underclass of domestic servants and casual workers.

(a) *Mostly authoritarian urban populism, 1930–45*

One might measure the scope of political inclusion in a given political system by combining the monographic literature's estimations of which social groups had political influence with demographic evidence as to each social group's relative size in the total population. President Getúlio Vargas' (1930–45) populist "revolution" in Brazilian politics opened up an elite-dominated political system, in which access to national power had been the result of the ongoing negotiations and jockeying among key state governors, to middle class participation. In 1930 Vargas replaced all of the sitting governors but one, and in 1937 he made a rough point about federal sovereignty by publicly burning the individual state flags (Erickson, 1979, p. 172; Skidmore & Smith, 1992, p. 165). For the first time voting was by secret ballot, although direct elections for president remained "postponed," and the electorate restricted to those with clear property or achievement (literacy) qualifications. Moreover, Vargas consistently deprived his political enemies of the rights to hold public office or vote, expelling about a third of the national legislature. Finally, Vargas created compulsory corporatist networks for both industrial entrepreneurs and their employees, which served as instruments of state control, a distribution network for state largesse, and a channel for informal aggregation of constituent demands (Erickson, 1979; Schmitter, 1976).

The era of Getúlio Vargas oversaw an expansion of popular political participation in comparison to the preceding era of agrarian oligarchy (Brazil's "Old Republic," 1889–30). Table 2 employs occupational data from the census to make rough inferences about the size of the upper plus middle classes, on the one hand, and the subordinate groups, on the other. As of 1940, I estimate that *politically included groups constituted only a minority of all Brazilians*: 31% at most. [2]

(b) *Postwar competitive democracy, 1945–64*

In 1945, Vargas' own military ministers forced him to abdicate, marking the beginning of the period of postwar competitive democracy. The decentralization generally associated with periods of increasing political democratization in Brazil manifested itself in a flurry of activity within the Congress, which wrote a new constitution in 1946 to replace the authoritarian and centralizing document of 1938. The rules of the new, vigorously competitive politics, however, *did not greatly expand political participation*. Congress made voting compulsory—but only for literates. Moreover,

Table 2. *The social basis of Brazilian political regimes of the middle sectors (percent of economically active males)*

Political regime	Census date	Politically included population			Politically excluded population		
		Middle class[a]	Formal sector labor[b]	Maximum politically included[c]	Informal sector labor[d]	Rural labor[e]	Minimum politically excluded[f]
Authoritarian populism	1940	8	13	31	9	70	69
Postwar competitive	1950	7	17	34	11	65	66
democracy	1960	9	18	37	13	60	63
Modernizing military	1970	12	20[g]	22[g]	17	51	78[g]
	1980	17	27[h]	54[h]	20	36	46[h]

Source: IBGE (1987, p. 73).
[a] "Middle class" includes commerce (except food service, street vendors), military, civil service, liberal professionals, and other services (except personal services).
[b] "Formal sector labor" includes mining, manufacturing, public utilities, transport, and communications.
[c] "Maximum politically included" sums middle class and formal sector labor, plus a generous 10% for elite occupations misallocated in the census.
[d] "Informal sector labor" includes construction, food service, street vendors, personal services, and undefined.
[e] "Rural labor" includes agricultural workers.
[f] "Minimum politically excluded" sums informal and rural labor, less 10% for elite occupations misallocated in census.
[g] In 1970, I assume that formal sector labor is politically excluded.
[h] By 1980, I assume the political reinclusion of formal sector labor.

the formula for representation in the legislature was deliberately skewed to over represent voters from rural, conservative states, where landlords could deploy low status farmworkers and tenants as compliant vote banks. Industrial states, whose workers had greater potential for militancy, were underrepresented (Ames, 1987, p. 106, fn. 3).

