

**Development in the Modern World: Power, Beliefs and Institutions
with an Application to Brazil***

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Economic and political development is contextual nevertheless there are some general elements in the process of institutional persistence and change. We present a framework which allows us to better understand development in the modern world by which we mean that there exist developed countries and that the developing countries are aware of and can potentially learn from the developmental paths of the already developed countries.¹ We focus on middle income countries where it is a puzzle that a greater number have not transitioned to more open economic and political societies, given that there are role models they could emulate.² By emulate, we do not mean that institutions can be directly imported but only that the leaders of countries have a good idea of some of the key ingredients that all open societies possess: e.g. rule of law; clear, secure and impersonally enforced property rights; competent and honest bureaucracies; and open and competitive economic and political systems. Our framework consists of several interconnected key concepts that we will first define and then utilize to show how they produce a dynamic of institutional change. The concepts include: a country's configuration of power and the preferences of those in power; the beliefs of those in power; institutions; political and economic outcomes; windows of opportunity; and leadership.

Configuration of Power

In our framework political power means the ability to change formal institutions, e.g. the laws of a society. Our view of government is expansive because it includes all of the players who can influence the outcomes of the political process. It consists of both economic and

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¹ By developed countries we do not simply mean rich but rather that they are open economically and politically. The Human Development Index captures our notion of development better than GDP/P.

² Candidates to the list of developed countries include Chile and South Korea.

political interests. Together the economic and political actors determine the formal rules of the game. In less developed countries we would describe the actors as part of the economic and political elite by which we mean that access to changing the rules is more limited.³ We find it helpful to think of a “demand” side of government which includes the special interest groups, which can be business or non-business groups. In today’s world there are myriad of interest groups including environmental, health, economic, business and many other NGOs. Some have power and others do not; it is a matter of access to those who actually make the laws. For this reason, many interest groups give to all viable political parties in order to guarantee that they will have a “seat at the table.” In developed countries and some “developing” countries, citizens also matter because they vote. Politicians listen to public opinion because disregarding it could mean being voted out of office or forced out by a coup. But, the “demand” for government gets filtered through a political process which varies from country to country. We can think of the political institutions as the “supply” side of government. The supply components include such elements as: whether a country has a parliamentary system or strong or weak Presidential system; the number of active political parties; the independence of the Supreme Court; the independence of the central bank; the competence and honesty of the bureaucracy; the actual degree of electoral competition; and those who enforce the laws, e.g. the local courts and police. All of these forces combine to produce a *de jure* and *de facto* configuration of political power. It is this set of actors and their relative power that defines and enforces the formal institutions in a society. The institutions in a society are shaped by those with political power and their preferences, i.e., the outcomes that they would like to see but there is uncertainty about precisely the impact of laws on outcomes. The actors differ in their beliefs about the cause and effect relationships between the institutions and the economic and political outcomes. It is the beliefs of the actors, rather than their preferences that ultimately constrain and shape the institutions of societies.

Beliefs

By beliefs we mean the subjective views of actors about the way the world works (North 2005) We are not proposing a full theory of the determinants of beliefs. Like, North Wallis and

³ North, Wallis and Weingast (2010) refer to these countries as Limited Access societies.

Weingast, we argue that “the cultural environment- the political, economic, social context- fundamentally influences beliefs” (NWW: 262). Our goal is more modest. We first posit that it is the beliefs about the perceived causal relationships between institutions and outcomes that determine which laws get passed. The actors have preferences over outcomes but it is their beliefs that determine their actions. Our view on the role of beliefs matches Mokyr’s view of the role of enlightenment in enabling the British Industrial Revolution:

To sum up: Britain became the leader of the Industrial Revolution because, ...thanks to the synergy of the Enlightenment: the combination of the Baconian program in useful knowledge and the recognition that better institutions created better incentives (Mokyr, 2009: 122).

The Enlightenment was a belief that with the application of useful knowledge, a country could progress over the status quo. It was the belief in Enlightenment that shaped institutions that promoted ‘progress.’ At the time this was a new belief and, a belief not shared by all powerful actors at the time. It is the very nature of subjectivity of beliefs that gives rise to different views about the impact of institutions on outcomes. For a modern example, following the financial crisis of 2008, there is a lively debate amongst economists, politicians and other interest groups about the impact of a stimulus plan versus an austerity plan for promoting recovery. The actions that get taken are result from the relative power of the actors and beliefs of those with the power.

In today’s modern world the actors can have a more forward looking view of beliefs because there are role models. Whereas the pioneer countries were trying to solve problems in light of their past experiences, today’s countries can draw on the experiences of the already developed world for some of their beliefs. Not only can leaders draw from these experiences, but in some instances they do so blindly even if the importation of institutions is not appropriate for a particular country. This was the problem with blindly relying on the “Washington Consensus.” We stress that learning from other countries does not mean that the implementation will have the same effect, but nevertheless, it can affect not only their “belief” but the depth of their belief, which determines how long leaders will hold on to the cause and effect relationship. For example, if those in power want to control inflation there is more or less a consensus that this easier to accomplish if the central bank has some independence from

political pressure. So far, we have simply posited that beliefs shape actions, but if beliefs shape institutions it is paramount to posit how beliefs change, at least on the margin. We will do so later in this chapter when we discuss the dynamics of the framework.

Institutions

We follow in the now standard tradition of defining institutions as the formal and informal “rules of the game” that shape behavior. Formal institutions include the laws of society and how they are enforced. For example, laws are passed by some legislative body and may need to be approved by an executive branch or they could be united as in a parliamentary system. Laws are typically passed under the shadow of a Supreme Court. The size of the shadow of the court varies from country to country. For example, in Argentina, since 1946 every administration but one (de la Rúa) has either impeached Supreme Court Justices, forced resignations or added Justices (Alston and Gallo, 2010). This has led to little if no constraints on the executive and legislative branches. Informal institutions include the norms of behavior within a society. For example, trust varies across countries and will in turn affect how actors – private and public -negotiate deals/contracts to prevent ex-post opportunistic behavior (Williamson, 1985). Together formal and informal norms provide the incentive structure for economic, political and social actions. By the incentive structure we mean the perceived reward structure faced by all individuals in political activity, in market activities, and within firms and other internal organizations. The perceived rewards and the actions undertaken produce economic and political outcomes some of which may be consistent with the underlying beliefs of cause and effect and others inconsistent with the beliefs of the designers of the formal institutions.

Economic and Political Outcomes

The institutions of societies generate the incentives for activity which in turn produce economic and political outcomes. It matters for those in power if the outcomes are consistent with their beliefs because they enact institutions to produce outcomes that they perceived as beneficial for their goals. Political outcomes include narrow outcomes, e.g., politicians want to get re-elected, and broad outcomes, e.g., the degree of personal freedoms in a society. Economic outcomes as well are narrow and broad, e.g. did import protection increase a

particular firm's profits, or broad, e.g., unemployment levels, economic growth per capita and income inequality. The economic and political outcomes can have two effects. If they are sufficiently different from expectations or repeatedly different from expectations they can affect beliefs. The extent to which outcomes differ from expectations depends on how firmly the beliefs are held by those in power. In addition to affecting beliefs the political and economic returns can change the relative power of the economic and political actors. It is the change in beliefs or the change in power that will generate the dynamics in our framework, producing either incremental institutional changes or more discrete large institutional changes. If the outcomes are very different from expectations we will define this as a window of opportunity for "big" institutional changes.

Windows of Opportunity

Windows of opportunity are historical occasions when there is a chance to change the trajectory of a country's economic and political outcomes by changing the institutions. Windows of opportunity can result when: 1) the rental streams fall short of expectations to members of the configuration of power; 2) a new member or organization enters the configuration of power because of an unanticipated economic and political return; and 3) the beliefs of some members in the configuration of power change either because of the change in the economic and political outcomes or because of an exogenous event, e.g. the recent financial crisis has affected the beliefs of many actors in the sanctity of the existing relative prices of housing to reflect long run values. There are undoubtedly many windows of opportunity but actors are naturally risk averse so this is where the interaction of beliefs and leadership matter. We also stress that windows of opportunity are only "windows" for changing institutions; they are windows through which leaders can change institutions to make societies **more** or **less** open, economically or politically.

