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Which developmentalism? A Keynesian–Institutionalist proposal*

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Academic discussion of Brazil's economic growth is currently framed in terms of export-led growth and wage-led growth, identified, respectively, with the new- developmentalism and the social-developmentalism approaches. This article presents a Keynesian–Institutionalist proposal to the Brazilian economy based on a wage-led regime without neglecting the long-run balance of payment current account requirement to ensure macroeconomic stability in the Brazilian economy.

Keywords: *new-developmentalism, social-developmentalism, Keynesian–Institutionalist, wage-led, profit-led, export-led growths*

JEL codes: *B, B5*

1 INTRODUCTION

While priority was given to monetary stability during the 1980s and 1990s, economic growth has gradually been finding its way back to both theoretical economic debate and economic policy discussions in Brazil since the 2000s. This has been due partly to the election of various governments critical of neoliberalism in Latin America, and partly to the 2007–2008 financial crisis, which restored interventionism to the agenda, not only for discussion, but also in terms of economic policy applied in several countries. Although it can reasonably be stated that, in the short run, the Brazilian economy showed signs of being less affected by the financial crisis than other countries (especially the developed countries),[1] prior to 2007–2008 it had already been registering relatively high growth rates as compared with the recent historical pattern.[2]

* The authors thank three anonymous referees for comments and suggestions. All remaining errors are the authors' responsibility.
1. As shown in Table 1, GDP fell by 0.3 percent in 2009, recovering significantly in 2010 when it grew by 7.5 percent.
2. From 2000 to 2008, GDP grew by an average of 3.7 percent per year (authors' calculation based on the data in Table 1), while in the 1990s the average growth rate of GDP was around 1.8 percent per year (author's calculation based on Brazilian Central Bank 2013).

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The ensuing climate of optimism was not restricted to government circles, but was also shared by a number of analysts (Belluzzo 2009; Cervo 2009; Nakano 2010; Novy 2009a; 2009b). Was developmentalism back as a guiding ideology for policy-makers? If so, it seems that this phenomenon could be interpreted, taking an Institutionalist approach, as not just temporary or conjunctural, but embedded in local culture or, in the expression coined by Castro (1997), as a 'growth convention': a certain consensus that growth was a priority, which formed part of the mindset of Brazil's elites during the twentieth century. The optimistic scenario was further sustained by the peculiarity of more recent growth that – unlike the 'old developmentalism' – was accompanied by redistribution of income, or at least with a declining Gini index.[3] This was hailed as a typical case of wage-led growth, as supported by Kaldorian models (Dutt 1992; Kaldor 1960; 1978; McCombie and Thirlwall 1994). Actually, although the gross capital formation rate was low (see Table 1), household consumption led this growth under the influence of various factors: (a) inflation rates were kept relatively low, putting an end to the erosion of real wages, which general price and wage indexation had not been able to contain;[4] (b) the purchasing power of the minimum wage was restored, rising by 522 percent from 1995 to 2012, against an accumulated inflation rate of 251.3 percent in the same period (which means that the minimum wage grew 77 percent in real terms); and (c) government cash transfer programs targeting low-income families, such as the *Programa Bolsa Família* (Family Allowance Program), were expanded.[5]

Criticism of this style of growth came not only from orthodox circles, which traditionally associate it with 'economic populism',[6] but also from economists who pointed to the impermanence of growth based on consumption while domestic industry's share of GDP was shrinking, although this was an international phenomenon (see, among others, Bresser-Pereira 2006; 2010; 2012; Bresser-Pereira and Gala 2010; Oreiro 2012; Sicsú et al. 2005). Bresser-Pereira, one of the leading formulators of this approach, called it new-developmentalism. For these new-developmentalists, a single variable accounted for both growing consumption and 'deindustrialization,' namely exchange rate appreciation during the period after the Real Plan, and especially during the 2000s. Consumption-led growth was only possible in a context where: (a) wages had historically been rising less than productivity, so that there was 'room to grow'; and (b) the external conjuncture was atypically favorable, owing to autonomous inflows in both the capital account and current transactions led by Chinese demand for commodities, which affected the prices and quantities of Brazilian exports.[7] This increase in import capacity favored exceptional growth in consumption without affecting the balance of payments, but this could hardly be relied on as a long-term model of development. The alternative they proposed points to an export-led pattern of growth, where currency devaluation becomes a key economic policy variable. In fact, the constraints on growth result both from the 'Dutch disease' and from excessive capital inflows, which cause the real rate of exchange to appreciate, leading to balance

3. From 2000 to 2012 the Gini Index fell from 0.589 to 0.526.
4. For example, from 1995 to 2012 the annual average inflation was around 7.2 percent. From 1999–2012, the period during which the inflation targeting regime was in effect, average annual inflation was about 6.7 percent (authors' calculations based on the data in Table 1).
5. At the end of 2012, about 13.6 million families benefited from the *Programa Bolsa Família* (2013). For details, see: http://www.mds.gov.br/bolsafamilia.
6. On theories of economic populism, see Bresser-Pereira (1991), Díaz-Alejandro (1981 [1991]), Dornbusch and Edwards (1989 [1991]; 1990), and Sachs (1989).
7. The impacts of the Chinese economy and its import demands to Latin America, especially Brazil, are analysed by Cunha et al. (2013).