For the period of postwar democracy, we have two possible yardsticks for estimating the size of the relevant constituency for political incumbents: (a) size of the occupational groups whose members historians consider minimally politically relevant and (b) share of the population voting. By Table 2's approximation, in 1950, those occupational groups likely to possess some political voice maximally constituted about 34%, and in 1960 about 37%, of the Brazilian population (compare to the similar reasoning and estimates of Bresser Pereira, 1984, pp. 47–65). Data on voting, shown in Table 3, became available after World War Two. Voting has been compulsory for literates since 1946, on pain of becoming ineligible for certain government benefits—benefits only of interest to formal sector workers, since those in the informal sector do not in any case qualify. National elections enfranchised about 24% of the voting age population (VAP) in the mid-1940s and 37% by the mid-1960s.

(c) *Modernizing military rule, 1964–84*

Although it began with an effort to exclude previously mobilized political actors from

Table 3. *Brazilian political participation: votes as share of the voting age population (VAP)*

Date	Type of election	Vote/VAP (%)
1945	Congressional	23.7
1945	Presidential	24.0
1947	Congressional	9.7
1950	Congressional	28.3
1950	Presidential	28.4
1954	Congressional	31.5
1955	Presidential	27.5
1958	Congressional	35.7
1960	Presidential	33.4
1962	Congressional	36.9
1966	Congressional	38.4
1970	Congressional	42.9
1978	Congressional	55.5
1982	Congressional	63.7
1986	Congressional	70.4
1989	Presidential	79.4
1990	Congressional	76.6
1994	Congressional	76.8
1994	Presidential	76.9
1998	Congressional	81.0
1998	Presidential	81.0

Source: IDEA (2004).

participation, Brazil's modernizing military regime by the mid-1970s was the third consecutive regime whose political tenure rested upon retaining the support, or at least acquiescence, of Brazil's elites, plus middle sector groups. Initially, the military coup in 1964 was about dampening political contestation (Collier & Collier, 1991, p. 555; Ianni, 1970, p. 200). For the first decade of Brazil's "bureaucratic-authoritarian" regime (O'Donnell, 1973), the urban industrial labor force lost the political rights and economic benefits it had gained under urban populism. From the mid-1970s onwards, organized labor pushed the envelope of politically permissible activities, eventually obliging Brazil's military leadership to consider labor's reactions to government economic policies once again. Thus, politically included groups may have summed to as little as 22% of the population (*excluding* formal sector labor) in 1970, but more than 50% by 1980 (with organized labor once again *included*), as shown in Table 2.

While issues, offices, candidates, and political parties were all severely restricted under military rule in Brazil, elections nonetheless served as an important indicator to the military incumbents of their popularity with their relevant publics. Electoral participation rose from 38% of the VAP, in the first postcoup limited election, to 64% in the crucial gubernatorial and mayoral elections of 1982, which the military party lost badly to the only opposition party the generals had permitted (see Table 3).

4. RECURRENT INFLATION IN THREE MIDDLE SECTOR REGIMES

Brazil's chronic inflation was essentially a *political* choice. Under each of Brazil's three political regimes of the middle sectors, successive presidents deployed a mix of distributive policies that, in the aggregate, resulted in recurrent, persistent inflation. Compensating favored groups for their direct costs from inflationary growth proved politically easier than implementing and retaining policies to cut fiscal deficits and public debt. In retrospect, fiscal austerity was a strategy that at any time during five successive decades would have been necessary, and perhaps also sufficient, to avoid persistent high inflation. The beauty of inflationary growth as the default option of senior political leaders from the late 1930s through the early 1980s was that it kept the politically included groups reasonably satisfied while shifting most of the macroeconomic costs to those outside the implicit political compact.

(a) *The political economy of authoritarian urban populism*

Vargas, the losing candidate in the 1929 election, came to power in 1930 via a largely bloodless coup. In 1932, political leaders from the economically dominant state of São Paulo staged a brief and unsuccessful secessionist rebellion. In a move typical of how Brazilian leaders often dealt with losing sectors and factions among politically included groups, President Vargas had the state-owned Banco do Brasil assume responsibility for making good on the war bonds the Paulista banks had floated to pay for the raising and arming of troops (Skidmore, 1967, p. 19). The gesture was expensive, but it served to reconcile disgruntled relevant political actors to the evolving political game. Thereafter, Paulista industrialists became crucial to the urban populist coalition, as state economic activity gradually came to favor an emerging industrial bourgeoisie. The central government invested in steel, iron ore, and hydroelectric power, all of which enabled private industry to prosper. In addition, new government jobs in the civil service and state enterprises opened up for Brazil's nascent middle class, while the benefits organized by the Ministry of Labor won the loyalty of the small but easily organized industrial working class, many of whom also worked for the state.

