

**UNIVERSITY OF LATVIA
FACULTY OF ECONOMICS AND MANAGEMENT**



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**MACROECONOMIC POLICY, BUSINESS CYCLES, AND
NEOLIBERALISM IN LATVIA**

Doctoral Thesis

Submitted for the degree of Doctor of Economics
Subfield: Latvian Economy

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Rīga, 2015

Abstract

Periods of expansion and contraction in economic activity, which can appear as crises, can be noticed throughout history. When a crisis is very deep, politicians are pressed to find the right set of macroeconomic policies that will lead to a new period of growth and development. If the macroeconomic policies currently considered to be mainstream cannot make the level of economic activity and employment return to normal, they will eventually be replaced by another set of macroeconomic policies that will then turn into the new mainstream. If Classical Liberalism was the mainstream until the 1930s, this was replaced by Keynesianism after the great slump; with the stagflation of the 1960-1970s, Keynesianism was then replaced by Neoliberalism. This process is determined by the fact that voting is also determined by macroeconomic performance. As political parties face the challenge of remaining in or gaining power, there is a process of party convergence to a predetermined set of macroeconomic policies, resulting from the establishment of a new economic ideology. Therefore, macroeconomic and social policies which are acceptable to parties and coalitions become limited by the boundaries of the economic ideology established at the time of the last great crisis. The result is convergence and consensus to a predetermined set of macroeconomic policies. This dissertation establishes a model formalising this process, first using the Brazilian case, then applying it to Latvia, and finally creating a structural analysis of the Latvian economy's transformation from independence until 2008.

Key Words: Macroeconomic Policy; Ideology; Neoliberalism; Business Cycles; Brazil; Latvia.

Anotācija

Ekonomiskās aktivitātes pieauguma un krituma periodi, kas var izpausties kā krīzes, novērojami dažādos vēstures posmos. Gadījumos, kad krīze ir ļoti dziļa, politiķiem ir jāmeklē tāda makroekonomikas politikas stratēģija, kas radītu jaunu izaugsmes un attīstības posmu. Ja tobrīd par vadošo uzskatītā makroekonomikas politika nespēj atgriezt pietiekamu ekonomiskās aktivitātes un nodarbinātības līmeni, tā galu galā tiek aizstāta ar citu makroekonomikas politikas stratēģiju, kas tādējādi kļūst par vadošo. Ja līdz 20. gs. 30. gadiem vadošais bija klasiskais liberālisms, tad pēc Lielās depresijas to nomainīja keinsisms; 20. gs. 60. - 70. gadu stagflācijas rezultātā keinsismu aizstāja neoliberālisms. Šo procesu virza tas, ka makroekonomiskā situācija lielā mērā nosaka vēlētāju izvēli. Tā kā politiskās partijas saskaras ar izaicinājumu iegūt varu vai saglabāt esošo varu, notiek politisko partiju konverģence uz iepriekš noteiktām makroekonomiskām rīcībpolitikām, kas rodas no jaunas ekonomiskās ideoloģijas. Tādējādi pēdējās lielās krīzes laikā radusies ekonomiskā ideoloģija nosaka partijām un koalīcijai pieņemamas jaunās makroekonomikas politikas izvēli. Rezultātā rodas konverģence un vienprātība par iepriekš noteikto makroekonomikas politikas stratēģiju. Promocijas darbā ir radīts modelis iepriekš aprakstītā procesa formalizēšanai, vispirms izmantojot Brazīlijas piemēru, tad piemērojot to Latvijai, un, visbeidzot, veicot strukturālo analīzi par Latvijas ekonomikas transformāciju laika posmā no neatkarības atgūšanas līdz 2008. gadam.

Atslēgas vārdi: makroekonomikas politika; ideoloģija; neoliberālisms; biznesa cikli; Brazīlija; Latvija.

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LIST OF ABBREVIATIONS

BNDES: Banco Nacional de Desenvolvimento Econômico e Social (Brazilian Bank of Development).

CACEX: Carteira de Comércio Exterior do Banco do Brasil (Foreign Trade Department of Bank of Brazil).

CESOP: Campinas State University's Centre of Studies of Public Opinion.

ECLAC: Economic Commission for Latin America the Caribbean.

IBOPE: Brazilian Institute of Public Opinion and Statistics

IMF: International Monetary Fund

ISEB: Instituto Superior de Estudos Brasileiros (Higher Institute of Brazilian Studies)

PSD: Partido Social Democrata (Social Democrat Party).

PCB: Brazilian Communist Party.

PC do B: Communist Party of Brazil.

PDC: Christian Democratic Party.

PDS: Social Democratic Party.

PDT: Democratic Labour Party.

PFL: Party of the Liberal Front.

PL: Liberal Party.

PMDB: Party of the Brazilian Democratic Movement.

PRN: Party of the National Reconstruction.

PSB: Brazilian Socialist Party.

PSDB: Party of the Brazilian Social Democracy.

PT: Workers' Party.

PTB: Brazilian Labour Party.

SPVEA: Superintendência do Plano de Valorização Econômica da Amazonia (Superintendency of the Plan for the Economic Valorisation of the Amazon)

SUDENE: Superintendência do Desenvolvimento do Nordeste (Superintendency of Development of the Northeast)

SUMOC: Superintendência de Moeda e Crédito (Superintendency of Monetary Affairs and Credit)

UDN: União Democrática Nacional (National Democratic Union).

INTRODUCTION

Since the Neoclassical revolution initiated by W. Stanley Jevons in 1871, economics is supposed to have been ideology-free. For many, the use of mathematical methods would avoid ideology interfering in economic research. However, many years later, the question about economic theory having been invalidated by ideological bias is still relevant. For example, Joseph Schumpeter was still absorbed with this question in 1950. For him, Social Sciences could not be ideology-free, since “(A)nalytic work begins with material provided by our vision of things, and this vision is ideological almost by definition.”¹ Unfortunately, Schumpeter did not develop the theme. After briefly discussing the issue in his *History of Economic Analysis*, the text breaks and a new chapter starts. Joan Robinson, from the University of Cambridge, discussed its relevance in the first chapter of her 1962’s book “*Economic Philosophy*.” For her, economics “has always been a vehicle for the ruling ideology of each period as well as partly a method of scientific investigation.”² She wrote an entire chapter analysing the metaphysics, moral, and science of economics, but did not develop the mechanisms of interaction between economics and ideology mediated by politics.

Therefore, the issue was never fully analysed. During the 1960s, Daniel Bell presented the idea that traditional grand humanistic ideologies were exhausted and more conservative ideologies would arise.³ Later, during the 1970’s, both right and left-wing authors scuttled their ideas, resulting in a new “end of ideology.” In the beginning of the 1990’s, as predicted by Bell, right-wing conservative ideology became again popular. Its adherents announced its superiority proclaiming the “end of history,” thus the end of all ideologies.⁴

A common characteristic of the debate is that every author claims his/her personal beliefs to be pragmatism, while other ideas are considered to be “ideologies,” or false beliefs and distorted reality. A second one is that these authors, implicitly or not, assume to know the real truth about human nature. Finally, a third characteristic is that usually it is also established a political and economic system based on the newly established pragmatism. As politics and economics presuppose relationships of power, from the very beginning personal convictions masked as policy are used to justify or to deny the established order. This includes choosing specific macroeconomic policies as vehicle for ideological dominance.

¹ Schumpeter, J. A. (1987). *History of Economic Analysis*. London: Routledge, p. 42.

² Robinson, J. (1978). *Economic Philosophy*. New York: Penguin Books, p. 1.

³ Bell, D. (2000). *The End of Ideology: on the Exhaustion of Political Ideas in the Fifties*. Cambridge, MA: Harvard University Press.

⁴ Fukuyama, F. (1992). *The End of History and the Last Man*. New York: Free Press.

It follows that during crises the established order can be questioned. In this case, ideology can be used as foundation for changing the political and/or economic system, at the same time maintaining the established relationships of power unchanged. Ideology, in this case, is the agent permitting change to occur, resulting in renewing or maintaining the established relations of power. When macroeconomic policy is used as an instrument for maintaining or changing the established relations of power, it becomes an ideology itself.

By the beginning of the 1970's, after approximately thirty years of Keynesian macroeconomic policies, a great number of changes ended the period of economic growth and full-employment in advanced countries, sustained by strategies of active national state intervention. These changes included the effects of the collapse of Bretton Woods and the first oil shock, which resulted in the world economy entering into defensive recession.⁵ With the crisis and the process of stagflation, supporters of economic liberalism began to questioning the Keynesian postulates, mostly in Europe and in the United States. It turned that neoliberalism, a regime of commercial and monetary policy coordinated by the United States and based on Neoclassical utilitarianism, became the new mainstream.⁶ As a result, direct state intervention in the economy to promote growth and development became unacceptable.⁷ Countries with huge structural, cultural, and political differences basically pursued very similar macroeconomic policies, basically based on the neoliberal framework. This can only be explained as the result of the interaction between politics, ideology, and macroeconomic theory, as presented in the model proposed in this dissertation.

From the discussion above, this dissertation's **topicality** is:

a) Since the Latvian economy is still recovering from the consequences of the previous economic crisis, it is necessary to examine its roots and consequences, including the choice of the current economic development model;

b) There is a need for economists and politicians to look outside the neoliberal paradigm to resolve present economic problems;

c) Until the end of the XIX century, there was not a clear division among politics, economics, sociology, philosophy, and anthropology. With the individualisation and specialisation of these disciplines, the interrelations between economics, politics, and ideology became increasingly ignored by the economic mainstream research agenda.

⁵ In a strict sense, the Bretton Woods system was a certain monetary order that was in force during the period 1946-1973, where the exchange parity fastens, however adjustable, based on the gold-dollar standard, although the concept can also refer, in general, to the applied economic policies for International Monetary Fund IMF and for World bank, under the United States government's orientation.

⁶ Hirst, P., Thompson, G., & Bromley, S. (2009). *Globalization in question: the international economy and the possibilities of governance, 3rd edition fully revised and updated*. Cambridge: Thompson Polity Press.

⁷ The reduction of economic growth, the increase of inflation and unemployment, and deficits in the balance of payments were considered a result of the Keynesian politics. Key Neoliberal policies are free trade, free capital mobility, monetary restraint, budgetary austerity, the flexibilisation of labour markets and the repression of wage demands, the privatisation of public companies and services.

d) This dissertation is based on a multidisciplinary methodological approach, including a dialogue between macroeconomics and politics;

e) It develops a new general model explaining the process transforming economic theory into political ideology. This model is robust enough to explain why Latvia has pursued Neoliberal policies since its independence.

f) Finally, the dissertation uncovers the process by which macroeconomic theory, instrumentalised as macroeconomic policy, turns out to be an ideological instrument.

This dissertation's **research object** can be defined as the interrelation among economics, politics, and ideology. At the same time, its **research subject** is the business cycle's influence on macroeconomic policy, reflecting economic and political ideological changes, mediated and instrumentalised by politics. In other words, by occasion of deep economic crisis, politicians try to choose the best set of macroeconomic policies to solve the crisis, aiming to remain in power. As economic theory is ideological by definition, the chosen set of macroeconomic policies results in politicians and parties converging to some specific political ideology. It will be expressed by macroeconomic theory, and instrumentalised by macroeconomic policies. This new ideology will substitute the previous one, until a new crisis occurs.

Therefore, the following **general hypothesis** can be formulated: macroeconomic policy is determined at the political level, following ideological changes in economic paradigms as the output of long-wave business cycles.

From the above hypothesis and theses the following **research questions** arise:

a) What is the relationship between economics, ideology, politics, and macroeconomic policy?

b) In what manner do business cycles change political ideology and macroeconomic policy?

c) Does the preference of left-wing parties for more state intervention in the economy and/or of right-wing parties for less state intervention in the economy change in direction according to the economic ideology in force? Is there convergence for a specific set of macroeconomic policies?

d) In Latvia's case, is the idea of convergence valid? Was there only one acceptable alternative at the political level for macroeconomic policy?

e) What were and are the consequences for the Latvian economy from the choice of macroeconomic policies?

To answer to these questions the **main aim** in this dissertation is to analyse the relationship between business cycles, the preference for specific macroeconomic policies, and ideology aiming to establish a new general theoretical model. The **specific tasks** to achieve this aim are:

- a) To conduct a review of the main literature about business cycles;
- b) To discuss the patterns of preference for macroeconomic policy from the general population's perspective.
- c) To discuss the patterns of preference for macroeconomic policy from the politicians' perspective.
- d) To determine the relationship between self-positioning in a left-right spatial scale and the preference for concrete models of state intervention in the economy, and its consistency with the assumed idea that left-wing ideology presupposes more state intervention in the economy, while right-wing ideology presupposes no state intervention.
- e) To analyse the pattern of convergence for preferring a specific economic ideology and its macroeconomic policies, from the side of the general population and politicians, taking political ideology into consideration.
- f) To establish a model explaining the relationship between macroeconomic policy and ideology.
- g) To apply the model to explain the process by which the preference for macroeconomic policy is determined in Latvia, and the implications for its economic structure.

This dissertation's **novelty** can be recognised in the following aspects:

- a) The author presents a new formal model explaining the existence and dynamics of macroeconomic ideological cycles, as a result of the economic crisis changing political ideology.
- b) The analysis and discussion of the results demonstrates that there is a process of political ideological change following economic crises, which results in the idea that there is a process of political convergence for a determined average set of political and economic ideals expressed as macroeconomic policy;
- c) It uncovers and discusses the process by which macroeconomic policy, since it is used as instrument of political legitimisation, turns into an ideology in itself;
- d) For the first time in Latvia, it presents an account of the political process in Brazil. It also introduces the Brazilian academic literature on the subject, its approach and findings, to the Latvian public, thus making it unique in Latvia.
- e) It renews the discussion of economics as ideology initiated by Joseph Schumpeter and Joan Robinson;
- f) It discusses the influence of business cycles and crisis on determining macroeconomic policies;
- g) It proves that what became mainstream macroeconomic policy today was politically determined during the latest deep economic crisis.

The defended **theses** are:

a) Ideological changes follow long-wave economic cycles;

b) As political ideology changes, the left-right scale moves through time, meaning that policies considered to be right-wing, for example, 50 years ago, turn to be considered centre or even left-centre policies as demonstrated on the third chapter;

c) These ideological changes result in the establishment of a situation where there is no alternative to implementing non-mainstream economic and social policies, because of the general belief these policies are right.

d) Macroeconomic policy can be a vehicle for ideology;

e) It can change political ideology to accommodate the necessities of implementing the new economic mainstream's policies;

Approbation of the Research Results

This dissertation is the result of several years of research, which started in Brazil. The following peer-reviewed publications is the ones of the author's more than 60 publications reflecting the ideas and model developed in this dissertation and their application to **Latvia**:

Books

Berzins, J. (2013). *Struggling for Development*. Riga: Lux Sit, ISBN 978-9934-8396-4-1.

Berzins, J. (2013). *A Desnacionalizacao da Economia Brasileira*. Riga: Lux Sit, ISBN 978-9934-8396-0-3.

Karnite, R., Berzins, J., Popovica, S. (2007). *Ārvalstu Kapitāls Latvijas banku pamatkapitālā*. Riga: LZA EI.

Chapters of Books

Sommers, J. & Berzins, J. (2011). "Twenty years lost: entropy and Latvia in the Post Soviet World", in Dale, G. (Ed.) *Eastern Europe: From the Transition to the Crash*. London: Pluto Press.

Woolfson, C. Kallaste, E., Berzins, J. (2010). "Industrial relations and social dialogue in the Baltic states: crisis, conflict and compromise", in Contrepolis, S., Delteil, V., Dieuaid, P. and Jefferys, S. (eds). *Globalising Employment Relations? Multinational Corporations and Central and Eastern European transitions*. New York: Palgrave MacMillan.

Articles in Peer-Reviewed Academic Journals

Berzins, J. (2014). "Ignacio Rangel visits Latvia: Crisis and the Political Economy of Duality." *Debate: Journal of Contemporary Central and Eastern Europe*, DOI: 10.1080/0965156X.2013.873190.

Berzins, J. (2010). "Neoliberalism and the Development of Underdevelopment in Latvia: a Latvian Disease?." *Spectrum: Journal of Global Studies*, vol. 1, no. 3.

Bērziņš, J. (2010). "Political aspects of the Knowledge Society in Latvia: Neoliberalism, Schumpeterian Democracy and populism." *Humanities*, vol. 1., no. 61.

Bērziņš, J. (2009). "Latvia and the Knowledge Society: Development, Underdevelopment and Macroeconomic Performance." *Humanities*, vol. 1, no. 58.

Bērziņš, J. (2009). "The Political Economy of Latvia or the Development of Underdevelopment." *RSU Zinātnisko rakstu krajūms*, Rīga, 2009.

Presentations in International Academic Conferences

Berzins, J. (2014). *Brazilian Political Parties' Ideological Convergence to Neoliberalism between 1990 and 2009*. ECPR General Conference 2014, 3 to 6 September, University of Glasgow, Scotland, presented paper.

Berzins, J. (2012). *The Effects of Austerity and Pro-Cyclical Policies upon Latvia*. ECPR Sixth Pan-European Conference on EU Politics, 13 to 15 September 2012, University of Tampere, Finland, presented paper.

Sommers, J. & Berzins, J. (2011). *Development without development: the case of Latvia*. The Eurozone in Crisis: Challenges and Controversies in the European Political Economy(ies) and in Political Economy Research, Friday 18 - Saturday 19 February 2011, Goethe University Frankfurt, Germany, presented paper.

Sommers, J. & Berzins, J. (2010). *Twenty years lost: Latvia and the entropy of order*. Historical Annual Conference 2010. School of Oriental and African Studies - SOAS, London, November 11-14, 2010, presented paper.

Berzins, J. (2010). *The International Political Economy of Crisis in Latvia: a Debate About the Role of the External and Internal Sides*. SGIR 7th Pan-European International Relations Conference: Politics in hard times: International Relations Responses to the Financial Crisis, The Swedish Institute of International Affairs, Stockholm, September 9-11, 2010, presented paper.

Bērziņš, J. (2010). *Neoliberalism and the Development of Underdevelopment in Latvia: Perspectives for the Future*. Latvia at Crossroads: Scenarios and Strategies for Socio-Economic Development, RTU Riga Business School, Riga, January 15, 2010, presented paper.

Sommers, J. & Bērziņš, J. (2009). *Twenty years lost: entropy and Latvia in the Post Soviet World*. University of London Union, Conference stream: Post-1989 transitions, Journal of Contemporary Central and Eastern Europe, London, 17-18 October, presented paper.

Bērziņš, J. (2009). *The Latvian Disease: Neoliberalism and the Development of Underdevelopment*. III Workshop of the International Initiative to Promote Political Economy SOAS/University of London, Ankara, Turkey, 14-16 September, presented paper.

Bērziņš, J. (2008) *Latvia and EU: the Political Economy of Underdevelopment*. Fourth Pan-European Conference on EU politics, Riga, 25-27 September, presented paper.

Articles in Popular Media

Berzins, J. (2011). "You Made your Bed, Now Lie on It". The Baltic Times, November 10, 2011.

Berzins, J. (2011). "Privatize What to Develop Who?". The Baltic Times, August 31, 2011.

- Berzins, J. (2011). “*Latvia and Development: Learning from Previous Mistakes?*”. The Baltic Times, August 03, 2011.
- Berzins, J. (2011). “*The Magic is Lost*”. The Baltic Times, July 06, 2011.
- Berzins, J. (2011). “*We Still Can Develop. Please, Hurry Up!*”. The Baltic Times, March 09, 2011.
- Bērziņš, J. (2011). “*Defending Nationalism*”. The Baltic Times, February 10.
- Bērziņš, J. (2011). “*Neo-liberal Populism and the State or who is Really Rational?*”. The Baltic Times, January 12, 2011.
- Bērziņš, J. (2010). “*Crisis and State reform in Latvia*”. The Baltic Times, December 08, 2010.
- Bērziņš, J. (2010). “*‘Schadenfreude’ and Economic Development*”. The Baltic Times, October 21, 2010.
- Bērziņš, J. (2010). “*Cut to Grow?*”. TheBaltic Times, August, 19.
- Bērziņš, J. (2010). “*Simple or useful?*”. TheBaltic Times, May, 20.
- Bērziņš, J. (2010). “*The Euro and its Crisis: a Financial or Structural Question?*”. The Baltic Times, April, 22.
- Bērziņš, J. (2010). “*Does the State Have a Role in Helping Latvia Exit This Crisis?*”. The Baltic Times, January, 28.
- Bērziņš, J. (2008). “*Jautrība ir beigusies: nu jādomā, kā tikt galā ar ekonomiku.*” Komersanta Vēstnesis, vol. 16, no. 123, pp. 16.04.
- Bērziņš, J. (2006). “*Kurp ej, Latvija?*”. Komersanta Vēstnesis, 25 (31), 28.06.2006, pp. 3-4.

Lectures as Guest Lecturer

Berzins, J. (2010). *Twenty Years Lost or the Development of Underdevelopment in Latvia*. Lecture at New York University’s Alexander Hamilton Center for Political Economy, 28.04.2010.

This dissertation is divided in three chapters plus the introduction and conclusion. It has 267 literature references, 22 figures, 39 tables, and one annex. In the first chapter the literature on business cycles on both economic and political perspectives is discussed, linking their occurrence with changes on ideology, macroeconomic policy, and political parties’ behaviour. The second chapter presents the process of ideological transition in Brazil, discussing how right and left-wing parties changed from supporting state economic intervention for neoliberal policies. The third chapter uses empirical evidence and statistic methods to show how much the population and politicians converged to a newly established economic and political ideological model based on Neoliberalism, adopting its macroeconomic policies as panacea for any economic condition.

Methodology

The development of this dissertation followed an analytical, descriptive, and quantitative methodological approach. The idea of writing about the influence of business cycles and the ideological determination of macroeconomic policies surged when once reading Kenneth Hoover's book "Economics as Ideology."⁸ There he cites Nixon saying "we're all Keynesians now" (p. 161), even though Nixon was a conservative himself, Milton Friedman was his special advisor, and George Schultz was in charge of the budget. As Friedman later said, the problem with Nixon "was not intelligence and not prejudices. The problem with him was that he was willing to sacrifice principles too easily for political advantage."⁹ Taking in consideration that economic policy is determined politically, thus changed accordingly to political needs, the main question of this dissertation was ready: what is the relationship among business cycles, ideology, and political preference for macroeconomics policy?

To answer to this and the other questions mentioned above, as well to fulfil this dissertation's main and specific objectives, its development is divided in two parts. The first part privileges an analytical and descriptive methodological approach to present the discussion about the interaction between business cycles, politics, and macroeconomic policy, as the borders between both fields are very unclear. Thus, instead of choosing one single theory and author, the first chapter discusses the main approaches and authors on business cycles. This dissertation is interdisciplinary since there are many interpretations and understandings about the inter-relationship between business cycles and politics. Therefore, since this dissertation attempts to propose a new theoretical approach, its theoretical analysis privileged a multi-level and multi-faceted interaction among several authors and approaches, aiming to construct a logic causality among them.

The first step was to structure the theoretical framework to be analysed. The choice was to discuss the literature on business cycles from the perspective of the main schools of economic thought. Second, the literature on what is called political business cycles was also discussed, aiming to find theoretical support for the idea that, on one hand, politics and political ideology are influenced by macroeconomic performance, but on the other, the former determine macroeconomic policy. Thus, this dissertation's theoretical discussion privileges the causality among business cycles, political ideology, and the preference for macroeconomic policy, advancing Joan Robinson and Joseph Schumpeter's discussion about ideology and economics. It also presents an alternative development to Anthony Downs' theorem of the medium voter, as presented in his book "An Economic Theory of Democracy."

⁸ Hoover, K. R. (2003). *Economics as Ideology: Keynes, Laski, Hayek, and the Creation of Contemporary Politics*. Lanham: Rowman & Littlefield Publishers.

⁹ Interview with Milton Friedman. Available in http://www.pbs.org/wgbh/commandingheights/shared/minitextlo/int_miltonfriedman.html. Access in August 21, 2009.

Thus, this dissertation's **theoretical and methodological fundament** is based on original texts of leading scholars in Economics and Political Science, providing a unique set of the most relevant literature in the field. Below are cited only the most important authors.

- About **ideology**: D. Bell, F. Fukuyama, T. Eagleton, M. B. Hamilton, J. B. Thompson, T. Veblen, K. R. Hoover, J. A. Schumpeter, J. V. Robinson, D. de Tracy, R. Williams, H. Barth, G. Lichtheim, G. Kennedy, A. Cassels, W. J. Stankiewicz, J. Larrain, A. Gouldner, G. Lukács, D. Hawkes, J. Decker, T. W. Adorno, H. Marcuse, L. Althusser, F. Nietzsche, M. Foucault, N. Chomsky, and others.

- About **economic cycles**: J. A. Schumpeter, S. Kuznets, I. Wallerstein, M. J. Gasiorowski, A. Shaikh, W. S. Jevons, M. Ezekial, T. A. Knoop, J. C. L. S. Sison, C. Juglar, K. Wicksell, M. I. Tugan-Baranovsky, C. Diebolt, R. G. Hawtrey, F. A. Hayek, G. Haberler, N. Kondratiev, J. M. Keynes, M. Kalecki, M. Friedman, R. E. Lucas, G. J. Stigler, G. Myrdal, and others.

- About the interaction between **economics**, including **cycles**, and **politics**: W. D. Nordhaus, B. T. McCallum, A. Alesina, C. D. MacRae, V. Ginsburgh, P. Michel, S. Price, R. E. Lucas, F. S. Mishkin, T. J. Sargent, K. A. Schulz, A. Downs, G. H. Kramer, G. J. Stigler, E. Tufte, M. P. Fiorina, H. Eulau, G. Myrdal, and others.

To empirically demonstrate this dissertation's theoretical innovation and its possibility of generalisation, the first step was to determine the country to be used as case study and the period of time necessary to conduct the analysis. The choice was Brazil. First, because it is sufficiently big, both territorially and economically, to have sufficient independency from the influence of external actors on internal affairs, such as development and macroeconomic policies. Second, because the Brazilian economic academia is considerably independent. Instead of trying to adapt foreign theories to explain economic phenomena in Brazil, Brazilian economists always tried to develop their own theories. One example is Mario Henrique Simonsen's Theory of Inertial Inflation, Ignacio Rangel's idea that budget deficits result from inflation, thus inverting the Monetarist logic, Celso Furtado's contribution to the debate on economic development, just to cite a few. Third, because the economic/business cycles in Brazil are detached from the ones experienced in Europe and the USA, exactly because the country is relatively independent as mentioned before. Fourth, because there are the databases of the University of Campinas' Centre of Studies of Public Opinion - CESOP (see below) and the IUPERJ - Oxford Legislative Survey (Pesquisa Legislativa IUPERJ - Oxford in Portuguese or PLIO). Both databases provide a unique source of raw data for making a comprehensive empirical analysis.

The year of 1989 was chosen as the beginning, because it can be considered the year national-developmentalism ended. In this year occurred the first direct elections for President in Brazil in 25 years. Second, during the second round the dispute was clearly between two distinct ideological models expressed by concurrent concrete macroeconomic

policies: one, supported by Fernando Collor, reflected what became known as economic Neoliberalism, mostly based on the conclusions of the Washington Consensus; other, supported by Luis Inácio Lula da Silva, reflected the national-developmental ideal in force since 1930. As Fernando Collor won the elections, 1989 can be considered as the very year national-developmentalism was substituted by a new political economic ideology. Twelve years later, following the theoretical assumption that parties with radically different ideologic and macroeconomic approaches than the mainstream are not elected, Lula da Silva's election as President in 2002 marks the consolidation of his party convergence to the mainstream economic ideology and its macroeconomic policies.

To empirically demonstrate this dissertation's hypothesis, a quantitative descriptive analysis based upon data from two sources followed: from the population's perspective, the database of the University of Campinas' Centre of Studies of Public Opinion - CESOP, an interdisciplinary initiative combining the academic and scientific area with private institutes of public opinion research, such as IBOPE and DATAFOLHA. Its main objective is to recover and make available to researchers the public opinion surveys covering politics, society, culture, behaviour, among others. Its database has more than 2300 surveys covering the period 1968 - 2012. From the politicians' and political parties' perspective, the source was the IUPERJ - Oxford Legislative Survey (Pesquisa Legislativa IUPERJ - Oxford in Portuguese or PLIO). This is a longitudinal project initiated in 1990, covering all elected legislatures since the ending of the military dictatorship. It seeks the congressmen's views on ideology, legislative activity, institutional design, social policy, state reform, and foreign policy, among other issues. Between 1990 and 2009 more than 800 different congressmen have answered the survey in the years 1990, 1993, 1997, 2001, 2005, and 2009.

First, all CESOP's database consisting of more than 2300 surveys was researched to find the ones containing questions relevant for this dissertation. Second, the variables of the surveys were selected and prepared for statistical analysis with IBM's *SPSS Statistics* version 18. First, basic statistical analysis was made, to determine the distribution of the variables. Then cross tabulations among the variables were made to check the logic consistence between them and to visualise their relationship. The second step was to make cross-tabulations among the variables to apprehend the pattern of ideological change. From the electors' side, the chosen years were 1989, 1993, and 2002. From the politicians' side, 1990, 1997, 2001, 2005, and 2009. Specifically in these years the surveys' questions and answers were the most adequate to show the relationship between ideology, economic policy, and politics. For the first time the CESOP's database was analysed in such an extent. Also, for the first time, the CESOP's database was analysed together with the PLIO database, resulting in this dissertation's empirical analysis being completely unprecedented and unique.

Additionally to cross-tabulations, regressions were also made to statically test this dissertation's hypothesis. Instead of just running a linear model or merely testing

correlation between/among variables, a simple model based on ordinal logistic regressions was established. Ordinary regression analysis is not appropriate for ordinal response variables as it is an incoherent model for discrete data.¹⁰ In the logistic ordinal model, the predictions are logits for the cumulative probabilities associated with being at or below a particular category “j” that can be exponentiated to arrive at the cumulative probabilities associated with being at or below the category “j”. Thus, the basic model used on chapter 3 can be written as:¹¹

$$\ln(Y'_j) = \ln\left(\frac{\pi_j(\underline{x})}{1 - \pi_j(\underline{x})}\right) = \alpha_j + (\beta_1 X_1 + \beta_2 X_2 + \dots + \beta_p X_p)$$

To test the relevance of the relationship between the variables, self-positioning following a left-right Likert Scale was set as the independent variable and the preference regarding state intervention in the economy is the dependent variable. The tested hypothesis by regressions is this dissertations’s hypothesis: that self-positioning in the left-right spatial scale has no or small influence in the political choice for state intervention.

Finally, to spatially demonstrate the hypothesis that the ideological self-awareness of both population and political parties’ converges to reflect the ideology connected to specific macroeconomic policies, two figures representing the mean and the standard-error of general people and politicians’ self-positioning in the Likert Scale were made using the software package *Statsoft Statistica* version 7. These figures show not only the ideological spatial change, but also the uniformity of opinion among the population and politicians (shorter whiskers meaning greater uniformity and vice-versa) between 1990 and 2006 (population) and 1990 and 2009 (politicians). The model than is applied to Latvia. The economic platforms of the political parties that got sits in the 5th, 6th, 7th, and 8th Saeima were analysed to establish their convergence to Neoliberalism. Second, a comparative analysis was made with the objective to show the effects of Neoliberal ideology manifested as macroeconomic policy on the Latvian economy.

¹⁰ Jackman, S. (2009). *Bayesian Analysis for the Social Sciences*. West Sussex: Wiley, p. 397.

¹¹ O’Connell, A. A. (2006). *Logistic Regression Models for Ordinal Response Variables*. London: Sage, p. 31.

1. BUSINESS CYCLES, IDEOLOGY, AND MACROECONOMIC POLICY

Before discussing ideology, business cycles, and macroeconomic policies, an important question must be answered: if economics is to be a “hard science” as proposed by W. Stanley Jevons, is it correct to suppose that economists will be rather pragmatic and committed to reality than to their own personal moral and political convictions? The answer is “usually not.” Therefore, economics as discipline is by definition ideological. As a result, although economists claim to pursue “truth,” they are very often influenced by personal ambition, rigid defence of theories, and the weight of tradition in detriment of creative participation directed to the common objectives of science. This establishes a system of beliefs instead of a system of knowledge.

Thus, an important question that need to be answered is what is or is not economic in nature, and how economics can contribute to the understanding of problems like politics, culture, crime, and other topics? The University of Chicago Economics Department’s answer was that Political Economy means the application of economics to politics, law, culture, and even family life, i.e. Gary Becker’s “Rotten Kid theorem.” For others like Mishan (1982), Political Economy is the “specific advice given by one or more economists (...) to governments or to the public at large either on broad policy issues or on particular proposals or, alternatively, as another term for “normative economics”.”¹²

In this sense, Political Economy could be considered another word for macroeconomics. However, in the scope of this dissertation, it is argued that the term must be understood in the same way Adam Smith and the Classics did: Political Economy deals with the structure and dynamics of modes of production. In other words, it refers to the relationship of the economic sector with the government, including regulations, customs, and law, the distribution of income and wealth, including national socioeconomic development as well. In this sense, since macroeconomics deals with the economy as role, it is part of Political Economy as discipline.

In this dissertation it is proposed a division between “macroeconomic theory” and “macroeconomic policy.” The first is the formalisation and scientificisation of interpretations of economic reality. The second is the application of macroeconomic theory to specific economic frameworks, taking in consideration political needs. As a result, macroeconomic policy is the adaptation/deformation of macroeconomic theory by political means to deal with political needs. It is politically determined, at the same time retaining a pseudo-scientific character. As macroeconomic policy shapes economic relations, the result is a self-reinforcing circle where macroeconomic theory determines macroeconomic policy, which will determine macroeconomic theory, starting all over again. This economic ideological cycle is the very base for the model developed in this dissertation.

¹² Mishan, E. J. (1982). *Introduction to Political Economy*. London: Hutchison.

This scientificisation of economics is very important for politics. First, politics is the vehicle putting macroeconomic policy in practice. Second, to a great extent, the popularity of politicians depends on economic performance. Third, macroeconomic theory can provide the theoretical justification politicians need for supporting their ideology and its policies. Fourth, macroeconomic theory can be an instrument of political legitimisation. Since politics is basically about groups of interest struggling for power, macroeconomic theory is used to discredit rival groups, at the same time giving a scientific character to shield one own policies from criticism.

On one hand, during periods of economic stability, the ruling party/coalition and its/their politicians gain social and political prestige. On the other, as society is the laboratory for Economic Science, the apparent success of some school of economic thought's macroeconomic policies in delivering economic stability and even development makes this specific approach to become the mainstream, as it is empirically proven to be correct. This specific school of thought will then set the research agenda and the valid ideas and presuppositions determining economic models, gaining importance and prestige. However, as economics is basically a moral science, when an economic school of thought becomes the mainstream, it helps to legitimise the moral and politics associate with it. The interaction between politics and economics results in the latter being used to consolidate and reinforce the power, dominance, and interests of specific social groups through concrete macroeconomic policies. In this case macroeconomics acts as instrument of ideological control.

However, economic stability and growth do not last forever. They are followed by periods of crisis and contraction. During these turbulent times, the set of macroeconomic policies in force loses credibility. If the crisis is superficial, the social pressure for change is not very strong. Politicians will try to adjust the macroeconomic policies in force to revert the crisis. This includes changing the interest rate, increasing government's investment, reducing taxes, or even devaluating the currency to boost exports. Nevertheless, the core economic theoretical fundamentals supporting such policies remains intact.

On contrary, when a crisis is very deep, the economic theory sustaining the policies in force becomes discredited. As such crisis often result in the impoverishment of the middle and lower social classes, including because of increasing unemployment, politicians are forced to look for different macroeconomic policies to make the economy stable. Naturally, the first changes will be within the boundaries of the established economic ideology. However, deep crisis usually result from inadequate economic paradigms, having structural roots. In this case, it is not enough to superficially change some policies. As they are ineffective, it is necessary to change the basic premises of their determinants. The challenge is to find a new political economic model that will give the necessary theoretical base to establish a new set of macroeconomic policies that will promote growth and development again.

In the case of softer crisis, the incumbent political group will lose credibility and, possibly, will be substituted by other in the next elections. In this case, the economic ideology in force will not change. However, when there is a deep crisis, the established macroeconomic wisdom is unable to revert the downturn. It is necessary to go beyond the established economic ideology's boundaries, as the ideas considered to be mainstream turn discredited. The process of ideological transition starts first among opposition parties. As the incumbent group becomes associated with the crisis and its economic ideology, opposition parties try to disconnect from the ideas supporting the policies in force and start providing alternatives, usually found in the academic field.

As economics is not an exact science, always there is disagreement among academics. Even during good times, when a specific theory seems to be leading to the best macroeconomic policy, there are always some people disagreeing and claiming that the mainstream is wrong. For them, a new crisis is always coming. Since capitalism is cyclical, sooner or later they will be correct. As society is the real laboratory to test economic theories, crisis will make the mainstream theories to lose credibility, thus academic prestige. Some of the unorthodox/heterodox considered to be marginal will be able to explain and to revert the crisis, turning to be the new mainstream. Opposition groups will adhere to the new mainstream, if not entirely, at least to the extent of what is politically acceptable at that moment.

As macroeconomic theory reflects a Political Economy, with the establishment of a new theoretical mainstream, economic ideology also changes followed by a process of political convergence to these new paradigms. However, although crisis can change economic ideology, thus macroeconomic policy, the extent of change will be limited by the severity of the crisis and by politicians' own individual moral and political convictions. One example is the British Labour Party which, with Tony Blair, started pursuing Neoliberal policies in the 1990's, although trying to deceive its electorate by calling these policies "Third Way." Other examples are George Papandreou's Panhellenic Socialist Movement, José Luis Rodríguez Zapatero's Spanish Socialist Workers' Party, Romano Prodi's the Olive Tree, just to cite some.

This movement can be explained by a quote of Giuseppe Tomasi di Lampedusa's book *The Leopard*: "if we want things to stay as they are, things will have to change."¹³ In other words, the political parties' economic ideology is flexible, changing accordingly to their necessity of maintaining the relations of power in force. It happened with Classical Liberalism, later with Keynesianism, and now it is happening with Financial Neoliberalism. This is consequence of capitalism presenting appealing crises that, in spite of a difference in appearance, resemble each other in its essence as they are fruits of its endogenous contradictions. Thus, every crisis is followed by ideologic change in some extent. As capitalism itself, economic and political ideology is also cyclical.

¹³ Lampedusa, G. T. (2007). *The Leopard*. London: Vintage Books, p. 19.

In a similar way, the debate about the level of state economic intervention since the 1930's seems to follow the economic cycles of expansion and contraction in such a way that, if in some moments the presence of the state in the economy is desirable, in others it is undesirable. In other words, Classical Liberalism (1790-1930) was substituted by Keynesianism after the crisis of the 1930s; and Keynesianism (1930-1970) was substituted by Neoliberalism since the 1980's. In each case, although different levels of state intervention were defended with passion, the result was the establishment at the political level of a specific set of economic policies with a correspondent level and form of state intervention.

Economic liberalism first surged in France during the XVIII century, after an intellectual movement called Physiocracy. Its main hypothesis was that all social wealth is originated from agriculture, and trade and industry were just transforming agents of the wealth produced by earth. Through his *Tableau Economiqué*, François Quesnay demonstrated the interdependence of several economic activities, showing how manufactured products in cities were changed for agricultural products, these changes being mediated by money. As there would be a natural social order of social and economic relations, the government should not intervene in the circular flow of goods, above all imposing price controls, because just free competition would be enough.¹⁴

After the I Industrial Revolution, Physiocracy's main postulates lost their validity, although some subjects as the rent of the land and the support for economic liberalism continued to be discussed in pieces like Adam Smith's "The Wealth of Nations." Adam Smith's liberalism is based upon the idea that each individual seeks the best for him/herself, so the union of all individual actions in searching individual well-being would automatically result in maximum social well-being. More precisely, the private capitalists individual actions would lead to an optimal situation for the society that could not be improved by the action of a political leader or legislator. More precisely, the actions of individual private economic agents would result in a well-being situation for the society that could not be improved by any action of a political leader or legislator. Therefore, there would be an "invisible hand" that would harmonise the social relationships, solving the conflicts of interest, especially those present in the existent contradictions between production and consumption. As a result, this process could be compared as if there was a sort of "invisible hand" that would harmonise social relations, thus solving conflicts of interest, including those relative to the contradictions between production and consumption.¹⁵

After the appearance still in the first half of the XIX century of several left-wing theories, including socialism, supporting broader state intervention in the economy as reaction to Classical Liberalism, the Marginalist school, also called Neoclassical School,

¹⁴ Quesnay, F. (2004). *The Economic Table*. Honolulu: University Press of the Pacific.

¹⁵ Smith, A. (2007). *An inquiry into the nature and causes of the wealth of nations*. Petersfield: Harriman House.

offered a renewed intellectual support for economic liberalism. It was established based on Jeremy Bentham and John Stuart Mill's epicurean concept of utilitarianism. The concept of maximum happiness is the fundamental generalisation of human nature, transforming morals in a type of calculation of pleasure and pain, abstracting to selfishness or altruism. With base in that concept, Neoclassical authors built a system where there is an unequivocal tendency to equilibrium, as the result of the human capacity to calculate suffering and pain using a compound mathematical tool. It gives the base to the theory of marginal utility. Still, social well-being would not come from the individual actions of capitalists, but from the consumers' capacity to choose what maximise their utility and whose demands are perfectly understood and fulfilled by the capitalists. This way consumers, holders of complete information when maximising their utility, would submit the capitalists to their desires and needs. Again, the state is not needed.

The same logic applies to the labor market. Labor consumers (the capitalists) would naturally maximise the amount of labor being demanded if there is no state intervention; in other words, they would maximise their utility relative to labor. The same applies to workers. They would calculate pleasure (the salary) in relation to pain (the work) and each individual would rationally decide how much labor to offer. Therefore, there would be only voluntary and frictional unemployment because, if the economy is in equilibrium, all those accepting a certain wage level proposed by the market would find work.¹⁶ That presupposition indicates that, without state interference, there would be no crisis as the economy would be always at full employment. Thus, crises shall be understood as the result of state and its inefficient bureaucracy limiting individual freedom.

Albeit there was a period of economic depression (1873 - 1890's) at the same time the Neoclassical School was established, liberal economic policies continued to be considered the most proper to promote economic development and growth. This can be explained as the result of a peculiar economic moment: the level of economic activity continued to considerably grow because although commerce experienced some sharp depressions between 1873 and 1890, the world production, far from stagnating, continued to increase strongly.¹⁷

Thus, the depression during this period was not within the productive and commercial sectors, but in falling prices, interests, and, more relevant, profits. However, thanks to the colonialist pulse and to the great volume of investments abroad, the crisis' negative effects were minimised thanks to the reversion of the fall of the profit tax by economic policies opposed to economic liberalism. Thus, the role of the state was not limited to just guaranteeing the right to private property, but to pursue protectionist policies while letting the internal private sector to be free. This combination of colonialist

¹⁶ Voluntary unemployment is that when the individual refuses to work, facing the effective salary level. Frictional Unemployment concerns the transition period among a job and another, being considered normal in the society.

¹⁷ Hobsbawm, E. J. (2006). *The Age of Empire: 1875 - 1914*. London: Abacus.

expansion with nationalist protectionist policies resulted in the was the World War I with the state assuming the rule of the economy.¹⁸

With the end of the conflict, there was an attempt of reestablishing the effective economical order of the previous period by readopting old liberal dogmas, personified in the gold standard and in price deflation.¹⁹ Despite the attempts of reproduction of the paradigms anterior to the World War I, there was the depression of the 1930s. During the 1920s, the process of internationalisation had reduced its expansion thanks to the maintenance of protectionism policies and to the fact that most of the big economies were self-sufficient. Still, there was an asymmetry in the level of economic development between the United States and the rest of the world so the former except to some raw materials, did not need the latter. Finally, the economy did not generate enough demand for a sustained expansion. This was the result of falling general wages, augmenting profits, income concentration, and the incapacity of mass demand in accompanying the growth of the industrial productivity. With the expansion of consumer credit and the increase of financial speculation in the United States, the fall of the stock exchange of New York triggered the Great Depression of the 1930's.²⁰

The idea supported by liberals that a fall in the consumption would result in falling interest rate, thus increasing investment, and leading the economy to a new equilibrium and to full employment, was unable to give a credible answer to the crisis. Concomitantly, the notion that state intervention would disturb private initiative and maintaining the gold standard through deflationary politics and fiscal rigidity was necessary were not effective to take the economy to full employment. Only direct state intervention reverted the situation.

Making a critic to the precepts of the liberal political economy, Keynes demonstrated that the economy would admit multiple levels of equilibrium, but only one would result in full employment. This way, he showed that besides frictional unemployment and voluntary unemployment, involuntary unemployment would still exist; an individual would accept the salary determined by the market and anyway he would not be able to find a job. This happens because of the "Say's Law" not being true. Instead of supply determining its own demand, expectations about future demand determine the level of economic activity. In other words, future demand determines present supply and not the contrary. This way, the direct intervention of the State in the economy was necessary to alter the expectations of the economic agents, making the economy to experience a new expansion cycle.²¹ The years that followed the Great Depression, mainly those after the World War II, were marked by the state planning and regulation of the economy in the

¹⁸ Hobsbawm, E. J. (2003). *The Age of Extremes: the Short Twentieth Century*. London: Abacus.

¹⁹ Ibid.; Eichengreen, B. J., & Flandreau, M. (1997). *The Gold Standard in Theory and History* (2nd ed.). London: Routledge.

²⁰ Hobsbawm, E. J. (2003). *The Age of Extremes: the Short Twentieth Century*. London: Abacus.

²¹ Keynes, J. M. (1997). *The General Theory of Employment, Interest, and Money*. Amherst: Prometheus Books.

capitalist block, both in developed as in underdeveloped countries, to avoid the occurrence of systemic crises.

The answer is that there was no alternative. Following the model developed in this dissertation, I shall argue that, in case Latvia had become independent during the 1950s, it would have adopted Keynesian macroeconomic policies with developmentalist tendencies, similar to Finland, South Korea, or Brazil. At that time, these economic policies were considered centrist in the political spectrum. Nowadays they are considered to be left-wing. As Latvia regained its independence in the beginning of the 1990s, it based its macroeconomic and development policies in the - at that time - newly established economic ideology, Neoliberalism. In Latvia's case, the model developed in this dissertation also can be used to answer to the questions presented above.

First, when Latvia was part of the Soviet Union, the economic theory in force was Marxism-Leninism. On the political side, it was enforced by the Communist Party, resulting in the establishment of Soviet Communism as macroeconomic ideology, with specific monetary and fiscal policies, trade regulations, among others. It also had its specific economic institutions and structures, reflected by Soviet industrial, educational, and social policy, and political institutions and structures like, for example, the state bureaucracy. The interaction of these three factors determined the USSR's macroeconomic performance. With the poor economic performance of the 1980s, the support for the system experienced a huge decline. As it was impossible to change the incumbent party and its macroeconomic policies, thus changing its ideology itself, the regime and its system collapsed. As the result was the former Soviet countries' converging in a greater or smaller scale to capitalism, they automatically were pushed to adopt Neoliberal ideology as their nexus. In Latvia's case, this transition was quite radical.

This was done in the article "Ignacio Rangel visits Latvia: Crisis and the Political Economy of Duality," published in Routledge's *Debatte: Journal of Contemporary Central and Eastern Europe*, by this dissertation's author. Latvia's transition to Neoliberalism is dually determined. On the one hand, it reflects the ideological imposition of Neoliberalism by the international community, mainly by the International Monetary Fund, the World Bank, and the European Union. On the other, it reflects the political alliance between the major (oligarchs and politicians) and the minor partners (industrial and financial economic agents).

As both have no specific economic ambition other than immediate short-term profits, both major and minor partner are indifferent to the internal consequences of the secondary pole external side's (the foreign one) interests. Oligarchs are satisfied with their business: although they lost some political power, they still have a great level of influence upon the state to keep things as usual. The minor partners are more worried about budget consolidation than with economic development, while people are emigrating with such intensity that demography became a matter of national security. In the political sphere, the

result is the establishment of a model similar to Schumpeterian democracy; in the economic sphere, the result was the last economic crisis.²²

To make clear the relationship between business cycles, ideology, and macroeconomics policy, first it is necessary to define the meaning of ideology to be used within this dissertation. The term ‘ideology’ has a whole range of useful meanings, not all compatible with each other. In this way, to try to determine a unique universal concept of ideology would be to put aside the wealth of the particular idiosyncrasies of each of the various existing concepts. To unmask the process of economic and political change that follows crisis, it is necessary to find a concept that apprehends the richness of the process. Most concepts of ideology are not able to help enlightening the process of political and economic change triggered by crisis. As a result, it is necessary to find or establish a concept of ideology reflecting the interaction between politics and economics, without simplifying the process to the usual notion of distorted reality.

The most usual notion of the term “ideology” can be found on dictionaries. One of the most common dictionaries on the Internet, the Microsoft’s Encarta, defines the term as:

1. system of social beliefs: a closely organized system of beliefs, values, and ideas forming the basis of a social, economic, or political philosophy or program; 2. meaningful belief system: a set of beliefs, values, and opinions that shapes the way a person or a group such as a social class thinks, acts, and understands the world.

Accordingly to the Dictionary of Latvian Language,²³ ideology is a “(...) form of consciousness, which reflects the reality regarding the interest of a political, juridical, moral, aesthetic, philosophic system of judgement.”²⁴

The Houaiss Dictionary of Portuguese language defines the term as a²⁵

System of interdependent ideas (beliefs, traditions, principles and myths) sustained by a social group of any nature or dimension reflecting, rationalising and defending its own moral, religious, political or economic interests and institutional engagements; (...) body of philosophical, social, political, etc, convictions of an individual or group of individuals.²⁶

Terry Eagleton has compiled a list of notions about the concept of ideology in recent decades as:²⁷

- i. the process of production of meanings, signs and value in social life;
- ii. a body of ideas characteristic of a particular social group or class;

²² Berzins, J. (2014). “Ignacio Rangel visits Latvia: Crisis and the Political Economy of Duality.” *Debate: Journal of Contemporary Central and Eastern Europe*, DOI:10.1080/0965156X.2013.873190.

²³ Guļevska, D., Rozensštrauha, Irēna, & Šnē, D. (Eds.). (2006). *Latviešu valodas vārdnīca*. Riga: Avots.

²⁴ Apziņas forma, kas atspoguļo realitāti kādu interešu skatījumā, politisko, tiesisko, morālo, estētisko, filozofisko uzskatu sistēma.

²⁵ Houaiss, A. (Ed.). (2007). *Dicionário Houaiss da Língua Portuguesa*. Rio de Janeiro: Editora Objetiva.

²⁶ Free translation from the original: “Sistema de idéias (crenças, tradições, princípios e mitos) interdependentes, sustentadas por um grupo social de qualquer natureza ou dimensão, as quais refletem, racionalizam e defendem os próprios interesses e compromissos institucionais, sejam estes morais, religiosos, políticos ou econômicos; (...) conjunto de convicções filosóficas, sociais, políticas etc. de um indivíduo ou grupo de indivíduos.”

²⁷ Eagleton, T. (2007). *Ideology: an introduction*. London: Verso, pp. 1-2.

- iii. ideas that help to legitimate a dominant political power;
- iv. false ideas, which help to legitimate a dominant political power;
- v. systematically distorted communication;
- vi. that which offers a position for a subject;
- vii. forms of thought motivated by social interests;
- viii. identity thinking;
- ix. socially necessary illusion;
- x. the conjuncture of discourse and power;
- xi. the medium in which conscious social actors make sense of their world;
- xii. action-oriented sets of beliefs;
- xiii. the confusion of linguistic and phenomenal reality;
- xiv. semiotic closure;
- xv. the indispensable medium in which individuals live out their relation to a social structure;
- xvi. the process whereby said life is converted to a natural reality.

A common feature of Eagleton's list is that the 'term' ideology is mostly attached to expressions as "faith," "political power," "false ideas," "distorted communication," "social interests," "illusion," "confusion." In other words, that the concept of 'ideology' is attached to the notion of falsification of the reality, to defend interests of some social group, what meet the usage by the person-in-the-street. When in an ordinary conversation someone claims the other is speaking ideologically, the first is judging that what is being said is the result of the judgement of a particular issue through some rigid framework of preconceived ideas distorting their understanding, being rather connected to fanaticism or to the manipulation of consciousness. In this case, the opposite of ideology would be "empirical" and/or "pragmatic," as in a positivist sense.²⁸

On the one hand, most of these formulations are incompatible with each other. If some of them are based on the idea that ideology means any sets of beliefs motivated by social interests, it cannot mean dominant forms of thought within a society. On the other, some formulations are compatible with each other. In this case "ideology is both illusion and the medium in which social actors make sense of their word, then this tells us something rather depressing about our routine modes of sense-making."²⁹ Also, some of these formulations are pejorative, while other are ambiguous or not pejorative at all.

²⁸ Eagleton, T. (2007). *Ideology: an introduction*. London: Verso, p. 3.

²⁹ *Ibid.*, p. 2.

Nobody would claim that his/her own thinking is ideological, in other words, nobody would acknowledge having convictions based on illusions.

The concept of 'ideology' has myriad definitions. Some of them are positive, like Lenin's "class consciousness"; some are negative, like Marx and the distortion of the reality of social relations to conceal forms of social domination; some are neutral, like the notion that ideology is the medium in which conscious social actors make sense of their world. Also, it has been used to describe different phenomena, like distorted communication and semiotic closure. Even, there were attempts by the postmodernists to give the term an accessory character, substituting the term ideology by discourse. However, a common feature among all definitions of the term is its relationship to a particular social class, representing its moral, costumes, patterns of conduct, and, most relevant, its social order and social stratification, which will determine class structure and the relations of social subordination.

Hamilton (1987) made an extensive examination of the literature on the concept of ideology finding "no fewer than 27 different elements or definitional criteria which have been combined in various permutations of from two to at least seven."³⁰ He proposed a definition of ideology as "a system of collectively held normative and reputedly factual ideas and beliefs and attitudes advocating a particular pattern of social relationships and arrangements, and/or aimed to justify a particular pattern of conduct, which its proponents seek to promote, realise, pursue or maintain."³¹

However, as Terry Eagleton noted, "the force of the term ideology lies in its capacity to discriminate between those powers struggles which are somehow central to a whole form of social life, and those which are not."³² This determines the essence of the term's various concepts, making possible to establish a division between two main groups: one, to whom ideology acts as a vehicle to establishing and sustaining social domination (Marx, Lukács, Gramsci, Althusser, Adorno, Foucault); other, to whom ideology represents a system of ideas reflecting the world view of a specific class, without an active role in determining the process of dominance (Lenin, Stalin). Although both share the idea of social stratification, the first deals with the idea that ideology is part of the mechanism of dominance; for the second, ideology has a neutral character and is not a direct mechanism of domination. It is rather a system of ideas, a world view to be imposed establishing a social structure of domination.³³

The second notion is sterile for understanding the role of ideology on shaping the sociopolitical process in the form of macroeconomic policies. As ideology presupposes

³⁰ Hamilton, M. B. (1987). "The elements of the concept of ideology". *Political Studies*, vol. 35, no. 1, pp. 18-38, p. 18.

³¹ Ibid., p. 38.

³² Eagleton, T. (2007). *Ideology: an introduction*. London: Verso, p. 8.

³³ An additional conclusion after researching the literature on ideology is that it is basically discussed by left-wing authors, while right-wing authors or ignore or reduce the concept to a system of ideas, resulting in a neutral concept.

relations of domination and it just represents the world view of a particular social class, it may be used only to clarify its idiosyncrasies, thus being a characteriser and assuming the character of “system of ideas.” It is this notion that assumes the role of system of ideas giving the justification to totalitarian regimes to establish ideal societies through direct relations of power resulting in social dominance. In this case, what is being called ideology is not a vehicle of dominance, but merely the representation of the ideal. That is why where there are direct relations of power there is no place for ideology. Totalitarian regimes use direct coercion, making the concept of ideology to be invalid in this case.

Taking in consideration that ideology is a vehicle for dominance, a general definition for the term can be “*the combined systemic ways in which social and political dominance is established and sustained through subliminal means.*” This meet much the notion of ideology accordingly to Gramsci, the Frankfurt School, and Foucault. However, Althusser was right when affirming that ideology is manifested through material actions. Thus, it is necessary to complete the proposed definition to “*the combined systemic ways in which social and political dominance is established and sustained through subliminal means, and which is manifested through material actions*”.

The base of this definition is Marx’s notion that ideology is a system of ideas expressing the interests of the dominant class, representing class relations in an illusory form.³⁴ However, this concept is insufficient to include the theoretical developments reflecting the social changes of the last 150 years. As society become more developed, raw forms of ideological domination loose their appeal, making the idea of illusory representation of class relations to represent just one part of the process. Much more important is the subliminal character of the process of domination. In the place of direct indoctrination, power relations must appear to be natural, like Marx’s idea that “sie wissen das nicht, aber sie tun es” (they do not know it, but they are doing it).³⁵

This is one of the most important features of the nowadays process of ideological control, where even the most ideological individual claims to not being subjected to ideology. The postmodern claim that ideologies do not exist anymore, together with false claims such as “end of history”, “end of politics,” among others, is one of the most peculiar and subliminal forms of ideological indoctrination and domination. It uniformises the possibilities of thought, offering a supposed non-ideological ideological version of truth. Making a paraphrase, “they do not know, but their thought is determined and subordinated to it,” because it is the culmination of the process of establishing a universal pseudo-truth in the form of a standardised thought which cannot be denied, because of the lack of acceptable alternatives. Thus, its power results from the suffocation of doubt.

³⁴ Thompson, J. B. (1990). *Ideology and Modern Culture: Critical Social Theory in the Era of Mass Communication*. Palo Alto: Stanford University Press.

³⁵ See Marx, K., & Engels, F. (1990). *Capital: a Critique of Political Economy* (vol. 1). London: Penguin Books, p. 166-67.

This acceptance of a standardising process of thought is mostly favoured by the natural tendency of mankind to socialise and to belong to some social group. Since self-respect is usually determined by the respect accorded by the other members of the social group one is part, only individuals with a very peculiar self-consciousness can in the long run maintain their self-esteem when facing the disesteem of their fellows.³⁶ As ideology unifies and uniformises the process of social thought, to be accepted as part of some social group is necessary to agree with this group's thought under certain limits of freedom, accepting its intrinsic moral values, social codes, world view, etc.

