2

Inflation in Oligopolistic and Technobureaucratic Capitalism

THE THEORY OF INERTIAL INFLATION

Luiz Carlos Bresser Pereira

Inflation has accelerated and taken on new characteristics in contemporary capitalism, that is, in oligopolistic and technobureaucratic capitalism. In short, instead of being merely a monetary phenomenon, inflation has become an intrinsic element of the economic system not only of the underdeveloped countries, but also of the central countries. In this chapter, I will try to make a general analysis of the new inflationary processes. I would especially like to call attention to "administered inflation," which is administered both by large corporations and trade unions with monopoly power, and to "inertial inflation"—the reproduction today of past inflation, given expectations, and the distributive conflict in which economic agents are permanently engaged. Next, I would like to look at "compensatory inflation," which is caused by the pressures exerted on the government to guarantee the rate of accumulation and to compensate economic agents for the eventual losses caused by the recessive phases of the economic cycle. Last, I would like to look at "corrective inflation," which is produced by the government when it tries to correct the distortions caused by its own economic policy. A dialectic is set up between these three types of inflation, which, when added to structural inflation, turn inflation into a phenomenon inherent to oligopolistic capitalism or technobureaucratic capitalism, a social formation characterized by large companies, big trade unions, and the high salaries of the top executives.

This chapter is divided into fourteen sections: (1) the new inflation; (2) the exchange equation and the monetarist view that attributes inflation to the increase in the money supply; (3) the causes of the direct increase in prices that are validated by an increase in the money supply: Keynesian or demand push, structural and administered, or cost push accelerating factors of inflation; (4) a new fact: market power; (5) the neoclassic "firm" and the

modern "corporation"; (6) administered inflation, markup pricing policy, and the inflation rate; (7) the idea of inertial or autonomous inflation as a result of the struggle for distribution; (8) the oil shock or inflation administered by governments; (9) the transformation of direct increases in the money supply into an endogenous variable and to the distortions caused by the economic policy that cause the state to have an unbalanced budget: compensatory inflation; (10) the political factor: inflation and legitimacy; (11) compensatory inflation in the context of the economic cycle and corrective inflation; (12) summary; (13) the recent Brazilian experience; (14) monetarist economic policy compared with administrative policy.

1

In the last ten or fifteen years, since the international capitalist system began to show the first signs of the crisis, which finally broke loose in 1973, inflation has accelerated on a worldwide level. At the same time, it took on new characteristics that suddenly made old theories obsolete. These new characteristics had been taking form for some time, but it was only at the end of the 1960s that, in the central countries, two things happened that created the need for a new explanation of the phenomenon of inflation. These two events were: (a) the coexistence of inflation and stagnation, and (b) a decisive increase in the average rate of inflation in the central capitalist countries. For years, these rates were in the range of 1 to 4 percent; then, suddenly, they tripled or even quadrupled. Double-digit inflation rates, which had been the exclusive privilege of the underdeveloped countries, became normal in the central countries. In other words, the obvious correlations of the ascendent phase of the economic cycle with inflation, and of recession (the declining phase of the cycle) with deflation, were no longer prevalent. We began to have inflation in all phases of the cycle, and now it can even accelerate during recessive periods.

After the classic analysis of Ignácio Rangel (1963), it was not only verified that in Brazil this correlation did not exist, but also, in the period 1960-1980, it was inverted. Shorter periods aside, inflation tended to decrease during prosperity (1967-1973) and to increase during recession (1960-1966, 1974-1980). Seventeen years have passed since Rangel's pioneering work, and history has only confirmed his fundamental analysis.

During this period, in Brazil as well as in the other underdeveloped countries, the average inflation rates also tended to increase. Although the inflation rates of different countries fluctuated, they definitely had a tendency to: (1) remain higher in relation to the developed countries; (2)

increase in relation to the previous period; and, (3) accentuate the lack of connection between prosperity and inflation, and between recession and deflation. In fact, the term deflation almost disappeared from the economists' vocabulary as declining prices became so rare as to be almost unheard of. Now what we have are increases or reductions in the rate of price increases, but never decreases in prices, as was common in previous crises of capitalism in the central countries.

Tables 2.1 and 2.2 present the average rates of price increases for five-year periods in some developed and underdeveloped countries.

Stagflation in the United States and the United Kingdom, for example, can be seen in the following data: in the United States, during the period from 1954 to 1958, the average annual per capita growth rate of

Table 2.1 Inflation Rates in Central Countries[a] (Annual geometrical averages) (%)

Period	Germany	USA	France	Japan	United Kingdom
1955-59	2.1	1.7	5.3	0.6	3.0
1960-64	1.5	1.2	2.9	5.2	2.7
1965-69	2.5	3.2	3.8	5.0	4.2
1970-74	5.5	6.1	7.6	10.6	9.5
1975-79	4.1	8.0	10.0	7.2	15.5

Source of raw data: *Statistical Yearbook*, United Nations (1959 and 1977) *International Financial Statistics*, IMF nº 6 (June 1980)
[a]Consumer Price Index used as deflator

Table 2.2 Inflation Rates in Underdeveloped Countries[a] (Annual geometrical averages) (%)

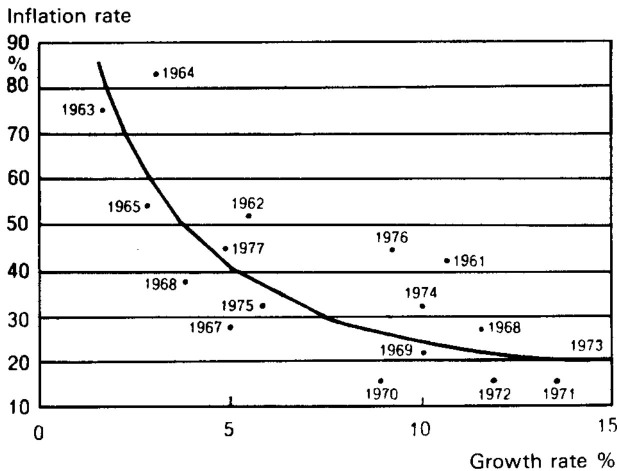
Period	Brazil	Colombia	Mexico	Portugal	Venezuela
1955-59	22.5	8.6	7.8	1.4	1.4
1960-64	53.5	12.1	2.1	2.4	0.4
1965-69	35.4	9.5	3.0	5.8	1.2
1970-74	19.9	15.1	10.0	13.2	4.0
1975-79	40.9	23.5	18.9	21.3	8.9

Source of raw data: *Statistical Yearbook*, United Nations (1959 and 1977) *International Financial Statistics*, IMF nº 6 (June 1980)
[a]Consumer Price Index used as deflator

the GNP was -0.2 percent and inflation was 1.5 percent. At that point, the phenomenon of stagflation did not exist. But in the period from 1969 to 1971, the yearly growth rate of the GNP was 0.7 percent against an inflation rate of 6.5 percent. This difference became even more accentuated in the period 1974-1975, when the annual rates were -1.8 percent and 9.9 percent, respectively. In the United Kingdom, from 1965 to 1969, the real per capita GNP grew only 1.8 percent against an average inflation of 4.2 percent. There we already see a moderate example of stagflation. From 1974 to 1975 there was a real decrease in production of -1.2 percent, together with a yearly price increase around 20 percent. Here the process of stagflation is very clear.[1] In Brazil, it is known that inflation rates accelerated during the cyclical declines beginning in 1962, and have continued to accelerate in new cyclical declines since 1974. Based on the original ideas proposed by Rangel, Marcos Fonseca constructed a graph that clearly shows the inverse relation between inflation and growth in Brazil since 1961 (Figure 2.1).

There are, therefore, clear indications that inflation took on new characteristics in the last ten to fifteen years: (1) the quantitative acceleration of the inflation rates was significant and implied a qualitative jump in the economic process; (2) the phenomenon of stagflation appeared, on a worldwide scale, as prices continued to increase and

Figure 2.1 Inflation and Growth



Source: Marcos Fonseca (1979)

eventually to accelerate their rate of increase while the economy itself was declining.

Given these facts, it is not only necessary to find new theories to explain this situation, but also, and more important, to determine the historical facts that cause these changes, which are transforming one of the most ancient economic phenomena in the world, inflation, into a "new inflation." Everything indicates that there has been a change in the very nature of the inflationary process. The old economic texts define inflation as a disproportionate increase in the means of payment in relationship to the national income.[2] The very etymology of the word implies this connotation. Increases in prices were thought to be the consequence of inflation, not inflation itself. It was never asked if an increase in the money supply did or did not cause a generalized increase in prices; this was an undisputed point. The question was to determine the causes of the increase in the money supply.

Today, it does not make any sense to define inflation in these terms. Inflation is simply a generalized and persistent increase in prices: it is the process that makes money lose its buying power. An increase in the money supply can be one of the causes of inflation, but it itself is no longer inflation.

The change in the definition of inflation occurred not because past economists were wrong, nor because their theories were incorrect, but because of new historical facts that modified the nature of inflation, given new decisive factors for the persistent and generalized increase in prices.