Although economic policy tilted toward industry, Vargas did not neglect the rural land barons. The federal government made clear it would not intervene in rural social relations, allowing large landowners to constitute the law as well as the only source of jobs in rural areas. Urban landholdings and real estate would be subject to tax, but rural landholdings would not. Finally, there were both fiscal and financial subsidies to big agriculture, notably the "coffee defense" program. Arguably, these expansionary policies were macroeconomically benign during the 1930s. Brazilian economist Furtado (1971 [1959]) even claimed that coffee price supports during the 1930s were sufficient to have nearly single handedly turned what would otherwise have been a Brazilian Great Depression into a decade averaging about 4.3% annual growth. [3]

(b) *The political economy of middle sectors' democracy*

Despite the genuine electoral competition under postwar democracy after 1945, there was strong continuity in both the relevant political actors and tenor of economic policymaking. The postwar pattern of national economic governance was more interventionist than the prewar one, as the dominant group of Brazilian business and government elites became explicit proponents of import-substituting industrialization (ISI) (Hirschman, 1961). The slogan for President Kubitschek's (1956–61) national development plan was, "Fifty years' [development] in five!," a goal his government pursued with contagious enthusiasm. Among the specific policy instruments inaugurated in the 1950s were a national industrial development bank, a multiple exchange rate scheme biased toward aiding national industrial "deepening," and explicit and compulsory mechanisms designed to construct profitable symbiosis among the "tripod" of foreign direct investment (channeled to modern sectors such as steel, automobiles, and consumer durables), local capital, and state-owned firms (Leff, 1968; Lessa, n.d. 1963; Shapiro, 1991; Willis, 1986). Industrialists received subsidies, public investment, and guaranteed markets for their goods, while the middle class and formal sector working class got good jobs.

In principle, taxation of the private sector's agricultural surplus could have financed much of this heavy state investment. But as before, rural elites also remained a crucial political constituency. Although the main economic policy package, which included tariffs and overvalued exchange rates, hurt export agriculture, policymakers satisfied landowners by enormous credit subsidies, while continuing the policies of no property taxes on agricultural land and noninterference in quasi-feudal rural social relations. The rapid pace of rural to urban migration was one indicator of the intense deprivation experienced by the rural poor. [4] Instead, the state relied increasingly on foreign borrowing and monetary expansion, contributing to the spike in inflation that was an immediate precipitant of the 1964 military coup.

(c) *The political economy of military rule*

The military rulers' explicit rationale for assuming and retaining power was that the postwar civilian governments had been poor economic managers. Initially, the new military regime attempted orthodox inflation stabilization. The three-year term of the first military president, Humberto Castello Branco, thus constituted one of the few periods prior to the 1990s in which an economically conservative policy coalition held the ascendancy. Increases in the charges for some public services and de facto cuts in public sector wages helped to balance the central government budget (Fishlow, 1973).

Ironically, one of the institutional innovations of this brief period of conscientious budget cutting ultimately assumed tremendous importance in perpetuating inflation. This was *inflation-indexing*, through which the nominal amounts to be paid on long-term financial contracts could be linked to inflation, thus reducing the risk for the lender by ensuring that the borrower would be responsible for the real value of the principal and interest (Baer & Beckerman, 1980). The early applications of what was then a novel technique were Treasury securities and residential mortgage bonds. However, by the early 1970s, continuing inflation had spurred the spread of indexation to most business contracts, financial assets, and wages and salaries—though only in the formal sector of the economy. Inflation was thus rendered comparatively toothless for most politically included groups.

