The political economy of emergence: shifting ideas and political coalitions

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Introduction

The idea that trade and finance are the two pillars of a globalized economy is far from new. Yet, it was only in the late 90's that they came to be closely associated with the narratives of emergence, in connection with the changing modes of integration of large emerging countries into the global system. Then (as now), understanding their comparative responses to economic globalization required that we situated trade and financial policies in the context of the political economy of developing countries: the interests, institutions and ideas that shaped their trajectory away from "the periphery".

The 2008 global crisis and the convulsions in the Eurozone brought to center stage a shift of focus in the way global governance – as a set of ideas and practices and as a set of challenges is approached. In the last six years, the actual mode of interdependence between trade and finance has been perceived as one of the critical deficits in global governance, alongside the question of re-regulating the world economy. On one hand because trade and finance operate under distinct international regimes, regulated by norms set in different institutional jurisdictions , the WTO and the IMF respectively: partly because those institutions differ in their analytical perspectives and enforcement capabilities. On the other hand, the Great Recession highlighted changes in North-South relations, driven by important shifts in the pattern of international trade. Respectively: the intensification of South-South trade transactions and the fact that the largest emerging market countries comparatively less dependent on trade with core industrialized economies did not suffer sharp recession, as in the past. Rather, countries like China, India , Brazil, Indonesia experienced a comparatively quick rebounding in terms of growth rates. In all of them, moreover, recovery was coupled with sustained redistributive policies initiated in the immediate pre-crisis period. Their positive impact in terms of poverty reduction and of upward

social mobility, is well documented: quite independently from the prevailing political regime, the massive emergence of new middle classes attests to a process of social inclusion than was not hampered by brief inflections in their rates growth .

Four developments have interwoven into a larger shift in North-South relations. First, the pace at which South-South trade transactions increased, due mainly to the gravitational pull of China. Second, the introduction of politically sensitive questions related to the interdependence between trade and finance in the international agenda. Namely: the impact of exchange rate misalignments on international trade policies and export promotion; and a growing sense of the "exorbitant privilege" enjoyed by a crisis-hit US, as the reserve currency issuer. Third, the fact that large emerging market countries had "adjusted" to the pre-crisis global conditions in ways that rendered them less vulnerable to external shocks. In other words, what financial markets reckon "the fundamentals" were in place. Also, measures geared at re-regulating their domestic financial sectors and/or establishing safety nets against moral hazards had been adopted in the aftermath of acute instabilities engendered by financial liberalization. Most importantly, the traditional pattern of financial relationship with core industrialized countries was overturned: most large emerging market countries had turned from traditional debtors into creditors, due to a defensive policy of reserve accumulation.

How new narratives of emergence approached those sharp variations in North South relations - highlighted but not engendered by the Great Recession? In what ways post-crisis narratives in the aftermath of the global crisis differ from the more recent ones , arising out of new developments such as the gradual economic recovery in core industrialized democracies; and the (more sobering) sense of an increasing diversification of large emerging countries in terms of their post-crisis performance , including their international standing , their creditworthiness, and their chances to access to the "top tables" ? As the concern with a great contraction recedes, and the rebalancing of the world economy accelerates, the very notion of global economic governance is being recast and in flux. So are the narratives of emergence focused on the expected role of rising powers, and second tier states in global economic governance. These questions will be explored in this paper as a key component of the ideational and policy shifts underlying two essentially unresolved political questions .

How best to rebalance the world economy? Can we still speak of North-South relations as a structuring feature of the international system?

Understanding the comparative responses to the changing international system requires that we situate the influence of trade and finance not only in the context of the political economy of large emerging market countries, but also the politics that shape their policy choices. It requires that we look for the domestic foundations of the relevant post-crisis adjustments: and these must include the political regime within which policy decisions are shaped.

Those questions will be explored in connection with the post-crisis policy choices in Brazil for two reasons. First , because it provides some clues about the political and ideational factors that may influence the decision-making processes in the context of an emerging market democracy. Second, because Brazil is actually at a cross-roads: in terms of her actual mode of integration into the world trade system and of her adherence to the financial and monetary disciplines adopted in the late 90's; and in terms of her prospects, concerning the transition from a middle income country to a high income country.

II. **Post crisis narratives**

The 2008 crisis and the macroeconomic instability in the Eurozone have highlighted the limits of the "dualized" narratives of emergence based on a postulated "one model fits all" approach to North-South relations. Likewise the familiar set of assumptions (and questions) on which they rested were are questioned and contested: how fast and under what conditions those states and societies would internalize the liberal tenets associated with integration into a western-led international system – and to an unquestioned global system? As the era dubbed the "Great Moderation" by the Governor of the FED, Ben Bernanke, came to end and the long period of macro economic stability enjoyed by the US revealed itself temporary, the mode of integration of emerging countries into the global system has been a matter of much rethinking. From 2010 on it has been framed in the context of a new *problematique,* dubbed as "The Great Rebalancing" in the policymaking circles of core industrialized economies. In what follows we introduce the ideational and power shifts underlying the approaches to North-South relations in the post crisis context.

Our reading - and criticisms - of the relevant narratives are based on the following set of propositions. First, when it comes to "rebalancing", differences among emerging powers must be unpacked. Defining and explaining the varieties of emerging market countries (EMC) is conceptually and empirically pertinent to situate them properly in terms of the global processes of power diffusion – and consequently, in terms of their differential chances of accessing to the 'top tables" in global institutions. This calls for an accurate diagnosis of how their mode of integration into the world system impinge upon their chances to get there as credible players. Second, while the centrality of trade and finance remains an essential component of the rebalancing processes, understanding the differential responses to the 2008 crisis require that we situate trade and financial policies in the context of their trajectories of integration. From this longer-term perspective, it matters to determine whether their actual policy choices *followed* previous experiments in economic liberalization, as in India, Brazil, Indonesia, Korea, or Turkey - or are part of a consistent longer-term strategy geared at using trade and finance as instruments of international power building , as in China. Set against this background, policy reactions and common statements in international *fora* on the responses of the US to the Great Recession, in particular its monetary activism acquire different meanings. They may represent defensive firewalls against the pressures of capital mobility, experienced in the past in the form of or financial crisis. Or, alternatively they are a consistent strategy of national power building, that is to say of "economic statecraft" in the sense first used by Hirschman and explored by Baldwin[1]. Thirdly, understanding varieties of emerging market countries require that we consider what *politics* produced their trajectory. In this regard, a major principle of political differentiation is whether the relevant policy choices were framed in a democratic framework or at least in a context of democratization or not.

While ideas about trade and finance as pillars of economic integration of emerging countries into the global system are far from new, this time is different in two important senses. For one, their actual role in economic governance unfolds in a background of a growing politicization of one of the most depoliticized areas of economics namely, financial and monetary theory. Interstate conflicts are often cast in monetary terms, such as "currency battle', "exchange rate manipulation" and

[1] Hirschman, A.O, 1945, National power and the structure of foreign trade; Baldwin D. 1986, Economic statecraft. Leslie Armijo, 2013

"quantitative easing"; while the "exorbitant privilege" attached to the dollar is now a matter of contestation and of much rethinking also in the US [2]. The crux of the matter is that now they unfold against an unprecedented power shift, already mentioned: the gradual transformation of large developing countries *from debtors into creditors*. Insofar as this new development is tied up to their trade and financial policies in the pre-crisis period, geared at neutralizing their exposure to contagion and to recurrent and protracted foreign exchange crisis, they are a key component of their trajectory. Moreover, as holders of foreign reserves mainly in dollars, they form a new contingent of politico-economic players with a direct interest in the management of the crisis by the US authorities and in the way the world economy is rebalanced. This brings to center stage the question of how such power shifts impinge upon the perception of North-South relations. For this reason it matters to know how their diversity as well as their distinctive features are perceived and acknowledged in terms of their economic standing and of their use of financial/monetary instruments..

II- Shifting Perspectives

The changing narratives of emergence in the post-crisis context provide a few clues to situate how ideas are being adjusted to new facts of trade and finance and how the power shifts that accompanied them are pictured in the North and in the South.. Over the last six years, narratives about North-South relations changed three times. A first ideational shift in the immediate post-crisis context, characterized by a shared intellectual framework: large developing countries and industrialized democracies alike responded to the threat of a Great Depression by resorting to various kinds of fiscal and monetary activism. A second shift followed : by the end of 2010 to mid 2013, a "two models fit all approach" was driven by the concern with the slow pace at which core industrialized countries responded to unconventional policies, in contrast to the economic dynamism of emerging countries. At this stage the world economic system was perceived by many , following Ben Bernanke's predicament, as "a dual economy". [3] In this narrative, the diversity among rising powers and second tier states is practically neglected. A third shift corresponds to the current

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[2] Eichengreen, 2009
[3] Bernanke, 2010

landscape: the existing diversity among emerging powers and third-tier states is perceived and acknowledged – but in accordance to the familiar standards established by rating agencies, financial investors and the IMF. Emerging countries are now regrouped in terms of their comparative vulnerability to volatile capital flows and other "external shocks" - attesting to the centrality of finance in the post crisis international system. While Brazil, India, Turkey , Indonesia fit in the "vulnerable" group, China' stands alongside some East Asian emerging market democracies like South Korea, Taiwan, in the cluster that make their transition to "high income" countries. As it will be seen next, each stage corresponds to different economic junctures.. The second one corresponds to the period when large emerging markets were reckoned the engines of the world economy in terms of growth, in contrast with the US and Western Europe mired in recession and unemployment. The third, corresponds to the current stage when the US economic recovery and the hopes attached to bilateral trade agreements between the US and *selected* developing countries as well as with the EU are brought home as key political components of economic rebalancing.

What kind of monetary activism?