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Table 1 *Main macroeconomic indicators for the Brazilian economy, 1995–2012*

Indicators/Year	1995	1996	1997	1998	1999	2000	2001	2002	2003
Inflation (IPCA – %)	22.4	9.66	5.22	1.66	8.94	5.97	7.67	12.53	9.30
GDP growth (%)	4.4	2.1	3.4	0.0	0.3	4.3	1.3	2.7	1.1
Real effective exchange rate[a]	71.1	69.6	68.2	75.3	102.8	100.5	116.7	157.4	133.2
Basic interest rate, end of year (%)	n.a.	23.0	38.0	29.0	19.0	16.5	19.0	22.0	17.5
Minimum wage (R$)	100.0	112.0	120.0	130.0	136.0	151.0	180.0	200.0	240.0
Trade balance (USD billion)	–3.5	–5.6	–6.7	–6.6	–1.2	–0.7	2.6	13.1	24.8
Current account (USD billion)	–18.4	–23.5	–30.4	–33.4	–25.3	–24.2	–23.2	–7.6	4.2
Foreign reserves (USD billion)	51.8	60.1	52.2	44.6	36.3	33.0	35.9	37.8	49.3
Fiscal result/GDP (%)	0.24	–0.09	–0.88	0.01	3.2	3.5	3.6	3.9	4.3
Public debt/GDP (%)	29.1	29.6	30.4	35.4	44.5	45.5	48.4	50.5	52.4
Gross capital formation/GDP (%)	18.3	16.9	17.4	17.0	15.7	16.8	17.0	16.4	15.3

Indicators/Year	2004	2005	2006	2007	2008	2009	2010	2011	2012
Inflation (IPCA – %)	7.60	5.69	3.14	4.46	5.9	4.31	5.91	6.50	5.84
GDP growth (%)	5.7	3.2	4.0	6.1	5.2	–0.3	7.5	2.7	1.0
Real effective exchange rate[a]	126.7	100.7	99.3	86.7	106.9	79.4	73.7	79.3	88.7
Basic interest rate, end of period (%)	17.25	18.5	13.25	11.25	13.75	8.75	10.75	11.0	7.25
Minimum wage (R$)	260.0	300.0	350.0	380.0	415.0	465.0	510.0	545.0	622.0
Trade balance (USD billion)	33.6	44.7	46.5	40.0	24.8	25.3	20.2	29.8	19.4
Current account (USD billion)	11.7	14.0	13.6	1.5	–28.2	–24.3	–47.4	–52.6	–54.2
Foreign reserves (USD billion)	52.9	53.8	85.8	180.3	193.8	238.5	288.6	352.0	373.1
Fiscal result/GDP (%)	4.6	4.3	3.9	4.0	4.1	2.1	2.8	3.1	2.4
Public debt/GDP (%)	47.0	46.5	44.7	42.8	36.0	43.0	40.4	36.5	35.1
Gross capital formation/GDP (%)	16.1	15.9	16.4	17.4	19.1	18.1	19.5	18.5	18.1

Note: [a]End of period, June 1994 = 100.
Source: Brazilian Central Bank (2013) and IPEADATA (2013).

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of payments disequilibrium and a disincentive to increase production capacity. With this strategy, considering that economic development should be financed essentially with domestic savings, fiscal policy space is restricted, as the public budget must be strictly balanced to ensure a stable long-term public debt–GDP ratio, while monetary policy needs to be aligned with the inflation-targeting regime, albeit with some flexibility (Bresser-Pereira et al. 2012; Oreiro 2012).

On the other hand, some authors (Bastos 2012; Carneiro 2012) believe that economic growth should be galvanized through consumption of wage goods (mass consumption), encouraged both by rising levels of employment and by income distribution through government social policies, real wage (especially minimum wage) increases, and actions by the State to improve supply of basic public services, including healthcare, education, and transport. Meanwhile, it is fundamental that credit expand to sustain the expansion of mass consumption. Credit, in turn, should be directed not only to the short term, but also to long-term financing for industry, which cannot dispense with the State financial system. Accordingly, this proposal, which has been called social-developmentalism, advocates active fiscal and monetary policies. Unlike new-developmentalism, it argues that the exchange rate should be held at appreciated levels, on the one hand facilitating the capital goods imports essential for domestic capital to absorb ongoing technological progress and reduce final production costs, and on the other hand preventing a decline in wages.

In other words, current debate in Brazil seems essentially to suggest a polarity between two at-first-sight opposed models of growth (wage-led and export-led). Despite this theoretical trade-off, our goal in this article is to present a model of growth to the Brazilian economy based on a wage-led regime without disregarding the long-run balance of payment current account requirement to ensure macroeconomic stability, defined as inflation under control, fiscal and trade equilibrium, and sustainable economic growth, with social inclusion. We therefore start from the assumption – similar to the assumption underlying social-developmentalism – that growth with more equitable income distribution is desirable and that a reversal of this trend would mean a significant loss in social terms. However, the macroeconomic and institutional policies that can make this feasible and sustainable as a *growth pattern* over the long term have to be accompanied by economic policy measures in order to meet the need (and in accordance with the new-developmentalism approach) for balance of payments equilibrium. As a corollary to this idea, we present a Keynesian–Institutionalist proposal.

This article is divided into four sections following on this introduction. Section 2 presents some considerations on demand-driven models of growth. Section 3 provides a brief historical account of Brazilian economic growth regimes from the 1950s to the 2000s. Section 4 offers a set of Keynesian–Institutionalist proposals for the Brazilian economy, seeking to ensure macroeconomic stability. In Section 5 we come to the conclusions.

