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Between Contestation and Cooperation**

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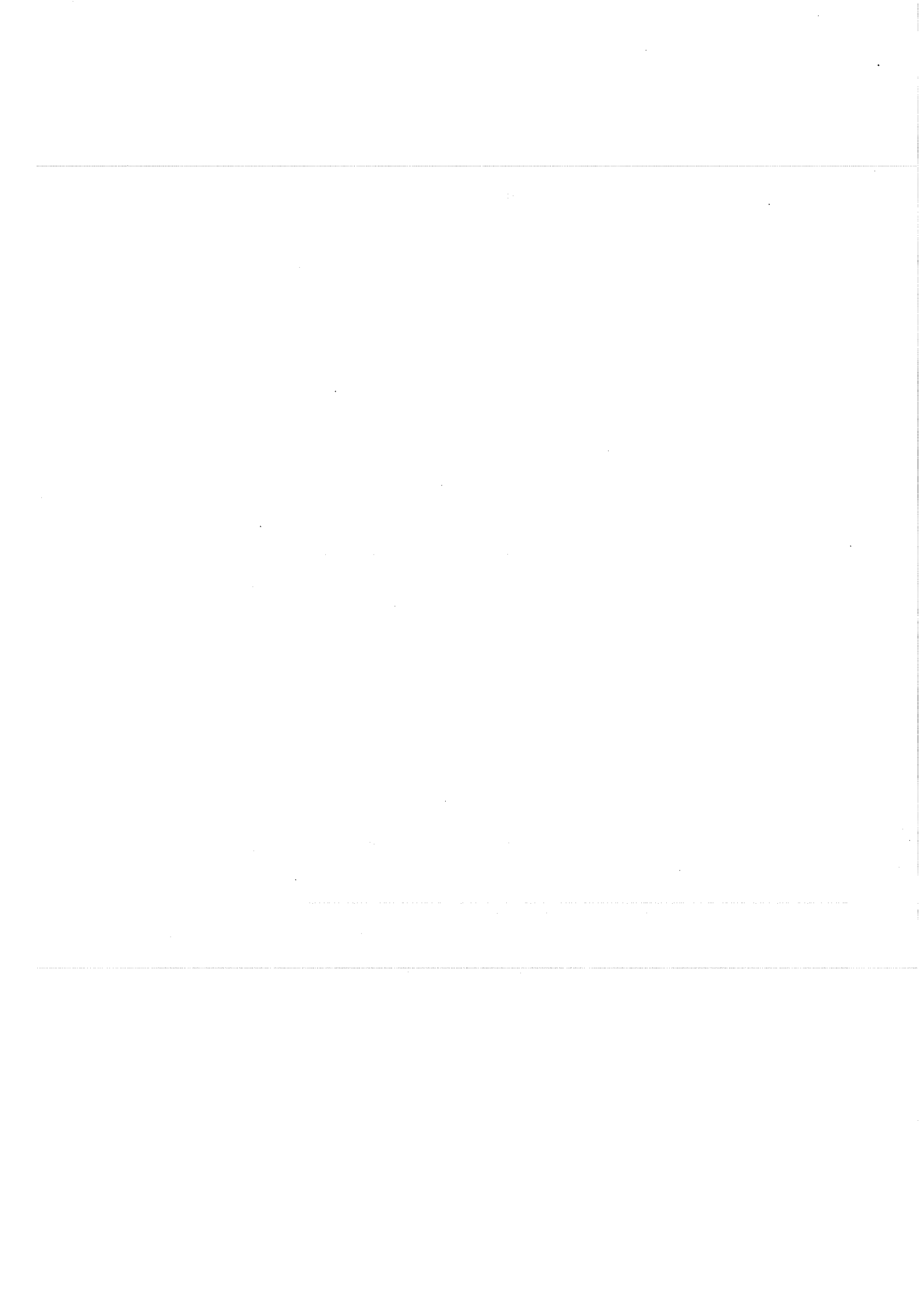
Abstract

This research paper places the policies of the Lula government in Brazil within the debate on development policy in Latin America and the efforts of the Latin American left to assert an alternative agenda to the increasingly unpopular neoliberal agenda. Considering the considerable convergence between the Post-Washington Consensus (PWC) and its most significant alternative on the left, known as neostructuralism, the author raises the question whether Lula can fulfill his electoral promise to significantly depart from neoliberalism. Moreover, it is suggested that, facing severe external constraints, Lula runs the risk of spending large amounts of political capital to further deepen neoliberal reforms that will enjoy renewed credibility, due to Lula's left-wing identity and high levels of personal popularity.

As the subsequent analysis of the Lula government policies shows, the former unionist has indeed become a champion of a neoliberal macroeconomic framework. Based on the need to repay Brazil's enormous levels of public debt, this has entailed severe budgetary restraint as well as the advancement of several key, neoliberal fiscal reforms. Similarly, in the areas of social policy and land reform, Lula has lagged far behind his promises and has essentially continued the agenda of President Cardoso.