The contrast between the immediate post-crisis and the 2010-13 junctures provides some clues about the shifting economic context within which politicization of monetary issues becomes meaningful. In the first two years, central banks and finance ministers around the world converged on a proactive monetary strategy to circumvent the risk of an imminent depression . A conflict-minimizing approach to the unconventional remedies adopted both by the *deficit countries* in the North and by *surplus countries* in the South was coupled with activation of the G20 almost from scratch. In other words, the immediate response to the 2008 crash, was marked by cooperation and by *a shared intellectual framework* anchored on a countercyclical monetary and fiscal activism . The management of the crisis, consequently, was premised on the empowerment of national monetary authorities as a key sub-state actor. It paved the way for a transition toward a change in their mandated functions, from checking inflation to financial stabilization. While this took the more extreme form of bailing-outs in the US , where the follies of finance and failures of

regulation were brought to center stage, large emerging countries could resort to the more conventional -and politically less costly - macroeconomic tools, such as credit and monetary expansion. In this sense it is accurate to look for a common policy denominator underlying the immediate responses of large emerging countries to the crisis. And also to relate their comparative resilience and economic stability to their past policy choices, driven by the commitment to prevent future financial crisis.

Thus, when it comes to pre-crisis policy choices it is possible to pinpoint a common pattern, that holds for , Brazil, India, for instance (alongside Korea and Turkey) but not for China. In those former cases, policymaking revolved around the quest for a second or third-best judicious trade off, between trade and financial liberalization, on one hand and , on the other policies that strengthened the regulatory and oversight powers of monetary authorities over their financial systems. These were combined with prudential policies and with foreign reserve accumulation. In short, as long as this set of pre-crisis policy had a defensive character and unfolded in a context of democratization, one can speak of a *shared policy framework* driven by similar policy challenges.[4]

The politicization of monetary issues in interstate relations dates back to end of 2010 and marks off a second shift in the way the challenges in global governance were approached in the North and in the South. From then on, currency became a matter of concern in multilateral agencies and transnational organizations: at the start, in connection with the relationship between a weakening dollar and a reinmibi deemed too inflexible by western economic analysts. The debates in the 2010 IMF Annual Meeting prompted by Olivier Blanchard's diagnosis of "what should be done" brought up front stage the principal question underlying the currency debate: how to rebalance the world economy? In economic parlance: how to ensure the redistribution of the adjustment costs between deficit and surplus countries, respectively the US and other North Atlantic countries on one hand and rising powers on the other.

From then on, as subsequent debates in the G20 have shown, it became clear that expectations of a cooperative game were premised on too strong assumptions. Namely, that unconventional monetary remedies and the fiscal *stimuli* adopted in the US would work as effectively to promote the country's economic recovery as they

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[4] Whitehad, L, 2006.

had been to check depression. By November 2010, in an address to western central bankers in Frankfurt Ben Bernanke, remarked that the evidences of a "two-speed" recovery called for a "more fundamental rethinking" of the interactions "between developing and advanced economies". As it will be discussed next, while this situation was a matter of anxiety in policy-making circles, private investors pictured emerging countries as the major engines of the growth and their dynamism was heralded as a new era of sustained growth.[5]

As is well known, ambivalence marked the reactions of large emerging powers to new rounds of quantitative easing. The upside aspect was that they turned to be a comparatively safer and profitable haven for private investors, improving on the investment opportunities offered by the size of their markets. The downside dimension was the currency appreciation vis a vis a depreciated dollar, with negative implications in terms of their export capabilities. For the purposes of this paper, what matters is to underscore the shifts in the analytical focus prompted by that mode of monetary activism - and how they impinged upon the narratives of emergence. It engendered two polar reactions, both of which rested on a "two model fit all" approach to rebalancing. In the North, it was centered on a biased unspecified version of the transformative processes that shaped the integration of emerging countries into the global system well before the 2008 crash. In the South, criticisms of QE1 and QE2 were also cast in monetary terms, voiced mainly by the Brazilian finance Minister, Guido Mantega in terms of a "currency war", and by President Dilma Rousseff as a (liquidity) "tsunami".

To account for the differential impact of QE1 and QE2 a line must drawn between those emerging countries which had pushed trade and financial liberalization far enough as to adopt flexible exchange rate regimes – and those which had not. Brazil , South Africa, (alongside Chile, and Korea) had adopted floating exchange rates in response to previous financial crisis.[6] This policy had aimed at restoring their creditworthiness and to attract back foreign savings indispensable to restore growth. The differential impact of US monetary activism therefore is better explained in terms of the nature – and sequencing - of the firewalls imposed to capital mobility :

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[5] City Group e, Mckinsey, Pricewaterhouse Coopers economists, in particular, excelled in projecting that image - often internalized by domestic policy makers in the relevant countries.

[6] Although in most occasions, their governments resorted to a trade off, intervening in the exchange rate markets to check the inflationary impact of free floating or to provide new incentives to exporters.

whether in response to exchange rate liberalization or as an instrument of economic statecraft. Accordingly, a key related criteria for assessing the extent of liberalization is the mode of operation of Central Banks: in most cases that policy shift was inseparable from a degree of operational autonomy vis a vis the the Executive. In those cases, the politico-economic logic underlying the tensions created by quantitative easing may be represented as follows. The appreciation of national currencies vis a vis the dollar generated by renewed inflows of foreign capital, entailed greater competitive losses in conditions of flexible/ floating exchange rates. Ironically, the reading of the US monetary activism voiced as "currency war", "exchange rate manipulation", or characterized as (liquidity) "tsunamis", by the Brazilian authorities, is the inverted mirror of those narratives put forward by macro economists and office holders in the US and the UK. While those criticisms reflect a shift of focus regarding the relationship between "rule-takers" and "rule makers, those claims are ideologically overloaded and biased, and are a special version of the "two models fit all" approach.. For a number of reasons that will explored in the next section.. First, they skirt over all too easily the distinctive features of China's illiberal monetary practices. Second, a critical factor of the appreciation of the Brazilian currency, the Real, was the spectacular increase of trade and financial transactions with China. The unspoken reason for the competitive losses of the Brazilian industry lay in the constraints posed by the composition of the policy coalition, integrated by the less modernized sectors of the Brazilian industrial and their pressures for more protectionist policies in response to the 2008 crisis.

The perspective of the North regarding both the "downhill" movements and the "uphill" flow of trade and capital, that characterized North-South relations from the 2010 on was brought by Martin Wolf (2011), in the Financial Times, in a nutshell:

"The private sector has *long* been trying to send a large flow of capital from the world's relatively sluggish rich countries to its dynamic emerging ones. But the governments of the latter have *resisted* by intervening in foreign exchange markets and sending the capital back as official currency reserves. But forces now at work in the world economy seem likely to bring this recycling to a natural end".

In retrospect this diagnosis tells more about a "purely macroeconomic" approach to emergence than about what happened thereafter. While Wolf correctly assesses the "new" logic underlying capital mobility - and eventually the challenges it posed to

capital recipient *market* economies - this mode of recycling was not brought to a natural end as suggested. It is against an unsettling tug-of-war that the narratives of emergence by a selected group of North Atlantic economists become meaningful. While they address the complexities of interdependence before and after the 2008 crisis and relate them to the delicate task of rebalancing – they rely on a specific depoliticized version of the "two models fit all " approach.[7] Because their picture of emergence rely only too much on the experience of China, lumped together with all other large emerging countries their approach to "rebalancing" is conveniently reductionist .They brush aside the consequential diversification of the emerging economies in terms of the financial and trade policies that led to different modes of insertion in the international system, and in terms of their prospective role in global governance. Thus, Mervin King, then governor of the Bank of England, Alan Taylor and Manoj Pradham, from the University of California at Davis converge on the issues involved in what they call "The Great Rebalancing". According to this approach , the emerging countries past policy choices – are characterized in terms that go beyond the so-called "savings glut': for the form and direction that the savings flows took would have "*helped to create the conditions for the disaster*". Thus, Mervin King, in the 2012 February's issue of the *Financial Stability Review* (Banque de France) focus on the impact of the uphill flow of savings on the advanced economies by packing them up in a general form - as summed up and endorsed by Wolf (2011)

"This "uphill" flow of capital from poor to rich countries, predominantly into supposedly safe assets, had important consequences: a reduction in the real rate of interest; a rise in asset prices, particularly of housing in several countries, not least the US; a reach for yield; a wave of financial innovation, to create higher yielding, but supposedly safe assets; a boom in residential construction; and ultimately a huge financial crisis. The underlying determinant was a surge in savings in already surplus regions even greater than their rise in investment".

While this analysis underscores the complex interactions and patterns of interdependence between North and South in the pre-2007 context , the underlying narrative of emergence hardly fits the experience of Brazil, India, Korea, or Turkey and South Africa. In the first place, because it is not so evident that "*a surge in savings in already surplus regions* even *greater than their rise in investment"* applies

[7] In what follows I rely mainly on the sources provided by Martin Wolf in his Financial Times article mentioned above – and on his own endorsement of the relevant arguments.

to them all. Likewise Mr King's explanation for the uphill flow of savings packs up a set of different factors that are not applicable to emerging economies other than China – at least not in that aggregate form. It includes : 1) a shift towards export-promotion, which created the need for highly competitive real exchange rates; 2) a decision to accumulate foreign currency reserves, in the aftermath of the financial crises of the 1990s; 3) the combination of low levels of financial development with inadequate social safety nets, which encouraged higher savings. To account for the diversity of pathways followed by emerging countries, it is necessary to identify whether or not those factors apply to individual cases and/or to a group of cases judged relevant: both in terms of their responses to the external shocks that characterized the 90's and in terms of how they impinge upon their actual mode of integration into the global system.

As suggested, these narratives are inseparable from a distinctive approach to " the "Great Rebalancing", for a number of reasons. First, because they highlight one of the limitations of a "purely macroeconomic" approach to what is a quintessentially political question: the redistribution of the adjustment costs involved. Second, and consequently, they fail to account for the fact that future adjustments will take place in an international context where the processes of power diffusion under way keep within narrower limits the chances of dominant powers to transfer the costs of their adjustments, as in the past. Thirdly, they miss important structural changes regarding South-South trade relations in contrast to the decreasing role of North-North transactions and the slight growth in North-South ones as figures 1 and 2 show.