2 SOME CONSIDERATIONS ON ECONOMIC GROWTH REGIMES

First, we need to clarify that both wage-led and export-led regimes, as understood here, are alternatives compatible with a predominantly Keynesian–Kaleckian (KK) approach, since they have to do with which aggregate demand variable is primarily responsible for expanding growth: household consumption or exports. It is thus implicit to both views that economic policy, by influencing aggregate demand, can alter both real and nominal product. Unlike the new-developmentalist strategy, in which

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the private sector's export is fundamental, social-developmentalism presents a strategy of capitalism development based on state-led distributive developmentalism.

From our point of view, these two alternatives, which are part of a spectrum of demand-driven growth models, seems to contrast with the profit-led regime, which is closer, as we see it, to the neoclassical tradition, and stresses the supply side of the economy, placing less emphasis on the State presence and more on the role of market mechanisms, on the need for prior savings, and on variables such as human capital and education as strongly associated with, or prerequisites for, balanced long-term economic growth trajectories. In other words, the profit-led regime relies on the relevance of profitability, and, as a result, the increase of the share profits in the national income. This, clearly, is the alternative that has since the late twentieth century been labeled neoliberal, and which has been showing visible signs of crisis at the international level in the 2000s, whether as a path to boosting growth in GDP and employment or as a means to achieving more equitable distribution of income.

Contrary to our view, for instance, Bhaduri and Marglin (1990) argue that the KK model can be both wage-led and profit-led, depending on the relative response of saving and investment to changes in profit share, while Palley (2012) holds that, on the one hand, export-led growth focuses on supply and price effects, and, on the other hand, there is a certain equivalency between export-led and profit-led regimes, as a real exchange rate depreciation to improve export competitiveness leads to lower real wages.[8]

Despite this theoretical debate, we are assuming that a wage-led regime vis-à-vis an export-led regime seems to be a false dichotomy as both are identified with aggregate demand, while the profit-led regime appears to be determined by the supply side.[9]

In general, the main variable leveraging growth (wage and/or export) – here termed the *trigger variable* – should not be regarded as the only factor responsible: it must interact with the main components of aggregate demand, consumption, investment, government expenditures, and net exports. The interaction between the *trigger variable* and the components of aggregate demand, *especially investment*, both public and private, shapes what is called a *growth pattern*. However, even though a *growth pattern* may appear in embryo when it reflects the policy-makers' clear intention, it is normally not automatic, nor does it reproduce spontaneously: it needs the right economic policy. Here, economic policy is not meant as just macroeconomic policies (such as monetary, fiscal, and exchange rate policies) to assure stabilization, but also ends-policies (that intervene horizontally or vertically in segments or sectors, such as industrial, agricultural, and technological policies and suchlike) and structural–institutional changes. These comprise changes of greater scope, generally with longer-term impact, to laws, civil codes, regulations, the 'rules of the game,' and delimitation of property rights, as well as the creation of State-owned (or even private or non-governmental) enterprises, agencies, and bodies. In addition, such changes influence

8. According to Palley (2012, p. 142), '[e]xport-led growth is a development strategy aimed at growing productive capacity by focusing on foreign markets. It is part of a new consensus among economists about the benefits of economic openness that took hold in the 1970s.'

9. It is important to mention that in a capitalist or entrepreneur economy, whatever the economic growth regimes, the main goal of economic activity is to produce profits. According to Keynes (1979, p. 82): 'in an entrepreneur economy ... [a]n entrepreneur is interested, not in the amount of product, but in the amount of *money* [profit] which will fall to his share.' This does not mean, however, that the economic growth regime is profit-led.

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and are influenced by habits, preferences, and conventions, current or even culturally embedded in each society.

That said, it is clear that a *growth pattern* does not entail only choosing the *trigger variable*, which will be effective in boosting growth only if it can ensure interaction with the components of aggregate demand. In this regard, Keynes (1936 [2007]) made a fundamental contribution to highlighting the importance of investment to determining aggregate demand. If it is capable of responding positively to wage increases, it then becomes possible to reproduce a successful wage-led trajectory. Here lies the difference between this pattern and the underconsumption theses, from the classic formulations of Sismondi and Malthus to the most recent.[10] Normally, these argue that consumption is central to determining income level, in a sense disregarding or underestimating investment as a crucial variable. However, the hypothesis underlying the remarks below is that, whether the pattern be wage-led or export-led, *it can only be reproduced and constitute a successful trajectory if the increase in, respectively, wages and exports is able to induce a higher level of investment*.

On this point, according to Keynes (1936 [2007], ch. 12), in a context where investment decisions rest on uncertain expectations about future demand behavior, then the degree of trust and conventions – or, more broadly, institutions – are fundamental for entrepreneurs' animal spirits to emerge. In the words of Keynes (ibid., p. 161), most decisions 'can only be taken as a result of animal spirits.' It is worth asking what constitute favorable conditions for animal spirits: optimistic expectations, political and social conditions, institutions and economic policy, or other variables. In summary, the interaction between the *trigger variable* and the determinants of aggregate demand must be given a prominent place in economic policy-making to foster a *growth pattern*.

This, then, proves to be the greatest challenge facing policy-makers, because that interaction does not depend on them alone: it is impacted by other variables – of a political nature, external constraints, and structural alterations in the current technological standards – that are considered 'exogenous' to their domain.[11] Therefore, opting for a particular pattern is no 'simple choice': there are variables that contribute to making it more or less feasible, and distinguishing its typical-ideal or 'model' formulation from the factual realities of its implementation. In practice, each pattern has what can be called, if not 'positive' or 'negative,' then 'strong' or 'weak' points.

