

## **Beyond economics: interactions between politics and economic development**

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**T**heories about a necessary link between authoritarianism and progress have been discredited by history. Now democracy and development are prominent (though not inseparable) values on nations' agendas. The link between the two is not a given; it is established by recognizing that democracy is justified in itself as a universal value that can be accepted by all. Democracy legitimizes public policies because it is based on deliberation and a negotiated trade-off of interests, under transparent rules. Democratic procedures can be used to cope with unexpected difficulties and strengthen the confidence of outsiders. The way to deal with the asymmetrical effects of globalization is to participate in the international economy on more advantageous terms, affirming the ability of democracy to shape a form of development that is non-exclusive, unlike that which we experienced in the past. This is no easy task, and if people are not rewarded by a higher quality of life, then not only will democracy be in jeopardy, but the economy will not prosper.

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# I

## The contribution of Prebisch and ECLAC

I began and ended my eight years in government in close contact with ECLAC, and this is very important for someone who has always drawn inspiration from that organization's determination to comprehend the reality of Latin America on its own terms. The person who set ECLAC on this path was, as we all know, Raúl Prebisch, the inspiration for the memorial lecture that bears his name.

I once wrote that the greatest merit of ECLAC was to have copied with originality, and I meant it as praise. Prebisch is the best example. His work did not come out of nowhere; he had good sources. He was familiar with development theory, he knew the classics and the work of Keynes, he was mindful of Hans Singer's achievements and he appreciated the statistical resources built up by the United Nations.

But he knew how to assimilate during the process of creation, which is usually the way innovation comes about in the economic and social sciences. Knowledge usually evolves through cumulative advances, with the opening of some new angle or perspective, not through a radical departure from the existing stock. The key that Prebisch found was the adaptation of development theory to the regional context of Latin America.

He showed that international trade had not brought that region the benefits proclaimed by the theory of comparative advantage, or by the neoclassical promise that trade would have a levelling effect on the remuneration of factors of production across countries. He also provided an explanation: the capacity for political organization of workers and businesses in the countries of the centre prevented the fruits of the greater technical progress achieved there from being

shared by the Latin American economies in the form of lower prices for industrial goods. What occurred in fact was a continuous if uneven deterioration in the terms of trade of the region's agricultural products.

Hence his recommendation that industrialization policies be applied, with the aim not only of increasing the accumulation capacity of the region's economies, but of reorienting its foreign trade profile as well. He was later to suggest a political arrangement to integrate national markets. He wanted to ensure the success of the import substitution process by addressing requirements of scale, and accordingly he sought to create the political conditions for an increased role and perhaps a greater weight for Latin America in the world economy.

Prebisch was no fatalist, however. He believed in development, despite internal obstacles and the asymmetries of international trade. And in this I was and am his disciple. In the study I carried out with Enzo Faletto, we never saw any contradiction between development and dependency (Cardoso and Faletto, 1969). Dependency made development exclusive and iniquitous, but it did not prevent it. It was the solid contribution made by foreign capital, combined with public investment and, to a lesser degree, domestic private-sector capital, that did so much to improve economic indicators in many of our countries in the 1960s. The challenge, which was not met, was to spread the benefits of this growth as widely as possible. It was to show faith in the idea of political autonomy and to find a political framework that was more sensitive to the interests of the majority, and this meant upholding democracy.

# II

## Links between politics and economic development

All this takes us on to the interplay between politics and economic development. This subject—which

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enthralled Raúl Prebisch, a fervent believer in politically guided development—evokes challenges that political actors will have to face in the new millennium and reminds us of the effort being made to adapt our economies to new patterns of competition and productivity, without neglecting the need to give the State the capability to

respond to ever more complex and diversified social demands. My first comment is that democracy and economic progress have not always been regarded as compatible. There have been many occasions throughout history when democratic demands have been inhibited by the supposed requirements of the economic process. Universal suffrage has been seen as conflicting with property rights, social rights with economic growth, and collective rights with budgetary stability.