Taylor and Pradhan (2011)'s paper for Morgan Stanley, entitled *The Great Rebalancing* illustrates those points. They claim that, as governments in the North are left with huge deficits and the private sector is bound to deleverage, *if such deficits are to be reduced, while sustaining recovery, massive shifts in the external balance are needed*. This would involve a shift from export promotion to domestic consumption, and to investments in infrastructure as the major sources of demand, *a reduction in the huge rate of savings* and a substantive reversal in the policy of official reserve accumulation. Those are indeed prescriptions that rely far too much on China's long-term trajectory of integration and do not apply to all other emerging powers. As figure 2 shows the share of reserve accumulation by China is much bigger that observed in all other BRICS taken together. Also the pattern of trade

transaction between South – South , North-North and North South , represented in figure 1 point out to a greater complexity than suggested in those analysis.

Wolf's prediction that "forces now at work in the world economy seem likely to bring this recycling to a natural end" were optimistic

Optimistic predictions such as those skirt over other components of the recycling process: the gravitational pull of large emerging powers over private capital was this time anchored not only in the investment opportunities inseparable from the size of their markets, but also because in *in almost all cases, the macroeconomic "fundamentals" were in place*. Moreover, the crisis provided new reasons for the "uphill" flows of capital from poorer to richer countries in the guise of official foreign reserves. After 2008, *the pattern of uphill capital mobility* was strengthened, by risk aversion on the part of the relevant governments: hence the preference for US treasury bonds notwithstanding their unattractive yields. With exception of China, in all other cases that pattern reflected a defensive response to a situation of unequal monetary power: based on the exclusive power of the US as a reserve-currency issuing country.

It is against the unsettling background of renewed monetary activism in the North - that the differences among emerging economies must be set. The claim that " the resistance shown by governments of the latter", "by intervening in foreign exchange markets and sending the capital back (to the North) as official currency reserves" lumps together policy responses that do not correspond to the same politico-economic logic. Their focus (and the political target) is China. Technically, because intervention in foreign exchange markets" is part of the Bank of China's monetary toolkit (alongside those of Japan and Switzerland) but not of other emerging countries. In the latter's case as they are partially liberalized/liberalizing, the state is being brought back in order to prevent currency appreciation and further losses in competitiveness. In China, by contrast, it has long been a matter of long term strategy of integration into de global system - not a defensive firewall against the unsettling economic environment engendered by the monetary policies of deficit countries such as the US. As it will be shown next, China's intervention in the foreign exchange markets is unique mode of monetary activism: one where trade and finance have played a strategic role in crafting new conditions of national sovereignty - inseparable from the slow and politically controlled pace at which liberalization are carried out. It

differs from large emerging market economies on two important aspects: in terms of the nature and function of the "firewalls" against external shocks; and in terms of the patterns of diffusion – and of embeddedness - of the liberal tenets underlying their respective development strategies. It is crucial therefore to explore those differences in order to identify how the use of monetary tools relates to the growing politicization of monetary issues - *in a context of unequal power to dispense/restrict liquidity to the international system*.

What kind of politicization? Where do we stand?.

During the 2010-2013 period, the US monetary authorities claimed that they were not engaged in a "currency battle" or on an "exchange-rate war". Technically, they were right. The appreciation of developing countries' currencies was partly a side-effect of their monetary policies to check economic contraction in their respective jurisdictions. What is at stake, however, is a decreasing tolerance for the FED's prerogative to expand or to restrict global liquidity, as issuer of the major reserve-currency. This ideational shift reflects a structural change in trade relations: a dramatic increase in South-South transactions since the late 90's , in particular with China .[8] While it paved the way for large developing countries to reduce their dependence on trade with core industrialized economies, its monetary effects in terms of currency appreciation have been conveniently neglected or minimized. In Brazil for instance , it is "the China's' effect" that explains better the appreciation of the Real: the country's trade balance shifted away from a deficit position in the 90's to a to a US$ 40 billion surplus p.a from 2003 on. The fact that narratives on currency appreciation in the South focused predominantly on the FED's policy – and neglected the part played by China's gravitational pull brings out a key dimension of the politicization of monetary issues.

To keep in perspective the criticisms from finance ministers in the South, voiced in multilateral *fora,* it is fundamental to draw a line between *two kinds of monetary activism*: the practiced by the FED, on one hand and that implemented by the central

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[8]For detailed information, see *Unctad Handbook of Statistics, 2013*. And Unctad's site]http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=673&Sitemap_x0020_Taxonomy=Statistics;#20;#UNCTAD Home;#4;#Globalization and Development;#1644;#Economic Cooperation and Integration among Developing Countries

bank of China (alongside those of Japan and Switzerland on a much minor scale). Only the latter represents a genuine intervention in exchange-rate markets, characterizing "currency manipulation". This distinction is critical. First, because it helps to identify more accurately the issues involved in the calls for "the Great Rebalancing" emanating from the North. Second, because it brings to the fore the narrower limits set to hard monetary "protectionism".

By resorting to successive rounds of QE the FED targets an expansionary *credit policy*, geared at re-establishing the conditions for economic growth in the US and at preventing j*obless* recovery. The objective of the European Central Bank, in turn, is to create new markets for the bonds issued by the relevant European treasuries. Conceptually, neither may be characterized in terms of exchange-rate wars. What is new is that both are exercises in a harder variety of monetary sovereignty: one where core central banks have been empowered with more discretionary powers than warranted by their admitted condition of last resort lenders.[9] Above all it reflects a significant *departure from the patterns of diffusion* exported (often enforced) to the South in the pre-crisis context - and from the economic orthodoxies that prescribed a de-politicized, independent central bank.[10]

From the perspective of the South, the "uphill" flow of capital from large emerging market economies to rich countries has long been driven by a policy of reserve accumulation as a hedge against the liquidity crises experienced in the 90's and 80's. Indeed, they do share with China a policy of reserve accumulation held mostly in dollars and in this condition they share an interest in the long-term appreciation of the US currency as well as the Euro's. What is distinctive about China's monetary activism is the scale of the "savings glut" and of foreign due partly to intervention in the local as well as in the international exchange- rate markets to prevent the appreciation of the reinmibi, to ensure a sustained export drive.[11]

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[9] Clearly new political skills are being required – and exercised – by the President of the ECB – to manage the crisis in the Eurozone. See Sola (2012).

[10] We deal with the changes underlying such power and ideational shifts elsewhere. Here it is sufficient to remind the reader that throughout the era of globalizing capital (since the late 70"s) central banking "best practices" were based on the assumptions that circumscribed its fundamental role to inflation and price stability. Much rethinking is taking place since as to the institution's function as financial stabilizer - which includes regulatory powers *inter alia.*

[11] It works this way: the Bank of China uses the proceeds from exports to intervene in the exchange-rate markets; and, by pegging the reinmibi to the dollar, China has a direct interest in the appreciation of the US currency.

Figure 1 - **Share of reserves in selected emerging countries – China x other BRICS**

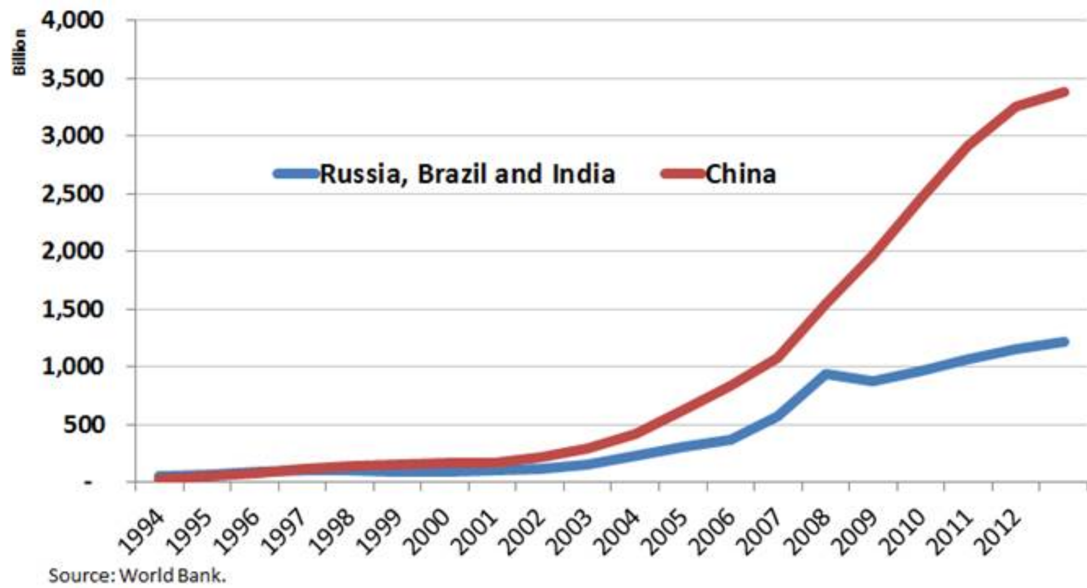
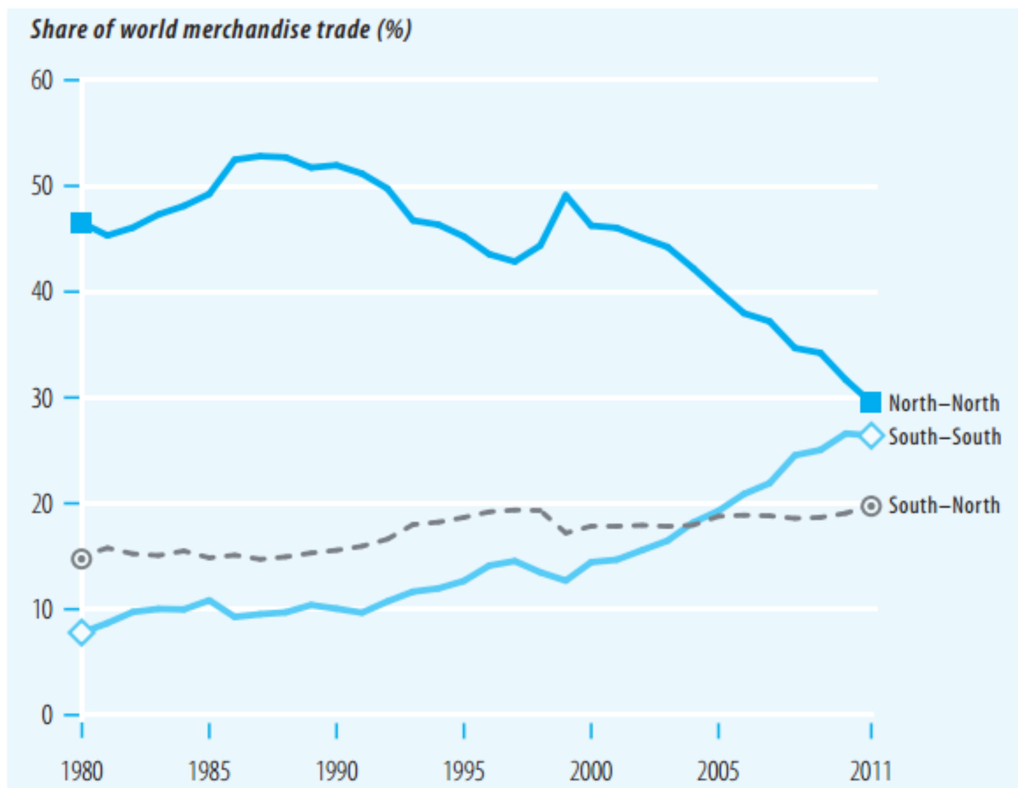