2

For traditional economic theory, whose contemporary representatives are the neoclassic or monetarist economists, the exchange equation explains the whole inflationary process.[3] According to this equation, which comes from the definition of the income velocity of money, V, as equal to nominal income Yp (real income, Y, inflated by the general price index, p) divided by the nominal money supply, M, we arrive at:

$$MV = Yp \qquad 2.1$$

If we admit, in the terms of the monetarist viewpoint, that there is a demand function for real money that is stable or, more simply, that V is constant, and that the money supply increases due to exogenous factors, an increase in M that is more than proportional to the growth of Y would necessarily cause an increase in prices. This would happen, in the first

place, because this equation is definitional, making it impossible to discuss the relations between the variables. In the second place, because with an increase in M and V remaining constant, consumers would confront producers with an excess of money—they would try to buy more merchandise than was being produced, and thus would set off an inflationary spiral. Thus, with inflation resolved theoretically in these terms, the only problem the monetarists have is to determine the exogenous, extraeconomic causes for the increase of M. These are easily defined as the incompetence and populism of governments that do not resist pressures from different sectors of the economy; in more sophisticated terms, the increase in the money supply would be the result of governments' attempts to guarantee, through a Keynesian administration of effective demand, that income grew at a rate above the "natural" growth rate.[4]

In this type of analysis, using an impeccable linear logic, its authors forget or dismiss the idea that an increase in the money supply can be considered endogenous to the economic system. It also does not take into consideration that the causal relations between the variables M and p can occur as much in the sense that M determines p as that of p determining M.

If something outside the exchange equation, but endogenous to the economic system, forced prices to increase, keeping V constant, either M would have to increase or Y diminish.

Another way to see the same problem is to look at what would happen to the real money supply given the original rise of p. If one takes the real money supply as $m = M/p$, then when p increases and M is kept constant, the real money supply decreases. Given that the fundamental function of money is to permit transactions, this would immediately provoke a liquidity crisis. A liquidity crisis either leads to a reduction in the gross domestic product, and therefore to a crisis, or else it forces the government and banking system to increase the money supply. For a period of time, an increase in the income velocity of money, and therefore a process of reducing cash balances, could postpone an increase in M, but in the end the increase of the money supply would be inevitable. It would happen even if the state budget were to continue to be balanced. Faced with a generalized reduction in liquidity and with the menace of a recession, the monetary authorities would be obliged to issue more currency, as well as to release credit, if the banking system did not do this on its own.

It is clear that, in this case, a monetarist could assert that it was the increase in the money supply that "caused" inflation after all, but this would be confusing causes with effects. What we can confirm in this case is that the increase in currency "sanctioned" or validated inflation that had

already been unleashed, making the increase in M endogenous. However, monetarist economists do not accept the argument that the increase in the money supply becomes endogenous. As they are used to thinking in terms of "must be" rather than in terms of "is," they argue that economic policy could refrain from increasing M and validating the increase in prices. The continuing recession would then control inflation. In the meantime, we can see that those who are responsible for economic policy do not in fact have this liberty, which could only be granted in terms of the voluntarist idealism of the neoclassicists. On top of that, given the monopolistic practices of the corporations and the trade unions, which refuse to reduce profit margins and wages, this eventual recession does not have the means to control prices, unless it turns into a profound and disastrous depression.

In these terms, although there may be (and in fact there is) a high correlation between M and p at any time in any country, this is not absolute proof that the monetarist theory is correct. We have heard often enough that regression analyses do not establish direct causal relationships. There is no doubt that M can cause an increase in p, as well as that p can cause an increase in M.

3

It obviously would be unthinkable to blame the generalized increase in inflation rates and stagflation on the incompetence and populism of governments all over the world. Therefore it would be useful for us to look for the factors that can endogenously and directly determine the initial price increases, which, in turn, provoke an increase in M, which would reinforce an increase in p. But we will not limit our analysis to the historically new factors that directly determine an increase in p, leading to the increase in M. In addition, we will examine the intrinsic and historically new factors that directly determine an increase in M, which in turn causes inflation.

There are three theories for explaining the initial increases in prices, independent of an increase in the money supply: (a) the Keynesian theory, which is based on an excess of aggregate demand over aggregate supply at the peak of the economic cycle; (b) structural inflation, caused by sectorial imbalances between supply and demand; and, (c) administered inflation, caused by the monopolistic power of corporations, trade unions, and the state.[5]

The first and second theories are, like the monetarist theory, based on demand. There is no doubt that in the ascendent phase of the cycle, and especially when, at the peak, the economy tends to reach full employment and full capacity, inflation tends to accelerate because of the pressure of

aggregate demand. But it is also clear that this theory does not explain either stagflation or the recent elevation of the inflation rates.

The Keynesian theory of inflation received important empirical corroboration with the research of the British economist A. W. Phillips, who established the relationship between the unemployment rate and variation in the rate of wage in 1958. The Phillips curve shows that as the unemployment rate goes up, the rate of variation in wages goes down. If we substitute prices for wages, we would have inflation caused by the pressure of demand when the unemployment rate goes down. The Phillips curve had immense theoretical repercussions not only because it was based on solid empirical data, relative to inflation in Britain in the period 1861-1957, but also because it permitted the establishment of an "optimum" level of unemployment that would guarantee price stability.

Conservative economists, who reduced Keynesian thought to a neoclassical scheme, imagined establishing a trade-off between an acceptable unemployment rate based on the Phillips curve (which they then called the "natural rate of unemployment") and an acceptable inflation rate. Without realizing it, they were reinforcing the Marxist theory of the industrial reserve army, because they were confirming the utility of unemployment for the capitalist system. But they were also trying to confirm the thesis that recession (or output gap) would cause inflation to slow down. Next, the monetarists, who are even more conservative, found themselves in difficulties and were forced to perform a series of theoretical acrobatics in order to make the empirical data compatible with their own theories. This is because, for the pure monetarist, the Phillips curve should be completely inelastic in the long run. In other words, for them, an inverse relation between the inflation rate and the unemployment rate, and therefore the growth rate, does not exist. The "natural" growth rate would be not only compatible with full employment, but also with price stability. Any attempt to manage the aggregate demand would only be inflationary, instead of raising the long-term growth rate of GDP.

Although this discussion can be very interesting and has attracted the attention of almost all of the economists in the central countries, who are divided between Keynesians and neoclassical monetarists, the fact is that it does not help us to understand the new inflation. As Phillips's data refer to an earlier period, they are about "old inflation," and demonstrate the exact opposite of stagflation. Empirical tests referring to recent inflation do not show a correlation between the unemployment rate and inflationary deceleration. On the contrary, recession tends to provoke an elevation of the inflation rate, especially in highly oligopolized economies like Brazil's, at least in the early phases.[6]

The same thing happens with the structural theory of inflation, as this

theory is limited to the problem of bottlenecks in supply and to the mechanisms by which these imbalances spread throughout the whole economy, thus remaining inside the framework of demand inflation. Structural imbalance, which arises from the imperfections of the market, is the fundamental cause of inflation, especially in the underdeveloped countries. Bottlenecks in the availability of certain products provoke price increases in those sectors. In an economy with a well-organized market, these price increases would be corrected quickly, including by falling back on imports, and prices would return to their normal level. In an underdeveloped economy, with poorly structured markets and chronic balance-of-payment problems, it takes a long time to the correct these sectorial imbalances. In the meantime, prices in those sectors remain high. The capitalists in the other sectors, forced to buy goods at higher prices, then try to increase their own prices and the workers to increase their wages, thus setting off the inflationary spiral.

Just as with the theory of inflation provoked by the excess of aggregate demand, the structural theory of inflation does not explain the recent acceleration of inflation rates coexisting with unemployment, that is, stagflation, because it does not supply us with any new information. Quite the contrary, in the underdeveloped countries that are growing, the importance of structural causes tends to diminish as their markets become better structured, thus allowing supply to respond more quickly to the stimulus of demand.[7]

4

Monetarist inflation, Keynesian employment-related cyclical inflation, and structural inflation are therefore perfectly legitimate kinds and causes of the acceleration of inflation. Cumulatively, they continue to explain the inflationary processes that occur all over the world; but, obviously, they do not explain the new inflation. They are all theories that assume demand inflation and, as such, they cannot explain stagflation. Besides, they don't concern themselves with new historical information that explains both stagflation and the decisive acceleration of the inflation rate all over the world.

In searching for new information to explain this new inflation and, consequently, in defining a new theory that takes the new historical processes into account, there seems to be no doubt that the fundamental phenomenon is the growing power of public and private enterprises, trade unions, and the state over the market.

The power of the oligopolistic corporations over the market is a

decisive phenomenon of the second half of the twentieth century. Big corporations have been emerging in the central countries since the last quarter of last century, but the oligopolistic sector of the capitalist economies was still secondary to the competitive sector, especially in the United States, Britain, and France. The two countries in which the oligopolistic sector assumed an important role from the beginning of their industrialization—Germany and Japan—were not effectively integrated into the world capitalist economy until after World War II.

In general, the quantitative growth of the oligopolistic sector in central countries and in industrialized underdeveloped countries caused a qualitative jump, as shown by the definitive dominance of the oligopolist or technobureaucratic system over the competitive or market system. One integral part of the monopolistic system is the large, modern, technobureaucratic state, which, aside from its classical political functions of repression and legitimation, assumes the new economic functions of regulating the market and producing goods and services.