On the one hand, the strong point of the export-led pattern is normally considered to be its ability to minimize one of the most frequent constraints on growth in countries with an internationally non-convertible currency: that is, persistent problems of balance of payments equilibrium can mean frequent recessions, inflation (with emergency exchange rate devaluations then being used) and external indebtedness. In this way, as experience has shown, emerging countries in particular can come up against a structural problem in their balance of payments, due to the effect of what is called Thirlwall's law (Thirlwall 2002).

10. Underconsumption theory argues that a decline in the wage share of national income would reduce aggregate demand and increase saving due to a lack of purchasing power in the consuming classes.

11. In this regard, Bielschowsky (2012) seems rightly concerned, when proposing a development model similar to the wage-led pattern (which he calls the mass consumption pattern), to seek to connect it with the expansion of investment in other sectors or 'expansion fronts' – in this case natural resources and infrastructure, which should be leveraged by technological innovation and by the reactivation of traditional production chains.

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Meanwhile, on the other hand, the wage-led pattern offers the advantage of opening up room to improve income distribution, because the idea is to create conditions for relations of 'cooperation' between wages and profits. In this pattern, wages may – albeit not necessarily – account for a growing share of income, but this aspect of its *ex post* performance cannot be its leading characteristic because, over the long term, that would entail a zero profit margin. Accordingly, it is best defined as a 'strategy' (Lavoie and Stockhammer 2012, p. 15): rising wages are expected to have positive impacts on consumption and investment, which will interact to ensure growing aggregate demand (Dutt 1987; Rowthorn 1981; Taylor 1983). While the impact on consumption is more or less immediate or strongly expected (assuming, as Kalecki does, that workers are highly likely to consume), *the challenge of the wage-led regime is how to create a virtuous relationship between it and investment*. In this respect, investment deviates completely from neoclassical theoretical constructs, which maintain, on the assumption of perfect competition, that increases in wages will have negative impacts on aggregate demand and level of employment.

One essential difference between the two regimes is the role of the exchange rate. In an export-led regime, exchange rate depreciation has a positive effect on the level of economic activity, while the opposite occurs in a wage-led regime. That is why some of the literature (Araújo and Gala 2012; Blecker 2010; Bresser-Pereira 2009; 2012) argues that, for economies that are less international leaders and more sensitive to export and import price variations, the export-led regime is the most appropriate. Thus, it is concluded that exchange rate policy demands a trade-off between better income distribution and external balance. If the proposition that wage growth is a significant variable in achieving better income distribution is admitted as reasonable, then a wage-led pattern would require a relatively strong currency and rising wages (or wages at least growing in step with productivity), but would have negative impacts on equilibrium in the trade balance and in current transactions. An export-led pattern, on the other hand, would require a depreciated currency and lower wages compatible with the export effort, pointing to income distribution that favors profits over wages.

To conclude this section, from our point of view there is no 'optimum choice' (wage-led vis-à-vis export-led), especially because each of them have their specificities and both regimes are theoretically demand-driven. Thus, we propose an economic model based on a wage-led regime without neglecting the long-run balance of payment current account requirement, (i) to pursue better income distribution or a greater share of wages in national income, (ii) to foster investment in a framework designed to stimulate growth in wages and consumption, and (iii) to formulate exchange rate and foreign trade policy capable of averting or minimizing possible adverse impacts that could impair balance of payments equilibrium.

3 THE BRAZILIAN ECONOMIC GROWTH REGIMES: A HISTORICAL EXPERIENCE

Analysis of Brazil's economy over the last century shows that it experienced various different growth regimes. For the first 30 years of the twentieth century, the approach advocated by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) prescribed an 'agro-export' or 'outward' model based on a *growth pattern* whose *trigger variable* was exports. Components of aggregate demand were greatly dependent on growth in exports: (a) consumption depended on income level and expansion of the market, both of which oscillated with agro-export cycles;

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(b) private investments and industrial production also oscillated with exchange rates, with private investment normally growing during periods of strong currency, and industrial production during exchange depreciation phases (Versiani and Versiani 1977); and (c) it was difficult for government spending to behave as an autonomous component of aggregate demand because, lacking a system to finance public debt, it was greatly dependent on foreign trade – that is, on taxation on imports and exports.

Since the export-led pattern consisted in the export of a few commodities, especially coffee, that depended largely on external demand, not even Brazil's privileged position in global coffee production – at times accounting for more than 80 percent of the world market – could protect the coffee economy from ever more frequent and extreme crises, which required increasing government intervention. 'In practice,' then, the export-led pattern, contrary to what might be expected, did not create a foreign trade balance capable of ensuring stability for the economy as a whole. On the contrary, it revealed its fragility in depending more and more on external financing to ensure government intervention in defense of coffee, and the frequent funding drove up the foreign debt. This is summed up in Furtado's classic contribution in chapters 29 and 30 of *Formação Econômica do Brasil* (1959 [1977]) as the 'socialization of losses,' as a social consequence of a typically 'outward' economy subordinated to the international market.