Figure2. Trade: North-South, North-North, South-South

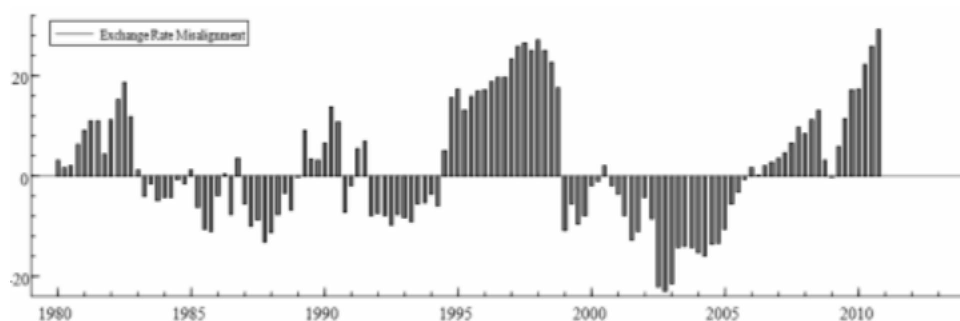


The more recent reactions against the US monetary activism have been coupled with a more general contestation of the unequal distribution of monetary power made explicit by the currency misalignments that benefit China as well as the US The chances of changing those power asymmetries in the short term are close to zero, not only within the sphere of a reformed IMF , due to the the US dominance but also in the G20 arena..

Figure 3 shows the misalignments between the Brazilian currency and those of the US and of China. While the former is appreciated by 29% , the the US dollar and the reinmibi are depreciated by 10% and 17% respectively. [12]

Figure 3 -Exchange rate misaligments- Brazil x US and x China [13]

BRAZIL



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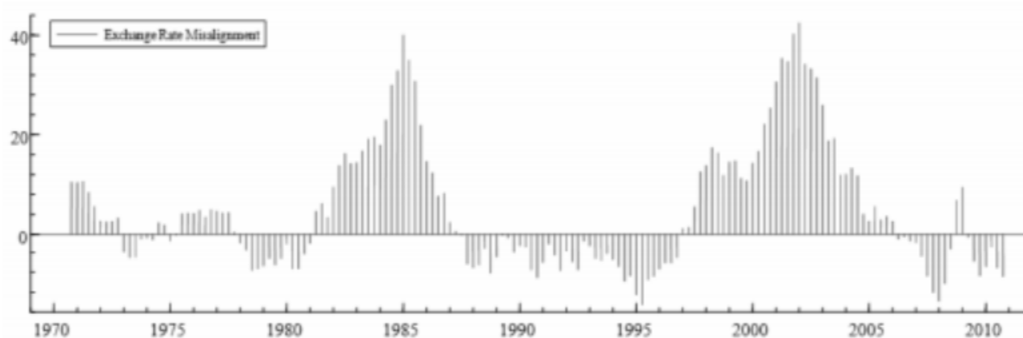
[12] Misalignment is an econometric index that measures the deviation of a country's actual exchange rate vis a vis an ideal exchange rate – which is where a country's external accounts would be in equilibrium. To capture that, the relevant index is based on three calculations, respectively : the terms of trade; the country's position in terms of foreign investment and productivity index.

[13] In Vera THORSTENSEN, Emerson MARÇAL & Lucas FERRAZ **"Exchange Rate Misalignments and International Trade Policy: Impacts on Tariffs", Journal of International Trade.**

USA



China

By mid 2013, ideas about emergence were again adjusted to new "facts" of trade and finance as the economic standing of large emerging powers was revised and refined.

The third narrative: varieties of emerging powers

Since mid-2013, some "facts" regarding the economic standing of rising powers and second tier states have been overturned. As the emerging world is slowing down, and the prospects of US recovery improve, as tapering reinstates the power of the FED to withdraw liquidity, narratives of emergence are recast, reflecting visible changes in the investor's perceptions.[14]. The debate now focus on their diversity in terms of macroeconomic performance, and of the systemic impact of their policy choices.

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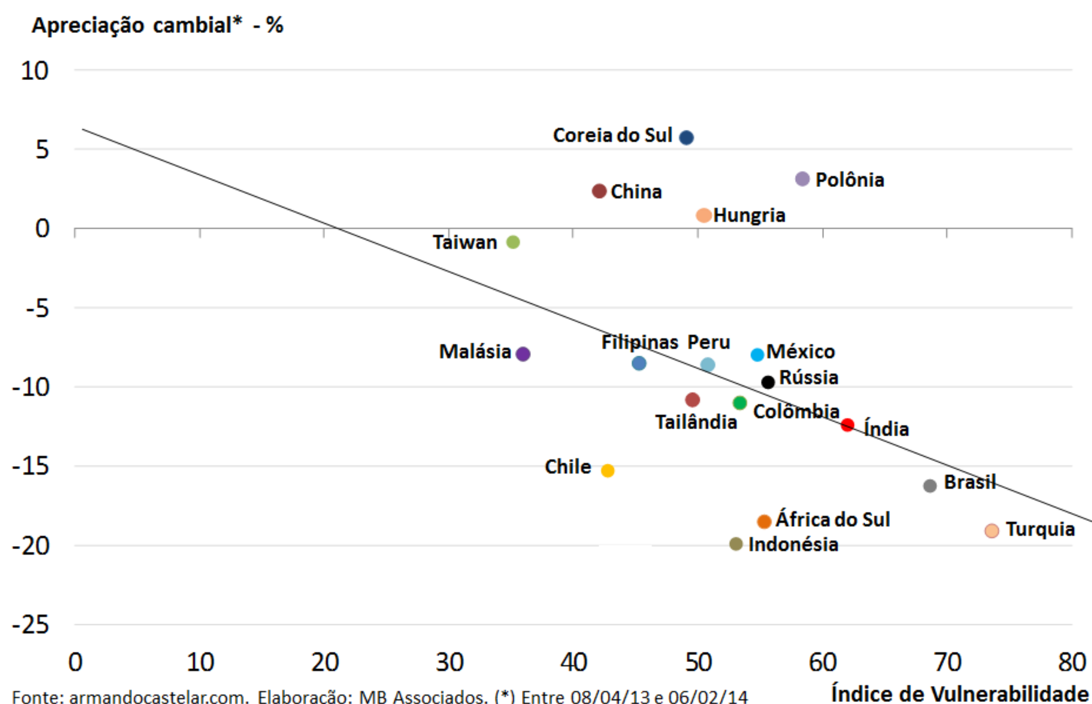
[14] Dani Rodrik, "E a morte virá pelas finanças", in *Valor Econômico*,11/02/2014.

Judging from the last reports on the world economy, from the IMF, the OECD and from the FED in particular, the vulnerability of *some* large emerging countries has become a major source of anxiety. While Brazil, India , South Africa, Turkey and Indonesia belong to this group, and risk to lose their " investment grade", others like Korea, Mexico, Peru stand well in terms of creditworthiness. To draw the line between those two subgroups, criteria such as solvency alongside a number of macroeconomic indicators, compound a complex vulnerability index. [15] (See figure 4). Currency depreciation vis a vis the dollar, driven (partly) by tapering, is held by many analysts just the starting point of a process where deep-rooted problems must be dealt with by domestic (elected) politicians. Narratives in this vein come from diverse quarters and include traditional critics of mainstream economic orthodoxies. Dani Rodrik for instance, points out that India and Brazil face similar challenges : both countries are bound to review their growth models and to initiate a new cycle of reforms to ensure a reasonable degree of insulation from market jitters.

Figure 4 - Currency Appreciation x Vulnerability Index.



While ideas about global economic governance are being adjusted to new "facts" of finance and trade and to the US monetary policy, it is increasingly clear that

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[15] The relevant indicators are: debt/GNP, inflation average in the last three years, exports/debt, GNP in the last three years, variation in bank credit to the private sector in the last 5 years, foreign reserves/PIB , public sector nominal account, foreign direct investmet/ PIB.

"rebalancing " is now conceived in terms of *variety of emerging market countries and of rising powers*. However, even a cursory reading of the reports mentioned suggest that the actual differences among them are accounted for according to macroeconomic criteria only.

Our proposition is that the varieties of large emerging powers are better accounted for by regrouping them according to two additional criteria. One is how the challenges inseparable from globalizing capital were approached and managed from the 90"s on. A key dividing line is whether flexible/floating exchange rates had been adopted as the major mechanism for absorption of external shocks – following the pattern established by *some* core industrialized democracies. This was a strategic policy choice insofar as the liberalization of the exchange rate is inseparable from two economic and political shifts. Respectively: the *centrality of finance and of market actors* in the management of domestic economies; and the *commitment to inflation control* as a key condition to attain creditworthiness. In other words, we approach the relevant choices as a structuring feature of a distinctive mode of integration into the world system – and of the politico-economic framework within which domestic policymakers were bound to operate since the late 90's . Moreover as long as this framework was shared by countries held vulnerable and non-vulnerable today we have a starting point to anchor explanations for their subsequent divergent paths. Thus, while Brazil and Korea responded to the "external shocks" with similar policy toolkits in the late 90's they differ significantly in terms of their actual international standing .