The economic winners and losers under authoritarian developmentalism were clear (Evans, 1979; Hewlett, 1980). The overall national economic regulatory framework clearly served the interests of elite and middle sector groups. [5] Eventually, formal sector industrial workers, losers from the initial orthodox stabilization, were quietly reincorporated, partly in response to labor activism, including strikes in the crucial automobile sector located around São Paulo. The public deficits that resulted from multiple state subsidies were paid for by a combination of money and credit expansion and the accumulation of public debt, both domestic and foreign. [6] The costs of this elaborate regulatory framework fell most heavily on those citizens without access to government jobs, subsidies, or indexed assets or streams of income—that is, on the poor. Brazil's already horrendous income distribution steadily worsened as inflation rose. As shown in Table 4, Brazil's inequality ratio—defined as the share of all income received by the wealthiest 20% of individuals divided by the income share of the poorest 50%—deteriorated from 3.0 in 1960 to 4.5 in 1980.

Table 4. *Inequality in Brazil under increasing inflation, 1960–90*

Year(s)	Income share of richest 20%	Income share of next 30%	Income share of poorest 50%	Inequality ratio[a]
1960	54	28	18	3.0
1970	62	23	15	4.1
1980	63	23	14	4.5
1990	65	23	12	5.4

Source: Neri and Considera (1996, p. 51).
[a] The "inequality ratio" is the ratio of the share of income received by the richest 20% to that received by the poorest 50% in the country as a whole.

(d) *Interim conclusions: Political inclusion and Brazilian inflation*

Proximately, high to very high Brazilian inflation from the late 1930s through the mid-1980s can be interpreted by what Hirschman (1981, pp. 183–184) termed the "sociological thesis," which views inflation as the outcome of conflicting demands for higher income shares in the form of a "tug of war" among conflicting class and sectoral interests, each seeking a nominal rise in its income, and thus a (temporary) rise in its relative income (see also Baer, 1991). The interesting question is *why* this macroeconomically perverse fiscal pattern could persist for so long. The answer is that there was *no strong political incentive* to national leaders to fix the problem. Everyone complained about inflation, but those within the set of relevant constituencies were compensated by the side payments and protections provided by the regulatory framework. From the viewpoint of politically included groups, inflation itself was effectively "disguised," falling into the category of an annoyance or inconvenience, rather than a fundamental threat to their material conditions of life (Armijo, 1996). It was only those groups without political representation and power—and whose incomes came largely from the unregulated, informal sector—that unequivocally lost from continued inflation. Inflation therefore continued, not because Brazilian policymakers were incompetent, nor because of the exceptional virulence of external shocks, nor even because of the existence of the oft-posited "weak state." Instead, the root cause of inflation was the fact that it was convenient for political incumbents—or at least less inconvenient than the alternative, which was to significantly reduce patronage disbursements and sectoral subsidies, including the system of indexation itself. So long as *persistent macroeconomic disarray was not a serious problem for the median member of the set of relevant political actors*, then it also was not a serious problem for incumbent administrations during 50 years of political regimes of the middle sectors—periodic urgent rhetoric notwithstanding.

5. THE MACROECONOMIC CONSEQUENCES OF MASS DEMOCRACY

Mainstream academic opinion suggests that Brazilian democratization in 1985 simply widened the macroeconomically dysfunctional tug of war by admitting additional contestants into the game. This occurred, first, via expansion of the franchise and, second, as a consequence of the decentralization of political power that accompanied the democratic transition. For example, the electoral arrangements of the new constitution of 1988 largely mirrored those of the last democratizing and decentralizing constitution: that of 1945. The immediate effect of the democratic transition consequently was to deepen Brazil's uncontrolled deficit spending and macroeconomic malaise (Montero, 2000; Samuels, 2003; Sola, 1995). As new claimants made demands of the government, annual inflation went from the low triple digits in the early 1980s to the mid quadruple digits by the close of the decade. I agree with the standard interpretation of this point.