It is not the case to affirm there is a unique universal thought, and every individual thinks exactly in the same way. Also, that there is only one social group in the society. Rather, there are a multitude of social groups interacting simultaneously in different social levels, with individuals often participating in more than one group at the same time. However, there are specific levels of ideological social hierarchy among these groups resulting from their social impact, from the group considered as the entire social fabric to specific micro-groups like social clubs and student organisations. The ideology of groups in social smaller positions - if there is any - is always subordinated to the upper ideology of the society they are part. An exception are revolutionary or anarchist groups. In this case, as ideology is not sufficient to control their members, most probably they will be arrested in the very first moment they constitute a serious threat to the established social order.

Individual thought is also differently influenced by ideology. Individuals have some degree of liberty to form their thought independently from ideology. They may even recognise the mechanisms of ideological dominance they are being submitted to. The way to do so is to acquire knowledge avoiding intellectual myopia. The ideological use of the educational system resulting in increasingly lower levels of educational quality, together with the process of glamorisation of ignorance in postmodern societies, and the reification of television as determinant of social reality together with sports as factor of social and political alienation, are making reality to be false consciousness. As this process is seen as unavoidable and there is no place for the establishment of other realities, reality became itself an ideology.

To understand how reality becomes ideology is fundamental to apprehend the process by which politics and economics turn to be ideologies themselves, and macroeconomic policy becomes an ideological instrument. As discussed before, as reality is also ideology, it can be shaped accordingly to particular interests. The media, the educational system, the legal apparatus, just to cite a few, can be used to alter, if not reality itself, the way it is understood and apprehended. Economic crisis can trigger deep changes, including changing the structure of established relations of power. At the same time,

³⁶ See Veblen, T. (2007). *The Theory of the Leisure Class*. Oxford: Oxford University Press, especially chapters 01 and 02. Although Veblen is known as one of the founders of the Institutional approach, his main work "The Theory of Leisure Class" is much more a treaty about human nature based on anthropology than an economic study.

economic interests - in a broader sense - determines much of politics. As a result, the behaviour the economy expressed in the form of business cycles affects the political sphere. Since politics by definition cannot be ideology-free, it is possible to conclude that there are ideological cycles connected to business cycles.

In other words, the political, economic, and social order is determined *a priori*, being imposed from above. Ideology will change to guarantee that the established relations of power will remain the same. This means that the instruments of ideological control, including macroeconomic policy, will also change to reinforce the established order. In this case, as economic crises are able to change the established relations of power, it is necessary to understand the process by which macroeconomic policy starts to instrumentalise some determined ideology reflecting specific relations of power. To understand this process, it is necessary to make a short discussion about ideology and economics as discipline.

When Adam Smith was alive, there was not a clear division between “economics” and “politics,” thus Political Economy was expected to be ideological. During the XVIII century, it was clear that what happen in the economic sphere is the result of decisions made in the political realm. This explains why Smith’s “The Wealth of Nations” is a piece of political advice upon how to make a nation wealthier, in this case the United Kingdom. Other authors of the Classical School of Economics as John Stuart Mill, David Ricardo, Thomas Malthus, and Jean-Baptiste Say, although mostly concerned with economic questions and supporting liberalism, were also aware that the economic system is regulated at the political level. The same applies to Karl Marx, who wanted to change the political structure with the objective of transforming the economic system or, at least, to increase the political bargaining power of trade unions to get social benefits, thus moulding the economic system accordingly to the needs of a specific social class. During this period, instead of “Economic Science” there was “Political Economy,” the study of the process of distribution of national income including government expenses.

It was only in the late XIX century that politics and economics became completely independent fields. The publication of W. Stanley Jevons’ “The Theory of Political Economy” in 1871. In this book, Jevons for the first time used the term “Economics” instead of “Political Economy.” Jevons was convinced that Political Economy should be transformed into Economic Science, a field of mathematics. Accordingly to him “it is clear that Economics, if it is to be a science at all, must be a mathematical science. (...) As the complete theory of almost every other science involves the use of that calculus, so we cannot have a true theory of Economics without its aid.”³⁷

With the publication of Alfred Marshall’s “Principles of Economics” in 1890, “Political Economy” became out of fashion. It was substituted by “Economic Science,” which ignores social, political, and cultural aspects in its analysis. Economists tried to

³⁷ Jevons, W. S. (1965). *The Theory of Political Economy*. Cambridge, MA: Harvard University Press, pp. 3.

subordinate the study of social questions - here in an ample meaning and including political relations - to a very limited framework based on Bentham's utilitarianism: there is no society, but a market where people are perfectly rational and information is freely available for every individual. Thus, to be an exact science economics turned asocial, apolitical, and acultural, at the same time pretending to be non-ideological.

Nevertheless, economics never got rid of ideology. First, although economics turned to be formalised by quantitative methods, all econometric models must follow a strong logic based on economic theory. In other words, these models are based on the same philosophic presuppositions economic theory is. If some philosophical assumption is flawed, the result is that even if the model is methodologically correct, it can be wrong because of its philosophical presuppositions; second, because economists have political positions. Making a simplification, Marxian/Marxist economists are left-wing, Keynesians economists orbit in the centre, and Neoclassical/Orthodox economists are conservative right-wing. As a result, the philosophical presuppositions giving base to economic models are the result of a subjective notion of the world determined by personal views about reality. The interaction of every person with reality is unique; it is determined by individual views and experiences, as well as personal idiosyncrasies, resulting in a particular concept of the real. As a result, the mathematisation of individual convictions and world-views turned into economic models does not make them to be scientific.

Macroeconomic performance is one of the most important factors influencing election output. Usually, the most stable a country's economy is, the better to the incumbent political group. Unfortunately to politicians, capitalism presents appealing crises that, in spite of being apparently different, they are similar to each other in their essence as the result of systemic disequilibriums. Each time a crisis is very deep, not only incumbent political groups are penalised, but the economic policies being enforced loose credibility. There is a double movement. By one side, the ideological pendulum changes from left to right or vice-versa, including new economic policies considered to be correct ones. By other, politicians change their rhetoric trying to connect themselves with the new correct set of ideologies recently established. This movement very often is very subtle, as it is the result of ideological change, in the sense discussed in the introduction. As the establishment and/or maintenance of relations of power is determined ideologically, macroeconomic policy turns to be an ideology itself independent of political convictions. However, on contrary, it can determine political convictions.

It is possible to notice expansion and contraction periods of the capitalist activity along History, that some times appear in the form of crises, other times in the form of a high accumulation level. Several authors researched the occurrence of economic cycles as, for instance, Kitchin, Juglar, Kuznets and Kondratiev, the following division could be used as for their duration:³⁸

³⁸ Schumpeter, J. A. (1987). *History of Economic Analysis*. London: Routledge.

Seasonal cycles: until one year

Cycles of Kitchin: 3 years

Cycles of Juglar: 9-10 years

Cycles of Kuznets: 15-20 years

Cycles of Kondratiev: 48-60 years

In a similar way, the debate about State intervention in the economy seems to follow somehow the expansion and contraction cycles of the economic activity in such a way that, if in some moments the presence of the state in the economy is desirable, in others it is undesirable. Since the capitalist system's establishment, three main phases of political and economic regulation may be perceived:³⁹ *Laissez-faire* before the Great Slump, planning/interventionism from the 1930s until the middle of the 1970s, and Neoliberalism since then. In each one, the hierarchical relationship between politics and economics have changed.

Economic, political and social paradigms' changes occur on different levels, usually resulting from crisis; it may be social, political or economic, with each factor occurring isolated or in combination. With a crisis, the social, political and economic models in force start to be questioned by social, political, and economic actors. In other words, the mainstream is challenged by the historical process natural outcomes, on three levels. The first is on the economic level, as a matter of course. The second is on political economy, as politicians start to look for answers for the question "how to solve the crisis," following different levels of radicalism, depending on how deep the crisis is. Thus, one group of ideas is substituted by others. Also, usually, society/voters are more prone to support political and economic reforms in times of crisis, resulting in a more favourable environment for change.⁴⁰ The third level is the intellectual, as it seems to exist a cyclical character affecting intellectual certainty, in a process where people's analysis become fuzzy and distorted by beliefs, and dialogue turns to be ideological rather than academic. As a result, what was once considered absurd and revolutionary turns to be dogmatic common sense until a new idea appears.

The existence of crisis and their cyclical character have always been of interest to economists. In political economy it is possible to distinguish three basic lines explaining how capitalism reproduces itself.⁴¹ First, there is the practically common sense that capitalism is able to regulate itself: it may be smooth and efficient accordingly to the neoclassical school, or it may be erratic and wasteful accordingly to Keynes, but in both

³⁹ In this dissertation, capitalism is considered to be established in the XVIII century's ending, as a result of the conjunction of the Industrial and French Revolution.

⁴⁰ See Gasiorowski, M. J. (1995). "Economic crisis and political regime change: an event history analysis". *The American Political Science Review*, vol. 89, no. 4, pp. 882-897 .

⁴¹ Shaikh, A. (1978). An introduction to the history of crisis theories. In URPE (Ed.), *US capitalism in crisis*. New York: Union for Radical Political Economics.

cases nevertheless being always self-equilibrating. As a result, if left for itself (Neoclassical theory) or if adequately managed (Keynesianism), it may last forever.⁴²

Second, there is the idea that capitalism itself is incapable of self-expansion, as it is necessary an external source of demand to assure growth. Malthus, and even Marx, discussed the existence of fluctuations due to temporary deficiencies in the demand for goods, although without assuming the existence of a regular pattern. Although John Stuart Mill and Sismondi perceived some regularity, but only in 1910 John A. Hobson developed the idea of a cyclic “underconsumption theory.” Third, there is the notion that although capitalism is able to expand itself, the process of economic reproduction deepens its internal contradictions resulting in a crisis. This line is almost exclusively Marxists, including such ideas like “falling rate profit” and “profit squeeze” explanations of crisis.⁴³ In the next section the main theories of business cycle are presented, arbitrarily organised in time, from the oldest to the newest.

1.1 Business Cycle Theories

1.1.1 The Laissez-Faire Tradition

The *laissez-faire* tradition relies on the well known assumption that capitalism is a self-regulating harmonious system, regulated by the natural tendency of reaching a general equilibrium determined by Adam Smith’s invisible hand, and supported by Say’s Law.⁴⁴ In this sense, crisis result from Human Nature meeting Physical Nature, with economists focusing on agriculture’s cyclical nature. One of the first of these models is William Stanley Jevons’ ‘Sunspot Theory,’ appearing for the first time in his ‘The solar period and the price of corn’ of 1875.

Between 1875 and 1882, Jevons outlined a theory of economic fluctuations relying upon the notion of a corn-generated surplus.⁴⁵ He explicitly attributed the existence of economic crisis as a result of fluctuations in the corn harvest as consequence of weather variations, arguing for the existence of a cyclical pattern. Accordingly to Jevons, low sunspot activity on the sun’s surface negatively influences plant growth, thus agricultural output. As a result, there would be an economic cycle closely following the sunspot’s cyclical behaviour.⁴⁶ The argument was that merchants, bankers, and investors base the decisions about credit and investment on observed data concerning the harvest.⁴⁷

⁴² Shaikh, A. (1978). An introduction to the history of crisis theories. In URPE (Ed.), *US capitalism in crisis*. New York: Union for Radical Political Economics.

⁴³ Ibid., p.220.

⁴⁴ The Say’s Law states that an economic system guided by a freely operating price system will automatically tend to fully employ its resources, including labour. Thus would be true because every act of production creates a market for the product produced through the monetary distribution of income payments to the people involved in its production. In other words, supply creates its own demand.

⁴⁵ Peart, S. (1996). *The economics of W. S. Jevons*. New York: Routledge.

⁴⁶ Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

⁴⁷ Peart, S. (1996). *The economics of W. S. Jevons*. New York: Routledge.

Jevons presented statistical evidence that economic cycles lasted approximately 10.43 years from peak to peak, while sunspot cycles lasted 10.45 years. As there is statistical correlation between both variables, Jevons was convinced that his theory was scientifically proved. Nevertheless, when new evidence showed that in reality sunspot cycles lasted 11 years, Jevons tried to preserve his theory arguing that this was well known by farmers, implying they would also change their behaviour accordingly, thus resulting in a break between real sunspot activity and economic pattern.⁴⁸ However, although today the sunspot theory is discredited, the hypothesis that expectations can be self-fulfilling, meaning that falling expectations can result in diminishing outputs without any real changes in the economy, anticipates the debate on how expectations might affect behaviour.⁴⁹

Another theory explaining economic cycles through agricultural behaviour was Mordecai Ezekiel's Cobweb theorem. The model explained the influence of shocks to supply and demand resulting in cyclical fluctuations in prices and output. It is based on the idea that there is a time lag between supply and demand decisions, specially to agricultural markets, since there is a time lag between planting and harvesting.⁵⁰ The model has two main assumptions: a) goods are perishable, so farmers must accept the current price, and b) the decision about the amount to be planted in the spring is based on what the price was last fall, meaning that expectations are backward and not forward looking. In the case of bad weather conditions resulting in poor harvesting, the shortage of a determined crop X results in higher prices. If farmers are expecting the high price conditions to continue next year, they will raise the crop X's production, resulting in a high and in lower prices. Following, if they expect the prices to be low, they will decrease the production of the crop X, resulting in high prices again.⁵¹

The equilibrium price is at the intersection of the supply and demand curves. A bad harvest in period 1 makes supply falls to Q1 and price rises to P1. If farmers expect the higher price to continue, the supply of the period 2 will be high, at Q2, making prices fall to P2. The process repeat itself, oscillating between periods of low supply with high prices and high supply with low prices. Nevertheless, although the Cobweb theorem is not a useful explanation of modern market's behaviour, because of its two assumptions, it represents very truthfully the essence of the laissez-faire tradition, where the system is disrupted by crisis, but their determinants are external to the system's normal functioning. In this sense, crisis are determined either by Nature (sunspots, crop failures, etc) and/or by

⁴⁸ Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

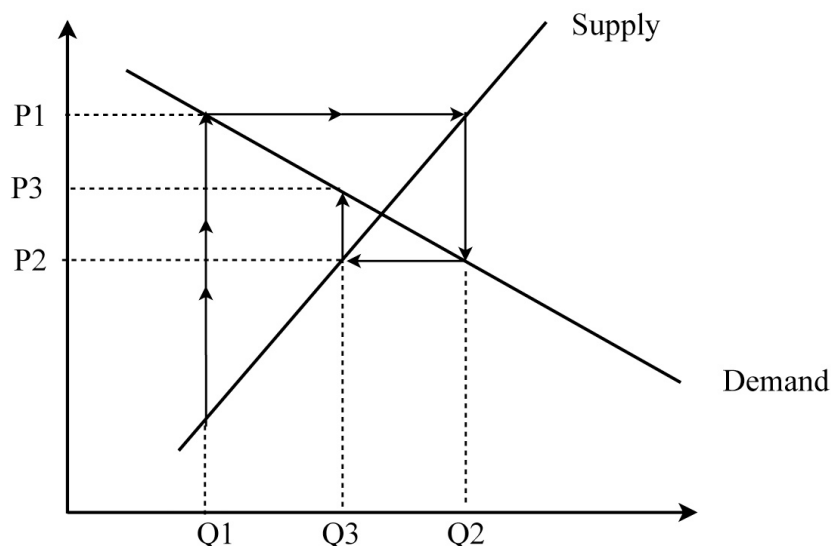
⁴⁹ Ibid.

⁵⁰ Ezekiel, M. (1938). "The Cobweb theorem". *The Quarterly Journal of Economics*, vol. 52, no. 2, pp. 255-280 .

⁵¹ Ibid.

human nature (psychological cycles of optimism and despair, wars revolutions, etc). The figure below shows how the model works.⁵²

Figure 1.1
Cobweb Theorem



A development of this approach is the Neoclassical Marginalist School. As discussed before, the concept of maximal happiness is the fundamental generalisation of human nature, transforming morality in a type of calculation of pleasure and pain, abstracting the selfishness or the altruism.⁵³ As a result, as each individual is looking to obtain the maximum amount of pleasure - here understood as satisfaction and well-being - the result is always the best for the society as a whole. Any kind of interference from the State is thought to promote undesirable disequilibria.⁵⁴ In other words, the absence of state intervention is the best guarantee for achieving growth and development.

This model has three fundamental assumptions. First, that *there is perfect competition in all markets*. This means that all firms and consumers are price takers, and wages and prices are perfectly flexible. Also, that there are no barriers to entry and/or exit, there is perfect information of economic conditions, all goods (including labour) are perfect substitutes, and markets always clear. Second, *decisions are made based on real and not on nominal values*, meaning there are no monetary illusions and the economic agents adjust all nominal variables changing the price level before they act. Third, *all individuals have the same preferences and act alike in every way*. Combined with the other

⁵² Shaikh, A. (1978). An introduction to the history of crisis theories. In URPE (Ed.), *US capitalism in crisis*. New York: Union for Radical Political Economics.

⁵³ Bentham, J. (2000). *An Introduction to the Principles of Morals and Legislation*. Kitchener: Batoche Books.

⁵⁴ Jevons, W. S. (1965). *The theory of political economy*. Cambridge, MA: Harvard University Press.

assumptions, this means that macroeconomic pattern is the simple summation of average microeconomic behaviour.⁵⁵

In the Neoclassical model, the aggregate output results from the combination of two factors of production, labour and capital. A very important feature is that both inputs are subject to diminishing marginal returns.⁵⁶ As consequence, as the demand for labour is determined by firms, this implies that firms will hire more workers only at lower real wages, looking to maximise profits. With the workers, it is the contrary. As people are making supply decisions, utility maximisation rather than profit maximisation is the main objective. As completely rational agents, workers will decide how many hours of work they will supply, basing their decision in the calculation between the benefits resulting from the income earned from working and leisure (pleasure), and working hours (pain).⁵⁷ As a result, the supply of labour will increase if wages are also increasing.⁵⁸

As they are determined by the labour market, in other words, between supply and demand for labour, there would be just voluntary and frictional unemployment. If the economy is in equilibrium, all workers accepting market wages would be able to work. This presupposition indicates that, without State interference, workers and firms are free to maximise their utility and profits, taking the economy to the equilibrium point, thus to full employment of the productive forces. As a direct result, unemployment is assumed to exist only as a result of voluntary rational choice. An individual is unemployed because of his/her own rational choice of not accepting the market wage.

As there is no unemployment, by derivation there is no crisis. This implies that, without state's interference, there are no cycles in the Neoclassical model, as all changes in output are temporary and automatically corrected by the market mechanism. However, when there is state interference, changes in output are considered to be permanent as a result of changes in the aggregate supply as the output of tax policy and government regulation. In this case, although the market reaches the equilibrium point. it is not the optimal. Thus, the responsibility for crisis fall on the State and its inefficient bureaucracy impeding individual freedom.⁵⁹

⁵⁵ Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

⁵⁶ Diminishing marginal returns refers to the fact that in the case the quantity of one of the productive inputs is fixed, a point will be eventually reached when additional units of output resulting from increasing the non-fixed input will get smaller, although the total input rises. This is a very important axiom in Neoclassical economics, as it implies a firm is unable to increase output unless it increase all inputs. Specifically about labour, this means that additional output declines as the amount of labour rises. See Koutsoyiannis, A. (1979). *Modern microeconomics* (2nd ed.). London: Macmillan.

⁵⁷ Another important axiom of Neoclassical economics, often unreal, is that the workers have the flexibility to choose how many hours per day to work.

⁵⁸ Of course there are other factors influencing the quantity of labour, as immigration and population growth. Also, public policy may influence individuals' incentives to work.

⁵⁹ Jevons, W. S. (1965). *The theory of political economy*. Cambridge, MA: Harvard University Press; Marshall, A. (2009). *Principles of economics: unabridged eighth edition*. New York: Cosimo Books

1.1.2 Overinvestment Theories

Jean Charles Léonard Sismondi in his 1819's "New Principles of Political Economy" argued that the circularity of transactions was not always complete and immediate, questioning capitalism's self-equilibrating character, and denying Say's Law. His argument was that investment allied with technological improvements would result in an over-supply. Usually receiving subsistence wages, the workers are unable to purchase all the products the economic system is able to produce. With further technological developments, competition among businessmen to profitably employ their capital will intensify over-production. As a result, the increasing gap between supply and demand turns into an economic crisis.⁶⁰

Thomas Malthus, more known because of his Law of Population than his debate about the need of unproductive consumption, also defended a considerably different idea about the nature of the aggregate demand than Say's view. Accordingly to him, it is the demand for consumer goods that regulates production and only a certain rate of growth is 'sustainable.' Malthus was convinced that workers' consumption was insufficient to maintain the level of economic activity. On the other hand, with increasing investments, production, and thus profits, there is a tendency for businessmen to spend a smaller proportion of their gains, saving more, as they are more interested in accumulating than in consuming. Although wages are source of purchasing power, they are also costs of production inversely related to profits, in the sense that higher wages mean lower profits. As a result, the only way to not reduce profits is to find a differential surplus whose expenditure increases the aggregate demand without inflating costs of production. The solution proposed by Malthus was to assure the existence of unproductive consumption to compensate the effects of overinvestment. In this sense, the expenditures of statesmen, judges, lawyers, clergymen, etc, would compensate the deficiency of consumer demand.

Only in the second half of the XIX century there was an attempt to establish a theory of the economic cycle. In 1862, the French doctor Clement Juglar published his "*Des Crises commerciales et leur retour périodique en France, en Angleterre, et aux États-Unis*," identifying a 7-11 years industrial cycle related to the credit cycle.⁶¹ Analysing time-series material,⁶² he established three main phases determining a cycle: upgrade - explosion - liquidation. This led him to diagnose the nature of depression as a natural consequence of prosperity,⁶³ meaning that depressions are adaptations of the economic

⁶⁰ Sismondi, J. C. L. S. (2009). *Novos Princípios de Economia Política*. Curitiba: Segesta Editora.

⁶¹ Juglar, C. (1862). *Des crises commerciales et leur retour périodique en France, en Angleterre, et aux États-Unis*. Paris: Guillaumin, available for download in <http://books.google.com>. Downloaded in 15/03/2010.

⁶² Mainly prices, interest rates and central banks balances.

⁶³ For an analysis of Juglar's method and chain of thought, see Schumpeter, J. A. (1987). *History of Economic Analysis*. London: Routledge, specially pages 1089-90.

system to previously periods of prosperity. Thus, it would be necessary to determine the causes of prosperity, in what Juglar has failed.⁶⁴

Knut Wicksell was one of the first to explore the relationship between investment and prosperity. He focused on the effects of money supply's fluctuations over investment, thus over output and employment. Accordingly to Wicksell's 'cumulative process,' there is a 'natural' rate of interest, where savings are equal to investment. In the case fluctuations in the money supply change the interest rates either above or below the natural rate of interest there are changes in the level of economic activity.⁶⁵ As a result, if the market rate of interest is under the 'natural' rate of interest there is a period of economic expansion with rising prices; on contrary, if the market rate of interest is above the 'natural' rate of interest there is a period of economic contraction with falling prices. As there is a natural tendency to equilibrium, sooner or later there is a period of correction/recession, where the level of investment, production of consumer goods is pushed back to a level compatible with the 'natural' rate of interest.⁶⁶

M. I. Tugan-Baranovsky used Wicksell's notion of freedom of investment levered by credit. In his theoretical explanation of the cycles free loanable capital had a crucial role. The accumulation of capital occurs practically at a constant rate, because it results from the flow of savings of those groups whose income is not affected by the economic cycle. On contrary, the transformation of these savings into fixed capital, i.e. investment, is essentially discontinuous. This different dynamic behaviour between the supply and demand of loanable funds is the basic cause of economic fluctuations.⁶⁷

In a contraction phase, falling investments results in free capital, which lie in banks waiting for investment. Thus, this excess supply will result in a continuous fall in the interest rate, resulting in a high degree of instability. The idea is the more there is such paralysed capital, the more powerful must be drive towards productive investment. As a result of lower interest rates and of re-established positive profit expectations, the stock of capital will flow to all productive sectors, mainly to those producing capital goods. The economic system enters an expansionary phase of the cycle.⁶⁸

In this phase, the rate of investment accelerates sooner or later making the demand for free capital to be greater than its demand. The consequence is the progressive exhausting of free capital, whose shortage will result in a fall in share prices, and *ipso facto* to a stock market crash. As turn to be impossible to direct new free capital into fixed capital, there is a fall in the aggregate demand in all sectors, thus ending overproduction..

⁶⁴ Schumpeter, J. A. (1987). *History of Economic Analysis*. London: Routledge.

⁶⁵ In economics, the interest rate is considered the price for money. Following the laws of supply and demand, if there is too much of some product, its price must go down and vice-versa. The same applies to money.

⁶⁶ Wicksell, K. (2008). *Interest and prices*. London: MacMillan.

⁶⁷ Colacchio, G. (2005). "On the origins of non-proportional economic dynamics: A note on Tugan-Baranovsky's traverse analysis". *Structural Change and Economic Dynamics*, vol. 16, no. 4, pp. 503-521.

⁶⁸ *Ibid.*

This downturn turns into a recession, establishing the conditions for a new expansionary phase.⁶⁹ During this period loanable funds are established in banks again, by savings on fixed incomes of those gaining on deflation, making the economic system ready for another expansion, as banks start to lend again.

Arthur Spiethoff, a student of Gustav von Schmoller and Adolph Wagner, built his theory of cycles upon Tugan-Baranovsky's cycles. His main contribution was giving credit an endogenous character through innovation. The expansion originates in some capital goods industry, probably from technological change resulting in reducing costs, or from opportunities in some underdeveloped country, i.e. new markets; the increase of profits results into a sectorial expansion, ending in a phase of general economic expansion financed by an explosive credit expansion.⁷⁰

As a result, there is a sharp increase in the demand for raw materials necessary to the production of durable goods, like cement, iron, glass, lumber, and other construction materials, resulting in new investment to add capacity in these sectors. Although much of the investment occurs during the expansion period, as new plants start producing, there is an increase of the supply, reducing prices, thus profitability. With the social need for these sectors being fulfilled, and as these sectors are overdeveloped, their consequent downturn spreads to the entire economic system, resulting in cumulative decline of income and employment. A new phase of expansion stay latent, waiting for innovations.⁷¹

Dennis H. Robertson followed Spiethoff's theoretical base, albeit concentrating on money as vehicle of fluctuations resulting from expansionary credit. There is a considerable time-gap between the moment the decision to invest is made, and the moment the implementation of the investment starts. Also, to make all investment plans real, huge loans are necessary, which the existing savings and profits are not sufficient to finance. As a result, there is a natural expansion of the monetary base resulting in inflation, creating an illusory inducement to expansion. The downturn follows Spiethoff's approach.⁷²

1.1.3 Early Monetary Overinvestment Theories

Three main authors turned a monetary theory into a cycle theory: Ralph G. Hawtrey, Friedrich A. von Hayek, and Gottfried von Haberler. The common feature on their theories is that they are highly based on Wicksell's idea of the relationship between the natural rate of interest and the money rate of interest. However, as Wicksell argued, the critical source of cyclical disturbance is the nature and operation of monetary institutions, i.e. the Central Bank and private banks. Since banks may create their own money, thus

⁶⁹ Colacchio, G. (2005). "On the origins of non-proportional economic dynamics: A note on Tugan-Baranowsky's traverse analysis". *Structural Change and Economic Dynamics*, vol. 16, no. 4, pp. 503-521.

⁷⁰ Diebolt, C. (2009). *Business Cycle theory before Keynes*. Paris, Association Française de Cliométrie, AFC Working Paper no. 11.

⁷¹ Ibid.

⁷² Ibid.

increasing the monetary base, they focused on the role of credit in the relationship between money, prices, investment level, and the cycle.

For Hawtrey, the economy is a 'single sector' system and the cycles result from vertical imbalances caused by miscoordination of monetary resources through time. He built his system on Marshall's oral tradition and Wicksell's analysis of credit expansion and contraction.⁷³ Accordingly to him, changes in bank credit make the economy to go out of the equilibrium point, as they change the the effective demand for commodities which is compatible with the money outlay of consumers. As Hawtrey accepted Say's Law, in equilibrium consumption equals production, and consumers' outlays equals consumers' income. As consequence, consumers and traders are not changing their cash balances, banks are not changing the volume of bank credit, and there is no net export or import of gold. This extremely delicate equilibrium, which is easily disturbed, will turn to be cumulative disequilibrium.⁷⁴

The key to understand Hawtrey's cycle is traders' future expectations in relation to the interest rate, meaning that increased spending by consumers out of their balance is the least source of economic disturbance.⁷⁵ As traders' future expectations improve,⁷⁶ they release cash and look for bank credit to increase their working capital. Thus, the interest rate turns to be working capital's price, explaining why traders are so sensitive to its changes. If the aggregate money income rises as a result of increasing loans,⁷⁷ the interest rate goes down. As a result, traders will borrow more money from the banks to increase their inventories demanding increases in production. As increasing production takes time, the aggregate money supply is momentarily too large for the level of economic activity. The increased income will be spent in consumption, stimulating excess demand, resulting in additional cash being released by traders and banks. This again adds to consumers' income, again reducing traders' stocks. A vicious cycle is established, where profits increase because wages and interest rates are relatively rigid in the short-run.⁷⁸

The downturn comes when bank reserves drain, what may be aggravated by an increase of imports and a flow of capital abroad, forcing the interest rates up, stopping the expansion. Traders will stop investing in their inventories reducing their demand for goods, what will make production to contract. However, monetary contraction comes first, resulting in consumers lowering their demand for goods, what will partially rebuild inventories and make traders to reduce their demand on firms even more. In the ending, the result is crisis and depression until the banks are well supplied with money and start

⁷³ Rima, I. H. (2009). *Development of economic analysis*. London: Routledge.

⁷⁴ Ibid.

⁷⁵ Ibid.

⁷⁶ The word 'traders' is used by Hawtrey as a synonym to wholesalers and middlemen.

⁷⁷ It is assumed that bank loans increase the monetary base, as they create fiduciary money.

⁷⁸ Hawtrey, R. G. (1927). "The monetary theory of the trade cycle and its statistical test". *The Quarterly Journal of Economics*, vol. 41, no. 3, pp. 471-486 .

lending again.⁷⁹ In resume, changes in bank credit, following changes in the state of monetary reserves is, in Hawtrey's view, the only cause of business cycles, what Friedrich Hayek disagreed.⁸⁰

Although Hayek believed that bank credit is the ultimate cause of cycles, he gave more importance to its impact in the productive structure. His theory combines a Wicksellian theoretical base with the process of increasing and decreasing the production of capital goods relative to consumer goods. Two fundamental elements of his analysis are: (a) the idea of domestic economic equilibrium resulting from the equality of domestic savings and investment, and (b) the disruption of this equilibrium is caused by monetary/ credit disturbances, rather than price disturbances.⁸¹

The cycle starts following a credit expansion resulting from the accumulation of loanable funds making the natural rate of interest to fall below the real interest rate,⁸² i.e. the interest rate resulting in equilibrium. An investment expansion follows, increasing the demand for capital goods, thus making the aggregate demand to be greater than the aggregate supply. However, as loans are used to increase the production of capital goods, there is a momentary relative shortage of consumer goods resulting in rising prices and in forced savings, funding a further expansion of credit. As the rising prices of consumer goods increase sectorial profits, their production also expands pressuring the capital goods sector. In this moment, the production of both consumer and capital goods can even increase together.⁸³

This process will take place until there is full-employment. In this case, the rising demand for consumer goods will result in rising prices again. This will make the consumer goods sector more profitable than the capital-goods sector, making both sectors to inter-compete for factors of production. This process will result in rising factor-costs, i.e. wage and interest rate. As capital goods sector dynamics are structurally fragile, higher wages resulting in decreasing profits, and higher interest rate reducing the overall investment level decrease the demand for its products. As consequence of the natural contraction process, people are fired, first on the capital goods sector. As these people stop to consuming, the consumer goods sector also shrink, making the investment level to fall further, as consumer goods firms also demand capital goods. The production of capital goods fall again, etc.⁸⁴ Thus, the business cycle is inherent to a credit economy.

Accordingly to Hayek, the divergence between the natural and real interest rate is a natural output of the process of economic development. It represents a tendency in the

⁷⁹ Hawtrey, R. G. (1927). "The monetary theory of the trade cycle and its statistical test". *The Quarterly Journal of Economics*, vol. 41, no. 3, pp. 471-486 .

⁸⁰ Rima, I. H. (2009). *Development of economic analysis*. London: Routledge.

⁸¹ A monetary disturbance may be both exogenous (the action of the monetary authority) or endogenous (a change in credit growth).

⁸² Hayek calls the real interest rate 'money rate.'

⁸³ Hayek, F. A. (1933). *Monetary theory and the trade cycle*. New York: Sentry Press.

⁸⁴ Ibid.

economic system. It is endogenous to the system.⁸⁵ Although the disturbance may not be monetary, money is what gets in the way of an immediate adjustment to a new equilibrium. In this sense, monetary creation is the most sensitive issue. Although changes in the money supply may result from flows of capital and issuance of central banks, the most important issue is the often disputed creation of deposits by other banks.⁸⁶ That's why Hayek defended the idea that bank activity should be regulated.⁸⁷

Another Austrian scholar in both senses, nationally and theoretically, Gottfried von Haberler stressed the role of money but also of institutional arrangements influencing the determination of wages and prices. Emphasising the similarities and differences among episodes of business cycles and downplaying their deterministic approaches, he believed the German word *Konjunkturschwankungen* (conjunctural fluctuations) to be more adequate to describe the phenomenon.⁸⁸

Haberler believed that economic cycles were mainly determined by credit, which has a much deeper and fundamental influence on the whole economic system. In a process of increasing money supply through banking credit enough to avoid general prices from declining even with lower relative costs and greater output, the interest rate goes below what the market level, i.e. the relationship between savings and demand for credit would determine. As a result, there will be long-term investment projects in excess to real savings in the market, what will manifest itself as an economic downturn and depression. During this period, people become reluctant to spend money due to pessimism and negative expectations about the future, wishing to hold their wealth in a liquid form. However, as prices decrease, their purchasing power, i.e. 'real' assets increase until a point where people start spending again. This will increase the demand for both consumer and capital goods, resulting in higher employment rates, and ending the recession/crisis.⁸⁹

Even if people were reluctant to spend in the depression because of pessimism and a desire to hold their wealth in a more liquid form, as prices and wages decreased, the real value and purchasing power of their money assets would be increasing, since each unit of money at lower prices could now buy more. A point would be reached at which people would find it advantageous to start spending again, at which time prices and wages would no longer have to fall, and all those desiring employment would find employers willing to hire them to satisfy this renewed demand for goods and services.

1.1.4 Long Wave Theories

⁸⁵ Bernard, H., & Bisignano, J. (2001). Bubbles and crashes: Hayek and Haberler revisited. In G. G. Kaufman (Ed.), *Asset price bubbles: implications for monetary and regulatory policies*. Oxford: Elsevier Science.

⁸⁶ Ibid.

⁸⁷ White, L. H. (1999). "Why did not Hayek favor laissez faire in banking?". *History of Political Economy*, vol. 31, no. 4, pp. 753-769 .

⁸⁸ Haberler, G. (1991). What happened to the business cycle? In E. H. Solomon (Ed.), *Electronic money flows: the molding of a new financial order* (pp. 81-88). Boston: Kluwer.

⁸⁹ Haberler, G. (1996). Money and the business cycle. In R. M. Ebeling (Ed.), *The Austrian theory of the trade cycle and other essays*. Auburn: Mises Institute.

Great booms and great breakdowns occur in Capitalism, attracting the attention of both economists and businessmen.⁹⁰ At first, crises were mainly looked as individual catastrophes, the interruption an even flow or of an expansion, caused by some external factor and not by the idiosyncrasies of the process of economic reproduction.⁹¹ The *laissez-faire* authors, including those of the overinvestment school as Hayek, believed that business cycles are short as proposed by Clément Juglar.

The Russian economist Nikolai Dmitriyevich Kondratiev in 1925, by occasion of the publication of his book “The Major Economic Cycles,” was the first to present to the international audience the idea that, from an empirical perspective, prices, wages, interest rates, investment, production, and consumption fluctuated in both short and long waves.⁹² Mainstream economists do not accept Kondratiev’s idea, rejecting it with considerable hostility, as it can pose a threat to policymaking based on Neoclassical orthodox monetarist theory and other similar ideologies like the Austrian School. In this sense, it is considered part of heterodox economics.⁹³ Besides the polemic, ten features of the Kondratiev cycle - also commonly know as Kondratiev’s waves - which can be joined in a broader theory, may be identified as follow:⁹⁴

- a) There have been four Kondratiev’s waves starting around 1785;
- b) The Kondratiev’s waves are not simple periodicities, as they differ in duration;
- c) The Kondratiev’s waves differ as to dominant technologies and industries;
- d) The Kondratiev’s waves differ as to dominant forms of energy;
- e) Consecutive Kondratiev’s waves show the advent of newly prominent nations;
- f) The Kondratiev’s waves is characterised by four qualitatively and quantitatively discernible stager: recovery, prosperity, recession, and depression;
- g) The Kondratiev’s waves must be fitted into a wider framework of shorter cycles (as Juglar’s cycles, for example) and longer cycles, and histories (i.e. the hegemonic cycle and the life history of contemporary civilisation);
- h) The four stages of the Kondratiev’s waves can be represented by logistic functions with diminishing returns;
- i) The stages of the Kondratiev’s waves differ macropsychologically, with the phases of recovery and prosperity being more exciting (i.e. open to new ideas and practices), and

⁹⁰ Schumpeter, J. A. (1989). *Business cycles: a theoretical, historical and statistical analysis of the capitalist process*. Philadelphia: Porcupine Press.

⁹¹ Ibid.

⁹² Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

⁹³ Heterodox here is used as a catch-all term for alternative ideas to the current dominant economic ideology in force.

⁹⁴ De Greene, K. B. (2006). Toward new conceptual models of the Kondratiev phenomenon. In T. C. Devezas (Ed.), *Kondratieff Waves, warfare and world security* (pp. 10-21). Amsterdam: IOS Press, p. 11.

more dangerous (i.e. greater tendency to wars, rebellions, etc.); the phases of recession and depression show increasing conservatism in thought and behaviour;

j) The interfaces between consecutive Kondratiev's waves show mounting instability and chaotic behaviour.

Nevertheless, the literature is not very clear about the idea of growing complexity of successive Kondratiev's waves. Globalisation and the establishment of the United States as main hegemon, together with increasing environmental problems, may have resulted in previous indicators of Kondratiev's waves losing their diagnostic value because "among other reasons, data are distorted or masked by the authorities and even by some scholars."⁹⁵ Although this maybe a real problem, another much more important factor is the process of restructurisation capitalism is passing through. Since the ending of the gold standard, a relevant part of the financial sector has been gradually constituting itself as an independent corpse from the productive sphere, but which has the power to determine the crisis since then. As Kondratiev's waves are based mainly on the real economy, this disconnection may have jeopardised its validity.

In any way, Kondratiev himself identified three long waves. The first Kondratiev's wave may be understood as the First Industrial Revolution, including the prolonged of its absorption. It is usually dated from the eighties of the XVIII century to 1842. The second goes through what is called the age of steam and steel, running between 1842 and 1897.⁹⁶ The third is connected with the Second Industrial Revolution, being known as the Kondratiev of electricity, chemistry, and motors, being dated from 1898 until the beginning of the II World War. After Kondratiev's death, some authors have identified at least one more, usually two waves. One going from 1940 until the ending of the 1980s, and another from 1990 which is still happening. Table 1.1 presents the dates and technological developments which hypothetically have been driving these long cycles.

Table 1.1
Kondratiev's Long Waves

	Length	Innovations
First Wave	1780-1815: Expansion	Water power; Textiles; Iron
	1815-1842: Contraction	
Second Wave	1842-1875: Expansion	Steam; Rail; Steel
	1875-1896: Contraction	
Third Wave	1896-1920: Expansion	Electricity; Chemicals; Internal-combustion engine
	1920-1940: Contraction	
Fourth Wave	1940-1970: Expansion	Petrochemicals; Electronics; Aviation
	1970-1990: Contraction	

⁹⁵ De Greene, K. B. (2006). Toward new conceptual models of the Kondratiev phenomenon. In T. C. Devezas (Ed.), *Kondratieff Waves, warfare and world security* (pp. 10-21). Amsterdam: IOS Press, p. 11.

⁹⁶ Schumpeter, J. A. (1989). *Business cycles: a theoretical, historical and statistical analysis of the capitalist process*. Philadelphia: Porcupine Press.

	Length	Innovations
Fifth Wave	1990-2010: Expansion 2010-20???: Contraction	Digital Networks; Software; New Media; Financialisation

Source: Author's own schematisation based on Schumpeter, 1989 and Knoop, 2004.⁹⁷

The explanation that these long waves are driven by technological innovation was given by Joseph Schumpeter in his 1928's book "The instability of capitalism."⁹⁸ The base of his argument is the idea of innovations destroying any stable economic system. Accordingly to him, there is one element in the capitalist process incarnated in the kind and function of the entrepreneur, which by its mere working and from within, will destroy any equilibrium that is already established or in process of establishing itself, even in the absence of outside disturbances. Thus, the action of the process of innovation is not reducible to description by means of infinitesimal steps, as it produces the cyclical waves; by its time, these waves are fundamentally the form progress assumes in competitive capitalism. As an answer to periods of depression, a new equilibrium that absorbs the result of innovation carried out in the preceding periods of prosperity will emerge.⁹⁹ The result is necessarily a new equilibrium, where "the old ones adapt themselves or drop out; incomes are rearranged; prosperity inflation is corrected by automatic self-deflation through the repayment of credits out of profits, through the new consumers' goods entering the markets and through saving stepping into the place of " created " credits. So the instabilities (...) do not go on accumulating."¹⁰⁰ This forms the base of Schumpeter's concept of creative destruction.

However, as Schumpeter argued later, technological innovation resulting in creative destruction is not constant, as it results from ideas developed sporadically among different industries. As consequence, business cycles must be understood as pulsations of the rate of economic evolution. In general, economic changes are attributed to three group of forces:¹⁰¹ external factors as the demand of governments for new military weapons; the factor of growth, meaning "the continuous gradual changes in population and in the volume of savings and accumulation, changes that do not require drastic shifts in the combination of productive factors and thus may be attained by the ordinary, run of the mill economic agent addicted to an habitual and adaptive type of activity,"¹⁰² and those innovations resulting into effective changes in the combination of productive factors.

⁹⁷ Schumpeter, J. A. (1989). *Business cycles: a theoretical, historical and statistical analysis of the capitalist process*. Philadelphia: Porcupine Press; Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

⁹⁸ Schumpeter, J. A. (1928). "The instability of capitalism". *The Economic Journal*, vol. 38, no. 151, pp. 361-386 .

⁹⁹ Ibid.

¹⁰⁰ Ibid., p. 383.

¹⁰¹ Kuznets, S. (1940). "Schumpeter's business cycles". *The American Economic Review*, vol. 30, no. 2, pp. 257-271 .

¹⁰² Ibid., p. 259.

Thus, business cycles are periodic fluctuations in the intensity at which innovations are introduced into the economy, but which are discontinued due to the fact that innovative ability is unequally distributed. The capacity to initiate and to overcome obstacles to innovations is limited to only few individuals, while a majority will only follow. In a state of equilibrium, some individuals will pioneer the innovative process; if they succeed, others will follow, until the innovation turns to be a common thing, what will turn into a new equilibrium.¹⁰³ However, simultaneously to this process, there is an expansion of banking credit making prices and interest rates to rise, resulting in the first phase of the business cycle to be a boom.¹⁰⁴

As innovations are usually concentrated in one or few industries, and the increase in risk of uncertainty is more effective if all opportunities to innovate are finished, the boom ends as soon as the perturbation of the previous equilibrium had gone far enough to make future expectations about the relations of prices, costs, and quantities to be fuzzy.¹⁰⁵ Also, as resources are diverted from known to unknown productive processes, which may not be efficient or reliable, productivity is overall reduced. While the rate of innovation diminishes, a period of readjustment in which entrepreneurs hold stock follows, receding the level of economic activity to a new equilibrium level. As a result, credit volume, interest rates, and prices decrease, although total output usually is larger than in the time of the first equilibrium.¹⁰⁶

Thus, the primary model accounts for a two-phase cycle: an upward boom from the equilibrium level that is followed by a recession resulting into a new equilibrium level. But as entrepreneurial activity is erratic, the fundamental process of innovation may intensify the boom and the depression, establishing a secondary model. Even in this case, the economy returns to equilibrium whatever the intensity of depression is, although the new equilibrium is not necessarily identical with that which would have been achieved without the depression. The combination of the primary and secondary models produces a four-phase cycle of prosperity, recession, depression, and revival. The upper turning point is determined mainly by the primary model, while the revival point is essentially determined by the secondary model's dynamics.¹⁰⁷

1.1.5 Keynes and Business Cycles

Keynes was the first economist to develop a truly aggregate model of economics, making a distinction between microeconomics and macroeconomics. His model was also

¹⁰³ Schumpeter, J. A. (1989). *Business cycles: a theoretical, historical and statistical analysis of the capitalist process*. Philadelphia: Porcupine Press.

¹⁰⁴ Kuznets, S. (1940). "Schumpeter's business cycles". *The American Economic Review*, vol. 30, no. 2, pp. 257-271 .

¹⁰⁵ Schumpeter, J. A. (1989). *Business cycles: a theoretical, historical and statistical analysis of the capitalist process*. Philadelphia: Porcupine Press.

¹⁰⁶ Ibid.

¹⁰⁷ Kuznets, S. (1940). "Schumpeter's business cycles". *The American Economic Review*, vol. 30, no. 2, pp. 257-271 .

one of the first quasi-general equilibrium macroeconomic models, as it looked for the interactions between the goods, money, labour, and financial market at the same time.¹⁰⁸ Although Chapter 22 of his *General Theory of Employment, Interest, and Money* is dedicated to the analysis of the business cycles, the entire General Theory is about business cycles, as Keynes believed capitalism is naturally unstable. Thus, business cycles are natural phenomena in this economic system. In order to discuss his vision about the business cycle, it is necessary to analyse his concepts of employment/unemployment, effective demand, as the role of expectations as determinant of the economic activity level.

He did not have a high regard for the Classical (or *laissez-faire*) theory of business cycle, as he thought it was incomplete. In his general theory, he wrote about the (Neo)Classical tradition that “it is astonishing what foolish things one can temporarily believe if one thinks too long alone, particularly in economics (along with the other moral sciences), where it is often impossible to bring one’s ideas to a conclusive test either formal or experimental.”¹⁰⁹ Keynes critic was mainly directed to the (Neo)Classics’ assumption that only voluntary unemployment exists, as discussed before; in resume, that only those works who do not accept the current real wage will be unemployed

His belief was that employment is very volatile. Thus, the (Neo)Classical economists’ explanation that unemployment results from changes in people’s incentives to work or by changes in the marginal product of labour could not be applied to the real world as these factors do not fluctuate in a month-to-month perspective as employment does.¹¹⁰ More, the (Neo)Classical approach do not consider involuntary unemployment as plausible, as it goes against perfect competition model’s fundamentals. This exposed this approach to ridicule, when they had to argue the 25% unemployment rate observed during the Great Slump was the result of too many workers being unwilling to work for the current wage, preferring to stand in breadlines for hours.¹¹¹ In this case, the usual solution to cut wages - direct or indirect) to increase employment would not work.

First, since there is imperfect mobility of labour, imperfect competition - and not perfect competition - is a better model to explain how markets work. Second, “wages do not tend to an exact equality of net advantage in different occupations, any individual or group of individuals, who consent to a reduction of money-wages relatively to others, will suffer a relative reduction in real wages, which is a sufficient justification for them to resist it.”¹¹² In other words, workers do not take real-wage in consideration, but rather compare their own money-wages relative to what similar workers are receiving. Third, even in the

¹⁰⁸ Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

¹⁰⁹ Keynes, J. M. (1997). *The General Theory of Employment, Interest, and Money*. Amherst: Prometheus Books, preface.

¹¹⁰ Marginal product of labour is the extra output from one more unit of labour input. As it is not easy to measure in some cases, what is measured is the extra product resulting, on average, from an extra labour input.

¹¹¹ Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

¹¹² Keynes, J. M. (1997). *The General Theory of Employment, Interest, and Money*. Amherst: Prometheus Books, p. 13.

case workers are organised and not prepared to work for lower money-wage, although a reduction in the current level of money-wages could result in strikes or in withdraw from the labour market of currently employed labour, if there is inflation resulting in lower real-wages the same is not to happen. Accordingly to Keynes, “it would be impracticable to resist every reduction of real wages, due to a change in the purchasing-power of money which affects all workers alike; and in fact reductions of real wages arising in this way are not, as a rule, resisted unless they proceed to an extreme degree.”¹¹³ Thus, voluntary and frictional unemployment are rather exception than norm.

Nevertheless, there is a third category of unemployment introduced by Keynes, named “involuntary” in the strict sense, what is not admitted by the (Neo)classical theory. Keynes concluded that “men are involuntarily unemployed if, in the event of a small rise in the price of wage-goods relatively to the money-wage, both the aggregate supply of labour willing to work for the current money-wage and the aggregate demand for it at that wage would be greater than the existing volume of employment.”¹¹⁴ In other words, there are situations where the workers are ready to work for lower money-wages, there would be a demand for such labour by such price, but the actual volume of employment is smaller. Thus, the economy may be at equilibrium without full-employment, meaning there are several levels of equilibrium, with only one resulting in full-employment.

What Keynes did was to deny Say’s Law, inverting the causality of aggregate demand’s determinants. Say viewed the economy as an exchange society, where goods are exchanged by other goods. Thus, every act of production automatically creates a market for the product produced, making available the monetary means for purchasing it. As a result, any excess supply of goods is a logical impossibility, and aggregate demand and aggregate supply are necessarily equal. However, if this were true, competition between business would always result in an expansion of employment until the point where a further increase in the value of the aggregate demand will no longer be followed by any increase in output, in other words, it is a situation of full employment.

Keynes denied this idea following two assumptions. First, that the present level of investment is determined following expectations about future demand. These expectations are dependent of the economic agents’ psychological state, together with what Keynes called inducement to invest.¹¹⁵ Second, following Malthus idea that a society will often suffer from an inadequate level of effective demand,¹¹⁶ that when aggregate real income is increased aggregate supply also increases, but less than income. In other words, higher

¹¹³ Keynes, J. M. (1997). *The General Theory of Employment, Interest, and Money*. Amherst: Prometheus Books, p. 13.

¹¹⁴ *Ibid.*, p. 14.

¹¹⁵ Inducement to invest refers to the amount of investment businessmen are willing to do. It depends on the relation between the expectations about return of capital and the complex of rates of interest on loans of several risks and maturities. Should be noted, that the kind of investment Keynes is referring is not financial/casino, but investments in real economy.

¹¹⁶ Although Malthus is must known by his theory of population, as a classic economist, his main interest was capitalism’s structural analysis.

incomes result in higher savings; part of the money invested to produce determined level of services and goods is not being used to demand these services and goods.¹¹⁷ As a result, “to justify any given amount of employment there must be an amount of current investment sufficient to absorb the excess of total output over what the society chooses to consume.”¹¹⁸ This adds uncertainty to Keynes’ approach.

The conclusion is that given the relationship between the propensity to consume and the amount of new investment, only one level of employment is consistent with full employment.¹¹⁹ Thus, if the propensity to consume and the amount of new investment result in an insufficient aggregate demand, the level of employment will fall below the supply of labour potentially available at the current real wage.¹²⁰ In this case, the richer a community is, the broader will tend to be the gap between its real and potential production. Nevertheless, the result is a paradox. A poor community will be able to consume by far most of its output, thus a small amount of investment is sufficient to result in full employment. On contrary, a wealthy society will have to find much more opportunities for investment to bestow full employment, as usually in this case much of what is earned is saved.

Keynes used this analysis to explain economic crisis in *General Theory*’s chapter 22. As he states in the beginning of the chapter, “we shall find that it (the trade cycle) is highly complex and that every element in our analysis will be required for its complete explanation.”¹²¹ Keynes’ explanation of business cycles relies in two elements. First, behaviour rooted in uncertainty and, second, cumulative dynamic processes taking place in historical time. Nevertheless, Keynes was convinced that macroeconomic instability was mainly caused by fluctuations in investment. He explained periodic economic fluctuations following two main ideas: a) investor behaviour is rooted in uncertainty; and b) fluctuations in investment reflects divergence between objective and speculative marginal efficiency of capital.¹²²

Keynes defined investment as the process of wealth accumulation in the form of durable capital, which is associated with fluxes of expected revenues and costs that are projected into the future. The decision to invest is based on expectations about the unknown future revenue and costs. As a result, the level of investment fluctuates because the future is uncertain, making investor’s expectations to change. These expectations are largely based on the economic agents’ impressions of what others believe will happen in the market, usually made with little confidence, mostly relying on conventional wisdom in

¹¹⁷ Keynes called this “propensity to consume.”

¹¹⁸ Keynes, J. M. (1997). *The General Theory of Employment, Interest, and Money*. Amherst: Prometheus Books, p. 25.

¹¹⁹ The propensity to consume is the proportion of a community’s aggregate wealth that is spent on the consumption of goods and services, as opposed to being saved.

¹²⁰ Ibid.

¹²¹ Ibid, p. 285.

¹²² Annual percentage yield earned by the last additional unit of capital. To a firm, the concept represents the market rate of interest at which it begins to pay to lend capital to make an investment.

face of individual ignorance. Nevertheless, economic agents are inherently optimistic. The natural forecast of this optimism as market sentiment, which does not reflex real economic conditions, will lead to them to continue to expect positive returns well beyond the point where would be acceptable. As reality appears, when real profits are compared with prior projections, the insubstantial fundamentals of the expectations means that the re-evaluation is sudden and even catastrophic.¹²³ Thus, expectations' volatility explains the dynamic nature of investment patterns.

The volatility of expectations reflects behaviour based on uncertainty in place of optimising behaviour in an environment characterised by risk. Keynes in *General Theory's* chapter 12 made a clear distinction between risk and uncertainty. The state of long-term expectations, which forms the base for decisions, depends not only on the most probable forecast possible to be made, but also on the confidence with which this forecast is made. In other words, on how much is possible a forecast to be wrong; if large changes are expected, at the same time it is very uncertain as to what concrete form these changes will take, then the confidence will be weak.¹²⁴ It is the lack of confidence resulting from uncertainty that will result into wrong decisions concerning investment. At the same time, it is the divergence between objective and speculative expectations during a boom that will result in crisis.

Following this idea, Keynes proposed the existence of a business cycle following the usual pattern, where a boom is followed by a recession, then a recover followed by another boom. The interaction of four factors explains the wave. First, the negative impact of rising stock of capital on the marginal efficiency of capital. As the stock of capital rises with net increases in investment, the expectations of future profits decline. It is a characteristic of the boom that investments are made with expectations of a much bigger yield than can be achieved in reality. For example, to expect an investment to yield 16%, when in conditions of full employment it would yield 8%. Keynes explain this behaviour as the result of the nature of organised investment markets under the influence of buyers ignorant of what they are buying, together with speculators who are more concerned with speculative than with reasonable estimations of capital assets' future yield. When disillusion comes, the optimistic expectation is replaced by a contrary pessimistic mood, where an investment that, for example, would in fact yield 8% is expected to yield near nothing.¹²⁵

Second, as the marginal efficiency of capital collapses, there is a sharp increase in the demand for liquid money. In other words, a collapse in the marginal efficiency of capital is associated with a rise in the interest rate, leading to a decline in investment. Nevertheless, increasing demand for liquid money, except those associated with increasing

¹²³ Keynes, J. M. (1997). *The General Theory of Employment, Interest, and Money*. Amherst: Prometheus Books.

¹²⁴ Ibid.

¹²⁵ Ibid.

trade and speculation, does not increase until after the marginal efficiency of capital's collapse. As the collapse has begun and economic agents in general start to fight for liquidity, the interest rate increases even more, sharpening the downturn even more. Third, the marginal propensity to consume accompanies the decline in the fall in asset values. As people see their assets being reduced they feel impoverished, what exerts a very depressing influence. Much worst is the case of people who have employed borrowed funds to increase their assets as, for example, in the case of investments in real estate or in the stock market. Fourth, the durability of capital and the carrying cost of surplus inventories will determine the persistence of stagnation. The depression is to remain until the economic agents' expectations change, resulting in more investment.¹²⁶

In resume, the boom which will result in a slump is the result of the combination of a rate of interest, which in the correct state of expectation is too high for full employment, with a distorted state of expectations preventing this rate of interest from being discouraging. Thus, a boom is a condition when over-optimism wins a rate of interest that would be seem as excessive in normal conditions. As a result, the remedy to avoid booms turning into recessions is a low interest rate. From here, Keynes reached two main conclusions.

First, that the remedy for the business cycle “is not to be found in abolishing booms and thus keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom.”¹²⁷ Second, that in “conditions of laissez-faire the avoidance of wide fluctuations in employment may, therefore, prove impossible without a far-reaching change in the psychology of investment markets such as there is no reason to expect.”¹²⁸ Still, the conclusion is “that the duty of ordering the current volume of investment cannot safely be left in private hands.”¹²⁹ In other words, the State must guarantee a low interest rate, or a level of investment sufficient to the economy to reach full employment, or both.

1.1.6 Chicago's Neoclassical Economics and Business Cycles

Chicago's neoclassical economics is today's mainstream. Also, it has also influenced much of Social Sciences in general, making Political Sciences, Anthropology, Sociology, among others, to apply neoclassical economic presuppositions, mainly rational choice behaviour based on utilitarianism, consumers theory, and perfect competition, as base to explain voters and candidates behaviour, social movements, psychology, international relations, in other words, it turned to be a universal methodological panacea of modern times. However, before the 1970s it was not. Rather, to disagree with Keynesianism until the ending of the 1960s was considered a heresy, in the same intensity

¹²⁶ Keynes, J. M. (1997). *The General Theory of Employment, Interest, and Money*. Amherst: Prometheus Books.

¹²⁷ Ibid., chapter 22.

¹²⁸ Ibid., idem.

¹²⁹ Ibid., idem.

then it is now to disagree with Neoliberal Chicago's economic neoclassical monetarism. Monetarism's main features are practically the same than traditional neoclassical economic theory. Thus, its fundamentals relies in three basic principles, each one presenting a slight modification from the original.

First, *prices and wages are perfectly flexible, although perfect information does not exist*. Monetarists believe that perfect competition best describes market behaviour. Nevertheless, perfect information about the money supply and the price level is impossible as a result of central banks' interference in the market mechanism. Firms and households have adaptive expectations, meaning that they are looking to the past instead to the future, and only change their expectations gradually based on past perceptions.¹³⁰ Second, *changes in the aggregate demand do not affect real output in the long run, but they do affect real output in the short run*. This means that money is neutral only in the long run, and not in the short run. The reason again is that there is not perfect information and there are prices misperceptions.