A second cleavage relates to the *centrality of democracy* as a set of procedural and substantive constraints to economic management *and* to the pace at which the adjustments required by a shifting global context, are carried out. The question at stake is how those vulnerable countries , struck the delicate balance between a reform-oriented international agenda, on one hand, and on the other the transformative processes and demands inherent to mass democracy . (And conversely, how the democratic non-vulnerable countries managed to reconcile those goals). This brings us to another more sensitive question: all countries held vulnerable - Brazil, India, South Africa, Turkey, Indonesia - share the condition of *emerging market democracies – and* also the *experience of* having liberalized their trade and financial system in a democratic context , or at least in a context of democratization.

Based on the experience of Brazil , we hypothesize that domestic narratives of the post-crisis international context and of the country's new-found standing in the international system have a bearing upon the policy shifts that explain why some of large emerging market countries find themselves at a crossroads. This brings to the fore a more general question: how the 2008 crisis was interpreted and narrated by policy-makers and democratically elected politicians? How the bonanza years of 2010-213 were filtered down domestically, and which factors contributed to the policy choices that shaped a model of growth , and of coalitional politics distinct from the pre-crisis mould.?

III – Narratives from Brazil and beyond.

The idea that economic narratives may have a strong bearing on the actual performance of a country's economic system is far from new. Theorizing their influence through the mechanisms that shape expectations of private investors, consumers, policy makers and elected politicians is a major contribution of the rationalist revolution. Yet, three topics remain understudied: the longer-term politico-economic conditions that help to explain how effective or fragile those "economic-related stories" can be; the part played by elected politicians to make them credible; the role of deep-rooted ideas through which validation of policy changes and of vested interest are sought.

Robert Shiller, the 2013 Nobel Prize in Economics, hinted at two of those topics in connection with the downbeat intellectual climate prevailing in core industrialized countries since 2008. In the aftermath of a recent tour to Japan, he remarked the "lack of understanding the rest of the world has about positive changes triggered off in Japan by Abenomics . In times of uncertainty , he says

"We seem to be at the mercy of our narratives. Ever since 2009, most of us have just been waiting for some story to turn our hearts aglow with hope and confidence – and to reinvigorate our economies."[16]

In Brazil ever since 2008, economic-related stories, in particular those appropriated by incumbent politicians and economic policy-makers offered a reversed image: an

[16] In www.project-syndicate.org - march 2014.
"Since Prime Minister Shinzo Abe assumed office in December 2012 and launched his program of monetary and fiscal stimulus and structural reform, the impact on Japanese confidence has been profound. According to the International Monetary Fund, the output gap – the difference between actual and potential GDP – narrowed from -3.6% in 2011 to -0.9% in 2013".

upbeat climate - seconded by specialized international media until mid 2013.[17] . Which conditions made them possible and credible? How to account for President Lula's famously publicized assertion that in Brazil, " the 2008 crisis is no more than a ripple (in a calm ocean)"? Understanding the responses to the "sudden stop" in subsequent years requires that we situate finance and trade in the context of the political economy of emerging market democracies, as well as the expectations raised by the post-crisis domestic narratives – insofar as they are reflected in the policy shifts that followed. These may be outlined in few strokes. One, a recombination of the state and market forces, under the egis of an increasingly proactive state enabled to mobilize financial resources channeled to selected "winners" in the private sector by a powerful system of state banks and state corporations. Two, a foreign policy and trade diplomacy focused on multilateralism, on preferential trade agreements with an enlarged Mercosur, and bilateral agreements with China and a few peripheral countries. Three, a model of growth based on the enlarged consumption of the domestic market as the major form of "social inclusion", driven by distributive policies including transfers to the poor, wage and credit policies aimed at the emerging middle classes..[18]

Four factors were interwoven to make those policy shifts and economic-related stories viable and credible up to mid-2013: 1) "the fundamentals" were in place and during his first term President Lula (2003-2006) was committed to keep the policy agenda that had ensured macroeconomic stability; 2) the unprecedented international bonanza ever experienced by the country, driven by the commodities boom and by de extraordinary inflow of foreign capital, from 2004-2011, and the dramatically positive impact on the trade balance 3) a long-standing ideology and a problem-solving style underlying the strong statist/nationalist bias in the dominant party, the Partido dos

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[17]. The most striking oscillation between an upbeat and a downbeat narrative in the international media are found in *The Economist's* two successive editions. The 12/11/2009 one, *Brazil takes off,* where the country's performance and prospects are grossly exaggerated, and inseparable from biased interpretations of empirical evidences. In an opposite, compensatory vein, the *Economist's* 28/09/2013 edition , *Has Brazil blown it?* highlights the country's economic, political and social weaknesses in terms of lost international opportunities. For a critical account of the diagnosis underlying both editions, see Marcelo de Paiva Abreu, "Cristo Metafórico", *in O Estado de São Paulo, Economia*, 09/07/2014, p. B2

[18] Improvements in the social front in terms of poverty reduction and of decreasing social and regional inequalities, combined with the massive increase of emerging middle classes - all of which ensured a dynamic internal market for the entrepreneurial elites.

Trabalhadores (PT); 4) a new variety of state capitalism driven by the way economic liberalization had been filtered down throughout the 90's and by a system of interest intermediation based on a state corporatist structure established since the 1930's

In what follows those factors will be explored in connection with the policy shifts that affected the role played by trade and finance in the country's mode of integration into the international system . They will be situated in the context of the political economy of emerging market democracies. In this regard, as relevant as the interest groups that have participated in the new policy coalition, the political institutions and ideas that kept that coalition in power, are the transformative processes inseparable from the way economic liberalization was carried out from the 90's on.

The political economy of a liberalized financial regime – Brazil and beyond.

One of the most distinctive features of the policy choices that preceded the 2008 global crisis during President Lula's government is the recombination between the existing liberalized financial and monetary regime, on one hand, and on the other a selective trade policy , which kept trade liberalization within narrower bounds as compared to the opening moves initiated by Collor de Mello and Cardoso. Trade was geared at strengthening preferential trade agreements (PTA) with an extended Mercosur, intensifying transactions with China and Africa, while averting the gravitational pull of the US-led trade agreements. [19] While this recombination responded to the imperative of reassuring the financial markets, by keeping in place the liberalized monetary and financial regimes introduced in 1998, it reflected a deliberate policy shift in terms of the country's insertion in the world's trade system. What made it possible was a longer-term, more structural transformative process. Namely, the rise of new varieties of state capitalism, in which the state works hand in hand with private investors in novel (often more efficient) governance arrangements.[20]

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[19] This was an integral part of a broader foreign policy thrust to project Brazil as a leading coordinating power in terms of other large emerging coutries, and a power foreign broker not only in Latin America, but also in the Middle East,.

[20] Musacchio, A. and Lazzarini, S., 2014, and Lazzarini, 2010.

Understanding the *politics* of those policy choices requires, in the first place, that we situate them in the context of the political economy of special set of emerging market democracies: those that engaged in a liberalized monetary and financial experiment in order to avert further external shocks. It consisted of the the combination of a floating exchange rate with an inflation target regimes - following the pattern established in advanced democracies to check the macroeconomic instability inseparable from capital mobility. A brief reference to those experiments will help us to highlight some of the key common features shared by this variety of emerging countries–which justify to approach them as a cluster. Also, insofar as its adoption in Brazil impinged upon the adherence of finance to the social coalition that backed President Cardoso, and later on President Lula's two terms (as well ad the election of Dilma Roussef) , it paves the way for a broader investigation regarding the context-specific centrality of finance in the relevant countries . .

There are many reasons why those experiments were made credible: they were conceived as reliable instrument to reconcile the need to put in place what the financial markets reckoned the "fundamentals" , while improving the conditions of democratic management of the economy. Conceptually and practically the inflation target regime is inseparable from the adoption *of a floating exchange* rate - in the wake of successive economic crisis that highlighted the economic and political costs of a fixed exchange rate policy. [21]More importantly, it is a policy mix that improves transparency and predictability as it brings to public knowledge *in advance* the rate of inflation agreed upon by elected politicians – and managed by a central bank endowed with a degree of *operational* autonomy . From this perspective, politicians as well as market analysts were enabled to control and to evaluate how effective the central bank's management and the economic models on which they rest are achieve the agreed target. The new policy mix aimed at creating the conditions for the reintegration of most emerging market democracies into the international system

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[21] The new monetary regime , therefore was s dictated by economic and by *political* necessity, insofar as a fixed (or pegged) exchange rate, was held the critical factor to explain the vulnerability of a large number of new democracies to the fluctuations of globalized capital. The inflation target regime , on the other hand, introduced a predictable medium-term mechanism to manage the impact of exchange rate fluctuations..

as creditworthy partners.[22] It proved effective in the emerging market democracies that adopted them: average inflation was substantially lower and sustained after its adoption.