The most significant departures from the neoliberal agenda of Lula's predecessor are identified within the sphere of microeconomic policy as well as foreign and trade policy. On the microeconomic level, Lula has essentially halted the privatization process and has reemphasized the role of the state in regulating certain key areas of the economy, such as the energy sector. On trade and foreign policy, Lula has pursued Brazilian interests with renewed assertiveness and has reemphasized the goal of South-South cooperation.

These policies are thus interpreted as a reorientation to a neostructuralist framework by the Lula government. However, in light of the continuing macroeconomic orthodoxy, this is not viewed as a significant challenge to the neoliberal paradigm promoted by Washington. On the contrary, as the author demonstrates, Lula's Brazil is largely viewed as a formidable ally by representatives of the international financial institutions (IFIs) as well as the conservative US establishment. Rather than signifying a break with neoliberalism, Lula's neostructuralist policies are thus primarily viewed as a more assertive articulation of Brazilian (business) interests within a consolidating neoliberal macroeconomic framework.



List of Abbreviations

- AEI – American Enterprise Institute
- BNDES – *Banco Nacional de Desenvolvimento Econômico e Social* (Brazilian National Economic and Social Development Bank)
- CAS – Country Assistance Strategy (World Bank)
- CFR – Council on Foreign Relations
- CSIS – Center for Strategic and International Studies
- FTAA – Free Trade Area of the Americas
- IFIs – International financial institutions
- IIE – Institute for International Economics
- IMF – International Monetary Fund
- ISI – Import substituting industrialization
- NICs – Newly industrializing countries
- PMDB – *Partido do Movimento Democrático Brasileiro* (Brazilian Democratic Movement Party)
- PPP – Private-public partnerships
- PSDB – *Partido da Social Democracia Brasileira* (Party of Brazilian Social Democracy)
- PT – *Partido dos Trabalhadores* (Brazilian Worker's Party)
- PWC – Post-Washington Consensus
- SAIS – Johns Hopkins School for Advanced International Studies
- UDR - *União Democrática Ruralista* (Democratic Ruralist Union)
- USTR – Office of the US Trade Representative
- WB – World Bank
- WC – Washington Consensus

1. Introduction

Lula's election in 2002 was an important indicator of popular resistance to neoliberal policies that has developed in Latin America in the recent past. Running on an anti-neoliberal platform, his victory reflects the disillusionment of large sectors of the population in Brazil with the neoliberal development agenda. Though Lula wasn't able to win the election on the more radical platform of the Brazilian Worker's Party (PT), he capitalized on the adoption of a more moderate campaign message that allowed him to profit from an alliance of "losers" of neoliberal adjustment (Morais and Saad-Filho 2003). Alongside the victories of other left-leaning politicians in countries like Argentina, Ecuador, and Venezuela¹ as well as the improving prospects for left-wing politicians in other Latin American countries, Lula is part of a clear trend that confidence in the traditional proponents of neoliberal policies in Latin America has faltered. Moreover, popular struggles against privatization schemes in Bolivia, Uruguay, and Mexico show increasing opposition to one of the central tenets of the neoliberal reform agenda (Bond 2004).

In light of these developments in Latin America, members of the left held high hopes for the Lula government to implement an alternative agenda to the market fundamentalism followed by the majority of Latin American governments since as early as the mid-70s (in the case of Chile) until the present. As the largest economy in Latin America, Brazil's path will have a strong impact on the future of Latin America and thus represents an important testing ground for the ability of the re-emerging left to assert an alternative development agenda.

However, even before Lula's election in October 2002, it was clear that, in spite of the increasing resistance to the neoliberal paradigm, a range of external and internal factors would constrain Lula's ability to fulfill these high hopes among the more radical sectors of his own party, the PT, the Brazilian social movements that had supported his candidacy as well as the Latin American left as a whole. Firstly, as Lula's support increased in the polls, Brazil's currency began slipping into a crisis reminiscent of the one in 1999. To calm the markets, Lula was forced to issue a "Letter to the Brazilian People," in which he guaranteed that Brazil would honor all its financial obligations. In the context of Brazil's staggering debt burden and its outstanding loans with the International Monetary Fund (IMF), Lula had, therefore, conceded to follow a rigorous path of fiscal austerity to honor his commitment. Internally, the

¹ Recently joined by the *Frente Amplio* government in Uruguay.

alliance that Lula had struck with the center-right Liberal Party represented a further constraint on Lula's ability to implement more radical policies (Saad-Filho 2003).