When the monetary supply abruptly changes, firms and consumers may be fooled into changing their real behaviour. However, they will eventually recognise their mistakes and gradually adjust their expectations, making prices and wages to adjust and return the market to its long-run equilibrium. As a result, changes in the aggregate demand can result into temporary economic fluctuations.¹³¹ Third, *fluctuations in the money supply drive fluctuations in aggregate demand and are responsible for business cycles*. Agreeing with the classical quantity theory of money demand and aggregate demand, monetarists believe that money is necessary to conduct transactions. Thus, there is a direct relationship between the amount of money in circulation and the level of nominal aggregate spending.¹³²

The conclusion is that business cycles are caused by unanticipated changes in the money supply that lead to fluctuations in aggregate demand. However, expectations' stickiness - and not price stickiness as in Keynes' model - is responsible for changes in the aggregate demand, hence influencing output and unemployment. Depressions are caused by money growth being lower than anticipated, while booms are caused by higher than anticipated money growth. Thus, business cycles are the result of unstable monetary policies.¹³³

Lucas' rational expectations model is based on Friedman's notion of long-run equilibrium in a market where firms and workers are in a large number, and prices and

¹³⁰ Friedman, M., & Schwartz, A. J. (1963). "Money and Business Cycles". *The Review of Economics and Statistics*, vol. 45, no. 1, pp. 32-64 .

¹³¹ Ibid.

¹³² Ibid.

¹³³ Ibid.

wages are perfectly flexible.¹³⁴ The unique imperfection is about information, as firms and workers are assumed to not observe changes in aggregate demand and price level. Rather, they only observe the price of the good they produce.¹³⁵ Nevertheless, the difference between Friedman's and Lucas' model is that the public has rational expectations and not adaptive expectations.¹³⁶ This implies that the agents take in consideration both the past and the future, and that individuals fully understand how changes in economic policy are likely to affect their income. As a result, business cycles are temporary deviations from equilibrium, resulting from unanticipated changes in aggregate demand.

Although the Rational Expectations approach permits the construction of models with high degree of rigour, it has also a high degree of scientificism. Critics have referred to Rational Expectations as a model "in which theory proceeds with impeccable logic from unrealistic assumptions that contradict the historical record."¹³⁷ Lucas himself has acknowledged that some implications of the Rational Expectation approach are not validated by what is observed in the real world. This reflects much what is considered science nowadays.

In spite of the claims to pursue "truth," scientific enterprise is often influenced by personal ambition, rigid defence of theories, and the weight of tradition, in detriment of creative participation directed to the common objectives of science.¹³⁸ A system of beliefs is established, instead of a system of knowledge based on dialogue, resulting in the dogmatisation of beliefs, like Hans Albert's idea of dogmatisation as the expression of the tendency to give priority to the need of intellectual certainty over the need to achieve optimal solutions of actual important problems.¹³⁹ As a result, economics turns to be ideology, helping to reinforce political relations of power following the business cycle.

1.2 Business Cycles and Politics: the Political Business Cycles Theory

The notion of political business cycles can be traced back to Kalecki, when he discussed the link between economic performance and politics in a lecture delivered in Cambridge in 1942 and published in the *Political Quarterly* in 1943.¹⁴⁰ Nevertheless, the first formal attempt to establish a theory of political business cycles was made by Nordhaus in 1975.¹⁴¹ Although early discussions assumed adaptive expectations, either

¹³⁴ The term 'rational expectations' means that expectations are the result of an optimal forecast of the future based on all available information. Although agents may still make errors, they do not make predictable or systemic errors.

¹³⁵ Lucas, R. E. (1972). "Expectations and the Neutrality of Money". *Journal of Economic Theory*, vol. 4, no. 2, pp. 103-124 .

¹³⁶ Knoop, T. A. (2004). *Recessions and depressions: understanding business cycles*. London: Praeger.

¹³⁷ Gordon, R. A. (1976). "Rigor and Relevance in a Changing Institutional Setting". *The American Economic Review*, vol. 66, no. 1, pp. 1-14 , p. 5.

¹³⁸ Bohm, D. (2003). *On dialogue*. London: Routledge.

¹³⁹ Geach, P. T., & Hołówka, J. (1991). *Logic and ethics*. Berlin: Springer.

¹⁴⁰ Kalecki, M. (1943). "Political Aspects of Full Employment". *Political Quarterly*, vol. 14, no. 4, pp. 322-331 .

¹⁴¹ Nordhaus, W. D. (1975). "The Political Business Cycle". *The Review of Economic Studies*, vol. 42, no. 2, pp. 169-190 .

implicitly or explicitly, it became dominated by the new-classical movement,¹⁴² more specifically by rational expectations.¹⁴³

This created a methodological problem. First, because in the very beginning the political business cycle literature was most influenced by the idea that governments would use their power to manipulate the economy for electoral objectives, resulting in political business cycles. As a strict understanding of rational expectations supposes that governments are unable to manipulate real variables to create booms in elections years, the result is a strong theoretical incompatibility between both approaches. Second, because there are significant doubts as to if the strict version of rational expectations is supported by empirical tests, in other words, by reality.¹⁴⁴ Nevertheless, the inclusion in more recent debates of uncertainty about government competence, preference over economic outcomes, and the emphasis in expectation errors resulting from party-dependent policy reaction functions and uncertainty about election outcomes have been trying to put both theories together again.¹⁴⁵

The term “political business cycle” has no single definition. Primarily, the term is understood as a relationship between elections and cyclical fluctuations in output, although the term can encompass other aspects. These include pre- and post-electoral fluctuations in

¹⁴² McCallum, B. T. (1978). “The Political Business Cycle: an Empirical Test”. *Southern Economic Journal*, vol. 44, no. 3, pp. 504-515 ; Nordhaus, W. D., Alesina, A., & Schultze, C. L. (1989). “Alternative Approaches to the Political Business Cycle”. *Brooking Papers on Economic Activity*, vol. 1989, no. 2, pp. 1-68 ; MacRae, C. D. (1977). “A Political Model of the Business Cycle”. *The Journal of Political Economy*, vol. 85, no. 2, pp. 239-263 ; Ginsburgh, V., & Michel, P. (1983). “Random Timing of Elections and the Political Business Cycle”. *Public Choice*, vol. 40, no. 2, pp. 155-164 . The new-classical approach has four fundaments: (1) a strong emphasis on underpinning macroeconomic theorizing with neo-classical choice-theoretic microfoundations in a Walrasian general equilibrium framework; (2) the adoption of the key neoclassical assumption that all economic agents are rational; that is, agents are continuous optimizers subject to the constraints that they face, firms maximize profits and labour and households maximize utility; (3) agents do not suffer from money illusion and therefore only real magnitudes (relative prices) matter for optimizing decisions; and (4) complete and continuous wage and price flexibility ensure that markets continuously clear as agents exhaust all mutually beneficial gains from trade leaving no unexploited profitable opportunities. See Snowden, B., & Vane, H. R. (2005). *Modern Macroeconomics: Its Origins, Development, and Current State*. Cheltenham: Edward Elgar, p. 223, chapter 5, ‘The New-Classical School.’

¹⁴³ See Price, S. (1997). “Political Business Cycles and Macroeconomic Credibility: a Survey”. *Public Choice*, vol. 92, no. 3-4, pp. 407-427 , p. 408; McCallum, B. T. (1978). “The Political Business Cycle: an Empirical Test”. *Southern Economic Journal*, vol. 44, no. 3, pp. 504-515 ; Lucas, R. E. (1972). “Expectations and the Neutrality of Money”. *Journal of Economic Theory*, vol. 4, no. 2, pp. 103-124 ; Lucas, R. E. (1975). “An Equilibrium Model of the Business Cycle”. *The Journal of Political Economy*, vol. 83, no. 6, pp. 1113-1144 ; Sargent, T. J. (1976). “A Classical Macroeconometric Model for the United States”. *The Journal of Political Economy*, vol. 84, no. 2, pp. 207-238 .

¹⁴⁴ Mishkin, F. S. (1983). *A Rational Expectations Approach to Macroeconometrics: Testing Policy Ineffectiveness and Efficient-Markets Models*. Chicago: The University of Chicago Press; Blinder, A. S. (1987). “Keynes, Lucas, and Scientific Progress”. *The American Economic Review*, vol. 77, no. 2, pp. 130-136 ; Akerlof, G. A., & Yellen, J. L. (1987). “Rational Models of Irrational Behaviour”. *The American Economic Review*, vol. 77, no. 2, pp. 137-142 ; Phelps, E. S., & Taylor, J. B. (1977). “Stabilizing Powers of Monetary Policy under Rational Expectations”. *The Journal of Political Economy*, vol. 85, no. 1, pp. 163-190 ; Fischer, S. (1977). “Long-Term Contracts, Rational Expectations, and the Optimal Money Supply Rule”. *The Journal of Political Economy*, vol. 85, no. 1, pp. 191-205 .

¹⁴⁵ Price, S. (1997). “Political Business Cycles and Macroeconomic Credibility: a Survey”. *Public Choice*, vol. 92, no. 3-4, pp. 407-427 ; Chappell, H. W., & Keech, W. R. (1986). “Party Differences in Macroeconomic Policies and Outcomes”. *The American Economic Review*, vol. 76, no. 2, pp. 71-74 ; Van der Ploeg, F. (1987). “Optimal Government Policy in a Small Open Economy with Rational Expectations and Uncertain Election Outcomes”. *International Economic Review*, vol. 28, no. 2, pp. 469-491 .

inflation and policy instruments, and partisan effects which are not necessarily connected with elections at all.¹⁴⁶ Basically, the theory assumes that (1) incumbent politicians want to be re-elected; (2) their electoral success depend heavily upon how well the economy is doing by the time of the election; and (3) they can use some policy instruments that at least to a certain extent determine macroeconomic performance.¹⁴⁷ On the other hand, ideological and electoral incentives have a considerable influence on politicians' choice of macroeconomic policies. Voters care about the economy, but politicians care about power. Thus, five sets of questions are central to Political Business Cycles' models:¹⁴⁸

- a) Voters: What determines voter behaviour? Have economic events large influence in voting behaviour? Are voters rational and well informed or irrational and poorly informed? Are voters past-looking or future-looking?
- b) Parties: What motivate political leaders or parties? Are they vote-maximising and opportunistic, or do they ideologically pursue a set of economic and social objectives as they serve a given constituency?
- c) Economic structure: What is the economy's structure? Can parties affect economic outcomes, or is policy ineffective? What are the important instruments of policy (i.e., fiscal policy, monetary policy), and who controls them (the central bank, the Parliament, the Cabinet of Ministries)?
- d) Shocks: What are the shocks to politics and the economy? Are shocks external (i.e. revolutions, natural disasters, wars) or internal to the political process (i.e. when one government leaves its successor high inflation or large deficits)?
- e) Competence: Do parties seek their objectives efficiently, or do they neither satisfy voters nor achieve their ideological objectives?

At the same time, there are at least five versions of the political business cycle:¹⁴⁹ First, the "Opportunistic Cycle," one of the first approaches. It combines opportunistic parties and non-rational voters. Accordingly to this approach, voters evaluate politicians in power by examining performance retrospectively, as they do not try to predict the future. Politicians choose economic policies to maximise their vote at the next election. These models use the Phillips Curve as main analytical tool,¹⁵⁰ where low unemployment results into higher inflation now and in the future. The main conclusions are, first, that parties will engage in anti-inflation policies early, but will stimulate the economy when elections are

¹⁴⁶ Price, S. (1997). "Political Business Cycles and Macroeconomic Credibility: a Survey". *Public Choice*, vol. 92, no. 3-4, pp. 407-427 .

¹⁴⁷ Schultz, K. A. (1995). "The Politics of the Political Business Cycle". *British Journal of Political Science*, vol. 25, no. 1, pp. 79-99 .

¹⁴⁸ Nordhaus, W. D., Alesina, A., & Schultze, C. L. (1989). "Alternative Approaches to the Political Business Cycle". *Brooking Papers on Economic Activity*, vol. 1989, no. 2, pp. 1-68 , p. 2.

¹⁴⁹ Ibid, pp. 3-6.

¹⁵⁰ The Phillips curve represents the relationship between the rate of inflation and the unemployment rate.

coming; and second, as voters evaluate retrospectively, the political system has a short time horizon, moving to a high-inflation equilibrium.

Second, the “Ideological Cycle.” It presupposes ideological parties and non-rational voters, also dealing with the Phillips Curve. In this approach, parties are ideologically identifiable, i.e., left wing and right wing. Left-wing parties choose high inflation and low unemployment, while right-wing parties choose low inflation and high unemployment. Voters will choose the parties that best represent their preferences, and parties in power will be replaced when they do not manipulate the economy to be reelected. It is expected that policies change as parties replace one another.

Third, the “Ultrarational Voters” model. This is one of the most influential critic of the theory of political business cycle. The main presupposition is that voters have the same information as parties, are looking to the future, and do not suffer from memory lapses. In this case, parties can not fool voters by undertaking partisan manipulation of the economy. In the case the government were to stimulate the economy before an election, the ultrarational voters would perceive the manipulative policies as populism. As parties are rational and opportunistic, they know that they could not fool the voters. Thus, they would not attempt to induce a political business cycle.

Fourth, the ‘External Shocks’ model. In the previous models, economic shocks result from the political system (Opportunistic Cycle) or do not have explicit sources (Ideological Cycle and Ultrarational Voters’ model). This approach deals with the idea that shocks from external events, like war or natural catastrophes, are responsible for political business cycles. In the case of opportunistic parties, the responses depend upon the rationality of voters. Ultrarational voters will recognise that the government is not responsible, and the its popularity will remain intact. Still, poorly informed voters may misunderstand the source of the shock, blaming the government and voting for the opposition. In the case of ideological parties, rational voters will respond to the external shock by choosing the party they see the best equipped to deal with the shock. For example, an inflationary shock may induce voters to favour conservative parties, changing the regime and the policies in force.

Fifth, the ‘Differences of Competence’ model. The first four models assume that all parties are perfectly competent and act in intransigent ideological ways or in venal and opportunistic ways. This model contradict this idea, dealing with the notion that elections are about competence and not about the ideology of parties. In this model, a party is competent to the extent that it manages the economy efficiently. The presupposition is that parties have the best available information about the structure of the economy, and use it effectively. As a result, the model implies Pareto-efficient outcomes. The table 1.2 shows a resume of the assumptions and predictions for the political business cycle models discussed before.

Table 1.2
Assumptions and Predictions for Different Political Business Cycle Models

Assumptions	Model 1 Opportunistic Cycle	Model 2 Ideological Cycle	Model 3 Ultrarational Voters	Model 4 External Shocks	Model 5 Differences of Competence
Voters	Non-rational; backward looking; weight recent events more heavily	Non-rational; backward looking; weight recent events more heavily	Ultrarational (make optimal forecast on the basis of full information)	Ultrarational or non-rational	Ultrarational or non-rational
Parties	Opportunistic (choose policies to maximise vote)	Ideological (privilege economic outcome then prospects of election)	Rational and either opportunistic or ideological	Rational and either opportunistic or ideological	Parties differ in competence
Economic Structure	Parties control policy instruments; policy is effective	Parties control policy instruments; policy is effective	Parties control policy instruments; policy is effective	Parties control policy instruments; policy is effective	Parties control policy instruments; policy is effective
Source of Shocks	Internal political decisions	Unclear	Internal or external	External	Internal or external
Competence of Parties	Parties are competent	Parties are competent	Parties are competent	Parties are competent	Parties vary in competence
Predictions of Model	A business cycle within the electoral cycle (austerity after elections and boom before elections)	Changes in economic policy are connected with changes in regime (booms with left-wing, contraction with right-wing)	There are no politically induced cycles. Popularity is a random variable. With opportunistic parties, popularity and elections are invariant to the state of the economy	With ultrarational voters and opportunistic parties, popularity and elections unaffected by true external shocks	Ultrarational voters evaluate parties on basis of competence; more competent parties survive longer. Voters may weight recent events more heavily if there is on-the- job learning

Source: Nordhaus, W. D., Alesina, A. et al. (1989). "Alternative Approaches to the Political Business Cycle." *Brooking Papers on Economic Activity*, vol. 1989, no. 2, pp. 1-68, p. 8.

At this point, a question must be answered: are parties opportunistic vote maximisers or are they ideological and issue-oriented? A way to answer to this question is to refer to Anthony Downs divide the literature of party behaviour in three groups, following the stipulated objectives of political parties: (a) vote-seeking, (b) office-seeking, and (c) policy-seeking.

The vote-seeking model is based on Anthony Downs' seminal *An Economic Theory of Political Action in a Democracy*, where he applied microeconomic principles, basically consumers' theory, to demonstrate a behavioural pattern of democratic governments. Thus, Downs main presupposition is that political agents behave in the same way rational economic agents do, making an analogy between market economics and politics. In this way, Downs supports the idea that in the same way firms maximise profits and consumers maximise utility, politicians aim to maximise profits (being elected) and electors to maximise utility (choosing the best basket of policies). As a result, electoral behaviour

follows five criteria: a) agents are able to choose among many alternatives; b) they classify the alternatives in order of preference; c) the rank of alternatives is transitive; d) the first preference is always the one chosen; e) the decision will be always the same if the preferences are also the same. Downs' model is based on two definitions:

1. Government is the agency that has the power to coerce all other agents in the society, being the locus of "ultimate" power in a given area.
2. A *democracy* is a political system that exhibits the following characteristics:
 - a) Two or more parties compete in periodic elections for control of the governing apparatus.
 - b) The party (or coalition of parties) winning a majority of votes gains control of the governing apparatus until the next election.
 - c) Losing parties never attempt to prevent the winners from taking office, nor do winners use the powers of office to vitiate the ability of losers to compete in the next election.
 - d) All sane, law-abiding adults who are governed are citizens and every citizen has one only vote in each elections¹⁵¹

Downs also added five axioms:

1. Each political party is a team of men who seek office solely in order to enjoy the income, prestige, and power that go with running the governing apparatus.
2. The winning party (or coalition) has complete control over the government's actions until the next election. There are no votes of confidence between elections either by a legislature or by the electorate, so the governing party cannot be ousted before the next election. Nor are any of its orders resisted or sabotaged by an intransigent bureaucracy.
3. Government's economic powers are unlimited. It can nationalize everything, hand everything over private interests, or strike any balance between these extremes.
4. The only limit on government's powers is that the incumbent party cannot in any way restrict the political freedom of opposition parties or of individual citizens, unless they seek to overthrow it by force.
5. Every agent in the model - whether an individual, a party or a private coalition - behaves rationally at all times; that is, it proceeds toward its goals with a minimal use of scarce resources and undertakes only those actions for which marginal return exceeds marginal cost.¹⁵²

From these axioms, Downs established his central hypothesis that political parties "in a democracy formulate policy strictly as a means of gaining votes. They do not seek to gain office in order to carry out certain preconceived policies or to serve any particular interest groups; rather they formulate policies and serve interest groups to gain office. Thus their social function (...) is to attain the income, power, and prestige of being in office,"¹⁵³ implying that these parties are not simply vote seekers but vote maximisers. This implies that parties' platforms will tend to converge to a common set of policies, which represents the preferences of the median voter.

In this case, parties use ideology is to minimise uncertainty. Downs presented four assumptions about the role of ideology:¹⁵⁴

¹⁵¹ Downs, A. (1957). "An Economic Theory of Political Action in a Democracy". *The Journal of Political Economy*, vol. 65, no. 2, pp. 135-150, pp. 136-137.

¹⁵² Ibid, p. 137.

¹⁵³ Ibid., p. 137.

¹⁵⁴ Downs, A. (1957). *An Economic Theory of Democracy*. Boston: Addison Wesley, pp. 97.

1. Because of uncertainty, widely varying ideologies may be employed by political parties even if all are motivated solely by the desire to maximize votes.
2. Some rational voters decide how to vote ideologically instead of by comparing policies.
3. The competitive struggle for office compels parties in our model to be both honest and consistent in formulating policies and ideologies and developing them over time.
4. Rational and institutional immobilities sometimes cause ideologies and policies to lag behind the real conditions relevant to party behavior.

From this, it is possible to conclude that, first, uncertainty limits the electors' possibility to relate government policies to his/her own views. Second, ideology is to be defined as each party's view of the good society, in other words, the views about what policies are needed to achieve this good society. Taking in consideration that there is a price to pay for getting acquainted with a party's every policy, for example spending time to know and understand them. As a result, ideology cut information costs. Thus ideology is a vehicle for providing information being neutral. A key point is that parties also consider ideology to cut decisions about the set of policies that will maximise votes. It follows that a diversity of parties ideologies can only exist because uncertainty impedes any one to be proved as superior. If one ideology can be proven to be more effective in gaining votes, other parties imitate it and subtler differentiation takes place, at the same time that when policies change significantly, ideologies also change.¹⁵⁵

Thus, Downs' model presupposes that parties seek to maximise their control over political office, as their main objective is to get private goods in the form of available governmental and subgovernmental appointments. Office-seeking behaviour consists in the pursuit of such goods, above their electoral or policy value. Although political-office may contribute to electoral success or policy effectiveness, behaviour resulting from such expectations is not to be considered office seeking. If vote-seeking parties are familiar with electoral competition, office-seeking parties look to be part of government coalitions in parliamentary democracies, as they aim to maximise their control of elected office through government portfolios.¹⁵⁶ Finally, Downs presupposed the relationship between ideology and policy, including macroeconomic policy, to be static, meaning that right-wing parties will support right-wing policies and left-wing parties will support left-wing policies.

On one hand, if turnout is variable and voting seeking serves office ambitions, in a single district is better to maximise pluralities than votes. On the other hand, in multi-district contests the rational party leader maximises his/her probability of winning a majority of the seats. These implications are extensively explored in spatial models of electoral competition.¹⁵⁷ I also argue that the presupposition that ideology is a vehicle for informing policy preference is flawed, as it does not take in consideration the fact that ideology meaning "system of ideas" from which policies are derived is contradictory to the

¹⁵⁵ Downs, A. (1957). *An Economic Theory of Democracy*. Boston: Addison Wesley, pp. 96-103.

¹⁵⁶ Ibid.

¹⁵⁷ Strom, K. (1990). "A Behavioral Theory of Competitive Political Parties". *American Journal of Political Science*, vol. 34, no. 2, pp. 565-598 .

idea of convergence that result in the medium voter. If all parties converge to a specific ideology, ideology loses its role in providing information about policy preferences, because there are no significant differences among them. In the next section I discuss a macroeconomic model of political business cycles.

1.3 Macroeconomics, Business Cycles, Political Business Cycles, and Ideology

Macroeconomic models explaining politico-economic interaction are being developed since the 1970s. Accordingly to Gärtner (1994):¹⁵⁸

The endogenous treatment of policy makers has become a frequently encountered, if not standard, feature of macroeconomic policy analyses. The incentive structure of policy makers is now a centerpiece in the discussion of policy, be they budget deficits, the size of the government sector, business cycles, exchange rate and trade regimes, policy cooperation, or the design of a European central bank.

To analyse this issues, economists usually adapt consumers' choice theory to political issues, including budget constraints, preferences, and rational behaviour meaning maximising utility. This led to the question "what do politicians want" and "why politicians choose the policies they do, sometimes adopting and sometimes ignoring advice from economists"? Also, why they shape institutions the way they do? The answer for the first question is rather a complicate one.

The first aspect to be taken in consideration is the relationship between politics and economics or, in other words, the relationship between voting and macroeconomics performance. The main question is "does macroeconomic performance affects electoral outputs?" The seminal work on this question is Gerald Kramer's article "Short-Term Fluctuations in U.S. Voting Behavior, 1896-1964," inspired by Anthony Downs' "An Economic Theory of Democracy."¹⁵⁹ Kramer performed econometric tests to explain short-term fluctuations in the division of national vote for the USA House of Representatives in the period 1896-1964, yielding "quantitative estimates of the impact of economic conditions on congressional elections, and of the effects of incumbency and presidential "coattails" as well."¹⁶⁰ As the presupposition of voting as the output of a rational choice between alternatives is difficult to test empirically, Kramer's model subordinated voting to macroeconomic performance, assuming that if the macroeconomy is doing well, vote retain to the incumbent party, and vice-versa.¹⁶¹

Accordingly to Kramer's model, the traditional idea that voters are rational, information-processing individuals who collects information, analyse it in light of their

¹⁵⁸ Gärtner, M. (1994). "Democracy, Elections, and Macroeconomic Policy: Two Decades of Progress". *European Journal of Political Economy*, vol. 10, no. 1, pp. 85-109, p. 85.

¹⁵⁹ Kramer, G. H. (1971). "Short-Term Fluctuations in U.S. Voting Behavior, 1896-1964". *The American Political Science Review*, vol. 65, no. 1, pp. 131-143 ; Downs, A. (1957). "An Economic Theory of Political Action in a Democracy". *The Journal of Political Economy*, vol. 65, no. 2, pp. 135-150 .

¹⁶⁰ Kramer, G. H. (1971). "Short-Term Fluctuations in U.S. Voting Behavior, 1896-1964". *The American Political Science Review*, vol. 65, no. 1, pp. 131-143 , p. 131.

¹⁶¹ Ibid.

own interest, and than vote accordingly is not realistic.¹⁶² Rather, voters consider the performance over the most recent year, taking in consideration growth rates of per capita real personal income and inflation, and the unemployment rate. The result of Kramer's regression was that per capital real personal income had positive effects on voting outcome while, in the presence of real income growth rates, unemployment and inflation had little or no electoral influence. Kramer's findings were later criticised, with some studies claiming that no relationship existed between economic conditions and electoral output. The first strong critic was made by George Stigler in 1973, who argued that voters did not answer to changing economic conditions.¹⁶³ Another study in 1976 stated that the American president's popularity was not influenced by economic conditions, as it followed a simply and regular cycle over time.¹⁶⁴ Nevertheless, these discussions did not end with the criticisms and in the following years several studies proved the connection between economics and politics.

In 1978, Tufte showed that in systems with single-party governments, short-term macroeconomic fluctuations, as unemployment, cost of living, and inflation, results in incumbent parties losing support.¹⁶⁵ Also in 1978, Fiorina demonstrated that voters will withdraw support from incumbent parties, when they experience deteriorating economic conditions.¹⁶⁶ This is the same conclusion reached by Eulau & Lewis-Beck (1985), who affirmed that "economic hard times can cause a voter to cast a ballot against the government."¹⁶⁷ In multiparty parliamentary systems like France and Germany, as most politics occurs around oppositional and situational blocks, poor economic performance had resulted in rising support for parties in concurrent coalitions.¹⁶⁸ More recently, Drazen (2001), Hibbs (2006), Van der Brug et al (2007), and Duch & Stevenson (2008) made clear that good economic performance benefits incumbents.¹⁶⁹ Although most of the studies about the relationship between voting and economics have been done focusing in the USA

¹⁶² Kramer, G. H. (1971). "Short-Term Fluctuations in U.S. Voting Behavior, 1896-1964". *The American Political Science Review*, vol. 65, no. 1, pp. 131-143.

¹⁶³ Stigler, G. J. (1973). "General Economic Conditions and National Elections". *The American Economic Review*, vol. 63, no. 2, pp. 160-167 .

¹⁶⁴ Stimson, J. A. (1976). "Public Support for American Presidents: a Cyclical Model". *The Public Opinion Quarterly*, vol. 40, no. 1, pp. 1-21 .

¹⁶⁵ Tufte, E. (1980). *Political Control of the Economy*. Princeton, NJ: Princeton University Press.

¹⁶⁶ Fiorina, M. P. (1978). "Economic Retrospective Voting in American National Election: a Micro-Analysis". *American Journal of Political Science*, vol. 22, no. 2, pp. 426-443 .

¹⁶⁷ Eulau, H., & Lewis-Beck, M. S. (1985). Economic Conditions and Electoral Behavior in Transnational Perspective. In H. Eulau, & M. S. Lewis-Beck (Eds.), *Economic Conditions and Electoral Outcomes: the United States and Western Europe*. New York: Athlone Press.

¹⁶⁸ Ibid.

¹⁶⁹ Drazen, A. (2001). "The Political Business Cycle After 25 Years". *NBER Macroeconomics Annual*, pp. 75-117 ; Hibbs, D. A. (2006). Voting and the Macroeconomy. In B. R. Weingast, & D. A. Wittman (Eds.), *The Oxford Handbook of Political Economy*. Oxford: Oxford University Press; Van der Brug, W., Van der Eijk, C., & Franklin, M. (2007). *The Economy and the Vote: Economic Conditions and Elections in Fifteen Countries*. Cambridge: Cambridge University Press; Duch, R. M., & Stevenson, R. T. (2008). *The Economic Vote: How Political and Economic Institutions Condition Elections Results*. Cambridge: Cambridge University Press.

or in Western Europe, scholars have demonstrated the existence of economic voting in Eastern Europe,¹⁷⁰ Africa and Asia,¹⁷¹ and Latin America.¹⁷²

Within this dissertation's scope, an important conclusion from the discussion above is that, although the linkage between macroeconomic performance and voting has been demonstrated, it is not the case to affirm that economic performance is the only determinant of voting. Rather, there are multiple determinants interacting with each other as, for example, welfare system, internal conflicts, including ethnic problems, presence or absence of war, just to cite a few. Thus, what can be affirmed is that when people feel poorer, they will tend to penalise incumbents trying to change things for better. In other words, bad macroeconomic performance will negatively affect incumbents only when it hurts people. As a result, the intensity of political change depends of the intensity of the crisis.

As discussed above, politicians can be opportunist, ideological, rational and either opportunistic or ideological, meaning that politicians want different things. As a result, to establish a utility function for political choice is extremely difficult.¹⁷³ However, politicians can only maximise their utility if in office, thus politicians need public support to get elected. There is a strong link between public support and the economy, with the main variables being inflation and unemployment, which the public like to be low.¹⁷⁴ Unemployment can also be substituted by income, in such a way that it is possible to say that the public's preference can be resumed as *the public likes low inflation and high income* or:¹⁷⁵

$$s = \bar{s} - 0.5\pi^2 + \beta Y$$

where s is public support for the incumbent party or government, for example, by voting share, π is inflation and Y is income. This means that if the government is interested in public support, it will rise when income rises and will decrease when inflation increases. This model's premiss can be used to construct a Nordhaus-type political business cycle:¹⁷⁶

¹⁷⁰ Pacek, A. C. (1994). "Macroeconomic Conditions and Electoral Politics in East Central Europe". *American Journal of Political Science*, vol. 38, no. 3, pp. 723-744 .

¹⁷¹ Pacek, A. C., & Radcliff, B. (1995). "The Political Economy of Competitive Elections in the Developing World". *American Journal of Political Science*, vol. 39, no. 3, pp. 745-759; Posner, D. N., & Simon, D. J. (2002). "Economic Conditions and Incumbent Support in Africa's New Democracies: Evidence from Zambia". *Comparative Political Studies*, vol. 35, no. 3, pp. 313-336 .

¹⁷² Benton, A. L. (2005). "Dissatisfied Democrats or Retrospective Voters?: Economic Hardship, Political Institutions, and Voting Behavior in Latin America". *Comparative Political Studies*, vol. 38, no. 4, pp. 417-442 .

¹⁷³ Gärtner, M. (2009). *Macroeconomics*. Essex: Pearson Education, 3rd Edition.

¹⁷⁴ Gärtner, M. (1994). "Democracy, Elections, and Macroeconomic Policy: Two Decades of Progress". *European Journal of Political Economy*, vol. 10, no. 1, pp. 85-109.

¹⁷⁵ Gärtner, M. (2009). *Macroeconomics*. Essex: Pearson Education, 3rd Edition, p. 308.

¹⁷⁶ The discussion above on mathematically formalised models of political business cycle is heavily borrowed from Gärtner, M. (1994). "Democracy, Elections, and Macroeconomic Policy: Two Decades of Progress". *European Journal of Political Economy*, vol. 10, no. 1, pp. 85-109.

$$(1) \quad y_t = \pi(\dot{p}_t - E_{t-1}\dot{p}_t)$$

$$(2) \quad E_{t-1}\dot{p}_t = \dot{p}_{t-1}$$

$$(3) \quad v_t = \frac{\dot{p}_t^2}{2} + \zeta Y_t$$

$$(4) \quad V_t = v_t + \omega v_{t-1}$$

where Y is the national aggregate demand, y is aggregate income, p. = inflation (policy instrument), V is the government's vote share, v is the voters' period utility stream, E is the expectations operator, ω is the voter memory coefficient, The model's structure is:

1. a "Lucas-surprise" aggregate supply curve, with inflation representing the effects of monetary and fiscal policy on the aggregate demand;
2. represents adaptive expectations in a very basic form;
3. this equation makes voters' period utility dependent on inflation and output;
4. this equation shows that voters are backward-looking, thus elections' output depends on past and present voter utility.

Substituting (1), (2), and (3) into (4):

$$(5) \quad V_t = -\frac{\dot{p}_t^2}{2} + \zeta\pi\dot{p}_t - \zeta\pi\dot{p}_{t-1} - \frac{\omega\dot{p}_{t-1}^2}{2} + \omega\zeta\pi\dot{p}_{t-1} - \omega\zeta\pi\dot{p}_{t-2}$$

If governments maximise voting exactly when there are elections (E), not doing so during non-election periods (N), and if $t = E$ in (5), and $t-1 = N$ and $t-2 = E$, thus:

$$(6) \quad V_E = -\frac{\dot{p}_E^2}{2} + \zeta\pi\dot{p}_E - \zeta\pi\dot{p}_N - \frac{\omega\dot{p}_N^2}{2} + \omega\zeta\pi\dot{p}_N - \omega\zeta\pi\dot{p}_E$$

As the inflation rate is a proxy for policies during election and non-election periods, vote maximisation is determined by:

$$(7) \quad \frac{\partial V_E}{\partial \dot{p}_E} = -\dot{p}_E + \zeta\pi - \omega\zeta\pi = 0 \quad \text{and} \quad \frac{\partial V_E}{\partial \dot{p}_N} = -\zeta\pi + \omega\dot{p}_N + \omega\zeta\pi = 0$$

As a result, there is a policy cycle that can be written as:

$$(8) \quad \dot{p}_E = (1 - \omega)\zeta\pi > 0 \quad \text{and} \quad \dot{p}_N = \frac{-(1 - \omega)}{\omega}\zeta\pi < 0$$

With the resulting output levels being:

$$(9) \quad y_E = \pi^2 \tilde{\zeta} \frac{1-\omega^2}{\omega} \quad \text{and} \quad y_N = -\pi^2 \tilde{\zeta} \frac{1-\omega^2}{\omega}$$

The result is that governments deliberately generate inflation during election periods, increasing output beyond full-employment levels. The contrary is valid during non-election periods, resulting in output below full-employment to control inflation. Thus, the cycle's amplitude depends on three parameters:¹⁷⁷

a. it depends on the weight of income ($\tilde{\zeta}$) in the public support equation (5). The greater this weight, the greater the cycle's amplitude;

b. as income is dependent on current inflation and expectations based on past inflation that affects monetary and fiscal policy. As a result, the smaller is π (inflation), the flatter is the Lucas-surprise aggregate supply curve, thus the larger the cyclical swings;

c. although voters are rational, they have limited memory (ω), the last parameter. In other words, the cycle's amplitude depends on whether voters forget past events. In other words, if voters completely forget about the past, the amplitude of political business cycles become infinitely large; if it is the contrary ($\omega = 1$), the political business cycle disappears and inflation is kept constant ($\dot{p}_N = \dot{p}_N = 0$) and income stays at the y_t level.

The model above describes shifts on macroeconomic policy as a result of changing which macroeconomic policy instruments are used to increase or reduce inflation. Thus, it reveals that democratic regimes have an inflationary bias as a result of political business cycles following elections. However, two fundamental interconnected points must be stressed. First, the macroeconomic policy instruments being used to promote inflation/increase the level of economic activity are within the established macroeconomic ideology. As a result, and second, it does not explain ideological shifts on macroeconomic policy.

Taking in consideration that what is acceptable in terms of macroeconomic policy follows ideological changes, this led to a question: how this ideological change occurs? How politicians shift from using one set of macroeconomic policies to another? The answer still relies on the process of economic voting. As discussed before, bad macroeconomic performance will influence voting accordingly to its impact on voters' wealth, forcing politicians to look for alternatives. In this case, there are two variables determining how far macroeconomic policies will change.

First, the gravity of the crisis. Second, its geographic extent. Regional or country-specific crisis will not result in ideological change, thus the base of the macroeconomic policy will be intact. As the economic system passes through deep structural crisis, sometimes the established economic ideology is not able to make the system to go back to the previous level of accumulation, what makes the incumbents' popularity to fall. Than,

¹⁷⁷ Gärtner, M. (2009). *Macroeconomics*. Essex: Pearson Education, 3rd Edition, p. 313.

with the involvement of the media, of private interests, and contending political parties, a societal debate starts. This process soon becomes tied up with electoral competition. As a result, each party's and/or coalition's offered economic policies become under a process of social scrutiny leaded by the media and its pundits. This is the moment when politics meets the academic system, mainly Social Sciences and Economics.

The interest of politicians on the academic system are dual. On one hand, as the academic system represents "science." To have the support of its members (or part of them) for some set of policies is a form of legitimisation. It is almost tantamount to affirm that some specific set of policies is science. On the other, during serious crisis politicians will look for policy advice at the universities and research centres, as it is natural to suppose that the best specialists on a subject are those people working in the academic system. As Myrdal (2004) put it, politics "is an art which is circumscribed by the Actual and the Possible, and precisely for this reason (...) (T)he politician may (...) expect of the economist that he should explain the actual situation and the state and effects of different possible modes of action."¹⁷⁸ It is also possible to have a third one, when there is a genuine interest in Science, as politicians may be interested in acquiring knowledge for personal purposes.

Although it is to expect that the task of Social Sciences, including here Economics, "is to observe and describe empirical social reality and to analyse and explain causal relations between (...) facts,"¹⁷⁹ usually a social scientist "proceeds to explain how the existence of the facts in question is consistent with social well-being and natural equity," while generally succeeding "in deluding himself with the idea that he has solved an economic problem, when, in fact, he has only vindicated, or persuaded himself he has vindicated, a social arrangement."¹⁸⁰ As a result, social scientists express views on what they consider to be socially imperative, implying the notion that social and economic analysis are able "of yielding laws in the sense of *norms*, and not merely laws in the sense of *demonstrable recurrences and regularities of actual and possible events*."¹⁸¹ One example is the theory of 'free competition.' Accordingly to Myrdal (2004):

(T)he theory of 'free competition' is not intended to be merely a scientific explanation of what course economic relations would take under certain specified assumptions. It simultaneously constitutes a kind of proof that these hypothetical conditions would result in maximum 'total income' or the greatest possible 'satisfaction of needs' in society as a whole. 'Free competition' thus on logical and factual grounds becomes more than a set of abstract assumptions, used as a tool in theoretical analysis of the causal relation of facts. It becomes a political *desideratum*.¹⁸²

¹⁷⁸ Myrdal, G. (2004). *The Political Element in the Development of Economic Theory*. New Brunswick, NJ: Transaction Publishers, p. 2.

¹⁷⁹ Ibid., p. 1.

¹⁸⁰ Ibid., p. 3.

¹⁸¹ Ibid., p. 4, italic in the original.

¹⁸² Ibid., p. 4.

In other words, no author has ever discussed the economic consequences of determined monetary system or principles of foreign trade without also providing precepts for political conduct. This attitude is explained by the fact that social scientists, including economists, have the honest ambition of seeing their work recognised as true science.¹⁸³ However, social scientists have values reflecting a moral system determined by their own life experience. This implies that even if these values are suppressed in the beginning of the research process, they may re-appear when establishing economic policy recommendations. As these economic policy recommendations reflect also an ideal model of social organisation to be achieved, it presupposes some form of social and economic control. Thus, they are ideological and, as ideology, they are transformed into political discourse/rhetoric, changing political ideology itself.

The ideological transformation occurs when, in times of crisis, agents expect the government to find a set of economic policies to end the crisis and to promote economic growth and development. Accordingly to the magnitude of the crisis, a more or less radical set of policies is chosen. In the case of a very serious crisis like the Great Slump or the stagflation of the 1960's, the economic ideology in force loses its validity. It is substituted by another ideology and the group connected to the previous ideology loses its academic prestige and respect. What was mainstream turns to be marginal, at the same time that what was marginal turns to be the new mainstream.

Because of ideological determinism, the set of economic policies available to the parties and coalitions to deal with crisis is limited to the boundaries of the macroeconomic ideology that became mainstream by the time of the last big crisis. The result is the process of party convergence identified by several authors,¹⁸⁴ where there was a general turn to the left until the 1980's, with macroeconomic policy privileging more state intervention in the economy, when centre-right and right-wing parties abandoned traditional ideologies seeking a broader electoral support.¹⁸⁵ After the 1980's it is the contrary: there is general turn to the right, with macroeconomic policy privileging less state intervention in the economy.

¹⁸³ Myrdal, G. (2004). *The Political Element in the Development of Economic Theory*. New Brunswick, NJ: Transaction Publishers.

¹⁸⁴ Downs, A. (1957). "An Economic Theory of Political Action in a Democracy". *The Journal of Political Economy*, vol. 65, no. 2, pp. 135-150 ; Thomas, J. C. (1980). "Policy Convergence Among Political Parties and Societies in Developed Nations: a Synthesis and Partial testing of Two Theories". *The Western Political Quarterly*, vol. 33, no. 2, pp. 233-246 ; Sundquist, J. L. (1983). *Dynamics of the Party System: Alignment and Realignment of Political Parties in the United States*. Washington: Brooking Institution Press; Alesina, A. (1988). "Credibility and Policy Convergence in a Two-Party System with Rational Voters". *The American Economic Review*, vol. 78, no. 4, pp. 796-805 ; Murillo, M. V. (2002). "Political Bias in Policy Convergence: Privatization Choices in Latin America". *World Politics*, vol. 54, no. 4, pp. 462-493 ; Lavelle, A. (2004). "A Critique of Murray Goot on Party Convergence". *Australian Journal of Political Science*, vol. 39, no. 3, pp. 645-650 ; Mair, P., Müller, W. C., & Plasser, F. (Eds.). (2004). *Political Parties & Electoral Change*. London: SAGE Publications.

¹⁸⁵ For a detailed discussion see Volkens, A. (2004). Policy Changes of European Social Democrats, 1945-98. In G. Bonoli, & M. Powell. *Social Democratic Party Policies in Contemporary Europe*. London: Routledge.

As noted by other authors, in the last 20 years the process of convergence has been more intense, due to effect of economic globalisation on national economic policies.¹⁸⁶

The process of ideological convergence of the last years is different from the one that resulted in the Bretton Woods System. Rather, it is the result of major parties abandoning their role in linking citizens to the political system, while becoming agents of elites who do not believe in government action and support minimal state roles.¹⁸⁷ The result is that the formal political system has been increasingly ceasing to be a medium that represents, articulates, redresses, and refines citizen concerns, in favour of a specific ideology to guarantee political survival. This process of ideological convergence provides the evidence of political collusion, establishing cartel parties.¹⁸⁸ There are four developments determining ideological convergence and the preference for macroeconomic policies.

First, the downsizing of voters' expectations as all parties had an interest in reducing their policy commitments, including state intervention in the economy and offering public goods for free. Despite their political complexation, giving the systemic economic changes started in the 1970's, none of them could deal with traditional electoral demands like over-increasing public goods. Second, the externalisation of policy commitments. The answer to the problem of competition over less was to create binding institutional fixes, making them not responsible for a large number of economic outcomes, at the same time insulating politicians from voters' preferences. Third, the declining relevance of the mass base changed the relationship between voters and politicians. At election time, politicians can effectively convince voters to vote for them. However, since the sources of funding, and thus re-election, are outside traditional mass-organisations and party membership has been reformed to the point of redundancy, after election voters have no effective power over politicians.¹⁸⁹

From the discussion above, the process of economic ideology change of the last 40 years has three outputs. First, and most important, it leads to the decline of policy makers' capacity to establish and conduct national policies independently of external ideological constraints. Second, it results in a situation near Shumpeterian democracy with voters losing their capacity to influence politicians when the electoral period ends. Third, and as

¹⁸⁶ Ibid; Blyth, M., & Katz, R. S. (2005). "From Catch-all Politics to Cartelisation: the Political Economy of the Cartel Party". *West European Politics*, vol. 28, no. 1, pp. 33-60 ; Soederberg, S., Menz, G., & Cerny, P. G. (Eds.). (2005). *Internalizing Globalization: the Rise of Neoliberalism and the Decline of National Varieties of Capitalism*. New York: Palgrave Macmillan; Katz, R. S., & Mair, P. (2009). "The Cartel Party Thesis: a Restatement". *Perspectives on Politics*, vol. 7, no. 4, pp. 753-766 ; Steiner, N. D. (2010). "Economic Globalization and Voter Turnout in Established Democracies". *Electoral Studies*, vol. In Press, pp. 1-16 .

¹⁸⁷ Mair, P., Müller, W. C., & Plasser, F. (Eds.). (2004). *Political Parties & Electoral Change*. London: SAGE Publications.

¹⁸⁸ Blyth, M., & Katz, R. S. (2005). "From Catch-all Politics to Cartelisation: the Political Economy of the Cartel Party". *West European Politics*, vol. 28, no. 1, pp. 33-60.

¹⁸⁹ Ibid, pp. 42-46.

consequence of the second, voter turnout in established democracies is declining.¹⁹⁰ The concrete result is that although Milton Friedman was convinced that under Neoliberalism people would be free to choose, in reality it is the contrary: there is no choice. Thus, it is possible to affirm that short-term political business cycles are determined and/or restricted by long-term ideological business cycles. However, as history is inexorable, after some time the prevalent ideology will change. Then, the economic and political paradigms will also change, resulting in the establishment of a new ideology, and the cycle will start again.

¹⁹⁰ See Steiner, N. D. (2010). “Economic Globalization and Voter Turnout in Established Democracies”. *Electoral Studies*, vol. In Press, pp. 1-16 .

2. CRISIS, MACROECONOMIC POLICY, AND IDEOLOGICAL CHANGE

Being verified that the academic literature supports the idea that there is a strong relationship between economic performance and politics, a general model is proposed in this dissertation, it is necessary to test its presuppositions against empirical evidence. This chapter analyses the relationship between business cycles, ideology, and macroeconomic policy, first in the United States, and second in Brazil. To analyse the United States is necessary to apprehend the movements changing what is the mainstream in economics. The change from classic liberalism to Keynesianism after the Great Slump and from the latter to Neoliberal Chicago Monetarism during the 1970's reflected the United States' choice in terms of macroeconomic policy. Thus, although not very clear, and still a subject to be researched, it seems to exist a correlation between the United States choice of economic policy and the economic approach turning into mainstream.

The Brazilian case is used as empirical base to support the model proposed in the next chapter. As discussed in the methodology before, the country of choice was Brazil. First, because it is big enough to choose its own policies. Second, because its economic academic field is original and independent. Third, and as consequence of the previous two, business cycles are independent from the ones experienced by the United States and Europe. Finally, because there is a considerable amount of data available to construct the models necessary for analysis.

Small crises or bad macroeconomic performance without any dramatic output may result in political changes, while serious crisis not only affect political output but also change much of the ideology in force. Thus, there are two political cycles: one resulting from small crises in relatively short periods of time, i.e. 5-10 years, and another one resulting from much more serious structural economic failure. The first case, short cycles resulting from small crisis, is the one studied by the literature. The second one, which comprehends ideological changes, thus economic policy paradigms, is neglected, even taking in consideration that it determines the scope of the policies available to deal with short-cycle crisis.

The existence of long-wave political cycles may be shown using History, following Kondratiev. The first serious depression in capitalism was the one observed in the period from 1873 to mid 1890s. Although it would be to expect a paradigmatic change, liberal economic policies continued to be in force. This may be explained by the particularities of the period. As the depression was the result of falling prices, interest rates, and profits, and not of structural problems of the productive and commercial spheres, the world production continued to increase strongly, most as a result of commercial activity.¹⁹¹ Together with the colonialist pulse and the great volume of investments abroad, the effects of the crisis were

¹⁹¹ Hobsbawm, E. J. (2003). *The Age of Extremes: the Short Twentieth Century*. London: Abacus, p. 58.

minimised as the profit rates remained the same. At the same time, there was a lack between the ideology in force - economic and political liberalism - and practical reality. As colonialism was promoted and controlled at the state level, the state was not only simply guaranteeing the right for private property and national security as idealised by liberal philosophers, but was actively increasing the levels of economic protectionism, while leaving the practical aspects of the economy under responsibility of private initiative. Nevertheless, the conjunction of colonialist expansion with protectionist policies of nationalist stamp resulted in the I World War, with the State assuming the rule of the economy.¹⁹² With the end of the conflict, there was a turn back to the old liberalism, with countries adopting the gold standard while practising deflationary policies.¹⁹³

2.1 The Crisis of the 1930's and Stagflation in the 1960s

The 1930's crisis was the result of the interaction of five points. First, during the 1920's, the process of economic internationalisation had reduced its expansion thanks to the maintenance of protectionist policies and to the fact that most of the big economies were self-sufficient. Second, there was an asymmetry in the level of economic development between the United States and the rest of the world in such a way that the first, except in relation to some raw materials, did not need the second. Third, the economy did not generate enough demand for a sustained expansion, as a result of the fall of the general wages resulting in a process of wealth concentration and in the incapacity of mass demand to accompany the industrial productivity's growth. Fourth, the expansion of consumer credit combined with speculation with real estate actives. Fifth, internal savings being directed to speculative investments in the stock market. The conjunction of these factors resulted in the Great Slump, which was deflagrated by the the collapse of New York's stock exchange.¹⁹⁴

At this point, there was the first political and economical ideological change, from classical liberalism in favour to Keynesianism. In general economic terms, the most significative consequences were a) the change in the way the state regulates the economy, favouring a more direct intervention to guarantee full employment, b) the establishment of welfare estates, c) the subordination of the financial system to the real system, d) the adoption of economic policies with the objective of promoting economic development even in the periphery. In other words, a softening of the process of international economic domination.

Classical liberalism was unable to give a pertinent solution for the crisis. Accordingly to economic liberalism, a fall in consumption results in a fall in the interest rate. As consequence, investment should increase leading the economy to a new

¹⁹² Hobsbawm, E. J. (2003). *The Age of Extremes: the Short Twentieth Century*. London: Abacus.

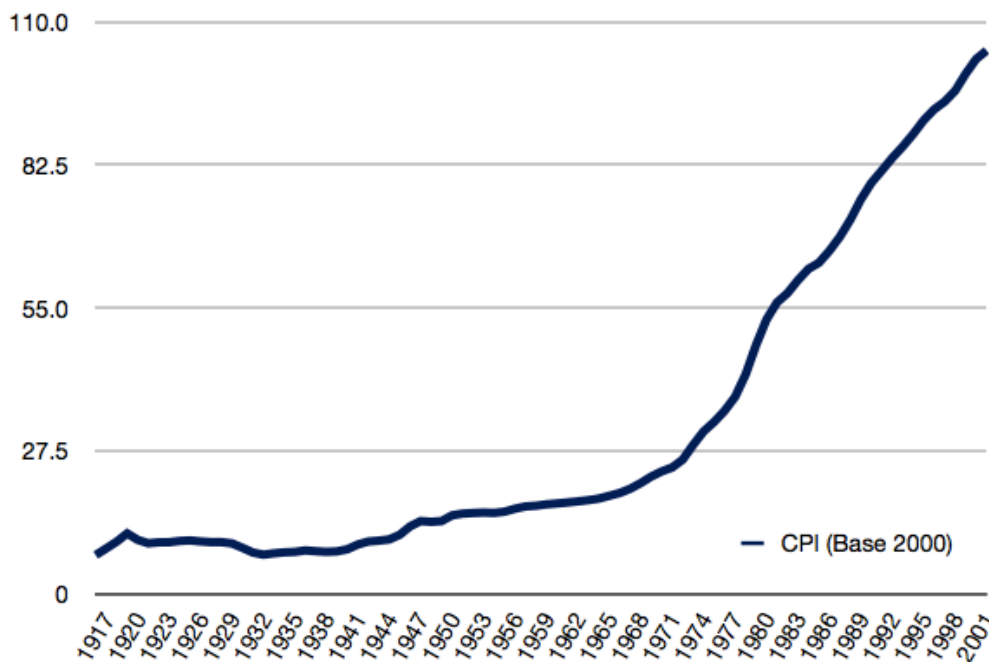
¹⁹³ Eichengreen, B. J. (2008). *Globalizing capital: a history of the international monetary system*. Princeton: University Press of California, Columbia and Princeton; Hobsbawm, E. J. (2003). *The Age of Extremes: the Short Twentieth Century*. London: Abacus.

¹⁹⁴ *Ibid.*, pp. 103-5.

equilibrium, thus to full employment. Concomitantly, it was maintained that state intervention would disturb private initiative and that gold standard and deflationary policies, including fiscal rigidity, were necessary to reduce the general level of prices, what should result into an economic boom. As it would be to expect, these policies were unable to produce the expected result. Although Keynesian policies have been used by the Roosevelt administration since the 1930's, only in 1944 Keynesian policies turned a consensus with the establishment of the Bretton Woods System.

In the beginning of the 1970's, after approximately thirty years of Keynesian economic policy, the world economy started to experience a process of stagflation.¹⁹⁵ To deal with the problem, the United States unilaterally dismantled the Bretton Woods system in 1971. The main objective was to boost exports at the same time reducing public deficit and inflation. Nevertheless, with the first oil shock in 1973, the price of oil quadrupled. This led the world economy to a deep recession. The conjunction of these factors established the way for a second ideological change: Keynesianism became a marginal approach, while Neoliberalism turned to be the new mainstream. This represented the second ideological change of the XX century.

Figure 2.1
USA's Yearly Inflation, 1917 - 2002



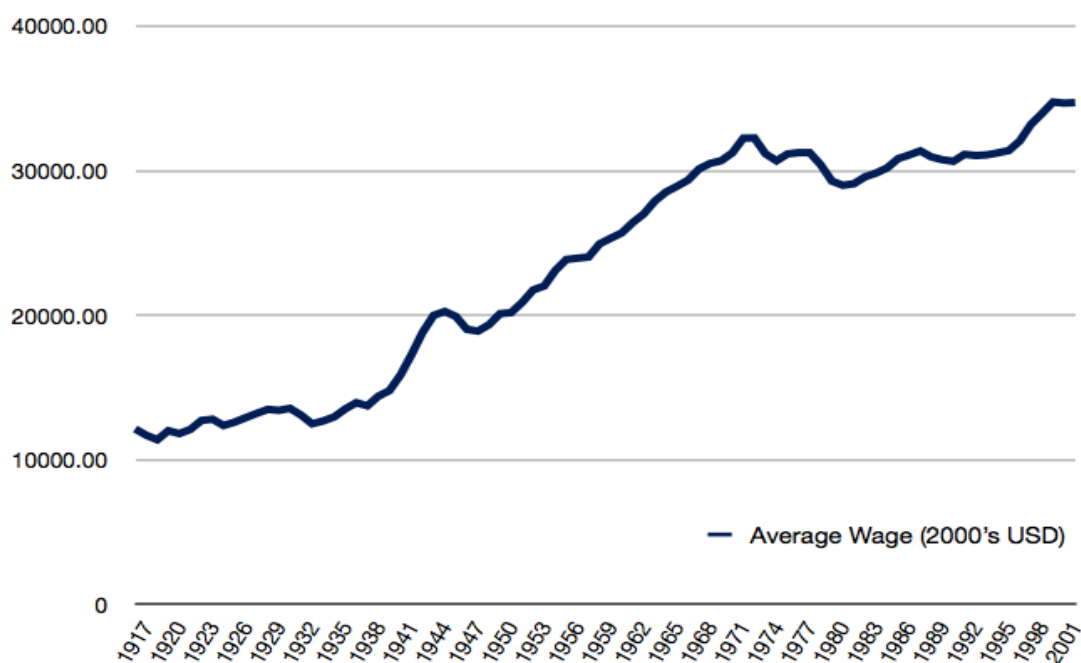
Source: USA Census.

As can be seen in chart 2.1 above, inflation started to increase in the USA already in the ending of the 1960's. During the next decade, there were two episodes of double digit

¹⁹⁵ Stagflation is the union of the words 'inflation' and 'stagnation.' Accordingly to the economic theories of that time, based on Keynesian theory, this was an improbable situation as inflation was expected to always result in more employment.

inflation, one in 1974 and another in 1979-80. The significant acceleration of inflation between 1972 and 1974 and 1979-80 was the consequence of three shocks: rising food prices, rising energy prices, and the end of Nixon wage-price controls program. The food shock was consequence of bad weather conditions not only in the United States, but in the world in general, resulted in significant retail food prices increases. The energy shock was the direct output of the establishment of the Organisation of Petroleum Exporting Countries (OPEC) after the Arab-Israeli conflict in 1973, when oil prices quadrupled in a few months. Finally, the end of wage-price controls fuelled inflation as it would be to expect: artificially depressed prices snapped back in 1974 when the program was abolished. In 1979, food and energy shocks also substantially changed relative prices.¹⁹⁶

Figure 2.2
Average USA Wages, 2000's USD, 1917 - 2002



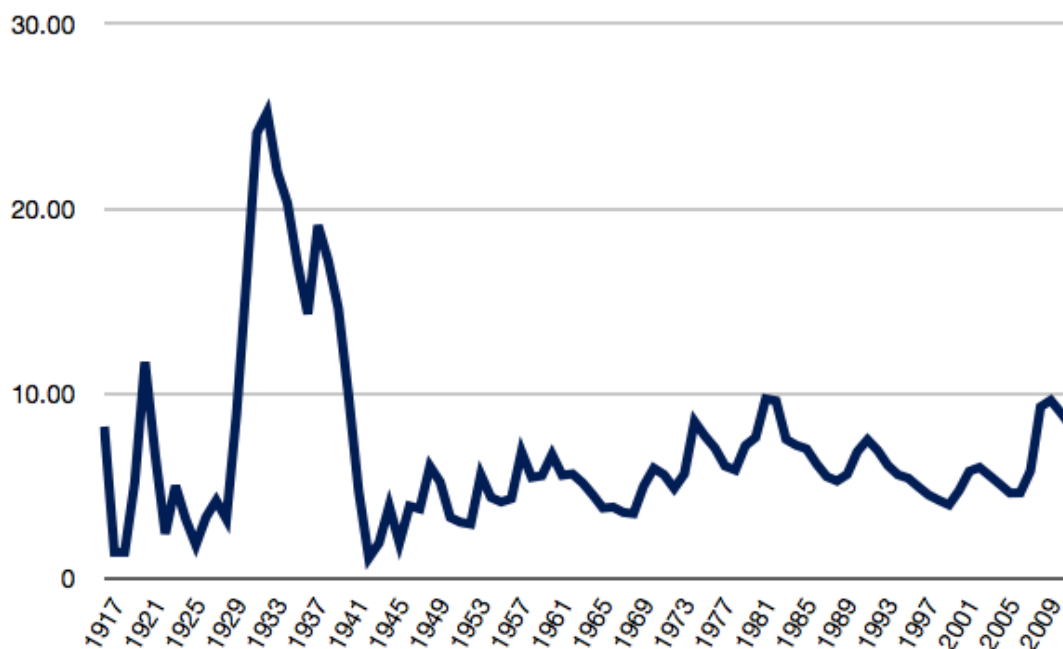
Source: USA Census.

