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978-1-108-84228-0 — Decadent Developmentalism
Matthew M. Taylor
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Introduction

Brazil has been caught in a low-level economic equilibrium for much of the generation since the return to democracy in 1985. Over three and a half decades, Brazilian per capita income has grown more slowly than citizens' incomes in both wealthier developed nations as well as developing economies. The chaos of the late 2010s – including the worst recession in a century, massive corruption scandals, street demonstrations, and a presidential impeachment drama – underscored demands for change but led to few shifts in the incentives that drive actors toward this suboptimal equilibrium. The potential opportunity offered by these intertwined economic, legal, and political crises also proved insufficient, as of the time of this writing, to significantly remake resilient political and economic structures.

There is considerable agreement about the sources of Brazil's low-level equilibrium. But why does this consensus not translate into action? A long tradition of developmentalism, dating back seven decades, continues to exert enormous influence on the economy, wielded through dominant ideas about policy, reinforced by the institutions of policy implementation, and sustained by the interests that benefit from these institutional frameworks. The empirical argument advanced in this book is that Brazilian developmentalism has staying power, despite its lackluster results, in part because institutional complementarities across the economic and political spheres buttress and sustain the system, and the incentives of political and economic actors drive them toward strategies that are individually first-best, but collectively suboptimal. As a consequence of this self-reinforcing cycle, the Brazilian developmental policy set persists in steady equilibrium.

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It persists, furthermore, despite the ready availability of other models of economic organization, either of a more effective developmentalist state or of a less *dirigiste* market economy.

The return to democracy in 1985 deepened the institutional complementarities that sustain the Brazilian developmentalist model, complicating reform by introducing a variety of new political demands, new veto players, and new veto points. Although democracy has changed the rhetorical justification for policy, and led to greater emphasis on human development, democracy has not significantly changed many of the standard operating procedures of the developmental state in the economic realm. Despite a general consensus about how to kindle growth, Brazil has settled on economic institutions that privilege regressive social redistribution over growth and that weaken growth drivers by squeezing investment, disincentivizing innovation, and rewarding large (and often oligopolistic) firms over medium and small competitors. Regime change brought new forms of political horse-trading which are significantly more transparent than politics under the military regime, but nonetheless frequently transcend the boundaries between formal and informal, and even between licit and illicit, in ways that benefit incumbent interests over reformers and established firms over newer or smaller competitors. The democratic regime failed, furthermore, to establish the instruments of control that would make the autonomous bureaucracy of the developmental state capable of both engaging firms and steering them effectively in the directions most likely to achieve sustained growth.

Theoretically and methodologically, this book innovates by demonstrating how these institutional complementarities function *within* five economic and political domains, as well as *across* them: the economy, including both 1) the macroeconomy of a middle-income developmental state; and 2) the microeconomy of a particularly Brazilian variant of firm organization that I will call "developmental hierarchical market economy" (or DHME); 3) a political system that can be summarized as "coalitional presidential"; 4) the weak set of control mechanisms this political system sets in place; and somewhat paradoxically, 5) an autonomous bureaucracy that has permitted incremental reform but in consequence, may have moderated demand for more dramatic, paradigmatic reform while also deepening some of the fiscal constraints that impel policymakers to preserve the developmental state apparatus and its fiscally opaque policy toolkit.

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A BRIEF SUMMARY OF THE ARGUMENT

In evaluating the causes of Brazil's suboptimal performance since the return to democracy, the book draws upon and contributes to two interrelated scholarly debates in the study of comparative political economy. The first body of work relates to the concept of a developmental state, which argues that the state can serve as a muscular engine of long-term development by consciously altering investment conditions, expanding human capabilities, and tackling the market failures and coordination problems that plague late developing economies (Haggard, 2018). Brazil has long been a prominent case study of a developmental state, but its role has hitherto largely been seen as either a success story or as an intermediate, but not especially problematic, case (Evans, 1992, 1995; Kohli, 2004; Trubek, Garcia, et al., 2013). The pages ahead challenge that perspective, suggesting that the logic, practice, and legacy of developmentalism have sustained political and economic structures that have become growth-constraining and, since the return to democracy, have failed to deliver even on their own decidedly long-term criteria for success. There is scant evidence of convincing improvements since 1985 by any common metrics of development such as industrialization, innovative advancement on the technological frontier, or human capital gains. This is not to say that developmentalism never worked, or that the institutions of developmentalism are entirely vitiated or lacking any redeeming value, simply that developmentalism as a set of institutions and policies has failed to deliver during the democratic era. Many of democracy's gains have come about *despite* rather than *because of* developmental policies and institutions.