This process was also characterized by the advent of the multinational corporations. Just like the large producing and regulating state, multinational corporations assumed their complete form and actually spread all over the world after the end of World War II, completing the process of the internationalization of capital. At first, capital internationalized itself commercially, and then, beginning at the end of the last century, financially. However, it was only in the last thirty years that capital actually internationalized itself in the sphere of production through the multinational manufacturing corporations.

The advent of the multinationals on the international level corresponded to the decisive predominance of large oligopolistic corporations on the national level. It was only after the war that they actually assumed the character of an alternative to the market, although this process had been identified by Marx in the last century as the process of the concentration and centralization of capital. Since then, we have begun to have, in both the central and the underdeveloped industrialized economies, what Galbraith (1968) called a planning system and a market system.

Rather than sectors of contemporary capitalist economies, these systems are alternatives for controlling the economic system. The market system is a competitive system of small- and medium-sized firms that the classic and neoclassic economists take for granted in their economic models of perfect competition. The planning system is the oligopolistic system dominated not only by the large public and private corporations, but also by the large trade unions and the vast regulating state. Corporations and trade unions try to substitute themselves for the market

by administering their prices. At the same time, the regulating state, faced with the relative paralysis of the mechanisms of the market, is also forced to substitute itself for it by counteradministering prices through various forms of price controls.

The advent or formation of a planning system has decisive effects on inflation, because it means that the self-regulating market does not exist anymore. It signifies that the basic definition of society would no longer be merely capitalist, based on the self-regulating market, but rather technobureaucratic-oligopolistic-capitalist. At the same time that a new class of technobureaucrats emerges in large corporations, in the state, and also in the large trade unions, the planners substitute themselves for the market. They do this by administering the system of prices, not for the whole economy, but for large, and now dominant, sectors of the economic system.

The formation and recent dominance of the oligopolistic or planning system, and therefore the transformation of capitalism into oligopolistic or technobureaucratic capitalism, is the most general and decisive new fact that can explain the new inflation of the 1970s. The attempts of the oligopolistic corporations and the trade unions to increase their participation in the income by administering prices, interest rates, and wages cause administered inflation. The tendency of the regulating state, which has become the main agent responsible for the rate of accumulation, is to control prices—given the growing incapacity of the market to do this. This, in turn, tends to provoke distortions that cause what we call "compensatory" and "corrective" inflation. On the other hand, prices administered by corporations, unions, and the state make the inertial component of inflation stronger.

5

With technobureaucratic capitalism and the dominance of the large corporations, inflation has become a "normal", or everpresent, phenomenon, since the regulating mechanisms of the market do not work as they are supposed to. However, new administrative forms for controlling prices that can adequately substitute for the mechanisms of the market do not appear immediately.

When the orthodox, neoclassical economists think about inflation, they still imagine a competitive market made up of an infinite number of "producers" or "firms." That is the way productive units are presented in the majority of the neoclassical microeconomics textbooks. The expression "corporation" is beginning to be used, but it has no place in the

neoclassical world. The neoclassical concept of a firm is still dominant in economics textbooks, presupposing small societies of limited responsibility, or the notion of the producer—that is, of the capitalist businessperson who individually and directly runs his or her business.

In these terms, perhaps it would be more appropriate to differentiate between two types of capitalist economic units, the business firm and the corporation, rather than to speak of small companies and large companies.

The neoclassical business firm is a small unit of production that does not have any market power. It is a unit of production that limits itself to adapting to the demands of the market and attempting to maximize its productive efficiency, which translates into a reduction in costs. A firm is only managed on the production level. On the market level, it does not have any policy on prices, products, trademarks, or advertising, because it has no power to do anything in these areas. A firm has no marketing strategy besides efficiently producing a homogeneous product.

The corporation has a legal definition. In economic terms, however, it may be characterized as a production unit that has market power, which carries out a marketing strategy, has a policy on prices, and tries to set its prices by making tacit or explicit agreements with its competitors, or by setting up areas of monopoly through product and brand differentiation. It is generally a large production unit. However, the concepts of "small," "medium," and "large" are arbitrary. What effectively distinguishes a corporation is its market power and its ability to formulate a policy on prices, generally based on setting a margin over variable costs (markup).

The planning system is made up of corporations, the units of production with market power. Market power is a decisive factor for inflation because it permits the corporations to maintain their margins and raise their prices automatically, inertially or, in other words, independently of the market, that is, independently of the existence of an excess demand over supply. On the other hand, this signifies that the laws of the market no longer control the economy, which in fact is a tautology, since we defined the planning system, where corporations operate, as the alternative to the market system, where firms still exist.

Summing up, orthodox economic policy, based on controlling the economy through market mechanisms, has lost a large part of its validity. Monetary and fiscal policies, which are based on the self-regulating market, become inefficient because they assume that, if authorities are able to correct the market on the aggregate level (state expenditures and revenues or the money supply), the market will recover its ability to control the economy. Macroeconomic policy continues to be perfectly valid for the maket system, but it loses part of its validity in the oligopolistic system, where market mechanisms no longer function as

they should. We will see that, in this sector, the consequences of the macroeconomic policies could even end up being the opposite of those desired.

6

The fundamental objective of the price policy of large corporations is to guarantee their profits and, second, to maximize their own expansion, or at least to maintain their participation in the market. Although, in principle, the planned rate of profits has precedence over the expansion rate, corporations are frequently driven to make a trade-off between these two objectives.

In order to understand both the basic phenomenon of stagflation and that of inertial inflation based on the price policy of the corporations, we should imagine the economy entering a recession or a descending phase of the cycle. At this point, corporations are faced with declining sales. In order to maintain their profit rates (profits divided by capital), the obvious alternative is to raise profit margins (profits divided by sales or profits divided by costs). This will necessarily signify an increase in prices because the productivity rate is considered constant for this analysis. If the recession were provoked by restrictive monetarist and fiscal policies, the response of the corporations would be even more pronounced in terms of raising prices and margins. In this situation, macroeconomic policies have the opposite effect of that desired. Corporations can raise their margins and prices because they do not have any direct competitors, or because their competitors accompany them through tacit or explicit agreements. This is how stagflation is set into motion. Acceleration of inflation and recession come together.[8]

The normal response of corporations to recession is not to raise profit margins but to keep them fixed. But even if we make the assumption that margins remain fixed during recession, stagflation, or more precisely inertial inflation, would occur.

Given the market system, what should happen as the economy slows down is not an increase or even a maintenance of margins, but rather their diminution. That is one of the basic assumptions of the orthodox economic policy about inflation. In order to try to maintain their sales, corporations should lower their margins, and thus not transfer the increases in costs on to prices. However, corporations do not belong to the market system. Their logic is the logic of the planning or oligopolistic system. So the fundamental law and practice of corporations in their price policy is that of markup pricing, of adding a fixed margin to direct costs. In this

way, the corporation automatically transfers the whole increase in direct costs to prices. Margins remain fixed, and prices rise inertially.

In order to understand this phenomenon, however, it is necessary to add one more variable. The increases in costs and in prices do not all take place at the same time in all of the corporations. They alternate between one corporation and another. This lack of synchronization is a decisive factor. Let us take three corporations, A, B, and C. If these three corporations rigorously and alternately apply the policy of a fixed margin over costs, the inflation rate, once started and established at a certain level, will become permanent. The combination of fixed margins over costs, with alternating price increases, does not necessarily lead to an acceleration of the inflation rate, but rather to the maintenance of a determined level of inflation. Given the maintenance of the margins and the alternating price changes, prices will continue to grow at the same rate at which they were growing before. Any other factor that raises this level, among which could be an elevation of margins, implies the maintenance of this new level.

Thus, we have here the informal process of the indexation of the economy, with the automatic passing on of costs to prices. This is a factor that maintains inflation, or inflationary inertia, keeping inflation from falling independently of aggregate demand.

There is a third factor that should be taken into consideration: the speed with which the corporations change their prices. If this speed, which is measured by the lag between one alternation and another, is increased, it immediately has an additional inflationary effect.

At this point, we could imagine one of the corporations breaking the golden rule of the planned system—that of never getting into price competition—causing what is disparagingly called a "price war." However, unless it is supported by gains in productivity resulting from exclusive technological innovations, a decrease in prices is unthinkable for a corporation, because it knows that its competitors will follow its lead.

Inflation that is the result of the corporations' pricing policies is called "administered" or "cost" inflation. When corporations are only maintaining their margins, they are also maintaining the inflation level, as long as the speed of the price changes is maintained. This is inertial or autonomous inflation. When they manage to increase their margins in order to compensate for a fall in sales, the effect is to accelerate inflation.

However, administered inflation does not necessarily occur only in the recessive phase of the cycle. When there is relative equilibrium between supply and aggregate demand, as well as when there is prosperity, an increase in margins is an alternative that is always available for corporations. Depending on the elasticity of demand, an increase in margins could be especially advisable when the corporations' productive

capacity is reaching its maximum level. Once margins are elevated, however, it will be very difficult to bring them down again; it is at this moment that the inertial component of inflation shows its weight. Thus the initial effect of an increase in margins is the acceleration of inflation and the result of fixed margins is the maintenance of inflation.