But I differ from many observers in my reading of the sources of Brazil's eventual stabilization, which did not occur until 1994, almost a decade after the formal democratic transition. Many analysts attribute the success of the *Real* Plan to the *level of crisis*, which at several thousand percent annual inflation finally had become sufficiently acute to cause at least some crucial combatants over shares to be willing to accept a drop in their relative incomes for the sake of price stability. In game theoretic terms, the payoffs for at least one significant player switched from those of "the Prisoner's Dilemma" to those of "Chicken," with those least able to endure continued inflation being the first to yield, as in the influential model proposed by Alesina and Drazen (1991). Numerous analyses of Brazilian stabilization also focus on policy learning, as Brazil's best econo-

mists saw the spectacular failure of six dramatic inflation stabilization packages during 1985–92, and fine tuned their successive packages accordingly (Cardoso, 2000; Dornbusch, 1997). Others have stressed the imperative of pleasing foreign lenders and investors, who prefer conservative macroeconomic policies. [7]

My alternative explanation is more explicitly political, and constitutes a special case of the ''net and total transition costs'' framework elaborated by Bresser Pereira (1993) and Bresser Pereira and Abud (1997). With Brazil's transition to mass democracy in the mid-1980s, the *net political costs of stabilization* finally came to be less than the *net political costs of continuing inflation*, though it took nearly a decade of political as well as economic learning for this fundamental shift to work its way through the system. By widening the franchise to make voting compulsory for all Brazilian adults, including illiterates, Brazil's Congress in 1986 dramatically shifted the boundaries of, and thus the center of gravity in, Brazil's set of relevant political actors. In the last previous presidential election, held in 1960, only 33% of the VAP had participated, while the corresponding figures for 1989 and 1994 were 80% and 77% (see Table 3). For the first time ever, the median voter was poor. He or she was also at best semiliterate and easily swayed by ''populist'' appeals, in the political sense of a charismatic politician connecting with the people by promising them immediate and probably impossible policy benefits in exchange for their emotional support and their votes. However, *poor voters in Brazil always desire low inflation, and have frequently been savvy enough to prefer less government spending*. The Brazilian masses thus take substantive policy positions at odds with many Latin Americanists' traditional perceptions of what ''the lower classes'' or ''the left'' prefer.

The first direct election for a Brazilian president since 1960 occurred in late 1989. Scholars have noted similarities in the style of candidate Fernando Collor de Melo and classic Latin American populism of the 1930s through 1960s, in which a charismatic candidate appeals directly to the masses, by-passing political parties and other traditional channels of political representation (see especially Weyland, 1999). The puzzle becomes why so many recent Latin American candidates with strong electoral support from the poor have, as in the case of Brazil's Fernando Collor or Argentina's Carlos Saúl Menem, pursued market-oriented, ''neoliberal'' economic reforms once in office—rather than the state-led distributionism associated with the earlier urban populist leaders such as Getúlio Vargas or Argentina's Juan Perón. Within the long-standing Latin American intellectual framework that views high levels of government economic interventionism as a political project of the left, which in turn is the natural political identity of the lower classes, the only logical conclusion is that voters have been duped. Moreover, in the case of Collor, stunningly elected in 1989 without a party base and later undone by corruption in his administration, some of the other pejorative connotations of ''populist'' have seemed to fit.

The problem with the preceding analysis is that it uncritically equates the interests of urban formal sector labor (such as those with unionized jobs in the private sector automobile industry or state-owned heavy industry) with the interests of the true underclass, the urban and rural informal sector workers, domestic servants, day laborers, and unemployed who have always been largely outside the net of state-orchestrated jobs, indexation, and social welfare benefits. Yet the economic policy preferences of formal sector industrial laborers are much closer to those of the salaried middle class than to the desires and needs of the hitherto economically and politically disenfranchised. If we *reinterpret the pattern of economic interests in Brazil in such a way as to consider formal sector industrial workers as one of the middle sectors*, all of whom have different material interests than the genuinely poor, then the pattern of poor voter support for Fernando Collor appears less as an example of false consciousness. Collor, the governor of a small, rural state, campaigned as the ''maharajah hunter,'' or sworn enemy of civil servants simultaneously and illicitly holding two and even three fulltime positions, each with full pay and benefits, including the right to generous pensions. In a poll taken before the first round of voting in November 1989, among those intending to vote for Collor the most important reason by far was his pledge to fight ''corruption, bribes, and maharajas,'' while the most important reason citizens supported his opponent, long-time trade unionist Luiz Inácio (Lula) da Silva, was Lula's ''support for the working class,'' that is, formal sector industrial workers. [8]