In his penetrating review of conservative thought over the last two centuries, Hirschman (1991) highlights the weight of economic considerations in the argument against expanding civic rights. An emblematic case was the resistance put up to the enactment by the British Parliament of the liberal reforms of 1832 and 1867. Both were considered a turning point in the political history of the United Kingdom, as they brought

domination by an oligarchy to an end by extending the right to vote.

No less tenacious was the campaign against social rights in Europe and the United States in the second half of the twentieth century, the argument being that extending social rights would reduce opportunities for growth. In contrast to the Keynesian theories that judged social spending to be compatible with economic growth, undue weight was placed on the risks entailed for fiscal balance and monetary stability by the over-expansion of the State.

There was also the misgiving that extending social guarantees could lead to a crisis of governance, a subject much dwelt upon by the well-known Trilateral Commission during the 1970s. The fear was that States might be taking on obligations that would go beyond their administrative capacity.

### III

## Politics and economics in Latin America

In Latin America, the conflict between politics and economics has had somewhat different, more distinctive features. In a way, it was harder to put that conflict into the right perspective in Latin America than elsewhere. I was among those who were unconvinced by the argument that authoritarianism was a condition imposed by the logic of the market for the successful pursuit of import substitution (O'Donnell, 1972). It seemed clear to me that the Latin American dictatorships were essentially political phenomena, bolstered by the ability of the autocrats of the moment to use the spectre of the Cold War to suppress dissent. The high growth rates achieved in some years during the 1970s were due to a huge supply of credit, not to authoritarianism, which only heightened certain perverse features of the model such as income concentration.

In the 1980s, in the midst of political liberalization, the argument that authoritarianism was a force for progress made a comeback in Latin America. Given the supposed inability of civilian governments to push through the reforms known to be necessary to resume sustainable growth, the performance of authoritarian regimes in South-East Asia was regularly praised.

We know that, one by one, theories about a necessary link between authoritarianism and progress have been discredited by history. Thus, the extension

of suffrage in Europe took place in tandem with the Second Industrial Revolution, and the advent of the Welfare State coincided with the powerful upsurge in the industrial economies that followed World War II. Latin America did not become a fairer place under its authoritarian regimes.

Democracy and development are now prime values on the agendas of all States. Yet, the fact remains that they are not, by nature, inseparable. While it can be inferred from the political history of the wealthiest nations that economic growth is hard to sustain without wide enjoyment of public freedoms, material affluence is not always a corollary of democracy.

I prefer to speak of an imperative link, one that is not automatic; it is rather established following the recognition that democracy is worth having for itself, a universal value that can be accepted as such by all.

It is not my purpose to discourage those who seek affinities between democracy and development. Rather, I want to help make this search a realistic one.

Many in Latin America expected the end of authoritarianism to usher in the promised land. Experience was soon to show us that the way would be harder and more challenging. The long and painful recession that this region suffered in the 1980s, when civilian governments were in place, provided very

telling proof that politics and economics can give conflicting signals, that democracy does not necessarily entail prosperity.

So what is the relationship between democracy and development? Should we accept the scepticism of some analysts who, seeing the difficulty of identifying specific, permanent links between these values, have chosen to regard them as completely separate and as interacting only on a random, ad-hoc basis? I am convinced that we can be more assertive in our appreciation of the role of democracy. Without attempting to reduce the benefits of the vote to figures, it is possible to discern aspects of the democratic experience that have an undeniable interest for economic actors and are essential in the quest for sustainable development.

First of all, there is the matter of legitimacy. We know that democracy has its own way of setting public policies, including those that affect economic management. Decisions cannot do without deliberation. They are the outcome of a negotiated trade-off of interests, in accordance with transparent rules and within a public process.