The effects of changing relative prices on real wages also were significant. As shown on figure 2.2 above, the average real wage as measured in 2000 US dollars fell from US\$ 32,255.82 in 1973 to US\$ 28,984.64 in 1981 or a contraction of 10.14% in real terms. Although this contraction can be considered severe, it is based on averages. In fact, the effects on common people was much more dramatic. Taking in consideration the amount of time for nominal wages to be readjusted in face of inflation, the lost of purchasing power experienced by people was much deeper than average statistics show. As a result, the feeling of being impoverished was much stronger. At the same time, as shown on figure 2.3 below, in 1975 the unemployment rate reached the highest point since the Great Slump (8.5%). There was a new record in 1982 (9.7%). Keynesianism was not working. It had to

¹⁹⁶ Blinder, A. S. (1982). The Anatomy of Double-Digit Inflation in the 1970s. In Hall, R. E. (ed.), *Inflation: Causes and Effects*. Chicago: University of Chicago Press, pp. 261-282.

be substituted by a new political economic model. The choice was Conservatism and Neoliberalism. Although not close in comparison with the Keynesian years, Neoliberalism reduced unemployment and increased real wages until the 2007's financial crisis.

Figure 2.3
Unemployment USA, % 1917 - 2009



Source: USA Census.gov.

2.2 Economic Crisis, Ideological Change and Macroeconomic Policy in Brazil

During the XX century, Brazil had three different ideological phases, resulting in three main patterns of macroeconomic policy. The first, from 1889 until 1930, was based on Classical Liberalism; the second, from 1930 until 1989 was based on National-Developmentalism; the third, from 1990 until now is based on Neoliberalism. As argued in this dissertation before, and also in Brazilian case, each ideological change is the direct output of the exhaustion of specific political economic models to deal with changing economic paradigms: a new ideology is established to substitute the previous resulting in new relations of power and dominance. As a result, the political groups that lost power will adapt their ideas to the new established ideology to retain or regain power.

The first change was the outcome of the exhaustion of the political and economic model based on coffee exports, resulting in the Revolution of 1930 and the establishment of developmentalism. The term “developmentalism” is usually associated to the United Nations Economic Commission for Latin America and the Caribbean - ECLAC theories of socioeconomic development, while as historic phenomena it is commonly associated to the Brazilian governments of the period 1950-85. It is often reduced to some forms of State intervention, from the support to industrialisation and interventionism through expansionist economic policies until economic planning, here included the creation of state owned

enterprises and banks of development, usually with an ideological rhetoric related to nationalist appeals.¹⁹⁷

However, developmentalism is more than ECLAC theories or a specific form of state intervention. It has its antecedents in the development of coffee cultivation after the middle of the nineteenth century, with the concomitant decadence of the production of sugar and the mining of gold in favour to coffee. The main point is that although the sugarcane and gold cycles have taken place into an explicit colonial period and have used slave labor, the cultivation of coffee marks the beginning of the use of wage labor in large scale as the coffee producers realised that the latter was cheaper,¹⁹⁸ with large consequences in the social, economic and political spheres.

On the social and economic sphere, remunerated labor appeared outside the urban centres on a large scale resulting in the establishment of an incipient domestic market. This gave the base that would permit the internally semi feudal Brazilian economy to develop capitalist features. The abolition of slavery in 1888 and the expansion of the cultivation of coffee intensified this process, together with a process of massive migratory flux from Europe, Japan and the Ottoman Empire.¹⁹⁹ Other important factors that must be considered antecedents of developmentalism are a) the development of the textile industry after the 1950s; b) the industrial expansion associated with the Baron of Mauá; c) the establishment of a system of railroad transportation; d) the establishment of a system of ports, hydroelectric facilities, communications systems, etc; e) the weak and speculative attempt to create a national industry just after the proclamation of the Republic in 1889 with the *Encilhamento*; f) the I World War, which forced the country to substitute imports, forcing the establishment/development of some industrial activities; g) the establishment of a middle class; h) the formation of the national army as an essentially middle-class organisation (in contrast with the navy and its aristocratic origins).²⁰⁰

¹⁹⁷ Fonseca, P. C. D. (2004). Gênese e Precusores do Desenvolvimentismo no Brasil. *Revista Pesquisa & Debate*, vol. 15, no. 2, pp. 225-256.

¹⁹⁸ The end of the slave traffic together with the high rate of infant mortality among slaves resulted in an increase of the price of the slaves in the period 1870-1876 between 100-250%. By this time, the value of the slaves represented between 80-90% of the investment of the “fazenda”, the Brazilian rural enterprise producing coffee for export. As consequence, the free worker, first by the regime of tenant farming and later by wage relations, started to substitute the slaves. For a more detailed analysis see Faoro, R. (2001). *Os donos do poder: formação do patronato político brasileiro*. Rio de Janeiro: Editora Globo and Furtado, C. (2005). *Formação Econômica do Brasil*. São Paulo: .

¹⁹⁹ Although the expansion of coffee cultivation is the main determinant of the migratory flux of the end of the XIX century and first-half of the XX century, the abolition of slavery also was determinant. Used to live under a regime of subsistence and considering labor a curse, the transition to a remunerated regime made the former slaves to develop a strong preference to leisure. Being able to achieve the level of subsistence with three or four days of work, the former slaves considered much more attractive to “buy” leisure than to continue to work, resulting in a sub-utilization of the local workforce. See Furtado, C. (2005). *Formação Econômica do Brasil*. São Paulo: Companhia Editora Nacional.

²⁰⁰ Prado-Junior, C. (1965). *História Econômica do Brasil*. São Paulo: Editora Braziliense; Furtado, C. (2005). *Formação Econômica do Brasil*. São Paulo: Companhia Editora Nacional; Bresser-Pereira, L. C. (2003). *Desenvolvimento e crise no Brasil: história, economia e política de Getúlio Vargas a Lula*. São Paulo: Editora 34.

Although the break with the patrimonial regime of the Empire by the Republic meant the victory for decentralisation and the landed aristocracy, at the same time it also signified the continuation of oligarchic rule in the so called Old Republic (1889-1930). The levels of popular participation did not increase, as the groups that had previously occupied important positions during the Empire continued to do so, making the patrimonial state to remain the dominant influence in the development of Brazil.²⁰¹ At the same time, although the electorate increased in the early years of the Republic, suffrage was still very restricted. Illiterates did not have the right to vote and the population. Since only 14,8% of the population was literate in 1890 - and 24,5% in 1920 - deducing females and literate males under 21, it is possible to deduce how small the electorate really was.²⁰²

The two most influential groups in this period were the military and the state governors. The militaries were never far from politics and power. They dominated the first five years of the Republic and Marshall Hermes da Fonseca served as president in the period 1910-14. The power of the state governors was based on a system called *coronelismo* or “rule of the colonels” in the regional level,²⁰³ and on an agreement among state leaders that granted to São Paulo and Minas Gerais axis preeminence in national political and economic affairs, while the central government would not interfere in the internal affairs of the smaller states known as the politics of “coffee with milk”.²⁰⁴ This was a system where the president guaranteed that the parties of the governors of the states would always win elections in their jurisdictions, in exchange for support of president policies in the parliament as support of the president successor.

The fragile political stability of the Old Republic ended in 1929 when President Washington Luís chose another *Paulista*, Júlio Prestes, after a consultation to the Presidents of the 20 Brazilian states.²⁰⁵ Only the governors of the states of Minas Gerais, Rio Grande do Sul and Paraíba denied support to Júlio Prestes. However, the Republican Party of Minas Gerais,²⁰⁶ specially the supporters of Minas Gerais’ Governor Antônio Carlos Ribeiro de Andrada, disagreed with what they considered a break of the Republican

²⁰¹ Roett, R. (1999). *Brazil: politics in a patrimonial society*. Westport: Praeger.

²⁰² Love, J. L. (1970). Political Participation in Brazil, 1881-1969. *Luso-Brazilian Review*, vol. 7, no. 2, pp. 3-24.

²⁰³ *Coronelismo* refers to a system of machine politics, where the control of patronage was centralized in the hands of regional and local leaders, usually rural oligarchs, know as *coronéis* (colonels). This system permitted these oligarchs to dominate state structures to their advantages, and to determine the result of the elections. For a more profound discussion, see Carone, E. (1971). *Coronelismo: definição histórica e bibliografia*. *Revista de Administração de Empresas*, vol. 11, no. 3, pp. 85-92, and Roniger, L. (1987). *Coronelismo, Caciquismo, and Oyabun-Kobun bonds: divergent implications of hierarchical trust in Brazil. Mexico and Japan*. *The British Journal of Sociology*, vol. 38, no. 3.

²⁰⁴ The arrangement was that one presidential mandate was to be held by a *Paulista* - a natural from the São Paulo State - and the next by a *Mineiro* - a natural from the state of Minas Gerais. “Coffee” represented São Paulo, the biggest producer of coffee, while “cream” represented Minas Gerais, which was one of the most important producer of dairy. There was even a samba of the notorious composer Noel Rosa stating that “*São Paulo dá café, Minas dá leite e a Vila Isabel dá samba...*” (São Paulo gives coffee, Minas gives milk and Vila Isabel - in that time a very bohemian neighbourhood of Rio de Janeiro - gives samba).

²⁰⁵ In that time, president of state was the same position as what today is governor of state.

²⁰⁶ Before 1930, the parties were still regional organisations.

pact. In response, they articulated together with the oligarchy of the states of Rio Grande do Sul and Paraíba a coalition called *Aliança Liberal*,²⁰⁷ which also had the support of opposition groups of other states, as the Democratic Party of São Paulo, as part of the military as well. In July of 1929, the *Aliança Liberal* launched Getúlio Vargas as an alternative candidate for the Presidential elections, with the President of the State of Paraíba, João Pessoa, as candidate for vice-president. The *Aliança Liberal*'s electoral platform was based on three points: the end of the policy of artificial valorisation of coffee, measures to protect the urban workers, and a deep political reform.²⁰⁸

The first point was mainly directed to the middle class, which not only did not feel politically represented, but also felt penalised by the policies of coffee price support. The second was clearly directed to the emerging urban working class, which was neglected as a political force by the oligarchs, as the establishment of mandatory vacations and a special labor regulation to women and children. The third was directed to attract the support of the lieutenants and other minor political groups, including the establishment of secret vote and a special electoral judiciary system, as amnesty to political prisoners as well.

However, as the government had the control of the political machine, the official candidate Júlio Prestes won the elections in March of 1930, having 1.091.709 votes while Getúlio Vargas had 742.794. As usual, the official result of the elections was received with discredit not only by the defeated candidates, but by the population in general. The members of the *Aliança Liberal* started a conspiracy against the government, led by Vargas, aiming the deposition of the still president Washington Luís. The assassination of João Pessoa in 26th of July gave more impulse to the revolutionary movement and in 3rd of October of 1930 armed forces started the 1930 Revolution.²⁰⁹

There are nine concurrent interpretations of the causes of the 1930 Revolution, which are, sometimes, complementary. Some defend the idea that 1930 was the result of the interests of the surging middle class.²¹⁰ A second interpretation is that the revolution was a movement of the industrial and financial bourgeoisie, in collaboration with the middle class and the working class.²¹¹ A third one stresses the role of the *Tenente* revolts in

²⁰⁷ Liberal Alliance.

²⁰⁸ Fausto, B. (2008). *História Geral da Civilização Brasileira: Sociedade e Política (1930-1964)*. São Paulo: Bertrand Brasil.

²⁰⁹ Although the assassination of João Pessoa was considered a political crime, the motivation was personal. The political debate between Pessoa and João Duarte Dantas through the newspapers resulted in mutual hate after Pessoa attacked Dantas's father. The police of the State of Paraíba invaded Dantas's office, where personal letters between him and the teacher Anayde Beiriz were found. Pessoa ordered the publication of the letters in the newspaper "*A União*", controlled by the government. Dantas and his brother-in-law shot João Pessoa in a dairy. Both were arrested and later found decapitated in October, 3rd 1930. The official version was suicide. Anayde Beiriz was found dead by poisoning some days later.

²¹⁰ See Peixoto, C. A., Oliveira, L. L., & Hime, M. A. (1970). *O contexto político da Revolução de 1930*. Rio de Janeiro: Dados.

²¹¹ See Bresser-Pereira, L. C. (2003). *Desenvolvimento e crise no Brasil: história, economia e política de Getúlio Vargas a Lula*. São Paulo: Editora 34.

the 1920s,²¹² as Virgínio Santa Rosa, John Wirth and Michael Conniff.²¹³ Another view bases on the idea that the crisis or even lack of hegemonic forces in the political process resulted in the establishment of a state of compromise, where the diversity and disarticulation of the sectors of the new pact would have resulted in a lack of power, which started to occur autonomously and in a personalist way.

A fifth interpretation is that the agrarian pact that was renewed in 1930 was not merely the result of the oligarchs' residual power, but rather an intentional arrangement, where old oligarchs were substituted by new ones in a complex system of alliances reinforcing decadent and marginal groups, while neutralising other sectors more resistant to changes. In this case, the state would have assumed vaster amplitude, as it included the urban middle and working classes, resulting in a populist variant of two extremes, the oligarchy and the masses.²¹⁴

Another one deals with the idea that the oligarchies had a fundamental role in the transitional process accelerated by the 1930 Revolution, in a process lead by an interventionist state representing the industrial bourgeoisie, which had absorbed the members of the oligarchy.²¹⁵ By the economic side, there is the idea that the igniting spark of the 1930 Revolution was the crisis initiated in 1929. This interpretation deals with the idea that the fall of the international price of coffee, together with the general bankruptcy experienced in the industrial sector, resulted in an impulse to the Brazilian industrialisation. As the capital moved from the production of coffee to urban industry, the old political order did not fit the new model. The solution was the 1930 Revolution.²¹⁶

A more recent work aims to provide a neo-institutionalist interpretation of the events culminating in the Revolution of 1930, which seeks to incorporate the insights of the two main currents of the modern new institutional economics: the transaction costs economics²¹⁷ and the theory of collective action. The core of the argument is that the Old Republic was not overthrown on that year due economic reasons, as the coincidence of that episode with the beginning of the great world depression of the decade of 1930. The main conclusion is that the political conflict can be better explained by factors essentially linked to the collective action logic. Francisco Weffort defended the idea of extreme ample and

²¹² The *Tenente* revolts is the name given to the political-military movements and to the rebellions of low and middle rank officials of the Brazilian army in the 1920s. Discontent with the political situation of the country, they did not defend any ideology, but proposed changes in the country's power structure like the end of machine politics, the establishment of secret vote and the reform of the public educational system.

²¹³ See Santa-Rosa, V. (1976). *O sentido do tenentismo*. São Paulo: Editora Alfa-Omega; Wirth, J. D. (1964). Tenentismo in the Brazilian revolution of 1930. *The Hispanic American Historical Review*, vol. 44, no. 2, pp. 161-179; Conniff, M. L. (1978). The tenentes in power: a new perspective on the Brazilian revolution of 1930. *Journal of Latin American Studies*, vol. 10, no. 1, pp. 61-82.

²¹⁴ See Camargo, A. (1976). *Autoritarismo e populismo: bipolaridade no sistema político brasileiro*. Rio de Janeiro: Dados Editores.

²¹⁵ See Miceli, S. (2001). *Intelectuais à Brasileira*. São Paulo: Companhia das Letras.

²¹⁶ See Furtado, C. (2005). *Formação Econômica do Brasil*. São Paulo: Companhia Editora Nacional; Prado-Junior, C. (1965). *História Econômica do Brasil*. São Paulo: Editora Brasiliense.

²¹⁷ Bueno, N. P. (2007). A Revolução de 1930: uma sugestão de interpretação baseada na nova economia institucional. *Estudos Econômicos*, vol. 37, no. 2, pp.435-455.

unbalanced political alliances, where old and new actors juxtaposed, in a case of conservative modernisation where the old oligarchs still controlled the state apparatus.²¹⁸

Boris Fausto offers a more comprehensive interpretation. Accordingly to him, the break of the political system must be understood as the result of the combination of various points of friction reaching the melt. The regional oligarchies were dragged to fight by the younger sectors, giving transparency to the regional disputes accumulated throughout the Old Republic. The dissatisfaction of the militaries had won encouragement by both the association between oligarchy and dissident rebel lieutenants, as by the fact that it was growing more extensively within the armed forces. The agitation of the middle class, the urban manifestations in favour of Vargas assured the political support of a significant part of the society to the revolution.²¹⁹

Finally, Thomas Skidmore (2007) understands that the forces supporting the Revolution of 1930 must be divided between non-revolutionary and revolutionary.²²⁰ The former can be further divided in three groups. First, there were high-rank militaries, like General Tasso Fragoso, the head of the junta that transferred power to Vargas. They were resentful over the policies of the political elite, which they considered shortsighted and unpopular. Also, the unwillingness of civilian governments to increase the budget of the armed forces. A second group were the coffee farmers, although the federal government was committed to a coffee support program since the beginning of the XX century. By one side, the government did nothing to help the sector by suppling further credit from São Paulo's Coffee Institute for purchasing surplus stocks. The idea was to reduce the previously fixed price of Brazilian coffee in the international market to increase sales. This strategy not only contradicted Washington Luiz previous policy, but reduced farmers' revenues as it did not increase the demand for coffee.²²¹ By the other, as Washington Luiz's maintained a fixed exchange rate for the Brazilian currency, the coffee sector's income fell following the decline of international coffee prices. Third, there were dissidents from the established political elite who were aiming to use a coup for their own purposes.

In this way, the Revolution of 1930 should be understood as the result of the association between part of the oligarchy with dissident military forces, strengthened by classes that were feeling politically underrepresented. However, as it was impossible to any political force to seize power exclusively, the collapse of the coffee oligarchy resulted into an emptied power represented by the *Estado de Compromisso* (State of Compromise).²²²

²¹⁸ Weffort, F. (1989). *O populismo na política brasileira* (4th edition ed.). Rio de Janeiro: Paz e Terra.

²¹⁹ See Fausto, B. (2008). *História Geral da Civilização Brasileira: Sociedade e Política (1930-1964)*. São Paulo: Bertrand Brasil.

²²⁰ Skidmore, T. E. (2007). *Politics in Brazil, 1930-1964: an Experiment in Democracy*. Oxford: Oxford University Press, pp. 9-12.

²²¹ The demand for commodities, including coffee, is inelastic-price after a determined point. In other words, after a determined point, the demand for commodities does not increase in case of lower prices. For more details see Furtado, C. (2005). *Formação Econômica do Brasil*. São Paulo: Companhia Editora Nacional.

²²² Fausto, B. (2008). *História Geral da Civilização Brasileira: Sociedade e Política (1930-1964)*. São Paulo: Bertrand Brasil.

Due the heterogeneity of the political forces supporting the Revolution of 1930, their expectations were not common. Instead, dissident oligarchs wanted to achieve a bigger political control to minimise reforms and guarantee new policies to help agriculture, more specifically coffee; young civilians wanted a deep reform of the political system; *tenentes* defended the centralisation of power and the introduction of social reforms; the sectors connected to the Democratic Party had as objective to control São Paulo state's government, besides the effective adoption of liberal principles. As none of them had supremacy, the *Estado de Compromisso* must be understood as a state opened to all pressures without submitting itself to any of them.²²³

These interpretations explain the changes observed on the Brazilian political model, but not on economic policy after the Revolution of 1930. On the economic side, the fact is that the balance of payment's disequilibrium observed already in the ending of the 1920's became unsustainable after 1929. The contraction of the international trade's levels together with the hyper-production of coffee jeopardised the economic model consolidated during the First Republic. Even taking in consideration that the Brazilian economy was passing through a period of strong economic growth between 1927 and 1928, it was based on a very fragile base, as it was completely dependent of the favourable international economic conditions observed already in 1926. As a result, the financial viability of the coffee valorisation policy depended of three factors: a) the amount of coffee produced; b) the world demand for coffee; and c) the conditions of domestic liquidity. As a result, because the Brazilian monetary policy was under the gold standard and the trade balance was deteriorating, the private sector's propensity for increasing credit was reducing.²²⁴

Thus, at the same time, the financing requirements for sustaining coffee prices were increasing because of a falling world demand, thus increasing the necessity of obtaining financial resources in the international market. Thus, in case of external instability and difficulties in obtaining external financing, there would follow a monetary shock and deteriorating the external accounts.²²⁵ For the first time since the end of the monarchy, the strategy of maintaining internal economic stability in face of external shock by artificially maintaining coffee prices very high was not working. In this case, the recomposition of the Brazilian state's political base as outcome of the Revolution of 1930 must be understood as the result of the exhaustion of the economic model of the First Republic, which by its time deteriorated the political support for the regime in force. With the First Republic's collapse, it was necessary to establish a new political economic model. Thus, the rationality of the

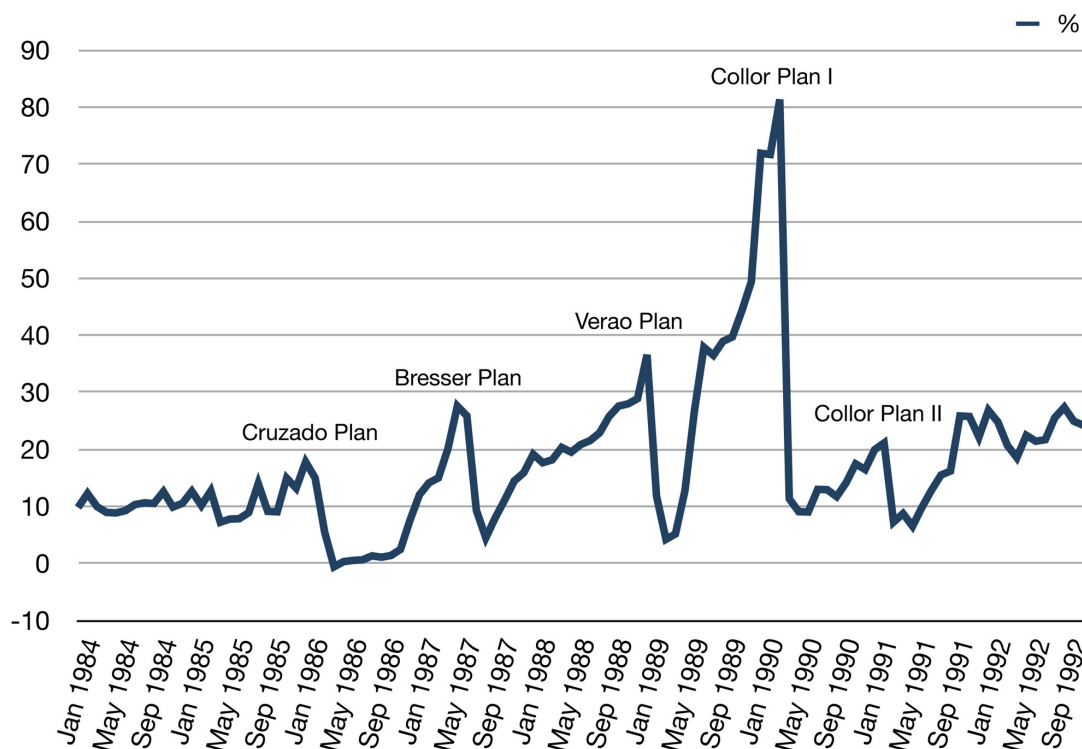
²²³ Fausto, B. (2008). *História Geral da Civilização Brasileira: Sociedade e Instituições (1889-1930)*. São Paulo: Bertrand Brasil.

²²⁴ The policy of valorization of coffee was an mechanism to artificially sustain the prices of coffee, due to the expanding supply. As the demand for coffee is price-inelastic, an increase in the supply resulting in an decrease of the prices doesn't result in more demand. To maintain the level of economic activity, as the profits of the oligarchs as well, the Brazilian federal government used to buy the coffee surpluses, primarily to store it, but after some time even burning it in locomotives.

²²⁵ Fritsch, W. (1990). Apogeu e Crise na Primeira República: 1900-1930. In Abreu, M. de (Ed.), *A Ordem do Progresso: Cem Anos de Política Econômica Republicana 1889-1989*. Rio de Janeiro: Editora Campus.

economic policies after 1930 were the result of the new dynamics of the international political economic system reflecting the Great Slump,²²⁶ and the new economic ideology being established at that time.

Figure 2.4
Brazil's Monthly Inflation, January 1984/December 1992 - %



Source: Own elaboration based on data of the IPEADATA.

As the figure 2.4 shows, the second time economic instability was strong enough to change the political economic system was in the ending of the 1980's. This time the problem was inflation. In 1989, it reached an annual index of 1,972.9%. that, even taking in consideration that prices and wages were indexed, strongly reduced households' income. The idea is that there is a hidden tax represented by inflation affecting both households' and government's budgets, called in Portuguese *imposto inflacionário* (literally translated as 'inflationary tax'). It results from the Central Bank printing money to compensate the effects of inflation on the governments budget. As the monetary base expands and the government's spending - in nominal terms - also raises, inflation also increases. Thus, accordingly to Rangel (1981), the causality 'public deficit resulting in inflation' is inverted: it is the public deficit that results from inflation and not the contrary.²²⁷ On the other hand, households are affected as, even if wages are fully indexed, from the moment wages are received until the next month, when wages are raised, residual real wages fall in the same proportion of inflation, thus reducing real income. Also, inflation distorts the price system,

²²⁶ Ibid.

²²⁷ Rangel, I. (1981). "A História da Dualidade Brasileira". *Revista de Economia Política*, vol. 1, no. 4, pp. 5-34 .

making real income also to fall. The result was the collapse of national-developmentalism and its substitution by Neoliberalism, what already occurred in the USA some years before. In the Brazilian case, as discussed in the next two chapters, Neoliberalism was not imposed but rather it was seen to be the natural choice for the new Brazilian economic model. After all, as was very often said during the 1950's, what is good for the USA is good for Brazil.

Neoliberalism is a conservative economic philosophy based on some principles of XIX century's liberalism. The common points are (a) the efficiency of market competition, (b) the role of individuals in determining economic outcomes, and (c) distortions associated with government intervention and regulated markets. However, differently from classical *laissez-faire*, Neoliberalism is not a system where market regulates economy. On contrary, it is a specific form of political and economic regulation within a financialised economy aiming to artificially reproduce the conditions of perfect competition, not only in the economic sphere, but also in the political and social levels. Thus, it is an ideology as it is essentially an instrument of social control based on specific values and moral.

2.3 The Birth of Neoliberalism in Brazil: Economic Crisis and the 1989 Elections

From the ideological point of view, the Revolution of 1930 represented the progressive abandonment of the traditional liberal policies. It marks the end of the Old Republic, changing the way the State interrelates with the society through politics and economics. It "(...) redistributed power among social classes, created national political parties, established a code of labor laws, a new university system, a widespread democratisation of Brazilian life, a reform of the State apparatus and many other changes".²²⁸ By the economic side, it established the notion that the state must lead the process of economic development directing the private economic agents through specific policies or, in certain cases, even establishing state-owned enterprises in strategic sectors. In other words, it established National-Developmentalism as main political and economic ideology. Although National-Developmentalism can be considered a leftist set of economic and social policies, the Revolution of 1930's legacy was strong enough to survive the period of conservative right-wing military dictatorship (1964-1984). Only the crisis of the 1980's would be strong enough to result in a new ideological cycle represented by Fernando Collor de Mello's victory in the 1989 presidential elections.

2.4 The 1989 Election

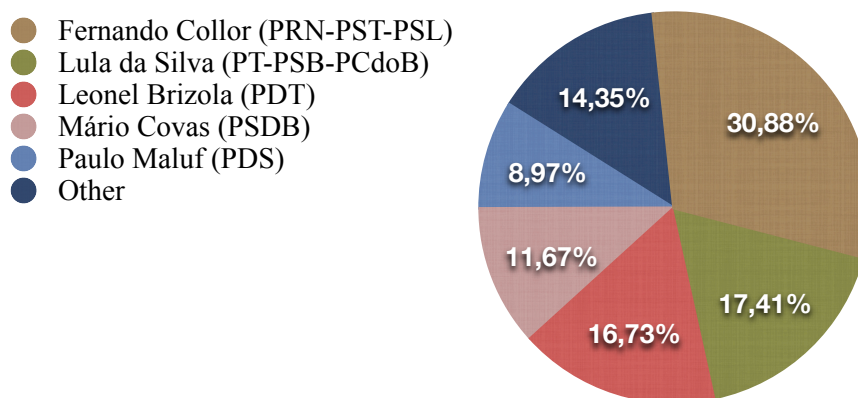
Fernando Collor de Mello was a relatively unknown politician, from a small and poor state from Northeastern Brazil. The election occurred in two turns: the first in November 15, 1989 and the second in 17 December, 1989. In total, there were 22 candidates, representing political forces ranging from the radical left to the extreme conservative right. As figure 2.5 shows, only five candidates surpassed the 5% barrier:

²²⁸ Ianni, O. (1964). Political process and economic development in Brazil (part II). *New Left Review*, vol. I, no. 26, pp.50-68, p. 61.

Fernando Collor, Luís Inácio Lula da Silva, Leonel Brizola, Mário Covas, e Paulo Salim Maluf.²²⁹

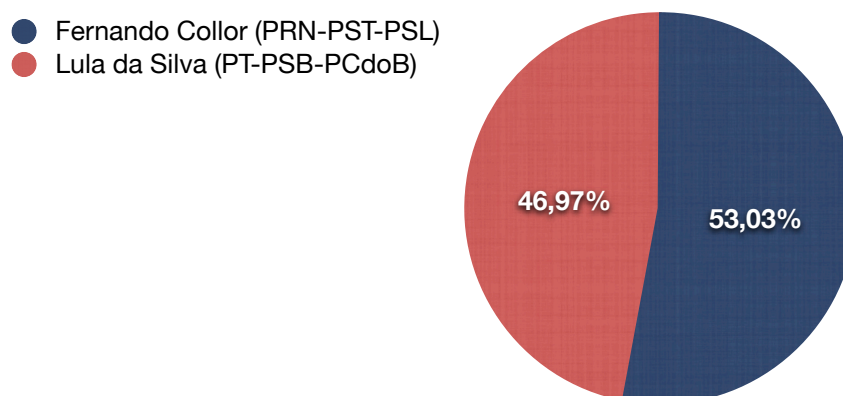
In the first turn, Fernando Collor defeated the traditional political forces represented by Leonel Brizola, Mário Covas, and Paulo Maluf. Brizola represented a left-wing Varguist tradition; Covas represented PSDB’s social-democrat project of the PSDB, a relatively new party formed in 1988 by dissidents of Sarney’s PMDB; Paulo Maluf represented a conservative wing connected with the militaries, as his PDS was the government’s party during the military dictatorship. As figure 2.6 below shows, in the second round, Fernando Collor defeated Lula da Silva being elected president, by a difference of 6.06 percentage points.

Figure 2.5
1989 Presidential Election’s First Round - % of valid votes



Source: Own calculations based on data of the Brazil’s Superior Electoral Tribunal.

Figure 2.6
1989 Presidential Election’s Second Round - % of valid votes



Source: Own calculations based on data of the Brazil’s Superior Electoral Tribunal.

²²⁹ For a typology of the Brazilian political parties in 1989 see table A.3. in the annexes.

The answer for the question why Fernando Collor was able to win the 1989 elections is difficult to answer. Several authors have written on this subject presenting several hypothesis, from ideological determinants to the role of media, specially Globo Television and the periodical *Veja*.²³⁰ The idea is that economic and political interests influenced the coverage of the elections, clearly favouring Collor. One of the most deep analysis on this subject is from a journalist, Mário Sergio Conti. His book “Notícias do Planalto” covers the process of decision making by the big media players like newspapers, periodicals, and television, together with the bonds the journalists establishes with politicians.²³¹ As Conti was *Veja*’s chief-editor between 1991 and 1997, it is clear that he had privileged information and a vision from inside, which cannot be neglected. Nevertheless, his book is not an academic work and as such lacks objectivity.

In the academic field, Venício Artur de Lima of the University of Brasilia constructed a model based on communication theories emphasising media’s influence on people’s cognition in the short and long run.²³² Accordingly to him, Collor’s victory may be explained by political representation scenario constructed by the Brazilian television before 1989.²³³ The author defends the idea that Collor could have won the elections in June of 1989, when election polls gave him 43% of voting intentions before the free political programs on the television.²³⁴ The free political programs would have helped Lula and Brizola to increase their voting share.²³⁵

Another work on the same line is Carlos Aguiar’s article about the Brazilian political elites’s imaginary and its expression on newspapers. Aguiar develops his idea on the basis that the Brazilian media is extremely conservative, privileging a determined set of political values and macroeconomic policy. One concrete example would be the press, where journalists and representatives of the ‘elites’ frequently used the image of a socialist/communist conspiracy to turn Brazil into a communist country, in the case the left - Brizola or Lula - won the elections. As a result, the political debate would have turned in a battle between “good” and “evil.”²³⁶ Following the same line, Anderson dos Santos discussed the role of the periodical ‘*Veja*’ in shaping Collor’s image. His hypothesis is that ‘*Veja*’ was one of the most important factors explaining Collor’s election. In the same article, he also

²³⁰ Rede Globo and *Veja* are arguably the most powerful television and periodical in Brazil.

²³¹ Conti, M. S. (1999). *Notícias do Planalto: a Imprensa e Fernando Collor*. São Paulo: Cia. das Letras.

²³² Lima, V. A. d. (1990). *Televisão e Política: Hipótese sobre a eleição presidencial de 1989*. *Cadernos de Comunicação e Política*, ano 9, no. 11, Abril/Junho.

²³³ The idea is that there is some political content in the entire set of programs of a TV station. Also, that this political content is presented not only during election times but always. As a result, they establish areas of relevance and transmit moral values that hugely influence a candidate’s chances.

²³⁴ Before elections there is a 30 minutes general political program on TV two times a day. The program’s time is divided among all political parties accordingly to their share on the Brazilian Congress, when they present their proposals and political views.

²³⁵ *Ibid.*

²³⁶ Aguiar, C. B. (1995). “Imprensa e Eleições 89: Imagens e Atores da Política”. *Revista Comunicação e Política*, vol. 1, no. 3, pp. 179-194 .

discusses the role of the same periodical shaping public opinion during Collor's impeachment in 1992.²³⁷

Other authors, mostly political scientists, explained Collor's election as a result of Sarney's bad macroeconomic performance and his inability to deal with the needs of the poorest social fabrics. Another factor often cited is the economic crisis and the high inflation rates of the second half of the 1980's. Accordingly to these authors, poor economic performance allied with high inflation would have debased Sarney's popularity as reducing trust in the coalition PMDB/PFL and in professional politicians.²³⁸ Other works stressed the fragility of the Brazilian party system as the main factor explaining Collor's election.²³⁹ Some also emphasised Collor's political marketing strategy, presenting himself as a competent administrator, ready to moralise the Brazilian political system and provide adequate macroeconomic policies.²⁴⁰

Nevertheless, one of the most comprehensive studies about the 1989 Presidential election is Andre Singer's PhD thesis, in which he analyses the ideological patterns of 1989 and 1994's presidential elections.²⁴¹ Using University of São Paulo and Datafolha's *Cultura Política/90* database,²⁴² Singer was able to test six hypotheses explaining electoral behaviour in the 1989's elections: first, that Collor election was the result of protest vote; second, that the output of the 1989's elections could be explained as opposition to the government; third, that the rejection to politicians was the main explanatory variable; fourth, that the rhetoric of reducing State intervention played a decisive role; fifth, that Collor was elected because he presented himself as a leader able to solve Brazilian economic and social problems; and sixth, that Collor was elected because of electoral ideological alignment.²⁴³

As the University of São Paulo and the State University of Campinas made available several political databases, including the surveilling conducted by Datafolha and Ibope, it was possible to reproduce Singer's statistical treatment of data, while presenting some new calculations and some modifications. Thus, it was possible to re-test Singer's

²³⁷ Santos, A. (2007). *Revista Veja e Fernando Collor: o Espetáculo na Política Brasileira (1988-1992)*. Paper presented at the XXIV Simpósio Nacional de História, São Leopoldo.

²³⁸ Lamounier, B. (1990). O Brasil sob Fernando Collor de Mello: Prospectos da Consolidação Democrática a partir da Eleição Presidencial de 1989. In R. Alfonsín (Ed.), *Agenda para la Consolidación de la Democracia en América Latina*. San José: Instituto Interamericano de Derechos Humanos/Fundación Friedrich Naumann; Sallum Jr., B., Graeff, E. P., & Lima, E. G. d. (1990). "Eleições Presidenciais e Crise do Sistema Partidário". *Lua Nova*, vol. Maio 90, no. 20, pp. 69-87 .

²³⁹ Lima Jr., O. B. d. (1993). *Democracia e Instituições Políticas no Brasil dos Anos 80*. São Paulo: Edições Loyola; Diniz, E. (1989). "Crise Política, Eleições e Dinâmica Partidária no Brasil: um Balanço Histórico". *Dados*, vol. 32, no. 3, pp. 323-340 ; Lavareda, A. (1989). "Governos, Partidos e Eleições Segundo a Opinião Pública: o Brasil de 1989 comparado ao de 1964". *Dados*, vol. 32, no. 3, pp. 341-362 .

²⁴⁰ Kinzo, M. D. A. G. (1992). "A Eleição Presidencial de 1989: o Comportamento Eleitoral em uma Cidade Brasileira". *Dados*, vol. 35, no. 1, pp. 49-65 .

²⁴¹ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo.

²⁴² Datafolha is one of Brazil's main public opinion research institute. Others are Ibope and Gallup.

²⁴³ *Ibid.*, pp. 67-88.

hypotheses, besides making additional analysis. To test the hypothesis of protest vote, Singer cited Guilhon Albuquerque's research to detect if the main motivation for voting was the expectations of results, opposition or identification.²⁴⁴ Also using the survey *Cultura Política/90*, this dissertation's author was able to cross the electors' choice with four possibilities: his/her choice was based on the idea that this candidate a) was able to implement the measures Brazil needs (basically, to implement correct macroeconomic policies to end inflation); b) would fight Brazil's enemies; c) represented people like me; d) was able to defeat other candidate.

Table 2.1
Motivation for Voting on the First Round - %

	Promised to implement the measures Brazil needs	He'll fight Brazil's enemies	Because he was the best candidate representing people like me	To defeat the other candidate	Total
Fernando Collor de Melo	45,97	6,16	43,60	4,27	100
Leonel Brizola	22,92	4,17	52,08	20,83	100
Luiz Inácio Lula da Silva	25,00	5,68	62,50	6,82	100
Mário Covas	18,79	4,24	48,48	28,48	100
Paulo Maluf	25,95	3,05	45,04	25,95	100
Outros	24,18	3,85	49,45	22,53	100

Source: Own elaboration based on data of the survey *Cultura Política/90*, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/html/busca.php>, own calculations.

Albuquerque established a voter's typology based on the idea of voting strategy, where the act of voting is determined by *identification*, *opposition*, or *performance expectation*. In this case, voting should be understood as a rational strategic act comprising three elements: the actor, the object of his/her action, and an obstacle between actor and object.²⁴⁵ As table 2.1 above shows, it is clear that Collor's performance in the first round was associated with the idea that he was able to implement the measures Brazil needed (45.97%), being able to end inflation and consolidate a new economic model and new macroeconomic policies. Also, with the feeling of identification between the electors and the candidate (43.60%). Tactical vote is more significant to explain the option for Brizola, Covas, and Maluf, while the option for Lula was based on self-identification.

On the second round, the option for Collor's structure continued to be practically the same, although in Lula's case there were some small changes. Notwithstanding that

²⁴⁴ Albuquerque, J. A. G. (1992). "Identidade, Oposição e Pragmatismo: uma Teoria Política do Voto". *Lua Nova*, vol. Cultura Política, no. 26, pp. 53-79, available on <http://www.google.com/books?hl=lv&lr=&id=ZqMGIT6DU7AC&oi=fnd&pg=PA53&dq=guilhon+albuquerque&ots=dH2-IrjrsC&sig=4QNT5KbQri3aOEIAO85mW1pfJWo#v=onepage&q=guilhon%20albuquerque&f=false>, access on November 22, 2010.

²⁴⁵ *Ibid.*, pp.61-62.

identification (because he was the best candidate representing people like me) was the main determinant of choosing Lula, his share of tactical vote increased almost 131%, at the same time the factor “implementing the measures Brazil needs” faced an absolute reduction in the same magnitude. This can be explained by the fact that Lula economic program was associated with national-developmentalism, thus indirectly with Sarney’s macroeconomic policies.

Table 2.2
Motivation for Voting on the Second Round - %

	Promised to implement the measures Brazil needs	He'll fight Brazil's enemies	Because he was the best candidate representing people like me	To defeat the other candidate	Total
Lula	16,36	4,98	62,93	15,73	100,00
Collor	41,96	5,14	41,77	11,13	100,00
Total	32,25	5,08	49,79	12,88	100,00

Source: Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

The analysis of the data presented above indicates that Collor choice was mainly determined by electors’ future expectations. More, that these expectations were associated with the idea of change. In this way, Singer’s conclusion that Collor choice did not result from protest or tactic voting, but on the belief that he was able to make the reforms the electors were expecting or believed to be necessary is correct.²⁴⁶ In this sense, voting in 1989 was more about the future than about the past, again meaning a break with national-developmentalism as economic model.

The second hypothesis, that voting was determined by opposition to the government, must be understood in a specific way. The idea was opposition specifically to Sarney’s government and not to the established *status quo*. As Singer mention, Collor’s campaign was very aggressive against the current government. To verify this hypothesis, Singer crossed the evaluation of Sarney’s government with voting choice in both first and second round.

Table 2.3
Sarney’s Evaluation and Candidate Choice in the 1989 Elections’ First Round - %

	Excellent	Good	Average	Bad	Terrible
Fernando Collor de Melo	37,50	50,00	32,56	41,44	39,98
Leonel Brizola	12,50	4,43	12,97	10,77	12,62
Luiz Inácio Lula da Silva	18,75	19,62	20,89	17,68	20,42
Mário Covas	18,75	6,33	11,24	12,43	9,16

²⁴⁶ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo, pp. 69.

	Excellent	Good	Average	Bad	Terrible
Paulo Maluf	6,25	6,33	9,08	8,01	7,67
Other	6,25	13,29	13,26	9,67	10,15
Total	100,00	100,00	100,00	100,00	100,00

Source: Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/html/busca.php>, own calculations.

The table above reproduces Singer's data with slight modifications taking in consideration a more formal statistic methodology. Nevertheless, the results are practically the same. The table above shows that Sarney's evaluation was not determinant in choosing any candidate. However, although some positive association between evaluating Sarney's government as excellent or good could be inferred, it is not significant when making an analysis in absolute terms.

Table 2.4
Voting in the 1989 Elections' First Round versus Sarney's Evaluation - %

	Excellent	Good	Average	Bad	Terrible	Total
Fernando Collor de Melo	0,77	10,08	28,83	19,13	41,20	100,00
Leonel Brizola	0,83	2,92	37,50	16,25	42,50	100,00
Luiz Inácio Lula da Silva	0,74	7,60	35,54	15,69	40,44	100,00
Mário Covas	1,43	4,76	37,14	21,43	35,24	100,00
Paulo Maluf	0,61	6,06	38,18	17,58	37,58	100,00
Other	0,40	8,40	38,80	15,20	37,20	100,00

Source: Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/html/busca.php>, own calculations.

Analysing the table 2.4 above is possible to agree with Singer, although it is also possible to reach a broader set of conclusions. First, that the total number of electors positively evaluating Sarney was irrelevant. Second, that there was a generalised rejection to Sarney's government, independently of the elector's choice. Anyway, in the second round (see table 2.5 and 2.6 below) the results were similar. As a result, "rejection of Sarney" is not a valid presupposition explaining Collor's victory. Although the table 2.5 shows that people who voted for Collor evaluated Sarney better than those who voted for Lula, table 2.6 shows that Sarney's evaluation was extremely negative overall.

Table 2.5
Sarney's Evaluation and Candidate Choice in the 1989 Elections' Second Round - %

	Very Good	Good	Regular	Bad	Terrible
Lula	28,57	23,18	38,72	39,48	38,27
Collor	71,43	76,82	61,28	60,52	61,73
Total	100	100	100	100	100

Source: Cultura Política/90, In: Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/html/busca.php>, own calculations.

Table 2.6
Voting in the 1989 Elections' Second Round versus Sarney's evaluation - %

	Very Good	Good	Regular	Bad	Terrible	Total
Lula	0,54	4,76	34,56	18,64	41,50	100,00
Collor	0,81	9,43	32,68	17,07	40,00	100,00

Source: Own elaboration based on data of the survey *Cultura Política/90*, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

The third hypothesis is that Collor's election was the result of a general rejection of politicians, instead of specific rejecting Sarney.²⁴⁷ The idea is that Collor established a "political electoral firm" instead of a political party. As a result, he was able to present himself apart the political class, being able to turn into a symbol of the popular hostility against politicians in general. To measure the variable "rejection of politicians" as predictive of electoral output, Singer analysed the results of the following *Cultura Política/90*'s question: in a general manner, the Brazilian politicians worry a) about their own interests or b) about the country's interests (table 2.7). As shown in table 2.7, Collor electors were the only group to believe that politicians worry about people's interests more than his/her own interests. However, as calculated by this dissertation's author on table 2.8, it is clear that, in a general manner, the electors were convinced that all politicians care about personal interests. However, Collor still had a significant better performance.

Table 2.7
Voting in the First Round and Politicians' Evaluation - %

Candidate	Which interests politicians care?	
	Own Interests	People's Interests
Fernando Collor de Melo	37	50
Leonel Brizola	12	10
Luiz Inácio Lula da Silva	20	17
Mário Covas	11	6
Paulo Maluf	8	7
Other candidates	13	11
Total	100	100

Own elaboration based on data of the survey *Cultura Política/90*, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

Table 2.8
Politicians' Evaluation and Voting in the First Round - %

Candidate	Which interests politicians care?		
	Own Interests	People's Interests	Total
Fernando Collor de Melo	86	14	100
Leonel Brizola	91	9	100
Luiz Inácio Lula da Silva	91	9	100
Mário Covas	93,97	6,03	100
Paulo Maluf	91,14	8,86	100
Other candidates	90,61	9,39	100

²⁴⁷ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo, pp. 71.

Candidate	Which interests politicians care?		
	Own Interests	People's Interests	Total
Total	89,42	10,58	100

Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

In the first round there was an unexpected connection between those answering that politicians care about people's interests and voting for Collor. The candidate associated to rejection of politicians was Mário Covas.²⁴⁸ If explicative to voters' behaviour, the rejection of politicians would have helped Covas to win the election, what did not happen. Following these results, Singer concludes that voting for Collor is associated to accepting instead of rejecting the political establishment. Also, as shown on table 2.8., the rejection to politicians was generalised. Nevertheless, it is interesting to note that Collor's voters were the ones mostly believing in politicians. Although not empirically demonstrable, a possible explanation is the fact Collor presented himself as a capable administrator, able to solve the national problems by adopting the correct economic measures and macroeconomic policy. As Collor was indeed a politician, it is possible that some of his electors hoped he was caring for their interests.

Data of the second round on table 2.9 and table 2.10 shows a similar pattern. There was a generalised hostility to politicians in general. When controlled by income, the association between a positive opinion about politicians and voting for Collor occurs mostly among low income electors. A possible explanation for this behaviour is the occurrence of "deference habits" among low income electors. The hypothesis is that very low income electors, usually marginalised from the political process systematically approve the government and its institutions.²⁴⁹

Table 2.9
Politicians' Evaluation and Voting in the Second Round - %

	Own Interests	People's Interests
Lula	39	23
Collor	61	77
Total	100	100

Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

Table 2.10
Voting in the Second Round and Politicians' Evaluation - %

	Own Interests	People's Interests	Total
Lula	93,4	6,6	100,0
Collor	86,7	13,3	100,0

Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de

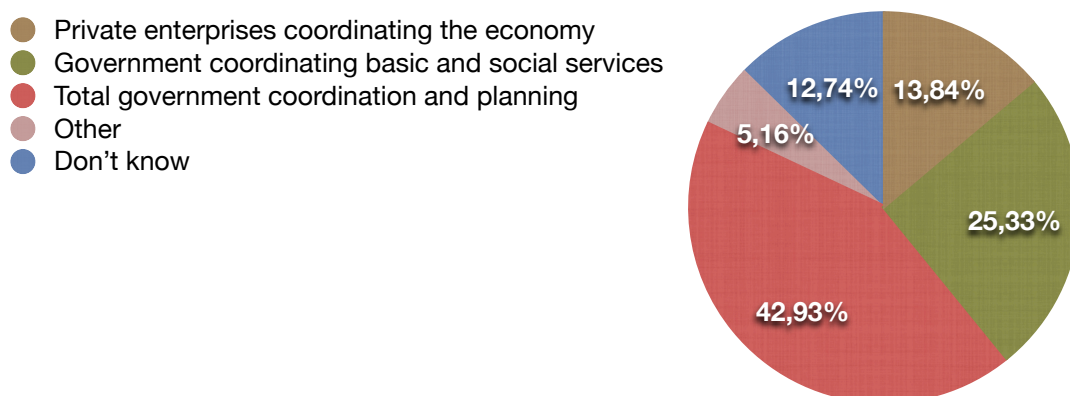
²⁴⁸ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo.

²⁴⁹ Ibid, pp. 71-73.

The fourth hypothesis - reducing state intervention or “state *versus* market” - was present in many public debates. Also, several publications started promoting an open campaign against the state and in favour of the market, helped by *Rede Globo*, Brazil’s most powerful television.²⁵⁰ As Singer mentions, some authors understood the general rejection to politicians as a form of opposition to the state. As a result, voting in the right was interpreted as a the desire to control public power by reducing the state, which was considered to be a permanent source of corruption.²⁵¹ As the question about state intervention was present only in the survey *Cultura Política/89* and not in the *Cultura Política/90*, there are only data for the first round.

People interviewed for the survey *Cultura Política/89* were asked, regarding the state’s role in the economy, what would be better. The possible answers were a) only private enterprises coordinating the economy, including basic and social services like education, health, and housing, b) the government should coordinate only basic and social services, or c) it is necessary total government coordination and planning, meaning controlling basic services, foreign trade, heavy industries, etc. The results - not presented by Singer - are presented below on the figure 2.7. The total majority preferred total government coordination and planning (42.93%).

Figure 2.7
Elector’s Preference Regarding State Economic Intervention



Source: Own elaboration based on data of the survey *Cultura Política/89*, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

Singer crossed these answers with the ones about voting in the first round. Also, to classify the candidates in a political left-right scale, Singer used the survey *Cultura Política/89*'s answers regarding the electors' own classification of political parties in the

²⁵⁰ Kowalski, C., & Santos, N. (2010). *A Mídia nas Eleições de 1989*. Paper presented at the XXXIII Congresso Brasileiro de Ciências de Comunicação, 2-6 September, Caxias do Sul, RS.

²⁵¹ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo, pp. 74.

spectrum left-right.²⁵² As this survey was also available, it was possible to reproduce Singer's calculations.

Table 2.11
Position of Brazilian Political Parties on a Left-Right Scale based on electors' opinion

Left	PT - PDT - PCB - PC do B - PSB
Center	PMDB - PTB - PSDB - PL
Right	PDS - PFL - PRN - PSD

Own elaboration based on data of the survey Cultura Política/89, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

Although Singer did not present the data on the position of political parties' preference for state intervention, it was possible to cross both variables. Surprisingly, state intervention was more connected with "right" (56.07%) than with "left" (49.13%). A possible explanation is that during the right-wing Brazilian military dictatorship, there was a high level of state intervention in the economy, and macroeconomic policy was used as instrument of economic development. As a result, the idea of state intervention possibly became connected with right-wing politics.

Table 2.12
Position of Brazilian Political Parties on a Left-Right Scale Based on Electors' Opinion and State Intervention

	Private enterprises coordinating the economy	Government coordinating basic and social services	Total government coordination and planning	Total
Left	12,11	38,75	49,13	100%
Center	15,38	53,85	30,77	100%
Right	18,93	25,00	56,07	100%
Total	16,46	32,61	50,93	100%

Own elaboration based on data of the survey Cultura Política/89, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

The next step was to classify the candidates accordingly to their party. The result was: Left - Lula (PT), Leonel Brizola (PDT) e Roberto Freire (PCB); Centre - Mário Covas (PSDB), Ulysses Guimarães (PMDB), Guilherme Afif (PL) and Affonso Camargo (PTB); Right - Fernando Collor (PRN), Paulo Maluf (PDS) and Aureliano Chaves (PFL).

²⁵² Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo., pp. 74-75.

Table 2.13
Voting Intention and State Intervention - %

	Private enterprises coordinating the economy	Government coordinating basic and social services	Total government coordination and planning	Total
Fernando Collor de Melo	17,60	22,53	59,87	100,00
Leonel Brizola	14,57	33,67	51,76	100,00
Luiz Inácio Lula da Silva	6,78	45,76	47,46	100,00
Mário Covas	17,95	58,97	23,08	100,00
Paulo Maluf	23,81	36,90	39,29	100,00
Other	14,29	52,10	33,61	100,00
Total	16,46	32,61	50,93	100,00

Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

As shown in table 2.13 above, since the idea of state intervention was connected with right-wing politics, it is no surprise that Collor and Maluf's electors also supported government coordination and planning. In Collor's case, it counted for practically 60% of the voters. Electors voting for centre politicians like Mário Covas coherently supported the state coordination of basic and social services. Nevertheless, accordingly to Singer, state intervention was not a relevant issue determining voting behaviour in 1989.²⁵³

The fifth hypothesis, strong leadership, is based on the idea the Brazilian political culture favours strong political leadership (Collor) instead of Lula's participative democracy. As Singer points out, some authors suggested that the electors were influenced rather by imaginary appeals than by the candidatures' rational meaning. This is explained by the campaign's tense political environment resulting from the economic crisis.

Starting from this presupposition, there were three candidates able to influence popular imaginary. Leonel Brizola would represent the saviour fighting the kingdom of darkness; Lula would represent the working class' revolutionary redemption; Collor would represent the solitary hero fighting against the temple of doom.²⁵⁴ In other words, Lula would represent the collective hope, while Collor was an individual leader. Another point to be considered is the hierarchal structure of the Brazilian society. There is a natural superiority of higher over lower classes, still the result of the colonial social stratification. As Lula's is from a very low social stratus of the Brazilian society, it was not admissible that he could be a better president than Collor, who had his origins within the sugar's elite.

²⁵³ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo, pp. 77.

²⁵⁴ *Ibid.*, pp. 77.

Table 2.14
Leadership and Voting - %

	A leader able to solve problems	Popular Participation	Both	Total
Lula	30,69	59,03	10,28	100
Collor	41,47	47,99	10,54	100

Own elaboration based on data of the survey *Cultura Política/90*, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

To test this hypothesis, Singer again used the survey *Cultura Política/90*. One question asked the respondents what would be better to solve Brazil's problems: a) a leader able to solve problems, b) popular participation, or c) both. Singer crossed the answers for this question with the respondents' electoral choice. The objective was to measure the degree of association between the options for leadership or democratic participation and voting. In both rounds the association among the variables was weak.²⁵⁵ Nevertheless, as shown in table 2.14, the option for Lula was more connected with the idea of popular democracy although in both cases popular participation was more important than individual leadership.²⁵⁶

The sixth and last hypothesis is that voting behaviour in 1989 was the result of ideological alignment. As Singer points out, several authors tried to test this hypothesis. Nevertheless, electors' ideological alignment following a left-right scale was only tested once by Singer in a previous paper.²⁵⁷ Using again data from the survey *Cultura Política/90*, Singer tested the electors' own location in a left-right scale. The result was that there was a significant association between voting behaviour and the electors' location choice already in the first round. However, in the second round this association became substantially stronger.²⁵⁸

Singer's conclusion is that self-positioning in the left was associated with voting for left-wing candidates, the same applying for those voters self-positioning in the centre and in the right. If observed at an individual level, to be self-positioned in the left was associated to voting for Lula and Brizola, rejecting Covas, Collor, and Maluf. To be self-positioned as centre was associated with voting for Covas and Brizola, while rejecting Collor and Lula. Finally, self-positioning in the centre meant rejecting Collor and Lula, but voting for Covas and Brizola. Finally, self-positioning in the right meant voting for Collor, while rejecting Lula, Brizola, and Covas, but not Maluf.²⁵⁹

²⁵⁵ Ibid., pp. 79.

²⁵⁶ The table 2.14 is a modified version of the one presented by Singer to make the results clearer. It was used the same dataset from the survey *Cultura Política/90*.

²⁵⁷ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo, pp. 80.

²⁵⁸ Ibid., pp. 81.

²⁵⁹ Ibid., pp. 83.

Table 2.15
Candidate's Ideological self-position versus voters' self-positioning in the Left-Right Scale - %

Candidates' Position	Voters' Self-Positioning		
	Left	Centre	Right
Left	65,63	33,49	20,37
Center	7,29	25,20	15,74
Right	27,08	41,31	63,89

Own elaboration based on data of the survey *Cultura Política/90*, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

The table 2.15, recalculated by this dissertation's author, shows that the electors' choice in the left-right scale was not as clearly reflected in the voting pattern as Singer claimed. First, 27,1% of the electors self-positioning as left voted for the right, while . Second, practically 33,5 % of the electors self-positioning as centre voted for the left, while almost 41,5% voted for the right. Only in the case of those self-positioning in the right there was a clear connection between the variables.²⁶⁰

A deeper analysis shows that Singer ignored some important aspects of voting and self-positioning in the left-right scale. As shown on table 2.16, Fernando Collor had the majority of centre and right-wing votes, while being the second most voted by left-wing electors beating Brizola and Freire, traditional left-wing politicians. Specifically about the centre, Collor was the most voted candidate (30.57%), with practically the sum of both Covas and Lula (34.19%).