Furthermore, on a theoretical level the left has yet to establish a viable counter-discourse to neoliberalism. There have been significant theoretical and practical challenges to the right on the local level, such as the PT's participatory budget process in Porto Alegre and other Brazilian cities, but on the national level the establishment of a clear counter-discourse has proven more difficult. As Gwynne and Kay (2004b) state, the most comprehensive theoretical challenge to the neoliberal paradigm coming from the left is to be found in the neostructuralist school. However, to many leftists this development model poses few fundamental challenges to the neoliberal reliance on the market and its bias towards integration into the world economy. It is even seen as the "logical continuation of the neoliberal model"(2004b:262). Leiva (1998:35) has argued that "neostructuralism's historical opportunity appears once it is necessary to consolidate and legitimize the new regime of accumulation originally put in place by neoliberal policies."¹

Moreover, as the neoliberal paradigm has come under increasing attack (especially in the aftermath of the Asian Crisis of 1997), the traditional proponents of neoliberalism, most notably in the World Bank (WB), have also reformulated their original set of policy recommendations known as the Washington Consensus (WC). Since Stiglitz's call for a Post-Washington Consensus (PWC) and the WB report *Beyond the Washington Consensus: Institutions Matter* (Burki and Perry 1998), neoliberalism itself has undergone changes that encompass significant overlaps with the neostructuralist view. It is, therefore, often unclear to what extent a departure from the neoliberal policies of the 90s represents a challenge to the neoliberal establishment or merely its internal dynamic of change.

This lack of a comprehensive theoretical alternative coupled with the considerable constraints Lula faces in the realm of national economic policies indicates that his ability to significantly depart from the neoliberal model installed in the late 80s and 90s in Brazil is severely limited. It remains an open question whether he will succeed in his promise to break with this model or whether he will merely prove to consolidate and legitimize the system put into place by neoliberalism. As Stolorowicz (2004:13) puts it, it is necessary to differentiate between "an approach aimed at creating new political conditions and those more self-limited approaches that seek to administer with efficiency and altruism the conditions that already exist."

¹ Quoted in Gwynne and Kay (2004b).

1.1 Justification of Research

Leftist writers in Latin America are engaged in an ongoing debate on what constitutes the most effective challenge to the neoliberal model. Ellner (2004) has outlined three basic proposals that have emerged: the center-left approach promoted by Jorge Castañeda, the anti-neoliberal strategy proposed by Martha Harnecker, and the anti-imperialist/anti-capitalist framework championed by James Petras. Castañeda's model proposes moderate strategies for change to be implemented by center-left coalitions. As he demonstrated, when he assumed the post of Foreign Minister in Mexican President Fox's cabinet, he accepts coalitions dominated by centrist or even right-leaning parties, thus implying an acceptance to continue many of the central neoliberal policies.

Harnecker and Petras, however, reject such an approach, arguing that the dilution of the struggle against neoliberalism for extremely limited gains achieved within such an electoral alliance is not justifiable. Harnecker nevertheless emphasizes the importance of winning electoral contests, including those necessitating alliances with non-leftist parties as long as these aren't permitted to dominate the coalition. She justifies this with the unfavorable political conditions faced by the left since the end of the Cold War, while rejecting the claim that leftist governments will be no more than "administrators" of the neoliberal system. Instead she considers the practice of government as an important opportunity for the left to demonstrate the feasibility of an alternative to neoliberalism.

Petras on the other hand focuses his attention not on the development of practical alternatives to the neoliberal paradigm. Instead he proposes to combine anti-neoliberalism with broader anti-imperialist and anti-capitalist struggles. He argues that in fact neoliberalism as such is not the central challenge to a leftist agenda but rather the imperialist nature of US foreign policy. Moreover, as Petras and Veltmeyer have indicated (2003a:2), if state power is assumed, it must remain faithful to "socialist beliefs" and "defend democratic socialism," thus excluding alliances with the center-right. Furthermore, they make it clear that this must imply "expropriation of existing property"(2003a:5).

As these differing viewpoints would suggest, the left's interpretations of Lula's performance in office are also varied. On the extreme left, there has been outright condemnation by writers like Petras (2004a:7), who has labeled Lula's Brazil as "a formidable bridge toward the most retrograde positions on the right." Supporters of the Lula government, on the other hand, have justified Lula's moderate reform agenda as a necessary stage on the path to more fundamental changes in the future. In between lie interpretations

that criticize only parts of his strategy, while supporting others, most notably his extremely pro-active foreign policy.

1.2 Research Objectives

It is within this discussion that I want to place my analysis of the Lula government's performance to date. It will be the question of whether (or to what extent) Lula's policies serve to consolidate the neoliberal framework, largely put into place under the Cardoso administration, or whether they indeed represent a significant departure from this model. As indicated above, this analysis is embedded not only in the debate on "anti-neoliberal strategy" and the options available within the Brazilian context; it is also situated within the theoretical debate on development models between left and right and the increasing convergence that has occurred on this theoretical level.