The benefits this brings for economic management seem to me obvious, starting with the credibility that market rules gain in a democracy. Macroeconomic policies cease to reflect the supposed omniscience of enlightened technocrats and represent instead a debate of legitimate interests, a consensus reflecting several wills, including that of the government itself.

A useful example here is the "Plano Real", whose purpose was to stabilize the Brazilian economy. Unlike previous attempts, all of them unsatisfactory, this Plan was brought into operation through a lengthy process of consultation, dialogue, persuasion and adaptation of points of view. It was not by chance, therefore, that it was well received by economic agents and by society in general. This was the result of its legitimacy as a process.

It was argued at the time that a plethora of economic preconditions had to be met before any stabilization plan could be considered. The reality proved that the necessary economic measures could be stages in the stabilization effort rather than prerequisites for it, provided they were applied with broad and informed political and social support. Willingness to provide explanations to social actors and public opinion in general: *this* was the precondition without which the Plan Real would not have succeeded.

Another example of the importance of the democratic process for overcoming difficulties can be

seen in the Brazilian reaction to the 2001 energy crisis.

When the seriousness of this situation became clear, the decision was taken to explain everything to the country, ask the population for cooperation, and apply strict rationing. Support was widespread. The mass media set to work and reported thoroughly and objectively on the issue. For about ten months, the country as a whole got behind the efforts to restrict energy consumption in each region (and, in some cases, in each major city), with all the implications this had for water reserves (the bulk of energy in Brazil is hydroelectric). The need for power cuts lasting some hours a day, as happened in California for example, was thus avoided. Without question, this collaboration between the State and society considerably limited the harm the crisis might have inflicted on the country's economy.

Economic decisions that are taken democratically also prove less vulnerable to the volatile circumstances in which wealth is generated today. The options usually available to government authorities for dealing with crises are shaped by the day-to-day debate between the government and the political opposition, or by the internal deliberation mechanisms of the State machine. It is interesting to recall in this connection the Brazilian reaction to speculative attacks on our currency, the Real.

The firmness with which this crisis was overcome would have been difficult to achieve had there been less democratic transparency and stability, to judge by the outcome of more authoritarian strategies adopted in other regions of the world.

I am not suggesting that democracy makes us immune to the mood of speculators. Decisions concerning how and when to allocate short-term capital have escaped the control of government, thereby causing currencies to be devalued, public accounts to be destabilized, and interest rates to increase. But this situation can be changed. There is a growing awareness among States of the need to re-examine the architecture of the international financial system and regulate capital flows more effectively, since the present lack of controls affects all, rich and poor, albeit to differing degrees.

I raised this issue for the first time at a conference held at ECLAC in 1995. At the twenty-ninth session of the Commission (Brasilia, 2002), I was pleased to learn from the then Executive Secretary of ECLAC, José Antonio Ocampo, that the organization had taken up the challenge and was treating the matter with the seriousness that the risks involved in it required. Unfortunately, the example has not been widely followed and proposals for stricter control and

monitoring of volatile capital remain absent from the agenda of the countries with the greatest influence over the international financial system.

It should be recalled that the idea of regulating international financial flows was included in the programme of the Bretton Woods Conference and accepted in the negotiations. Article VI of the International Monetary Fund Articles of Agreement provides for the possibility of the IMF asking a member State to adopt controls to restrain excessive capital flight and the consequent need to draw on the organization's reserves.

It is true that the two main architects of the Bretton Woods agreement—John Maynard Keynes, an adviser to the Exchequer (United Kingdom ministry of finance), and Barry Dexter White of the United States Treasury Department—were at odds over the degree of autonomy the Fund should have and the amount of available reserves. Keynes wanted the IMF to be a true international central bank that would provide a counterpoint to the economic power of the United States and possess, among other prerogatives, the right to create its own instrument of credit, as a lender of last resort. White, meanwhile, saw the job of the Fund as being to ensure balanced growth in world trade in a way that preserved the central role of the dollar in international finance. And such was the institution that was created, anchored solely in the United States currency.