Table 2.16
Voting in the First Round X Self-Positioning in the Left-Right Scale - %

Candidate	Left	Center	Right
Aureliano Chaves	0,00	0,93	0,00
Fernando Collor de Mello	24,31	30,57	54,26
Guilherme Afif Domingos	2,43	6,65	4,63
Leonel Brizola	19,10	14,35	5,56
Luis Inacio Lula da Silva	41,32	17,62	14,44
Mario Covas	3,82	16,57	5,19
Paulo Maluf	2,78	9,57	9,26
Roberto Freire	5,21	1,52	0,37
Ronaldo Caiado	0,00	0,23	0,37
Ulysses Guimaraes	1,04	1,98	5,93

²⁶⁰ The *Cultura Política/90* survey asked respondents to position themselves in a scale Left-2-3-4-5-6-Right. To make the analysis simpler, the seven categories of ideological self-positioning were grouped in this dissertation as:

Left+2=Left

3+4+5= Centre

6+Right= Right.

The candidates were grouped in the same way.

Candidate	Left	Center	Right
Other	0,69	0,12	0,19

Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

Nevertheless, in the second round the ideological a possible division became clearer. As shown on table 2.17 below, although it was to expect that the distribution of electors' ideological preferences should guarantee an easy victory for Collor, the division among the electors of the centre resulted in an equilibrium between Collor and Lula. This is the result of Covas' electors choosing Lula, following his party guidance. This division that resulted in centrist electors voting for both Lula and Collor explains the former good perform and the latter difficult to win in the second round, although the right had clear supremacy over the left.²⁶¹

Table 2.17
Voting in the Second Round X Self-Positioning in the Left-Right Scale - %

	Left	Centre	Right
Lula	67,49	41,83	20,23
Collor	32,51	58,17	79,77

Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

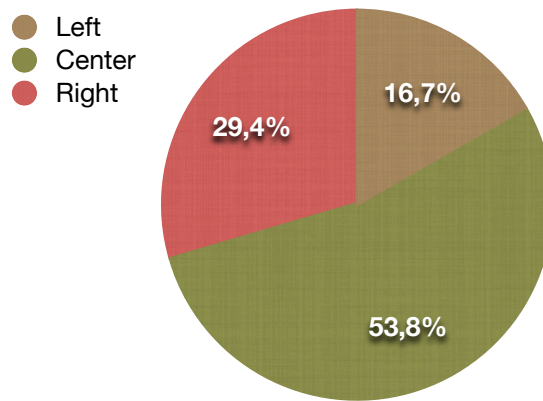
Thus, accordingly to Singer, electors' ideological self-positioning is the best predictor for voting in the 1989 elections' second round. Left-wing electors voted for left-wing candidates, the same applying for centrist and right-wing electors. As a result, to know an individual's party preference would be very effective in predicting voting, thus party and voting choices would follow an ideological criteria.²⁶²

Although Singer's hypothesis is statistically demonstrable, there are some problems. First, as figure 2.8 shows, almost 54% of the electors identified themselves as centrist, while only 29,4% as right-wing and 16,7% as left-wing. As a result, it would be to expect that Covas would have won the election already in the first round. Nevertheless, Collor won both first and second round. More, if voting was determined ideologically, Lula would not even go to the second round. As a result, although Singer's hypothesis is statistically demonstrable, it lacks logical consistency to be accepted.

²⁶¹ Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo, pp. 82-83.

²⁶² Singer, A. (2002). *Esquerda e Direita no Eleitorado Brasileiro: a Identificação Ideológica nas Disputas Presidenciais de 1989 and 1994*. São Paulo: Editora da Universidade de São Paulo, pp. 84-85.

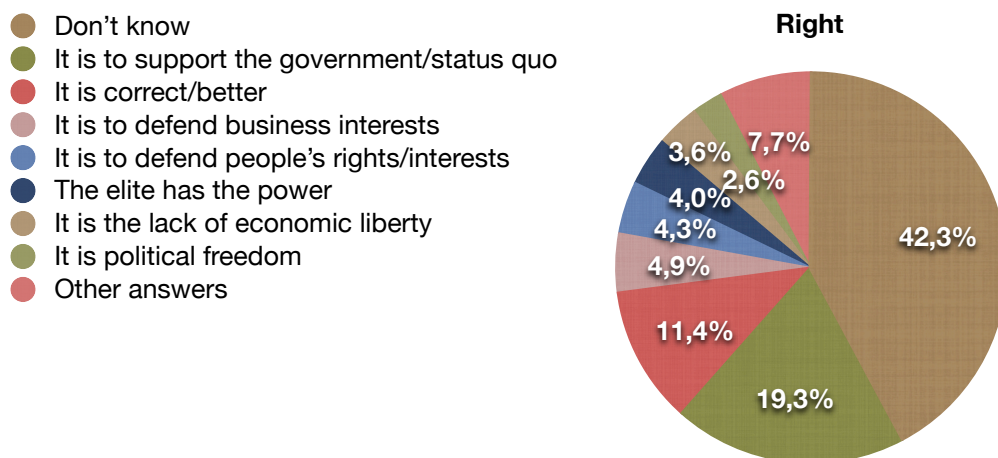
Figure 2.8
Elector's Self-Positioning in a Left-Right Scale - %

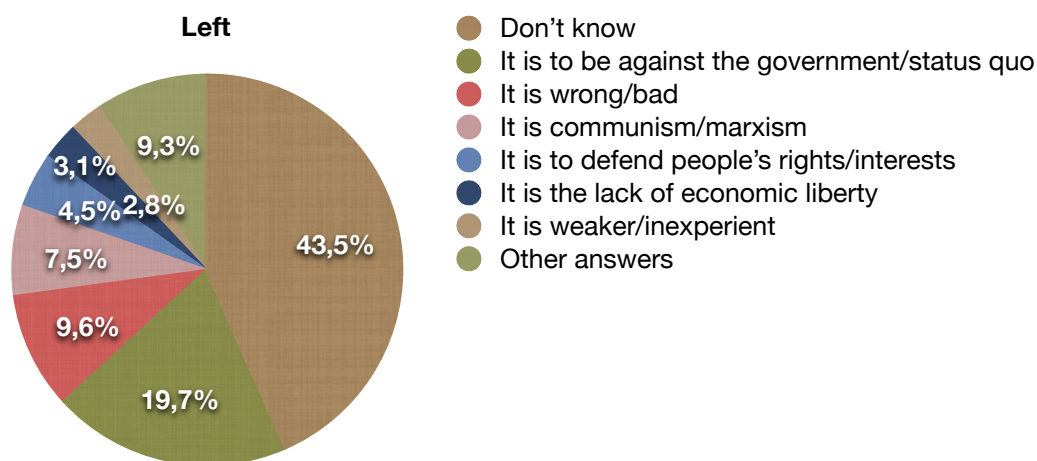


Source: Own elaboration based on data of the survey Cultura Política/90, In: Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/htm/busca.php>, own calculations.

Brazilian electors at that time had no understanding about the meaning of left-wing, right-wing, or centrist politics. As shown in the figure 2.9, around 43% of the Brazilian electors do not know the meaning of being right or left-wing. The ones claiming to know defined being right-wing to be equal to support the government /status quo (19.3%), to be correct/better (11.4%), to defend business interests (4.9%). The same applies to left-wing politics. To be left-wing was understood as being against the government/status quo by 19.7% of the respondents, while 9.6% considered it wrong/bad, and 7.5% equalised it with communism/marxism. Thus, it is not correct to claim that ideology was determinant for voting. At the same time, this means that there was no connection between ideological self-positioning as left or right-wing, and the preference for determined macroeconomic policies.

Figure 2.9
Elector's Understanding of the meaning of being Right or Left-Wing - %





Source: Own elaboration based on data of the survey Cultura Política/90, Banco de Dados do Centro de Estudos de Opinião Pública - CESOP - UNICAMP. Available in: <http://www.cesop.unicamp.br/site/html/busca.php>, own calculations.

Rather, the answer for voting behaviour in the 1989's elections can be found in the candidates' association with changing the Brazilian political and economic model, and its macroeconomic policies. Thus, it results from the influence of multiple variables. Collor's good performance in the Presidential election's two turns can be explained mostly by the conjunction of several factors. First, the public dissatisfaction over the political order established by the federal government during the period between 1985 and 1989. Second, the level of corruption and the crisis of governance that resulted from the constitutional reform, including poor economic regulation. Third, the macroeconomic stabilisation plans' inability to deal with the economic crisis and the inflationary process. Fourth, the incapacity of the state to compensate or attenuate the deterioration of living standards.²⁶³

In his Inaugural Speech, Collor was clear about his intentions to establish a new economic model, based on monetarist principles rather than based on keynesian macroeconomic policies:

My government's immediate objective, (...), my first year's target number one is not to contain inflation: it's to liquidate it. I'll concentrate all the energies of the executive power, I'll ask the Congress for all support to definitely eradicate from the Brazilian economy the weed that is inflation, our old indulgence with the furious (monetary) emission and the public deficit. My term will put everything on the victory against this social cancer, this intolerable obstacle to retaking our economic and human development. I'll make the monetary and financial stabilisation the absolute priority of this government's first steps.

²⁶³ Oliveira, F. (1992). *Collor: a Falsificação da Ira*. Rio de Janeiro: Imago Editora; Panizza, F. (2000). "Neopopulism and its Limits in Collor's Brazil". *Bulletin of Latin American Research*, vol. 19, no. 2, pp. 177-192.

(...) during the combat of the campaign, I could deeply realise how the Brazilian people want to eliminate the carnival of public expenses, monetary emission and prices.²⁶⁴

His strategy during the electoral campaign was to present himself as a new element, someone outside the traditional political establishment, thus able to solve Brazil's economic, thus social, problems by implementing a new model of development. In spite of being himself a member of Alagoas' sugar oligarchy, he presented himself as an independent maverick, apart the conservative parties and politicians. During the 1989's political campaign, he presented himself as the protector of the politically and economically marginalised to whom he started to refer as '*descamisados*,' an obvious reference to Perón's appeals to the Argentinian working class.²⁶⁵ Also, it was extremely difficult for both the Right and Left to attack him, without giving the perception of supporting the political, economic, and social models in force, amply repudiated by the population.

With a typical populist discourse, (Collor) attacked both the Left and the Right, accusing the Workers' Party of inciting invading land and armed conflict, at the same time he denounced the political oligarchy and the Brazilian economic elite. He also supported ecological questions, an item that was not part of the right-wing political agenda. As a result, it is possible to affirm that he was able to exasperate the Right and to perplex the Left.²⁶⁶

Starting from the popular opinion that the Brazilian political class is corrupt and just want to satisfy private needs, he centred his attacks against the state bureaucracy and the political class. Campaigning against the "maharajas" since his term as Alagoas' governor,²⁶⁷ Collor was able to please both the lowest social stratum and economic elite promising the reform of the public administration apparatus as part of his macroeconomic plan of stabilisation.²⁶⁸

The transformation of the social and economic order was considered a moral problem resulting from the actions of the privileged political class and economic elite, instead of the output of the Brazilian political history. In this way Collor was able to

²⁶⁴ Free translation from: "O propósito imediato de meu governo, (...), a meta número um de meu primeiro ano de gestão, não é conter a inflação: é liquidá-la. Concentrarei todas as energias do executivo, pedirei todo o apoio ao Congresso para erradicar definitivamente da economia brasileira a erva daninha da inflação, nossa velha indulgência com a fúria emissionista e o déficit público. Minha presidência jogará tudo na vitória contra esse câncer social, esse obstáculo intolerável à retomada decisiva do nosso desenvolvimento econômico e humano. Farei da estabilização monetária e financeira a prioridade absoluta de todos os primeiros passos desse governo. (...) no combate da campanha, pude perceber a fundo até que ponto o povo brasileiro deseja eliminar o carnaval dos gastos, das emissões e dos preços." From <http://www.collor.com>, access in 18 April 2002.

²⁶⁵ Ibid.

²⁶⁶ Free translation from: "Com um discurso tipicamente populista, atacou tanto a esquerda como a direita, acusando o Partido dos Trabalhadores de incitar a invasão de terras e a luta armada, bem como denunciando a oligarquia política e a elite econômica brasileira. Também defendeu as questões ecológicas, quesito que não fazia parte da agenda política da direita brasileira. Com isso, pode-se afirmar que, conseguiu deixar a direita indignada e a esquerda perplexa." From Schneider, B. R. (1991). "Brazil under Collor: Anatomy of a Crisis". *World Policy Journal*, vol. 8, no. 2, pp. 321-347, pp. 334.

²⁶⁷ The term "maharaja" was used to characterise civil servants who did not work and/or whose wages were much higher than the average.

²⁶⁸ Oliveira, F. (1992). *Collor: a Falsificação da Ira*. Rio de Janeiro: Imago Editora.

present himself as a messiah who would not permit the state bureaucracy and the politicians to continue working against public interest. More, this discourse was aligned with Neoliberal ideology, which was increasingly determining economic policy in place of developmentalism/Keynesianism. As Luiz Inácio Lula da Silva was publicly against neoliberalisation and globalisation, he was considered to be conniving with inflation and corruption. Collor made his alignment with the neoliberal discourse clear in his inaugural speech:

I believe that it is the responsibility of private initiative - and not of the state - to create wellness and stimulate the economy. The state must be responsible for planning development without statism while assuring justice in an ample and substantive mean. The state must be apt, permanently apt to guarantee some vital goods to the poorer. It must guarantee housing, food, health, education, and public transport for those who need these goods and services to achieve or maintain a dignified existence in the context of equal opportunities - as justice must be understood as the social dynamic based on freedom from all for all.²⁶⁹

Specifically on the necessity of liberalising the Brazilian economy as part of his macroeconomic policies, he also affirmed:

(I have) the conviction that a market economy is definitely a superior form for generating wealth, for intensive and sustainable development. That's why I'm convinced that, in the international plan, the most efficient and competitive economies are the opened ones, as they offer a high living standard to their citizens, with better wealth distribution. By the way, we will not have any colonial prejudice against foreign capital.

In resume, this plan of economic modernisation by privatising and liberalising the economy is the hope to complete the political liberty retaken by the democratic transition with the most ample and effective economic freedom.²⁷⁰

Collor's proposals were resumed in the same speech, when he reaffirmed his candidate's proposals and the directions of his national reconstruction plan, his moral crusade, where he clearly linked political ideals and morality to his macroeconomic policies:

It is my obligation to present you my candidate's proposals and elected President's profession of faith, my national reconstruction plan's directions. (...) They are: democracy and citizenship; inflation as main enemy; state reform and

²⁶⁹ Free translation from: "Creio que compete primordialmente à livre iniciativa - não ao Estado - criar riqueza e dinamizar a economia. Ao Estado corresponde planejar sem dirigismo o desenvolvimento e assegurar a justiça, no sentido amplo e substantivo do termo. O Estado deve ser apto, permanentemente apto a garantir o acesso das pessoas de baixa renda a determinados bens vitais. Deve prover o acesso à moradia, à alimentação, à saúde, à educação e ao transporte coletivo a quantos deles dependam para alcançar ou manter uma existência digna, num contexto de iguais oportunidades - pois outra coisa não é a justiça, entendida como dinâmica social da liberdade de todos para todos." From <http://www.collor.com>, access in 18 April 2002.

²⁷⁰ Free translation from: "a convicção de que a economia de mercado é forma comprovadamente superior de geração de riqueza, de desenvolvimento intensivo e sustentado. Daí a certeza de que no plano internacional, são as economias abertas as mais eficientes e competitivas, além de oferecerem bom nível de vida aos seus cidadãos, com melhor distribuição de renda. Não abrigamos, a propósito, nenhum preconceito colonial ante o capital estrangeiro. Em síntese, essa proposta de modernização econômica pela privatização e abertura é a esperança de completar a liberdade política, reconquistada com a transição democrática, com a mais ampla e efetiva liberdade econômica." From <http://www.collor.com>, access in 18 April 2002.

economic modernisation; the ecology; the social debt's challenge; and finally, Brazil's position in the contemporary world.²⁷¹

Accordingly to Fernando Collor, he was the only person capable of undertaking such moral crusade renovating the national political and economic order, as he was not aligned with any political faction or committed with business interests. Although he was in reality committed with business interests, during the campaign he was able to aggregate the lowest social classes' frustration with the Brazilian social and economic situation, making itself an icon.²⁷²

His image was constructed to disconnect his persona from his aristocratic origins. As he was born in one of the poorest Brazilian states, as he was fighting against the political and economic establishment, his political journey became associated with the life of millions of migrants who looked for a better life in the Southern big economic centres.²⁷³ Also, to connect his image with such ideas as innovation and independence, he usually presented himself as an excessively elegant, arrogant, and reckless young man, making his image to be synonymous with the idea of modernity.²⁷⁴

Using the media, mainly the *Rede Globo de Televisão* and the periodical *Veja*, Collor used his personal activities to show he was a venturesome leader. His appearances on television and on the press driving jet-skis and potent motorcycles, and performing sports tried to unite his personal image to the popular imaginary. As a result, Brazilians were able to identify themselves through cultural codes characteristic to television and sports symbolism.²⁷⁵ The strategy of uniting his apparent independence from the traditional political class with a moralising and populist rhetoric, promising a new political, economic, and social order, restoring macroeconomic order and the economic agents' confidence, resulted in a great appeal to public opinion. Insisting in the bankruptcy of the state, thus pleasing the lowest social stratum, at the same time supporting transitioning the economy to a neoliberal model as modernisation strategy.

On the other hand, Lula's macroeconomic policies reflected developmentalist ideas based on nationalist ideals. Basically, Lula program was based on a plan of long term economic development focusing on four points. First, macroeconomic management based on a) controlling inflation by regressive indexation and fiscal and monetary policies; b)

²⁷¹ Free translation from: "É meu dever apresentar-lhes, resumindo minhas propostas de candidato e a profissão de fé de presidente eleito, as diretrizes do meu projeto de reconstrução nacional. (...) São eles: a democracia e cidadania; a inflação como inimigo maior; a reforma do Estado e a modernização econômica; a preocupação ecológica; o desafio da dívida social; e finalmente, a posição do Brasil no mundo contemporâneo." From <http://www.collor.com>, access in 18 April 2002.

²⁷² Diniz, E. (1990). *O Plano Collor: Implicações Éticas e Políticas*. Iuperj, Grupo de Conjuntura 28.; Lessa, C., & Earp, F. S. (1999). O Insustentável Abandono do Longo Prazo. In J. P. d. A. Magalhães (Ed.), *Vinte Anos de Política Econômica*. Rio de Janeiro: Contraponto; Oliveira, F. (1992). *Collor: a Falsificação da Ira*. Rio de Janeiro: Imago Editora.

²⁷³ Panizza, F. (2000). "Neopopulism and its Limits in Collor's Brazil". *Bulletin of Latin American Research*, vol. 19, no. 2, pp. 177-192 .

²⁷⁴ Oliveira, F. (1992). *Collor: a Falsificação da Ira*. Rio de Janeiro: Imago Editora.

²⁷⁵ Panizza, F. (2000). "Neopopulism and its Limits in Collor's Brazil". *Bulletin of Latin American Research*, vol. 19, no. 2, pp. 177-192 .

unilaterally breaking the agreements with the IMF and suspending the payments on the external debt; c) a financial reform, mainly by elongating the domestic debt's profile and only issuing medium and long-term bonds. Second, policies to promote wealth distribution by a) increasing purchasing power by doubling the real minimum wage already in the first year of Lula's term; b) encouraging the production of staple goods and controlling supply; c) increasing the resources for social policies; d) supporting small producers and strategic activities promoting spatial decentralisation; e) reforming the fiscal system, including increasing taxes on capital gains, high income, and fortunes. Third, strategic investments to support a long-term expansive economic cycle by a) establishing a plan of strategic investments for the 1990's; b) increasing and modernising the productive structure; c) investing in science and technology. Fourth, supporting state efficiency by a) reforming the direct administration; b) democratising the management and restructuring state-owned companies, besides establishing a realistic tariff policy; c) generalising the practice of planning, maintaining state control over corporate and financial sectors; d) implementing rigorous practices of inspection of tax collection and combating tax evasion; e) review of the whole system of incentives and subsidies resulting in private appropriation of public resources.²⁷⁶

Land reform was considered one of the most important issues. Lula's idea was to amend the article 185 of the Federal Constitution, establishing a concrete concept of productive land permitting confiscating and distributing non-productivity properties. By the external side, the idea was to continue the previous policies pursued by the military regime and José Sarney, establishing a Latin American bloc to negotiate the external debt with developed countries.

While Lula's program was a continuation of the national developmentalist policies with few modifications, Collor's proposals were aligned with the Washington Consensus' conclusions, reflecting the political economic ideology in vogue.²⁷⁷ In other words, Collor's proposals basically reflected the Chicago School of Economics' neoclassical

²⁷⁶ Partido dos Trabalhadores. (1989). *Programa de Governo de 1989*. São Paulo: Partido dos Trabalhadores/Fundação Perseu Abramo..

²⁷⁷ The term Washington Consensus was coined by John Williamson in 1989, reflecting a set of policies aiming to promote development in Latin America. His original 10 points were: 1) keep budget deficits small; 2) shift public expenditure priorities from non-merit subsidies to expenditures that are pro-growth and pro-poor, like spending on basic health, education, and infrastructure; 3) construct a tax system that combines a broad tax base with moderate marginal tax rates; 4) liberalise interest rates (meaning that while independent central banks should fix the base rate, commercial lenders should be free to set whatever the market can bear on top of base rate); 5) maintain a competitive exchange rate via an "intermediate" regime, between fixed and free-floating; 6) liberalise trade; 7) liberalise inward foreign direct investment, but without pursuing comprehensive capital account liberalisation; 8) privatise state enterprises, with the exception of some sectors as, for example, public transport or water supply; 9) ease sectoral barriers to entry and exit; 10) provide the informal sector with the ability to gain property rights at acceptable cost. (see Williamson, J. (1990). What Washington Means by Policy Reform. In J. Williamson (Ed.), *Latin American Adjustment: How Much has Happened?* Washington: Peterson Institute for International Economics. This set of policies was radicalised and detached from its original origin by people championing Neoliberal ideology, being applied to all developing countries, including those in transition from socialism. In the 1990's, the ten points were transformed by politicians into a simplistic fundamentalist set of economic policies based on 'stabilise, deregulate, open up, and privatise'. see Wade, R. H. Washington Consensus. In W. A. Darity Jr. (Ed.), *International Encyclopedia of the Social Sciences* (pp. 38-40). Detroit: Macmillan.

monetarist theoretical framework, mostly based upon the ideas of Ludwig von Mises, Friedrich von Hayek, Milton Friedman, and George Stigler. As *Rede Globo*'s owner Roberto Marinho pointed out, the rivalry between Collor and Lula reflected the opposition between the modern and the archaic and not an ideological dispute between left and right,²⁷⁸ although Lula and his adherents considered it an expression of class struggle. In other words, the battle between Collor and Lula was the expression of the struggle between two different economic models and macroeconomic policies, where one is the new and the other the archaic.

Table 2.18
Collor and Lula's Macroeconomic Policy and the 1989's Elections

Item	Collor	Lula
Inflation	No freezing prices. Focus on budget deficit.	Freezing prices only if extremely necessary. Negotiation with business and unions to enforce a monthly prices and wages' reducer.
State-Owned Enterprises	Strong privatisation.	Restructuring state-owned companies, and establishing a realistic tariff policy
Industrial Policy	End of subsidies and incentives, together with import liberalisation.	Import restrictions for strategic sectors. Opening the market for foreign banks. Control of staple goods' prices.
Internal Debt	Elongate the debt profile.	Elongate the debt profile.
External Debt	Negotiate each item separately, showing that some sectors are able to borrow.	Suspension of payments and starting new negotiations after auditing the debt.
Land Reform	Stimulation of cooperatives.	Land confiscation and distribution.
Diplomacy	Creation of the Latin American Common Market. Strengthening economic laces with the EU, USA, and Japan.	Establishing a Latin American bloc to negotiate the external debt with developed countries
Wages	Total indexation.	After controlling inflation, indexation.

Source: Own elaboration.

Thus, Collor's victory should be understood as the result of two variables. First, the breakdown of national-developmentalism as economic model. Although several developmentalist authors had alerted that opening and liberalising the economy should follow the initial period of economic protectionism, the government ignored such advices. As a result, the model of development and state intervention was in crisis. Lula represented this model. Second, since the 1970's the economic mainstream were shifting from Keynesian-based economic policies to Neoclassical monetarist economics. It was to expect that the new mainstream would determine what was acceptable in terms of economic policy. Lula's program was against this new mainstream, while Collor's proposals were

²⁷⁸ O Estado de São Paulo, 23 nov. 1989, p. 4.

aligned with it. By a small margin, the society chose to end 60 years of national developmentalism, giving place to a new economic ideology. In this sense, the election of Fernando Collor symbolises the political determination of a new set of macroeconomic policies, following the establishment of a new economic ideology.

3. A MODEL OF IDEOLOGICAL CONVERGENCE AND MACROECONOMIC POLICY

After taking office, Fernando Collor implemented several measures to align the Brazilian macroeconomic policy with the Washington Consensus' prescriptions. If from the 1930's until the 1989's development was presupposed to be led by the state, after Fernando Collor's election there were severe changes. First, import substitution was substituted by trade liberalisation. Second, by opening the capital and financial accounts, in other words freeing the international movement of capital, including the so called 'hot-money'.²⁷⁹ Third, by establishing a program of privatisation aiming to end the state's direct coordination and planning of the economy. The former economic minister Marcílio Marques Moreira explained the connection of Collor's ideas with neoliberal ideology and the Washington Consensus:

In January 1990 the elected President, Fernando Collor, made a trip to the United States. He went with a very concrete agenda, including very diversified meetings: he met President Bush and Nicholas Brady, at that time Secretary of Treasury, but also with Michel Camdessus, Managing Director of the IMF, and with Enrique Iglesias of the IDB (Inter-American Development Bank). (...) I went with Collor to see Bush and the talks were very good. The themes discussed were the same Collor would approach in his inauguration speech: trade liberalisation, economic liberalisation, negotiating the external debt. (...) President Collor was fully aware of the multilateral agencies recipes for Latin America, which became known as Washington Consensus. I was present in the seminary in which the Washington Consensus' ideas were established. It was a seminary about the economic reforms for Latin America, organised by the Institute for International Economics between 6 and 7 November 1989. I have the book with the seminary's proceedings, published in 1990. Who presented the Consensus' ten points was John Williamson, and I've attended to this seminar. Eliana Cardoso and Daniel Dantas, both from Brazil, presented papers.²⁸⁰

These measures were not something really new. Instead they reflected the same recommendations gave by multilateral agencies to Latin America during the 1980's. Unilateral trade liberalisation for US products and services, for example, was a

²⁷⁹ Hot money refers to high volatile short-term speculative capital fluxes.

²⁸⁰ Free translation from: "Em janeiro de 1990 o presidente eleito, Fernando Collor de Mello, fez uma viagem aos Estados Unidos. Ele foi com um programa totalmente fechado que incluía contatos bastante diversificados: esteve não só com o presidente Bush e com Nicholas Brady, então secretário do Tesouro, mas também com Michel Camdessus, diretor-gerente do Fundo Monetário e com Enrique Iglesias, presidente do BID. (...) Fui com o presidente ao Bush e a conversa foi muito boa. Os temas foram aqueles que iriam compor a pauta do que seria o discurso de posse: abertura comercial, abertura da economia, negociação da dívida externa. (...) O presidente Collor tinha plena consciência do receituário das agências multilaterais para a América Latina que ficou conhecido como Consenso de Washington. Eu tinha estado no seminário em que se cristalizou a idéia do Consenso de Washington. Foi um seminário sobre as reformas econômicas para a América Latina, organizado pelo Institute for International Economics em 6 e 7 de novembro de 1989. Tenho o livro com os anais do seminário, publicado em 1990. Quem expôs os dez pontos do Consenso foi John Williamson, e assisti a essa conferência. Do Brasil apresentaram papers Eliana Cardoso e Daniel Dantas". Moreira, M. M. (2001). *Diplomacia, Política e Finanças: de JK a Collor; 40 Anos de História por um de seus Protagonistas*. Rio de Janeiro: Objetiva, pp. 225-31.

precondition for IMF and the World Bank lending money to the region.²⁸¹ Also, monetary stabilisation was considered to be an end in itself, together with reducing social expenses to consolidate the government's budget. Also, it was considered of extreme importance to reduce the taxes on the wealthy and mitigate the power of workers' unions by increasing unemployment. Only following this recommendations Brazil could start growing and developing again.²⁸²

This formulation of a new economic model to substitute national-developmentalism occurred in a context of ideological, thus also political and economic, change. The main victim - also on a global level - was the state, which was considered irrational, corrupt, ineffective, incompetent, and spendthrift. As a result, Collor's policies were aimed to consolidate the democratic transition and the recently gained political liberty with economic liberalism, at the same time stabilising the economy.

3.1 The New Macroeconomic Model: Economic (Neo)Liberalism

The first half of the 1980's was marked by high rates of inflation. Although during Ernesto Geisel's term it was relatively stable, around 40% a year. Between 1980 and 1982 it surpassed 100% a year, reaching 220% a year between 1983 and 1985. During the period between February 1986 and January 1991, several economic plans tried to stabilise the economy: in February 1986 there was the Cruzado Plan, in June 1987 there was the Bresser Plan, in January 1989 the Verao Plan. Fernando Collor tried two times to stabilise the economy, but the result was the same achieved by its predecessors: inflation was put down for some months just to come back more intense. Basically, all plans tried to initially synchronise wage and income's purchasing power eliminating indexation after some time by decrees (before the 1988's Constitution) or 'provisory measures.'²⁸³

These plans mainly failed first because of ignoring the internal demand's variables, at the same time artificially maintaining economic variables indexed. This was done by temporarily freezing prices, devaluating the exchange rate, prohibiting short-term indexation, and maintaining the real interest rate aligned with the plan's provisions. As prices, income, and profits were not really aligned, when indexation was eliminated prices automatically went up to recompose profits. As a result, workers also pressured for wage increases. On the other hand, with the end of inflation, general purchasing power increases resulting in stronger demand pressures. Thus, Fernando Collor's biggest challenge was to deal with a yearly inflation of around 1780%, while changing the development paradigm. In March 15, 1990, his first day in office, Fernando Collor promulgated several provisory

²⁸¹ Batista Jr., J. P. (1994). *O Consenso de Washington: a Visão Neoliberal dos Problemas Latino-Americanos*. São Paulo: Pedex, Cadernos da Dívida Externa no. 6.

²⁸² Anderson, P. (1996). *Balanço do Neoliberalismo*. In E. Sader (Ed.), *Pós-Neoliberalismo - as Políticas Sociais e o Estado Democrático*. São Paulo: Paz e Terra.

²⁸³ Translation of '*medida provisória*.' In the Brazilian constitutional law is a personal act of the President with force of law, without the participation of the legislative power, which will discuss and approve it (or not) *a posteriori*. Its justification is based on the concepts of 'urgency' and 'relevance.'

measures to reach his objectives. To deal with inflation and to stabilise the economy, he promulgated the provisory measure no. 168 which became known as “Collor Plan.”

Table 3.1
Collor Plan Liquidity Block Measures, Emergency Measure 168, March 15, 1990

Blocking most of financial actives with the exception of paper money in circulation. The amount of blocked “Cruzados-Novos” is to be retained at the Brazilian Central Bank for 18 months, being remunerated by 6 percent annual interest plus full inflation. Starting from the 19th month, the money would be freed in 12 month payments.
Financial actives would be converted au pair to “Cruzeiros” (Cr\$), after extraordinarily paying 8% of Tax on Financial Operations in the case of non-monetary actives, operations in the stock market, and gold. Bonds and short-term deposits of financial institutions were exempted.
The conversion to “Cruzeiros” was to be made in the same moment the blocked actives were freed. There were some specific rules: <ul style="list-style-type: none"> - Paper money: immediate conversion, no blocking; - Short-term deposits and ordinary savings accounts were permitted to be converted and withdrawn until the limit of 50 thousand cruzados (approximately US\$ 1,350.00 in 1990 or US\$ 2,300.00 in 2010); - Short term investments and overnight deposits could be converted and withdrawn until a limit of 25 thousand cruzeiros or 20% of the total, the highest one; - Other financial actives, including private enterprises’ deposits, could be converted until the limit of 20 per cent of the total.
All limits were to be calculated by investor and/or financial institution. Bonds and deposits of the financial institutions’ active followed the same rules.
Long-term deposits and debentures were to be converted by occasion of their maturity. Investment funds followed the same rules, with the exception that conversion was dependent on the availability of liquidity in cruzeiros. Shares not being converted were to remain being denominated as “Cruzados Novos” until maturity. Bonds which maturity was longer than 18 months were to be denominated in “Cruzados Novos”.
The blocked “Cruzados Novos” could be used for 60 days (until May 18, 1990) to pay taxes and pension contributions; for 180 days they could be transferred among individuals and firms to settle debts from before March 15, 1990.
Resources from the national, state, and municipal level were not blocked.

Source: Own elaboration, based on the Emergency Measure 168, available in <http://www6.senado.gov.br/legislacao/ListaPublicacoes.action?id=133851&tipoDocumento=MPV&tipoTexto=PUB>, access in January 21, 2011.

As can be seen on table 3.1 above, the five fundamental points were a fiscal adjustment to guarantee an operational surplus of 2% of the GDP, a monetary reform to give back to the state the control of the monetary base, an income policy determining the price system *a priori* at the same time eliminating any sort of indexation, and an industrial and commercial policy liberalising finance and trade.

The fiscal adjustment had three main points. First, a tributary reform reducing the term of tax collection and the indexation of tributes, increasing taxation and/or tax rates (in the case of agricultural rent and exports), the suspension of all incentives, including those to the Northern and Northeastern regions, with the exception of the Free Economic Zone of Manaus’s. It also increased the taxation on financial operations, including operation in the

stock market. This would be equivalent to 6 per cent of GDP. Second, a patrimonial reform by selling state owned assets by establishing a privatisation program. Third, an administrative reform, reorganising the State administrative apparatus and reducing bureaucracy.

The monetary reform was the most controversial issue. First, the Brazilian currency was changed from 'cruzado' to 'cruzeiro,' to erase the economic agents' inflationary memory connected with the old currency. Second, prices and wages were converted following a rate of one cruzado to one cruzeiro. Deposits and investments followed specific rules. First, all ordinary deposits and savings were frozen in cruzados. It was permitted to convert and withdraw 50 thousand cruzados (approximately US\$ 1,350.00 in 1990 or US\$ 2,300.00 in 2010). The rest was to remain frozen for 18 months remunerated by 6 percent annual interest plus full inflation. After this period, all money could be converted and withdrawn. Short term investments and overnight deposits could be converted and withdrawn until a limit of 25 thousand cruzeiros or 20% of the total, the highest one. Private enterprises could convert and withdraw 20 percent of their deposits and investments. The exchange policy remained the same, with the difference that the exchange rate started to be determined by the market instead of unilaterally by the Central Bank.²⁸⁴ The monetary adjustment was equivalent to 10% of GDP and reduced liquidity to 20 percent of the prior period.

The income policy was mainly based on freezing prices and wages. Prices were frozen by their value in March 12, 1990. It was permitted to practice lower prices but increases should be authorised by the government. In the first date of every month the government would make public an index of inflation expectation to readjust prices. Wages were first readjusted in 72.28% in March. After that, they were readjusted following an index of inflation calculated *a priori*. In the case inflation was higher than the inflation index, the workers were expected to freely negotiate with their employers. In case of conceding wage increases, the latter were forbidden to transmit the difference to prices.

However, the most important change was related to the model of development. Since the 1930's Brazil's development was based on developmentalism, where the state has a direct role in inducing development.²⁸⁵ Fernando Collor considered this model partly responsible for the national economic problems. Thus, a new industrial and commercial policy was established to modernise the economy. The main objective was to change the

²⁸⁴ There were three exchange rates in Brazil. The 'commercial,' used for international trade and financial transactions; the 'touristic,' used for air-tickets, hotel reservation abroad, and international operations using credit cards; and the 'parallel' or black-market. Although since 2005 the Brazilian exchange market became unified, private agents still use different rates for specific operations.

²⁸⁵ For a discussion on developmentalism and its problems see Bresser-Pereira, L. C. (2008). Macroeconomics of Stagnation and New Developmentalism in Latin America. In M. Forstater, & L. R. Wray (Eds.), *Keynes for the Twenty-First Century: the Continuing Relevance of the General Theory*. New York: Palgrave Macmillan.

focus from expanding productive capacity to increasing competitiveness.²⁸⁶ The main measures were directing incentives to the production of goods to be exported, increasing the support to technologically capacitating the national industry, and a specific strategy to developing high technology infant industries.²⁸⁷

The national economy was to be exposed to international competition also by reforming the commercial legislation in force. The import policy's reform included abolishing tax exception and special tax regimes for some imports, introducing import tariffs as basic instrument of protection instead of quantitative restrictions, the progressive reduction of import tariffs and their dispersion, the establishment of mechanisms to protect the national economy from the excessive penetration of imports, and mechanisms to minimise the structural adjustment costs of the most affected sectors.²⁸⁸

The general directives of the system of protection, stimulus, and regulation of industry and foreign trade were established by the provisory measures 158 (later Law 8032/90) and 161 (later Law 8034/90) and by the regulation MEPF 56. The main objective was to dismantle the system of protection and incentives in force for decades. The Law 8032/90 revoked the exemption and reduction of import tariffs and *Imposto sobre Produtos Industrializados* - IPI on imported goods, mainly informatics, imported goods by international trade agreements, and capital goods acquired for the industrialisation of Zones of Exporting Processing.²⁸⁹ Finally, it established zero tax on imports of goods not produced in Brazil. The regulation MEPF 56 revoked the lists of products prohibited to importing (Annex C), the requirement for private companies to present programs of imports, and the previous agreement of federal agencies to import, with exception of informatics. Also, the law 8034/90 changed the legislation on income tax applying to juridical personas.

Specific measures were adopted to reduce non-tariff barriers. First, all non-tariff barriers without explicit legal provision were, with the exception of informatics, which was regulated only in 1991 with the new Law of Informatics. Second, in August 1990, the minimum requirements for financing imports were abolished. Third, the indexes of nationalisation for credits from the National Bank of Economic and Social Development applying to capital goods were reduced. Fourth, a considerable part of the legislation establishing the administrative procedures affecting cost formation (incentives and subsidies) or entry conditions (protection mechanisms) for informatics was removed. Import tariffs were reformed following a schedule of gradual reductions (table 3.2) until 1994 (table 3.3). Still, several legal proceedings deepened the process of commercial

²⁸⁶ Guimarães, E. A. (1996). *A experiência recente da política industrial no Brasil: uma avaliação*. Brasília: IPEA, Texto para Discussão no. 409; Lyra, F. T. d. (1996). *A política industrial brasileira: mudanças e perspectivas*. Brasília: IPEA, Texto para Discussão no. 413.

²⁸⁷ Guimarães, E. A. (1996). *A experiência recente da política industrial no Brasil: uma avaliação*. Brasília: IPEA, Texto para Discussão no. 409.

²⁸⁸ Ibid.

²⁸⁹ Tax on industrialised products.

liberalisation. The concept of ‘nationally produced capital goods’ was changed, reducing the level of nationalisation to 70% and later to 60%. Table 3.2 shows the nominal import tariffs’ evolution between July 1988 and October 1992, when Fernando Collor was impeached.

Table 3.2
Nominal Import Tariffs’ Evolution between 1988 and 1992

Period	Simple Mean	Weighted Mean
July 1988	38,5	34,7
September 1989	31,6	27,4
September 1989	30,0	25,4
February 1991	23,3	19,8
January 1992	19,2	16,4
October 1992	15,4	13,3

Source: Kume, H. (1996). *A Política de Importação no Plano Real e a Estrutura de Proteção Efetiva*. Brasília: IPEA, Texto para Discussão no. 423.

By promoting commercial deregulation the objective was to stimulate the presence of imported goods in the national market pressuring the national industry to be more competitive. Also, to help fighting inflation with the cheaper imported goods, at the same time avoiding demand pressures. The biggest challenge was to protect the international reserves and to maintain the external accounts in equilibrium.²⁹⁰ This happened until 1995, when the Real Plan used imports to curb inflation, as shown on table 3.4 below.

Table 3.4
Brazil’s Trade Balance 1988 - 1995, US\$ million

Year	Imports	Exports	Result
1988	14.605	33.789	19.184
1989	18.263	34.383	16.120
1990	20.661	31.414	10.753
1991	21.041	31.620	10.579
1992	20.054	35.793	15.239
1993	25.480	38.597	13.117
1994	32.701	43.554	10.843
1995	49.859	46.506	-3.353

Source: Own elaboration based on data of the Central Bank of Brazil.

Financial liberalisation and the return of the Brazilian economy to the international capital market occurred concomitantly to the the commercial liberalisation. Basically, it was the result of a strong process of financial deregulation freeing international movement of capital notably after Marcílio Marques Moreira took office as minister of economics. This process was part of a broader adjustment by highly indebted underdeveloped countries to get access to the international financial market and to voluntary foreign investments inside a conflictual relationship with external creditors.²⁹¹

²⁹⁰ Andrade, R. P. d. (1991). Plano Collor e Setor Externo. In F. Oliveira (Ed.), *A Economia Brasileira em Preto e Branco*. Campinas: Editora Hucitec.

²⁹¹ IESP. (1995). *Gestão Estatal no Brasil: Limites do Liberalismo 1990-1992*. São Paulo: FUNDAP.

The main instruments of financial liberalisation were: a) the elimination of the taxes (40% - 60%) on dividends exceeding 12% of the capital (Law 8383/91); b) the elimination of the 8% taxation at source on liquid profits (Law 8383/91); c) the elimination of the prohibition on paying royalties and technical assistance from subsidiaries to main companies (Law 8383/91); d) the end of the temporary prohibition on dividends' remittance before the updating of the Central Bank of Brazil's records (Circular Letter BACEN 2165/91); e) the permission to financial revenues to be registered as foreign capital (Circular Letter BACEN 2266/92); f) the reduction of the required minimum period for resources from the external public debt's bonds spent in privatisation auctions to stay in the country from 12 to six years; g) the permission to transnational companies to register as capital acquired technology (copyright, permission to use brands, etc) as inflation correction of reinvested profits; h) the permission to foreign investment in real estate.

In the same way as with the process of commercial liberalisation, financial deregulation was based on neoliberal ideology, as recommended by multilateral agencies. Since the external debt crisis in the ending of 1982, foreign investment in Brazil was mainly from debt negotiations with international creditors, including the IMF. Nevertheless, as a result of financial liberalisation, in 1990 the influx of foreign investment significantly increased to US\$ 911 million, from which US\$ 631 million in commercial paper, US\$ 258 million as intracompany investment, and US\$ 22 million from government bonds (in 2010 values, respectively US\$ 1,560.11, US\$ 1,080.60, US\$ 441.83, and US\$ 37.68 million).²⁹² Nevertheless, should be noted that foreign interest rates were lower than the Brazilian rates, mainly in relation to the exchange and to the real interest rate.²⁹³ As a result, part of these investments was of highly volatile speculative capital. In other words, financial liberalisation was financed by increasing public debt, weakening the monetary, fiscal, and exchange policies' effectiveness.

Another important point of Collor's program of economic reform was to change the model of state administration, including its role on promoting economic development. The main objective was to adapt the Brazilian economy to the Washington Consensus' directives. Thus, besides the process of commercial and financial liberalisation, the acceleration of the National Program of Privatisation - PND was fundamental. The main idea was to reduce public debt, induce private investment, modernise the Brazilian industrial sector, and incentive the democratisation of capital property. Nevertheless, the main PND's role was to reduce public debt.

Privatisation was considered a key element of stabilisation because of four points. First, because it permits the entrance of private players in sectors with high barriers to entry because of very high initial investment requirements, like infra-structure, petrochemical, and siderurgy. Second, it is possible to buy a company by low prices and with low good financing opportunities. Third, because such firms already have an

²⁹² Banco Central do Brasil. (1992). *Relatório Anual*. Brasília: BACEN.

²⁹³ Banco Central do Brasil. (1993). *Relatório Anual*. Brasília: BACEN.

established market share, guaranteeing demand. Fourth, companies being privatised usually were sanitised, in other words, the state had absorbed their debts.

Table 3.5
Phases of the Brazilian Program of Privatisation

Phase	Period	President	Main Sectors	Number of Companies	Value (*) US\$ million	Comments
First Phase (re-privatization)	1981-1989	General João Figueiredo and José Sarney	Many	39	735	Privatisation of companies, which were absorbed by the government because of bankruptcy
Second Phase	1990-1992	Fernando Collor	Siderurgy Petrochemicals Fertilizers	18	5.189,9	Privatisation as neoliberal policy
Third Phase	1993-1994	Itamar Franco	Siderurgy Petrochemicals Fertilizers	15	6.503,0	Privatisation as neoliberal policy, but in less scale
Fourth Phase	1995-1996	Fernando Henrique Cardoso	Chemicals Railways Electricity Services	19	6.377,0	Mostly concession of public services, specially infra-structure
Fourth Phase (cont.)	1997-	Fernando Henrique Cardoso	Mining Ports	13	10.694,0 (**)	Vale do Rio Doce and Eletrobrás' privatisation

Source: Own elaboration, based on data of the Brazilian National Bank for Economic and Social Development.

(*) Revenues plus transferred debt. The revenues from concession are not included.

(**) Until December 31, 1999.

As can be seen on table 3.5 above, the debate on privatisation was present in Brazil since the beginning of the 1980's, thus still during the military regime, and may be divided in four main phases. The first phase begun during General Joao Figueiredo's government. At this time the objective was not to implement an effective program of privatisation, but rather to transfer back to the private sector the companies nationalised because of financial problems. The main objective was to avoid intensifying the presence of the state in the productive sector. During this period, 39 small companies were privatised by a total of US\$ 735 million.

The second phase started in the beginning of the 1990's, after the law 8031/90 created the National Program of Privatisation, as part of Collor's strategy of economic stabilisation and modernisation. Thus, privatisation was connected with commercial and financial liberalisation, and the administrative reform of the state, reflecting the changes the Brazilian model of economic development was passing through. During this phase, the companies included in the National Program of Privatisation were mostly those of the sectors before considered strategic, as petrochemicals, siderurgy, and fertilisers. It were included 68 companies, from which 18 were of strategic sectors. The projected revenue would be US\$ 5,000.0 million. From 1993, this process was intensified until 1995, when the privatisation of siderurgy was complete. As matter of comparison, the result of Usiminas' privatisation was more than double of all the 1980's privatisations.

Although privatising was connected with modernising and increasing competitiveness, in reality the main focus was promoting fiscal adjustment by debt reduction. Thus, the basket of privatisation money was very ample, including privatisation certificates, government's internal debt bonds, agrarian debt bonds, external debt bonds, Siderbras' debentures, among other. As a result, the total of rotten assets used was equivalent to 87.7% of total revenue. Adding the amount of transferred debt, rotten assets were 90.3% of the total. Deducing only what was invested on the four metallurgical companies before privatisation from the total really collected, privatisation resulted in losses of around US\$ 10,249.5 million to the national treasury.

3.2 Old Political Determinants of New Macroeconomic Policies

Although Fernando Collor was elected with considerable electoral support, he formed a minority government. The literature points three main points to explain: a) Collor's personal negative, irresponsible, and/or centralising characteristics resulting in ignoring the National Congress; b) the party system's fragility that made impossible to establish a solid majority in the Congress, as also impeded the establishment of a big centre-left party as well; c) the Brazilian plebiscitary presidentialism compromises the creation of coalitions, at the same time it jeopardises the relationship between executive and legislative.²⁹⁴

Fernando Collor was convinced that neoliberal macroeconomic policies were the best to stabilise the economy and promote economic growth and development. Nevertheless, to be able to implement these policies, he had to deal with the National Congress elected in 1986. As a result, the 1990's National Congress was not homogenous. Although the left got 20% of the seats, the centre got 41% and the right got 39%. Taking in consideration that the PMDB, the party with most seats, was not inclined to support full market liberalisation, but rather to defend the status quo, Collor had to be very careful when negotiating the reforms.

Thus, taking in consideration the context of the presidential elections, it is possible to conclude that forming a minority government was ideal for Collor. There are four variables to be considered, to help understanding this rationale: a) the dynamics of the post-military party structure, principally the decline of PMDB; b) the new presidential legislative instruments introduced with the 1988's Constitution; c) the economic crisis and the inflationary boom; d) the temporal gap between Collor's inauguration in March 1990 and the legislative elections in October 1990. In other words, Collor's government's political sustainability was based on exploring unilateral advantages as strategy of dominance.

²⁹⁴ Lamounier, B. (1991). *Depois da Transição: Democracia e Eleições no Governo Collor*. São Paulo: Edições Loyola; Lamounier, B. (1992). *Estrutura Institucional e Governabilidade na Década de 1990*. In J. P. d. R. Velloso (Ed.), *O Brasil e as Reformas Políticas*. Rio de Janeiro: José Olympio Editora.

Table 3.7
Collor's Ministries

Ministry	Minister	Party
Agriculture	Joaquim Domingos Roriz	PTN
Economy	Zélia M. Cardoso de Mello	-
Infra-Structure	Ozires Silva	-
Education and Culture	Carlos Alberto Chiarelli	PFL
Health	Alceni Guerra	PFL
Labour and Social Care	Antonio Rogério Magri	-
Social Action	Margarida Maria Maia Procópio	-
Justice	José Bernardo Cabral	PRN
Foreign Affairs	José Francisco Rezek	-

Source: Own elaboration, based on several editions of the hebdomadary *Veja* digital archive available at <http://veja.abril.com.br/acervodigital>.

The analysis of the table 3.7 above shows that, with the exception of Collor's own PRN, the only parties getting a ministry were the PFL, one of the heirs of the military's official party (PDS), and the small PTN. Thus, Collor hoped to negotiate with the PMDB, the biggest party in the congress, at the same time composing with the right-wing parties that supported him in the second round. Also, he was counting on the efficacy of provisory measures to avoid problems with the opposiiton.

In Brazil, provisory measures have force of law immediately after its promulgation, and usually the legislative ends passing them later. As provisory measures change the status quo immediately, the legislative does not analyse the prior status quo (SQ) and the one resulting from the provisory measure's promulgation (SQmp). Rather, it decides between SQmp and the expected output of rejecting the provisory measure being discussed (MPrej). The legislator's preference system can be simplified as $SQ > SQmp > MPrej$, > being equal to "preferred to."²⁹⁵ Thus, provisory measures result in legislative cooperation and even in a situation of minority support the executive is able to pass their bills.

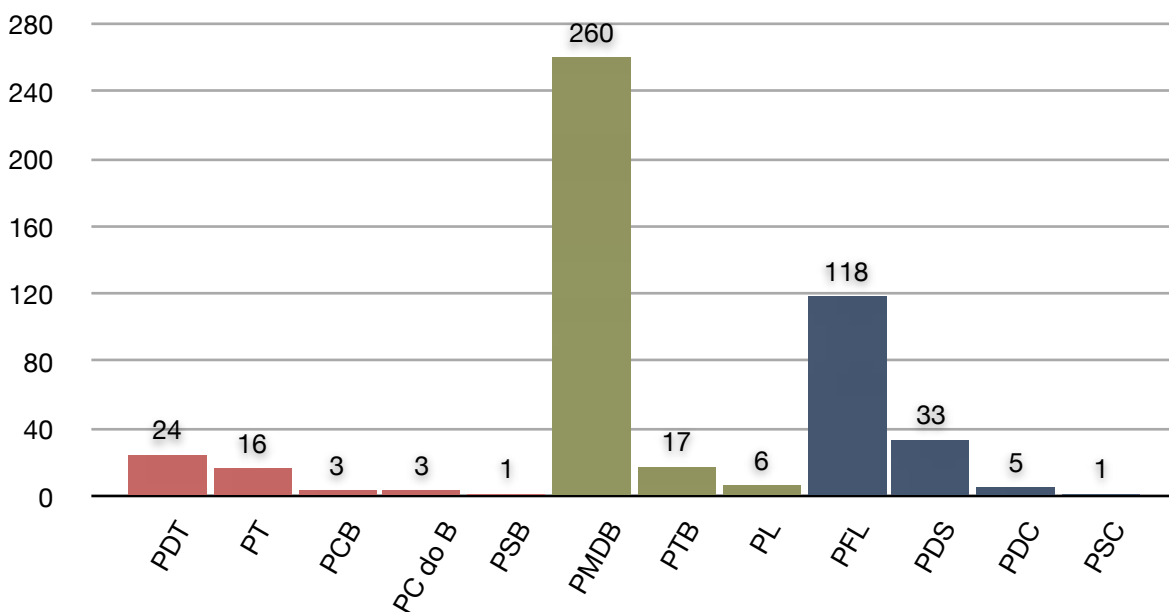
By the side of the newly elected government, any agreement with the PMDB would mean to jeopardise the principles of the economic plan. Not only it was Sarney's party, but was also deeply connected with the system of political patronage of Brazilian politics and the biggest political party. At the same time, several PMDB's congressmen were quite left-wing, what could have reduced party discipline or resulted in very strong pressures to soft the plan even before its becoming public. In the case this group of left-wing congressmen left the PMDB, Collor's support in the Brazilian congress would be very thin, even considering the discipline of both PRN and PFL.

The challenge was to pass all emergency measures implementing the new macroeconomic policies intact in a congress dominated by the PMDB. Being Sarney's party, its name was associated with the fight for democracy and the ending of the military regime. This popularity resulted in the party being extremely popular. In the 1986

²⁹⁵ Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV, pp. 25-26.

elections, the party elected 22 from the 23 state governors, the exception being the state of Sergipe which elected PFL's Antônio Carlos Valadares. As shown on figure 3.1 below, in the National Congress, 260 of the 487 elected congressmen (53.4%) and 38 of the 49 elected senators (77.6%) were elected by the PMDB.

Figure 3.1
Party Composition of the Brazilian Congress by Ideological Orientation in 1987
 (Red=Left, Green=Centre, Blue=Right)



Source: Own calculations and elaboration based on data from the Brazilian Superior Electoral Tribunal.

Notwithstanding the possible problems, Collor's government succeed and the congress approved the economic plan. None of the 22 provisory measures was rejected, with 19 being approved and transformed in law before the constitutional limit of 30 days, and 2 being substituted by new provisory measures for being unconstitutional. Only one was re-edited, loosing its power in the ending of its second edition. In spite of that, as the PMDB was able to be reporting all emergency measures, the government was forced to negotiate and to make concessions in the form of some amendments.

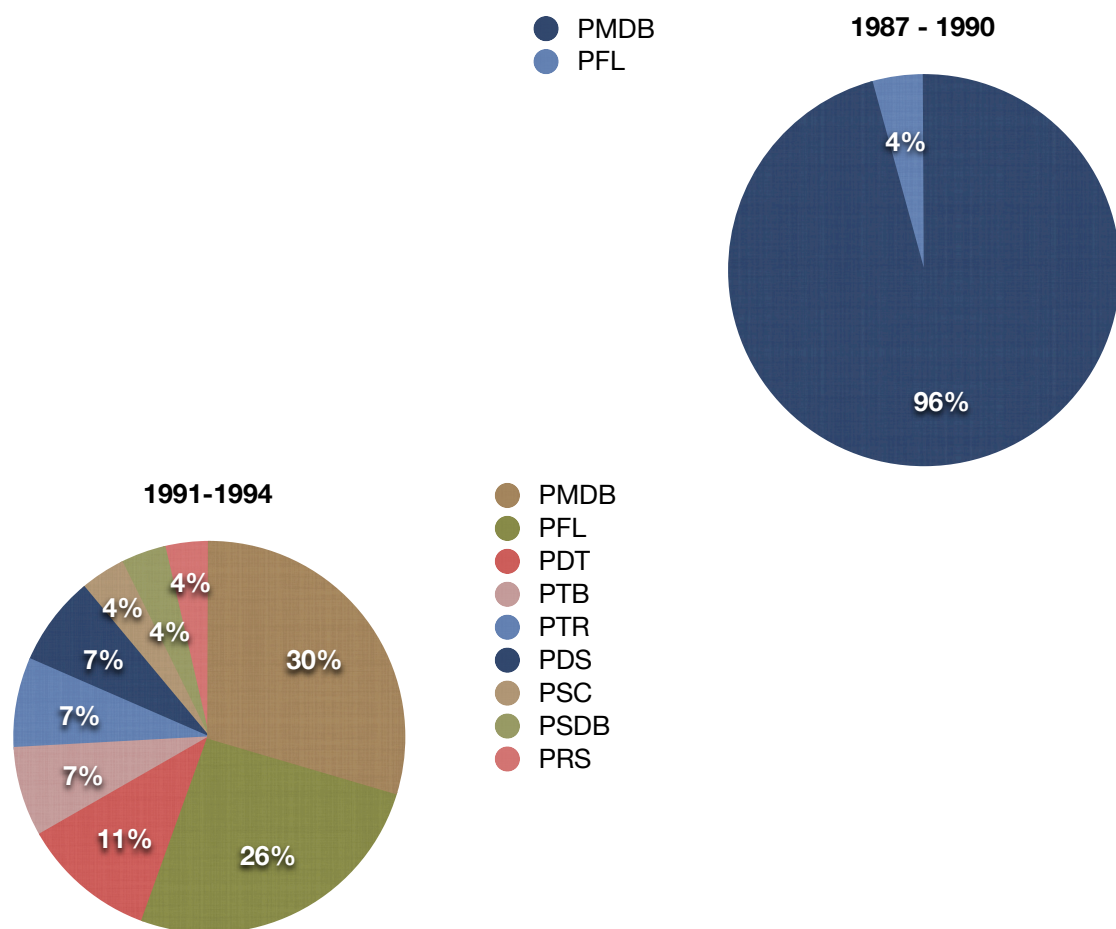
The PMDB explicitly supported 13 of the 16 emergency measures voted on nominal ballots, with the exception of the MPs 161 and 168. The votes controlled by its leadership were more than enough to assure passing the previously agreed emergency measures. Even taking in consideration that, in the case of some specific bills, the PMDB's left-wing could not follow the leadership's orientation, it was small enough to not affect voting outcome. As a result, the government always had a considerable margin for approving all emergency measures.²⁹⁶

However, an important question remains: why did the PMDB voted for Collor's changes if it was part of the opposition? The question relies on several factors. First, the

²⁹⁶ Ibid., p. 176-177.

party was passing through an internal crisis. had being loosing popular support after the disaster of Sarney's government. Having elected 260 congressmen in 1987, after three years the PMDB had lost 103 (39.6%) of them, with more than a half (54) switching to the newly founded PSDB. In the 1989's Presidential elections, PMDB's candidate Ulysses Guimarães got only 4% of votes, mainly as a rejection of the party's social and economic program. The process of loosing popular support would continue through the year. This trend can be illustrated by the results of the elections for governor. As figure 3.2 shows, the PMDB lost its political hegemony after 1990.