Table 1. Inflation Target regimes: countries and date of adoption

	Date of Adoption Inflation Targeting	First Target	Inflation Right Before IT Adoption	Inflation 12 Months After IT Adoption
Developed Economies				
Australia	Apr-93	2% - 3%	1.22	1.74
Canada	Feb-91	3% - 5%	6.83	1.68
Iceland	Mar-01	2.5% (-1.5%+3.5%)	4.05	8.72
New Zealand	Mar-90	3% - 5%	7.03	4.52
Norway	Mar-01	0.03	3.64	1.10
Sweden	Jan-93	2% (+-1%)	1.76	1.70
Switzerland	Jan-00	<= 2%	1.63	0.90
United Kingdom	Oct-92	1% - 4%	3.57	1.35
Average		**2.8%**	**3.72**	**2.71**
Median		**2.5%**	**3.61**	**1.69**
Emerging Market Economies				
Brazil*	Jun-99	8% (+-2%)	3.15	6.51
Chile	Jan-91	15% - 20%	27.31	19.47
Colombia	Sep-99	15%	9.22	9.35
Czech Republic	Jan-98	5.5% - 6.5%	9.98	3.5
Hungary	Jun-01	7% (+-1%)	10.78	4.87
Israel	Jan-92	14% -15%	18.03	10.74
Mexico	Jan-99	<= 13%	18.61	11.03
Peru	Jan-94	15% - 20%	39.49	13.71
Poland	Oct-98	<= 9.5%	10.44	8.82
South Africa**	Feb-00	3% - 6%	2.65	7.77
South Korea	Jan-98	9% (+-1%)	6.57	1.46
Thailand	Apr-00	0% - 3.5%	1.04	2.47
Average		**10.3**	**13.11**	**8.31**
Median		**9.3**	**10.21**	**8.3**

* In Brazil, the inflation of the period previous to the adoption of inflation targeting was in part a result of the overappreciation of the domestic currency

**First target established for 2002

The dates in Table 1 indicate that in all cases, the new regime was adopted in the aftermath of a financial crisis , based on the similar experiments carried out in *some*

[22] Its impact Brazil's reputation was specially remarkable: it had been badly hit by the country's default in 1987 - and the mega-inflation that followed.

advanced democracies. The conditions that prompted the choice of that policy mix were partly shared with them while others were context-specific. In all cases, it was prompted by the need to reconcile two objectives: attracting foreign investments in countries where the savings rate was held unsatisfactory, while reducing the macroeconomic volatility that characterized the globalized world economy. Another set of conditions, however . is context -specific. They relate to the pressing need to reconcile both goals in a context characterized by fragile institutions, lesser credibility, including that of their respective central banks and the magnitude of their vulnerability to external shocks. In a paper where the politico-economic aspects of the new regime are theorized, Arminio Fraga the former President of the Brazilian Central Bank , underscores its general positive impact on two grounds: in terms of inflation performance and in terms of the enhanced credibility of the monetary institutions..

"under inflation targeting [emerging economies] face the challenge of breaking the vicious circle between, on one side, low credibility and more fragile institutions, and, on the other side, higher macroeconomic instability and vulnerability to external shocks.".

A distinctive feature of those experiments in emerging market democracies consisted in adding a fiscal prescription to the monetary disciplines just described. This was driven by the recognition that "fiscal dominance", - the tendency to resist fiscal discipline – reflects an inherent institutional weakness. To be effective and restore market confidence, an additional requisite was prescribed: fiscal surpluses to cover debt service.

Macroeconomic policies, however, do not explain why most emerging market democracies fared comparatively well in the post-2008. Institutional reforms, including a stricter regulation of the financial institutions and the implementation of "safety nets" limited dramatically the scope for moral hazard. [23] In countries such as Brazil , Chile, and Korea , for instance, the liberalization of the monetary regime was coupled with the attribution of greater regulatory and oversight powers to their respective central banks. Those reforms (alongside the shifts in those country's coalitional position in terms of international trade) - paved the way for the comparative invulnerability of the relevant emerging market democracies to the

[23] Sola explored the financial reforms in Brazil, in connection with the empowerment of the Central Bank and the o dramatic reduction in the chances to bail out both private and state banks reckoned "too big to fail" in Sola and Whitehad, 2006

global crisis. While as a general rule, the new regime reflected a significant shift toward *market-friendly monetary policies,* in practically all cases these were combined with a redesign of *state capabilities, that enabled public authorities to avert future crisis: the re*-regulation of the financial system, *and the empowerment of the central banks with new oversight functions.*

This policy mix provides the background against which the *coalitional position of finance* in those democracies must be understood, that is its role as a "pivot sector": one that due to its its power resources not only affects policy decisions but also affects the outcome of a conflicting situation when switching sides.[24] Understanding the comparative responses of the emerging market democracies to the global crisis requires that we situate how such a coalitional position is perceived and articulated by elected politicians into a broader coalition of social interests. It requires also that we situate the assumptions underlying the ideational shifts on which they new political realignments are premised. In other words, it requires that we bring to center stage domestic politics. This point will be explored next in connection with the processes that framed the responses to the 2008 crisis in Brazil.

The global inside the national and the politics of a policy coalition

The question of how the global gets partly structured inside the national has been extensively theorized in connection with advanced industrialized democracies.[25] The idea that the national is one of the terrains for the global, and that it includes sub-national spaces, processes and actors, underlies most of the recent analysis about how the agenda of economic globalization has ben internalized and eventually *embedded* in those countries. Among the theoretical and methodological implications of this approach, two are specially pertinent to address the varieties of emerging market countries. One is that the challenges posed to "state-centric" social sciences, are perceived in a different light, as compared to those posed by the binary global versus national. A second one relates do the issues that acquire prominence for the study of emerging market democracies. How the global gets embedded inside the national?

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[24] Gourevitch, 2013, uses this concept in connection with the "centrality of finance" in the post-crisis USA, while I will use it recombined with the centrality of the State, based on the case of Brazil

[25] Sassen, S., "The State and globalization" 2008 , in Hall, R.B., Biersteker,T. eds. The Emergence of P"rivate authority in global governance, 3a.ed. Cambridge: Cambridge University Press, and "

Insofar as the relevant processes develop in "a national territory, that is, in a geographic terrain inserted in a set of national laws and of administrative capabilities" [26] the intermediation of state institutions also gains prominence - even when it comes to explain the state's (partial) withdrawal. It matters, therefore, whether those processes develop in the framework of a democratic state.

Yet, while those structural dimensions are necessary conditions to account for the variations we are interested in, a set of questions remain unanswered. What *politics* explain the variations and commonalities in the responses to the 2008 crisis? To address this question a more context-specific analysis of is needed . The experience of Brazil may offer a few clues for further comparative analysis. From this perspective, what *politics* shaped the policy coalition that prevailed during President Lula's two terms (2003-2010)? What politics explain the recombination between market friendly financial policies, on one hand, and on the other, the selective bias inseparable from the preference for trading partners less committed to free-market, western-led policies? Finally, what politics underlie the widely shared sense that Brazil is now at a crossroads, making it more difficult to keep that coalition in power ?

Changes in the country's economic performance provide a convenient background to set those questions in perspective. [27] From 2004 to 2011, the unprecedented international bonanza –estimated a 10% of GNP - was engendered by a commodities boom and by the extraordinary inflow of foreign capital. This made possible to fund the huge increase in domestic demand (including some increase in a comparatively low rate of investment), and in GNP growth, *combined* with distributive policies that ensured a significant improvement in income distribution[28]. Moreover, no inflationary pressures were observed. Other, context-specific factors contributed to this outcome: 1) exchange rate appreciation, due mainly to transactions with China; 2) the growth prospects driven by the structural complementarity between the two economies; 3) the

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[26] "The global inside the national, A research agenda for Sociologoy" in *Sociopedia*.isa, 2010

[27] I draw from the narratives by Edmar Bacha (2013) , and by Antonio Delfim Netto (2014) deliberately, to underscore two points: 1) what is common ground, what is not between economic analysts that participate in rival political coalitions respectively: the PSDB and the PT; 2) where their diagnosis coincide with the narratives from international actors and agencies.

[28] Improvements in income distribution are evidenced by the 68% increase for the poorest 20% - and 31 % for the richest 20%. In, Delfim Neto "Finalmente o Brazil sem Burocracia?", *Valor Econômico*, 08/07/2014 .

demographic bonus ; 4) the massive incorporation of the workforce into the service and the productive sector.

For the subsequent four-year period (2011-2014), instead, average GNP per capita is estimated to grow at 1%, while the rate of inflation is above the agreed target: indicating that the economic euphoria was only temporary and that it was due to factors *of a cyclical nature* rather than to the agency and foresight of economic policy-makers. In this context, one of the most striking features of the Brazilian pattern of development comes to the fore: notwithstanding the proactive trade (and foreign) policy in the last eight years, Brazil stands out as one of the most closed emerging market economies. Its economic isolation is indicated by the share of exports in GNP, just 12.5%, which in turn represent just 1.3% of the world total. [29] Most economic analysts converge in relating this poor integration into the world trade system to the political factors that constrained the Brazilian government to take full advantage of the bonanza years and to initiate a new round of structural reforms...[30] Situating those factors in a broader perspective is the object of the next section.

President Lula's two arms: trade and finance

The politics that cemented the policy coalition during the euphoria years is far more complex than a reductionist economic explanation would warrant. It may be characterized in terms of as a skilful and rather pragmatic series of balancing acts, where the incoming President Lula combined two complementary moves, involving quite distinct *political* pay-offs and costs. On one hand the imperative to defer to the acute market pressures in order to restore the country's confidence, by keeping in place the monetary and fiscal regime and by completing the social security reform – bequeathed by his predecessor President Cardoso. On the trade end, a selective but limited openness policy, driven by investment opportunities abroad and by a proactive foreign policy geared at projecting Brazil's leadership in the "South". For reasons to

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[29] According to Bacha, in terms of GNP , Brazil share is 3.3 % of the world total, which is 2.5 times higher than its share in world exports..

[30] Reforms would be geared at increasing the average productivity of the economy, and involve both the transformations in the legal framework but tax and labour reform geared at overcoming the technological backwardness , the insufficient scale and lack of competitiveness of the country's industrial sector . See Bacha, E. , 2013,

be discussed next, the latter move was politically less costly and required fewer balancing acts as compared to the former.