With the collapse of the agro-export model, in part due to the Great Depression, the model veered towards industrialization by import substitution, following a logic that was closer to the wage-led rationale. Turning 'inward' meant fostering a positive correlation between growth in consumption and production, favoring a situation of increasing investment in industries that produced wage-consumption goods. Thus, from 1930 to 1945, during the first Getúlio Vargas government, nationalism and laborism gave ideological expression to this new phase: it was the State's role not only to pursue exchange, fiscal, and monetary policies, but also to introduce large-scale institutional changes to enable the new pattern to emerge (new codes and constitutions, agencies and institutes in the State apparatus, labor legislation, and State enterprises in heavy industry and mining etc.).[12] One very particular feature of this wage-led regime was that it was *unable*, over the long term, to alter income concentration. This was due in part, as the ECLAC theories themselves showed, to the unlimited labor supply resulting from intense migration from rural to urban areas.[13] Whether for this or other – also possibly political – reasons, it can be inferred that total wages grew as new workers were drawn into the labor market, without necessarily depending on any increase in the wages of each individual worker. Thus, this particular wage-led regime was able to coexist with wages growing less than productivity, despite labor legislation that imposed minimum parameters and rules on the labor market, without which the income concentration might have been even greater.

During the 1950s, the Brazilian economy experienced rapid growth and a considerable diversification of production due to the import-substitution industrialization process. More specifically, Vargas's second term, 1951–1954, was characterized by an ambitious industrialization plan and the nationalization of the country's natural resources, while Juscelino Kubitschek, 1956–1961, with his ambitious 'fifty years

12. For more on the institutional changes of the period, see Fonseca (2003; 2011).
13. Moving in the same direction, as is well known, Lewis (1954) built a model to explain the development of economies with unlimited supplies of labor. According to his model, analysis of the problems of distribution shows that, on the one hand, the workers' income share will continue to worsen until the labor force surplus disappears, and, on the other hand, capital expansion has the effect of raising the share of profits in the national income.

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of progress in five' economic development plan, implemented special programs aimed at removing bottlenecks and promoting, through government incentives to foreign investment, vertical integration in certain industries, such as the automotive, steel, and chemical industries.

From our point of view, and based on Cardenas et al. (2000), the import-substitution industrialization process was a State-led development in which the autonomous investment of the State was the crucial demand-driver in the process of economic growth. Despite the modernization of the country in the 1950s, the Brazilian economy experienced critical problems of inflation, balance of payments disequilibrium, and external debt.

At the beginning of the 1960s, the João Goulart government implemented some contractionary fiscal and monetary policies to control the inflation rate and to reduce the fiscal deficit and public debt. At the same time, Goulart introduced the Plano Trienal (Triennal Plan), based on institutional reforms to tackle structural economic and social problems, aimed at assuring sustainable economic growth and income distribution. For us, these reforms were identified with the national-developmentalism model, and, during this period (1961–1964), the Brazilian economy was characterized by a wage-led regime.

In the 1970s, according to Bruno (2003), during Brazil's Second National Development Plan (II PND), economic growth was associated with infrastructure spending plans by the government, while, in the 1980s, due to both the balance of payments and external debt crises, which led to economic intervention by the International Monetary Fund, and the high inflation process, the economic growth regime shifted income distribution in favor of the capitalist class.

In the 1990s, during the Fernando Collor de Mello, Itamar Franco, and Fernando Henrique Cardoso governments, a liberal economic policy was implemented based on some kind of deindexation, and an exchange rate anchor with liberalization of the balance of payments trade and capital accounts. In this context, in 1994 the Real Plan was created to reduce and control the inflation rate. Despite the success of the Real Plan in terms of price stabilization – the immediate effect was an abrupt drop in the rate of inflation – the Brazilian economy became highly vulnerable, owing to heavy dependence upon foreign finance, the financial fragility of the domestic debt, and the fact that Brazil's economic growth was very poor.[14] In those years, the economic growth regime depended on the capital inflows.

In the 2000s, according to Araújo and Gala (2012), on the one hand, owing to the government's social programs and the expansion of domestic credit, Brazil's economic growth was characterized by a wage-led regime, especially after the outbreak of the international financial crisis and great recession, but, on the other hand, from 2003 to 2007, when the world economy knew prosperity, the demand-driver of the Brazilian economy was the external sector (as given by net exports) and, as a result, the regime was closer to the export-led regime. Thus, at the domestic level, aggregate demand responded positively to an increase in the wage share of total income, but in an open economy aggregate demand was more sensitive to a rising share accounted for by profit in total income, which corroborates evidence from other countries (Blecker 2010; Hein and Vogel 2008). These authors take this result as an argument to support the case for the export-led growth advocated by new-developmentalism: a significant currency devaluation would increase the profitability of investments, which would 'mean greater capital accumulation, savings, exports and a higher level of aggregate

14. For more details, see Ferrari Filho and Paula (2003).

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demand … [and] could lead the Brazilian economy to a macro pattern of growth that is more sustained and less subject to problems of external constraints, driven by more investment and *less consumption*, which would lead to higher growth rates' (Araújo and Gala 2012, p. 53, our emphasis).

It is, we contend, clear that these authors not only associate new-developmentalism with a strictly export-led regime, but also characterize it as fully profit-led. Permeating their argument is the understanding that, as this is the pattern in place in Brazil, there are clear signs that it also must be the path to be followed. However, this argument is not totally convincing if better income distribution is included as a value to be pursued, and if attaining that goal depends on the *growth pattern*. Prominent in these authors' argumentation is the proposal for 'more investment and less consumption,' which runs diametrically counter to the wage-led growth rationale, implying formulation of a policy and institutional framework in which both investment and consumption can grow together.[15]

In this way, Arbix and Martin (2010, p. 3) argues that the government of Lula da Silva, from 2003 to 2010, marked the 'state capacities to address new activities – e.g. investing in market supporting – and missions – investing in social policies.' Moreover, they point out that

> new state activism differs at least in three important ways from its *dirigiste*, developmentalist predecessor. The first concerns the new decentralized political structures that play a significant role in the making and implementation of economic and social policies ... The second ... is in the relationship to the private sector. Instead of seeking to impose specific competitive strategies on firms, state initiatives are geared toward providing an enabling environment ... State actions are more market-adjusting than market-dominating. The third singularity ... concerns traditional social exclusion ... Thus, in the social arena, Brazil has witnessed some important reforms over the past decade and a half to reform basic social services and benefits in the area of public health, education, and social security, as well as an unprecedented expansion of social benefits targeted at the poorest citizens. (ibid., pp. 3–4)

Despite visible signs of the strength of a domestic market anchored on consumption and nearly full employment,[16] between 2000 and 2012 the economy was not able to respond with higher rates of private investment (from 2000 to 2012 the annual average of Gross Capital Formation/GDP was around 17.3 percent), and growth rates proved negligible as a result (see Table 1).