7

This analysis, especially in respect to what it has to say about the corporations A, B, and C who take turns raising their prices, assumes that inflation has very important distributive effects, making the corporations' pricing policies a form par excellence for conserving or increasing their share in total income. In general, one could say that in the world of technobureaucratic capitalism, made up of corporations, trade unions, and the state, inflation is a pitched battle between corporations, between industrial sectors, between corporations and trade unions, between social classes and even between fractions of classes, and finally between the public and private sectors, in the fight for the appropriation of the economic surplus.[9]

In competitive capitalism, inflation seemed to be an impersonal phenomenon, the result of distortions between supply and aggregate demand, for either monetary or cyclical reasons. It was never the result of isolated economic agents, because neither companies, nor workers, nor consumers were capable of making decisions or of establishing price policies. In technobureaucratic or oligopolistic capitalism, it is clear that inflation is the result of the struggle of economic agents or of associations of economic agents organized into groups, systems, or classes, to increase, or at least to maintain, their participation in the economic surplus.

In this situation, inflation is transformed into a mechanism for transferring income to the sectors that are the strongest economically or the most powerful politically. For example, as the planning system becomes economically more powerful than the market system, inflation becomes an excellent mechanism for the planning sector to appropriate part of the surplus generated in the market sector for itself. In underdeveloped countries, where the workers are unorganized, inflation functions to lower their wages and to assure high profit rates and the accumulation of capital.

However, in underdeveloped countries where the workers have already reached a higher level of political and trade union organization, inflation tends to lose this function. There, the fundamental struggle of workers is to index their wages to inflation and to introduce a productivity clause in

the wage negotiation. In this way, they assure their participation in the national income, and their wages are not inflationary . However, as trade unions become stronger (and this tends to happen as the planning system expands), they tend to demand wage increases above inflation plus the rate of productivity. At this point, in view of the threat to profit rates, this also sets off inflation.[10]

It is important to take into account that even if wages are perfectly indexed, inflation can be set off by a change in the corporations' policies. This is partly what happened in Brazil after the passage of the wage law of November 1979. This law simply assured a complete semestral indexation of wages. Indexation already existed before this and, in practice, it was often semestral. But the announcement of the new law led corporations with market power to make preventive increases in their prices. This was a new inflationary factor that set off a discussion of whether inflation is or is not caused by wage policy. Actually, this discussion was not well stated: one of the causes of inflation was obviously not a real increase in wages, because they were not really increasing. But the reaction of corporations with market power to the possibility of a decrease in their profits, as a result of the new wage law, had very clear inflationary consequences. This fact reminds us that, in political economy, given the distributive conflict, what is most important for us to know is not what has already happened, but what the corporations' and consumers' expectations are.

The main thing to note is that, in technobureaucratic capitalism, the economic agents that have the will and the means to influence prices are in constant and direct, if not personal, conflict with each other. It is very different from competitive capitalism, where this conflict is watered down by the impersonality of relations between thousands and thousands of economic agents who have no other alternative than that of adjusting to the conditions of the market. Inflation is based directly on the following struggles: the class struggle, as seen in the conflict between trade unions and corporations; the inter-corporate struggle, between buyers and sellers; the struggle between sectors, as between the financial and industrial sectors; and, finally, the struggle between systems, which is the struggle between the planning and the market systems.

Even the struggle between corporations and consumers, which is unbalanced in favor of the former, is not just a struggle of a few businessmen against powerless, disorganized consumers. Consumers are beginning to form cooperatives and associations, but this is not the most important fact. What is more important is that the state, under pressure from consumers, is frequently forced to set prices for consumer goods. At this point, it takes the side of consumers against corporations. This obviously does not signify that the state is losing its fundamental

characteristic of being at the service of capitalist accumulation. It only highlights the relative autonomy that is necessary for the state, which could lead it to defend, within very strict limits, workers against capitalists. This type of action by the capitalist state, which allows it to maintain an appearance of neutrality, is essential for exercising its function of legitimating the existing system of the relations of production. It also serves to emphasize the illusion that the state controls the monopolistic power of corporations.

In the context of this process, the economic agents that are in conflict over the division of the economic surplus try to administer their prices, with an eye to maintaining their participation in the income. Thus, they tend to constantly raise the inflation levels and then to conserve these new levels, giving the whole economic system a tendency toward rigidity.

8

Price administration, with its inflationary consequences, can be carried out by private corporations, state corporations, trade unions, and by the state itself. All that is necessary is for one of these types of organizations to have some power over the market, individually and/or in the form of a cartel, for price setting to be possible, and thus for administered inflation to be established.

However, there is still another possible origin of administered inflation that has taken on decisive importance in the last few years: the administration of prices for exported goods by the states themselves. There had been attempts along these lines for a long time; one example was the international agreements on the price of coffee. But it was only after OPEC's success in quadrupling the price of oil in 1973 that this form of administered inflation on the international level, directly between states, became significant.

The inflationary effects of the increase in oil prices are obvious. It implied an enormous gap between costs and prices; by dealing with a scarce, unrenewable natural resource, it was possible to completely disconnect its price from its value. This increase in margins benefitted not only the oil corporations, but especially the oil-producing states.

The most obvious inflationary effect of the oil price increase is in the corporations' practice of passing increased costs on to prices. There are also workers who consume gasoline, principally lower-level executives and technobureaucrats in all countries, who felt the need to pass their increase in expenses on to nominally higher wages and salaries. Thus, the inflationary spiral was set off, this time called "imported inflation," but

which actually was an example of administered inflation, because it was the result of OPEC setting the international price of oil.[11]

The increased oil prices and the subsequent price war between the oil consumers and producers, between the intermediate and final consumers of oil, and also between those who do and those who do not directly use oil undoubtedly played an important role in the acceleration of inflation in the last decade, as well as in aggravating the phenomenon of stagflation. It is important, however, to point out that these last two phenomena had been occurring since before 1973.

In the meantime, the increase in the price of oil did not limit itself to being inflationary by provoking a price war; the corporations attempted to maintain their profit rates and the workers and technobureaucrats to maintain their wages and salaries. It was also inflationary because of its effects on the real and potential national income, the balance of payments, and the foreign debt of each country.

The sharp increase of oil prices provoked a strong deterioration in terms of trade for the oil-consuming countries. This purely and simply means that these countries became poorer; in fact, from that moment on, they had to produce more merchandise in order to buy the same amount of oil. This impoverishment could have been postponed by increasing the external debt of the consumer countries. Some countries could have managed to increase their exports in a compensatory manner by utilizing their idle capacity. All of them tried to counterattack by increasing their own prices in order to reduce their losses in terms of trade.

Although the capacity of the international financial system to recycle petrodollars is great, it is certainly limited. The utilization of idle capacity and the ability to increase exports was possible only for a limited number of countries. Increases in the prices of exports, aside from being very limited, were also counterbalanced by subsequent increases in the price of oil. In view of this, a world recession or, more specifically, the end of a long wave of investments, which had already been foreseen since the beginning of the 1970s, was sparked.

However, contrary to the predictions of neoclassical economic theory, economic deceleration did not contribute to a reduction in inflationary pressure. Corporations had to pass on to prices not only the increase in the price of oil, but also the expectations (and the reality) of a reduction in sales, due to a general, although moderate, recession of the world economy starting in 1974. Increases in, or even attempts to increase, corporations' margins at that point certainly resulted in accelerating inflation all over the world.

9

The state can play various roles in administering prices. It can be a primary cause of administered inflation by increasing its corporations' and agencies' prices, or else by making agreements like that of OPEC. It can also contribute to inflation by its policy of trying to administratively control prices and wages that are the origin of administered inflation, as it ends up legitimating prices higher than the market can allow. In this way, the state, and in particular its agency for controlling prices, is transformed into a substitute for cartels.

The state can also provoke an increase in prices when it decides to set high levels for the interest rate or for exchange rates. We will see that this happens especially when the state is led to engage in a policy of "corrective inflation."

Actually, when the state acts as the administrator of prices, it takes on a very special role. In general, its job is to hold prices down, substituting itself for the market as the only alternative for controlling prices in an economy that is dominated by the planning system. This administration of prices by the state is fundamentally an administration of profits, wages, and salaries. Therefore, it is an income policy. By administering the price of merchandise, the state tries to control the profits of the corporations; by controlling wages, the profits of the corporations and the wages of the workers; by controlling interest rates, the profits of the banks and the incomes of the financial rentiers; and by controlling rents, to control the profits of real estate rentiers.

This control has very defined limits. The state can try to control the big distortions. It cannot try to paralyze price increases at the cost of large distortions in the market. The price of merchandise should maintain its basic relationship to the amount of direct and indirect work incorporated in them. Profit rates, on the other hand, should be relatively equalized between sectors. Put another way, the market prices of merchandise should maintain their basic relationship to the prices of production; any deviation in relation to this parameter should be avoided. In the same way, wages should relate to a given profit rate that is considered "acceptable" and to a given rate of productivity. An increase in real wages, therefore, should necessarily be tied to an increase in productivity, assuming a constant profit rate. In other words, state controls cannot go against the law of value, or rather, cannot provoke serious distortions in the market. These distortions would quickly become insupportable, resulting in the emergence of free parallel markets and/or in a political and economic crisis.

In this setup, the state feels an inescapable need to control rising

prices because the market mechanisms are incapable of doing this. Given this, as well as the inherent limitations of control determined by the law of value, or, which is almost the same, by the law of the need for parity in the exchange of any merchandise, another tendency appears at the heart of the state itself. This is the tendency to concentrate the negative aspects of price controls in its own hands; it makes the state assume the losses that come from the rigid control of certain prices.