Leadership

Leadership is an absent concept in frameworks of institutional change. By leadership we mean that certain individuals at certain moments in a country's history make a difference because of their actions. The counterfactual is that if someone else were in the same position of power with the same beliefs that the forthcoming institutions could have been different. The

fact that history is replete with the mention of individuals lends considerable anecdotal weight and circumstantial evidence to our argument that certain individuals *did* make a difference. Leadership matters for several reasons: 1) it may be needed to overcome the free rider problem; 2) certain individuals can persuade others in power to share their beliefs; 3) certain individuals have more courage to take the “leap of faith” or 4) charismatic leaders are able to keep the non-politically connected mass populace content through occasional populist acts. This does not mean that leadership produces institutions that lead to greater economic or political openness but rather that leadership can change the trajectory of a society for better or worse. We also stress that leadership is only an important concept when there are windows of opportunity. For much of the time, countries are on “auto-pilot” such that the rental streams are within a tolerable band to those in power so that there is no reason to rock the boat by changing institutions in a big way.

The Dynamics

Now that we have the elements we can discuss in broad terms the dynamics of the framework. We start at some moment in time; we are never in a historical vacuum. There is an existing configuration of powerful individuals or organizations. This includes the economic and political actors as well as interest groups to the extent that they are in a position to shape institutions. The relative power of the individuals/organizations changes over time, and new players enter and some existing players exit but at some starting point we can take the configuration of power as fixed. The world that the players face is never static so they always take some actions to change some institutions, though others they may leave as fixed. Many institutions remain fixed because the outcomes that institutions produced supply a sufficient rental stream to the actors such that they see no reason to “rock the boat.” For other institutions they tinker on the margin. They make decisions, e.g. pass laws, issue decrees, and render judicial decisions, *inter alia*. Beliefs about the impact that the institutional changes will have on outcomes determine the institutions put in place, though the institutions may ultimately produce unintended consequences. To the extent that the overall outcomes produce adequate rents to the players in the configuration of power we will not see “big”

institutional changes and societies may cruise along in this “auto-pilot” mode for decades.⁴ Societies function and operate under a belief system of: “this is the way our world works.” The system is meeting the expectations of the elites; it is like a tide that washes over society and is predictable and is sustained by the social fabric of society, i.e., familial, religious, social and cultural relationships. In such a world, outcomes are consistent with expectations so there is no one in a position of power to push for big changes nor do actors outside the configuration of power question the legitimacy of the extant institutions.

But, at some historical moment, the cumulative effect of small changes reaches a tipping point, or there is an exogenous shock, either internal or external to a country, which changes either who is in the configuration of power or the beliefs of those in the configuration of power. The economic/political system may stop meeting expectations for a variety of reasons, some endogenous to the system and other external shocks: the gains from Import Substitution policies, though initially high, slow down and produce stagnation; or world relative prices change causing a different configuration in economic rents or political power. In these moments the beliefs of some of those in power about the cause and effect relationships of policies may change. Amongst some in power, there is a new view that the system is ‘not working.’ Though there is no predetermined way in which institutional change occurs, beliefs of the actors are an integral factor. Change happens because beliefs about the way the world works have changed. The beliefs of the benefits from change do not happen in a vacuum: elites can view the impact of institutions around the globe, e.g. an independent judiciary, secure property rights or less trade protection. In addition many of the economic and political elites acquired part of their education in wealthy countries which shaped their beliefs and their perceived benefits of importing institutions, though with modifications to suit their needs. Knowledge of institutions from the outside world would also allow the elites more conviction “to stay the course” when there are upfront costs for downstream benefits from institutional change.

As an example, in Brazil, there was a belief in the mid-1960s until the late 1970s held by the majority of the business elites and the political elite in power (the military government) that

⁴ This is analogous to how most of us live our lives. Most of us operate according to certain routines and it takes something out of the ordinary, e.g. a heart attack to cause us to change our way of life.

'developmentalism' increased the size of the economic pie for Brazil.⁵ Increasing the size of the pie was more important than the distribution of the cake; concerns over distribution would come later. Consistent with this belief was the central planning role of the military along with some degree of authoritarianism and censorship. Of course not all elite groups held this belief. The intellectual left and the unions did not hold this belief but they did not have sufficient power to change the prevailing *de facto* belief in the face of a system that produced double digit economic growth. Only when growth slowed down in the late 1970s did the economic elite begin to question their belief in 'developmentalism'. This change in beliefs by the business elites proved crucial for bringing down the military, and bringing in its wake a belief in democracy and a more open participatory political system.

It is the competing and incompatible beliefs amongst groups within the configuration of power, either the new players or old players with new beliefs, that brings about the "window of opportunity," i.e., the potential for moving towards a more open political and economic society.⁶ In such a situation, competing elites are constrained by the beliefs of each other and their relative power. A new set of institutions is only reached when there emerges a consensus on a new belief system among the winning coalition. In the case of Brazil, the winning coalition consisted of business elites, who were disappointed in the slow rate of growth, some centrist politicians at the state and local level, and the "social reformers," consisting of the union leadership and "intellectuals" (academics, artists and others who opposed the censorship of the military).

We argue that elite groups react to the perception of a problem and that the perceived solution to the problem is shaped by their beliefs about the likely consequences of their actions. In this sense our actors are both forward and backward looking. Here is where today's threshold countries can learn from the experiences of countries that have already transitioned to open societies. Of course the elites can't perfectly foresee the outcomes of their actions but

⁵ In Brazil 'developmentalism' meant state run technocratic planning.

⁶ We stress that the competition only brings about the "potential" for moving to a more open society. It depends on the beliefs of those who win the competition for power. Our concept of "windows of opportunity" is similar to that of Acemoglu, Johnson, Robinson and Yared (2008) who argue that economic growth does not necessarily lead to democracy and whether it does they label a critical juncture. They reach this conclusion after an econometric exercise which convincingly demonstrates that country specific effects make the difference.

they can make an educated prediction.⁷ For example, most of the open societies in the world have been lowering import protection since the Bretton-Woods agreement after WWII.⁸ Economic growth accompanied the lowering of tariffs. A country on the threshold today can learn from the experience of lowering trade protection over time and then it will be a decision for economic and political elites whether to retain the current rents from protection or open up.⁹

Opening up either politically or economically is problematic because the future has some uncertainty – though today less than for policies bringing development for the pioneer countries of the past- and some groups will lose, e.g. the military elite in Brazil in the mid-1980s. Moreover, generally opening up the economy entails some upfront costs, e.g., stabilization policies typically have short-run costs with long run benefits. This means giving up political rents in the short run for some unknowable but positive probabilistic increase in rents in the future. As we will see, the *Plano Real* (the stabilization plan of 1993) succeeded in part because after a series of hyperinflationary periods and failed stabilization plans elites believed that taming inflation was the number one priority for Brazil in the early 1990s. Enacting political and economic institutional changes requires some risks to the elites and this is where leadership matters. Opportunities present themselves but not all potential leaders take advantage of the opportunity, either because: they lack the perception to see the opportunity; they lack the power of persuasion; or they are too risk averse. Recognizing a role for leadership is a departure from the standard economic model consisting of “representative agents.” We also recognize that this leads to a certain degree of arbitrariness which is why analytical narratives entail thick description in the same way that courtrooms need to rely on circumstantial evidence when there is not a ‘smoking gun.’ We stress that windows of opportunity can allow certain leaders to effect institutional changes that can lead to less political or economic openness than the previous order. Windows of opportunity are not

⁷ Of course this does not dismiss the role for unintended consequences of which history redounds.

⁸ The General Agreement on Tariffs and Trade (GATT) eventually transitioned into today’s WTO which is a forum for expanding world trade by reducing trade barriers across its members.

⁹ In this sense our actors are forward looking, similar to the AJR 2005 versions of England and Spain responding differentially to oceanic trade. In other versions of AR, e.g. AR 2006, the elites are forced by citizens to give up rents. We believe that citizens have a greater role to play in the developmental process in proportion to the extent that the rule of law pertains to a greater percentage of citizens.