At this point, two questions arise: Why is the macroeconomic stability in Brazil so shaky? What economic policies should be proposed to ensure macroeconomic stability, social inclusion, and a better Gini Index?

The problem thus seems to lie not in the *trigger variable*, but in formulating and implementing economic policies to sustain the components of aggregate demand, the *growth pattern*, over the long term. A pattern is unlikely to set spontaneously or merely

15. Palley (2012), for instance, takes a critical view of export-led growth: 'As a result of … export-led growth the global economy confronts an extended period of asymmetric stagnation marked by slower growth in EM [emerging market] economies, stagnation in developed economies, and increased economic tensions between EM and developed economies' (ibid., p. 142).
16. According to IBGE (2014), the average unemployment rate in 2012 was around 5.5 percent, the lowest since the introduction of the new methodology in 2003. Despite this low unemployment rate, it is to be noted that low productivity jobs are abundant and that the informal sector – a part of the economy not included in the GDP – has, unlike the formal economy, increased in the last few years.

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as a result of the purportedly 'natural' rationale of the markets. As already mentioned, this requirement applies to any pattern; what does change are the policies appropriate to each of them. Besides, as mentioned earlier, the key variables to ensure long-term performance in a wage-led regime without neglecting the external sector equilibrium are the induction of investments, public and private, as a consequence of the implementation of macroeconomic policies, and structural–institutional changes.

4 A KEYNESIAN–INSTITUTIONALIST PROPOSAL FOR THE BRAZILIAN ECONOMY

As is well known, Keynesian economic policy, in both conception and practice, aims at maintaining levels of effective demand so as to mitigate involuntary unemployment by creating stable conditions upon which the confidence of business people can rest.

The focus of Keynes's proposal was the power that the State should hold to steer the economic system, given that, if left to the free workings of the market, the economic system and economic policies themselves – unless there was coordination among them – would contribute not to solving, but to aggravating the major problems of monetary production economies.

In this regard, the role of the State is fundamental to restoring macroeconomic stability. For that purpose, the Keynesian macroeconomic policy should be coordinated in such a way as to: (i) operationalize fiscal policies designed to expand effective demand and reduce social inequalities; (ii) make use of a more flexible monetary policy so as to galvanize levels of consumption and investment; and (iii) coordinate and regulate the financial and foreign-exchange markets in order to stabilize capital flows and exchange rates. In short, taking up the idea proposed by Minsky (2008), there is a need for State intervention and regulation through *Big Government* and *Big Bank*.

Thus, Keynes's (1936 [2007], p. 378) idea of 'socializing investment' should be understood, as can be inferred from Ferrari Filho and Conceição (2005), as the State participating actively in the economy, through economic policies that signal to entrepreneurs the existence of effective demand for their production.

Moreover, the original ideas of the 'old' American institutionalists, such as John Commons and Thorstein Veblen, relate the concept of institutions to habits and rules and to the evolution of institutionalism itself, perceiving a strong relationship between historical specificities and an evolutionary perspective. Hodgson (2002, p. 113), for instance, argues that institutions are defined as 'durable systems of established and embedded social rules that structure social interactions. Language, money, law … firms (and other organizations) are all institutions.' Thus, the 'economic theory of institutions' regards not only institutions, but also human activity, and the evolutionary nature of economic processes. In this context, for the institutionalists the economic system represents a 'continuous process' of change that involves the restructuring of capitalism rather than acquiescence with the automatic mechanism of the market.

Considering these Keynesian and Institutionalist ideas, and building on the theoretical arguments of the previous sections while taking into consideration the dynamics of economic policy operations conducted by the Economic Authorities (EAs) since the second half of the 1990s, it can be argued that the various institutional changes that occurred in the Brazilian economy ultimately affected the national environment directly, generating new guidelines or trajectories. They might have contributed to a process of sustainable

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economic growth, but they ended up undermining such growth, primarily because its characteristic dynamic was stop-and-go. The most significant changes included: the opening up to foreign trade in the early 1990s, which set new standards of both external and internal competitiveness; the Plano Real, which changed the monetary regime and thus the rules for coexisting with inflation; a new design for the Nation-State, which began to be guided more by neoliberal strategies than by 'developmentalist' measures (at the time considered obsolete, backward, and anachronistic); and the orthodox direction given to economic policy as an antidote to aspirations for the return of inflation.

The argument, then, is that there were two aspects to the outcome of these strategies. First, the 'institutional' changes that accompanied the Plano Real were not actually embedded by economic agents, thus preventing the creation of an institutional environment favorable to investment. Second, the macroeconomic policy implemented over this period, which was based on the New Macroeconomic Consensus (NMC) – comprising an inflation-targeting regime and fiscal surplus targets, together with a flexible exchange rate – limited the autonomy of monetary and fiscal policies and, consequently, their impact on GDP. In summary, from 1995 to 2012, the institutional and macroeconomic conditions did not arouse the entrepreneurs' animal spirits.