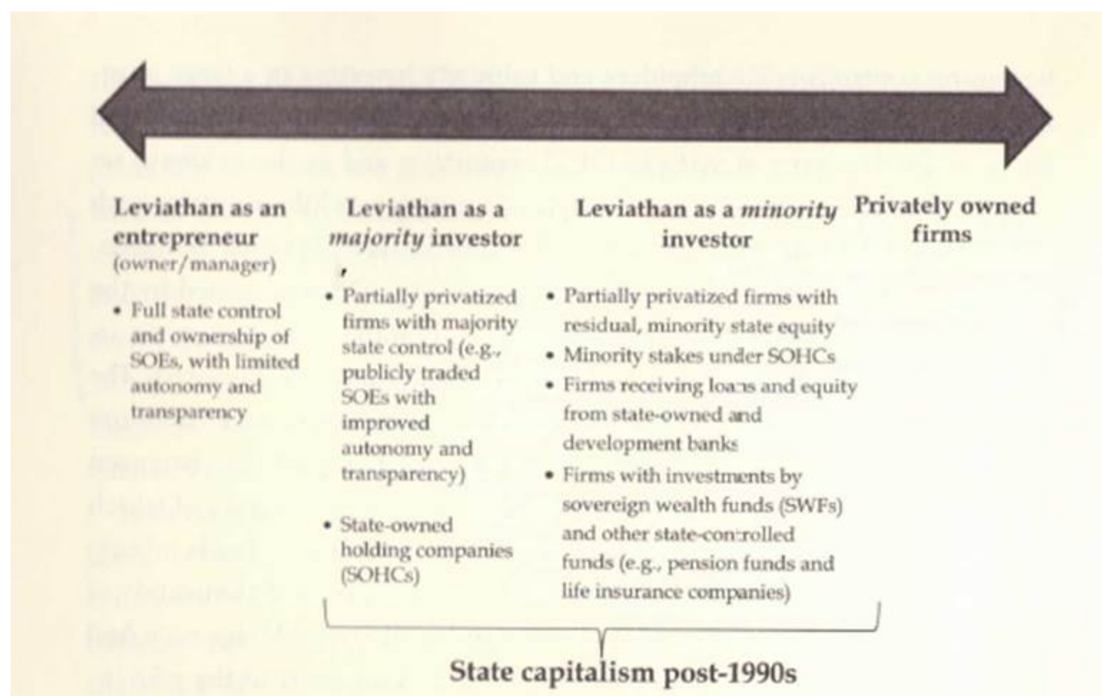
The trade policy goals highlight the quest for new strategic realignments, with developing countries and the Brics, less committed to market-friendly, western-led policies.[31] Respectively: exploring the trading opportunities provided by the complementarity between the Brazilian and the Chinese economies; strengthening transactions with Africa and the South American more protectionist axis (Argentina in the Mercosur, Venezuela and Bolivia); the active refusal to integrate the US-led multilateral trade agreements such as the FTAA and or to engage in bilateral agreements such as the Transpacific TPTA. These initiatives provide a background against which the socioeconomic sectors that participated in the policy coalition are intelligible.

Figures, 4 and 5 show the main direction of trade transactions. Even a cursory look at them suggest the diversity of the economic sectors involved. They include the most dynamic and technological ones, such as mining and agro-business industries, and the less advanced manufactures that operate increasingly within the more limited space of Mercosur and the rest of South America. To those must be added two other critical sectors. On one hand, the expanded investments of "pivot" corporate groups, such as the building industries (empreiteiras) that are dominant in the huge domestic infrastructural works, and that have extended their participation in Africa, Venezuela and Cuba. On the other, national corporations, such as Petrobrás and Vale, together with a constellation of other industries involved in the relevant production chains.

The most striking feature of those arrangements is this: in most of them the government interacts with private investors either as a majority or as a minority shareholder in publicly traded corporations or as a financial backer.

[31] In regional terms it stands in contrast with the reform path followed by the cluster represented by Chile, Colombia, Peru and above all Mexico.

Figure 7 – Networking interactions – changes in the pattern of State capitalism.[32]



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If the new trade coalition was made possible by a longer-term structural transformation culminating in a novel pattern of interaction between the government and the private sector,[33] where to situate *the politics* that prompted the relevant policy shifts? As far as trade policy goes, it includes, power resources, ideology and policy making tradition. First, political and economic calculations that have backed the decision to keep commercial state banks and the national development bank (BNDES) away from privatization, when this process was at its highest, during President Cardoso's government (1995-2002). Second, an the ideational shift inseparable from the beliefs and value system of the new economic team centered around the Finance Ministry and the BNDES. In contrast to the preceding policy makers they were defenders of the "industrial policy view" who see state intervention as a way "to promote development beyond what is possible under free markets".[34] Third, it was a

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[32] In Musacchio and Lazzarini, 2014

[33] It corresponds to a shift away of the state as entrepreneur, and is partly due to the privatization model adopted under Cardoso's government, where the state's involvement as minority shareholder was thought inevitable See, Musacchio and Lazzarini, 2014.

[34] The way the previous team understand the relationship between the state and the private sector is subtler than the atribute "neoliberal" makes believe. The distance between them is however is great, to judge by the fact that they introduced the regulation mechanisms that reduced

key element of a set of balancing acts that marked out President Lula's commitment to keep the policy agenda that had ensured macroeconomic stability.

Figure 4 - Exports to China as a proportion of total exports

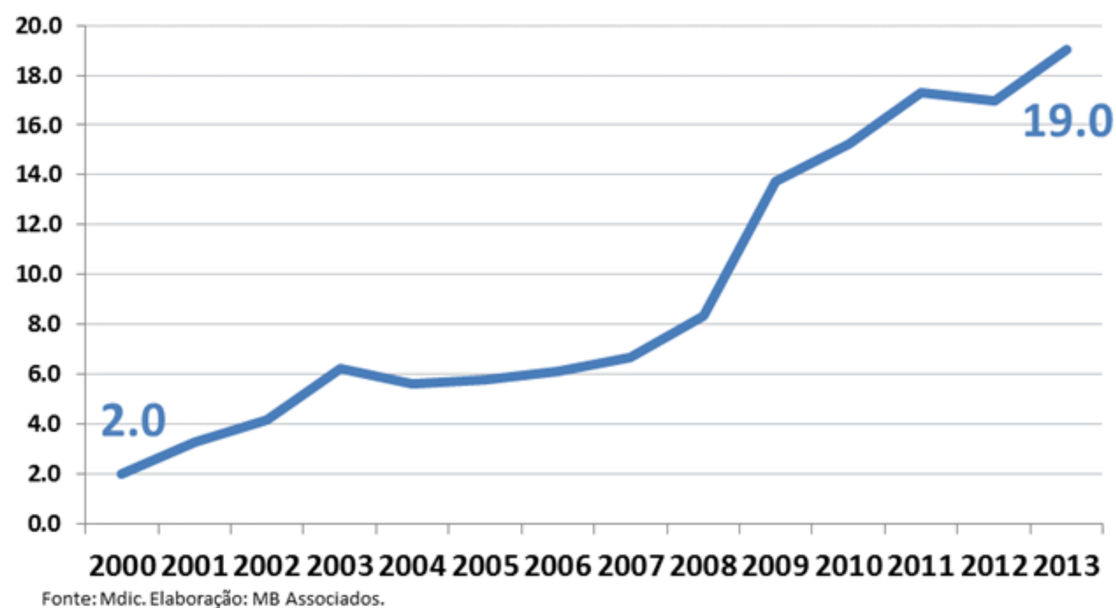

Figure 5
Agricultural trade balance deficits and surpluses (billion US$, source WTO)

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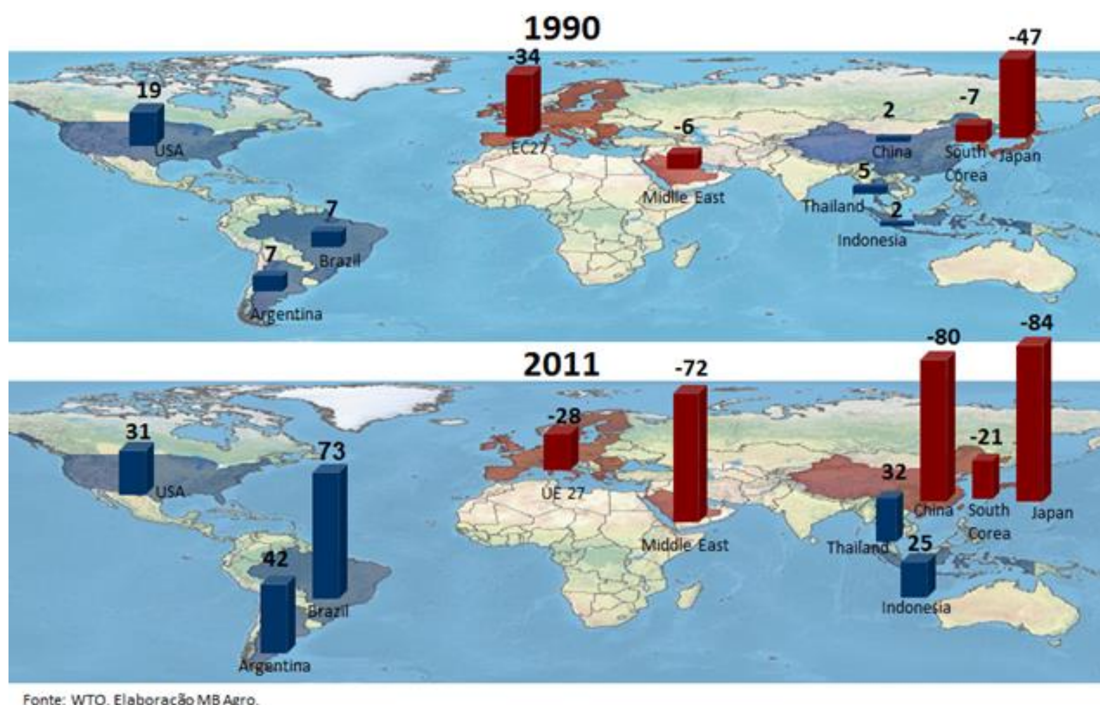
the "moral hazard opportunities" dramatically all of which were kept by Lula's team during the 2008 crisis, See Mendonça de Barros, 2012 .



Fonte: WTO. Elaboração MB Agro.