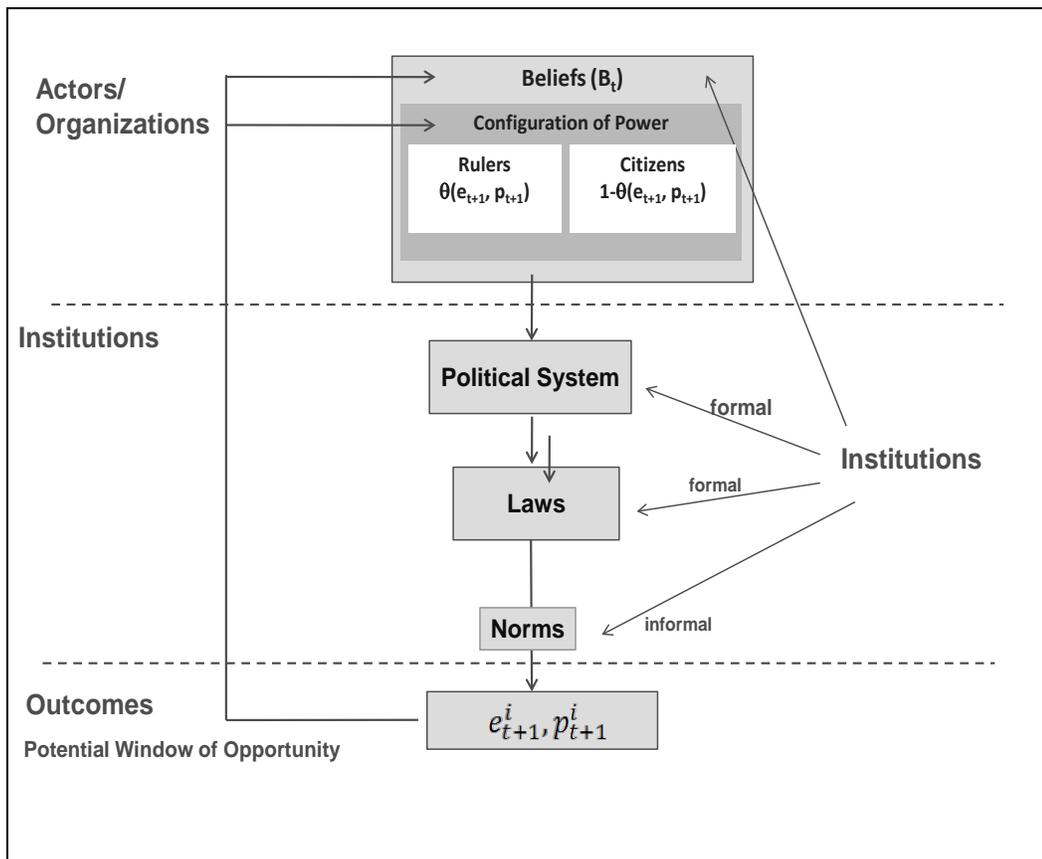
unidirectional in proceeding from less to more openness; the reverse is equally likely. For example the revolution in Cuba was a window of opportunity that did not bring about greater political or economic openness but rather led to the sustained power of Fidel Castro, a leader of the revolution and subsequent leader of Cuba.

At times, leaders enact “big” institutional changes that lead to outcomes consistent with expectations and also lead to greater economic or political openness. If the electorate rewards politicians for increasing political and economic openness within a framework of rule of law there is a tendency for the dynamic to become virtuous with institutional deepening, i.e. successive smaller institutional changes buttress the initial “big” institutional change. Institutional deepening is necessary for countries to transition to a sustained path of economic and political openness – the big institutional change is not sufficient. We will argue later in the book that the *Plano Real* only led to taming inflation and that it was the subsequent smaller institutional changes from 1994 through today that have produced a very different Brazil from the one in 1994, or 1985, the end of the military regime. In the spirit of North, Wallis and Weingast (2010), politicians find it in their interest over time to provide public goods to secure votes, and citizens in a competitive political system tolerate less corruption in society. Increasingly, the rule of law applies to political rulers in the sense that they are not above the law; impeachments are a sign that leaders are not above the law.¹⁰ In the economic system, regulation and loans can be used preferentially or in patron-client fashion but politicians come to realize that such treatment no longer delivers the same political support nor generates economic growth for consumers. The virtuous dynamic produces a more impersonal society but a more open society, though progress is neither continuous nor always towards more openness.

¹⁰ In our chapter on the early years of democratization, Collor, the first elected President in Brazil, was impeached for corruption and yet the transition of the Vice-President to the Presidency was peaceful, and process evolved according the formal institutions put in place in the constitution. There was never a hint that the military would take over government.

A Recap of the Framework

We summarize our framework in the following Figure 1.



The main elements in our framework are power, beliefs and institutional change. The dynamics amongst these elements produce outcomes which, along with external shocks, can lead to windows of opportunity that may induce shifts in economic and political openness. Again, the shift in openness may lead to greater or lesser openness in either the political or economic arenas. A key aspect of the framework is the notion that, although there is always continual and incremental change in the process of development, we can nevertheless think of periods where a more-or-less stable dynamic status quo takes place in which power, beliefs and institutions are comparatively stable, though changing on the margin. Throughout this period, pressure for change may arise leading to situations where the whole system is knocked off balance and shifts to a new configuration of power that then persists until it, in turn, undergoes a similar process. Through this perspective the process of development is viewed as following a punctuated path composed of a series of different configurations of power and beliefs which

produce either incremental changes in institutions when outcomes are consistent with expectations or “big” changes in institutions when the rental streams from institutions no longer match the expectations of those in power.

Dissatisfaction with the outcomes that emerge both in the political and the economic realm motivate the change from one configuration of power to another. This mounting dissatisfaction increases pressure for change, triggering circumstances that we label as ‘windows of opportunities.’ Both endogenous changes within the country’s own policymaking process but also external shocks can cause changes in the configuration of power. Change in the configuration of power may come about, for example: by a revolution where the previous elite is ousted; by an expansion of the rule of law to incorporate new members into the elite; or by a host of mechanisms that are country-specific.

Elites make choices about institutional change based on their preferences but it is their beliefs that determine the institutions that they establish. The institutions endogenously lead to a variety of economic and political outcomes. But the outcomes are also importantly affected by exogenous shocks which might come from the global economy, other countries or even from nature. The outcomes naturally impact the well-being of all members of society, possibly in different ways. In our analysis we adopt a separation of economic and political outcomes, though economic and political actors constantly interact. We are simply stating that we can specify how the outcomes affect political and economic actors differentially, e.g. the business community versus politicians. We can make finer specifications, e.g. within the business elite there are exporters and those who produce for the domestic market. This is a simplification, and these dimensions are by no means orthogonal, and one might be tempted to add other dimensions such as social and environmental outcomes. Nevertheless it is a useful abstraction that allows us to classify the emerging outcomes as positive and negative in each of these dimensions in a fairly unambiguous manner.