Given this state of affairs, the question that arises is: What can be done for the Brazilian economy to, effectively, achieve a state of greater macroeconomic stability under wage-led and export-led growth regimes, as defined in the Introduction to this article?

Before answering that question, an important point to bear in mind is that the Brazilian economy displays some historic restrictions on growth: as in the case of the other emerging economies, it does not have an internationally convertible currency, and chronic foreign imbalances recurrently lead to exchange rate crises; infrastructure-related bottlenecks on industrial capacity limit expansion of aggregate demand; the system of financing for economic activity, and long-term financing in particular, depends essentially on the public sector; and income distribution, despite some improvement in the 2000s, is still very uneven.

Mindful of those constraints and within the theoretical framework developed above, our proposal must contemplate both short-term macroeconomic policies, and structural–institutional changes.

Our point of departure is the understanding that, in macroeconomic terms, as a percentage of GDP, gross capital formation must be expanded from its present 19 percent to 25 percent.[17] In this respect, favorable conditions need to be created to get the entrepreneurs' animal spirits going once and for all. For that purpose, monetary policies must explicitly consider the goal of employment stability, together with price stability; fiscal policy must prioritize public investment and social programs; and exchange rate policy must be designed to maintain balance of payments equilibrium. More specifically:

(i) Fiscal policy should be implemented in such a way as to ensure that present expenditures on social programs are maintained and to concentrate budget

17. Why 25 percent? First, during the 1970s, when the Brazilian economy achieved its highest rates of GDP growth, the relation between gross capital formation and GDP was around 25 percent; second, the average ratio of gross capital formation to GDP for the principle in emerging countries is, approximately, 25 percent (authors' calculation based on IMF data, 2014); and, finally, Oreiro and Paula (2007) estimate, based on the Harrod–Domar model, that the gross capital formation must increase to 27 percent of GDP in order to achieve an average growth rate of 5 percent (*warranted growth rate* in the Harrod–Domar model) for the Brazilian economy.

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efforts and resources on public investments, especially in infrastructure.[18,19] Lastly, the government should always seek fiscal *responsibility*, as Keynes recommended,[20] although this should not be pursued as an end in itself, but on the criterion of countercyclical fiscal policy management: this should be expansionist in periods of crisis and recession while, in times of prosperity or economic growth above productive capacity, it should be, respectively, neutral or contractionist.[21]

(ii) Monetary policy should be oriented by employment goals and not just inflation targets. For this purpose, discretionary monetary policy is indispensable. That does not mean, however, that the Brazilian Central Bank (BCB) has an inflationary bias, thus creating problems of intertemporal inconsistency in monetary policy, as argued by Kydland and Prescott (1977). At this point, it is important to mention that the optimal monetary rule can be a nominal GDP. Sumner (2014, p. 324), for instance, argues that '[a] nominal GDP target is consistent with any preferred rate of inflation or deflation … [it] responds to demand shocks (or changes in velocity) in exactly the same way as an inflation targeting regime.' Also, macro-prudential measures should be taken to mitigate financial risks and expand liquidity in the economy. Lastly, as regards the financial system, the BCB and AEs should: (a) point to measures to decentralize the system, with a view to reducing bank spreads and democratizing access to credit; and (b) underscore the importance of the public banks, such as the BNDES, *Banco do Brasil* and *Caixa Econômica Federal*, and the regional and State development banks, in relation to long-term financing for productive investment.

(iii) As regards the exchange rate, the BCB should administer the rate in such a way as to ensure that the real effective exchange rate (REER) is kept competitive, so that any speculative actions on the foreign currency market can be contained. In this direction, Ferrari Filho and Paula (2012) propose the creation of an Exchange Stabilization Fund. The idea is similar to the Federal Reserve Bank: the Brazilian National Treasury would buy and sell foreign currency

18. On this point, it is worth mentioning that public–private partnerships (PPPs) – that is, a relationship between a private company and a governance agency to aim at completing an investment that will serve the public – should be encouraged. And, by the way, since the 2000s PPPs have been implemented in the Brazilian economy, in programs such as *Programa de Aceleração do Crescimento* (Growth Acceleration Program), and *Minha Casa, Minha Vida* (*My House, My Life*).

19. Mention must also be made of the fact that, according to Brittan (2006, p. 195), Keynes can be considered 'a spiritual father of today's public-private partnerships.'

20. The idea of fiscal responsibility is in line with the perspective of Keynes (1980), where management of public expenditures should operate according to the current and capital budget. According to Keynes, the current budget should preferably be balanced or running a surplus and would be related to the State's current expenditure on education, healthcare, social security, etc. The capital budget, on the other hand, would be related to public investments, especially in infrastructure, in order to stabilize economic cycles.

21. As we know, the effects of fiscal policy on economic activity, especially during the Great Recession, have been the object of controversy in Post-Keynesian circles. The main conclusion of this controversy is that, on the one hand, the economic and social consequences of fiscal austerity, in the developed and emerging countries, have been decidedly disastrous, and, on the other hand, fiscal policy has a strong macroeconomic role. For details see, among others, Arestis (2012), Bougrine (2012), and Seidman (2012). Moreover, Dutt (2013) develops a growth model to show that fiscal policy affects the rate of growth of the economy in the short run as well as the long run.