Figure 3.2
Governors Elected by Party - 1987 and 1990



Source: Own calculations and elaboration based on data from the Brazilian Superior Electoral Tribunal.

Because of Collor's popularity, in 1990 PMDB's campaign strategy was to make what was called "responsible opposition" to Collor. In other words, to wait for the edition of the first emergency measures, analysing *a posteriori* the merits of each one. Because of Collor's strong criticism to Sarney, it was natural that the PMDB would be part of the opposition. In this sense, voluntarily starting supporting the government was considered to admit the political defeat and the party's debacle. However, it was understood that there were limits to rising legislative barriers to the first government democratically elected in almost 25 years. Also, the political characteristics of the new government have been made

explicit already during the campaign. Thus, to be opposition was considered the rational thing to be done, at the same time trying to push the government's agenda to the left by backstage negotiations.

Also, the terms of what would later be called Collor Plan have been presented to the PMDB's economic team even before Collor's inauguration. The conclusion was that they were not compatible with the party's ideology. Knowing that the idea of blocking financial activities had its origins in the academic field and was naturally "imposed" to the main presidential candidates, the PMDB was counting with the possibility of immediate and strong popular rejection to the economic shock.²⁹⁷ The party's strategy was to capitalise this rejection - in case it would happen - or to the plan's failure in the short run. However, although facing political decline, the PMDB still was the most powerful party in the national congress with 108 (21.5%) chairs.

Being a centrist party or, in other words, a catch-all party, it just could not be ignored by any government, right-wing or left-wing. The combination of the fact that to directly collide with the party would turn Brazil ungovernable with the PMDB's fear to be responsible for ruining the plan resulted in an equilibrium with considerable level of elasticity from both parts. This was a risky situation to the government, which was afraid of the plan becoming too disfigured, as the coalition supporting the government was a minority group.

Although relatively small, this group was known as "assault troop" because it was extremely active. Led by PRN's Renan Calheiros and PFL's leader Ricardo Fiúza, its main objective was to avoid interference from the opposition, assuring Collor Plan's integrity. Also, to guarantee the victory of the government's coalition when voting the emergency measures and to deal with the high volume of amendments and detachments.²⁹⁸

In a general manner, this number was high, reflecting the congressmen's will to change the plan. The fourth column from the left shows the number of accepted amendments. It is to be noted the difference between the number of amendments presented by congressmen and the number of amendments that were really incorporated into the initial proposal reformulating it. In this case, the filter was the PMDB, who forced Collor to make concessions to avoid turning the turbulent voting process into chaos, as illustrated on table 3.8 below.²⁹⁹

²⁹⁷ Carvalho, C. E. (2006). "As Origens e a Gênese do Plano Collor". *Nova Economia*, vol. 16, no. 1, pp. 101-134, pp. 123-125.

²⁹⁸ See table A.1. in the Annexes.

²⁹⁹ Ibid..

Table 3.8
Presented, Incorporated, and Voted Amendments and Highlights, Collor Plan I,
March 1990

PM	Subject	Number of Proposed Amendments	Number of Accepted Amendments	Number of Proposed Detachments	Number of Accepted Detachments
148	Alienation of State Owned Real Estate	10	1	10	0
149	Idem	208	22	60	4
150	Ministries	260	87	133	4
151	Extinction of Public Organisms	517	241	356	13
152	Private Pension System	14	4	1	0
153	Economic Power Abuse	481	Revoked	Revoked	Revoked
154	Prices and Wages	181	No Information	350	0
155	Privatisation	227	56	423	4
156	Fiscal Crimes	33	Revoked	Revoked	Revoked
157	Privatisation	45	1	39	0
158	Industrial Products Tax Exception/Reduction	39	20	46	6
159	Norms of Conduct (Civil Servants)	82	46	27	3
160	Financial Operation Tax Changes	140	43	44	1
161	Tributation	44	2	13	2
162	Tributation	0	0	0	0
163	Civil Servants Dismissal	7	1	0	0
164	Tributation	0	0	0	0
165	Tributation	25	5	0	0
166	Income Administration	6	No Information	3	0
167	Rural Income Tax	30	21	3	1

PM	Subject	Number of Proposed Amendments	Number of Accepted Amendments	Number of Proposed Detachments	Number of Accepted Detachments
168	Currency change to "Cruzeiros." Freezing Financial Actives	914	No Information	No Information	0
169	Public Debt	16	No Information	0	0

Source: Diary of the National Congress and CEBRAP's database, in Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV, pp. 174.

The fifth column of the table 3.8 above shows the number of proposed detachments, selected for voting separately.³⁰⁰ They should be understood as a second chance for congressmen to champion their private interests. As there were practically no restrictions for presenting detachments, voting was very turbulent and the number of detachments was considerably high. Also, usually there were a tactical agreement among parties' leaders to withdraw most detachments voting only few. In Collor Plan's case, the left-wing parties were left away of these agreements, resulting in very turbulent debates and ballots. Nevertheless, the sixth column shows that detaching was not very effective, as detachments were voted merely as formality. Only those supported by the parties' leaders were really taken in consideration.³⁰¹

The role of the PMDB's leader in the national congress, Ibsen Pinheiro, was also very important. He explicitly declared his vote for the government, in the cases agreed between the government and the party. His influence was fundamental for directing the voting of several congressmen. At the same time, in spite of some PMDB's members, mainly from the party's left wing, were voting contrarily to the leadership indication, they never represented a serious threat. Thus, even with a minority coalition in the congress, as the government was able to get the PMDB's support to specific measures, the left-wing opposition became powerless.³⁰²

Although it appears to be a simple process, where the government accepted some minor changes while the PMDB agreed to not jeopardise the plan, in reality the process was quite turbulent. While all was decided in the cabinets among party leaders and government emissaries, the PMDB's public discourse was of trying to soft the plan's though points like freezing the money on deposit accounts. Nevertheless, these modifications were presented as amendments, thus giving Fernando Collor the opportunity to veto them. The rationale was to present the party as the protector of the poor targeting

³⁰⁰ A 'detachment' or 'destaque' in Portuguese is a mechanism permitting congressmen to take away (detach) part of a bill already voted. It can also refer to an amendment presented after the bill has been voted and approved.

³⁰¹ Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV.

³⁰² Ibid.

the elections of October 1990. Nevertheless, the government was able to assure a significant margin of votes, guaranteeing victory, as shown on table 3.9 below.

Table 3.9
Share of Votes aligned with the Recommendations of Parties' Leadership,
Accordingly to the Government's Proposition, MP's Collor Plan I, March 1990

Emergency Measure	PDS		PFL		PMDB		PSDB		Total*
	For	Against	For	Against	For	Against	For	Against	
1- MP 148	95.5	-	100.0	-	94.2	-	91.7	-	96.4
2- MP 159	100	-	97.6	-	91.6	-	86.8	-	94.6
3- MP 149	100	-	94.1	-	80.0	-	-	98.0	90.7
4- MP 161	95.8	-	92.3	-	-	74.1	54.0	-	82.3
5- MP 161	100	-	97.7	-	80.4	-	-	98.0	92.4
6- MP 150	100	-	95.6	-	84.1	-	67.3	-	88.2
7- MP 151	95.6	-	91.8	-	79.8	-	-	85.1	87.2
8- MP 151	100.0	-	95.4	-	82.6	-	-	86.1	90.9
9- MP 151	100.0	-	97.6	-	85.2	-	82.0	-	91.4
10- MP 154	100.0	-	95.2	-	79.5	-	-	82.8	88.4
11- MP 154	100.0	-	99.0	-	90.0	-	75.9	-	92.2
12- MP 155	100.0	-	97.6	-	82.8	-	70.0	-	88.1
13- MP 155	100.0	-	98.6	-	93.3	-	87.2	-	95.5
14- MP 157	100.0	-	98.4	-	81.5	-	-	94.9 ²	92.4
15- MP 168	100.0	-	97.6	-	-	66.1	-	100.0	88.4
16- MP 168	100.0	-	97.3	-	62.0 ¹	-	-	92.3 ¹	95.5

Source: National Congress Diary. Legislative Database, CEBRAP. Adapted from Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV, p. 176.

* Average of all parties' proportional nominal discipline.

¹ Party's leadership freed congressmen.

The government's tactic was to gain the support of parties' leaders in closed-door negotiations in the very last moment. Then, the leaders reported the to the plenary, in a very instructive way, what was the parties' orientation to their congressmen, who were waiting to vote. The leaders and the congressmen which were not involved in these negotiations took notice of the agreements only when the voting process started. These agreements worked very well regarding Collor Plan's marginal points, which did not represent a serious threat to the opposition. The first serious discussion occurred when voting the emergency measure 161, which changed the legislation on legal personalities' taxes. The controversy was regarding cutting incentives to the Northern and Northeastern regions, the poorest in Brazil. In this case, no political group, including the government's base, had interest to go for nominal voting. Thus, voting was symbolic. From this time,

how the Congress would vote became subject to the strategy of both government and opposition to maximise their interests.³⁰³

The emergency measure 161 was defeated by symbolic voting. The government counteracted using an inverted strategy: the government leader Renan Calheiros proposed a detachment eliminating all modifications proposed by the opposition. In other words, the text of the emergency measure would stay as originally intended by the government. At the same time, Calheiros asked the detachments to be subject to nominal voting. The result was favourable to the government by a vote of 246 for and 186 against. In this case, the government fraction's discipline reached 92.3%.³⁰⁴ Thus, even those originally against the emergency measure 161 in the end voted with the government. The conclusion is that the control of the leaders over the voting process limited the space available for party indiscipline.³⁰⁵

The opposition, specially the left-wing parties, also start doing the same, after realising the strategy worked. In this case, left-wing parties would ask for nominal voting and, as usual, it would loose. However, following the internal norms of the Brazilian National Congress, after one case of nominal voting follows a period of one hour when only symbolic voting is permitted. Thus, in case of doubt after symbolic voting during this period, party leaders have to openly indicate their party's vote, and the result is determined by the sum of chairs controlled by each party. In this case, the centre-left coalition was able to usually beat the government. The voting method passed to be part of the presidential political calculus, as it was fundamental to co-opt undisciplined congressmen or to guarantee the discipline of the big parties.³⁰⁶ This voting method became fundamental to approve the core of the economic plan: the emergency measure 168.

The emergency measure 168 was not only Collor Plan's core, but also the most polemic of all emergency measures. Although there were several backstage negotiations between the government and the opposition, a substantial number of PMDB's congressmen also presented a full alternative to the emergency measure 168 known as '*Plano Osmundo*' (Osmundo Plan), a reference to its author, Osmundo Rebouças. Its main points were a) to exclude pension funds and insurance companies from having their financial actives blocked; b) to increase the limits people could withdraw from current, savings, and overnight accounts Cr\$ 600,000.00 (US\$ 16,200.00 in 1990 or US\$ 30,100.00 in january/2015) in trimestral payments of Cr\$ 200,000.00; c) emergency cases were to be discussed by the Brazilian Central Bank's board of directors. The main objective was to limit the government's arbitrary influence by the emergency measure 168.³⁰⁷

³⁰³ Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV, p. 180-181.

³⁰⁴ Data in the annexes.

³⁰⁵ Ibid, p. 182.

³⁰⁶ Ibid, p. 183.

³⁰⁷ Ibid.

In spite of the left-wing parties' negative attitude, taking in consideration the orientation from party leaders, the *Plano Osmundo* was virtually approved by the congress. Although the government was forcing passing the emergency measures through leadership agreements, in this moment, the leader of the government Renan Calheiros asked for open voting to verify the disposition of congressmen to follow the party leaders' orientation. The objective was to force those congressmen supporting the PMDB's plan, who were feeling comfortable under the protection of party leadership, to change sides.

The general sentiment among the congressmen was that the proportion of financial actives to be freed by *Plano Osmundo* would result in extremely high inflationary pressures invalidating Collor Plan's core point. Thus, the congressmen were afraid to be personally accountable for permitting inflation to come back. The result was 248 votes against and 202 votes for the *Plano Osmundo*. The PMDB's congressmen were among the most undisciplined: although 78 congressmen followed the party's leadership, 40 voted with the government. Taking in consideration the discipline of the right-wing parties, those 40 votes were sufficient to guarantee the government's victory.³⁰⁸

Although his first measures had a wide support among the population, the media, and the business people, "Collor's reluctance to give prominent congressmen powerful and lucrative posts in the share-out of bureaucratic power when he took office helped fuel the resentment among those whose support he would need to court."³⁰⁹ After 100 days in office, Collor was becoming increasingly isolated. Inflation and unemployment were increasing, while wages were declining. Also, several strikes, specially in the public sector, were under way.

Nevertheless, after passing the emergency measure establishing the Collor Plan, the government believed it had the support of the majority of the congress. As the discussions turned to other points of the Collor Plan, the government started asking for nominal voting all times. The opposition, led by the PMDB, answered asking for symbolic voting. As last resource, the PMDB started accusing the government of trading individual votes for political favours and offices and posts in its administrative apparatus. The government coalition answered leaving the plenary each time, to obstruct the voting process by lack of quorum. As a result, many emergency measures lost their validity, making the government to reedit them. In this case, the government will prevailed.³¹⁰

Gradually, the political conditions permitting to pass the emergency measures promulgated during Collor's inauguration ceased to exist, and Collor's failures became part of the opposition discourse aiming the October 1990 elections. Collor's frequent exercise of veto, blocking parliamentary action, turned the Brazilian congress to be

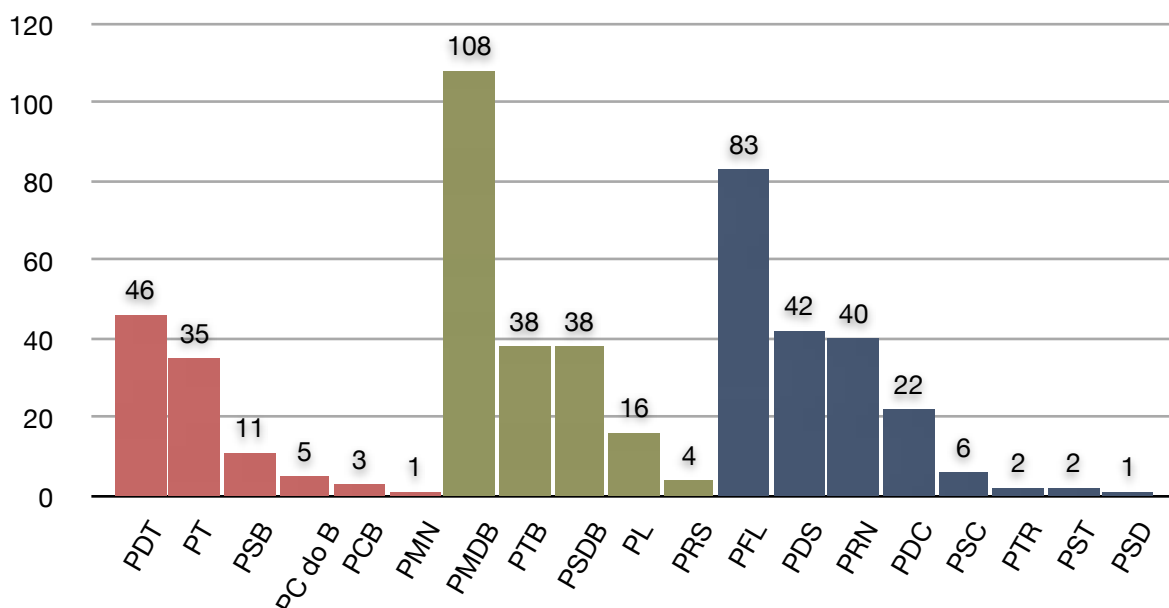
³⁰⁸ Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV.

³⁰⁹ Crabtree, J. (1991). "The Collor Plan: shooting the tiger?". *Bulletin of Latin American Research*, vol. 10, no. 2, pp. 119-132, p. 129.

³¹⁰ Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV.

unwilling to abdicate its legislative power to support the government's emergency decrees. As a result, the relationship between the government and the Congress turns to be increasingly conflictive, as no political power was able to establish dominance. Passing complementary points to the plan, like technical corrections turned to be a very long process. Some of them would pass only after several months of long debates, in October. The relatively simple process of approving the first emergency measures gave place to a complex process marked by partial victories and many conflicts.³¹¹

Figure 3.3
Party Composition of the Brazilian Congress by Ideological Orientation - 1991-1994
 (Red=Left, Green=Centre, Blue=Right)



Source: Own elaboration based on data from the Brazilian Superior Electoral Tribunal.

As demonstrated on figure 3.3, in October, 1990 a new congress was elected. Only 40% of the federal deputies were reelected. In contrast to 1987, the PMDB elected only 30% of state governors, and 21.5% of all congressmen. Although a relatively good performance in absolute terms, in comparison with previous years, the party was suffering from its internal contradictions allied with the fact it was connected with political and economic models considered preterit. Although still the biggest party in the Brazilian national congress, with many of its members migrating to other parties, the PMDB lost much of its influence, forcing the party to pass through a process of internal change.

Fernando Collor also had problems. His economic plan was a fiasco. After only three months, inflation was already nearly 10% a month. In six months, the accumulated inflation between March and October 1990 was 115.42%. In December 1990, it would be 194.65%. Taking in consideration the first three months of 1990, the ones before the Collor Plan, 1990 yearly inflation reached 1,476.71%. To deal with economic instability, Collor

³¹¹ Figueiredo, A. C., & Limongi, F. (1999). *Executivo e Legislativo na Nova Ordem Constitucional*. Rio de Janeiro: Editora FGV, p. 191.

issued the second Collor Plan in January 31, 1991, one day before the new Congress was seated. On March 14, 1991, he launched his National Reconstruction Plan, a package of constitutional amendments and new legislation to implement a broad fiscal reform. However, the it was not well received by the Congress and it became stuck. Collor's continued defeats finally made him to understand his poor political support.³¹²

To change the situation, Collor substituted some of his friends and collaborators, especially those holding visible positions, for nominees of supporting parties. The first to go was the minister of justice Bernardo Cabral, followed by the minister of economics and her team who were blamed by the economic disaster. This inaugurated the second phase of Collor's term, called by him 'soft.' The demise of two emergency plans and the continuous poor state of the Brazilian economy helped to put Collor's popularity in decline. In August 1991, Collor tried to revive Sarney's defunct idea of making a political pact, exchanging reforms by rolling over state and municipal debts. With inflation reaching 20% a month in October 1991, opinion polls showed that over 90% of those interviewed were dissatisfied with Collor's administration.³¹³

Collor's popularity was also demised by the several scandals involving government officials. First, there was the love affair between the economic minister Zélia Cardoso de Mello and the minister of justice Bernardo Cabral who was married. Later, in September 1991, the first lady Rosane Collor was charged with diverting charity funds to her family business and to electoral campaigns. There were also scandals involving purchases of the Ministry of Health's central drugstore, the leaking of confidential information on Brazil's operations in the international coffee market by some high level officials of the Economic Ministry, the former minister of labour and social security Rogério Magri, once a labour union leader, being accused of receiving US\$ 30,000.00 (approximately US\$ 79,500.00 in 2012) in bribes, the case of the secretary of strategic affairs Pedro Paulo Leoni Ramos using his appointees in Petrobrás for dark deals, which resulted in its own congressional inquiry. However, one of the most shocking revelation to the public opinion was that the President, his campaign treasurer Paulo César Farias, the minister of economics, and others, had cleared their bank accounts shortly before the announcing the first Collor Plan.³¹⁴

With the government almost collapsing because of the economic crisis, scandals, and being blocked by the Congress, Collor tried to make a new political agreement by promoting minor changes in his cabinet in mid-January 1992 followed by a major one two months later, including increasing the number of ministries, which had been reduced from 23 to 12 at the start of his government, to 16. He also tried to replace his more independent

³¹² Valença, M. M. (2002). "The Politics of Giving in Brazil: the Rise and Demise of Collor (1990-1992)". *Latin American Perspectives*, vol. 29, no. 1, pp. 115-152.

³¹³ Ibid.

³¹⁴ Ibid.

approach with a more traditional one, in other words, ceding to old patrimonialist practices of “it is in giving that we receive.”

The attacks on the government became more virulent. Collor tried to set peace with the Congress with a new political coordinator, Ricardo Fiúza, a professional politician and an expert in patronage-clientelistic practices.³¹⁵ Collor tried to reestablish favourable conditions to govern, including gaining the cooperation of the Congress. In other words, he adopted the same clientelist forms of political intermediation and government’s patronage he had condemned and tried to change. Because of the economic fiasco that reduced his popular support, of the enemies he had made, and of the interests he displaced, including those of militaries and civil servants who had been experiencing a decline in their living standards as a result of the government’s policy of indexing wages below inflation, it was already too late.³¹⁶

Fernando Collor would not end his term. He is the only Brazilian president to face a process of impeachment ever. In May 1992, his younger brother, Pedro Collor, in a series of interviews to *Veja* magazine denounced Collor’s connections with his former campaign treasurer Paulo César Farias in a web of underworld bribery, extortion, influence-peddling, and several other illegal activities. In spite of early skepticism, Pedro Collor’s interviews resulted in several investigations into Farias’ business and the government ordered by the president himself. Although Collor was hoping for lack of proof, evidence appeared in stages and put together.

A congressional inquiry was initiated and after 932 days of presidency, a little over half of his five-year term, Collor was suspended from the presidency for 180 days. On October 2 he was replaced by his vice president, Itamar Franco. The Senate made a quick investigation and following popular pressures voted for Collor impeachment. Collor resigned during the beginning of the trial, in December 29, 1992, hoping to maintain his political rights. The Senate voting 73 to 8 decided to proceed with the impeachment process. The result was the one expected: Collor was impeached by 76 to 3 votes in December 30, 1992. Itamar Franco became the new president. Even taking in consideration that Itamar Franco historically had supported national developmentalism, he did not change the premises of the economic model in force and its macroeconomic policies.

Although in the United States the ideology determining the interconnection between economics and politics had started changing already in the ending of the 1960’s, in Brazil it started only almost thirty years later, after Collor election. The acceptance of the relationship among the ideas of interventionist state, development, inflation, and economic stability started to change the ideological paradigm defining what is and what is not acceptable in terms of economic policy, conditioning political agents’ political and ideological understanding about economics to a specific view.

³¹⁵ Valenca, M. M. (2002). “The Politics of Giving in Brazil: the Rise and Demise of Collor (1990-1992)”. *Latin American Perspectives*, vol. 29, no. 1, pp. 115-152.

³¹⁶ *Ibid.*

The economic debacle during Sarney's government has a fundamental role to explaining Collor's victory and the ideological change that took place in the 1990's Brazil. The idea that the state is structurally ineffective and corrupt in contrast to an idealised perfect liberalism guided by market forces started to determine Brazilian macroeconomic and development policy. The role of the state in promoting development completely changed from active to passive. In ten years after Collor's impeachment, most of the state-owned companies had been privatised, the programs of credit for development, including to agriculture, had been terminated or reduced, the control of foreign financial capitals ended, as many other mechanisms of economic protection. The national-developmentalism from the 1950's, which had determined the economic policies until Collor's election, was dead.

3.3 Electors and Converging Preferences for Macroeconomic Policy

Twelve years after Collor being elected, the Workers' Party (PT) won the Brazilian presidential elections and Luiz Inácio Lula da Silva became the 35th President of Brazil in 2002. Without the intention to oversimplify the political process that resulted in Lula's victory, Lula's rhetoric experienced a deep change in relation to 1989, from a considerably radical left-wing political program to a moderate one. Thus, although in 2002 the opposition was still trying to show Lula as a radical who would jeopardise inflation control because of populist policies, the privatisations would be reverted, the agreements with the International Monetary Fund would be ignored, just to cite the main points. In the very ending of the campaign, Lula's main adversary, José Serra, turned its campaign to nationalist terms, using the national colours to represent himself, while representing Lula and his coalition with red flags. A well known soap opera actress, Regina Duarte, even recorded an add affirming that she was afraid of Lula and his leftist past.

In the 1989 elections, one of Collor's main arguments was that a left-wing government would increase the level of state's intervention in the economy and would make the agrarian reform. In 1994, Fernando Henrique Cardoso used the argument that with Lula's election inflation would come back, besides a governability crisis because of Lula's PT sectarianism. In 1998 and 2002, a crashing stock market and a extremely volatile exchange rate as consequence of foreign capital leaving the country were used to threaten electors. The argument was that foreign investors were taking out their money because of being afraid of Lula, thus his popularity in opinion polls would explain the fall in the stock markets and the exchange rate's volatility.

Lula's counterattacked very politely, using logic argumentation and denying any kind of radicalism. His strategy was to present himself as an agent for change, however without the extremist leftist rhetoric of the previous campaigns. In his "*Carta para o Povo Brasileiro*," Lula made clear he would maintain the basic premises of Fernando Henrique Cardoso's economic policies. In addition, that he would not revert any privatisation, that budget deficits were unacceptable, low inflation was to be the main mandate of the

Brazilian Central Bank, that the currency should be devaluated. He also made clear that any social policy was to be subordinate to the country's economic conditions.³¹⁷ He also invited José de Alencar, a well known businessman from the conservative right-wing Liberal Party (PL), to be his vice-president.

Lula's newly appointed ministers of Agriculture and of Development, Industry, and Trade had supported his opponent, José Serra. The same applied to the main team of the Ministry of Economics. The new governor of the Central Bank of Brazil, Henrique Meirelles, was a congressman elected by José Serra's party (PDSB), who maintained the same board of directors than before. Also, the secretary of the Treasury and the secretary of the National Revenue worked in the previous government. The Economic Ministry state secretary, although member of Lula's PT, was one of the very conservative "*Política Econômica e Reformas Estruturais*" plan's authors. The Ministry of Planning, Budget, and Administration was totally renewed, but its policies and objectives remained the same.³¹⁸

Thus, Lula clearly continued his predecessor's economic policies, the same the PT used to condemn as neoliberal radicalism just some years before. Comparing with the 1989 campaign's proposals, Lula's rhetoric assumed much of what is used to be called economic Neoliberalism based on the Washington Consensus. In other words, Lula's party converged to the set of macroeconomic policies commonly accepted as the correct one. In the Brazilian case, Lula's PT is only one example. The objective in this chapter is to investigate from both the population and political parties' perspective the existence, the behaviour, and the correlation between ideology and preference for macroeconomic policy between 1989 and 2009.

To determine the variables of investigation, some presuppositions were made. First, macroeconomic policy is the result of politics, thus it is decided at the political level and is often limited by the interests of specific groups or individuals. Second, the understanding about economics by politicians lacks sophistication, resulting many times in implementing inadequate economic policies, just because these policies are the most popular. Third, the definition between left and right follows the notion of fairness. "Left" emphasise fairness in terms of outcomes while "right" emphasise fairness in terms of process and stability of use of traditional processes.³¹⁹ In other words, "left" presupposes the preference for more state intervention in the economy, mostly through macroeconomic policies to reduce

³¹⁷ Silva, L. I. L. (2002). *Carta ao Povo Brasileiro*. Retrieved in 15/08/2011, <http://www2.fpa.org.br/carta-ao-povo-brasileiro-por-luiz-inacio-lula-da-silva>.

³¹⁸ Borges Neto, J. M. (2003). "Um Governo Contraditório". *Revista da Sociedade Brasileira de Economia Política*, vol. no. 12, pp. 7-27, pp. 10-12 and 26.

³¹⁹ It is not the case to simplify the notion of left and right just to more or less state intervention in the economy. There are two more broad categories: A second one is related to status quo policy of current government; left reformers seek to change status quo policies and break free outmoded or repressive rules of the past while right conservative defenders the status quo, customary relations, and tradition. A third is based on property, in which 'left' the government uses its power to redistribute wealth and to promote social and economic development, while 'right' means that the government uses its power to preserve the status quo and the state of wealth distribution and social status is the output of the market forces resulting in a social Pareto's optimum. See Hinich, M., & Munger, M. C. (1994). *Ideology and the Theory of Political Choice*. Ann Arbor: University of Michigan Press.

market imperfections, while “right” presupposes less state interference, thus more liberal macroeconomic policies.

Fourth, the left-right spatial division is connected with particular beliefs and issues that are changing over time. It has also a transcultural character meaning that a similar understanding of left and right imagery and its connection with politics is commonly shared. Thus, although left and right may be useful to characterise political positions and preference for economic models and policy, the actual meaning of the extremes of Left and Right are culturally and time-bound specific.³²⁰

Fifth, ideological convergence among political parties is a supra-ideological process determined by the occurrence of economic crisis that changes and determines what is and what is not acceptable in terms of macroeconomic policy. As a result, the causality being left-wing as tantamount for supporting state intervention in the economy and Keynesian like economic policies, and being right-wing as tantamount to non-state economic intervention and economic, political and social freedom,³²¹ can be or can not be true depending on the historical period, as discussed before.

Sixth, the process of ideological convergence in peripheral countries follows Ignácio Rangel’s idea of duality. Ignácio Rangel (1914-1994) was probably the most original thinker of the Brazilian economic development. Only Celso Furtado has a comparable contribution upon the analysis of the dynamics of development. Although his bachelor was in law, he was an autodidact in economics always researching the process of social and economic transformation of the concrete world, profoundly engaged with questions of national development. His economic thought was formed at the nationalist school of the Superior Institute of Brazilian Studies (ISEB) and at the Economic Commission for Latin America and the Caribbean’s (ECLAC) structuralist school. He was also profoundly influenced by Keynes, Schumpeter, and Marx, integrating these authors’ thought in a very personal way. As Rangel made his career at the Brazilian Development Bank (BNDE), his thought was independent from the academic politics and discipline. This explains why he was so original and creative, besides his own personal talent. Although he is unknown at the international level, at least one of his contributions has universal value: the principle of endogenous money. Also, very characteristic of Rangel was his courage and venture to affirm and to analytically sustain his innovative approach.

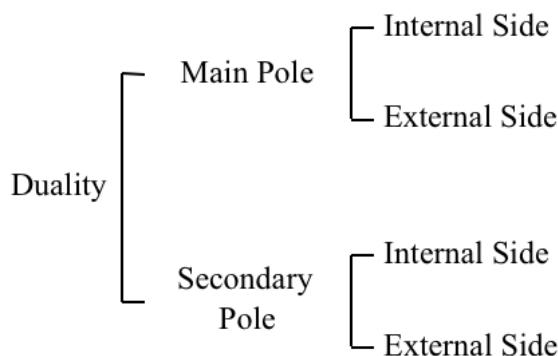
Rangel’s idea of duality is based upon the notion of concurrent but simultaneous modes of production interacting through history. In his classic article “A História da Dualidade Brasileira” (The History of the Brazilian Duality), Rangel analysis the specific contradiction that resulted in contemporary Brazil. It is a dialectic explanation, not only of the dynamics of economic development, but also of other spheres of social reality, that

³²⁰ Borges Neto, J. M. (2003). “Um Governo Contraditório”. *Revista da Sociedade Brasileira de Economia Política*, vol. no. 12, pp. 7-27.

³²¹ For an account on economic liberalism as determinant to individual freedom see Friedman, M., & Friedman, R. (1990). *Free to Choose: a Personal Statement*. New York: Hartcourt.

results from a historic-structural reality. The duality is a complex mode of production that combines elements of different fundamental modes of production. In other words, it deals with the specificity of Brazil being at the same time a capitalist and a pre-capitalist society. Although the representation of the duality seems to be simple, it must not be considered a mechanical scheme. Rather, it synthesises the evolution of the interaction between the internal and the core mode of socioeconomic production. This duality may be schematised as follows:

Figure 3.4
Ignácio Rangel's Duality



As figure 3.4 demonstrates, the main pole represents the internal economy itself. Its internal side reflects the internal relations of production; its external side reflects the internal socioeconomic-political model in force. The secondary pole's internal side reflects the internal emerging relations of production; its external side represents the most advanced mode of production, reflecting the central countries' economic, social, and political structure. These relations are always more advanced than those observed internally, stressing the main pole's subordinate and peripheral character. This structure is always changing, as the development of the productive forces changes the structure of the economic model. Nevertheless, as usually occurs in peripheral and underdeveloped countries, this development is often late in comparison with the core. As a result, these countries experience a partial and subordinated process of development, forcing them to reproducing - instead of overcoming - the duality. The reproduction of the duality follows certain laws:

- a) when the preconditions for changing from the current stage of development for a superior one are established - when new economic and social forces develop and start conflicting with the established socioeconomic model - only one pole changes. The other maintain its structure;
- b) the external and the internal pole change by turns;
- c) the change occurs from the external to the internal side. In other words, the socioeconomic model already present in the external side is adopted by the internal side;

d) as a result, the external side of the changing pole also changes, adopting institutions characteristic to a more advanced socioeconomic model. A new dialectic union with the new internal side is established;

e) this kind of duality is only present in peripheral countries. It results from the changes experienced by the systemic core toward which the periphery gravitates;

The application of this process to the Brazilian economic history may be seen in the figure below:

Figure 3.5
Ignácio Rangel's Duality Applied to Brazil

		1st Duality (1815-1870)	2nd Duality (1873-1922)	3rd Duality (1922-1973)	4th Duality (1973-????)
Main Pole	Internal Side	Slavery	Feudalism	Feudalism	Semi-wage
	External Side	Feudalism	Mercantile Capitalism	Mercantile Capitalism	Rural Semi-Capitalism
	Major Partner	Proslavery Farmers	Mercantile Bourgeoisie	Latifundiary Farmers	Industrial Bourgeoisie
Secondary Pole	Internal Side	Mercantile Capitalism	Mercantile Capitalism	Industrial Capitalism	Industrial Capitalism
	External Side	Industrial Capitalism	Industrial Capitalism	Financial Capitalism	Financial Capitalism
	Minor Partner	Mercantile Bourgeoisie	Latifundiary Farmers	Industrial Bourgeoisie	Financial Capitalism

Source: Own adaptation based on Rangel, I. (1981). "A História da Dualidade Brasileira". *Revista de Economia Política*, vol. 1, no. 4, pp. 5-34 and Bresser-Pereira, L. C., & Rêgo, J. M. (1993). "Um Mestre da Economia Brasileira: Ignácio Rangel". *Revista de Economia Política*, vol. 13, no. 2, pp. 98-118.

Figure 3.5 shows that although the economic structure of the Brazilian duality is determined by four distinct socioeconomic models, its political structure results from the alliance of only two social classes. The structure of this implicit political alliance is determined by the duality's structure, and follows its changes. The main pole is governed by one class only, which is the political expression of the dominant socioeconomic model. Rangel calls it 'major partner.' The secondary pole's external side is foreign. It influences internal affairs through one of the internal dominant classes. Nevertheless, its internal side represents an emerging internal dominant class called 'minor partner.' It is dialectically united with the major partner, as their interests are different, forming a 'dual class.'

When there are internal advances following Schumpeter's process of creative destruction, the differences between both classes turn to be contradictory and antagonistic. As the pre-conditions for the transformation of the social and economic relations of production are mature, the dual class experience a rupture. By one side, there is a progressive dissidence supporting the interests of the external side; On the other hand,

there is a retrograde and reactionary faction defending the status quo in force. After a political battle, there is the establishment of a new political pact. The most radical elements are excluded, and there is a new composition of the 'dual class.' A new pole and a new regime are established.

Brazil's dualities begun with the Republic in 1889 and went until 1930, when Getúlio Vargas took power by revolution. By the political side, the first duality was characterised by the understanding of the conservative agrarian oligarchy about political and economic liberalism, meaning political rights to few and state intervention to support coffee price in the international market.³²² The second duality can be politically divided in two periods: 1930 - 1945 and 1945 - 1964. The first was dictatorial and the second can be considered democratic, both being based on nationalism and populism mixing elements traditionally associated with both right-wing and left-wing politics.³²³ Nevertheless, in terms of macroeconomic policy, the entire period was of non-liberal economic policies based on National Developmentalism, usually considered left-wing economic policies.

The third duality started with the 1964's military cup. It was supported by the most conservative sectors of the Brazilian society, principally the middle class, the Catholic Church, and the United States.³²⁴ Although the Brazilian military regime was extremely conservative and right-wing, its macroeconomic policies were a continuation of Vargas' National Developmentalism. The fourth duality started in 1990 after Fernando Collor's election and, by the political side, it is the reinvention of the same conservatism of 1964 with modern elements; by the economic side it is neoliberal populism.³²⁵

Taking in consideration the transformation pattern of politics and economics in the most advanced countries, it is possible to conclude that Brazil's four dualities are the internal expression of the ideological changes in the form of economic and political ideologies occurring in the outside space. The Republic was founded based on Liberalism, both on politics and economics, the same ideology in force, for example, in the United States; the economic policies of the following period were based on National Developmentalism, at the same time Keynesian economic policies were politically acceptable; although the third duality marks a change in political terms from left-wing to conservative right-wing politics, the economic policy remained the same because of political inertia and, of course, because of the army's nationalist character; finally, the fourth duality represents a re-orientation in both political and economic terms to what was

³²² As the demand for coffee is price inelastic after a certain point or, in other words, lower prices do not result in increasing demand, the Brazilian government used to buy coffee to maintain the international price artificially high, thus maintaining the profit level of the coffee sector.

³²³ For example, at the same time Vargas established a specific legislation regulating labour relations very favourable to workers, he strongly repressed any opponent, right or left-wing, conservative or not. See Fausto, B. (2008). *História Geral da Civilização Brasileira: Sociedade e Política (1930-1964)*. São Paulo: Bertrand Brasil for an account on Vargas period.

³²⁴ Ibid.

³²⁵ For a discussion and application of the concept of Neoliberal Populism see Weyland, K. (1999). "Neoliberal Populism in Latin America and Eastern Europe". *Comparative Politics*, vol. 31, no. 4, pp. 379-401 .

happening in the centre. By the political side, it represents the consolidation of democracy after the military dictatorship; by the economic side, it is the end of National Developmentalism and the beginning of Neoliberal Populism, the understanding of the Brazilian political class about Neoliberalism. Thus, the dual character of the ideological and political dualities is the transformation of the newly established external ideology by internal forces into a specific version.

To analyse the Brazilian case, data was selected from two sources: from the elector's perspective, the database of the University of Campinas' Centre of Studies of Public Opinion, an interdisciplinary initiative combining the academic and scientific area with private institutes of public opinion research, as IBOPE and DATAFOLHA.³²⁶ Its main objective is to recover and make available to researchers the public opinion surveys covering politics, society, culture, behaviour, among others. Its database has more than 2300 surveys covering the period 1968 - 2007. From the politicians' and political parties' perspective, the source was the IUPERJ - Oxford Legislative Survey (Pesquisa Legislativa IUPERJ - Oxford in portuguese or PLIO). This is a longitudinal project initiated in 1990, covering all elected legislatures since the military dictatorship, and seeking their views on ideology, legislative activity, institutional design, social policy, state reform, and foreign policy, among other issues. Between 1990 and 2009 more than 800 different congressmen have answered the survey.³²⁷

The first step was to select from CESOP's database the surveys containing questions on self-positioning following a left-right Likert Scale in which there were also questions regarding individual preferences for macroeconomic policies, including the level of state intervention in the economy, and individual preferences regarding political parties. The second was to select the variables of both CESOP's and PLIO's surveys and to prepare them for statistical analysis. First, basic statistical analysis was made, to determine the distribution of the variables. Then cross tabulations between the variables were made to check the logic consistence between them and to visualise their relationship. Finally, a simple model based on logistic regression for ordinal variables was established to test the relevance of the relationship between the variables, with self-positioning following a left-right Likert Scale as independent variable and the preference regarding state intervention as dependent variable. The hypothesis to be tested by regressions is that self-positioning in the left-right spatial scale has no or little influence in choosing the level of state intervention, thus the politically acceptable macroeconomic policies are determined by a supra-ideological process of convergence by politicians to a specific ideology that has its own macroeconomic policies determined *ex-ante*.

³²⁶ IBOPE and DATAFOLHA are two of the main public opinion research institutes in Brazil.

³²⁷ The PLIO 1990 did not have a question regarding preference for more or less state economic intervention. However, in 1989 Leôncio Martins Rodrigues from Sao Paulo's University included a similar question in a survey to the Brazilian Congress. As in 1990 it was still the same legislature, it was possible to merge Rodrigues's survey to the PLIO.

3.4 Electors, Ideological Convergence, and Preference for Macroeconomic Policy

In 1989, 2083 electors were asked about their preferences regarding state intervention and their ideological position in the left-right scale. The question about state intervention was “In your opinion, which would be the best to Brazil.” The possible answers were “the government should let private companies control the entire economy, including basic services as education, health, and housing;” “the government should control only these basic services, leaving the rest under private control;” “the government should control the entire economy, including basic services, international trade, the commanding height, etc.”

Table 3.8
Preference for State Economic Intervention and Personal Positioning in the Left-Right Scale in 1989 - Electors

	Left	Centre-Left	Centre	Centre-Right	Right	Total Average
State	48,9%	31,6%	42,1%	61,2%	61,9%	50,7%
Intermediary	34,6%	49,7%	40,7%	22,9%	18,2%	31,4%
Private sector	16,5%	18,7%	17,2%	15,9%	19,9%	17,8%
Total	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%

Source: Own calculations based on Intenção de Voto para Presidente VI, CEDEC I-1989, DAT/BR89.SET-00186. In: Banco de Dados do Centro de Estudos de Opinião Pública – CESOP-UNICAMP. Available in: <http://www.cesop.unicamp.br>.

As shown on table 3.8 above, in 1989, the preference for total state intervention was much stronger among centre-right and right-wing electors than among left-wing electors, although the latter also preferred the state controlling the economy. The preference for the state controlling only basic services, thus leaving the rest under private control, was stronger among centre-left and centrist electors, and the second choice for left-wing. Nevertheless, the strongest support for private control of the economy was also among right-wing electors. Overall, independently of the left-right positioning, 50.7% preferred full state control of the economy, while 31.4% were for an intermediary positioning and only 17.8% supported the full control of the economy by the private sector.

The results of ordinal regression analysis confirmed that both variables are correlated. The model fit’s p level (Sig.) is less than 0.05, thus the model gives better predictions than if just guessing on the marginal probabilities of the outcome category.³²⁸ However, although the two variables are correlated, the three other tests show that the model’s explanatory power is not good enough. First, the goodness-of-fit, which contains the Pearson’s chi-square for the model, is not statistically significant. As this test’s null hypothesis is that the fit is good, if p-level is large, usually if $p > 0.05$, than the hypothesis is not rejected. However, if $p < 0.05$, the model does not fit well. In this regression, the Pearson’s chi-square significance is less than 0.05, thus the model does not fit well.

³²⁸ The tables with the outputs of each regression for each case are in the annexes.

The second test is the pseudo R-square statistics. Although the statistics' software presented three alternatives, on this dissertation Nagelkerke's pseudo R-square was taken in consideration. Accordingly to the results, although the model is significant, its explanatory power is just 3.2%. In other words, the self-placement in the left-right scale explains only 3.2% of the probability of choosing more or less state. Finally, the test of parallel lines. This test shows the proportional odds assumption, as its null hypothesis is that the slope coefficients in the model are the same across response categories, thus lines should be parallel. If the null hypothesis is rejected based on significance of the chi-square statistic, the conclusion is that the coefficients are not the same across the levels of outcome. Thus, to not reject the null-hypothesis it is expected a P-level > 0.05, while -2 Log Likelihood between the null hypothesis should be the smaller the best fit. In this model, we reject the hypothesis, as $p < 0.05$ and -2 Log Likelihood is almost 100%.

The explanation for this pattern can be found in the 20 years of military dictatorship between 1964 and 1984. Politically, the Brazilian military regime can be considered extremely conservative and nationalist, although in terms of international politics aligned with the United States. As a result, and taking in consideration the Cold War, the militaries considered communists and socialists a threat for national security. The political police and even the army often arrested, tortured, and killed members of left-wing organisations. At the same time, the economic policies of this period were clearly based on national-developmental strategies of development, which are considered to be left-wing or Keynesian. Thus, state intervention was associated with the militaries and with right-wing conservative policies.

The next year a similar question was present in a survey was in 1993. In this year the question was 'Now I am going to read some statements and I would like to know your opinion: the government should intervene more in the economy to make the country to grow. The possible answers were: "I very much agree;" "I agree a little;" "I disagree a little;" and "I very much disagree." This variables were recoded to "state;" "more the state;" "more the private sector;" "the private sector. The survey was conducted between March 27-28, 1993 and 2499 electors were interviewed.

Thus, as demonstrated in table 3.9 below, even taken in consideration that 1993 was the third year of economic (neo)liberalisation in Brazil, a strong state intervening in the economy to promote economic development was still the first choice among right-wing and centre-right electors. It is not a surprise that the same applies to left-wing and centre-left electors. The lowest support for state intervention was among centrist electors. Nevertheless, with the exception of the latter, in all cases more than 50% of the interviewed electors preferred a strong state in economic matters. Curiously, the second choice for all, with the exception of centre-right electors, was total private economic control of the economy.

Table 3.9
Preference for State Intervention in the Economy and Personal Positioning in the
Left- Right Scale in 1993 - Electors

	Left	Centre-Left	Centre	Centre-Right	Right	Total
State	62,9%	52,1%	47,4%	63,8%	68,3%	58,5%
More the State	12,9%	16,4%	19,2%	15,6%	13,9%	16,0%
More the Private Sector	4,3%	10,0%	7,2%	5,2%	3,6%	6,1%
Private Sector	19,9%	21,4%	26,2%	15,3%	14,2%	19,4%
Total	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%

Source: Own calculations based on Avaliação Itamar Franco (6 meses), DAT/BR93.MAR322186. In: Banco de Dados do Centro de Estudos de Opinião Pública – CESOP-UNICAMP. Available in: <http://www.cesop.unicamp.br>.

Again, regression analysis showed that both variables are correlated. The model fit's p level (Sig.) is less than 0.05, showing that the model gives better predictions than if just guessing on the marginal probabilities of the outcome category. With the exception of pseudo R-square statistics, all other tests showed the model had a good fit. First, the goodness-of-fit, which contains the Pearson's chi-square for the model, is not statistically significant. As this test's null hypothesis is that the fit is good, if p-level is large, usually if $p > 0.05$, than the hypothesis is not rejected. However, if $p < 0.05$, the model does not fit well. In this regression, the Pearson's chi-square significance is equal to 0.197, thus the model fits well.

The test of parallel lines shows that chi-square is relatively low and p-level is equal to 0.218. In this case, the slope coefficients in the model are similar, resulting in parallel lines. However, although the tests show that the model has a good fit, Negelkmerke's pseudo R-square shows that its explanatory power is of just 2.8%, making the model to be rejected. A further investigation running a linear regression model (results not showed) showed that the variables have strong collinearity with an Eigenvalue's index equal to 1000.

Table 3.10
Elector's Preference for State intervention in Specific Sectors Accordingly to Left-Right Self-Positioning in 2002

	Left	Centre-Left	Centre	Centre-Right	Right	Total Average
Education	75,3%	69,3%	78,2%	83,3%	80,4%	78,3%
Health	79,1%	76,1%	77,0%	85,3%	82,5%	80,6%
Pension and Social System	76,6%	69,3%	73,3%	84,3%	84,1%	79,3%
Judicial System	81,6%	79,5%	82,4%	91,2%	85,7%	84,4%
Public Transport	60,1%	50,0%	43,0%	52,0%	60,5%	55,2%
Water Service	75,9%	68,2%	72,1%	81,4%	74,5%	74,5%

	Left	Centre-Left	Centre	Centre-Right	Right	Total Average
Mobile Telecommunications	34,4%	25,3%	29,1%	34,0%	39,6%	34,7%
Electricity	76,6%	70,5%	65,5%	82,4%	72,7%	72,9%
Banks	53,2%	46,6%	41,2%	47,1%	60,5%	52,7%
Automotive Industry	30,4%	20,5%	25,5%	19,6%	37,9%	30,4%

Source: Own calculations based on Estudo Eleitoral Brasileiro 2002, CESOP-FGV/BRASIL02.DEZ-01838 In: Banco de Dados do Centro de Estudos de Opinião Pública – CESOP-UNICAMP. Available in: <http://www.cesop.unicamp.br>.

Only almost 10 years after the question about the role of the state in promoting economic development was included in a survey, this time in the *Estudo Eleitoral Brasileiro* 2002 (Brazilian Electoral Study 2002) - EEB/2002. There were included 20 questions not simply about the role of the state in the economy, but about national-developmental principles. As shown on table 3.10 above, Twelve years after Fernando Collor initiated the process of neoliberalisation in Brazil, with the exception of electricity, the strongest support for state economic intervention comes from right-wing and centre-right electors. Centre and centre-left electors are the ones supporting less state intervention. Another interesting conclusion is that the sectors with strongest support for state intervention are those which traditionally were controlled by the state during the Keynesian years or, in the Brazilian case, during the national-developmental period. Thus, it is no surprise that mobile telecommunications, banks, the automotive sector, and public transport have the weakest support for state intervention, the contrary being true to education, health, the pension system, the judicial system, water service, electricity and, in a less scale, banks.

Table 3.11
Elector's Preference for Specific Policies Accordingly to Left-Right Self-Positioning in 2002

	Left	Centre-Left	Centre	Centre-Right	Right	Total Average
Price Control (Basic Services)	69,0%	59,1%	60,6%	61,8%	71,9%	66,9%
Control of Private Enterprise	29,7%	22,7%	18,2%	22,5%	39,8%	30,3%
Help Private Companies with Financial Problems	56,3%	39,8%	43,0%	47,1%	66,3%	55,4%
Wage Control	34,8%	27,3%	30,3%	32,4%	53,8%	41,0%
General Price Control	62,0%	42,0%	53,9%	55,9%	66,3%	59,7%
Import Restriction	50,0%	29,5%	45,5%	51,0%	55,2%	49,4%
Restrict Foreign Workers	27,2%	22,7%	26,7%	24,5%	32,6%	28,7%
Profit Remittance Abroad	15,8%	9,1%	14,5%	11,8%	19,4%	16,0%

	Left	Centre-Left	Centre	Centre-Right	Right	Total Average
FDI Facilitation	59,5%	47,7%	49,1%	55,9%	54,1%	53,7%

Source: Own calculations based on Estudo Eleitoral Brasileiro 2002, CESOP-FGV/BRASIL02.DEZ-01838
 In: Banco de Dados do Centro de Estudos de Opinião Pública – CESOP-UNICAMP. Available in: <http://www.cesop.unicamp.br>.

The analysis of the table 3.11 above shows that the strongest support for policies characteristic to National Developmentalism comes from right-wing electors, and just than by left-wing. One explanation could be that electors do not know the meaning of being left-wing or right-wing. This hypothesis could be tested, since the Brazilian Electoral Stud of 2002 included one question regarding the understanding of the left-right scale by the respondents. From the valid answers, 48.9% understood it, in contrast to 51.1% who did not understand it. However, 45.1% of the respondents did not answer to the question, resulting that only 26.9% of the sample understood the meaning of left or right. In other words, it is possible to conclude that 73.1% of the respondents or did not understand the meaning of left and right or were unsure enough to give a definitive answer.³²⁹

This explains the results of the regressions. All of them had a bad fit, thus the relationship between being left or right-wing is not statistically significant. The ones with $p\text{-level} < 0.05$, thus in principle statistically significant, did not pass in the tests of goodness-to-fit and/or parallel lines. All regressions Nagelkerke's pseudo R-square were very low. The ordinal regressions which were statistically significant and passed in one or more of the tests were run again as linear regressions to test the presence of collinearity between the variables. In all cases, the eigenvalue index was equal to 1.000. Although collinearity can appear in the case the variables are very correlated, another kind is when a regression's variables add up to something that is very close to a constant. As the majority of the respondents in all cases supported state economic intervention independently of their self-positioning in the left-right scale, it is the case.

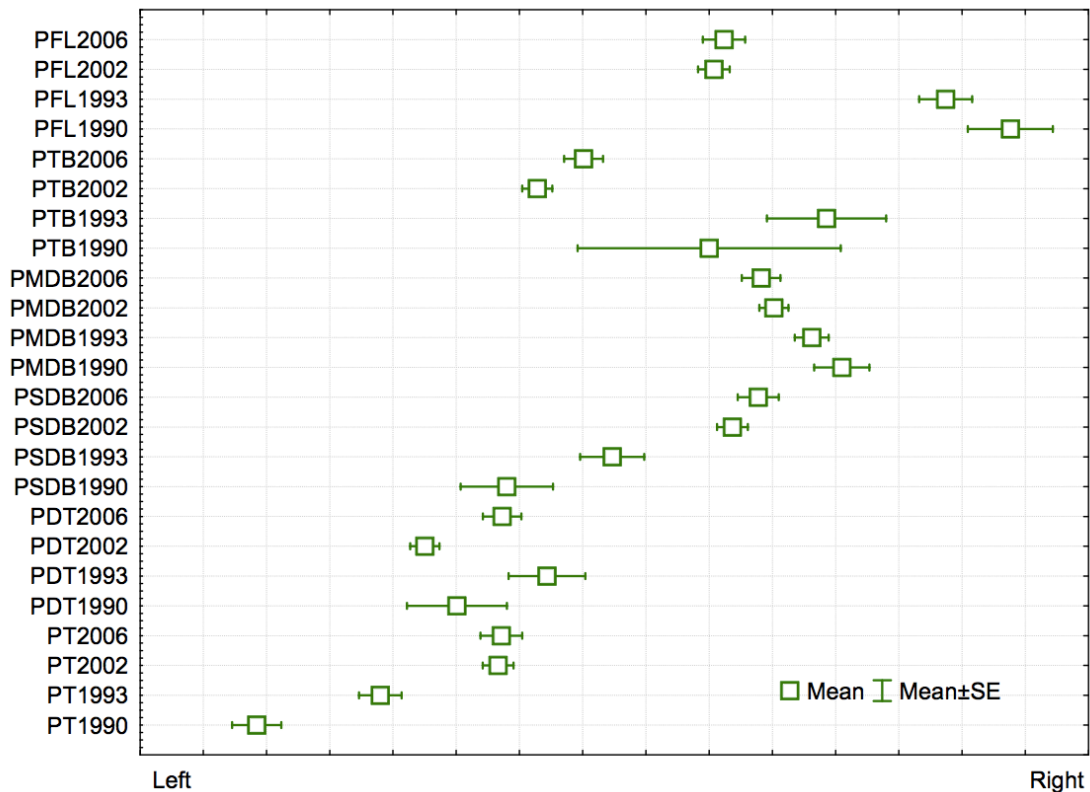
Another question when analysing the surveys was about the electors' perception about the Brazilian political parties in the left-right space. Some of the surveys asked the respondents to classify the Brazilian political parties in a Likert left-right scale. This question was asked in the years 1990, 1993, 2002, and 2006. Although Brazilian electors' own understanding about the meaning of "left" and "right" is fuzzy, political parties explicitly position themselves as left, right, or any intermediary position between, and this position is reflected by the media. Thus, although electors may be unsure about themselves, they are aware of the parties' self-positioning in the left-right scale.

One of the presuppositions in this chapter is that the left-right scale moves through time or, in other words, that what was considered to be right-wing macroeconomic policies, for example, 50 years ago, now are considered to be centre or even left-centre. This means that the ideological change is not occurring merely inside the parties, but rather that there is

³²⁹ Data in the appendix.

a general movement from the outside changing the definitions of left and right and, in consequence, changing the economic policies the political parties identify themselves. Thus, the change is dual: first there is an ideological change in the outside moving the entire left-right scale; an internal movement of adaptation follows the new ideological configuration in force, making political parties to move to the left or to the right in the moving scale.

Figure 3.6
Elector's Perception of Political Parties Positioning in a Left - Right Scale, 1990 - 2006



Source: Own calculations, based on the CESOP database.

The Figure 3.6 above shows these movements: left-wing parties moved to the right while right-wing parties moved to the left. In 1990, the PT was the most left-wing of the parties analysed. In 1993 it moved to the right and, in 2002 and 2006, it is practically in the same position the PSDB was in 1990 and 1993. Among electors, this positioning is considerably consistent. The standard error of the average, measured by the whiskers in the figure 3.7, is considerably short in PDT's case (the second most left-wing party). It also pended to the right, staying in the same position than PT in 2006 and PSDB in 1990 and 1993. Although in 1990 electors were unsure how to position it, as the long whisker shows, the move to the right was consistently perceived by electors in the following years.

The PSDB, traditionally a centre-left social-democrat party, strongly moved to the right, achieving a position in the right of PTB in 1990 and PFL in 2006. The electors considered PMDB remaining consistent with its centrist position, changing a little to the left, and meeting both PSDB and PFL. As shown by the whiskers, in 1990 the PTB was the

party with the most intense crisis of identity, ranging from centre-left to centre-right. Nevertheless, following the movement of other right-wing parties, between 1990 and 2006 it changed to the left. The PFL also strongly moved to the left, meeting the PSDB and the PMDB. In the next section, instead of electors, the answers of the Brazilian National Congress' deputies are analysed.

3.5 Macroeconomic Policy and Ideological Convergence at the Political Level

Taking in consideration the parties' positions in 1990, it is possible to apprehend two simultaneous movements, one from left-wing and other from right-wing parties. In the first case, left-wing parties moved to the right. This is not to say they abandoned leftist ideals, but rather assumed a more right-wing political agenda to achieve their objectives, mainly assuming the right-wing idea that the state has a diminutive role in guaranteeing full-employment, while the 'market,' specially the financial sector, assures a Pareto's optimal resource distribution. At the same time, although right-wing parties did not change their political agenda, they moved to the left, as the left-right scale itself moved to the right. In other words, a political agenda that would be considered to be extremely right-wing during the 1950's nowadays is considered to be centrist or centrist-right.

Ideology was defined in the beginning of this work as *the combined systemic ways in which social and political dominance is established and sustained through subliminal means, and which is manifested through material actions*. As a result, the process of ideological change occurs without the actors involved acknowledging it. In this sense, it is possible to conclude that the change experienced by left-wing parties is really ideologic, as it is the result of subliminal internal structural changes; On the other hand, right-wing parties became more centrist because their political and economic ideology turned to be mainstream.