Some countries may eventually reach outcomes where both political and economic outcomes will be positive for a great majority of the population in a sustainable manner. Naturally there may be fluctuations due to external shocks, but if the configuration of power and the beliefs are sufficiently robust to these shocks, then the dynamic may be stable. The

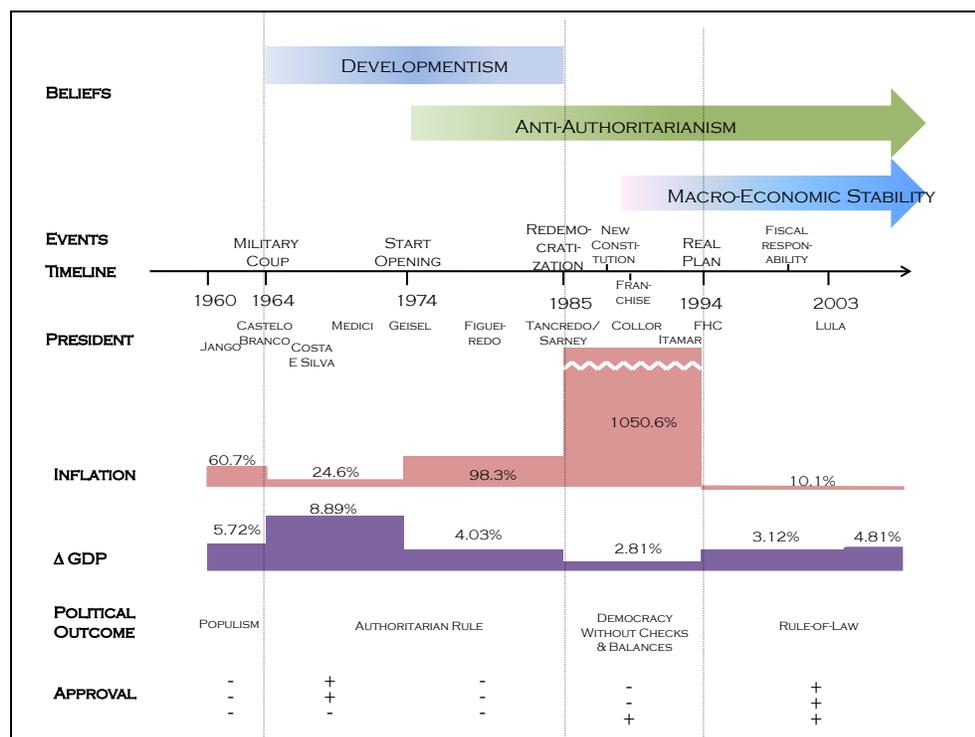
institutions necessary to reach this situation and how they can be created is the big question with which the literature on institutions and development grapples.¹¹ From the lenses of history we know that reaching a sustainable virtuous dynamic is not an easy task and is not inevitable. Indeed those countries who have achieved relatively sustainable open societies are the exception rather than the norm (NWW, 2009). The answer appears to be so highly country specific that generalizations can only take the form of very broad frameworks such as the one we presented here. Nevertheless, by applying the framework to Brazil, which we claim to be one of the few countries currently making the transition, we can both explain the ‘Brazilian miracle’ and gain insights for understanding the general process.

An Application to Brazil

Figure 2 presents our interpretation of the four periods through which Brazil has passed from 1960 to the present. The figure provides information on a series of central elements from our framework along a timeline which shows the delimitations of those periods; pre-1964, 1964 to 1985, 1985 to 1994 and post-1994. The top portion of the figure shows the key beliefs that prevailed in each period. Above and below the timeline are a series of important political and economic events, and a list of all the Presidents. Below the Presidents is information on the level of inflation and GDP in each period. The data is averaged for each period instead of showing yearly variations in order to give a unified notion of each period, as society’s evaluation of their current situation most likely considers not just the current events, but also what it has come to expect as likely outcomes based on recent experiences. Below the economic data we classify the political circumstance that we interpret as prevailing in each period. The economic and political outcomes are then classified as positive or negative in the bottom row.

¹¹ Our manuscript in progress complements and augments the literature on development by proposing a general framework along with a detailed case study.

Figure 2 – Brazilian Development since 1960.



Clearly different groups will evaluate outcomes differently as there are many distributive consequences of each situation. Our goal is to depict the beliefs of those in power. Although subjective, in most cases this classification will not be very controversial. In some cases the classification hinges on a comparison with the previous period, so that a positive sign does not mean that the outcome is ideal, but rather, compared to what the country had previously undergone, the new outcome is perceived as a marked shift in the right direction. We give details and the connections between each of the elements as we discuss each of the periods in turn.

We begin our analysis of Brazil's move towards an ultimate virtuous path of development with the 1964 military coup. The idea is not to give a detailed account of the history, but to analyze each period in the light of our framework and to show the forces that lead to each instance of change. In order to do so we need to establish who are the elites, what are their preferences and what beliefs prevail. We will not enter into the pre-1964 period except to note that the coup came about due to the dissatisfaction with both the economic and political outcomes. Recurring periods of high inflation and low growth mired in populism and political

volatility set the stage for the overthrow of democracy with significant approval, or at least a lack of resistance, by most of the elites and the population in general (Bresser Pereira, 1994: 193; McDonough, 1981b; Von Mettenheim, 1990; Skidmore, 2003: 244). McDonough (1981a) underscores how the failed policies of the past shaped the perceptions of the actors in the subsequent period:

Among Brazilian elites, the judgment that a trade-off must occur in favor of economic over social development derives not only from academic principle or from the casual observation that resources are limited and the time to catch up is short but also from their recollections of the populist era immediately preceding the 1964 coup. However short-lived, the experience of double-digit inflation and of stagnation in real growth during the last year of democratic rule left many of the elites with a deep skepticism about the feasibility of equitable development. (McDonough, 1981a: 537)

Similarly, on the political side McDonough (1982: 90) traces the lack of enthusiasm in defending democracy after the coup to “bitter recollections of the electoral frauds - the double voting and voting by citizens long buried - practiced by local bosses in preauthoritarian days.” But who were the elites that emerged in the early military period? Identifying elites is not always an easy task as it involves disaggregating ‘the elites’ into separate groups that have distinct sources of power as well as distinct objectives. These distinctions can arise from *de jure* versus *de facto* sources of power, as in Acemoglu and Robinson (2006), or can be thought of as differences between political versus economic elites. In any case, given its authoritarian nature, identifying the elites during the military period in Brazil is not terribly controversial.

In Figure 2 we divided the authoritarian period in two sub-periods as there was a clear inflection in the direction of economic growth and the subsequent political support for the regime after 1974. In both sub-periods political power was clearly in the hands of the military as well as the technocrats to whom they delegated the running of the governmental machine. As for the economic elites, for the early sub-period Frieden (1987: 100), identifies the following ‘new growth coalition’:

A powerful grouping of economic actors was especially important to national development after 1964. The domestic banking system grew institutionally and financially stronger. The state firms expanded continually, bringing along with them networks of suppliers, especially in the capital goods industries, where the parastatals accounted for two-thirds to three-quarters of domestic orders. The multinationals, which dominated the consumer durables sector, had the opportunity to tap a rapidly growing national market of middle-class consumers, many of whose purchases were financed by the vibrant financial system. (Frieden, 1987: 100)

Who was left out of the elite, besides the masses? According to McDonough (1986: 379) “... many formerly well-entrenched groups were also marginalized: politicians as a class, labor leaders, many intellectuals, some members of the business community and, gradually, the church.”

But what were the preferences and what were the beliefs of the new elites? It is axiomatic that each group prefers policies that promote their own welfare. But beyond that consideration one can also identify different prescriptions for how the country should be organized. McDonough (1981a) conducted 250 interviews in Brazil in 1972 and 1973, the height of the ‘Brazilian miracle,’ in a study of the elites. He identified three broad trends. The first is preference for prioritizing quick economic growth above all other goals, epitomized in the saying that first you should make the pie grow so that you can divide it later. The second preference perceives as primary the goal of establishing democratic values that promote inclusion and participation of all members of society. The third sees as most important the need to reduce poverty, inequality and other social ills, be that by whatever means can do so most effectively, democracy or economic growth. Which of these views was dominant was clear according to McDonough (1981a: 542): “Most Brazilian elites rank national priorities along a hierarchy of needs, the foundation of which is the nation's economic might, with the luxury of politics in last place.”