The state's absorption of these distortions, which seems to be necessary in order to control prices (although they actually aren't), can take various forms. State corporations can inadequately set their own prices, or the state can control certain prices and compensate the producing corporations with subsidies. In any of these hypotheses, the state is carrying out a compensatory policy: it controls the prices of determined sectors within or without the state, and compensates for the losses that occur with ever-increasing transfers of funds. However, the limitations of this type of policy are obvious. The state corporations or agencies that produce goods or services below their value soon have deficits and need to cover these deficits with state funds. On the other hand, the private corporations that receive subsidies become a direct burden on the state treasury.

Similar processes tend to occur with the exchange rate. The exchange rate can be kept artificially high for a certain period in order to prevent an increase in the price of imported goods. Exporters, in turn, are compensated by subsidies, which again are a burden on the state budget.

After a while, the accumulation of these distortions, all of which have repercussions on the state budget, becomes unbearable. At this point, the state can issue money or go into debt internally in order to cover its deficits, with the obvious inflationary consequences. Rather than prices increasing autonomously, causing an increase in the money supply, it is the money supply that increases, causing an increase in prices. This provokes what we propose to call "compensatory inflation."[12]

Faced with an unbalanced budget, the government would perceive the need to eliminate the distortions, restoring prices to their proper places in terms of their value and, therefore, of their true costs. Here would be a policy of "corrective inflation," in which the prices of the distorted sectors are adjusted, because they had been repressed and then compensated for by state subsidies in an effort to balance the state budget.

Corrective inflation will probably accelerate inflation, unless it is extremely well balanced. Actually, it is a new form of administered inflation, characterized by a strong increase in the profit margins of the corporations whose prices had been repressed. As a result, the other corporations and the trade unions, which had already fit their profit rates

and wages to the distorted prices, would immediately pass the increases in their costs on to prices, even if aggregate demand is controlled.

This process of compensatory inflation and administered inflation reinforcing each other in a phase of structural imbalance occurred in Brazil between 1974 and 1979, aggravated by a cyclical decline. Inflation in this period grew slowly from approximately 25 percent to 60 percent. At the end of 1979, the decision was made to apply corrective inflation.[13] As this consisted of administering the prices of basic products, it resulted in an explosive increase in prices, raising the level of inflation to more than 100 percent in less than one year.

10

This analysis of the behavior of the state serves as an ideal bridge for us in analyzing the role of the increase in M as a cause of inflation. At the beginning of this chapter, we criticized the monetarist theory that states that inflation is caused by increases in M, which, in turn, are caused by exogenous factors (or, in other words, by the demagoguery and incompetence of governments) as simplistic. This does not mean that we should or could discard the idea that the increases in M that originate in government deficits could cause inflation; it is clear that an increase in the money supply above the growth rate of the GDP is inflationary, or at least reinforces inflation.

For example, in Brazil, between approximately 1966 and 1973, the federal budget was basically balanced. Nevertheless, the government was forced to issue money during this entire period in order to guarantee the liquidity of the market. This was because the market was faced with an inflation that obviously was not caused by government deficits and the issuing of currency, but rather by structural and price-control-related factors. Although the data in this respect are very vague given the separation between the fiscal and monetary budgets, everything indicates that, beginning in 1974, the government began to have growing deficits. The fiscal budget remained balanced, but the monetary budget, where more and more subsidies for agriculture based on interest rates tied to a growing inflation rate were concentrated, showed larger and larger deficits. The total economic deficit was finally acknowledged and quantified in 1979, having been estimated at about 5 percent of the gross domestic product.

There is no doubt that, in this case, the government deficit, which forced massive issues of currency, was inflationary. The increase in the money supply was not simply for reestablishing the liquidity of the financial system. It covered not only the nominal public deficit, but

financed a real public deficit that sustained the economy near full employment.

In this case, however, can it be confirmed, as the monetarists propose, that the government deficits come from causes that are exogenous to the economic system, specifically from demagoguery or from government incompetence? The authoritarian government of that period certainly cannot be accused of demagoguery. As for being incompetent, it was neither more nor less so than the previous governments; therefore, it also seems unjustifiable to attribute the inflationary acceleration of this period to such a cause.

Actually, this kind of simplistic and personalized reasoning is inconsistent with the dynamics of historical processes. Demagoguery and incompetence can most certainly cause governmental financial instability. On the political level, however, it is necessary to be more careful in examining the processes that lead to this instability. Pressures are put on the government to increase its expenditures from all sectors of society. In societies that are characterized by technobureaucratic capitalism or oligopolistic capitalism, the state is a fundamental agent for the redistribution of income. Through a complex system of transfers, taxes, and subsidies, the state concentrates or redistributes income and harms or helps one class or another, one sector or another, one group or another, one region or another.

These pressures can become unbearable for a government that is politically weak or has no legitimacy in the eyes of civilian society. This happened in Brazil during the Kubitscheck government and especially during the Goulart government; it also took place during the Geisel government. The first two governments were populist democracies, the last a technobureaucratic authoritarian regime; but, all three governments' lack of legitimacy for the dominant classes, whose power is decisive in a civilian society, was clear. This lack prevents the government from limiting expenditures or from increasing taxes, which results in a deficit. At this point, compensatory inflation becomes dominant.[14]

This political analysis of inflation helps explain, among other things, why the plans for stabilization proposed by the monetarist economists are generally only viable in dictatorial regimes, which receive strong protection from the local bourgeoisie and from the interests of international capitalism. This was the case of Brazil between 1964 and 1974, of Chile from 1973 on, and of Argentina from 1977 on. Note, however, that the fact that these plans were possible does not mean that they were successful. Generally, they cause heavy recession and the failure of small- and medium-sized businesses. Also, they only have some success if they are accompanied by the political-administrative measures of wiping

out trade unions and strangling wages, which has no support in the monetarist theories. Containment of inflation by democratic means generally not only implies the existence of governments with political legitimacy in the eyes of civilian society and with popular representation, but also acknowledges that an unbalanced government budget is not the only cause of inflation.[15]

11

According to this analysis, an unbalanced state budget is sometimes endogenous from a political point of view. Meanwhile, are there any reasons of a more strictly economic type could help explain the unbalanced state budget, making it at least partially endogenous to the economic system as well?

In the ninth section of this chapter, we looked at two fundamental economic causes that are opposites, but which complement each other. On the one hand, there is the need felt by the government to carry out price controls through the state itself, with these controls causing an unbalanced fiscal budget, which then forces it to print more and more new currency, provoking demand inflation. On the other hand, there is the tendency to apply a policy of corrective inflation, which causes cost push inflation.

The first mechanism corresponds to compensatory inflation. We can, however, examine the problem from a complementary angle. The most general cause of the tendency to have an unbalanced state budget is related to movements of the economic cycle. Our hypothesis is that it is in the declining phase of the economic cycle that the tendency toward imbalance is accentuated.

Economic deceleration is immediately and directly reflected in the collection of taxes, especially in underdeveloped countries, where indirect taxes tend to dominate. On the other hand, the vast majority of expenditures that maintain the state cannot be cut back. There may be some flexibility in expenditures for investment, but it is precisely these which should and do tend to increase at this point because of the need to counterbalance the cyclical movement in retraction. The imbalance of the state budget begins to be based on this contradiction: decreasing revenues opposed to the need to maintain, if not increase, state expenditures.

Actually, due to the (historically new) role of the state in technobureaucratic capitalism, fundamentally responsible for private accumulation and as a substitute for the market in the allocation of resources and the redistribution of income, the economic policy of the government takes on decisive significance. In this type of social

formation, the state partially substitutes itself for the market in controlling or coordinating the economy. What is expected from the state is that it will limit the cyclical fluctuations that result from pure and simple coordination of the economic system by the market. One would expect compensatory action from the state when there is a declining cyclical movement.

This compensatory action can take place in two fundamental ways. One, obviously, is the Keynesian fiscal policy, which tends to be implemented not only because of the theoretical beliefs of the economists who design economic policy, but principally due to pressure from civilian society. It proposes to increase state expenditures or to cut taxes in order to induce investments, as well as to reduce unemployment and idle capacity. Theoretically, in a situation of unemployment, this policy would not be inflationary; however, if we imagine that certain sectors will reach full capacity before others, it is not difficult to link compensatory inflation to structural inflation.

There is a second, more direct, compensatory action, which is to simply subsidize certain activities or certain types of consumption. In the last analysis, this kind of compensatory action is caused by cyclical decline, as is the Keynesian fiscal policy. Its mechanisms, however, are much more casuistic, and its distortions much deeper. They are more common in underdeveloped countries, but they also occur in developed ones. In the latter, which are characterized by the welfare state, expenditures for social ends tend to increase systematically. The governments are permanently faced with pressure from the society for higher standards of living, and the alternative—private consumption through higher wages—is not only in general more expensive (therefore less efficient), but it also offers fewer opportunities for supplier contracts for capitalist corporations. During the cyclical slowdown of the economy, there is even more pressure to increase expenditures for social consumption.