Data breaking down intentions to vote by income support this analysis. In the week prior to the runoff elections in December, the polling

agency DataFolha reported second round preferences according to three income groups. Among those voters with a preference who earned up to five times the minimum wage, that is, the poorest group surveyed, 56% preferred Collor, while 44% chose Lula. Of those receiving between 5 and 10 times the minimum wage, however, 53% preferred Lula. Finally, and surprisingly, 61% of those making more than 10 times the minimum wage reported a preference for Lula, the trade union candidate in this highly socially and economically stratified society. In addition, people in urban areas and the better educated preferred Lula, while rural and less educated voters expressed an intention to choose Collor. [9] This breakdown suggests that poorer voters preferred the more "neoliberal" candidate, while wealthier voters leaned toward the "labor" candidate. In the event, Collor won decisively.

To some extent, the urban and middle and upper income groups' rejection of Collor can be attributed to his origins as a rural landowner in a backwater state, unrepresentative of "modern" Brazil. Supporters of Lula also blamed a slick media campaign for enticing unsophisticated voters to choose Collor. However, this essay's analysis would suggest another explanation altogether: the resonance among the havenots of Collor's well-publicized promises to reduce the privileges of state employees, petty bureaucrats, and clientelistic politicians. In the context of a pattern of significantly regressive overall state spending–emphatically including "social spending" on health, education, social security, and unemployment insurance (International Monetary Fund, 2001, pp. 56–99)—the support of the lower classes for someone who ran as the equivalent of a "beltway outsider" is understandable. Collor's promises to privatize state-owned enterprises, shrink public sector deficits, and bring down inflation, although in the end they proved inept, in fact furthered the interests of his mass constituency, while imposing costs primarily on middle sector groups. Unfortunately, Collor's problems with corruption eventually rendered most of his reform initiatives both illegitimate and ineffective, and he resigned to avoid impeachment.

Itamar Franco, Collor's vice president, became chief executive in January 1993. Initially prone to populist economic nostrums, [10] Franco went through four finance ministers before settling on Fernando Henrique Cardoso. Cardoso was not a professional economist, but a well-known scholar, dissident during the military years, and more recently diplomat and senator from the major industrial state of São Paulo (Goertzel, 1999). While taking technical advice from several of Brazil's best economists, Cardoso approached stabilization primarily as a *political challenge*, rather than an economic puzzle. Unlike the other "shock" programs since the restoration of democracy, the *Real* Plan (after the new currency, the *real*) was announced more than six months before it went into operation, which allowed for an overt political process of bargaining among various sectors over the process of relative price adjustment (Kingstone, 1999). A simple calculation—through which each sector, firm, union, or other factors of production would, in principle, be entitled to a relative price equal to the average of its real income level over the previous six months—served as a fair initial benchmark, around which negotiations could occur. This helped greatly in solving the collective action dilemma embodied in the long-running struggle for shares.

In April, shortly before the switch to the new currency on July 1, 1994, Cardoso resigned as finance minister in order to run for president in the elections scheduled for October of that year. Da Silva (Lula) of the Workers' Party had been campaigning for the job since his loss to Collor four years previously, and had made large strides in public opinion, distancing himself from his more radical economic pronouncements of the past to reassure the business community and undertaking an extraordinary bus tour around Brazil to raise his profile in rural areas. During the first half of the year, Lula held a commanding lead over all other declared and/or likely candidates. Virtually all commentators agreed that it was the success of the *Real* Plan in suddenly stopping inflation that eventually brought an easy victory to Cardoso in the first balloting, with 54% of the votes.