The relevance of that ideational shift and how it was reflected in economic policies is best evaluated by the new oil regulation approved in 2010, in the wake of new pre-salt resources, *notwithstanding that the preceding system was considered very effective by exports.* It consisted in four main points. [35]One, a new public enterprise was created: compulsory participation in all explorations was ensured together with an executive management empowered to participate in all decisions regarding the exploration. The second one establishes production- sharing contracts as the model, indicating that Petrobras will be the operator of all explorations, with a 30% minimum participation (The royalty/tax system introduced by the previous regulation is kept for other explorations). A third point consists in creating an investment fund to mitigate possible macroeconomic financial stresses, and for reasons of "intergenerational equity." Finally, a 5 billion barrels onerous cession to Petrobrás, which increased the share of the state in the oil company.

It is against this background, including ideology and new abundant prospective fiscal resources that the policy shift towards a more state-centered approach to economic development is intelligible. It also helps to situate two more developments. On one hand, the almost exclusive emphasis on the consumption side of demand management as the principal (so-called) countercyclical response to the global crisis and the

[35] In Beni Trojbciz, 2014

comparatively low rate of investment (averaging 18%) On the other the shift away from the reform agenda advocated by the government's critics, geared at increasing the productivity - and the competitiveness - of the industrial sector.

The politics underlying the approach to monetary and financial policy provide evidences of how the political costs of market-friendly policies were dealt with and turned into a political advantage by the incumbent government. The most immediate political costs related not only to the strong statist/nationalist bias of the dominant party in the new political coalition but mainly the intense campaign against market-oriented policies and privatization while in opposition. The commitment to "the fundamentals" was a late component of the pre-electoral campaign and reflect a "trade off" between, economic necessity that led Lula and his party to reassure the markets on one hand and on the other the "left wing " value systems on which his political legitimacy rested. [36] [37]Successive balancing acts followed. Thus while the attribution of (informal) operational independence to the Brazilian Central Bank combined with a more market friendly economic team under the Minister of Finance, a state-centric Minister of Planning provided the incentives for the BNDES and the huge pension funds public sector to finance "national champions" and new partnerships with the private sector. Those moves were well understood by Lula's constituencies and by other parties in the governing coalition,. For two context-specific reasons. One, the number of ministries was almost doubled , accommodating new and old members into the enhanced number of government- controlled posts. For another, it was well within the Brazilian tradition of policy making the idea that conflicting goals should be reconciled– and managed– by a wise leader. In short, tradition enabled Lula to use both arms simultaneously.

An accurate evaluation of the payoffs involved, however , must take into account not only a pragmatic response to economic necessity, but also the full adherence of finance to the policy coalition under way, once the mistrust engendered by the government turnaround was made clear. It is more accurate to say that, as long

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[36] Whithead, L. 2006, 'The Political Dynamics of Financial Crisis in " Emerging market"democracies

[37] For a full account of this transition, see Sola, (2006) "Financial credibility, legitimacy and political discretion: the Lula da Silva government" in Sola, L and Whitehead, pp 237-268

as the bonanza years lasted, and the macroeconomic fundamentals were kept in place, the new policy mix granted that the coalitional *position* of finance was converted into active participation into the governing coalition (and in funding the next electoral campaigns) . [38]

A distinctive feature of the policy coalition, relates to the position of the organized interests incorporated into the dominant party including trade-unions and other social movements. Their coalitional position is such that it makes extremely difficult to switch sides: their interests and state-centric approach to reform are inseparable from the pattern of interest intermediation prevailing in Brazil since the 30's – and strengthened in the last twelve years. That pattern was correctly characterized by Schmitter as "state-corporatism" , as distinct from the "societal corporatism" prevailing in Northern Europe. While in the former the relevant associations are subject to the pervasive influence of the state, in particular through state funds and through hierarchical patterns of organization, the associations characterized as "societal corporatism" are autonomous and actively pervade the state structures . [39]

The best way to characterize the responses to the changing international environment during President's Dilma's term is the shift toward a more state-centric "Keynesianism", that gradually dispensed with the balancing acts practiced by President Lula. As the rebalancing of the world economy unfolds and the end of the bonanza years hits, the crisis provided not only the ideational ingredients for the economic team to call in question the liberal agenda, but also to gradually relinquish the commitment to the inflation target regime, and to the fiscal disciplines imposed by the agreed fiscal surplus. The global crisis provided the background against which new patchy forms of interaction between the government and the private sector are experimented. A most instructive initiative was the decision to unilaterally cut down the prices of the electricity sector , without investigating (or consulting with) whether

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[38] A group's coalitional position is here understood in the sense defined by Gourevitch (2013) :" one that that can switch sides easily and thus is decisive to the final outcome", given its strategic function and power resources . We hypothesize that such a strategic position is played in those emerging market democracies that adopted a similar set of policies decisive for aa specific mode of integration into the global system.

[39] In Schmitter, 1974 and 1988, and Tavares de Almeida, 1995;

the enterprises involved could absorb the costs - which they did not. One year after this episode, it is clear that it costs the Treasury $ 12 billion (R$ 25 billlion). Those initiatives reveal a set of contested beliefs: that the post-crisis policies can be extended in the coming years; that there is a much greater tolerance of inflation than emerging and traditional middle sectors are prepared to accept; and that a depreciated exchange rate may be a permanent policy.. Evidences of an accentuated protectionist bias include: tariffs imposed on imported products when there are domestic similar, ones in particular in the auto industry, and in the constellation of industries that participate in the oil chain created in the aftermath of he pre-salt regulation. The same bias is seen in the alignment with emerging countries that pride less free-market practices and that resort to similar modes of protectionism, such as the other BRICS , just evidenced by the creation of a new Development Bank. The difficulty to opt for a more open trade policy goes hand in hand with other forms of autarchic moves, that affect the capital account side of balance of payments. Respectively: taxes imposed on short-term foreign capital, to keep the exchange rate depreciated, and avoid further inflationary pressures.

IV - Brazil at a cross roads? .

In the domestic front, Brazil actual and prospective standing in the international system became a matter of controversy well before 2013. While a number of international analysts offered good empirical grounds for skepticism about the country's future standing as "great power " in the last four years the domestic debate has revolved around the ideational and policy shifts underlying the country's poor economic performance in three fronts: growth, economic diplomacy and financial creditworthiness. For many analysts, therefore, the IMF and the FED's recent warnings about the country's vulnerability were predictable and part of a foretold story. On the 24th March this year Standard and Poor revised downwards to BBB the ratings of Brazil. And the problems in corporate governance gained new momentum with the downward rating of Petrobras, state banks like Banco do Brazil, and Caixa together with other private banks.

Two unrelated developments explain why the controversy ceased to be circumscribed to academic circles and to a few think tanks. One has to do with the protests that took

place throughout June 2013. The emergence of a nationwide non-partisan mass movement, brought to center stage far more than the generalized discontent with inflation and the deficits in public service. It highlighted that the Partido dos Trabalhadores ,in power since President Lula's election in 2002, was not anymore perceived as the *only l*egitimate representative of popular movements. The mass movement , therefore, removed one of the most powerful narratives emanating from the Party: a narrative that had acted as a powerful constraint to the criticisms voiced by other democratic forces . It came as a surprise to most party members and deprived the party leadership of one of its most effective instruments against the opposition: the ever pending threat of popular mobilization. A second unrelated factor is the split within the entrepreneurial elites, due to the growing disappointment with the growth prospects, to the competitive losses in international trade, and in particular the evidences that Brazil is an outsider in terms of new international trade agreements. On this front, criticisms from the representatives of the modernized sectors of the economy ,are being voiced unambiguously in terms of the "exhaustion" of the growth model adopted since President Lula's second term.

Concluding Remarks.

In the shifting and unstable international context, the role of rising powers in global economic governance needs much rethinking. There are a couple of questions that remain unanswered, and that are difficult to resolve within the frame of existing international institutions. One : is it realistic to expect some kind of agreement regarding exchange rate policy which might include some compensation to make up for the impact of exchange rate misalignments on trade? Two: which are the consequences of the centralism acquired by finance at the international level – and within some rising powers, and which are the institutions enabled to enforce the rules that might be shaped within the frame of the G20?

In the aftermath of the 2008 crisis, large emerging powers managed to participate in top tables that had been the exclusive domain of the G7. While the G20 engendered new opportunities and forms of negotiation between them and the core industrialized countries, in recent years there are increasing doubts concerning their standing both

as a group and individually (except for China) . Here the difficulty seems similar to that encountered by the WTO to establish multilateral agreements, even though, in principle it would be easier to reach exchange rate agreements among 20 countries, rather than 200. The problem, however, is that this group includes those which have a vested interest in exercising their monetary power via currency misalignments , China, US, in a minor scale Japan. This is one core difficulty in the way to reach a consensual understanding.

We do not mean to brush aside the institutional standing of the G20, as a permanent decision-making arena, where member countries are involved in frequent negotiations. It lacks, however, enforcement capabilities precisely in those arenas discussed in this paper. On one hand because of the domestic fragilities of some rising powers, may impinge upon the exchange rate conflagrations within the G20. On the other there are substantive reasons, specific to those arenas. Why that? In the first place because it is much easier to agree upon bank regulation (as it was done within the G20 sphere) than to achieve exchange rate realignments. The latter imply are premised on a zero-sum game, as the gain of one member would be the loss of another, while bank regulation revolves around a decision where all members are adjusted simultaneously.

A second open but unspoken question relates to one important implication in terms of the centrality of finance in emerging market countries, as the were bound to face the challenge of integrating into the global system through exchange rate and trade liberalization. The question is: which institutions are enabled to enforce when distortions from global standards multiply ? The case of Brazil (and others) suggest that one of the reasons why “this time is different” is that their comparative autonomy vis-à-vis the IMF and its conditionalities imply that with the institution’s loans.

What seems clear however, is a dilution of monetary authority at the global level. Ironically what is being brought to center stage in the case of Brazil is the power of rating agencies to act as an enforcer. For the simple reason that the loss of investment grade, would entail not only the withdrawal of foreign investors – in a context where foreign savings are a key condition for growth but also in political terms. This outcome would resonate as an effective loss of authority and prestige of the incumbent governments. Thus we are back to one of the distinctive features of global economic governance: the emergence and now full exercise of private authority.

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