Although the views in the previous paragraph sound much like beliefs they are actually preferences as they refer to how the agents would like the country to be if it were in their power to make it happen. Our conception of beliefs refers instead to the agents perceptions of how things actually work, given the configuration of power in place. As indicated in Figure 2, the key belief we identify for the authoritarian period is based on the notion of ‘developmentism’. This is a development strategy that prioritizes fast industrial growth through state-led investment in large infrastructure projects and protection of selected private industries. It includes heavy doses of nationalism and the quest for national champions. As a belief, ‘developmentism’ was the recognition that given the military regime’s hegemonic power and their preference for strong and orderly economic growth, policy would necessarily pursue those objectives whatever the costs in terms of other goals such as equity, democracy, justice,

and environment. In Figure 2 we depict beliefs as fading in gradually after 1964. The first three years of the period were marked by austerity and restrictive measures that brought down inflation and set the house in order. It was in the subsequent years, peaking in 1974 but only gradually declining, that 'developmentism' was at its height, underlying and being confirmed by what became known as the 'Brazilian miracle':

From 1967 until 1980, the growth coalition succeeded extraordinarily well in utilizing previously installed productive capacity, a reorganized financial system, and foreign finance to obtain impressive rates of industrial growth. The booming international trading and financial systems helped accelerate the economy's upward trend, and it was not difficult to maintain a level of political agreement among major economic interests so long as the world and local economies were growing. (Frieden, 1987: 100)

In the period of 1964 to 1974 inflation averaged 24% per annum and yearly real GDP growth averaged almost 9%. This contrasts with the previous period (1960-1964) where the averages were, respectively, 60% and 5.7%.¹² These positive economic outcomes brought about relative prosperity to many and thus approval or at least acquiescence of the regime's performance (Frieden, 1987: 101). Yet on the political margin the level of dissatisfaction gradually increased, especially after the hardening of the regime in 1968. This sentiment started with those former elite members that found themselves excluded but progressively spread as repression, torture and censorship became increasingly routine. Although it is generally accepted that the level of repression in Brazil was milder than in most other Latin American military dictatorships, it came to have an extremely profound impact on the country's beliefs. Skidmore (2003: 246-247) stresses the subtle way in which the perception by many in the elite changed regarding the legitimacy of strong-handed methods to maintain order and pursue the policies that so benefited that same elite. The military regime's methods of social control disturbed not only the Church, lawyers and intellectuals but, according to Skidmore (2003: 247), even factions within the military evinced dissension.

While the economic performance continued to improve, dissatisfaction with repression was only enough to induce very subdued pressure for change. In 1974 the regime announced a 'slow and gradual' process of opening whereby command of the country would be returned to civilians in a controlled and orderly manner, maintaining the rights and prerogatives of the

¹² The GDP differences become even starker if one considers only the years after 1967.

current political elites. However as the economic situation took a downturn with the economic crises of the late seventies and early eighties this orderly process became increasingly hard to control. In our framework we stress the role of endogenous and exogenous events in producing pressure for change through their impact on outcomes. The deterioration of the economy in this period was a result of such interplay, with the internal dysfunctions of the economy being triggered and amplified by the external crises. With the now negative economic outcomes adding to the already negative political outcomes the pressure for change increased. Frieden (1987) describes how the magnitude of discontentment destroyed any hope the regime had of closely dictating the nature and pace of the process of redemocratization:

By 1981 the cycle had ended. Foreign finance, parastatal orders, and domestic finance all dried up. The "miracle" was definitely over, and its end spelled the collapse of the coalition of economic interests that it had supported. ... (T)he Brazilian economy began a downward spiral that drove increasingly influential social groups into opposition and culminated in a new civilian opposition government assuming power in March 1985. ... By 1982 business discontent with the regime was widespread; by 1984 it was nearly universal. The regime had lost most of its popular and elite support. (Frieden, 1987: 115-116)

In light of our framework, the transition to civilian rule in 1985 is seen as the shift to a new set of elites, preferences, power and beliefs. The change from the previous to the new 'status quo' takes place in a window of opportunity or a critical juncture. In this case the transition took place over an extended period of time and there was no single 'big bang' event as in the 'revolutionary' transition of 1964. The framework does not assume that all shifts in 'status quo' take the same general form; on the contrary, each case will have its own specificities. Importantly the transition brings with it new configurations of elites, power, preferences, and beliefs. We now turn to the new period and, as we did for the previous one, specify the new elements.

The elites which came to power with democratization were led by the nation's modern industrial sector which had precipitated the fall of the previous regime as it abandoned the ruling coalition. They included industrial workers and the urban middle classes, including technicians, bureaucrats and intellectuals. According to Frieden (1987: 121) "... in the simplest terms, the national industrial bourgeoisie had both come of age and come to power." Domestic bankers had been among the last to abandon the previous regime and only gradually

transitioned to the new coalition. Politically the opposition candidates who had been elected as governors in the 1982 election became particularly powerful, especially those of the industrial south-east, as the vote legitimized their position *vis-à-vis* the indirect route to power by President Sarney.

What were the beliefs of this new and expanded coalition? Politically there was a great repugnance to the exclusionary practice of the previous regime. The long experience without voice or vote, subject to repression, censorship and torture, led to a strong reaction against those practices and instilled high regard for democratic values of participation and citizenship, that quickly overturned any attempt to limit the pace and scope of the opening. Rochon and Mitchell (1989: 318) note that although the Brazilian middle class had historically supported an elite-centered democracy instead of one based on mass participation:

... as the transition to a civilian government unfolded it proved impossible to maintain the carefully circumscribed electoral democracy envisioned by the outgoing authoritarian rulers. Within months after the inauguration of President José Sarney, the government enfranchised illiterates (25 percent of the population) and ended campaign restrictions, the ban on cooperation between parties, and the prohibition of split ticket voting. The Sarney administration also made plans for the first direct presidential elections. Both the partisans of civilian control and the partisans of mass democracy, both the democratic legalists and the populists got what they wanted. (Rochon and Mitchell, 1989: 318)

Economically the preferences that prevailed were centered on anti-austerity measures that moved radically away from the financial conservatism of the last years of the previous regime. The hardships of the previous crisis and resentment against foreign indebtedness instilled preferences for growth-oriented policies, strong industrial growth and abhorrence to foreign dependence.

Out of these preferences and the new structure of power emerged the first of two beliefs that we claim to have played a crucial role in setting Brazil on its current path. The essence of this belief is the perception that the behavior of governments, firms and individuals is required to adhere to notions of inclusion, participation, citizenship and equality.¹³ Remnants from the authoritarian past such as censorship, top down decision-making and lack of

¹³ This belief was always held by many on the left including the intellectual elites and the union leadership but these groups never had power. Now the belief became shared by the business elites.

accountability and transparency would not be tolerated. For lack of a better term we call this a belief in anti-authoritarianism. It does not mean that from one moment to the other there was equal access to political and economic resources to all and that social justice would always prevail, but rather that there came to rule a presumption that behavior and policies would, if not actually progress towards these values, at least not explicitly contradict them. Often times this belief would be counterproductive, other times innocuous as it would simply affect the packaging and not the content. Nevertheless we argue that the existence of this lens through which the world is perceived did and still does have profound impacts in the path the country has followed.

An anecdotal indication of this belief is the way in which after 1985 practically no politician admits to being in the political right, opting instead for terms such as 'center'. According to Powers (2000: 206-207) this phenomenon of an 'abashed right' could be seen in the way "conservative public figures were continually uncomfortable, apologetic, and generally squirming in the presence of journalists and intellectuals."

Two other early manifestations of the anti-authoritarian belief were the extraordinary rise in social movements and the surprisingly powerful role assumed by the *Ministerio Publico* as a truly independent and effective defender of the diffuse and collective interest against government ineffectiveness and incompetence. Similarly the proliferation of councils as a means of policy-making in the most diverse areas, from education to health, from river basins to the environment, at municipal, state and federal level, are all expression of the anti-authoritarian belief.

Let it be clear that to this point we have not made any claims about the desirability or the nature of the impact of the mode of governance that emerged under this belief. We will elaborate on the consequences of the anti-authoritarian belief below. For now we simply provide a clear notion of what the belief encompasses to convince the reader of its importance.

Land reform is an area in which the anti-authoritarian belief is particularly evident. Land reform played a key symbolic role in both the 1964 and the 1985 transitions. Rural unrest, land invasions and the growing demand for land reform were one of the major issues that prompted

the military coup in 1964. Ironically the military regime nevertheless actively pursued a redistributive land reform as it recognized the need for a modern agricultural sector as a crucial input in their quest for economic might. Similarly, in 1985 one of the flagship policies of the new civilian government, and a regular staple in the new democratic discourse, was the realization of a massive and widespread land reform. It seems contradictory that a new government that was intent on severing any resemblance to the previous regime would put such emphasis on a policy that had previously been championed by that regime. The explanation of this paradox is in the beliefs that justified the policy in each period. Whereas the early land reform effort was sanctioned by the belief of ‘developmentism’, in the New Republic it was advanced as a case of social justice.