Second, the "varieties of capitalism" literature provides theoretical leverage to explain the persistence of this relatively ineffectual institutional framework, particularly via the notion that unique national contexts may drive economies into distinct equilibria that are often quite sticky and resistant to change. Pioneering studies of the varieties of capitalism saw a world divided between "liberal market economies" and "coordinated market economies," where complementarities between the structure of labor markets, the organization of firms, and the provision of education created incentives for workers and firms to invest in context-specific institutions, moving actors toward steady equilibria, and thereby limiting the possibilities for convergence between a North Atlantic model and a continental European model (Hall and Soskice, 2001; Hall and Gingerich, 2009). This prevented the convergence toward a common "liberal market economy" that many anticipated with the fall of the

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Berlin Wall and the rise of the Washington Consensus and its liberal market-oriented policies in the 1980s and 1990s. This book builds on later works in the varieties of capitalism tradition to draw attention to the unique incentives generated by the pattern of state-firm relations in Brazil, but goes beyond them to focus on the complementarities not just within firm relations, but also within the realms of macroeconomic policy, politics, control mechanisms, and the bureaucracy, as well as across all five domains.

The focus on the incentives generated by institutional complementarities in a developmental state has important analytical consequences. Because they typically study different institutions in isolation – bureaucracy, congress, parties, firms, etc. – scholars have largely missed the ways in which these organizations *jointly* drive diverse actors toward common equilibria. This has often blinded scholars to the fact that different institutional domains are intricately intertwined, nonrandom configurations that provide a contextual logic for economic and political action (Deeg and Jackson, 2007).

A focus on institutional complementarity forces us to expand the lens of analysis of the study of political institutions. Economists have often assumed that all that is needed to get Brazil on a more productive trajectory is political leadership. Political scientists have long emphasized executive-legislative relations to the general neglect of the economy, focusing more on the process of governing than on its content or performance. This has given many social scientists an artificial and perhaps overly optimistic perspective of how well Brazilian politics could function or actually functions, suggesting that all that is needed is stronger leadership, or focused more on narrow measures of legislative production and executive control than on the broader content of this legislation, the murky processes that often produce it, the options that are foregone, or the lackluster long-term performance of the system. Failure to recognize the weakness of control mechanisms, including democratic checks and balances, in constraining the sometimes nefarious interactions between the executive and legislative branches, or between firms and politicians, has permitted overly rosy claims that Brazil is on a path to a new and more virtuous developmental equilibrium. Scholars have also overlooked the almost complete absence of the forms of strategic planning and oversight that would be needed to make the developmental state deliver. The prevailing wisdom further overlooks many of the complementarities that hold together the current institutional framework, including the routinized ties between political incumbents and established private sector firms,

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which have important implications for the structure of politics and economic policy.

Failure to incorporate these complementarities into our analysis of Brazil's political economy may have warped our understanding of Brazil's trajectory and contributed to the boom and bust cycle of media reports on Brazil's prospects, which have alternately depicted the country as either taking off into a brilliant future or instead crashing into an inextricable morass. Focusing on institutional complementarities and the equilibrium behaviors they generate enables one to question the triumphalist narrative that took hold in Brazil during the commodity boom of the 2000s. Brazil's heady growth during the 2000s led to a wave of books heralding the important gains the country made since its 1985 transition to democracy, including titles claiming that the country was new, starting over, reversing its fortune, making itself work, and on the rise (Rohter, 2010; Fishlow, 2011; Roett, 2011; Melo and Pereira, 2013; Montero, 2014a). Although many of these works were more nuanced inside their covers than their triumphalist titles suggested, they stood in stark contrast to an alternate perspective that questioned the country's ability to overcome the deadlock generated by multiple veto players, patrimonial politics, party underdevelopment, particularism, and networked capitalism (Cardoso, 1975; Roett, 1978; Mainwaring, 1993, 1995; Ames, 2001; Lazzarini, 2010).