Important sub-questions that I will focus on in order to answer my central research question are the following:

1. In which ways has Lula departed from the policies of his predecessor, President Cardoso?
2. How does Lula's role as leader of the Brazilian left influence the policy making process? Does his affiliation with the left facilitate the implementation of conservative policies by shielding him from leftist opposition or do pressures coming from his own constituency facilitate progressive change?
3. What policies do actors among the conservative US establishment, the international financial institutions (IFIs), and the international financial markets approve of and about what policies are their concerns? In what ways do Lula's policies serve their interests and in what ways do they pose obstacles to their objectives in Latin America and Brazil?²

1.3 Scope and Limitations

After less than two years in office, it is, of course, too early to give a conclusive answer to whether Lula will be able to depart from the neoliberal development paradigm. The objective of the paper is thus to point to the existing trends and what they imply for the future.

² Originally, I had intended to review the entire spectrum of conservative viewpoints under this sub-question. However, having found that there is a widespread convergence of views on the performance of the Lula government, I have chosen to neglect the more hostile, ideologically-driven viewpoints as they represent only a very small, marginalized group.

Moreover, I have chosen to focus on policy outcomes of the Lula government and how they relate to the objectives of the international neoliberal establishment, comprising the international financial community as well as influential policy makers in Washington. Consequently, the paper doesn't present any detailed analysis of areas such as the changes taking place within the PT and its relationship to its traditional base or the dynamics of the Brazilian political landscape. Rather my discussion focuses on the broader implications of Lula's government for the advancement of the neoliberal agenda promoted by Washington.

1.4 Methodology

My discussion of Lula's policies draws on a range of recently published materials on the Lula government. Due to the very current nature of the issues being presented, I have used not only strictly academic literature, but also transcripts of conferences and recorded statements by prominent scholars on the topic. This has been further supplemented by several interviews with academics as well representatives of the US foreign policy establishment, the IFIs, and the international financial community more broadly. A complete list of the interviews conducted and the conference transcripts used, including short descriptions of the experts cited in the paper, is provided in Appendix 1 and 2.

1.5 Structure of Paper

In Chapter 2, I will briefly review the main theoretical arguments of the reformed neoliberals (i.e. the PWC) on the one hand, and the neostructuralists on the other. I will emphasize the most important points of agreement and contention to clarify to what extent neostructuralism represents a departure to the neoliberal paradigm. Furthermore, I will discuss possible implications of the increasing convergence of these two paradigms for the process of market reforms in Latin America and Brazil. I will close this chapter with a brief assessment of Lula's electoral agenda to situate his promises to break with neoliberalism within the theoretical context mentioned above. In Chapter 3, I will review the most prominent fears within conservative US policy circles and the international financial community that emerged during the run up to Lula's election and its implications for the Lula government. Chapter 4 will then review the emerging domestic policy agenda, while Chapter 5 will address Lula's foreign policy and pose the question whether it constitutes a challenge to the US objective of promoting so-called market democracies in the region.

2. Neostructuralism: A Challenge to Neoliberalism?

As already mentioned, it is an issue of contention whether neostructuralism represents an alternative development model to neoliberalism, the dominant paradigm of the 80s and 90s. As Gwynne and Kay (2004b) point out, it has been argued that neostructuralism merely represents the next phase of structural adjustment, a period of consolidation of the neoliberal model. Nevertheless Gwynne and Kay identify several differences to the neoliberal paradigm. Though conceding that “neostructuralism has taken on board some elements of neoliberalism,” they maintain that it “has retained some of the core structuralist ideas”(2004b:263). Ultimately, however, they leave it open for debate whether the adjusted structuralist agenda still merits the label of a real alternative to neoliberalism.

This open question takes on particular relevance within the context of an evolving neoliberal paradigm. As the original WC is being replaced by a modified and expanded PWC, neoliberal policy makers are increasingly embracing an agenda that incorporates elements that could also be associated with the structuralist school. This simultaneous process of change has, therefore, yielded two development models, which are increasingly difficult to distinguish. While the state-oriented neostructuralist school has acknowledged the necessity to respect the constraints of the market, market-oriented neoliberals are increasingly willing to accept the importance of the state in correcting market failures. Though departing from different starting points, the two agendas display an increasing number of similarities.

It is this convergence of these two development models that I seek to address in this chapter. By comparing the PWC with neostructuralism I will highlight those aspects where convergence has occurred as well as the remaining areas of contention. Finally, I will touch on some possible implications of this theoretical rapprochement for the practice of development policy in Latin America in general and more specifically in Brazil.

2.1 Neostructuralism: coming to terms with the market

The key shift within the neostructuralist agenda has been the recognition that the developing economies can't shield themselves from the forces of global competition and the discipline of the market, as was the objective of the model of import-substituting industrialization (ISI). This implies an acceptance of the need for structural adjustment and

macroeconomic stabilization, the two core policy proposals of the IMF and WB. “Adjustment policies should stimulate the reallocation of resources towards the production of tradeable goods with particularly strong incentives during the first few years, especially for exports,” while inflation should be contained, if necessary through the implementation of “shock policies”(Sunkel and Zuleta 1990:42).