Inflation stabilization is a strongly pro-poor policy (Easterly & Fischer, 1999). The poor majority in Brazil wanted inflation to end, and quite rationally held this view with a ferocity not felt by those who were at least partially protected by their incorporation into the web of indexation and benefits available only to formal sector workers. As shown in Table 5, the end of inflation brought immediate improvements in income distribution, which had worsened dramatically in the year of quadruple digit inflation preceding the *Real* Plan (Mostajo, 2000; Neri & Considera, 1996, pp. 49–50). [11] Urban labor and the middle classes also gained with

Table 5. *Urban poverty and inequality, before and after 1995 stabilization*

Year(s)	Inequality ratio, metropolitan data[a]	Percent in poverty, metropolitan data[b]
1991, May	4.1	23.2
1992, May	3.7	28.8
1994, May	4.5	33.3
1996, May	4.0	25.9
1997, May	4.0	25.1

Source: Ter-Minassian *et al.* (1998, p. 16).
[a] The "inequality ratio" is the ratio of the share of income received by the richest 20% to that received by the poorest 50% in the major metropolitan areas.
[b] "Poverty" is defined as income less than the equivalent of US$50 a month.

the end of very high inflation, though their relative gains were lower.

Stabilization, however, brought net medium-term losses to many business interests in Brazil—especially in the financial sector, whose profits and contribution to national income had expanded steadily and dramatically under Brazil's peculiar financial regulatory framework since the mid-1970s (Armijo, 1996; Ness, 1994). Moreover, manufacturing industry suffered from the overvalued exchange rate and high domestic interest rates that were part of the stabilization package (Dinsmoor, 1999, p. 10). All of these outcomes eventually lost Cardoso some support among businesspersons, some of whom were ready to return to positive growth, no matter what the consequences in terms of macroeconomic disarray. In June 1995, for instance, Finance Minister Pedro Malan complained about "sectors both inside and outside the government that defend the idea of inflation in terms of 10–15% a month." [12]

The crucial difference between the earlier failed stabilization plans and the successful *Real* Plan of 1994 was that the executive branch's bargaining power had increased following Cardoso's big election victory in October, subsequently enabling him and Finance Minister Malan to face down the various sectors begging for readjustments or compensation and maintain the various tough disciplines of the *Real* Plan, including the exchange rate anchor. As compared to Collor, Cardoso also showed a high level of skill at that traditional Brazilian political virtue of intra-elite bargaining, backroom dealing, and factional conciliation. Now that the president was committed to market-oriented economic reform, it was possible, albeit incrementally and with great persistence, to get even Brazil's fractious Congress to amend anachronistic and expensive economic legislation dear to the hearts of many special interests (Ames, 2001, pp. 182–184; Goertzel, 1999, pp. 125–176).

Cardoso was reelected on the first ballot in 1998, once again benefiting from his administration's success in ending high inflation. His second administration was relatively successful, after much persistence, in passing much of its priority legislative agenda, notably the Fiscal Reform Law of 2001, which virtually eliminates the ability of sub-national governments to run deficits. Not surprisingly, after eight years of low inflation, and also low growth, unemployment in both the organized and unorganized sectors of the economy became the new core economic issue for the 2002 election. Workers' Party candidate Lula da Silva defeated Cardoso's chosen successor, becoming president on his fourth attempt. Da Silva has continued his predecessor's emphasis on fiscal austerity (and not only because of pressure from foreign investors!), while pledging renewed concentration on growth and distribution, all of which the majority of Brazilian voters now demand.

6. LESSONS FROM BRAZIL?

Brazil's experience illustrates how the political costs of continued inflation can overwhelm the expected costs of stabilization (Bresser Pereira & Abud, 1997). It also suggests a possible reconceptualization of the relationship between political democratization and macroeconomic performance. It probably is true that the expansion of participation and contestation (Dahl, 1971) associated with a political regime shift to mass liberal democracy typically generates an up tick in economic populism, as newly enfranchised actors make expensive policy demands of their elected representatives. Thus, Gasiorowski (2000) finds that democracy in developing countries on average worsens macroeconomic performance by leading to increasing wages, fiscal deficits, and inflation, all of which reduce growth. At the same time, *political incorporation of the majority may provide clear outer limits to the perpetuation of truly awful macroeconomic outcomes*—say, sharply negative per capita economic growth over a decade or more, or similarly long periods of inflation in excess of 30% annually.