This book falls squarely in the more skeptical camp, but also offers a comprehensive analytical perspective that seeks to weave together various disciplinary perspectives in a way that improves our understanding of Brazil's trajectory and considers new paths forward. It provides a broader understanding of why it is that the political economy of Brazilian democratic institutions has been solid and resilient to shocks, but also unable to bring to fruition the promises of a deeper and more just society. The answer, I will argue, is that many of the economic and political institutions of the new democracy are regressive and inefficient; but more importantly, that complementarities across the political and economic spheres generate incentives that drive actors toward a suboptimal political and economic equilibrium that has become stable over time. This is not to say that change is impossible: the very notion of institutional complementarities suggests that when change occurs in one institutional arena, it may rapidly shift incentive structures in other institutional arenas. Thinking about what shifts are most likely to alter incentives, and thereby generate change, may enable us to consider how best to structure paths toward reform. Understanding how the system functions as a whole may thus help

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us to better understand the political and economic responses to the crises of the 2010s, as well as the possibilities for change going forward.

EMPIRICAL CONTRIBUTION: COMPLEMENTARITIES THAT STABILIZE INSTITUTIONAL EQUILIBRIA

Brazil's Low-Level Equilibrium

Let us begin with the painful but unsentimental argument that there does not seem to be much objective evidence for a feel-good story about economic development under the democratic regime inaugurated in 1985. Brazil often seems to be ambling leisurely toward a grim future in which an unresponsive political system, an inefficient economic framework, the end of the demographic dividend, and a deeply unjust social structure conspire to rob Brazilian youth of their future. Despite social policy gains since the return to democracy, Brazil's economic performance has been middling. Per capita growth has been unremarkable, averaging 1.2 percent a year between 1985 and 2017, far below the 3.3 percent average for Brazil's upper middle-income country peer group.[1] Indeed, by comparison to many important peer countries and income groups, the country has been steadily losing ground, as Figure 1.1 illustrates. This is true by comparison to BRICs countries such as India and China; to other Latin American economies of various economic policy persuasions, such as Chile and Uruguay[2]; to the upper middle-income nations group, which has doubled its share of Brazilian per capita gross domestic product (GDP) in the past generation, from 37 percent to 76 percent; and to a variety of high-income nations, including the United States, EU countries, and OECD members.[3]

Economists generally agree that one reason for this continued loss of ground is that the factors that might drive Brazilian growth, such as savings and total factor productivity, have remained flat. Although the peak years of the country's demographic dividend were between the late 1990s and 2018,[4] national savings between 1985 and 2017 averaged only 17.6 percent, against a peer group average of 29.8 percent.[5] Total factor productivity at constant prices was 10.5 percent lower in 2014 than it had been in 1985, having declined year-over-year in 14 of those 30 years.[6] Successive governments have proven incapable of getting past emergency fixes and implementing lasting reforms that could put the country on a more fiscally sustainable grounding and permit the investment needed to spur growth.