The difference to the original neoliberal proposal lies in the role of the state in mediating this process of adjustment and integration into the world economy and the call for gradual and selective implementation of the adjustment process. Drawing on the experience of the East Asian newly industrializing countries (NICs), neostructuralists recognize the state’s responsibility in implementing industrial policies that enable a “more efficient utilization of market signals, of entrepreneurial perception, information, coordination and initiative, and of international competition”(Ibid.). The state’s role is to guide a gradual integration into the world economy by creating an enabling institutional environment for business. Furthermore, the state has an important responsibility to promote technological progress and improve the knowledge base of the economy (Gwynne and Kay 2004b; Sunkel and Zuleta 1990). Finally, neostructuralists attribute an important role to the state in tackling the structural problems of inequality and poverty (Bitar 1988).

Despite this emphasis on the responsibilities of the state in the development process, however, neostructuralists also recognize the need to refocus the state’s role on core functions. While the “classical” functions, such as the provision of public goods, as well as certain “auxiliary” functions, such as the promotion of technology and competitiveness, should be strengthened (Sunkel and Zuleta 1990:45), neostructuralists acknowledge that the state should avoid involvement in the productive sector and intervene in the economy only in a “restricted and sporadic fashion”(Gwynne and Kay 2004b:263). The limits of state capacity should be taken into consideration. Rather than attempting to correct all the inefficiencies of the market, the state should prioritize and intervene strategically (Sunkel and Zuleta 1990).

2.2 The Post-Washington Consensus (PWC): rediscovering institutions

Though maintaining a central role for the state, in important ways the neostructuralists have, therefore, edged closer to the market-oriented wisdom of the neoliberal development model. Disagreement with the original WC policies is no longer based on a fundamental rejection of integration into the world economy or of the vital importance of macroeconomic stability but rather in the way these market-oriented reforms are implemented. However, in

this particular area the neoliberal wisdom has itself undergone important changes. Induced by Stiglitz's (1998) call for a PWC with "more instruments and broader goals," policy makers in Washington, especially within the WB, have moved to a more flexible approach to the implementation of market reforms. While the neostructuralists have been forced to acknowledge the importance of the market, neoliberals have accepted that "institutions matter" (Burki and Perry 1998). Consequently, Stiglitz's concept of the state's role bears striking resemblance to the neostructuralist approach:

Trying to get government focused on the fundamentals – economic policies, basic education, health, roads, law and order, environmental protection – is a vital step. But focusing on the fundamentals is not a recipe for minimalist government. The state has an important role to play in appropriate regulation, industrial policy, social protection, and welfare (Stiglitz 1998:24).

Arguably, Stiglitz may have gone further than most policy makers in Washington, which would explain his resignation as Chief Economist of the WB in 1999. Nevertheless, the relevance of institutional strengthening has been widely acknowledged. For example, in his recent book *After the Washington Consensus: Restarting Growth and Reform in Latin America*, John Williamson, who coined the term "Washington Consensus" in 1990, calls on the state to promote a business-friendly environment by providing not only macroeconomic stability and basic infrastructure but by performing the "modern task of building a national innovation system to promote the diffusion of technological information and fund precompetitive research" as well as "encouraging the growth of industrial clusters" (Williamson 2003a:12). Though he still rejects the introduction of an explicit industrial policy, the role of the state has clearly regained importance in the promotion of economic development. As Deraniyagala (2003) puts it, the PWC does endorse a number of interventionist industrial policies. However, she continues, they remain at the level of correcting market failures and thus stop short of endorsing an explicitly selective industrial policy.

In the debate on poverty reduction, Williamson (2003a) asserts that growth remains the most important tool to tackle the problem. However, he concedes that in Latin America "the case for action to improve the distribution of income is rather compelling" (2003a:14). Due to the high levels of Latin American inequality, he even accepts modest losses in efficiency to achieve large distributive gains. Similarly, the WB has recently published a report on inequality in Latin America that emphasizes, among other things, the need to strengthen the state's capacity to redistribute wealth (Ferranti et al. 2003).

The role of the state has thus clearly regained ground. The main difference to the neostructuralist approach appears to be a matter of emphasis rather than a matter of principle.

The most important divergence remains not on the necessity but on the extent of industrial policy.

An additional divergence concerns views on the functioning of the world economy. Critics on the left have argued that the PWC fails to address the socio-economic structures that condition the development process (Fine 2001). Neostructuralists, on the other hand, emphasize structural asymmetries in the world economy as important constraints on the development process. As Gwynne and Kay (2004b:263) point out, neostructuralists “view the world as a hierarchical and asymmetric power system which favours the centre countries and the TNCs in particular.” While neoliberals remain fundamentally optimistic about the prospects of further trade liberalization, neostructuralists favor a more strategic approach to economic integration, advocating the concept of “open regionalism.” The objective is to improve the region’s bargaining power, while engaging in further steps towards integration with markets in the developed world. Though the underlying need to adapt to the discipline of the (international) market remains largely undisputed, the process of integration into the world economy takes on a slightly different form.