Brazil's experience under a succession of political regimes of the middle sectors, 1930–85,

demonstrates that there may be a set of macroeconomically undesirable but politically palatable economic policy options available to incumbents in regimes that deny political participation to a large group of residents. The favored subset of residents who are politically relevant may, under some circumstances, be content even in the absence—*for decades*—of an overall scenario of stable, noninflationary growth. For example, economic policy and regulatory options available to socially narrow regimes include income-concentrating redistribution (which redirects costs toward politically excluded groups) and foreign borrowing (which pushes the problem of fiscal balance to the future or, arguably, onto foreigners). However, once there is a shift to genuine majority rule, then extreme distortions over long periods should become tantamount to electoral suicide for incumbents, because the *only way to protect the income of the median member of the set of included political actors (in this case, the median resident)* is to pursue policies that can generate at least a rough approximation of stable, noninflationary growth. Where incumbent governments cannot deliver at least mediocre economic results for the majority, rational voters will cast the bums out.

The logic is similar to that employed by Drèze and Sen (1989, pp. 204–225) to explain the incidence of poverty and hunger in India and China through the mid-1980s. Famines in India occurred under British colonial rule (a political regime that excluded the vast majority of Indians) as recently as the early 1940s, because famine prevention was not a top priority of the constituents whom the colonial government represented. Drèze and Sen acknowledge that India's imperfect mass democracy has not (or had not as of the late 1980s) yet led to sustained and rapid economic growth comparable to that of China, but note that democratic India, unlike authoritarian China, has avoided horrific famines. Drèze and Sen attribute independent India's success in avoiding widespread famine to the pressures on elected leaders resulting from a vigorously free press and reasonably honest and hotly contested elections. Elected leaders in a mass democracy, however venal and incompetent, cannot afford to permit their constituents to expire in large numbers.

I expect Brazil's current broadly sensible macroeconomic framework to endure, irrespective of the individual leaders elected, because its *political logic* should be compelling for elected leaders. While political democratization with universal suffrage may not yield stellar economic results (independent India being a case in point), it can *dramatically increase the incentives to elected leaders to avoid the worst policy distortions*. For citizens in many developing and transitional countries, having their politicians constrained in such a way could be a great blessing.

NOTES

1. Then sociologist Cardoso (1979, p. 39) observed that "an identical form of state—capitalist and dependent, in the case of Latin America—can coexist with a variety of political regimes: authoritarian, fascist, corporatist, even democratic."

2. To arrive at this number, I sum the urban middle and formal sector working classes, then add an additional 10% to compensate for elite occupations not specified in the census.

3. Pelaez (1971) notes that coffee supports were not the *only* cause of Brazil's counter-cyclical policies in the 1930s.

4. Although the urban poor received few direct welfare benefits, they profited from the employment opportunities that Brazil's decades of high growth offered.

5. In fact, many obligations owed by the business community to the state—most notoriously, agricultural loans—were denominated only in nominal terms, which meant a huge transfer of real resources from the state to elites as inflation heated up (World Bank, 1982, pp. 16–27).

6. Even the existence of public deficits was for many years highly contentious in Brazil. Official figures show a fiscal surplus almost every year under the military regime (IBGE, 1987, p. 571). Concern over deficits was long conceived of as an economically *and socially* conservative topic, suggestive of pro-authoritarian political leanings (Armijo, 1996; Kearney, 2001). Well into the 1980s, many Brazilian economists insisted that public deficits *per se* had little to do with recurrent inflation (e.g., Gonzaga de Mello Belluzzo & Coutinho, 1984). It is only since the 1990s that Finance Ministry officials have acknowledged their inheritance of massive off-budget liabilities—known in Brazil as "fiscal skeletons."

7. I thank Mark Setzler for reminding me of this point.

8. *Folha de São Paulo*, October 17, 1989, B8.

9. *Folha de São Paulo*, December 8, 1989, B6.

10. During this period of several thousand percent annual inflation, for several months President Franco devoted himself to a crusade to hold down the prices of prescription drugs.

11. The poorest Brazilians were also aided by the fact that stabilization was accomplished, at least during the first two years, in the context of positive growth and reasonably strong employment (Paes de Barros, Neri, & Mendonça, 1996).

12. "Economists discuss the Real," *Gazeta Mercantil International Weekly Edition*, July 3, 1994, p. 4.

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