Table 3.12
Congressmen's Preference for State Economic Intervention Accordingly to Party Membership in 1990 - Politicians

	PMD B	PFL	PDS	PSDB	PRN	PDT	PTB	PT	PL	PSB
State	1,9%	0%	0%	0%	0%	16,7%	0%	33,3%	0%	0%
Most the State	15,4%	2,8%	0%	26,1%	50,0%	41,7%	20,0%	66,7%	0%	50,0%
Equilibrium	55,8%	25,0%	15,4%	52,2%	50,0%	25,0%	20,0%	0%	28,6%	50,0%
Market	26,9%	72,2%	84,6%	21,7%	0%	16,7%	60,0%	0%	71,4%	0%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Own calculations based on IUPERJ - Oxford Legislative Survey 1990.

As table 3.12 shows, in 1990, the Brazilian parties' preference for state intervention was well divided, following the idea of left-wing parties supporting more state intervention

and right-wing parties supporting less state intervention. The PT, the PTB, and the PSB's congressmen were the strongest supporters of state intervention in the economy, although in both cases the strongest support was not for absolute state control, but for more state than market controlling the economy. Congressmen of centrist parties like the PMDB and the PSDB supported the equilibrium between state and market, with the latter being for more state intervention than the latter. Right-wing conservative parties' congressmen, like the PFL, the PDS, the PL, and the PTB, were for more market than state. Surprisingly, Fernando Collor PRN's congressmen were more aligned with the left-wing PSB than with right-wing parties like PFL and PDS, showing its lack of a solid ideological base.

Taking in consideration the congressmen's positions in 1990 (see table 3.13), it is possible to apprehend that there were already a clear relationship between self-positioning in the left-right scale and the preference for more or less state intervention. Only left-wing and centre-left congressmen supported full state control of the economy. At the same time, none of left-wing congressmen supported pure market economics although 22.9% of centre-left did. The strongest support for pure market control was among centre-right congressmen (60%). Half of right wing congressmen supported full economic liberalism, what is less than among centrist congressmen (58.1%). The explanation is that right-wing congressmen were still connected with the national-developmental ideas of the military regime.

Table 3.13
Congressmen's Preference for State Intervention and and Personal Positioning in the Left- Right Scale in 1990 - Politicians

	Left	Centre-Left	Centre	Centre-Right	Right	Total
State	38,5%	4,2%	0%	0%	0%	5,2%
Most the State	46,2%	29,2%	4,8%	0%	0%	17,0%
Equilibrium	15,4%	43,8%	37,1%	40,0%	50,0%	37,8%
Market	0%	22,9%	58,1%	60,0%	50,0%	40,0%
Total	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%

Source: Own calculations based on the IUPERJ - Oxford Legislative Survey 1990.

The ordinal regression's results show that both variables are correlated. The model fit's p level (Sig.) is less than 0.05, showing that the model gives better predictions than if just guessing on the marginal probabilities of the outcome category. First, the goodness-of-fit, which contains the Pearson's chi-square for the model, is not statistically significant. As this test's null hypothesis is that the fit is good, if p-level is large, usually if $p > 0.05$, than the hypothesis is not rejected. However, if $p < 0.05$, the model does not fit well. In this regression, the Pearson's chi-square significance is equal to 0.197, thus the model fits very well. This is reflected by the pseudo R-square statistics of 0.379, meaning that 37.9% of the model's variance is explained by congressmen self-positioning in the left-right Likert

Scale. The test of parallel lines shows that chi-square is low (4.383) and p-level is equal to 0.821. In this case, the slope coefficients in the model are similar, resulting in parallel lines, thus the model fits well.

The next year Brazilian congressmen were asked about their preference regarding the degree of state intervention in the economy was 1997. Notwithstanding Collor's impeachment, between 1990 and 1997 his political project of opening and liberalising the Brazilian economy was continued and deepened. Although Collor's vice-president Itamar Franco supported an economic model more aligned with national-developmental principles, including relaxing the monetary policy. Nevertheless, during his presidency the basic pillars of economic reform based on the Washington Consensus' principles were maintained, including the National Program of (*Programa Nacional de Desestatização - PND*) and the process of commercial liberalisation.

When Fernando Henrique Cardoso became his Minister of Economics in 1993, inflation was considered Brazil's most urgent economic problem reaching approximately 2490% that year. In February 1994 Cardoso's implemented a successful stabilisation plan, called Real Plan (*Plano Real*), combining heterodox economic policies *ex-ante* to deal with inertial inflation and Orthodox Neoclassical Monetarism *ex-post* to keep inflation low. Being elected president in 1994, Cardoso deepened Fernando Collor's policies and the process of economic liberalisation, with considerable political support.

Table 3.14
Congressmen's Preference for State Economic Intervention Accordingly to Party Membership in 1997

	PMDB	PFL	PDS/ PPB/ PPR	PSDB	PPS	PDT	PTB	PT	PL	PSB
State	3,1%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Most the State	12,5%	2,9%	0%	7,4%	0%	0%	0%	26,7%	0%	0%
Equilibrium	40,6%	26,5%	4,0%	29,6%	100%	37,5%	37,5%	73,3%	0%	100%
Market	43,8%	70,6%	96,0%	63,0%	0%	62,5%	62,5%	0%	100%	0%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Own calculations based on IUPERJ - Oxford Legislative Survey 1997.

Thus, as shown on table 3,14 above, in comparison to 1990, all parties moved away from state intervention in direction to free-market. Fernando Henrique Cardoso's party PSDB, initially a social democratic party, Lula da Silva's PT, and PDT experienced the most radical changes. In 1997 the majority (63%) of the PSDB's congressmen were supporting total market liberalism in contrast to 21.7% in 1990. At the same time, none of PT's congressmen were supporting full state control of the economy, in contrast to 33,3% in 1990; 73.3% were for equilibrium (0% in 1990) and the support for an economic model

with more state than market felt from 66.7% in 1990 to 26.7% in 1997. The PMDB also shifted to the right with 43.8% of its congressmen supporting total market liberalism in contrast to 26.9% in 1990, while 40.6% supported the equilibrium between state and market. The PSB also shifted to from partially supporting ‘most the state’ to entirely supporting the equilibrium between market and state. Even the PPS, the former Brazilian Communist Party that was aligned with the Soviet Union for several years, supported some form of equilibrium instead of full state control of the economy, as it would be to expect from radical left-wing parties.

In comparison to the congressmen’s positions observed in 1990, the table 3.15 below shows that the preference for more or less state intervention in the economy was also well distributed, with left-wing parties supporting more state intervention and right-wing parties supporting a more liberal market-based economic system. What changed was that left-wing, centre-left, and centrist parties moved to the right of the Reinert scale, showing a tendency to abandon supporting state economic intervention. Centre-right congressmen became more inclined to supporting a liberal market economic system, at the same time right-wing politicians broke with the policies of the military regime, thus with national-developmentalism, fully supporting a free market model.

Table 3.15
Congressmen’s Preference for State Economic Intervention Accordingly to Party Membership in 1997 - Politicians

	Left	Centre-Left	Centre	Centre-Right	Right	Total
State	5,9%	0%	0%	0%	0%	5,2%
Most the State	29,4%	12,2%	0%	0%	0%	17,0%
Equilibrium	47,1%	53,7%	21,1%	35,7%	0%	37,8%
Market	17,6%	34,1%	78,9%	64,3%	100%	40,0%
Total	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%

Source: Own calculations based on the IUPERJ - Oxford Legislative Survey 1997.

The regression analysis showed that both variables are correlated. The model fit’s p level (Sig.) is equal to 0.000, showing that the model gives better predictions than if just guessing on the marginal probabilities of the outcome category. First, the Pearson’s chi-square for goodness-of-fit is not statistically significant. As this test’s null hypothesis is that the fit is good, if p-level is large, usually if $p > 0.05$, than the hypothesis is not rejected. However, if $p < 0.05$, the model does not fit well. In this regression, the Pearson’s chi-square significance is equal to 0.961, thus the model fits very well. This is reflected by the pseudo R-square statistics of 0.375, meaning that 37.5% of the model’s variance is explained by congressmen self-positioning in the left-right Likert Scale. The test of parallel lines shows that chi-square is low (3.942) and the p-level is equal to 0.862. In this case, the slope

coefficients in the model are similar, what results in parallel lines. In other words, the model fits well and is valid.

The next IUPERJ - Oxford Legislative Survey's round was in 2001, one year before the 2002's Presidential elections. Fernando Henrique Cardoso's popularity was in decline: in May 2011, an opinion poll conducted by the Sensus Institute showed that Cardoso's positive evaluation fell from 29.7% to 22.1% while the negative evaluation increased from 27.9% to 37.1%.³³⁰ This can be explained by several factors. First, the energetic crisis that started after the combination of several failures switching-off Itaipu Hydroelectric Powerplant's main generator, leaving 21 states without electricity for several hours. As the system collapsed, several structural failures were discovered, resulting in a program of electrical energy rationing for several months, resulting in a general popular dissatisfaction with the government, including with the energetic sector's privatisation and chosen regulatory model. Second, there were several accusations of corruption involving 11 ministers, 194 congressmen, 33 senators, and Cardoso himself.³³¹

Table 3.16
Congressmen's Preference for State Economic Intervention Accordingly to Party Membership in 2001 - Politicians

	PMDB	PFL	PDS/ PPB/ PPR	PSDB	PPS	PDT	PTB	PT	PL	PSB
State	0%	0%	0%	0%	0%	0%	0%	8,3%	0%	0%
Most the State	7,1%	3,6%	25,0%	4,0%	100%	40%	16,7%	50,0%	0%	0%
Equilibrium	57,1%	28,6%	33,3%	44,0%	0%	40%	33,3%	33,3%	100%	50%
Market	35,7%	67,9%	41,7%	52,0%	0%	20%	50%	8,3%	0%	50%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Own calculations based on IUPERJ - Oxford Legislative Survey 2001.

Table 3.16 shows that, in comparison to 1997, there was a dual movement. First, after the apex of supporting market in 1997, in 2001 the majority of the political parties had retreated in direction to a more centrist position. Although this rebound can be explained as the result of Cardoso's falling popularity, a second explanation is a feature of the Brazilian political environment known literally as the 'abashed right.' It means that conservatives do not want to be identified as right-wing. Pierucci in 1987 was the first to identify such behaviour, stating that "(...) for politicians depending on winning votes, a

³³⁰ Folha de São Paulo, May 29, 2001, <http://www1.folha.uol.com.br/foha/brasil/ult96u20479.shtml>, access in December 02, 2011.

³³¹ The Solicitor General during Cardoso's two terms, Geraldo Brindeiro, was referred by the media and the population as "*Engavetador Geral da República*," a joke with his office in portuguese "*Procurador Geral da República*," and the portuguese word for drawer (*gaveta*). The joke was justified: from 626 criminal inquiries on corruption, he archived 217, put on hold ("put into the drawer") 242, and refused 107. Gaspar, M. (2002, 17 July). *A Gaveta Mágica do Dr. Brindeiro*. *Veja*, pp. 82-83..

rational-cost benefit analysis suggests that it is not very clever to confess being on the right. Even worst is to confess being on the extreme right.”³³²

Leôncio Martins Rodrigues in his 1987’s book on the Constituent Assembly detailed this phenomenon. Asking 428 congressmen to classify themselves on a left-right five-point Likert Scale, none of them has chosen “radical right.” At the same time, only 6% classified themselves as moderate or centre-right. The rest classified themselves as centre (37%), centre-left (52%), and radical left (5%). Rodrigues’ conclusion was that judging by the self-definition of politicians, Brazil is a country without a right.³³³ As Timothy Power pointed out, “(...) a voter in Brasília tried to explain the *direita envergonhada* to me by remarking of the candidates: “If they do not say what party they are, they’re usually PFL.””³³⁴

Nevertheless, although both explanations certainly have some degree of validity in determining the observed counter-movement, what changed was the notion of supporting free market economic policies as tantamount to right-wing politics. In other words, what changed was the entire notion of which degree of state intervention is associated with left-wing or right-wing ideological positions. This conclusion is valid because as table 3.17 below shows, contrary to the non-left-wing parties, left-wing parties, like the PT and the PSB, had moved to the right, supporting more market than in 1997. This was the first time members of both parties explicitly supported total free market as economic model, reflecting not only a process of internal ideological change, but that the policies associate with “being left-wing” had also shifted to the right, as expressed on Lula da Silva’s *Carta ao Povo Brasileiro*.

Table 3.17
Congressmen’s Preference for State Economic Intervention Accordingly to Party Membership in 2001 - Politicians

	Left	Centre-Left	Centre	Centre-Right	Right	Total
State	20,0%	0%	0%	0%	0%	2,1%
Most the State	50,0%	19,0%	11,1%	16,7%	0%	16,5%
Equilibrium	20,0%	57,1%	50,0%	0%	66,7%	46,4%
Market	10,0%	23,8%	38,9%	83,3%	33,3%	35,1%
Total	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%

Source: Own calculations based on the IUPERJ - Oxford Legislative Survey 2001.

³³² Pierucci, A. F. (1987). “As Bases da Nova Direita”. *Novos Estudos CEBRAP*, vol. no. 19, pp. 26-45 , pp. 38.

³³³ Rodrigues, L. M. (1987). *Quem É Quem na Constituinte: Uma Análise Sócio-Política dos Partidos e Deputados*. São Paulo: OESP, pp. 97-99.

³³⁴ Power, T. J. (2000). *The Political Right in Postauthoritarian Brazil: Elites, Institutions, and Democratization*. University Park, PA: The Pennsylvania State University Press, p. 94.

The ordinal regression for 2001 data confirmed that both variables are correlated. The model fit's p level (Sig.) is equal to 0.000, showing that the model gives better predictions than if just guessing on the marginal probabilities of the outcome category. The Pearson's chi-square for goodness-of-fit is not statistically significant. As this test's null hypothesis is that the fit is good, if p-level is large, usually if $p > 0.05$, than the hypothesis is not rejected. However, if $p < 0.05$, the model does not fit well. In this regression, the Pearson's chi-square significance is equal to 0.156, thus the model fits well. The pseudo R-square statistics is 0.23, meaning that 23% of the model's variance is explained by congressmen self-positioning in the left-right Likert Scale. The test of parallel lines shows that the chi-square is low (9.348) while the p-level is equal to 0.314. In this case, the slope coefficients in the model are similar, resulting in parallel lines. In other words, the model fits well and is valid and the hypothesis is accepted.

The IUPERJ - Oxford Legislative Survey was run two times more, one in 2005 and another in 2009. The results of the regressions in both cases did not show anything new, but the consolidation of the trends discussed above.³³⁵ Specifically in 2009, there is a small tendency of parties going in direction to the state, but this is rather the result of the international economic crisis than a reversion of the process of ideological convergence for a common set of economic and political ideologies. The tables and the results of the regressions are available as annexes.

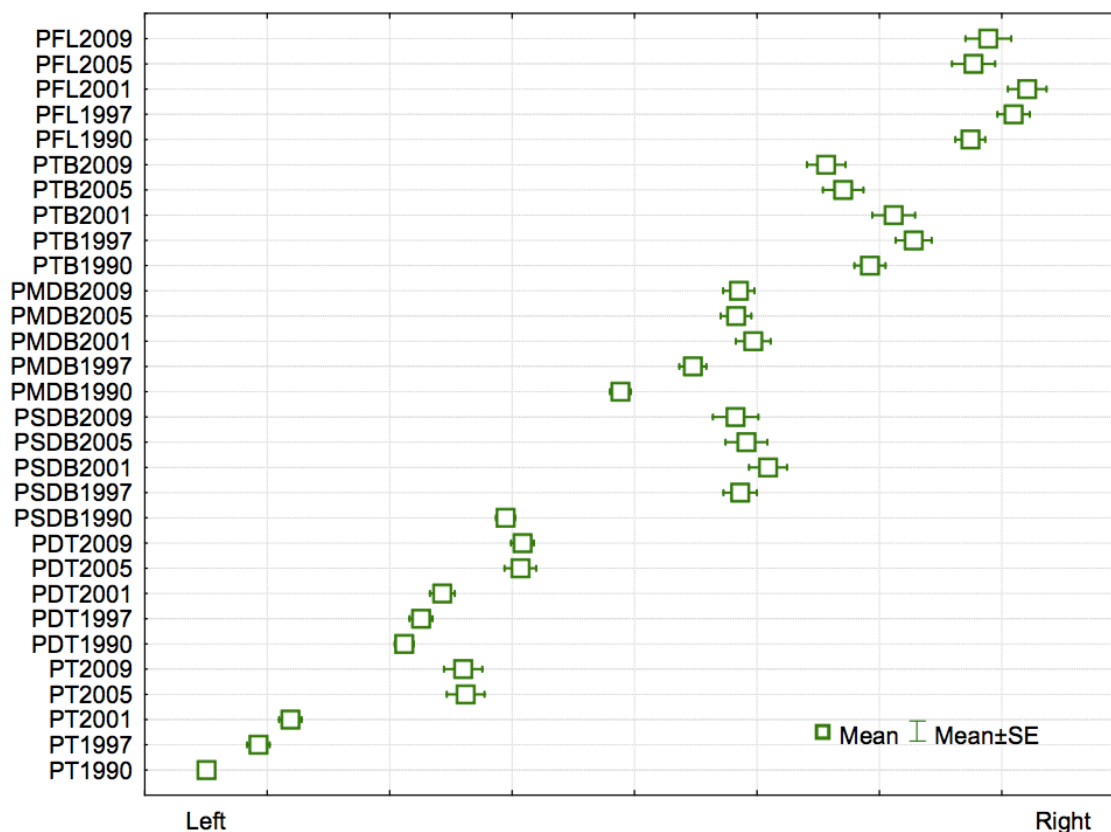
Although the ideological choice seems to be better defined inside the parties than among electors, the process of convergence to a specific economic model and its macroeconomic policies expressed as political ideology was clear in both cases: political parties moved to the right in the period analysed, accordingly to the perceptions of both electors and politicians. It is interesting to note that in the very beginning of the process of transition, the majority of the politicians supported state intervention in the economy independently of their ideological self-positioning as left or right-wing. This can be explained as the result of the influence of national-developmental ideology upon political actors. Among left-wing individuals, the idea of the state promoting social justice to correct capitalism's structural problems or even to establish a socialist or communist state was still vivid. On the other hand, the national-developmental ideals expressed by a strong state promoting development was associated to the economic model implemented during the years of military dictatorship (1964-1984), which was clearly right-wing.

Thus, in the Brazilian case, the idea of a strong state regulating the economic and social policies was common for left and right-wing electors and politicians until the middle 1980's. However, in the ending of the 1980's and beginning of the 1990's, it was clear that among politicians, the option for more or less state was very well correlated with being left or right-wing oriented. This correlation reached its apex in 1997, when Cardoso and his

³³⁵ See tables A.8. and A.9. in the Annexes.

neoliberal policies' popularity reached their highest point, reflecting the Real Plan's success in dealing with inflation and stabilising the Brazilian economy.

Figure 3.7
Political Parties Self-Positioning in a Left - Right Scale, 1990 - 2009



Source: Own calculations based on the IUPERJ - Oxford Legislative Survey 1990, 1997, 2001, 2005, 2009.

As also shown on figure 3.7 above, with Cardoso's popularity declining in the following years, the phenomenon known as "ashamed right" regained place. As a result, there was a rebound of those parties that had significantly moved to the right in direction to the left. The surprise was that traditionally left-wing parties like Lula da Silva's PT moved to the right, with some of their congressmen even supporting free market. This can be understood as the result of, first, a process internal ideological change and, second, that the policies associate with "being left-wing" had also shifted to the right, meaning that the left had assumed right-wing policies as their own, resulting in ideological convergence. In this sense, it is true that, at least in Brazil there is no Left.

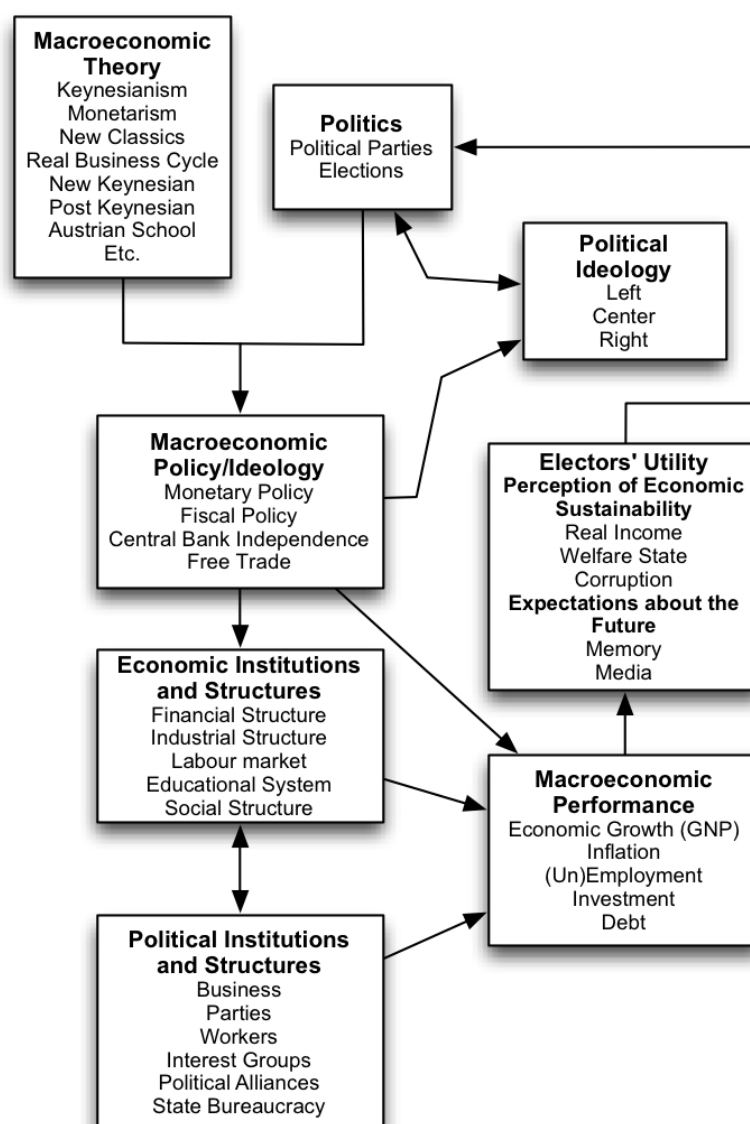
This dissertation presents the hypothesis that macroeconomic policy is determined at the political level, following ideological changes as the output of long-wave business cycles. As a result, what is acceptable in terms of macroeconomic policy is already determined *ex-ante* at the ideological level, leaving few space for manoeuvre. Another contribution is developing the hypothesis that macroeconomic policies themselves are subject to change in the left-right space of the ideological spectrum. What were conservative right-wing policies 50 years ago are now regarded as centrist policies. It also develops the idea that there is a process of ideological change following economic crises,

supporting the median voter theorem's explanation of the process of party convergence. Also, to deny the idea of pure voters' rationality based on an one-dimension field. The finds in this dissertation show that voters' decision is based on each individual's subjective idea of what is the best for the society as determinant of what is the best for himself/herself. It proposes that individuals are more like Jeremy Bentham and Adam Smith supposed. Individuals understand they are part of the society, thus they base their decisions on what they believe is the best for the society and not only in their immediate personal gains, as proposed by Neoliberal theory.

Several macroeconomic approaches/schools of thought exist. Their objective is to explain the dynamics of macroeconomics, as discussed above, but they also reflect a moral and ideological pattern, implicitly providing guidelines for political conduct. As theory, they are limited to the boundaries of the academia, without influencing the real world. When politicians choose one of these schools of thought as the theoretical base for macroeconomic policies to be implemented in the real world, what was macroeconomic theory turns to be macroeconomic policy, therefore turning to be ideology. The result is dual. On one hand, the school of thought giving the theoretical base for the macroeconomic policy in force turns to be the academic mainstream. It then determines the research agenda at the academia, at the same providing clear boundaries for what is and what is not acceptable as macroeconomic policy. On the other, as it is determined at the political sphere, it turns to be an ideology in itself, because its transmutation into macroeconomic policy makes it as the main instrument for obtaining and maintaining power.

With the boundaries of macroeconomic policy being determined, both economic and political institutions and structures adapt to the new economic ideology. This is not to say that the process is smooth, as there are many actors involved and they can influence - but not change - the core macroeconomic ideology in force, aiming to adjust it to their needs. The interaction between macroeconomic policy, economic institutions and structures, and political institutions and structures then determines the macroeconomic performance. In the case the latter fulfil the electors' expectations on macroeconomic performance, there is no need to change the current macroeconomic policy, thus political ideology is also unchanged. Political business cycles resulting from electoral use of macroeconomic policy as described before can occur, resulting in inflation. However, the boundaries of what is and what is not accepted in macroeconomic terms remain unchanged. As a result, political ideology also remains unchanged. A model of business cycle, macroeconomic policy, and ideology can be schematised as:

Figure 3.8
Macroeconomic Policy, Politics, and Ideology



However, as history has shown, sometimes depressions occur. They reflect the collapse of the macroeconomic ideology in force to maintain the social and economic structure's level of reproduction. In this case, macroeconomic failure expressed by low levels of GDP growth and investment, high unemployment and debt and, in some cases, inflation - not necessarily all at the same time. As a result, politicians are unable to create inflation to temporary boost the level of economic activity aiming to win coming elections within the established macroeconomic ideology.

Electors are rational and look to the past and the present to form expectations about the future. Their utility changes accordingly to their perceptions about the sustainability of the macroeconomic ideology in force, and their expectations about the future. The first is determined by real income, the level of social protection, and corruption. The second is determined dually. First, by the electors' memory and its duration. People look to the past as a way to get information, although memory is both selective and limited. Thus, these

two variables change perceptions and expectations. Second, there is the role of the media. Ordinary people have limited knowledge of both what is happening at the political level and about economics. The media provides information and analysis, shaping the electors' expectations about the sustainability of the current macroeconomic ideology and the future.

As politicians become convinced the macroeconomic ideology in force cannot provide the instruments to make the social and economic system to start growing and developing again, they start looking for alternatives to avoid losing power in coming elections. At this moment, a new macroeconomic ideology and a new academic macroeconomic mainstream are established. However, as discussed above, each macroeconomic theory reflects a specific moral and ideological structure, implicitly providing guidelines for political conduct. As a result, to adopt a macroeconomic theory as base for establishing a new macroeconomic ideology, the political sphere must also change the political ideology in force. Thus, the new political ideology is shaped accordingly to the new macroeconomic mainstream's moral and ideological structure, which reflecting Downs' theory of the medium voter and the process of party convergence discussed above, will be the new ideological "centre;" the "old" centre will be the new left or right.

4. IDEOLOGICAL CONVERGENCE AND MACROECONOMIC POLICY IN LATVIA

Before applying the model developed in this dissertation to Latvia, it is necessary to stress once more that macroeconomic policy is a political choice. In other words, the macroeconomic policies one country adopts is the result of the political struggle among political parties to get or to stay in power. It is also limited or, at least, strongly influenced by what is internationally considered to be the economic mainstream. This was not the case when Latvia was definitely annexed by the Soviet Union in 1944, beginning a long period of deep economic integration into the Soviet economy. Rather, there was no political struggle to define the economic model to be adopted. It was simply vertically imposed from Moscow.³³⁶

During the period of the Cold War, the Soviet Union's policy was much determined by the fear of foreign intervention. Its main objectives were to contain Germany, to repel Japan, to increase its influence in Spain, and to establish closer ties with the United States. The fundamental concern was protecting the borders. Thus, albeit the nazi-Soviet pact was signed to contain a belligerent Germany, it also gave the possibility for the USSR to increase its influence area until the Baltic Countries, Ukraine, and Belarus.³³⁷ After the Conference of Yalta, this international political-geographical division became consolidated in such a way that Latvia became part of the Soviet Union. Its political, economic, and social structure were totally changed to the Soviet model.

Following the political and economic isolation from the West, the Soviet economy experienced a process of autonomous development. This not only made the country to be immune to the Great Slump, but resulted in increasing isolation after the World War II. This contradicted the Bolsheviks' hope of a wave of revolutions in the more developed industrial countries, that would result in further integration instead of isolation.³³⁸ The result was the establishment of a specific model of economic development based on state planing, focused on the inside. The core of the Soviet economic system consisted of six points:³³⁹

- 1) State ownership or control of most productive enterprises;
- 2) central planning of production and allocation of goods and services at State determined prices;

³³⁶ Reardon, J. (1996). "An Assessment of the Transition to a Market Economy in the Baltic Republics." *Journal of Economic Issues*, vol. 30, no. 02, pp. 629-638.

³³⁷ Kennedy-Pipe, C. (1998). *Russia and the World, 1917-1991*. London: Arnold/Oxford University Press.

³³⁸ Hobsbawm, E. (2003). *The Age of Extremes: the Short Twentieth Century, 1914-1991*. London: Abacus.

³³⁹ Chandra, N. K. (2004). "Relevance of Soviet Economic Model for Non-Socialist Countries." *Economic and Political Weekly*, 29/05/2004, p. 2287.

3) a subsidiary role for money, banking and public finance with primacy assigned to production targets in physical units;

4) price control and supply restrictions on domestic trade, except for foods produced on the collective farmers' private plots;

5) limited freedom for workers to choose their jobs and;

6) state monopoly over foreign trade and transactions.

The model allowed the Soviet economic structure to change between 1917 and 1985 from an economy with 82% of rural population and most of the GDP originating in agriculture, to one that was 78% urban, with 40-45% of the GNP originating in manufacturing and related sectors. However, although its progress was evident, the GNP's annual rate of growth that was 5.7% during the 1950's fell to 2.0% between 1980 and 1985. In the same way, the GNP per capita's annual rate of growth dropped from 3.9% during the 1950's to 1.1% between 1980-85.³⁴⁰ Also, the overall productivity of the Soviet economy declined on average by 3.3% between 1950 and 1985, as a result of structural problems.

Table 4.1
USSR GNP's annual rates of growth (%), 1950-85

	1950-85	1950-60	1960-70	1970-75	1975-80	1980-85
Gross National Product	4.3	5.7	5.2	3.7	2.6	2.0
GNP per capita	3.2	3.9	3.9	2.7	1.8	1.1
GNP per employed	2.8	4.0	3.0	2.2	1.4	1.3
GNP per unit of capital	-3.3	-3.5	2.6	-3.9	-3.9	-4.0

Source: Ofer, G. (1987). "Soviet Economic Growth: 1928-1985." *Journal of Economic Literature*, vol. XXV, December, pp. 1778.

Although the objective of establishing key industrial sectors was successful, there were many structural problems contributing to the USSR's collapse. There are five main structural factors contributing to the collapse of the Soviet model. First, the industrialisation process leaned on the field workers. They were more taxed, but had less social insurance. Second, the basic agricultural policy substituting the New Economic Policy (NEP) resulted in forced collectivisation. Agricultural productivity fell in such a way that the Soviet Union was forced to import grains during the 1970s. Third, the process of bureaucratisation, consequence of the model of centralised command, resulted in a situation where all effort to increase the efficiency and the flexibility of administration and production resulted in the opposite.³⁴¹ Fourth, the inflexibility of a system drifted for the constant growth of the production of goods, without any internal mechanism foreseeing changes of production levels and quality assurance. As a result, innovation in the productive process became virtually impossible. This situation was worsened because great

³⁴⁰ Ofer, G. (1987). "Soviet Economic Growth: 1928-1985." *Journal of Economic Literature*, vol. XXV, December, pp. 1778.

³⁴¹ Hobsbawm, E. (2003). *The Age of Extremes: the Short Twentieth Century, 1914-1991*. London: Abacus.

part of the resources for research and development were destined to the defence sector as direct consequence of the Cold war. A direct consequence was the reduction of the civilian sectors' productivity development.³⁴² Fifth, the Soviet planners' spent vast sums retooling old plants and investing into Siberian development.³⁴³ The result was the collapse of the Soviet Union, Latvia's independence, and the beginning of its transition to a market economy.

4.1 Application of the “Model of Macroeconomic Policy, Politics, and Ideology” to Latvia

The sections below applies the model developed on this dissertation to Latvia. The section 4.1.1 analyses how neoliberalism turned to be macroeconomic policy, and the process by which it became implemented by the countries of the former Warsaw Pact in the beginning of the 1990s. Section 4.1.2 analyses the extent by which it influenced political ideology, as expressed by the economic program of the political parties elected to the 5th, 6th, 7th, and 8th Saeima. The transformative effect of neoliberal economic ideology on economic and political institutions and structures is analysed in section 4.1.3. Finally, the concrete output expressed as macroeconomic performance and the prospects of change are discussed in section 4.1.4.

4.1.1 Neoliberal Chicago Monetarism as Macroeconomic Policy after the USSR (Macroeconomic Theory)

Latvia became independent in 1991, when Neoliberalism was established as the mainstream economic ideology substituting Keynesianism. Thus, neoliberal ideology based on the Washington Consensus' conclusions became the guide for economic reforms. More specifically, the process of transition from a centralised administrated economic system towards a market economy in Latvia followed what became known as Shock Therapy. The countries which adopted this model were Albania (July 1992), Bulgaria (February 1991), Czechoslovakia (January 1991), Estonia (September 1992), Latvia (June 1993), and Russia (February 1992).³⁴⁴

The entire model is based on the neoclassical marginalist economic theory thus, in the absence of obstacles for the free action of the market, productive and allocative Pareto efficiency is a natural outcome. It has three primary elements:³⁴⁵

- i. The speed to implement the reforms;
- ii. A political structure consonant with the model;
- iii. An ideological structure consonant with the model.

³⁴² Allen, R. C. (2001). “The Rise and Decline of the Soviet Economy”. *Canadian Journal of Economics/ Revue Canadienne d'Economique*, vol. 34, n° 4.

³⁴³ Hobsbawm, E. (2003). *The Age of Extremes: the Short Twentieth Century, 1914-1991*. London: Abacus.

³⁴⁴ Marangos, J. (2002). “The Political Economy of Shock Therapy”. *Journal of Economic Surveys*, vol. 16, no. 01, pp. 41-76.

³⁴⁵ *Ibid*, p. 41.

As it is based on neoclassical marginalist economic theory, shock therapy presupposes that self-interest in a free competitive capitalist system is reinforced by political freedom, at the same time neoclassical economic ideology is the instrument to make it real. The expected result would be growth, full employment, low inflation, and stability. In resume, “the shock therapy model is a neoclassical model of transition advocating the immediate implementation of the necessary reforms to establish a free market process.”³⁴⁶ It has seven secondary instruments:³⁴⁷

- i. Price liberalisation-stabilisation;
- ii. Privatisation;
- iii. Institutional structure;
- iv. Monetary policy;
- v. Fiscal policy;
- vi. International trade and foreign aid;
- vii. Social policy.

Since the secondary instruments are based on neoliberal logic, as economic policy they mean immediate price liberalisation, minimum state intervention, an institutional structure as a product of market forces, an independent central bank, a neutral tax system and balanced budget, free international trade, a fully convertible currency, and a safety net. Thus, implementing such model is not only an economic challenge but also a political challenge.³⁴⁸ The task was facilitated by the “glamorisation of markets and privatisation by right wing think tanks dispersing advice at odds with the real experiences of western markets.”³⁴⁹ Also, by the IMF, the World Bank, and several organisations related to the United Nations. Together with the American administration and the countries of the G7 group, the belief in Neoliberalism as universal policy to substitute statist models became not only a mantra but was imposed to transition countries.³⁵⁰

Governments and multilateral institutions were the ones transition countries were forced to turn for help, which was always dependent of fulfilling certain clauses of policy conditionality based on shock therapy. Since very often these countries experienced macroeconomic chaos, lack of stability, and hyper inflation, there was no choice than to apply these reforms. For example, Mira Muc, head of the Slovenian privatisation bureau,

³⁴⁶ Marangos, J. (2002). “The Political Economy of Shock Therapy”. *Journal of Economic Surveys*, vol. 16, no. 01, pp. 41-76, p. 42.

³⁴⁷ Ibid.

³⁴⁸ Ibid. p. 42.

³⁴⁹ Thompson, P. & Smith, C. (1992). *Socialism and the Labour Process in Theory and Practice*. In Smith, C. & Thompson, P. (Eds.), *Labour in Transition*. London: Routledge, cited in Reardon, J. (1996). “An Assessment of the Transition to a Market Economy in the Baltic Republics.” *Journal of Economic Issues*, vol. 30, no. 02, pp. 629-638.

³⁵⁰ Berend, I. T. (1994). *End of the Century Global Transition to a Market Economy: Laissez-Faire on the Peripheries?*. In Berend, I. T. (Ed.), *Transition to a Market Economy at the End of the 20th Century*. Munich: Südosteuropa-Gesellschaft, Eleventh International Economic History Congress, Session A-3, September 12-17, 1994, Milan, Italy.

declared in 1993 that “we gave our word to the World Bank for privatising 400 firms in 12 months (...) without that there are no credits. Another example was Poland. When its budgetary deficit surpassed the prescribed limit of 5%, the IMF suspended any credit to the country until decreasing the deficit from 7.5 % to 5.5%.³⁵¹ However, it would be unfair to affirm that external actors unilaterally imposed the reforms. Rather, the local political elite was extremely receptive to them at the same time local economic experts were confused.³⁵² Latvia was no exception and shock therapy’s policies were implemented relatively smoothly and were similar with Estonia and Lithuania, although slower and not so successful in rapidly turning towards Western markets.³⁵³

4.1.2 Neoliberalism Expressed as Politics: Political Parties’ Economic Platform from the 5th to the 8th Saeima (Politics)

Since economic policy is defined and instrumentalised at the political level, it is necessary to understand in what extent shock therapy’s economic ideology influenced the economic programmes of the political parties which gained seats in the 5th, 6th, 7th, and 8th Saeima, or from Latvia’s independence until joining the European Union and NATO. The Parties’ economic platforms are presented starting from the more to the less Neoliberal. it is not the intention here to present this division as a definitive classification. Rather, it is an arbitrary tentative to group similar parties’ programs to make easier to understand the similarities and differences among parties and their economic platforms.³⁵⁴ The table 4.2 below presents the political parties elected to the 5th, 6th, 7th, and 8th Saeima.

Table 4.2
Result of the 5th, 6th, 7th, and 8th Saeimas’ Elections

Name	Number of Votes	%	Number of Seats
5th Saeima (1993 - 1995)			
Latvia’s Way	362,473	32.41	36
Latvian National Independence Movement (LNNK)	149,347	13.35	15
Harmony for Latvia - Rebirth of the National Economy	134,289	12.01	13
Farmers’ Union	119,116	10.65	12
Equal Rights	64,444	5.76	7
The Union for Fatherland and Freedom	59,855	5.35	6

³⁵¹ Berend, I. T. (1994). End of the Century Global Transition to a Market Economy: Laissez-Faire on the Peripheries?. In Berend, I. T. (Ed.), *Transition to a Market Economy at the End of the 20th Century*. Munich: Südosteuropa-Gesellschaft, Eleventh International Economic History Congress, Session A-3, September 12-17, 1994, Milan, Italy, pp. 19-20.

³⁵² Ibid.

³⁵³ Mygind, N. (1997). *Different Paths of Transition in the Baltics*. Copenhagen: Copenhagen Business School, CEES Working Paper no. 5.

³⁵⁴ It was not possible to find the individual economic platform of the party Christian Democratic Union’s in the 1990s, since it was always part of some coalition: in 1995 with the Farmers’ Union; in 1998 with the Labour Party and the Green Party, which later united with the Farmers’ Union; in 2002 with Latvia’s First Party. Thus, the Christian Democratic Union’s economic platform shall be considered the same as the one of the parties it formed the coalition.

Name	Number of Votes	%	Number of Seats
The Christian Democrat Union	56,057	5.01	6
Democratic Center Party	53,303	4.77	5
6th Saeima (1995 - 1998)			
Democratic Party Managers (Saimnieks)	144,758	15.51	18
Latvia's Way	139,929	14.65	17
People's Movement for Latvia (Siegerist)	142,234	14.90	16
The Union for Fatherland and Freedom	114050	11.92	14
Unity Party	68,305	7.15	8
Farmers' Union	60,498	6.33	8
Latvian National Independence Movement (LNNK)	60,352	6.32	8
National Harmony Party	53,041	5.55	6
Latvia's Socialist Party	53,325	5.58	5
7th Saeima (1998 - 2002)			
People's Party	203,585	21.19	24
Latvia's Way	173,420	18.05	21
Fatherland and Freedom/Latvian National Conservative Party (TB/LNNK)	140,773	14.65	17
National Harmony Party	135,700	14.12	16
Latvia's Social Democratic Alliance	123,085	12.81	14
New Party	70,214	7.31	8
8th Saeima (2002 - 2006)			
New Era	237,452	23.9	26
For Human Rights in United Latvia	189,088	19.0	25
People's Party	165,246	16.6	20
Union of Greens and Farmers	93,759	9.4	12
Latvia's First Party	94,752	9.5	10
Fatherland and Freedom/Latvian National Conservative Party (TB/LNNK)	53,396	5.4	7

Source: Central Election Commission of Latvia.

Latvia's Way (*Latvijas Ceļš*) had the most comprehensive, well-documented, and also Neoliberal economic platform. It was drafted by the Economists' Association 2010. The main objective is to integrate Latvia in the European Economic Area resulting in joining the European Union in the future.³⁵⁵ For achieving it, there are seven interrelated pillars:

- i. to liquidate the Soviet institutions and their political logic's implementation;
- ii. to promote Latvia's transition to a free-market economic system, stimulating its citizens' private initiative and entrepreneurship;
- iii. to establish a model of state regulation that provides to Latvia's citizens a feeling of stability, resulting from stable and transparent property relations. Property

³⁵⁵ The analysis of the Latvia's Way program is based on the Association of Economists' projects *Latvijas saimnieciskās reformas programmas projekts Latvija 2000* and *Latvijas ekonomiskās programmas (modeļa) projekts*.

rights are to be guaranteed by the state, following the model used by democratic and developed countries;

iv. to invest in education;

v. to implement the national demographic program to avoid the numbers of Latvians to be reduced;

vi. to integrate Latvia in the European Economic Area with the objective of joining the European Union in the future;

vii. returning to Europe means to develop and to renew one compatible environment, economy, and way of life.

Liberal ideas are obvious in the program as the emphasis on individual and economic freedom, also meaning that individuals shall be responsible by themselves is evident. The party was fully committed to market-economic reforms based on Neoliberalism, although this is not stated clearly and the words “shock therapy” and “Neoliberalism” were not present in the economic program. First, since the party’s main objective was to make Latvia a member state of the European Union, it is clear that Latvia’s Way economic program was subordinated to promoting economic and social reforms in accordance to the European Union’s framework, which Neoliberal in its essence.³⁵⁶

The monetary policy’s main objective was to reduce inflation, keeping the expansion of the monetary base in accordance with the expansion of the economy, resulting in a tight monetary policy. This included the Bank of Latvia avoiding any interference in the market for credit. The party was against the devaluation of the lats, as it would only lower living standards, without increasing the external competitiveness of the industrial sector. In concrete terms, this meant an exchange-rate system similar to a currency board. The party also supports the Bank of Latvia’s independence and its monetary and financial policy.

Fiscal policy was to follow the idea of austerity, thus of equilibrated budget. Also, the tax burden should be transferred from companies to consumption and to works, increasing Latvia’s competitiveness. A corporate income tax of 25%, one of the lowest in Europe and similar to Finland’s, was to be implemented, at the same time dividends were

³⁵⁶ There is a solid literature on the European Union being a Neoliberal construct, not limited to: Hermann, C. (2007). “Neoliberalism in the European Union”. *Studies in Political Economy*, vol. 79; Moss, B. H. (Ed.) (2005). *Monetary Union in Crisis: the European Union as a Neo-Liberal Construction*. New York: Palgrave Macmillan; Apeldoorn, B., Horn, L., Drahoukoupil, J. (Eds.) (2009). *Neoliberal European Governance and Beyond: the Limits of a Political Project*. New York: Palgrave Macmillan; Gill, S. (1998). “European Governance and New Constitutionalism: Economic and Monetary Union and Alternatives to Disciplinary Neoliberalism in Europe”. *New Political Economy*, vol. 03, no. 01; Bohle, D. (2006). “Neoliberal Hegemony, Transnational Capital and the Terms of the EU’s Eastward Expansion”. *Capital & Class*, vol. 30, no. 01; Biebricher, T. (2013). “Europe and the Political Philosophy of Neoliberalism.” *Contemporary Political Theory*, vol. 12, no. 4.

subject to a 10% tax. New regulations for amortisation were expected to result in new investments in manufacture.

Since the state has no direct role in the economy, all State enterprises were to be privatised as soon as possible, including natural monopolies. All state companies, including the large ones, must be evaluated in the long-run perspective. If some company is near bankruptcy, in the absence of a potential buyer, it should be closed notwithstanding the social impact of workers being fired. Industrial development was expected to result from foreign direct investment, but not in heavy industry. Rather, it should concentrate on sectors of low material and energetic intensity. The main economic sectors to be developed were banking and transit, a logic choice because of Latvia's geographical position resulting in a natural advantage, and because of these sectors being easier to develop than manufacturing. There should be free movement of capital and goods.

Agriculture is to be exposed to external competition, without subsidies and tariffs protecting Latvian producers. This process was expected to occur in a slower pace in comparison with the industrial sector, but taking in consideration that free market is the norm, the objective was to fully expose the sector to foreign competition, notwithstanding the fact that the sector is heavily subsidised and protected in other countries. At the same time, it was foreseen a policy of minimum prices to be adjusted by import tariffs and quotas. Agrarian reforms were to continue, by privatising land and restructuring companies. The party merged with the Latvia's First Party (*Latvijas Pirmā partija*) in 2007.

Latvia's First Party was originally called New Party (*Jaunā partija*). Its economic platform was simplistic if compared to Latvia's Way program. Being called a "liberal theocracy" by political analysts,³⁵⁷ it was based on supporting traditional values such as the family and the church, at the same time promising to support and to develop many populist goals. Its economic platform can be resumed as to support Latvia becoming a member of the European Union, to support some strategic economic sectors such as transport and the wood-working industry, reducing taxes, and not privatising Latvenergo.³⁵⁸

The party New Era (*Jaunais laiks*) is one of the newest parties being analysed in this dissertation. It was established in 2002 under the leadership of the former Bank of Latvia governor Einars Repše's leadership. Thus, it is not a surprise that the party's economic platform is similar to other parties'. In other words, the state shall not be involved in any kind of business activity. Instead, it is responsible for creating a favourable environment for business development. This is the key for economic development. Taxes must be reduced, at the same time effective mechanisms to increase tax collection shall be

³⁵⁷ Puriņš, G. (2006). *Latvijas Pirmā partija: liberālā teokrātija*. Retrieved from <http://politika.lv/article/latvijas-pirma-partija-liberala-teokratija>.

³⁵⁸ Latvijas Pirmā Partija. (2002). *Latvijas Pirmā Partija priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27461.html>.

established. Since the state shall not directly intervene in the economy, the budget must be equilibrated, also reducing inflation.³⁵⁹

The party considered the high priority sectors of the national economy (*tautsaimniecība*) to be six: energy, transport, construction, agriculture, forrest, and tourism. Energy encompass electricity, heating, gas distribution, and oil. The main objective was to produce all electricity necessary for national needs in Latvia. Secondary objectives were to increase the share of renewable energy (specially wood and peat) for heating and electricity, to reduce heat loss from old houses increasing the energetic effectivity, to increase the production of biofuel and to stimulate its use in Latvia, to increase the security of the distribution of energy. These objectives were to be achieved by directing funds from the European Union, changing the legislation - including measures to liberalise the energy market and to reduce taxes, joining the European net.³⁶⁰

The main challenge in relation to the transport sector was considered to guarantee the effective maintenance and development of the roads, to assure qualitative, stable, and accessible public transport. To increase transit services, including passenger and cargo by air and railway. The construction sector's productivity was to increase, as a result of simplifying administrative procedures, the transparency of the construction process, developing human resources, stimulating qualitative and energy-efficient constructions, and supporting research, development, innovative solutions.³⁶¹

Regarding the agriculture sector, there were two main objectives. First, to achieve that the level of the European Union's subsidies were equal to old and new member-states. Second, to support small properties to become more competitive by stimulating them to collaborate with cooperatives. Secondary objectives were to increase the exports of agricultural goods, to provide education to farmers, and to improve the overall level of agricultural education in the country. Also, scientists should receive incentives to develop the sector, specially ecologically clean products. The program for the forrest sector had the main objective of develop the production of high added-value products. Finally, tourism was to be developed on the base of Latvia's national natural, cultural, and historical values by developing its infrastructure and Latvia's identification as international touristic destination. In general, the development of the national economy was to be solely the result of private business. The role of the state was to be limited to creating favourable legislation, to establishing industrial clusters and technological incubators, and some financial mechanisms like export guarantees. Overall, the party's economic platform was one of the most Neoliberal analysed in this dissertation.³⁶²

The Latvian National Independence Movement's (LNNK) economic program was

³⁵⁹ Jaunais laiks. (2006, August 30). Jaunā laika rīcības programma. *Diena*. Retrieved from <http://www.diena.lv/sabiedriba/jauna-laika-ricibas-programma-386>.

³⁶⁰ Ibid.

³⁶¹ Ibid.

³⁶² Ibid.

based on three principles. First, no state interference in people's personal concerns; second, individuals are to be responsible for their own welfare; third, individual private initiative is to determine economic and social development. Thus, the LNNK's program is based on the notion that the state should establish minimalistic regulations and let market forces to act freely. The program had seven main pillars.³⁶³

i. to make logic economic reforms, resulting in financial stability for concluding the process of privatisation and land reform;

ii. to support a strict monetary policy, the independence of the central bank, and a balanced (non-deficit) government budget. Also, to reinforce banking regulation and to implement a system of investment protection;

iii. to reform the tax system to stimulate manufacturing and eliminate tax avoidance. To reduce the tax burden and to balance municipal budgets;

iv. to create conditions for increasing transit business and exports, developing ports, collecting taxes, and fighting smuggling to supplement the budget;

v. to reform the pension system, increasing and differentiating pensions, at the same time establishing private pension funds. To remove the restrictions for working individuals to receive pensions;

vi. to make private health insurance compulsory;

vii. to direct state investments, including the state foreign credit guarantees to the national economy's development, improvement of infrastructure, resources' saving, and environmental projects;

viii. to support the establishment of strong small farms and agricultural companies, stimulating their cooperation. To protect the internal market by state purchases to regulate the internal price.

The first conclusion is that the Latvian National Independence Movement's economic platform was basically a repetition of that of Latvia's Way. Again, Neoliberal ideology was obviously the base for supporting the notion that the state has practically no responsibility for their own welfare. It had the same objective of Latvia joining the European Union, one more factor determining the platform's Neoliberal character. Thus, the party supported the introduction of economic reforms in consonance with the European Union's Neoliberal framework.

The tight monetary policy should follow the principle of austerity to fight inflation. The government budget must be balanced, meaning that deficits were unacceptable, at the same time the expansion of the monetary base was to follow the expansion of the economy. The national currency was to continue following the *quasi* currency board model. The

³⁶³ LNNK/LZP. (1995). *Latvijas Nacionāli konservatīva partijas LNNK un Latvijas Zaļās partijas (LZP) priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27775.html>.

Bank of Latvia was to remain independent, determining the monetary policy without external interference.

Fiscal policy could be used to stimulate the development of specific economic sectors. As taxes were to be reduced, it would be necessary to improve the system of tax collection at the same time hardening punishment for those not paying taxes. Tariffs affecting external trade were also to be reduced, including agriculture. The burden of social security was to be redistributed between the employer and the employee in an equal share (50% each).

The process of privatisation was to be concluded, although companies were to pass through a process of restructuring to increase their value. Latvia should develop transit and banking as key economic sectors, at the same time the manufacturing was to concentrate on high productivity goods. Special tax incentives were to be used to help. In the agriculture sector, land reform was to be concluded. The sector was to be supported by a policy of minimum prices, which the government was to regulate by purchasing and selling to influence the market, and by subsidised credit for farmers.

The Union for Fatherland and Freedom's (*Tēvzemei un Brīvībai*) economic platform was not much different from that of Latvia's Way, although it embraced a milder form of Neoliberalism. The party supported the idea that the role of the state is to be reduced to strategic planning and providing proper regulation for the market work smoothly. It was for privatisation, although some areas should remain state monopoly, and the process should take in consideration national interests. Additionally, land ownership should be limited to Latvians, foreign direct investments were to be directed towards projects of infrastructure.³⁶⁴ In 1997 the party merged with the Latvian National Independence Movement's (LNNK) forming the party TB/LNNK. As a result, it incorporated the LNNK Neoliberal economic platform, which fully supported the Bank of Latvia's monetary policy, the absence of state interventionism in the economy, and adapting the Latvian legislation to the European Union's legal framework.³⁶⁵

The People's Movement for Latvia (*Tautas kustība Latvijai*), also known as Siegerist Party. Its 4,000 characters' political platform for the 6th Saeima's election presented many tasks to be done, such as to renew Latvia's most important manufacturing sectors and to increase exports, but it did not specifically stated how. It promised to end monopolies, to protect private property, and to support micro and small companies. Since the state is not to be directly involved in business activities, these objectives were to be achieved by a pro-business legislative framework. The party emphasised the need for Neoliberal reforms being made as quick as possible, however taking people into

³⁶⁴ Apvienība Tēvzemei un Brīvībai. (1995). *Apvienības Tēvzemei un Brīvībai priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27767.html>.

³⁶⁵ Diena. (1998). "Valsts vara un ekonomika. 13 jautājumi partijām." *Diena*, 16.09.1998.

consideration.³⁶⁶

The People's Party (*Tautas partija*) characterised itself as a right-wing conservative party. Thus, it is not a surprise that its economic platform was very Neoliberal, to the point of applying market principles to the ethnic question. The party's main focus was on protecting private property rights, completing privatisation, and liberalising trade tariffs between the Baltic States. It also supported Latvia joining the accession to the World Trade Organisation, fiscal austerity based on decreasing income tax for private business, trade, and financial international investments at the expense of social expenditure. It is also important to guarantee maximum freedom for entrepreneurs at the same time decreasing state protectionism and interventionism. The party supported Latvia joining the European Union as soon as possible.³⁶⁷

Specifically to social policy, the party strongly opposed expanding social expenses, the wages of civil-servants, and pensions. It believes that the role of the state is to be limited to helping individuals to succeed and take care of their families themselves, instead of providing social protection. One example was a pension law issued in 1999 by Andris Šķele cutting the pensions of working pensioners, with the objective to decrease budget expenditures. It is to believe that the law had popular support. The Social Democrats, the People's Harmony Party, and For Fatherland and Freedom organised a referendum on this issue, but less than 50% of voters participated, thus invalidating it. The party was even in favour of applying Neoliberal ideology to ethnic politics. As a result, the integration of non-Latvians would have to follow the logic of market incentives. In resume, the idea was to establish a set of incentives, making easier to compete and succeed for the ones integrating, at the same time not integrating would be against one's self-interest. Overall, the party's idea was that economic development would make ethnic differences to be irrelevant.³⁶⁸

The fiscal policy should follow the logic of austerity. Thus, taking in consideration the existence of business cycles, during economic booms it would be necessary to have budget surpluses. The party was not satisfied with the Bank of Latvia's monetary and supervisory policy, considering that too many mistakes were made supervising credit institutions. It was in favour of establishing a separate institution dedicated only to supervise the financial market.³⁶⁹ Overall, the party was one of the most Neoliberal of all in Latvia.

The Farmers' Union (*Zemnieku savienība*) could be described as another Neoliberal party, if its economic platform did not foresee protection for the agriculture sector by

³⁶⁶ Tautas kustība Latvijai (Zīgerista partija). (1998). *Tautas kustības Latvijai (Zīgerista partijas) priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27724.html>.

³⁶⁷ Zake, I. (2002). "The People's Party in Latvia: Neo-Liberalism and the New Politics of Independence." *Journal of Communist and Transition Politics*, vol. 18, no. 3, September, pp. 109-131, p. 123.

³⁶⁸ Ibid, idem.

³⁶⁹ Diena. (1998). "Valsts vara un ekonomika. 13 jautājumi partijām." *Diena*, 16.09.1998.

imposing import tariffs on imported products. The party supported the privatisation of natural monopolies such as Latvenergo and *Latvijas kuģniecība*, as way of modernising their infrastructure. The exception were *Latvijas pasts* and the Latvia's Railways' rails. The party's industrial policy can be defined as minimalist, with state support not deforming market competition. In other words, the state should not reduce the risk of business activities, what is contradictory with its statement that the state must support exports, specially of agriculture products.

The main instruments were to provide education to businessmen, information about the tendencies of development in the world and recommendations for establishing new manufacturing sectors, to support scientific research and experimental work to increase competitiveness, to assist Latvian producers in the international arena, to establish a simplified credit and guarantee system, to use international and regional credit lines and funds, and to grant a tax exemption for infant companies with an annual income of less than Ls 3 000,00. The fiscal policy should have as main objective to avoid budget deficits. This was to be attained by the development of the national economy instead of increasing taxes and reducing social guarantees. The party considered that the Bank of Latvia's monetary policy was correct. although it believed that the currency rate should be set in a more realistic level.³⁷⁰

The Democratic Centre Party (*Demokrātiskā Centra Partija*) was a parliamentary fraction within the Popular Front (*Tautas Front*) that merged with the Democratic Party Managers (*Demokrātiskā partija Saimnieks*) in 1994. Thus, only the Democratic Party Managers' economic platform is being analysed in this dissertation. The first mention about the economy is that market relations must be an instrument to guarantee a decent living standard. Thus, the party was not against market-oriented reforms, but rather believed in a milder form of Neoliberalism. Its economic platform had seven pillars:³⁷¹

- i. The minimum wage must be determined to guarantee a decent living standard, being indexed to inflation;
- ii. The state must protect workers in case of unemployment, with emphasis in re-qualification training programs;
- iii. The minimum pension is to be equivalent to the minimum wage. Working pensioners shall continue receiving pension;
- iv. Latvia's economic development is dependent of local industries, thus it is necessary to protect them from external competition;
- v. Economic reforms, privatisation, and foreign investment must reflect Latvia's

³⁷⁰ Diena. (1998). "Valsts vara un ekonomika. 13 jautājumi partijām." *Diena*, 16.09.1998.. Ls 3 000,00 in 1998 were equivalent to approximately Ls 5 681,70 in 2013 (own calculations, data from the Central Statistical Bureau of Latvia).

³⁷¹ Demokrātiskā partija Saimnieks. (1995). *Demokrātiskās partijas Saimnieks priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27757.html>.

national interests. The main criteria are labour productivity, competitiveness, creation of new jobs;

vi. Latvia must develop the transit and tourism sectors;

vii. Latvia must to export to both Western and Eastern partners. There is no such thing as good or bad market for Latvian products and services;

viii. Tax reduction for companies.