2.3 The practice of neostructuralism: Cardoso’s legacy in Brazil

So, despite a considerable degree of convergence between the adapted structuralist model (i.e. neostructuralism) and the adapted WC, theoretical differences remain, most notably in the approach to industrial policy and the model for economic integration. But what does this mean in practice? What implications do these theoretical differences have on actual policy outcomes?

In many ways, the theoretical debate on development policy between neoliberalism and neostructuralism finds its counterpart in the political debate on the Third Way. Very basically, Giddens (1998), the founding father of the Third Way, has argued for a renewal of social democracy based on the core values of the left yet adapted to the realities of the various dimensions of globalization. In a very similar way to the renewal of structuralism, proponents of the Third Way have accepted the discipline of a global economy, while seeking to keep leftist principles, such as the redistributive role of the state, intact. Since the origins of the Third Way lie in Europe, it could, therefore, be said that neostructuralism could provide the theoretical underpinning of a Latin American Third Way.

It is, therefore, not surprising that Brazilian President Cardoso has been presented as a case study for both the neostructuralist school and Third Way politics. With Cardoso’s

intellectual legacy rooted in the dependency school, he was originally clearly associated with the left-wing. As Cunningham (1999) has pointed out, Cardoso has also clearly rejected the neoliberal ideology. Instead he has asserted, “We’re not abolishing the state in the name of what is often called neoliberalism, a doctrine of laissez-faire whereby the market can do what it likes”(Cardoso 1997:22-23).¹

Nevertheless, Cardoso’s policies during his presidency, most notably macroeconomic stabilization under the *Real Plan*, are commonly viewed as a neoliberal response to the instability that had plagued the country since the debt crisis (Cunningham 1999). Cardoso oversaw the most extensive wave of privatization of Brazilian state enterprises, deepened trade and financial liberalization, further opened the economy to foreign investment and reigned in public spending (Font 2003). Moreover, the exchange regime of the *Real Plan* and the opening of the capital account necessitated a rigid monetary policy of high interest rates to attract the necessary capital inflows to roll over the growing levels of government debt (Arruda 2000). In other words, during his presidency Brazil experienced its most dramatic phase of structural adjustment. Leftist critics like Petras and Veltmeyer (2003) and Branford (2003), therefore, don’t hesitate to interpret Cardoso’s famous statement asking the press to “Forget everything I have written,” as an admission of his transformation to neoliberalism.

Cunningham (1999), on the other hand, defends a more nuanced view, seeing Cardoso’s policies as a necessary response to the difficulties faced by his country and the increasing constraints imposed on the state’s policy options. In Cardoso’s (1997:17) own words, “With globalization, the State needs to recompose its functions. Thus the mission of the State to provide steering capacity for development becomes much more important than the patently ineffectual attempt to take the place of private enterprise in the production of goods and services which are not of an eminently public nature.”² Based on Cardoso’s proclaimed rejection of neoliberalism, she defends his Third Way or neostructuralist identity. According to Cunningham’s interpretation, Cardoso’s transformation reflects not a conversion to neoliberalism but rather a response to global realities as reflected in the debate on neostructuralism and the Third Way

This interpretation seems to be confirmed by the circumstances within which Cardoso undertook his series of structural adjustment measures. Not only was Cardoso’s *Real Plan* a response to Brazil’s endemic inflationary problems, but it was also accompanied by negotiations with the IMF and private creditors to restructure US\$49 million of Brazilian commercial debt. The agreement, known as the Brady Plan, was signed in 1994, the same

¹ Quoted in Cunningham (1999), 82.

² Quoted in Cunningham (1999), 80.

year Cardoso launched the *Real Plan*, and set out a series of deadlines for future reforms (Chussodovsky 1998). In other words, though Cardoso presided over Brazil's most extensive phase of neoliberal structural adjustment, this can be viewed as a response to external pressures.

Power (2001), on the other hand, detects a more pronounced shift towards the right by the Cardoso administration and his party, the PSDB. Cardoso's candidacy for the office of president, he states, marked a turning point in the party's history, completing a gradual rightward shift from a social democratic line to a more market-oriented approach. Lacking the traditional trade-union base of European social democratic parties, Cardoso could embark on an ambitious set of neoliberal reforms, frequently referring to the left's policy proposals as *atrasados* (backward). Power, therefore, questions the legitimacy of the Third Way label in Cardoso's case. Along the same lines, Gwynne and Kay (2004b:262) state that despite his social democratic profile, "to characterize the policies pursued by the Cardoso government as neostructuralist would be going too far."