White soon realized, however, that the stability of the dollar would be jeopardized by the explosive growth of world trade that was in prospect and the need for a matching expansion of international reserves. He then fell in behind Keynes' position and eventually proposed that the Fund Articles of Agreement be revised to allow it to create its own reserves. The proposal was unsuccessful. Just two decades later the amendment was to be accepted, leading to the creation of special drawing rights (SDRs), although in extremely limited quantities. And the fact is that the expansion of these SDRs is still being proposed today with a view

to creating a buffer of reserves that can provide better protection for countries that run into difficulties.

In discussing the importance of democracy as a basis for foreign policy, some mention must be made of Mercosur. This was a product of democracy, which enabled rivalries to be dispelled and trust to grow between Brazil and Argentina. The process took place under the auspices of democracy, with the participation of national societies. The democracy clause was so effective that it inspired the adoption of similar mechanisms at the Summit of South American Heads of State (Brasilia, 2000) and, at the hemispheric level, at the Third Summit of the Americas (Quebec, 2001).

Had the Southern Cone not been democratized, Mercosur would not exist; and by existing, integrating markets, solving crises and creating wealth, it has promoted democracy beyond its borders. This virtuous circle confers authority upon its members' struggle for a more democratic world order.

To return to the idea which has informed this whole paper—that the link between democracy and development is not a given, but is established—it is important to highlight that this approach places a great political responsibility on a country's leadership: the responsibility both to resist the easy, seductive appeal of populism, so akin to authoritarianism, and also and above all to have the boldness to modernize positions, think anew and explore new paths, when this is what the common good requires.

There were many occasions when those exercising power in the Latin America of the 1990s were faced with this challenge. I refer to situations in which failure would inevitably have meant dragging the country back into the past, to outdated formulas. In the face of globalization, the inevitability of it, the task has been to seek the most advantageous international positioning for our countries, without yielding to fantasies of self-sufficiency, but rather with an awareness that the process tends to produce asymmetrical effects, to perpetuate inequalities.

## IV

### A new growth agenda

In the early twenty-first century, challenges of this nature remain. What is at stake is more than the economic performance of the Latin American

democracies. Also being tested is their ability to shape, democratically, a concept of development different from the one they have traditionally known:

development that is not exclusive, that extends to all, that can eradicate want and put an end to the poverty in which millions of Latin Americans still live.

But if all this is not to smack of vagueness or even demagoguery, it is necessary to outline a new growth agenda.

Since the 1990s it has been clear that, under present circumstances, there is no place for closed economies, nor for inflationary financing of consumption and investment, nor indeed, even in the cases of countries at an intermediate level of development, for a straightforward return to the import substitution policy.

Yet, this does not mean just accepting what has come to be known as monetary orthodoxy or the Washington Consensus. Indeed, the Latin American countries have expanded their education policies, created social safety nets to offer some hope to the poorest, and reorganized public-sector administration and the structure of the State. With few exceptions, they have not yielded to the “neoliberal” vision of a minimal State.

The time has come when, along with continuing efforts to achieve steady productivity growth and

conquer external markets, steps are required to gradually win back the domestic market.

This is easy to say and hard to do, but not impossible. Perhaps the most important thing (and this takes us to the heart of the relationship between economics and politics) is to grasp what is hardest to accept: that the ground rules simply cannot be altered, there are no miracles, and so the way will be long and, regrettably, what leaders will have to offer is “sweat and tears”.

But sweat and tears without reward obviously lead to discouragement (to social discontent, to outbreaks of disorder, to the demoralization of governments) that makes the promises of populists attractive. So the path of gradual progress —and there is no other— is only acceptable if the progress is continuous and benefits all.

Our political leaderships have not been firm enough in explaining the difficulties along the way. There has also been a failure, nationally and internationally, to understand that without adequate rewards in the form of better quality of life, not only is democracy jeopardized, but the economy itself will not prosper.

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