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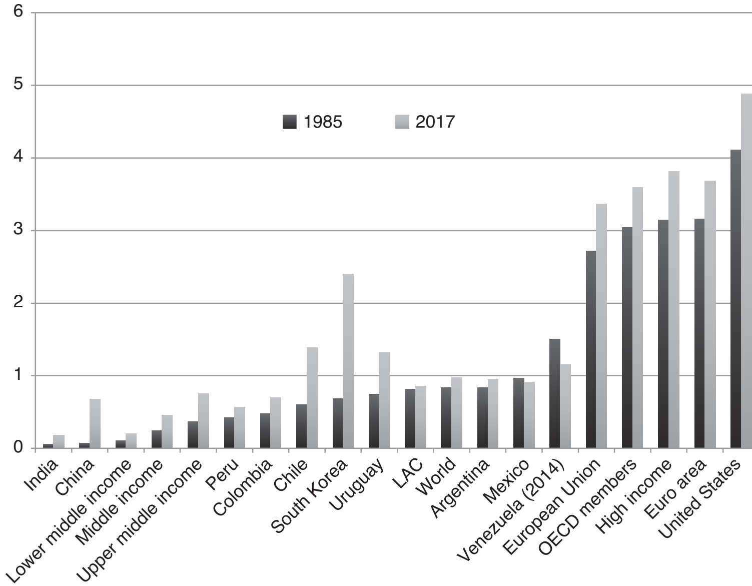

FIGURE 1.1 Selected countries' per capita income as share of Brazil's, 1985 and 2017.
Source: Compiled by author from World Bank World Development Indicators, GDP per capita (constant 2010 US$), accessed September 2018. Shares are calculated as share of Brazil's per capita GDP in 1985 and again in 2017.

Democracy has changed the justifications for policymaking, and forced politicians to adopt more universal programs, leading to improvements in human welfare. Both the *Real* Plan of 1994, which stabilized hyperinflation, and the *Bolsa Família* conditional cash transfer program of 2003, which began to address the severest income inequality, raised hopes for more equitable and durable social policies. By some measures (based on household census data[7]), the country had success in reducing income inequality during the two decades from 1994. But even if these gains prove permanent, rather than yielding to the recession of the mid-2010s, it is important to consider the counterfactual. Brazil did not do better than other large economies in the Latin American region, and in fact, performed worse than its regional and global peers on social matters. Inequality improved notably, by about 12.5 percent in a comparison of the 1985–9 period with the 2010–16 period, but Brazil's gains lagged regional peers (e.g., Chile and Peru, where inequality fell by 15 and 20 percent, respectively), and Brazil's inequality remains higher than all

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of its large Latin peers except Colombia. Brazil would have had to double its performance in combatting inequality over this period, in fact, to reach the levels of the other five large Latin economies; it would have needed to triple its gains to reach South Korean levels of inequality.

Something is not working, and Brazilians know it. The long cycle of protests beginning in 2013 demonstrated a palpable frustration with the country's inability to undertake comprehensive reforms that might alter some of the most pernicious incentives present in both the political and economic spheres. The political system is deeply divided, and the 2018 election was the most wide-open since the return to democracy in 1985, in part because the deeply felt desire for change has not been matched by even minimal consensus about the direction of reforms (Kingstone and Power, 2017). But Brazil's stagnation is not simply a problem of political leadership: indeed, virtually all presidents elected since 1989 have run on a promise of reform and change. Something is getting in the way.

The Developmental State

Developmentalism is an academic theory, a set of ideas and ideals, and an array of policies. In all cases, it is motivated by the observation that late developing nations face a unique challenge of competing in a world where relative national wealth results from a skilled work force's ability to produce high value-added goods that are globally competitive and where first movers have already set the terms of competition (Amsden, 2001). Attention to the international context suggests that liberalizing a less-developed economy could be counterproductive, by failing to improve either the stock of human capital or to alter the structure of the economy in ways that move it up the technological frontier, all while worsening the terms of trade (Bairoch, 1972; Haggard, 2018, 11). Indeed, the paradigmatic cases of successful developmental states – such as Japan, South Korea, and Taiwan – turned outward and opened their economies only after first developing indigenous industry and comparative advantages higher up the technological frontier. In developing these capacities, the state played a central role in guiding firms and markets.[8]

Developmentalism thus carries with it a healthy skepticism of open or "free" market prescriptions. One foundational assumption is that the technologies needed to catch up to early industrializers will not be produced naturally by markets in developing nations: market failures, externalities, increasing returns, information asymmetries, and transaction costs may all impede the private sector from moving to fill the gaps or to