Whichever label one ultimately chooses to accept, Cardoso's Third Way or neostructuralist profile has gone hand in hand with a range of neoliberal policies. Petras and Veltmeyer (2003), therefore, make no distinction between the PWC and neostructuralism. They accept the existence of a neostructuralist agenda but simply equate this with the PWC. Rather than as an alternative, they view these approaches as the second wave of the structural adjustment process. From this perspective, the social democratic or leftist image of Cardoso is, therefore, no more than a mask for a neoliberal agenda.

2.4 Neostructuralism, the left and the politics of second-generation reforms

Jayasuriya (2004) develops this interpretation of the Third Way in developing countries further. He identifies the current phase of neoliberalism as the continuation of economic liberalization going hand in hand with the construction of a new social contract between citizen and state based on neoliberal values. What he terms "neoliberal sociability" is no longer based on social democratic class identity and its model of social insurance and redistribution. Rather it promotes an "inclusive" market-oriented society with the goal to create a framework that reduces political conflicts and thus sustains the neoliberal order into the future. Leftist leaders, like Cardoso and now Lula, who bring together a commitment to economic reform and a strong social agenda are viewed as the implementers of this next phase of neoliberalism.

Navia and Velasco's (2003) discussion of the politics of second-generation reforms essentially confirms this view, though they turn its conclusions on its head. They state, "This means, in plain but old-fashioned language, that second-generation reform mongering need not be a right-wing affair; it can be a progressive or left-wing affair just as well"(2003:270). They argue that not only does the second-generation of reforms require strengthening the state but, unlike first generation reforms, its losers are typically found among more privileged groups like "the upper echelons of public bureaucracy," "owners and managers of private monopolies" as well as "judicial and teacher's unions" (2003:268). Nevertheless, ultimately Navia and Velasco admit that the proposed agenda of second-generation reforms remains rooted in the conservative neoliberal agenda. As they make clear in the subsequent discussion, reforms undertaken by the left-wing are viewed as policy reversals.

In spite of this, Navia and Velasco propose that, in fact, left-wing leaders may be more efficient reformers than leaders on the right. As it took Nixon to go to China,³ they suggest that, considering the popular discontent with neoliberalism, a right-wing leader would face a strong opposition from the left, if he was to implement so-called second-generation reforms. A left-wing leader, on the other hand, can implement this conservative agenda without major opposition. Moreover, left-wing leaders can more credibly claim that their dedication to the reform process is based not on ideological conviction but on new information or circumstances that have changed their policy preferences. This has the effect that the policies themselves become more credible and will enjoy increasing public support. Regarding Lula, Stephen Kay (2003), therefore, notes that his government may be performing a "litmus test" for second-generation reforms in Latin America. He states, "If a very popular left-of-center president like Lula cannot accomplish such reforms, it does not bode well for other governments in the region"(Kay 2003).

On the other hand, the power of trade unions may stand in the way of left-wing governments adopting reforms that may hurt their direct electoral constituencies. However, with the declining power of organized labor, a more favorable perception of the government by the trade unions often can induce them to greater concessions in the context of reform negotiations. Moreover, Navia and Velasco note that in the recent past, political platforms have become increasingly vague and unspecific, so that it matters less and less what policies are implemented but rather how successful they are in the medium term in bringing benefits to the general public.

³ The analogy of Nixon going to China refers to the rapprochement with China that occurred under Nixon. It is said that it took an anti-Communist like Nixon, isolated from attack from the right, to convince the public that the US should pursue a more cooperative relationship with China.

2.5 Lula's conversion to neostructuralism

Indeed, Lula's election campaign, characterized as "Lula, Peace and Love," reflects this trend towards a more vague political message in place of more radical, ideologically driven rhetoric. Nevertheless, he promised to break with the previous neoliberal economic model and prioritize the problems of the 50 million poor in Brazil. His electoral platform entitled *A ruptura necessária* (A necessary rupture) condemned the heightened social exclusion and increasing social inequality generated by neoliberalism and advocated the need for a new development model. In particular, the PT platform promised to address such social ills as malnutrition, illiteracy and inadequate public health care and pledged to place agrarian reform at the center of their new agenda. In terms of economic policy, it advocated a break with the IMF to liberate the national economy and rejected the Free Trade Area of the Americas (FTAA) as it stood as a "project of political and economic annexation of Latin America by the US" (PT Manifesto 2002:13). Privatization would be halted, an active industrial policy would be implemented, and the government would use anti-cyclical spending to stimulate economic growth.

Simultaneously, however, Lula promised that this wouldn't come at the expense of the market, promising to honor the Brazilian debt payments. The primary surplus would be maintained to ensure debt sustainability. In other words, growth with equity rather than radical redistributive measures would be at the core of his policy goals. As Gwynne and Kay (2004b) have stated, Lula's priorities may thus signal a shift to a neostructuralist program.

In light of the considerations by Navia and Velasco as well as the ambiguous relationship of neostructuralism to the neoliberal agenda, it is thus unsurprising that Lula has been heavily criticized among certain sectors of the left. In the eyes of a Petras as well as the more radical wing of Lula's PT itself, he has simply advanced the consolidation of the neoliberal model rather than the break that was envisioned.