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> to promote exchange rate stability and counter disorderly conditions on the foreign exchange market. In addition, capital controls should be used to enhance the BCB's autonomy in setting the nominal interest rate to support domestic objectives, prevent the *real* from appreciating, and avert financial and exchange crises. Moreover, it is indeed noteworthy that the REER proposal aims not only to maintain balance of payments equilibrium, thus mitigating the external constraints, but also to establish an exchange rate that is not so appreciated as to create disincentives to industry, nor so weak as to reduce the purchasing power of wages.[22] In other words, the REER has to be at the 'right' equilibrium level to avoid both external constraint on development and the exchange rate pass-through effect.

In parallel with the macroeconomic policy measures, the following structural–institutional changes are also important:

(a) taxation and financing policies, to encourage exports (for example, by lowering taxes on exports and opening export credit lines through the BNDES);
(b) to encourage an institutional environment to galvanize the stock market and, especially, the private corporate debt, contemplating, for example, investor protection, exposure limits for financial institutions and risk limits for institutional investors, and taxation appropriate to risk profile;
(c) to boost trade and financial relations with partners in Latin America, the BRICS nations, and other emerging countries in order to increase the bargaining power of Brazil and these other countries on the international scenario;
(d) tax reform to introduce higher rates of taxation on income and wealth and a more progressive tax rate; and
(e) income policies to regulate wages and prices, in line with productivity gains in the economy and the dynamics of market competition.

Moreover, any structural–institutional change cannot neglect that, on the one hand, the State's role in the economy must be redefined by rebuilding the coordination mechanisms that were dismantled during the 1990s. In other words, the State should once again exercise its function as a regulator and inducer of economic activity, and its power needs to be reaffirmed in terms of establishing a real Welfare State in the country. Once these functions have been restored, the State should select and finance investment priorities in both industry and infrastructure, thus helping form and stabilize medium- and long-term expectations, both of which are essential for resumption of private investment, while guaranteed employment and income distribution must become the key pillar of State economic intervention.

On the other hand, to expand productive capacity, and consequently potential GDP, active industrial policies are required to coordinate public and private efforts to attain a rate of capital accumulation compatible with expansion of aggregate demand. Also, it is essential to synchronize macroeconomic policies with technological changes deriving from the change of techno-economic paradigm, as in Freeman and Perez (1988), which we are currently undergoing. Thus, the macro-environment's permeability to a new surge in innovation, R&D on new fronts, and the search for new knowledge in areas of potential promise for windows of opportunity are all absolutely crucial, creating conditions for the Brazilian economy to find a place in the international scenario

22. For instance, taking another theoretical approach, Comin (2009) comes to the same conclusion about the need for an intermediate exchange rate.

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such that it can absorb the ongoing technological and structural revolutions and attract participation by foreign capital in productive investments that can in turn generate added value, with a view to exporting, for example tradables.[23]

5 CONCLUSION

Taking inspiration from the Keynesian and Institutionalist approaches, we drew a distinction between *trigger variable* (wages and exports) and *growth pattern*, and argued that macroeconomic stability depends on the interaction between these variables and the components of aggregate demand, especially investment, both public and private. This *growth pattern*, however, does not become viable spontaneously; macroeconomic and institutional policies have to be applied to achieve this end. The low growth rates experienced for several years now suggest that the problem does not lie in the *trigger variable*, but rather in connecting it with the others in order to foster an appropriate environment for growth. Moreover, the stop-and-go economic policy suggests that there is no growth strategy – that is, economic policy sends out contradictory signals that are inconsistent with one pattern or the other. The first decision to be made is thus to opt for one of them.

In summary, the measures described here, although not exhaustive, are intended to inform macroeconomic policy-making with an approach that converges with Institutionalist thinking, in order to interlink the national conventions or strategies (to be formulated) more strongly and explicitly with the growth process, so that its fruits can be shared by the whole range of social segments, which must see themselves represented in the implementation of this project.

In this way, the macroeconomic nature of the pattern would interrelate an aggregate institutional environment with individual disaggregated decisions, ensuring systemic consistency for a developmentalist project. This is what Castro (1997) termed new 'conventions of growth without inflation,' which started to take shape with the advent of the Plano Real, but only in the 2000s began to show clearer effects in the Gini Index. In our view, this new *growth pattern* strategy seeks to fill the gap left by the import substitution process as regards income distribution, aggravated by low growth since the 1980s. Thus, with the illuminating example of the theoretical tools described here, it would be possible to foster Keynesian–Institutionalist developmentalism, which is a truly new prospect in Brazil's history and one capable of articulating a pattern of wage-led growth regime and income distribution without neglecting the need to equilibrate the external sector.

23. It is worth noting that, in the last 10 years, the Federal Government has issued three versions of industrial policy guidelines: *Política Industrial, Tecnológica e de Comércio Exterior* (Industrial, Technological and Foreign Trade Policy) in 2004, *Política de Desenvolvimento Produtivo* (Productive Development Policy) in 2008, and *Plano Brasil Maior* (Greater Brazil Plan) in 2011. The first was designed to address Brazil's external vulnerability, and accordingly focused on technology-intensive sectors (semiconductors, software, and suchlike). The second aimed to strengthen competitiveness in strategic sectors, both capital goods and consumer durables. Finally, the 'Greater Brazil Plan' focused on 'building competences with a view to technological and productive densification of value chains' (Kupfer 2013, p. A13). According to Kupfer (ibid., p. A13), at least two criticisms should be made of the government's industrial policy efforts: they became auxiliary to macroeconomic policy, not 'achieving ... their own space' and they were unable to 'think ahead of their time.'

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