The clearest manifestations of the anti-authoritarian belief is the 1988 Constitution, as Constitutions by definition are places where elites delineate guiding principles, general rules and the accepted outlook on how things should be setup and operated.¹⁴ The fundamental spirit of the new Constitution was exactly to make a break with the past, abandoning the development-at-any-cost nature of the previous regime and embracing values of equality, social justice, human rights, inclusiveness, citizenship, and participation. These values not only oriented the content and tone of much of the text, but several were explicitly highlighted as fundamental principles. Article 1 establishes at the outset ‘citizenship,’ ‘dignity to the human person,’ and ‘political pluralism’ as fundamental principles. Article 3 proclaims it a fundamental objective, among others, to ‘build a society that is free, just and has solidarity.’ Similarly, Title 5 of the Constitution, dedicated to Fundamental Rights and Guarantees has 78 items, assuring things such as the ‘inviolability of the right to life, liberty, equality, security and prosperity (Article 5). Clearly much of this is the regular window dressing that tends to ornate many Constitutions throughout the world, and certainly many articles privileging specific groups at the expense of the collective found its way into the 1988 Constitution, given the way it was drafted by the elected members of Congress. Nevertheless this inclination of the Constitution has not been innocuous as its content has frequently been exploited by politicians, parties,

¹⁴ Here we refer to “true” constitutions rather than the numerous sham constitutions that are window dressing but are not statements of guiding beliefs.

social movements, judges, district attorneys and even individuals to significantly affect governmental policies and decisions. This has become increasingly the case in Brazil given the independence of the judiciary and the extreme 'constitutionalization' that has evolved in Brazilian Law.¹⁵ The fact that the judiciary has become a major locus of policymaking in Brazil implies that the anti-authoritarian bent of the Constitution does in fact have palpable consequences.

A key change that was squarely compatible with the new belief and that would corroborate the above mentioned impact of the new Constitution was the extension of the franchise that took place with re-democratization. Figure 3 shows the evolution of the proportion of total population that effectively voted for President and Congress from 1894 to 2006. Only in 1985 did Brazil authorize the right to vote to illiterates, so the first time that a majority of the Brazilian population voted for President occurred in the 1989 election. The previous presidential election had been almost 30 years earlier and less than 20% of the population voted in that election.

Although Congressional elections took place during the 1964-1985 period, these were clearly of a less significant nature. This implies that the political scenario initiated in the 1990s was remarkably different than anything that the country had ever experienced before. The incentives of politicians were thus of a very different nature than those of previous periods. This is particularly true and relevant for the case of the President given the strong presidentialism that prevailed after the 1988 Constitution.¹⁶

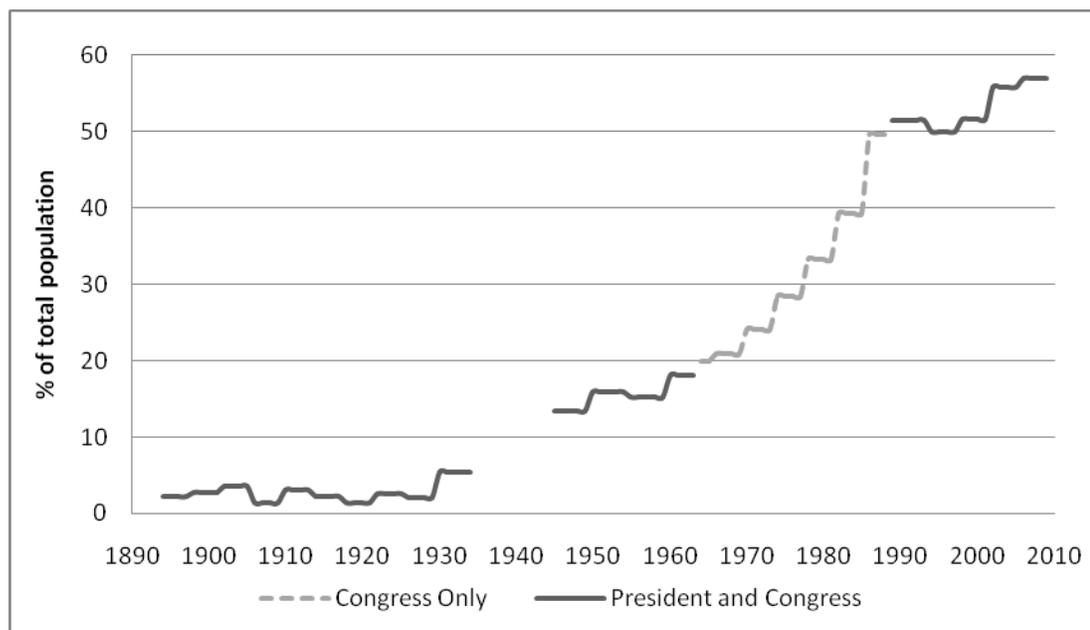
More than in any other time in Brazilian history there were strong electoral incentives for policy to pursue the public good rather than private interests. This effect has probably grown over time becoming stronger in each subsequent election as voters and politicians have come to understand and believe in the new rules of the game. Similarly, bad electoral practices which were the norm in the past are clearly being shed, such as clientelism, vote buying and the

¹⁵ Increasingly over time Brazil tied the hands of politicians by making a 'law,' a constitutional amendment. In addition after the Constitution many parts had to excised as constraining the ability of the government to meet its fiscal target. We will discuss this in detail on our chapters addressing the two terms of Cardoso.

¹⁶ Brazil authorized very strong powers to the executive branch relative to most Presidential systems. The executive in Chile has similarly very strong powers of agenda control.

use of public office by incumbents in the electoral race.¹⁷ The inception of greater political openness, equality and inclusiveness changed the negative approval along the political dimension which had prevailed throughout the authoritarian period.

Figure 3 – Percent of total population that voted for President and Congress, 1894 – 2006



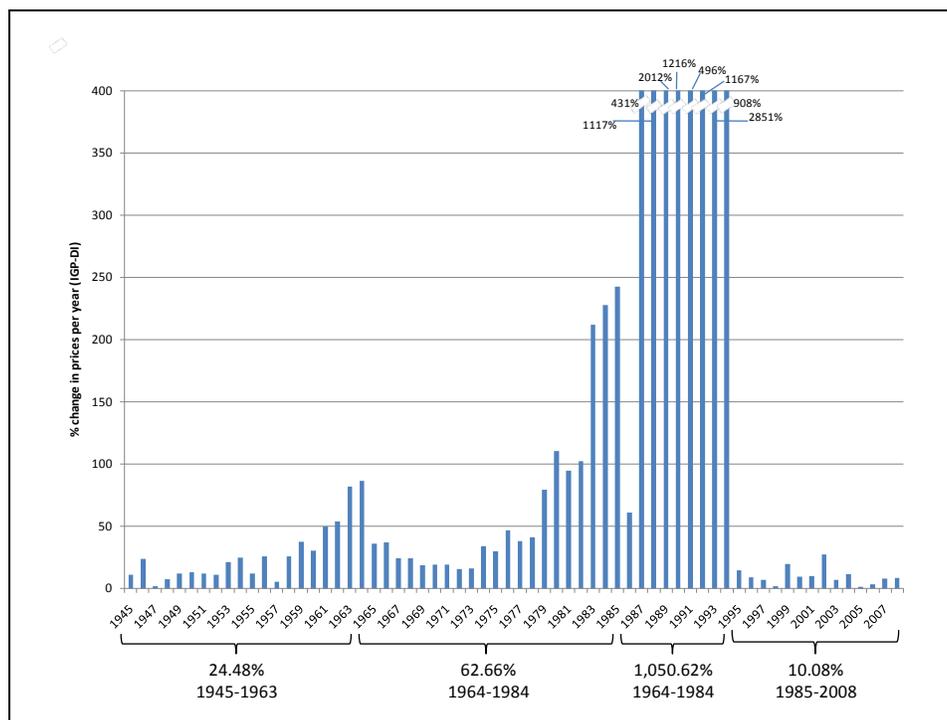
Source: Nicolau (2003) and Tribunal Superior Eleitoral for the elections of 2002 and 2006. The data is for the total number of voters that actually voted and not the number eligible to vote. Data for Congressional elections is for the period after 1933 and is very close but not identical to that for Presidential elections.