One of the most common compensatory actions, which is directly related to private accumulation rather than to social consumption, is the sectorial fixation of interest rates below the existing inflation rate. This implies a subsidy for accumulation for that sector whose volume, meanwhile, is indefinite. It increases as the inflation rate increases, given a controlled interest rate. The subsidy is obviously paid from the coffers of the government, whose deficit grows.

Another compensatory action is to reduce the taxes of a sector in the name of economic planning and the need to stimulate that particular sector or region. A reduction in the state revenue is immediate and a deficit inevitable. In the same category, we find the acquisition of corporations

that are in the process of bankruptcy because of cyclical retraction. Transformed into the main party responsible for the level of employment, the state has no other choice than to assume, in various forms, these debts.

Actually, in contemporary technobureaucratic capitalism, the state was made responsible for the process of capital accumulation and the rate of economic development. Thus, put at the service of private accumulation, it has no other choice than to continue to make investments itself and to finance private investments, generally by subsidizing them.

In underdeveloped industrialized countries, which tend to be strongly technobureaucratic, long-term financing is generally the direct responsibility of the state, as the private mechanisms for financing accumulation (stock markets and private banking systems, including investment banks) are unable to perform this role. If the state is made responsible for development, and if it directly controls a considerable part of investment through its own corporations, as well as the rest of investment indirectly through long term financing, it has no other choice than to compensatorily maintain the accumulation rate of the system.

Its freedom of action in this process is very limited, because the state is not an organism from outside the economic system or some kind of external regulatory agent, but rather an intrinsic part of the productive and financial economic system.[16] When the economy enters a cyclical decline, the economic policy of the state tends to become even more endogenous and immobilized. It becomes much more the result of the pressures and limitations that come from the system itself than the result of decisions of a relatively autonomous regulatory agent, as those who formulate economic policy claim.

These are characteristics of technobureaucratic capitalism, in both the developed and underdeveloped industrialized countries. They tend to be more accentuated in the latter because private interests are weakly controlled by the state, because the structural inflationary factors related to points of strangulation in supply are more accentuated, because of the frequent lack of legitimacy of governments, and finally because of the pressures that are put on the state to guarantee the accumulation of capital and the level of consumption at any price.

12

All of this analysis can lead us to various general conclusions. First, the acceleration of the inflation rates, and especially stagflation, which characterize the new inflation, are related to the substitution for competitive capitalism by technobureaucratic or oligopolistic capitalism.

Only in this type of capitalism is it possible to have inflation that maintains itself and sometimes even increases in the recessive phase of the cycle.

Second, inflation always has causes that are endogenous to the concrete social formation.

Third, these causes can, in the exchange equation, MV = Yp, act both directly on the money supply, provoking an increase in prices, and directly on prices, implying a need to increase the money supply in order to reestablish liquidity.

Fourth, the autonomous increases that operate directly on the level of prices are: (a) an imbalance between supply and aggregate demand at the peak of the cycle; (b) structural inflation; (c) administered inflation.

Fifth, only administered inflation is a historically new factor that can explain this new inflation.

Sixth, administered inflation is a result of the capacity of the large corporations, the trade unions, and the state itself to carry out a pricing policy in technobureaucratic capitalism—particularly in the subsystem that characterizes it, the planning system.

Seventh, this administration of prices makes it clear that inflation can be independent of excess demand. It is the result of an undeclared struggle for the division of the income between corporations, between corporations and trade unions, between corporations and consumers, and between various sectors of the economy.

Eighth, economic agents, in the distributive conflict process, change their prices alternately, one after the other, making inflation autonomous or inertial.

Ninth, the state is always an active, although at times contradictory, member in this struggle for the division of income. It tends to sustain capitalist accumulation, but its policy is the result of the class struggle.

Tenth, in this process, and particularily in the declining phase of the economic cycle, the state tends to intervene in the economy, either by controlling prices or by compensating for the losses caused by recession. In this process of intervention, the state tends to provoke distortions in the market and incur growing deficits, which are covered by an inflationary increase in the money supply.

Eleventh, governments' lack of power, which is a result of a lack of legitimacy (support from civilian society), leads them to carry out a compensatory policy in a generally irrational way, resulting in public deficits and profound distortions in the economic system.

Twelfth, correcting these distortions by using the mechanism of "corrective inflation" ends up provoking even greater inflationary pressures because the state administratively raises margins and prices, which the

businesses then immediately pass on to the other areas of the economy.

Thirteenth, in an economy characterized by technobureaucratic capitalism, by price controls, and by the tendency toward compensatory distortions (which are all reflected in the public deficit), we can distinguish between the causes that maintain the inflation level and those that raise it. Administered inflation, characterized by establishment of fixed margins and wage indexation, is the main cause of the maintenance of the existing inflation level. The causes of an acceleration of inflation are: (a) prices set by the oligopolistic corporations, which succeed in increasing margins; (b) prices set by trade unions, which manage to increase their wages above the average increase in the productivity rate; (c) "corrective inflation," which is nothing more than the administered increase of repressed margins; (d) the structural sectorial imbalances between supply and demand; (e) excess demand at the peak of the cycle; (f) an excess of currency caused by compensatory deficits endogenous to the state; and (g) imported inflation.

Fourteenth, any one of these seven causes can raise the inflation level. However, once the level is raised, it becomes extremely difficult to lower it because this would imply a generalized reduction of margins, which is incompatible with the oligopolistic corporations' policies of price controls. It would mean that these corporations would be forced to pass on only part their cost increases to prices.

To sum up, inflation has numerous causes, which operate directly on the administration of prices and through the imbalance of the state budget. The new facts that explain the acceleration of the inflation rate, as well as inertial inflation and stagflation, are related to the setting of prices by large corporations and trade unions and by the corrective-distortive actions of the governments' attempts to control a process that the market no longer has the means to control.[17]

13

The model that we just developed for explaining inertial inflation and the generalized worldwide increase in the inflation rate is obviously based on the Brazilian experience during the 1970s. According to this model, there are some factors that help raise the inflation rate. Others, specifically that particular form of administered inflation that maintains fixed margins even when the economy is in a recessive phase, guarantee that once each inflation level is reached it is maintained. Inflation then becomes autonomous of demand, with prices increasing inertially.

Among the factors that accelerate inflation, there are some that act directly on prices, which then force an increase in the nominal money

supply in order to maintain the liquidity of the system. Some of these, such as structural inflation and demand inflation at the peak of the cycle, appeared before technobureaucratic capitalism became dominant and continue to be active. Others are peculiar to this new social formation: inflation administered by corporations that raise their margins, by trade unions that increase their wages above productivity, by the OPEC nations that have caused the so-called imported inflation, and "corrective inflation" provoked by the government when it decides to raise the profit margins of the sectors whose prices had been repressed. On the other hand, there are those factors that act directly on the money supply, starting with state deficits, as well as pressures from the private sector to increase the money supply. These factors are especially active when there is a cyclical deceleration. In these cases, the increase in the money supply is not simply the fruit of demagoguery or of governmental incompetence. Rather it is a phenomenon endogenous to the social formations defined as technobureaucratic capitalism, in which the state is transformed into the main agent responsible for the process of accumulation.

The inflation rate in Brazil was declining from 1964 until 1972. In the first period, from 1964 to 1966, this was principally the result of a violent repression of wages, and, secondly, of some orthodox means for fighting inflation. In the second period, from 1967-1972, it was the result of administrative price controls that restrained profit margins, together with high profit rates that were possible not because of an increase in margins, but rather because of an extraordinary increase in production.

Beginning in 1973, the inflation rate began to climb again, with a decisive acceleration in its growth rhythm starting in 1979 (see Table 2.3). The change in the direction of inflation in 1973 is clearly related to a cyclical peak, with full employment and full capacity. In 1974, inflation continued to accelerate because of prices set by OPEC. Probably beginning in 1976, when deceleration became clear, growing state subsidies and pressures from the private sector provoked compensatory inflation. This process continued until the first semester of 1979. During this whole period, the government was practicing a stop-and-go policy; it would try to carry out an orthodox policy for fighting inflation, and then, being pressured by the corporations, would give up the attempt. This giving up was inevitable, because the Brazilian authoritarian state had been going through a profound political crisis of legitimacy in the eyes of civilian society since 1974. During the third period, from 1973 to 1979, there was no administered inflation characterized by an increase in the corporations' margins or caused by increases of real wages above the production rate.

Table 2.3 Inflation in Brazil: 1964 - 1980

Year	General Price Index	Cost of Living Index
1964	91.9	72.9
1965	35.5	53.9
1966	38.8	52.3
1967	24.3	25.9
1968	25.4	26.1
1969	20.2	22.3
1970	19.2	16.5
1971	19.8	24.8
1972	15.5	22.5
1973	15.7	26.7
1974	34.5	35.2
1975	29.2	28.5
1976	46.3	44.2
1977	38.8	39.2
1978	40.8	40.1
1979	77.1	70.8
1980*	110.2	93.6

Sources: General Prices Index (IGP) - Getúlio Vargas Foundation
Cost of Living Index, São Paulo - Departamento intersindical de estatística e estudos sócio-econômicos.
Variance for the twelve months ending in October.

Inflation administered by corporations and trade unions was limited to guaranteeing the stability of each inflation level reached due to the three courses mentioned above (demand inflation in the cyclical peak, imported administered inflation, and compensatory inflation). Naturally, structural inflation should be added to this, because it did become a permanent part of the Brazilian economy, although its role did not increase.