The party's economic policy focused mostly in a mix of social protection with state support for industrial development. Although the objective was to convert Latvia into a modern market economy, the process of economic reform, including privatisation should be pragmatic and not ideological, with national interests determining its pace. Although the party defended the notion that state intervention is necessary to guarantee economic development, its economic platform was in no way a radical alternative to Neoliberalism. Rather, it rejected Latvia Way's extreme approach with the objective to safeguard national industry. Since it represented an alternative to Latvia Way within the same Neoliberal ideological boundaries, is no surprise that the party got most of the votes by occasion of the 6th Saeima's elections in 1995.

During the 5th Saeima, the party Harmony for Latvia - Rebirth of the National Economy (*Saskaņa Latvijai - Atdzimšana Tautsaimniecībai*) split resulting in two new parties. One was called Political Union of Economists (*Tautsaimnieku politiska apvienība*); the other took the name of National Harmony Party (*Tautas Saskaņas partija*). By occasion of the 6th Saeima's elections in 1995, the Political Union of Economists was unable to surpass the electoral 5% barrier required to be represented in the Latvia parliament. This can be explained by the model developed in this dissertation. Since its economic platform was the opposite of the economic ideology in force, it did not have appeal for assuring enough votes, thus its economic platform was not analysed in this dissertation. On the other hand, the National Harmony Party economic platform did not challenged the main pillars of economic reforms, being able to surpass the 5% electoral barrier. Its economic platform had seven pillars:³⁷²

i. to make the government, the municipalities, and the Bank of Latvia responsible for the development of the national economy by force of law;

ii. to use the Bank of Latvia's foreign reserves that surpass the minimum requirements to guarantee the lats' stability to subsidize credit for developing the national economy;

iii. to promote and develop local production by offering government's contracts to domestic manufacturing and agricultural companies;

³⁷² Tautas Saskaņas partijas. (1995). *Tautas Saskaņas partijas priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27752.html>.

- iv. to guarantee purchases of Latvian agricultural products from individual and collective producers;
- v. to control monopolistic prices, specially those related to primary commodities;
- vi. to establish the Baltic Free Market Association;
- vii. to carry out structural policies, encouraging those companies producing competitive export products using local raw materials, and create jobs in small towns with endemic unemployment.

Although the party supported non-Neoliberal ideas like to help local industry by offering preference in government contracts, the very core of its economic platform was basically Neoliberal. First, it fully supported privatisation for making companies more efficient, instead of fulfilling the budget. It was also for the elimination of all bureaucratic and political barriers to entrepreneurship. The role of the state is only to establish general regulations, letting the market to act freely. The party also rejected state support to specific products or economic sectors. In 2010 the party merged with the Social Democratic Party and the New Centre forming the political alliance Harmony Centre (*Saskaņas centrs*). It is interesting to note that its economic platform nowadays is more left-wing than before, as it is based on the idea of social justice. Nevertheless, it is a softened version of Neoliberalism with increased social protection and state support to specific economic sectors and new business basically by fiscal stimulus.³⁷³

The Latvia's Social Democratic Alliance (*Latvijas sociāldemokrātu apvienība*) supported Latvia joining the European Union, thus the core of its economic platform was very much influenced by Neoliberal ideology. It did not question Neoliberalism's basic premises, at the same time it foresaw many incompatible policies with regulations from the European Union. Its economic platform, at least as presented to the Central Election Commission, was an amalgamation of points without further explanation. It started with the promise of radically increasing the Latvia's population quality of life by: supporting local industrial activity, increasing small and medium enterprises; the sale of Latvian products to the internal and external market; attracting foreign investment; directing the funds obtained with privatisation to support and increase the business sector; writing-off the debt of state companies; to improve the economic relations with Russia and the CIS; providing cheap long-term credit to agriculture firms; establishing cooperatives to process and sell agriculture products; renewing roads in the countryside.³⁷⁴

It supported the state monopoly of alcohol and tobacco. Also, higher import tariffs for alcohol beverages similar to those produced in Latvia, what is contradictory to the European Union's norms. The party was against the privatisation of natural monopolies,

³⁷³ Saskaņas centrs. (2014). *Ekonomiskā politika*. Retrieved from http://www.saskanascents.lv/lv/musu_programma/socialdemokratiskas-partijas-saskana-programma/ekonomiska-politika.

³⁷⁴ Latvijas sociāldemokrātu apvienība. (1998). *Latvijas sociāldemokrātu apvienības priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27729.html>.

including Latvenergo, Latvian Railways, Latvian Shipping, and ports. It was in favour of the state regaining control of Lattelekom. Finally, capital transactions should be regulated and a progressive tax system should be established.³⁷⁵

The Latvian Unity Party's (*Latvijas Vienības partija*) economic platform was one of the most left-wing of all political parties being analysed in this dissertation. It was one of the most laconic too. The party foresaw the national economy as a socially oriented free market, with developed private initiative, and several forms of property, limiting the extreme liberal economic approach. The privatisation of strategic objects was to be interrupted. The exchange rate policy was to be used as instrument to help developing the industrial sector, stabilising the state finances. The state should keep the monopoly of alcohol, tobacco, currency exchange, and others. The state should guarantee the purchase of agricultural products, at the same time reducing taxes to stimulate manufacturing, resulting in the Gross Domestic Product reaching the same levels of 1990.³⁷⁶ Following the model of ideological convergence presented in this dissertation, it is not a surprise that the party was closed in 2001.

Equal Rights (*Līdztiesība*) was the Latvian Socialist Party's (*Latvijas Sociālistiskā partija*) precursor, which had its roots in the last Supreme Soviet elected in 1990. Thus, it is no surprise that in 1995 it had the most left-wing economic platform of all. First, the party was against the notion of free-market as regulator of the national economy. Instead, it was necessary to regulate the economic process with programming methods and conjuncture policies. Privatisation was to be subjected to societal control, and the state should buy unused privatisation certificates from the population by their face value. The state manufacturing companies were to start producing again, and could be used to buy energy and heating. The Bank of Latvia's independence and its monetary policy was considered to be wrong, because it artificially created shortage of means of payment. Finally, the party was against Latvia joining the European Union and NATO.³⁷⁷

In 2002, the Latvian Socialist Party was part of the coalition For Human Rights in United Latvia (*Par cilvēka tiesībām vienotā Latvijā*). Since the party is the only truly left-wing of all being analysed, it is interesting to identify that it followed the model of convergence proposed in this dissertation, changing to a much more Neoliberal ideological position in comparison to 1995. The party's political program implemented during its 7th conference in April 12, 2003 stated that integrating in the European Union will foster the development of democracy. Thus, since the party was in favour of Latvia joining the European Union, it is fair to conclude that it also supported the same Neoliberal model that comes attached to a European Union's membership. This is clear in the section dedicated to

³⁷⁵ Latvijas sociāldemokrātu apvienība. (1998). *Latvijas sociāldemokrātu apvienības priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27729.html>.

³⁷⁶ Latvijas Vienības partija. (1995). *Latvijas Vienības partijas priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27749.html>.

³⁷⁷ Latvijas Sociālistiskās partijas. (1995). *Latvijas Sociālistiskās partijas priekšvēlēšanu programma*. Retrieved from <http://cvk.lv/pub/public/27759.html>.

economic policy, in four main points. First, the base for revitalising the Latvian economic is the establishment of an intense internal market, increasing the population's purchasing power. Second, the right to private property is one of the fundamental rights people have. Third, the role of the state in the economy should be minimal, the exception being fiscal policy in the form of lower taxes for business and investments. Fourth, the market for passengers' services, medicine, education, and housing maintenance services should be free and face competition.³⁷⁸ As a result, Neoliberalism in Latvia turned to be the only alternative for macroeconomic policy.

4.1.3 Economic and Political Institutions and Structures

Since the end of the USSR, the Latvian economy has passed through a strong and rapid process of transformation based on Neoliberal ideology. However, Neoliberal economic policy in Latvia has been dissociated by the political elite to something close to market anarchy. It follows that economic institutions and structures, such as the financial, industrial, educational, and social structure started to be shaped also by neoliberal principles. Latvia's financial structure is based on three main Neoliberal principles. First, total capital mobility; second, the mandate of the Central Bank being purely to guarantee the stability of the exchange rate and, in a lesser extent, of prices even at the expense of the real sector and social interests; third, the Financial and Capital Market Commission's mandate is solely to protect the interests of financial institutions and does not consider the interests of the general public.

The transformation of the industrial structure also followed the Neoliberal logic. First, by privatisation; second, by the reduction or elimination of tariffs and non-tariff barriers for imports; third, financing business was almost totally transferred to private banks. The labour market was reformed to have greater market flexibility, at the same time most of the tax burden felt to the workforce. The result is a less-organised workforce, greater wage disparities, which at the same time - at least in theory - is more adapted to business needs.

With an independent Central Bank, monetary policy became independent of political interference. Its policy was also very Neoliberal. First, the exchange rate was pegged first to the Special Drawing Rights (SDR) and second to the Euro, in an arrangement similar to a currency board. Second, because its main objective was to maintain the stability of the exchange rate, instead of regulating the endogenous creation of money by private banks and the influx of foreign financial investment.

The fiscal policy can also be characterised as Neoliberal. First, the income tax rate is flat, thus regressive. Second, the overall tax burden is much greater on the real sector and consumption, than on real estate and the financial sector. This means that the labour force pays most of taxes. Third, Latvia has been pursuing a policy of fiscal equilibrium

³⁷⁸ PCTVL. (2003). *Partijas "Līdztiesības" programma*. Retrieved from http://www.pctvl.lv/?lang=lv&mode=party&submode=program&page_id=103.

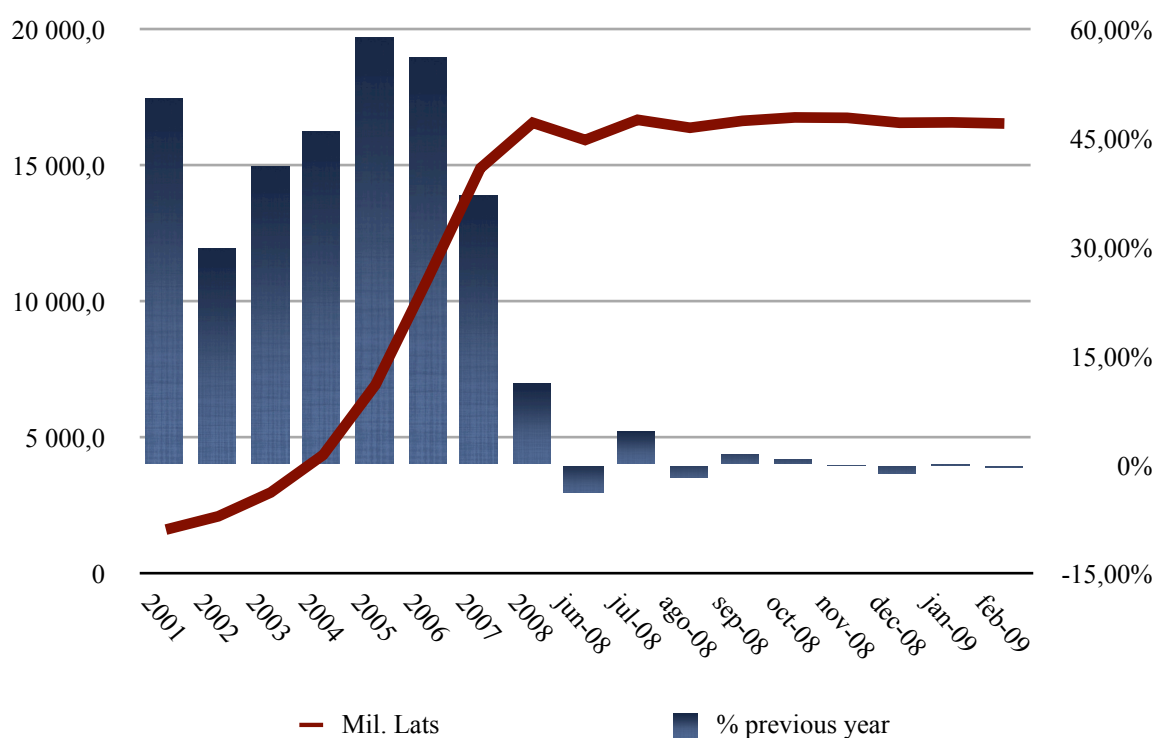
since the year 2000. Before the 2008 crisis, the budget deficit/surplus as percentage of the GDP was reduced from -2.8% to + 0.1% in 2007.³⁷⁹

Indeed, political institutions and structures, the workforce and unions, business, and other interest groups such as the state bureaucracy, rarely answered negatively to the Neoliberal reforms. Rather, they had considerable support. This is explained by the macroeconomic performance being considered acceptable, at least until 2008. In other words, the overall expectations were sufficient to maintain Neoliberal ideology as mainstream in Latvia. Also, social and political (neo)liberalism became associated with the idea that the state and the politicians are not responsible for what happens in the country, but the market. The result is a classic case of state capture, since many Latvian politicians and civil servants use the state as instrument to realise their private interests.

4.1.4 Macroeconomic Performance

After joining the European Union, the complete openness of Latvia's financial and capital accounts, together with the sentiment of low risk, changed the structure of the credit market. Therefore, during the period 2004–2008, there was a credit boom following the strategy of the foreign banks operating in Latvia. In the last quarter of 2008, the loans issued to residents have amounted to Ls 14,737.4 million or 90.1% of GDP. The chart 4.1 shows the bank credit growth in Latvia.

Figure 4.1
Bank credit growth, 2000-2009

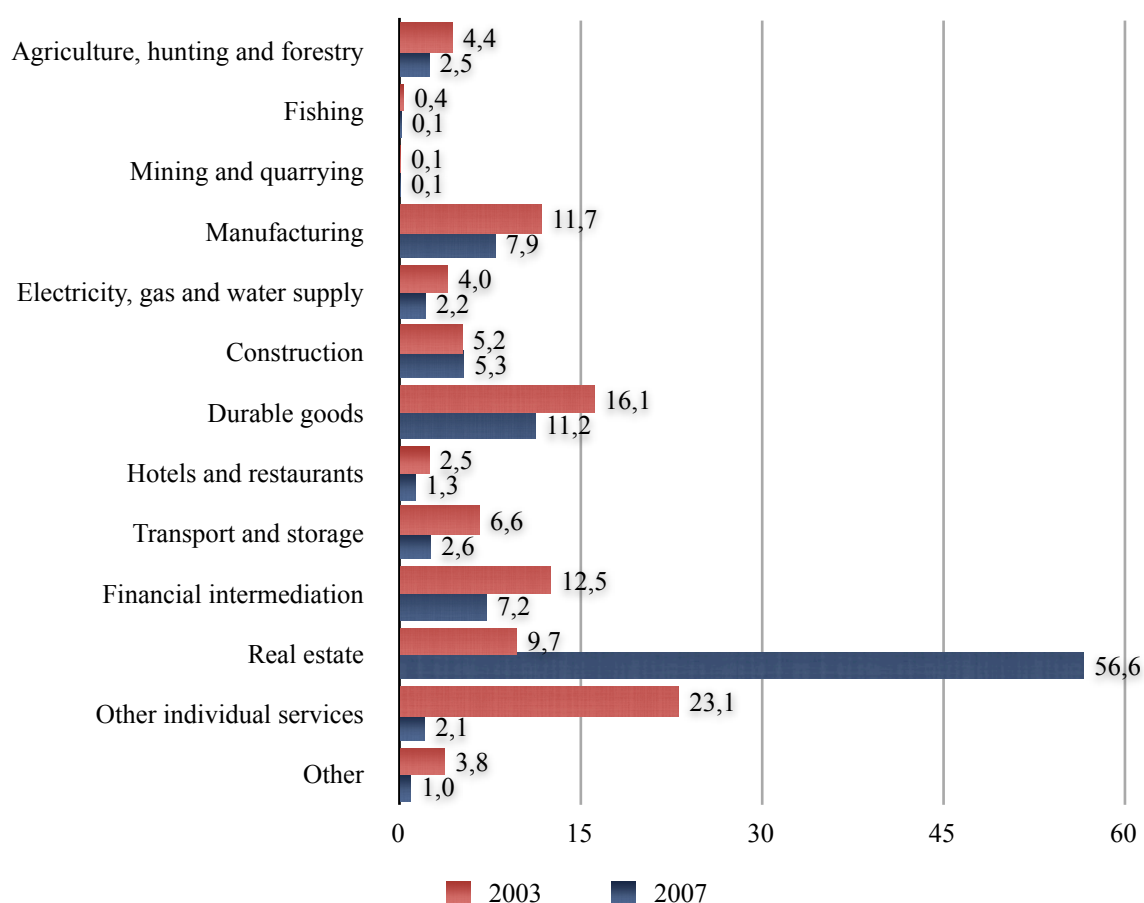


Source: Latvia's Financial and Capital Market Commission, own calculations.

³⁷⁹ Bērziņš, Jānis (2009). *Economic and Political Challenges of Acceding to the Euro Area in the post-Lehman Brothers' World: Country Report Latvia*. Sofia: Open Society Institute.

As chart 4.2 below shows, while in 2003, the most privileged sectors were individual services (23.11%), wholesale (16.09%) financial intermediation (12.5%) and manufacture (11.73%), at the end of 2008, the situation had changed drastically. From 2004, the banks started to lend relatively cheap money to finance operations in the real estate sector and consumption of durable goods. Besides, because of the process of increasing financial needs, the availability of credit for financial intermediation also rose. In this way, the money lent to non-banks in the years before the crisis turned out to be mainly directed to finance operations with real estate activities (56.6%), consumption of durable goods (11.2%) and financial intermediation (7.2%), while all other sectors experienced a relative reduction.

Figure 4.2
Structure of the loans classified by national economy sector in 31.12.2003 and in 31.12.2007 – %



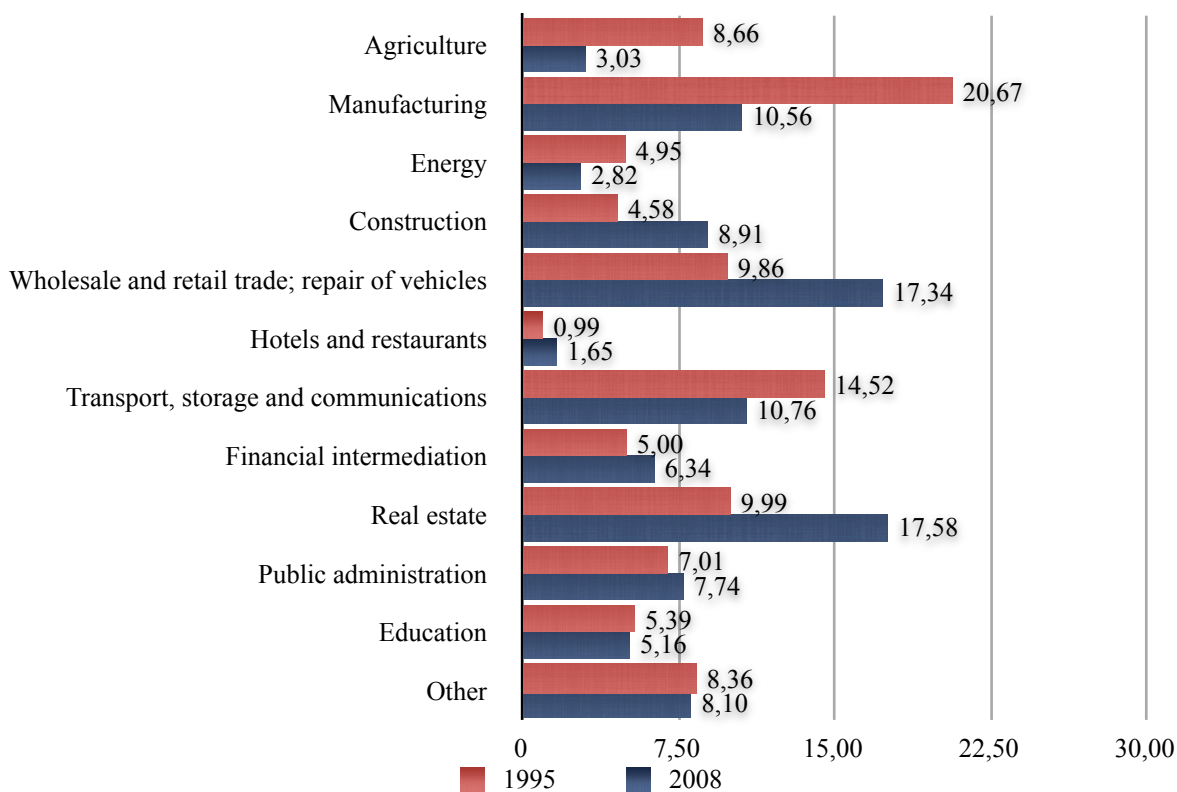
Source: Latvia's Financial and Capital Market Commission, own calculations. Access in January 21, 2010.

In 1995, manufacturing, agriculture and energy accounted for, respectively, 20.67%, 8.66% and 4.95% of GDP. However, in 2008 the same sectors accounted for 10.56, 3.03 and 2.82% of GDP. The main point is that although GDP was growing, the result of the structural changes was to deepen structural fragilities. First, because the demand for durable goods has a natural limit. As there was a huge repressed demand for these goods as people wanted to get rid of the old Soviet durable goods; with the

availability of credit, the consumption of these goods experienced a boom. However, when this demand was fulfilled, the sectors associated with it tended to experience a strong reduction in their level of economic activity. Second, as economic history shows, artificially inflated prices of real estate always go down, in other words, bubbles always deflate. Third, and most relevant, because the capacity of people to borrow is directly related to the amount of money they can dispose to pay back the credit, which naturally limits the credit market

The transport and storage sector depends on the production of goods, which in turn is dependent on their demand. With a crisis, both in the internal and the external side, this sector tends to suffer a reduction in its performance. Latvia's manufacturing sector had been already shrinking because of the crisis. Besides the inevitable decrease in the commerce of durable goods, the transport and storage sector also experienced a slow down. In this way, nearly a half of Latvian GDP has been remaining in an unsustainable basis, showing that a crisis would have occurred with or without the current financial crisis. Although the GDP was growing fast, in reality the structure of the Latvian economy was debasing and becoming increasingly dependent on four sectors that, by their own idiosyncrasy, are not sufficiently dynamic to push the economy in the medium and long terms. In other words, the failure of the internal model was a natural consequence of its own structure. In other words, the failure of the internal model was a natural consequence of its own structure.

Figure 4.3
Structure of Latvia's GDP – 1995 and 2008, %



Source: Latvia's Central Statistic Bureau, own calculations. Access in January 21, 2010.

Besides the process of economic restructuring, another problem was inflation. As a result of the influx of foreign money from the banks from 2003 to 2007 the monetary base of Latvia increased by 181%.⁴ From May 2004 to June 2008, the increase was 163%. Besides M1, the biggest growth was in overnight deposits, leading to the conclusion that the issuance of money by the Bank of Latvia was not the main cause of the increase of the monetary base. Rather, this was the result of the strategies of the private banks operating in Latvia. If on one side they can naturally create money, on the other the increase of their activities has been financed by external remittances of money.

Usually inflation is seen as a bad indicator; it is also true that it may signal economic growth. What developing countries must take into consideration is that an annual rate of 13% of inflation is not so bad if there is economic growth and, more important, development. Inflation is a problem when it is 13% a month. A yearly inflation of about 2-3% is the case of developing countries in recession or developed countries approaching stagnation and starting to face problems such as unemployment. Before achieving such an inflation, a country first must develop. On the contrary, such a low inflation rate is going to be at the expense of low economic growth/development.

The restructuring of the economy and the inflationary process was the result of ineffective regulation of the market by the Minister of Finance, the Financial and Capital Market Commission, and the inability of the Bank of Latvia to deal firmly with the increases of the monetary base. The Financial and Capital Market Commission assumed a position of not intervening in the market, being rather an observer. It did not fully perform its basic function of regulating the financial system to guarantee its stability or controlling the explosion of the credit market and therefore protecting banks and non-banking institutions from overexposing to risk.

The Bank of Latvia's case is different. Its institutional discourse relies on the impossibility of performing monetary policy due to the "impossible trinity," as Latvia's exchange rate is practically fixed against the euro and the capital and financial accounts of the Balance of Payments are open. Also, on the fact that more than 85% of the credit lent in Latvia is in euros, the Bank of Latvia cannot use the interest rate as an instrument to control inflation.

Although this may be a true, this rhetoric has been used to shield the institution from criticism, through the discourse of impotence in the face of the actions of the market. Much more important for the Bank of Latvia was to artificially maintain the exchange rate from going beyond the fluctuation band, and to maintain the long-term interest rate in accordance with the Maastricht criteria. These goals have been achieved administratively, without active interventions disciplining the market. Therefore, although aware of the growing inflation, it completely ignored the role of the monetary base as the main determinant of inflation in Latvia. It also ignored the fact that regulating the expansion of

the monetary base could have avoided the process of economic restructuring being so drastic.

A working paper of the Bank of Latvia even discussed changes in the expectations of economic agents as determining inflation, but the authors did not consider the monetary aggregates, which would have been a logical way of trying to explain why expectations were changing.³⁸⁰ Although most of the sectors of the Latvian economy were developing in a way based on unreal positive expectations, people were feeling that they were getting richer and richer and that this was occurring in a sustainable way. The result was a distortion of the apprehension of reality by the majority of the economic agents.

Nevertheless, the Bank of Latvia was the only institution alerting several times the structural problems the Latvian economy was going to face, although it did nothing to avoid them. The central government never took these alerts into consideration, often discrediting them, while the Financial and Capital Market Commission was ignoring the macroeconomic aspects of its chosen regulatory model. In this sense, the general institutional passiveness, together with the narrow attitude of politicians, is an important component of the formation of the structural crisis.

With regard to private banks, even when the signs that this process was unsustainable, they were still considering safe to lend, since the risk associate to mortgage is very low. Besides, there was a component of moral hazard. The answer of the head of the real estate division of one of the top three banks of Latvia to the question of why they were inflating the real estate market with credit was that it was known that "(...) it is unsustainable, but everyone's annual bonus depends on making more money. We know it will crash, but we are all making too much money now to stop it."³⁸¹ Although appetite for risk by large foreign banks was particularly strong given the modest exposure of their portfolios to the Latvian market and the very high returns on equity invested there, international experience shows that perceptions of loan quality are notoriously procyclical-positive during economic upswings, but deteriorate rapidly when conditions turn less favourable.

The crisis had two main consequences. With regard to the banks: (a) the soundness of the loan portfolio experienced a reduction of its quality, in other words, the collateral of the issued loans was considerably less than the amount advanced implying losses; and (b) the assets of the banks suffered a reduction that might affect the profitability of the banks. As foreign-owned institutions dominate most of the banking system of Latvia, this meant exporting losses to the parent institutions. This had been already suggested by the

³⁸⁰ Beņkovskis, K. & Paula, D. (2007). *Inflācija gaidas Latvijā: patērētāju apsekojuma rezultāti*. Rīga: Bank of Latvia, Latvijas Banka Pētījumi, 1/2007.

³⁸¹ Sommers, J. (2008). "Latvia living at the extremes: seeking equilibrium between central planning and financialization." *Humanities and Social Sciences Latvia*, vol. 3, no. 56, pp. 34-54.

International Monetary Fund in the “Request for Standby Arrangement” no. 09/3.³⁸² To the general population, the main problem was the psychological impact affecting consumption, thus credit and the general level of savings. As buying a real estate property is seen as an investment and a form of saving, a decrease in the price of property makes people consider they have lost part of their savings. This negatively affects the level of confidence in the national economy. The result is a fall in the consumption level, and in the expectations of economic agents. Therefore, the result is a lower level of economic activity and employment.

As at least in 2006 it was already clear that a crisis was possible to happen in the short term, some measures could have been taken to avoid it. In this case, the Bank of Latvia could have at least taken one significant measure. Although its possibilities of shaping a comprehensive monetary policy are limited, in this specific case one instrument was available: the compulsory reserves. As the monetary base was increasing mainly as a consequence of the remittance of capital from foreign banks to their subsidiaries to be issued as credit, together with the endogenous creation of money by banks operating locally, a stricter increase in compulsory reserves would have been sufficient to dry the liquidity of M2. Combined with stricter regulations by the Financial and Capital Market Commission and a more prudent tax policy by the Ministry of Finance, the crisis would not have been so radical.

Thus, since the Latvia’s economic policy’s main goal was to develop the financial, transit, and real state sectors, high-tech services and manufacturing have been struggling for developing. In 2008, the most important industrial sectors are food and beverages (25%), wood and its products (23%), non-metallic mineral products (9%), metal products except machines and equipment (6%), and electrical equipment. The sectors classified as “other” are mostly related to the cited before.³⁸³ In other words, they are not related to the Knowledge Society. This explains the low level of employment in high and medium-high-technology manufacturing sectors.³⁸⁴

This means that Latvia’s insertion in the international economic system results in paths of dependence being strengthened instead of lightened. Latvia’s main exports are mainly primary products or products of the paradigm of the Second Industrial Revolution. Imports are constituted by machinery and equipment for the fragile real sector of the economy, together with imports of combustible minerals and their derivatives. Latvia also imports a considerable share of prepared foodstuffs, showing that its agriculture is not capable of meeting internal demand and that national agribusiness is not sufficiently

³⁸² International Monetary Fund. (2009). *Republic of Latvia: Request for Stand-By Arrangement - Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Latvia*. Washington: IMF Country Report, no. 09/3.

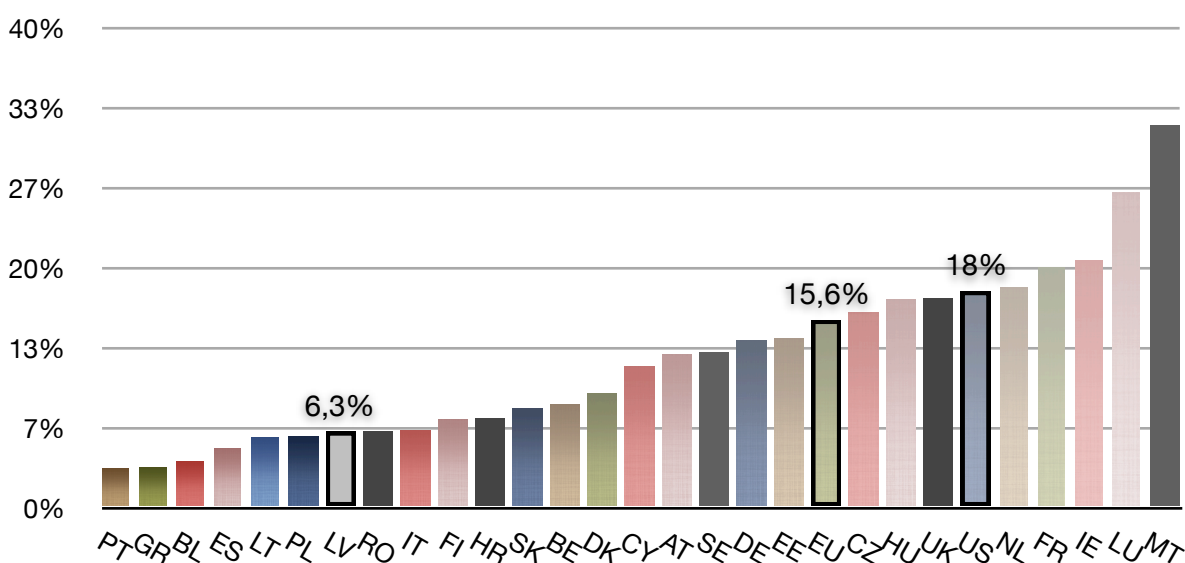
³⁸³ Data from Latvia’s Central Statistical Bureau and own calculations.

³⁸⁴ See Bērziņš, J. (2009). “Latvia and the Knowledge Society: Development, Underdevelopment and Macroeconomic Performance”. *Humanities and Social Sciences*, vol. 1, no. 58.

developed. On the other hand, the huge influx of financial capital resulted in real exchange rate appreciation, reducing the Latvian economy's external competitiveness.³⁸⁵

As shown on chart 4.4. below, a natural consequence, the level of high-tech exports of Latvia is very low, just better than Portugal, Greece, Bulgaria, Spain, Lithuania, and Poland. It is well below the level of the European Union (15,6%) and of the United States (18%). As the value of non-high-tech exports is usually lower than the imports of high-tech exports, naturally it is impossible to a country to have a well-balanced trade balance. In the medium term, without socio-economic development and the reversion of this situation, the output is a contraction of the capacity of import and a consequent crisis.

Figure 4.4
High-tech Exports as % of total - 2012



Source: EUROSTAT. United States' data is of the year 2011 from the Worldbank.

In Latvia's case, this deficit was being financed by the remittances of foreign banks to their Latvian branches, resulting in an increasing national external debt as consequence. This money was used to finance the expansion of their activities, mainly in the credit market. With the natural exhaustion of the market for credit in Latvia, the main source of financing the external imbalances drained.³⁸⁶ Allied with the effects of the international financial crisis, which resulted in some investors to get money out from the country, the economy collapsed. As a consequence, the persistent deficit on the Current Account of the past is still a problem, mostly because of the difference of the terms of trade.

That's the essence of what may be called the "Latvian disease", a modern version of the "Dutch disease", as the latter is a concept dealing with economic paradigms

³⁸⁵ See Bērziņš, J. (2009). "Latvia and the Knowledge Society: Development, Underdevelopment and Macroeconomic Performance". *Humanities and Social Sciences*, vol. 1, no. 58.

³⁸⁶ See Berzins, J. (2014). "Ignacio Rangel visits Latvia: Crisis and the Political Economy of Duality". *Debatte: Journal of Contemporary Central and Eastern Europe*, vol. 22, no. 1, pp. 81-102. DOI:10.1080/0965156X.2013.873190.

surpassed by the establishment of the abstract-capitalism. Accordingly to the Routledge Dictionary of Economics, the Dutch Disease is defined as:

The harmful consequences for a national economy of discovering natural resources, especially the decline in traditional industries brought about by the rapid growth and prosperity of a new industry. New dominant industries can afford to pay wages far in excess of other industries, so the latter raise their wage levels to unaffordable levels causing unemployment. The successful new industry has high exports, creating a foreign exchange surplus and raising the country's exchange rate, with the consequence that other industries of the economy become internationally uncompetitive. This was noticeable in the Netherlands after the discovery of North Sea gas. There rising prosperity brought about higher levels of welfare benefits which persisted after the downturn in the economy, causing immense difficulties for the financing of public expenditure.³⁸⁷

While the concept of Dutch disease deals with natural resources and the real sector, the concept of Latvian disease deals with the financial sphere and its relationship with the economy in its totality. It must be understood as the harmful consequences for a national economy of receiving huge amounts of financial capital. The result is the creation of a foreign exchange surplus, permitting or causing the real exchange rate to be overvalued. There was a dual process of economic transformation: at the same time manufacturing and services have been struggling through a lack of competitiveness resulting from the overvalued exchange rate, the economy experienced a process of reorganisation in favour of speculative and/or non-sustainable sectors, as for example, real estate and consumption of durable goods.

Since the independence, Latvian authorities and opinion makers have believed that a successful transition resulting in economic development was only possible through Neoliberalism. The promise of a smooth transition followed by sustainable economic development was seductive enough to politicians to accept the thesis that the neoliberal order was unavoidable. This confirms that the model developed in this dissertation can be applied also to Latvia. At first, Neoliberalism was established as the economic ideology, since it was already the established mainstream in the international system. Since it already has its own macroeconomic policies pre-determined, there was a process of political convergence to Neoliberal economic policies as the only one acceptable for Latvia. This pattern is so strong, that even in face of the last crisis, the chosen economic policy was rather a return to Neoliberalism, although other economic policies could be considered. While Neoliberalism will be considered the economic mainstream ideology, radical changes in the Latvian macroeconomic policy will be limited to its ideological boundaries. As a result, the model developed in this dissertation can be applied to Latvia.

³⁸⁷ Rutherford, D. (2002). *Routledge Dictionary of Economics (2nd edition)*. London: Routledge.

CONCLUSION

As a result of the research developed in this dissertation, it is possible to present the conclusions below. They **confirm this dissertation's hypothesis** that “macroeconomic policy is determined at the political level, following ideological changes as the output of long-wave business cycles” in the cases of both Brazil and Latvia.

1. The concept of ‘ideology’ has myriad definitions. Some of them are positive, like Lenin’s “class consciousness”; some are negative, like Marx and the distortion of the reality of social relations to conceal forms of social domination; some are neutral, like the notion that ideology is the medium in which conscious social actors make sense of their world. Also, it has been used to describe different phenomena, like distorted communication and semiotic closure. Even, there were attempts by the postmodernists to give the term an accessory character, substituting the term ‘ideology’ by ‘discourse.’

If ideology is a vehicle for dominance, a general definition for the term can be “the combined systemic ways in which social and political dominance is established and sustained through subliminal means”. This meet much the notion of ideology accordingly to Gramsci, the Frankfurt School and Foucault. However, Althusser was right when affirming that ideology is manifested through material actions. Thus, it is necessary to complete the proposed definition to “the combined systemic ways in which social and political dominance is established and sustained through subliminal means, and which is manifested through material actions.” These material actions are also the set of economic policies considered to be acceptable during determined historical period, and which are determined at the political level, thus dependent of ideology.

2. Economics can be a vehicle for ideology. Economic analysis, when discussing, for example, the monetary system or the principles of foreign trade, always provide precepts of political conduct. This can be explained by social scientists, including economists, having the ambition of seeing their work recognised as true science. However, the individual moral values of each social scientist is the result of his/her own personal experiences. Therefore, even if these values can be suppressed in the beginning, they may appear when making policy recommendations. As a result, as policy recommendations presuppose an ideal model of social organisation, it also presupposes some form of political control. As a result, “economics” as discipline is ideological by itself.

3. Much of the research on short-term political business cycles following Kitchin and Juglar cycles has lost its sense after the 1980’s. First, because of the process of ideological change followed by party convergence that constrains internal choices by external means. Second, because economic policy is increasingly being determined by independent institutions, i.e., independent Central Banks, where policy-makers deal with

long-term goals. Third, because of the reducing electoral turnout in Western democracies observed in the last years. This results in Milton Friedman's hypothesis that under Neoliberalism people would be free to choose being wrong. Instead, it is the contrary: there is no choice. As a result, it is possible to affirm that short-term political business cycles are determined and/or restricted by long-term ideological business cycles. At this moment, the current ideological business cycle made short-term political business cycles irrelevant. However, as history is inexorable, after some time the prevalent economic ideology will change. Then, the economic and political paradigms will also change.

4. Because of this determinism, the set of economic policies available to the parties and coalitions to deal with crises is limited to the boundaries of the economic ideology established in the time of the last big crisis. The result is the process of party convergence identified by several authors, where there was a general turn to the left until the 1980's, when centre-right and right parties abandoned traditional ideologies seeking for a broader electoral support. After the 1980's, there has been a process of convergence to right-wing policies due to the effects of economic globalisation on national economic policies.

5. Ideological transformation occurs when, in times of crisis, voters expect the government to find a set of economic policies to deal with it, making the economy to experience the same activity level than before. Accordingly to the magnitude of the crisis, a more or less radical set of policies is chosen. In the case of a very serious crisis like the Great Slump or the stagflation of the 1960's, the economic policies in force loses its scientific validity. It is substituted by another ideology and the group connected to the previous ideology loses its academic prestige and respect. What was mainstream turns to be marginal, at the same time that what was marginal turns to be the new mainstream. Nowadays, the mainstream is financial neoliberalism.

6. The process of ideological convergence of the last years is different from the one resulting in the Bretton Woods System. Rather, it is the result of major parties abandoning their role in linking citizens to the political system. As a result, the political system has been increasingly ceasing to be a medium that represents, articulates, redresses, and refines citizen concerns. Therefore, the determination of economic policy becomes conditioned by the particular interests and views of specific social groups, and not of the society as whole. The only chance people have to they disapprove economic policy is during elections.

7. Politicians shift from using one set of economic policies to another, following economic crisis. Because of the process of economic voting, bad macroeconomic performance will influence voting accordingly to its impact on voters' wealth, making politicians to look for alternatives to keep their popularity.

8. There are two variables determining how far economic policies will change following crises. First, how serious a crisis is. Second, its geographic extent. Regional or country-specific crisis will not result in dramatic economic policy changes. As the economic system passes through structural crisis, sometimes the established economic

ideology is not able to make the system to go back to the previous level of accumulation, what makes the incumbents' popularity to fall. Then, with the involvement of the media, of private interests, and contending political parties, a societal debate starts. This process soon becomes tied up with electoral competition. As a consequence, each party's and/or coalition's offered economic policies become under a process of social scrutiny led by the media and its pundits.

9. The transformation of the established economic ideology occurs when, in times of crisis, the population expects the government to find a set of economic policies that will make the economy to experience growth and development. Accordingly to the magnitude of the economic crisis, a more or less radical set of policies might be chosen. In the case of a very serious crisis like the Great Slump or the stagflation of the 1960 - 1970's, the economic ideology in force loses its scientific validity. It is substituted by another economic ideology and the group connected to the previous ideology loses its academic prestige and respect. What was mainstream turns to be marginal; what was marginal turns to be the new mainstream. The result is the process of political convergence identified by several authors, where there was a general turn to the left between the 1930s and 1980s, when centre-right and right parties tended to the left seeking a broader electoral support. However, since the 1980's there is a process of convergence to right-wing economic policies called Neoliberalism.

10. The acceptable economic policies are determined by a supra-ideological process of convergence to a specific ideology which has its own macroeconomic policies determined *ex-ante*. Therefore, it leads to the impossibility of establishing and conducting economic policy independently of ideological constraints. In other words, what is acceptable as economic policy is already pre-determined, although adapting to particular circumstances.

11. Neoliberalism is not the same than completely free economics as apposite during the period of classic Liberalism. Rather, it is a specific form of socio-economic regulation aiming to artificially reproduce the conditions of perfect competition. As a result, there is an established institutional and legal framework shaping how economic relations occur, which is not determined economically but rather at the political level by politicians and political institutions.

12. Although in the USA the ideology determining the interconnection between economics and politics had started changing already in the ending of the 1960's, in Brazil it started only almost thirty years later, with Collor's election. The acceptance of the relationship among the ideas of "interventionist state," "development," "inflation," and "economic stability" started to change the ideological paradigm defining what is and what is not acceptable in terms of economic policy, thus conditioning the understanding about economics to a specific view. Therefore, the change occurs first in the central countries, spreading later to the periphery.

13. The economic problems during Sarney's government had a fundamental role to explaining Collor's victory and the ideological change that took place in the 1990's Brazil. The idea that the state is structurally ineffective and corrupt in contrast to an idealised perfect liberalism guided by market forces started to determine Brazilian macroeconomic and development policy. The role of the state in promoting development completely changed from active to passive. In ten years after Collor's impeachment, most of the state-owned companies had been privatised, the programs of credit for development, including to agriculture, had been terminated or reduced, the control of foreign financial capitals ended, as many other mechanisms of internal economic protection. The national-developmentalism from the 1950's, which had determined the economic policies until Collor's election, ended.

14. Twelve years after Collor being elected, the Workers' Party (PT) won the Brazilian presidential elections and Luiz Inácio Lula da Silva became the 35th President of Brazil in 2002. Without the intention to oversimplify the political process that resulted in Lula's victory, Lula's rhetoric experienced a deep change in relation to 1989, from a considerably radical left-wing political program to a moderate one.

15. During the 1989 elections, Collor's main argument against Lula da Silva was that a left-wing government would destabilise the economy even more, since his economic policy would be based on old-fashioned developmentalist economic theories. In 1994, Fernando Henrique Cardoso argued that with Lula da Silva inflation would come back as a result of non-mainstream/heterodox economic policies. In the 1998 and 2002's elections, the argument changed to include the poor performance of the stock market, the volatile exchange rate, and foreign capital outflow. In the last case, since Lula da Silva's popularity was very high, the rationale was that foreign investors were concerned with his left-wing/heterodox economic policies. Lula argued in his "*Carta para o Povo Brasileiro*" he would maintain the basic premises of Fernando Henrique Cardoso's economic policies. He also invited José de Alencar, a well known businessman from the right-wing Liberal Party (PL), to be his vice-president. Lula da Silva's convergence to right-wing/orthodox economic policies is the result of the process of ideological convergence initiated with Fernando Collor and discussed in chapter 3 using data from CESOP and from the PLIO.

16. In 1989 the preference for total state intervention was much stronger among centre-right and right-wing individuals than among left-wing individuals, although the latter also preferred the state controlling the economy. The preference for the state controlling only basic services, thus leaving the rest under private control, was stronger among centre-left and centrist individuals, and the second choice for left-wing. At the same time, the strongest support for private control of the economy was also among right-wing individuals. Although this denies the logic of left-wing preferring more state intervention in the economy and right-wing less, in the Brazilian case the explanation relies on 20 years of military dictatorship between 1964 and 1984.

17. Although politically the Brazilian military regime was very conservative and nationalist, the economic policy was clearly based on national-developmentalism, which are considered to be left-wing or Keynesian. Thus, state intervention was associated with the militaries and with right-wing conservative policies. In 1993, strong state economic intervention was still the first choice among right-wing and centre-right individuals. It is not a surprise that the same applies to left-wing and centre-left individuals. The lowest support for state economic intervention was among centrist individuals. Nevertheless, with the exception of the latter, more than half preferred strong state economic intervention; at the same time, the second choice for all, with the exception of centre-right individuals, was total private economic control of the economy.

18. One of the presuppositions in this work is that the left-right scale moves through time. This means that economic policies considered to be right-wing, for example, 50 years ago, turn to be considered centre or even left-centre policies nowadays. As a result, there is a general movement changing the definitions of left and right, changing the set of economic policies the political parties identify themselves. Thus, the change is dual: first there is an ideological change in the outside moving the entire left-right scale; second, an internal movement of adaptation follows the new ideological configuration in force, making economic policy to move to the left or to the right to reflect the economic ideology in force.

19. Latvia became independent in 1991. At this time, Neoliberalism was already the mainstream economic ideology. Therefore, neoliberal ideology based on the Washington Consensus' conclusions became the guide for economic reforms. More specifically, the process of transition from a centralised administrated economic system towards a market economy in Latvia followed what became known as Shock Therapy.

20. Since Neoliberal ideology already have its own macroeconomic policies pre-determined, it is possible to affirm that all major Latvia's parties are Neoliberal.

21. It followed that economic institutions and structures, such as the financial, industrial, educational, and social structure started to be shaped also by neoliberal principles. The political institutions and structures such as business, parties, workers and other interest groups as the state bureaucracy, many times answered negatively to some reforms.

22. With the exception of the Latvian Socialist Party, the economic platform of all parties elected to the 5th - 8th Saeima shared the same Neoliberal principles: opening the trade and financial account, flat tax system, privatisation, fiscal equilibrium, currency board as exchange rate model, no or minimal state role in the economy, free competition in markets traditionally regulated by the government such as passengers' services, medicine, education, and housing maintenance services. Thus, it is no surprise that Latvia pursued Neoliberal economic policies from the very beginning.

23. The Latvian Socialist Party followed the model of convergence proposed in this dissertation, changing its economic platform to a much more Neoliberal ideological position in comparison to 1995. The party's political program implemented during its 7th conference in April 12, 2003 stated that the base for revitalising the Latvian economic is the establishment of an intense internal market, increasing the population's purchasing power. Second, the right to private property is one of the fundamental rights people have. Third, the role of the state in the economy should be minimal, the exception being fiscal policy in the form of lower taxes for business and investments. Fourth, the market for passengers' services, medicine, education, and housing maintenance services should be free and face competition.

24. Monetary policy in Latvia has been very Neoliberal. First, the exchange rate was pegged first to the Special Drawing Rights (SDR) and second to the Euro, in an arrangement similar to a currency board. Second, because its main objective was to maintain the stability of the exchange rate, instead of regulating the endogenous creation of money by private banks and the influx of foreign financial investment.

25. Latvia's Fiscal policy can also be characterised as Neoliberal. First, the income tax rate is flat, thus regressive. Second, the overall tax burden is much greater on the real sector and consumption, than on real estate and the financial sector. This means that the labour force pays most of taxes. Third, Latvia has been pursuing a policy of fiscal equilibrium since the year 2000. Before the 2008 crisis, the budget deficit/surplus as percentage of the GDP was reduced from -2.8% to + 0.1% in 2007.

26. Latvia's financial structure is based on three main Neoliberal principles. First, total capital mobility; second, the mandate of the Central Bank being purely to guarantee the stability of the exchange rate and, in a lesser extent, of prices even at the expense of the real sector and social interests; third, the Financial and Capital Market Commission's mandate is solely to protect the interests of financial institutions and does not consider the interests of the general public.

27. The transformation of the industrial structure also followed the Neoliberal logic. First, by privatisation; second, by the reduction or elimination of tariffs and non-tariff barriers for imports; third, financing business was almost totally transferred to private banks. The labour market was reformed to have greater market flexibility, at the same time most of the tax burden felt to the workforce. The result is a less-organised workforce, greater wage disparities, which at the same time - at least in theory - is more adapted to business needs.

28. After joining the European Union, the complete openness of Latvia's financial and capital accounts, together with the sentiment of low risk, changed the structure of the credit market. Therefore, during the period 2004–2008, there was a credit boom following the strategy of the foreign banks operating in Latvia. This created a bubble in the real state market and increased the consumption of imported durable goods. Because if these

sectors' own structure, Latvia's GDP would substantially contract with or without the international crisis.

29. The model developed in this dissertation is able to explain why in Latvia the choice of macroeconomic policy does not take in consideration economic structural conditions and requirements for promoting economic development. As it is empirically verifiable that, if Latvia is not an economic disaster it is not a success story either, what can explain the adoption of concrete macroeconomic policies that resulted in the current situation is the lack of alternatives.

30. The model developed in this dissertation can be applied also to Latvia. At first, Neoliberalism was established as the economic ideology, since it was already the established mainstream in the international system. Since it already has its own macroeconomic policies pre-determined, there was a process of political convergence to Neoliberal economic policies as the only one acceptable for Latvia. This pattern is so strong, that even in face of the last crisis, the chosen economic policy was rather a return to Neoliberalism, although other economic policies could be considered. While Neoliberalism will be considered the economic mainstream ideology, radical changes in the Latvian macroeconomic policy will be limited to its ideological boundaries.

Finally, the observation of the following suggestions and recommendations are necessary:

1. There is a general agreement that multi-disciplinarity is necessary for the social sciences to cope with today' challenges in research. Thus, the first recommendation is directed at the Latvian academic community: to increase multidisciplinary research.

2. In Latvia's case, the model developed in this dissertation is able to explain why the choice of macroeconomic policy does not take the economic structural conditions and requirements for promoting economic development into consideration. Thus, the second recommendation is about development of research on macroeconomic policy and Latvia's growth and development, combining the interaction between the macro and micro level.

3. To research the strategies of development employed by other countries and their results, making a comparison with Latvia.

4. In accordance with the model developed by the author, Macroeconomic policy is developed at the political level. However, politicians and most civil servants lack knowledge in economics. At the same time, the best knowledge about economics, both at the micro and macro level, is at the universities. Therefore, the government should rely more on the academic sector for economic expertise.

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ACKNOWLEDGEMENTS

This dissertation is the result of a long way started back in 1995 in Florianópolis, Brazil, when I started my bachelor in economics. Without knowing it, I had enrolled in one of the most interesting departments of economics in Brazil. It was really about Economics, with a capital “E,” and not merely about dogmatic economics. Thus, in the first place, I would like to thank my first lecturers for teaching me not being dogmatic, but opened to learn and ready to question my own convictions, specially Prof. Jesiel de Marco Gomes, Prof. Idaleto Malvezzi Aued, Prof. Renato Campos, Prof. Joao Sanson, Prof. Wagner Arienti, Prof. Duilio Berni, Prof. Silvio Cario, Prof. Fernando Seabra.

I also would like to thank my many friends from that time, specially (in alphabetical order) Júlio Nicastro Filho (*in memorian*), Márcio Rutkoski, Sandro Grisa, and Wolney Carvalho for their friendship.

My many thanks to my professors and friends from FCLAR/UNESP.

Special thanks to Prof. Alfredo Saad-Filho from the University of London/SOAS for the support and advising.

Special thanks for Cesar Zucco who sent me the PLIO’s database.

I would like to start thanking the Faculty of Economics of the University of Latvia. Special thanks to Prof. Erika Šumilo for the support. Also, I would like to express my deepest gratitude to Asoc. Prof. Viesturs Karnups and Asoc. Prof. Edgars Brēķis. Their advising and support were amazing.

Finally, I would like to thank my family, specially Ingrīda and Elīza for the patience and understanding.

This dissertation is for Prof. Jesiel de Marco Gomes.

ANNEXES

Table A.1.
Brazilian Political Parties in 1989

Party	Glossary
PCB	Brazilian Communist Party. Follows the Soviet line.
PC do B	Communist Party of Brazil. It's an Albanian oriented party.
PDC	Christian democratic Party. Contrasting to Christian Democracy parties in many countries, the Brazilian party is on the right end of the political spectrum.
PDS	Social Democratic Party. In spite of its name, it is a conservative party. It provided the partisan support for the military dictatorship (1964-1984). It was known as ARENA before.
PDT	Democratic Labour Party. Predominantly social democrat.
PFL	Party of the Liberal Front. Created in 1984 by dissidents of the PDS. Very conservative.
PL	The Liberal Party. Conservative party with strong antistatist discourse.
PMDB	Party of the Brazilian Democratic Movement. Its precursors, the MDB (Brazilian Democratic Movement) was created in 1966 as the official party of opposition to the military regime. It was renamed the PMDB in 1978. Since its inception, the PMDB has been a very heterogenous party, but its hegemonic group is centrist. Many conservatives have left the party since the military dictatorship end.
PRN	Party of the National Reconstruction. A right party created in 1989 to enable Fernando Collor de Mello to run for president.
PSB	Brazilian Socialist Party. An independent leftist party.
PSDB	Party of the Brazilian Social Democracy. Created in 1988 by a dissident group of the PMDB, it follows the line of social democracy.
PT	The Workers' Party. A heterogenous leftist party, ranging from revolutionary groups to social democrats.
PTB	Brazilian Labour Party. Predominantly a center-right party.

Source: Author, adapted from Mainwaring, S. (1992). "Brazilian Party Underdevelopment in Comparative Perspective". *Political Science Quarterly*, vol. 107, no. 4, pp. 677-707, p. 680

Table A.2.

Ordinal Regression Results of Preference for State Intervention in the Economy and Personal Positioning in the Left- Right Scale in 1989 - Electors

Model Fitting Information	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	147,942			
Final	109,504	38,439	4	0,000
Goodness-of-Fit				
	Chi-Square	df	Sig.	
Pearson	54,048	4	0,000	
Deviance	53,631	4	0,000	
Pseudo R-Square				
Nagelkerke	0,032			
Test of Parallel Lines				
	-2 Log Likelihood	Chi-Square	df	Sig.
Null Hypothesis	109,504			
General	55,872	53,631	4	0,000

Table A.3.

Ordinal Regression Results of Preference for State Intervention in the Economy and Personal Positioning in the Left- Right Scale in 1993 - Electors

Model Fitting Information	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	149,87			
Final	93,847	56,023	4	0,000
Goodness-of-Fit				
	Chi-Square	df	Sig.	
Pearson	11,084	8	0,197	
Deviance	10,714	8	0,218	
Pseudo R-Square				
Nagelkerke	0,028			
Test of Parallel Lines				
	-2 Log Likelihood	Chi-Square	df	Sig.
Null Hypothesis	93,847			
General	83,133	10,714	8	0,218

Table A.4.

Ordinal Regression Results of Preference for State Intervention in the Economy and Personal Positioning in the Left - Right Scale in 1990 - Politicians

Model Fitting Information	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	88,717			
Final	31,834	56,883	4	0,000
Goodness-of-Fit				
	Chi-Square	df	Sig.	
Pearson	3,079	8	0,929	
Deviance	4,383	8	0,821	
Pseudo R-Square				
Nagelkerke	0,379			
Test of Parallel Lines				
	-2 Log Likelihood	Chi-Square	df	Sig.
Null Hypothesis	31,834			
General	27,450	4,383	8	0,821

Table A.5.

Ordinal Regression Results of Preference for State Intervention in the Economy and Personal Positioning in the Left - Right Scale in 1997 - Politicians

Model Fitting Information	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	75,374			
Final	25,831	49,543	4	0,000
Goodness-of-Fit				
	Chi-Square	df	Sig.	
Pearson	2,514	8	0,961	
Deviance	3,942	8	0,862	
Pseudo R-Square				
Nagelkerke	0,375			
Test of Parallel Lines				
	-2 Log Likelihood	Chi-Square	df	Sig.
Null Hypothesis	25,831			
General	21,889	3,942	8	0,862

Table A.6.

Ordinal Regression Results of Preference for State Intervention in the Economy and Personal Positioning in the Left - Right Scale in 2001 - Politicians

Model Fitting Information	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	53,330			
Final	29,703	23,627	3	0,000
Goodness-of-Fit				
	Chi-Square	df	Sig.	
Pearson	5,967	6	0,427	
Deviance	6,374	6	0,383	
Pseudo R-Square				
Nagelkerke	0,243			
Test of Parallel Lines				
	-2 Log Likelihood	Chi-Square	df	Sig.
Null Hypothesis	29,703			
General	23,329	6,374	6	0,383

Table A.7.

Ordinal Regression Results of Preference for State Intervention in the Economy and Personal Positioning in the Left - Right Scale in 2005 - Politicians

Model Fitting Information	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	49,289			
Final	28,879	20,409	4	0,000
Goodness-of-Fit				
	Chi-Square	df	Sig.	
Pearson	7,773	4	0,100	
Deviance	9,433	4	0,051	
Pseudo R-Square				
Nagelkerke	0,229			
Test of Parallel Lines				
	-2 Log Likelihood	Chi-Square	df	Sig.
Null Hypothesis	28,879			
General	9,425	19,455	4	0,001

Table A.8.

**Ordinal Regression Results of Preference for State Intervention in the Economy and
Personal Positioning in the Left - Right Scale in 2009 - Politicians**

Model Fitting Information	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	50,367			
Final	24,001	26,355	4	0,000
Goodness-of-Fit	Chi-Square	df	Sig.	
Pearson	1,621	8	0,991	
Deviance	2,532	8	0,960	
Pseudo R-Square				
Nagelkerke	0,256			
Test of Parallel Lines	-2 Log Likelihood	Chi-Square	df	Sig.
Null Hypothesis	24,011			
General	0,000	24,011	8	0,002