Along the economic dimension, however, dissatisfaction was not eliminated. Although the new civilian government radically altered fundamental economic policies, economic outcomes deteriorated. In Figure 4 we show that average yearly inflation increased from 98% in 1974-1985 to over 1000% in the 1985-1994 period. Over the same period, GDP growth fell from 4% to 2.8%. The new levels of inflation are so high that they could not be shown proportionally in Figure 2. In order to provide more detail, Figure 4 shows the yearly inflation levels from 1945 to 2007, yet even here it was not possible to fit the 1985-1994 period in the graph at actual

¹⁷ Today elections in Brazil are widely recognized as fair and well run, with a competent Electoral Tribunal in charge and, since 2000, 100% computerized voting which increases the speed of the process and reduces the possibility of fraud (Kinzo, 2004; Sadek, 1995). The fact that the Electoral Tribunal has removed from office since 2000 more than 460 mayors and vice-mayors and 5 governors shows that there are still abuses of electoral practice. More importantly, it shows that contrary to previous periods in Brazilian history effective enforcement mechanisms have started to evolve that dissuade those practices.

scale without making the other years indiscernible to the eye. This was not simply another bout of high inflation that had been recurrent in Brazilian history. This was in fact a Weimar Germany-style hyperinflation with all the associated pain and disruptiveness.

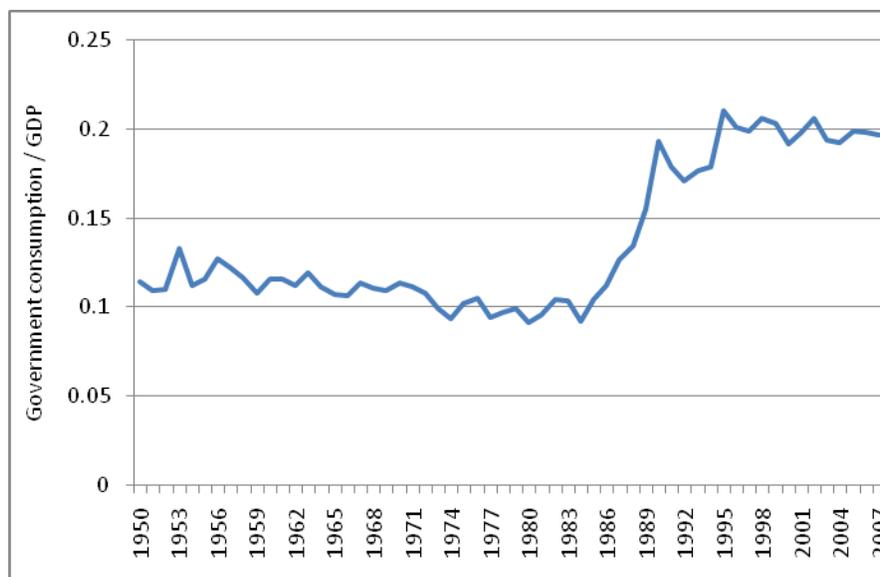
Figure 4 – Inflation in Brazil 1945 – 2008, % per year



The adoption of new economic measures caused the hyper-inflation bouts. The choice of policies was firmly rooted in the new anti-authoritarian belief and was a natural reaction by the new coalition seeking to redress what it saw as the errors and injustices of the previous government. This belief led to a strong presumption that policy would thereafter be inclusive and promote social justice. The 1988 Constitution epitomized this process not only in terms of political rights, as noted above, but also by distributing economic benefits to large arrays of the population. An example of this is the extension of social security and pensions to non-contributing rural workers. This has had an important redistributive effect but at the same time added considerable pressure to the system's precarious financial balance. Other examples are the universalization of education and health, and the guarantee of job stability to civil servants. Together with these social and universalistic transfers in the Constitution, interest groups also managed to embed their own particularistic transfers and so insulate them from future

alterations. The result of this unmitigated inclusiveness was naturally a sharp jump in public expenditure. Figure 5 shows the distinct upward shift of government expenditures as a percentage of GDP that resulted from re-democratization and the 1988 Constitution. Clearly this abrupt doubling of government expenditure is causally connected to the surge in inflation that was observed at precisely the same point in time.

Figure 5 - Government Expenditure / GDP, 1950 – 2007



Source: Central Bank of Brazil in IPEADATA.

The ten years of hyperinflation that followed re-democratization were a time of economic distress and uncertainty. Inflation at this level systematically reduces real incomes, drains government effort from other policy domains and wreaks havoc on any attempt at planning for the future by individuals, firms and government. It is a tax that falls disproportionately on the poor, quickly wiping out the gains achieved through the new inclusive policies. Even those who had access to financial instruments that afforded protection from rising price levels were nevertheless bogged down by the substantial transaction costs and uncertainty that inflation unleashed. When salaries have to be corrected almost monthly to keep their value, labor relations become strained and strikes endemic. Similarly, when delaying a payment by even one day can yield a significant gain in the overnight market and at the same time a significant loss to the creditor as prices will rise in the meantime, the probability of conflict and litigation over contracts increased greatly. These ten years witnessed several

economic plans devised to end inflation. In the few cases where the plans managed to stem the rise in prices, the effect was fragile and temporary, eventually reverting to even greater inflation. Repeated failures undermined the hope that stabilization was possible. To many it came to seem that inflation, with the accompanying pain and disruption, had become an inherent and unavoidable characteristic of Brazilian life.

By the early 1990s the situation was arguably becoming set for some sort of coup, as public opinion became increasingly disillusioned with the merits of the new institutional arrangements. Instead, what took place was the *Plano Real* in 1994 and the sudden demise of inflation. How this window of opportunity arose, why it was successful and what resulted will be analyzed below. First we need to describe the second belief that we contend has been crucial in the recent transformation in Brazil. It is a belief that is very much in effect in the present day and underlies the entire policymaking process constraining choices and actions, as will be shown in detail in Chapter X. This belief is based on the notion that inflation is perverse, impending and to be avoided at all costs.¹⁸ The collective strife of the hyperinflationary decade created an implicit understanding of the kind of policy that translates into inflation and a tacit consensus that such behavior should be curtailed. This does not mean that political opportunism was eliminated and that interest groups no longer pressured for redistribution. It does mean that there were now countervailing forces to those natural instincts. When voters instinctively understand the link between the price level and fiscal and monetary discipline, politicians, and in particular the President, have greater incentives to pursue better macro-economic policies. In this sense the combination of increased franchise and the inflation-aversion belief had an important impact having set the tone of all Presidential administrations, independent of party affiliation, establishing a clear precedence of fiscal and monetary discipline over other demands.

In many instances the anti-authoritarian belief and the inflation-aversion belief are in direct opposition to each other. In such cases which one prevails? When Lula came to office in 2003 his flagship project was the Zero Hunger Program which had the noble goal of eliminating hunger and sub-nutrition throughout the country. Although the program proved to be popular

¹⁸ Germany today still holds this belief.

from the outset, with individuals, firms and celebrities vowing to help, it was eventually sidelined and ostracized by the President himself, who quickly perceived the greater importance of consolidating and maintaining monetary stability and fiscal discipline. As with this example most policy choices since 1994 have shown that the anti-austerity belief takes precedence over the anti-authoritarian belief. This does not mean that inclusiveness and citizenship are no longer important policy objectives, but rather that they depend lexographically on monetary stability before they can be directly pursued.