There is a fourth period, which began in mid-1979 with a change in the economic policy. The level of inflation changed dramatically (almost doubling). The main cause of this was corrective inflation, including the maxidevaluation in December of that year. The effects of the corrective inflations were aggravated by the new wage law, which also was approved in the second semester of 1979. This law guaranteed full and semestral indexation of wages, into which production increases should be incorporated. This law did not succeed in increasing the real average wage only because corporations, faced with the perspective of a reduction of their profits, managed to increase the inflation rate, thus increasing the loss in the workers' real wages between each readjustment.[18] A third factor that

increased inflation was the new increase in oil prices, which occurred in the middle of 1979.

At the end of 1980 (when this chapter was finished), a new economic policy of an orthodox nature was being presented. On the one hand, this new policy was the result of errors that had been committed previously, especially the violation of the law of value as evidenced by the preannouncing of the monetary and exchange corrections. On the other hand, it was also the result of pressures from an international financial system that could not accept not only the growing international debt, but also the constant deficits in the Brazilian trade balance. Its consequences were to raise the inflation level once more. The new economic measures, which are oriented toward freeing prices and interest rates, and a new exchange devaluation (because the economy had already accumulated profound distortions due to the extraordinary policy of preannouncing monetary corrections and exchange devaluations) clearly aim to achieve a balance-of-payments adjustment through "deflationary," recessive monetary and fiscal policy. Actually, as this policy includes new adjustments of relative prices, they show that, given a choice between balanced trade and reduced inflation, it is the former that is preferred. The result will be corrective inflation, or, in other words, a curious trade-off between inflation and a balanced trade account which neither neoclassical nor Keynesian theories can explain. Orthodox economic theory assumes that a recessive economic policy contributes to balancing international trade, as well as to decelerating inflation by increasing the hiatus of production. In an economy like Brazil's, which is dominated by oligopolies and state corporations and is full of distortions, it is very clear to everybody, including those who formulate the economic policy, that this theory is not valid. Recession could help to achieve trade balance, but it will also most certainly push inflation to a higher level.

Everything points to the fact that the government made a conscious choice for this option, giving priority to balance-of-payments adjustments at the price of an increase in the inflation rate. This reminds us that inflation is useful for capitalist accumulation; it transfers income from wage earners and the capitalist sectors that are politically weaker (or that are not considered to be a priority by the planned system) to the more dynamic and powerful capitalist sectors.

On the other hand, we should note that during the whole period that we were analyzing, the "anti-inflationary" economic policy was notable for its endogenous nature. Given the government's lack of legitimacy, as well as the lack of clear objectives of the economic authorities who (in the final analysis) were incapable of deciding if they really wanted to fight inflation or not, economic policy was no longer the result of decisions made

rationally and implemented coherently. Rather, it was the result of pressures and counterpressures from the different factions into which the dominant classes are divided and, secondarily, from the pressures of the workers themselves.

14

The assertion that the market hasn't the resources to control inflation in a technobureaucratic capitalism characterized by administered prices means that the orthodox economic policies, which aim to cool off the economy and provoke a recession, are inefficient (or least insufficient) to fight inflation. If inflation tends to accelerate during a cyclical decline, either as the result of the oligopolistic corporations' mechanisms for defending their profit rates or as a result of the compensatory policies of the state, it is clear that orthodox policies, unless of an extremely severe nature, will work to stimulate rather than inhibit inflation. The simple fact is that these policies are forced to start off with corrective measures for relative prices, aiming to reestablish the truth of the market—that is, to eliminate the distortions in the law of value inherent in monopolist technobureaucratic capitalism. This is an indication that their character is inflationary instead of deflationary, at least in the beginning. Once the inflation level is raised in this way, it becomes most difficult to lower it unless the recession becomes a profound and long-lasting depression.

The only alternative to the orthodox policies is administrative price controls. This is extremely necessary; but we have already seen that it has narrow limits and tends to provoke distortions, which in the end are inflationary. When intervening in the price system, the state should, in principle, concentrate only on those sectors that are clearly monopolistic, able to raise their margins, or maintain them at artificially high levels. In this process, in which the state is substituting itself for the market to a certain extent, it could react selectively by stimulating certain sectors and penalizing others through a combination of income, balance-of-payments adjustment, and capital accumulation policies. The limitations, however, on the process of administering prices are narrow, not only because prices should not become disconnected from value or, more precisely, from the price of production, but also because of the administrative and political difficulties involved. On the one hand, a very complex information system is needed; on the other, the officials responsible for the controls are submitted to all kinds of pressures by the corporations, and thus they often end up simply making official the price increases. Instead of reducing the inflation rate, they stimulate it or at least maintain it at a given level.

Effective price controls would not imply that corporations should be impeded in their efforts to increase their profits margins, but rather that they should be forced to lower these margins, thus preventing them from passing on all of their increases in costs to prices. It is plain that this is not an easy task in any kind of state, and even less in those that suffer from crises of government legitimacy.

Therefore, the general conclusion about economic policy is obvious. If inflation has various causes—monetary, structural, administrative, or aggregate demand-related—which all add up, it is useless not only to pretend that there is only one correct theory for explaining inflation, but also that there is only one valid policy for fighting inflation. An anti-inflationary policy should necessarily utilize, in various degrees, all the weapons of economic policy, from the classical instruments of monetary and principally fiscal policy to the mechanisms of administering prices and wages, as well as the interest and exchange rates.

An orthodox policy for controlling inflation, which, in the last analysis, comes from the belief in the capacity of the market to control the economy, consists of: (a) decontrolling prices, interest rates, exchange rates, and (contradictorily) administratively reducing wages; (b) rapidly eliminating government deficits by reducing expenditures and increasing taxes; and (c) drastically reducing the money supply. As a result of these policies, the economy would go into a recession, and the market, given an aggregate supply greater than demand, would automatically take it upon itself to reduce wages, margins, and prices.

An administrative policy for controlling inflation would, in the first place, have to be based on a respect for the law of value. It should interfere with the four basic prices of an economy (those of merchandise, interest, exchange, and wages), but this must be done within strict limits, respecting the balance of relative prices in order to avoid distortions: high profit rates or capital gains in certain sectors and losses in others. The objective is not to guarantee equal profit rates in all sectors, since, in technobureaucratic capitalism, economic policy is used to establish a hierarchy of profit rates in keeping with the economic priorities defined by the planners. But, in the short run, difficult decisions have to be made about which sectors should suffer more and which should suffer less from the anti-inflationary policy. In other words, it has to be decided who will "pay the bill" for controlling inflation.

The only sure thing is that it is impossible to fight inflation without profits, interest rates, rents, and wages being reduced in some way. Orthodox economic policy attempts to affect all profits indiscriminately through recession. In practice, it ends up mainly affecting wages via additional means of direct control. The administrative policy should decide

which ones should and will be penalized. In principle, rentiers and the business sectors that are not considered to have priority in the development process should be chosen. However, these decisions are always political and extremely difficult, not only in their making, but especially in their implementation.

We don't propose to substitute this administration for the market. We only propose that the imperfect, oligopolistic market of a technobureaucratic capitalism pattern function without great distortions in relative prices, thereby guaranteeing realistic and planned rates for profits and wages—an essential condition for price stability. This is possible—always respecting values and production costs, which should be taken as a referent for the main prices—by controlling the stategic prices of the economy: interest rates, the exchange rate, wages, and the prices of the cartelized oligopolistic sector. Other prices should be left to the whims of the market. It is important to note that, in technobureaucratic capitalist societies, a large part of these controls already exist to one degree or another; the difficulty lies in applying them efficiently.

This policy of price controls would naturally be complemented by fiscal policies (mainly tax increases) that would aim to balance the state budget in the medium term, as well as by a flexible monetary policy.

It is not a question of choosing between the market and administration, but of recognizing that, in oligopolistic capitalism, the market and the planning systems are both present. The problem is to know how to live with inflation, accepting that the inertial mechanisms for its maintenance are very powerful and, at the same time, to fight it, using the different policies in varying degrees of intensity, according to the needs of each situation.

The serious problem entailed in this conclusion is that the state, in charge of carrying out this economic policy, is definitely not a neutral agent. It is not a referee who can be put above society, but rather an intrinsic element of it. In oligopolistic or technobureaucratic capitalism, the state is no longer simply a basic juridical-institutional superstructure for society; it also takes part in the economic infrastructure when it acts as a producer.

Aside from this limitation, which is outside the scope of this analysis, it is certainly possible to control inflation in technobureaucratic capitalism by using an adequate economic policy. However, in order to obtain results, this policy should not only be intelligent—using flexibly any kind of instrument of economic policy—it should also be the product of a government with effective power, of a government that is legitimate in the eyes of the civil society.

There is an implicit fact behind this whole analysis that should be made explicit here. The monetarist proposal for a constant, neutral increase in the money supply in exact proportion to the increase in real income is obviously ideal. However, it is strictly out of the question in an economic system that not only develops in the midst of cycles of expansion and contraction, but also in which inflation is imbedded in an intrinsic or structural way.