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invest in overcoming missing synergies that may be impeding development (Reinert, 2007, 36). For a country like Brazil in the 1940s to create an indigenous capacity for steel production required a slew of backward linkages, such as adequate sources of financing, electricity generation, and railroads to move both inputs and outputs. Individual private firms had little incentive to produce any of these, yet without them, not only was steel production unviable, but so too were all the forward linkages that might result from having a steel industry: production of automobiles, white goods, ships, and any variety of other industrial pursuits (Gerschenkron, 1962; Hirschman, 1968, 1987). Second, the human capital consequences were also significant: little demand for skilled labor meant little incentive to invest in education, and few opportunities for the individual skills improvement that would benefit workers and their families. Third, the theory of comparative advantage was misleading: poor countries' lower wages were insufficient to overcome rich countries' higher productivity, and thus any effort to industrialize by specialization in low-technology industries would be unproductive (Amsden, 2001, 5).

Developmentalists argued that the state needed to create incentives to overcome these market failures. At their broadest, these incentives could be summarized in terms of "getting prices wrong": using the state to provide protections, subsidies, rents, and other enticements that would steer the private sector in directions distinct from those dictated by the unfettered market. Such incentives would encourage individual firms to undertake investments they might otherwise avoid, while generating broader gains across the entire structure of industry (Johnson, 1982; Amsden, 1989). Developmental policy goals were ambitious, including reallocating capital, shifting the composition of investment, learning and incorporating foreign technologies, protecting domestic industry, and increasing comparative advantage in strategic industries. The precise toolkit might vary, but it included incentives to large-scale industries, entry regulation, local content requirements, tariffs, preferential financing, and selective liberalization (Khan and Jomo, 2000; Amsden, 2001; Haggard, 2018).

The central balancing act was political. For the developmental state to work in practice required a strong state, capable of both designing policy and pushing firms in the right direction without being captured by a rent-seeking private sector. As Haggard (2018) notes in his masterful review of the developmental state literature, it is "surprisingly hard to find" an integrated statement of the political model that would permit this result, but it seems to demand two characteristics: 1) a strong executive

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delegating to a capable bureaucracy; as well as 2) political insulation from both the working class and the private sector. The focus on a centralized, internally coherent and politically insulated state was justified by 3) the need to accumulate capital; and 4) to steer investment into "sectors that were dynamically efficient" (Haggard, 2018, 45).

Haggard's political model provides the scaffolding for this book's first argument: namely, that the Brazilian developmental state under democracy has lost the characteristics needed to accomplish this difficult political balancing act. Brazil has a strong executive, able to delegate to a capable bureaucracy. The state's performance as a developmental authority has been clouded by political and private sector influence over the policy process. The insulation of the executive bureaucracy was enforced under authoritarian rule (albeit somewhat capriciously and tenuously) by the coercive power of an executive branch dominated by the military. Under democracy, this coercive power has not been reinstituted, in part because of the president's reliance on a broad coalition for political support, but also because of the corresponding weakness of accountability agencies and the judicial branch as enforcers of the boundaries between state and firm. Lost, too, has been the capacity for strategic planning and strategic control over developmental policies. With regard to the third and fourth components of Haggard's model, the ability of the Brazilian state to accumulate the needed capital and steer it effectively has been severely diminished by fiscal constraints, which are themselves a paradoxical consequence of the growth of the state for much of the past century. Brazil has failed to update the incentive structures of developmentalism which, together with the absence of controls, has led the state into "followership," rather than leadership with regard to the private sector (Wade, 2004). This has limited the state's capacity to effectively "steer" investment and explains many of the country's lackluster results over the past generation, meriting the label "decadent developmentalism."

An Alternate, Neoliberal Path

If Brazil has failed to make the developmental state effective, it has also failed to go down an alternate, more market-oriented path, often referred to as the "neoliberal" path. This is puzzling because these market-oriented options have been available to policymakers for much of the past generation, with a clear and relatively unchanged agenda of suggested reforms.

By way of example, in 1984 the World Bank recommended opening to trade, increasing domestic savings, undertaking fiscal and tax reform as

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