The details of how inflation was finally tackled by the *Plano Real* in 1994 and the important changes that ensued will be discussed in a subsequent chapter. Here the interest is to continue the analysis of Brazilian development through the lens of our framework. As shown in Figure 2, the period after 1994 can be seen as a one with a new configuration of power and set of beliefs, which succeeded the one which prevailed since 1985. As we have seen, the previous situation had led to substantial political openness but displayed the poorest economic performance in several decades, with average GDP growth of only 2.8% and quadruple digit inflation. As a result, there was widespread dissatisfaction and pressure for change. The success of the *Plano Real* resulted in both positive political and economic outcomes, the first time we see such a result in Figure 2. Average inflation fell by two orders of magnitude and GDP started to grow at a moderately higher pace with significantly less variation and uncertainty.¹⁹

The claim being made is that the post 1994 ‘status quo’ dynamic has some important features that has lead the country along a virtuous path of development in which both political and economic competition and openness have taken root and have been consistently evolving. It is a period when the rule of law has been significantly extended to greater portions of the population and where political and economic institutions have gradually evolved in ways that increasingly sustain impersonal economic and political exchange. The implication of our claim is that this new ‘status quo’ set of beliefs will continue to lead to greater institutional strengthening and economic growth. Because both the economic and political dimensions have reached stable positive outcomes, positive feedback will tend to reinforce the beliefs in place

¹⁹ The standard deviation of GDP growth from 1985 to 1994 was 3.82 while the figure for 1995-2008 was 1.95. Whereas Brazil exhibited slower growth than many other countries in the same period, such as Argentina, the process proved to be more sustainable over the long run.

though there is always the possibility that a big enough exogenous shock can knock the country off that path.

This is not a trivial claim. It goes against much of the received wisdom that highlights the deep structural, social and cultural problems inherited from the past and sees the recent changes stressed above as merely superficial and not addressing the deep-rooted causes, such as inequality, corruption, and a flawed political system. The claim also flies in the face of most Brazilians, who in our experience often counter it with a list of the recent scandals, negative statistics and examples of the daily absurdity from the morning paper. How can this claim be made, the reasoning goes, in a country where such things can happen? We will not attempt to defend our claim in this section. This will be left for Chapter X where we present the facts and discuss how the data in favor and against our claim can be considered, given that this is an issue where there is no single 'smoking gun' piece of evidence, but rather where the verdict must be reached through a preponderance of circumstantial evidence.

The purpose here is to understand the process that led to the transition from the previous configuration of power and beliefs to the new set of power and beliefs. If we are correct that this transition has led the country to a virtuous path of development, then it is important to understand how and why this has happened as it is clearly an exceptional achievement in the modern world and, in the light of only a few years ago, in the most unlikely of countries. The idea is not that the process can be replicated directly elsewhere, but rather to understand the more basic elements that operate in the developmental process. In particular we stress the role of beliefs, power, leadership and windows of opportunity.

In order to understand the shift in power and beliefs that took place in the mid-1990s it is important not to be fooled by the benefit of hindsight into perceiving the changes that ended inflation and started reforming the country's institutions as inevitable. By the time of the *Plano Real* the country had been mired in hyperinflation for nearly a decade and a large number of explicit economic plans and other assorted policies had been tried, yielding only temporary reprieve and collapse back to what increasingly seemed an inescapable order of things. Given the cumulative experience of previous failures each new attempt at dealing with inflation and associated macroeconomic problems elicited less and less hope of success. In contrast to the

public elation generated by the first few months of the *Plano Cruzado* in 1986, the *Plano Real* was greeted with resignation and skepticism. As we noted above, the protracted cost of inflation on firms and individuals made the likelihood of some form of political upheaval ever more likely. If this was what democracy had to offer, then many might be less resistant to some other form of government that might offer less suffering and hopelessness. Although this could come about through a military coup, given the anti-authoritarian belief and the experience of other Latin American countries in the same period, it could also come about in the form of a Chavez-like government in Venezuela. Alternatively the series of stabilization plans could have continued indefinitely and even have been successful, following the general trend in Latin America, yet without initiating a process of deeper institutional change. The question is then: why did the the *Plano Real* succeed and why did institutional deepening transpire in its wake?

Once again, here we want to answer this question not in its specific details, but more generally in the light of our framework. As shown in Figure 2 the *Plano Real* is interpreted as a window of opportunity in which a jump was made to a new configuration of power with new beliefs. Because the change took place when it did it may seem with hindsight to have been obvious or preordained. This is because we are aware only of those windows of opportunity that have been acted upon and have materialized. Many other windows of opportunity that open are not perceived or realized and therefore leave no legacy. In this sense windows of opportunity have a strong element of serendipity in that they are unpredictable and unexpected. This does not mean that they are simply happenstance. Although windows of opportunity come about unplanned and often by surprise, they require that someone be able to recognize and act upon the opportunity. This is where leadership becomes important.

It is quite possible that other events prior to the *Plano Real* had presented windows of opportunity for change, such as the Constitution of 1988 and its failed revision of 1993, or the impeachment of Collor in 1992, or even some other instance of which history books are now unaware. During those periods the dissatisfaction with the economy was sufficiently large to generate a demand for change. Yet it was only with the *Plano Real* that the shift to a new set of beliefs took hold. In Chapter X we provide the details of the circumstances behind these events. Several key elements contributed to allow such a shift. The first was the fact that the prolonged

hardships of life under hyperinflation made society more willing to accept sacrifices that held the promise to lead to a solution to those problems, though as noted before past failures made each new attempt seem increasingly futile. Already in 1990 the Collor Plan revealed this willingness to sacrifice when the government announced a surprise freeze for 18 months of all but a small margin of the populations' bank deposits and savings accounts. A measure that in other circumstances might lead to despair or rebellion, in a situation of 80% inflation per month, the population accepted the Collor Plan with passive resignation. The second contributing element was the lack of a coherent game plan by the opposition, due to scandals and other political events that we detail elsewhere. In addition, the cumulative experience with failed plans as well as lessons from other countries that were undergoing similar problems had increased the knowledge of the kinds of policies that work and especially the kind of policies to avoid.

Yet even with all these elements in place there was nothing inevitable about the way things turned out. Realizing that the elements were there, and could be exploited in a very precise way to reach an envisioned outcome required leadership in the form of an individual or a group that was serendipitously at the right place at the right time with the right powers so as to coordinate the necessary actions. Despite the facilitating circumstances noted above, change of this magnitude requires persuasion and coercion to overcome disperse and specific resistance, actions which were all the more difficult in Brazil given the limits imposed by the anti-authoritarian belief.

We view the leadership roles played by Fernando Henrique Cardoso and his economic/political team, as an essential element in the shift to a new set of beliefs that resulted in the end of inflation and the start of a long period of reform that dramatically changed the nature of the Brazilian economy, polity and society. Cardoso's role started as finance minister with the coordination of the team that devised and implemented the *Plano Real* in 1994, so as to realize the window of opportunity that had presented itself. More importantly it continued with the capitalization of the popularity that arose from the success of the plan so as to initiate a process of long term structural reform that not only modernized and liberalized the economy in many important ways, but more importantly established political

institutions and other arrangements that would lock-in and reinforce that direction of change by affecting the constraints and incentives of individuals, organizations and especially politicians. These institutions and arrangements created an evolving set of property rights, checks & balances and a rule of law that we see as the foundation of the virtuous developmental path that the country has since pursued. These institutions will not be detailed here as they are the main topic of several of chapters in this book.

Once the new configuration of power and set of beliefs was reinforced by institutional deepening, the role of leadership took a qualitative change. Although the decisions of the leader are still important in navigating the country forward, and through the mishaps and hazards along the way, they are nevertheless decisions within the prevailing the bands of the new status quo of beliefs and power; and not decisions that impel a jump to a new configuration of power or set of beliefs. In this sense the leadership of Cardoso lies mainly in the recognition of the latent belief in the priority of macro stabilization and the establishment of an institutional environment where the government pursued all other objectives subject to this preponderant macro stability constraint, as well as the secondary, sometimes conflicting anti-authoritarian constraint. Once this dynamic path had been accepted, by the second term of Cardoso (1999-2002), the leadership role of the President receded to the background. The country was by then on 'auto-pilot' in the sense that changes became incremental within the prevailing configuration of power and set of beliefs. The strongest evidence of this interpretation is the unexpected conversion of President Lula to the macro stability constraint and further institutional deepening along the same lines initiated by Cardoso, culminating with Brazil becoming investment grade and poised for higher rates of economic growth and political openness.²⁰

²⁰ President Dilma Rousseff's economic team remains committed to a belief in macro-stability as its top priority: 'Inflation is my permanent preoccupation' Guido Mantega, Finance Minister of Brazil (Financial Times July 13 2011):8

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