Given these conditions, there are only two economic policies left for fighting inflation: either the orthodox policy of provoking recession by a drastic reduction in the money supply and state expenditures, or else the administrative policy of controlling prices through a variety of methods. These could be not only of a monetary or fiscal nature, but also of the state's firmly administering the prices of the oligopolistic sector and trying to find a medium-term solution for the bottlenecks in the economy, by moderately increasing production instead of decreasing it, and, finally, by living with a certain inflation rate.[19] An orthodox policy necessarily results in a stop-and-go process that the monetarists blame on the Keynesians, but which really is inescapable during an attempt (naturally not achieved) to apply a recessive economic policy all the way to its ultimate consequences. It results in a medium-term depression of the growth rate, rather than in a guarantee of a "natural" growth rate as the monetarists expect. An administrative policy would probably guarantee higher rates of medium-term economic growth for the system; as well, it would succeed in maintaining inflation at acceptable levels. Its assumption is that any policy for controlling inflation will only have results from success in diminishing the corporations' resistance to a reduction in their profit margins through price controls, and, at the same time, allowing the workers to limit wage demands to maintaining their real wages plus the average productivity increase. Given the market power of corporations and the growing bargaining power of workers, these two conditions for controlling inflation will be much easier to attain in a growing economy, which reduces the idle capacity and increases the employment level. That is the only way that it would be possible to make a moderate but constant increase in wages consistent with almost full employment, as well as a reduction in profit margins consistent with maintaining profit rates.

April 1981

Notes

1. The source for the data on inflation and on the growth of the GNP is the same as that for Tables 2.1 and 2.2.

2. As one person, who is both a journalist and lawyer, told me one day, quite perplexedly, "In my youth, when I studied political economy in law school, inflation was the issuing of money, it was an excess of money in circulation. Now everything has changed and I don't understand anything anymore."

3. Of course, one could make a distinction between pure neoclassicals, who are more interested in reestablishing the predominance of the competitive market, the neoclassicals who are influenced by Keynes, and the monetarists whose emphasis is on controlling the money supply.

4. The bibliography on the monetarist theory of inflation is immense, especially after Milton Friedman (1956) developed and refined the ideas of Hayek on this subject. For this type of bibliography, see Helmut Frisch (1977). It helps to note that the monetarist theory as developed by Friedman, more than being a theory on inflation, is a neoclassical alternative to Keynesian macroeconomics based on the concept of effective demand. However, this discussion is completely outside the scope of this work.

5. In this chapter, we do not intend to make a complete list of the theories on inflation. These lists have already been made, among others, by Bronfenbrenner and Holzman (1963), who did an especially interesting list of the theories of administrative inflation; Harry Johnson (1963), who emphasizes the monetarist view; Helmut Frisch, who contrasts the monetarists theory with the theories based on the Phillips curve (which, after all, is a Keynesian inspiration), in addition to presenting the structural and administrative theories and the recent attempts at synthesis; Francisco Lopes (1978), who lists the Brazilian works on inflation; and, Paul Davidson (1978), who reworks the Keynesian view.

6. Francis Cripps analyzes the Phillips curve and its monetarist revision and concludes, based on studies carried out in Britain, that the inverse relation between unemployment and nominal wages (and therefore inflation) has not been verified since World War II (1977, 109-110).

7. We will examine the different theories on inflation and bring up the basic Latin American literature on this in Chapter 4. An interesting formal exposition of the structural theory of inflation, emphasizing a survey of non-Latin American contributions on this subject, is done by André Franco Montoro Filho (1977). In this work, the author stresses that, as based on Lipsey's contribution, structural inflation can occur even when there is unemployment, because all that is needed is for one of the sectors to have reached full capacity. Note that we are limiting the concept of structural inflation to the sectoral imbalances between supply and demand. Sometimes

the concept is used to include all structural and, therefore endogenous, imbalances in the economic system that cause inflation, including the monopoly power of the business community.

8. A study carried out in the United States (Wachtel and Adelsheim, 1977), relating to the recessions of 1948-1949, 1953-1954, 1957-1958, 1960-1961, and 1969-1970, shows that the majority of the corporations, especially in the more concentrated industrial sectors, but also in the less concentrated ones, tended to increase their margins or to maintain them in those recessive periods. Among the more concentrated corporations, taking a general average, 52.6 percent increased their margins, 9.3 percent maintained them, and 38.1 percent reduced them. However, in longer periods of crisis, it is possible that the margins of the corporations ended up declining slightly, and as a result, the profit rates also went down. That is what has been happening all over the capitalist world since the second semester of 1979 despite all the inflationary resistance of the corporations.

9. André Lara Rezende (1979) and Edmar Bacha (1980) recently made two interesting formalizations of the inflationary process related to the redistributive process. According to Bacha, who even managed to incorporate administrative inflation into the model, "Inflation is an instrument for reducing the share of real wages in the income, so as to permit the capitalists to invest and consume at the levels that they want to" (p. 545). *See* also Adroaldo Moura da Silva (1978), who tries to combine various points of view on inflation into a general model.

10. James O' Connor (1977, 48) observes that usually the workers in the oligopolistic sector, being better organized, initiate an inflationary increase in wages, being followed by the workers of the public sector. An increase in wages is a way for the monopolist and public sectors to keep gains in productivity for themselves, to the detriment of the competitive sectors. But it is also a source of administered inflation.

11. Some economists have used the name "supply shock" both for phenomena like the oil price increase and for inflation that is the result of sudden and generalized deficiencies in supply, such as crop failures. Even though both phenomena occur at the level of supplies, they are very different from each other. In the firstcase, we have prices set for supply: administered or cost inflation is always "supply" inflation. In the second case, there actually is a "supply shock," but the inflation is a market inflation, as prices rise because of a drop in supply for reasons that are independent of the wishes of the business community (therefore without any "administration"), making them insufficient to meet demand.

12. For James O' Connor, this is one of the bases of fiscal crisis, whose consequences are inflationary. This fiscal crisis, which is marked by a tendency for a systematic increase in state expenditures, is structural in the capitalist system. In order to face this, the governments increase taxes or take on internal debts (which often are loans to itself, because it first permits an increase in bank deposits and therefore in the money supply).

O'Connor calls this process "inflationary finances" (1977, 54). The last resource is naturally the pure and simple issuing of money to finance the deficit in the state treasury.

13. It was José Serra who called my attention to the problem of "corrective inflation." Beginning with the first measures of Delfim Netto in the second semester of 1979, in an attempt to correct repressed prices, Serra published articles and interviews in *Folha de São Paulo*, pointing out the explosive effects that they would have on the inflation rate.

14. The first time I tried to make this analysis, which tries to make the deficits of the government and the issuing of money endogenous to the capitalist system, was in *Desenvolvimento e crise no Brasil* (1968, 59-65).

15. It is necessary, meanwhile, to point out that the tendency toward public deficit in technobureaucratic capitalism is structural, regardless of the legitimacy of the governments. James O' Connor's analysis of this subject is definitive (1973), but it is also worthwhile to quote Manuel Castells (1977, 186) here: "The socialization of prices and the privatization of profits have structural limits that the state in a monopolist capitalist society cannot overcome without provoking uncontrollable inflation." It is important to note that for "socialization of prices" Castells means the tendency of the modern state to continually increase its expenditures for social consumption, especially for the urban areas.

16. For state intervention in a state capitalist an economy, *see*, among others, Claus Offe (1977), Heinz Rudolf Sonntag, editor (1977), J. M. Vincent, J. Hirsch, M. Wirth, E. Alvater and O. Yaffe (1975), Alberto Martinelli, editor (1977), Nicos Poulantzas, editor (1977), Carlos Estevam Martins, editor (1977), Luiz Bresser Pereira (1977a), Francisco de Oliveira (1977), João Manoel Cardoso deMello (1977), Luiz Gonzaga de Mello Belluzzo (1977), Luciano Coutinho (1977), Fernando Henrique Cardoso (1977).

17. Labinini called attention to a factor that is inflationary and reduces profit rates at the same time, aside from the pressure from the workers for higher wages and the oil shocks: the elevation of indirect costs, especially the salaries of the top executives, "who set the salary levels for themselves and for other top executives in such a way that the profits of the companies are partly institutionalized and transformed into salaries for the top administrators" (1979, 13). Of course, this factor only accelerates inflation, as the corporations manage to compensate for the increased salaries with higher margins through price administration.

18. This chapter was already written when I became aware of the excellent theoretical and econometric work of Francisco Lopes and André Lara Rezende (1980) on the causes of the recent acceleration of inflation in Brazil. In this work, the authors not only show that there is no correlation between recession and inflationary deceleration, but they also construct a model that begins with the inflation level accounted for by a markup policy, and thus explain the recent acceleration of inflation by the increase in oil

prices and the new wage law. The model and their econometric tests confirm the hypothesis of this chapter. Their explicative power would have been better if they had taken the policy of the "corrective inflation" of 1979 into consideration, which actually brought about an increase in margins, thus becoming a third fundamental cause for the recent inflationary acceleration.

19. In the case of Britain, Francis Cripps notes that, because it is not the demand for workers that determines wages (as is assumed in the Phillips curve), but rather the bargaining power of the workers, recessive monetarist policies are inefficient for fighting inflation. It should be fought with production increases and a moderation of the workers' wage goals (1977, 111). In the case of Brazil, the recommendation for increasing production is the same (Ignácio Rangel 1963), it only being necessary to moderate the profit goals rather than wage goals.