Indeed, his leftist credentials have equipped him with a large amount of political capital that he can employ to implement unpopular reforms as well as neoliberal policies, such as a primary surplus that exceeds even the prescriptions of the IMF. This allows him to balance the demands of his constituencies with the realities of the Brazilian economy. However, it also places him in danger of placing the interests of such neoliberal constituencies as the international financial markets over those of his electorate. It is, therefore, questionable

whether Lula is truly changing the course of Brazilian development or merely generating credibility and a social framework for the consolidation of the current model.

3. Fears of Lula Taking Power

Before Lula took office in 2003, it seemed that Lula did indeed pose a more fundamental challenge to the system favored by the US. Despite Lula's moderate electoral campaign and alliances with the conservative Liberal Party, the prospect of Lula winning the Brazilian presidency caused a very negative response among a range of conservative policy analysts in Washington as well as the markets. There was a widespread fear that Lula posed a threat to Brazilian stability with significant repercussions for Latin America as a whole. Though Lula indicated that he would honor all government commitments, the fears among investors continued.

This chapter will, therefore, analyze the particular concerns that were brought forth by conservative policy circles, most notably Paul O'Neill, the US Treasury Secretary at the time. However, instead of suggesting that these fears indeed indicate a more fundamental disagreement with Lula's policies, I will argue that most importantly these fears reveal the nature of Brazil's precarious financial position and the fear that Lula would renege on his commitments in the realm of economic policy. Furthermore, rather than causing the financial fallout feared by the markets, these circumstances have, in fact, been instrumental in forcing Lula to adopt the kind of neoliberal macroeconomic framework desired by investors.¹

3.1 Explosive debt dynamics

The fears of investors and policy analysts were primarily grounded in the potentially explosive debt dynamics of the country and Lula's past calls for a default. As Lula's numbers in the polls increased in the first quarter of 2002, financial institutions began demonstrating their concerns by refusing to purchase government bills maturing after 31 December 2002, the last day of Cardoso's term (Morais and Saad-Filho 2003). Interest rates had to be increased to roll over the debt, and Wall Street repeatedly downgraded Brazilian bonds. Foreign banks began recalling their short-term loans and the value of the *Real* started slipping. By September the Brazilian currency had reached a record low of R3.78 to the dollar, having lost about 40

¹ Initially, there was also a group of Congressmen headed by House Chairmen of the International Relations Committee, Henry J. Hyde who had more widespread fears and warned the Bush administration about a new Latin American "axis of evil." However, this was a marginalized viewpoint dominated by outdated Cold War rhetoric, and it was not heeded by the Bush administration in its engagement with Lula. For more details see Menges (2002a/b;2004).

percent of its value since the beginning of the year. As a consequence, the Brazilian government debt, which is for the most part either denominated directly in dollars or indexed to the dollar exchange rate, had increased from 48 percent of GDP at the end of 2001 to an unprecedented 62 percent shortly before the election. To avoid a default in this extremely volatile situation, the next administration would be required to maintain an even higher primary budget surplus than the Cardoso government.

To stabilize the situation the Cardoso administration signed a new US\$30 billion loan agreement with the IMF. Only US\$6 billion of this would be available immediately, while the rest would be available to the incoming government, provided that its economic policies met with IMF approval. Lula himself tried to calm the markets by issuing a “Letter to the Brazilian People,” in which he promised to continue servicing the government debt on schedule and to pursue economic policies in accord with IMF agreements.

To many critics on the left, this was a major turning point in Lula’s final conversion to neoliberalism, and, in fact, it allowed Lula to generate confidence among a range of important actors of the US foreign policy establishment, including the influential Council on Foreign Relations (CFR) as well as the State Department itself. However, simultaneously many investors, a range of conservative analysts as well as Treasury Secretary Paul O’Neill continued to mistrust either Lula’s sincerity or his ability to fulfill his promise to act fiscally responsible.²

The doubts about Lula’s sincerity can be explained with his leftist past as well his promises to tackle Brazil’s “social debt” and to depart from neoliberalism. As political scientist David Fleischer at the University of Brasilia put it, “Lula will have to explain how you can aspire to totally different economic model, but at the same time maintain the parameters of the [IMF]: low inflation and a high primary surplus.”³ The central point raised here is whether the promises mentioned are compatible with a rigorous macroeconomic framework based on fulfilling the government’s obligations to repay the debt. Investors worrying that the social commitment would come at the expense of fiscal discipline, therefore, remained fearful. As Williamson (2003b:106) puts it, “The markets doubted that he would impose the sacrifices required to sustain debt service.”

Other market analysts were even more pessimistic, seeing the Lula threat as no more than the trigger for a default that would eventually prove inevitable. Walter Molano, head of research at BCP Securities, for instance, opined that “[y]ou could try to avert it [a default], but

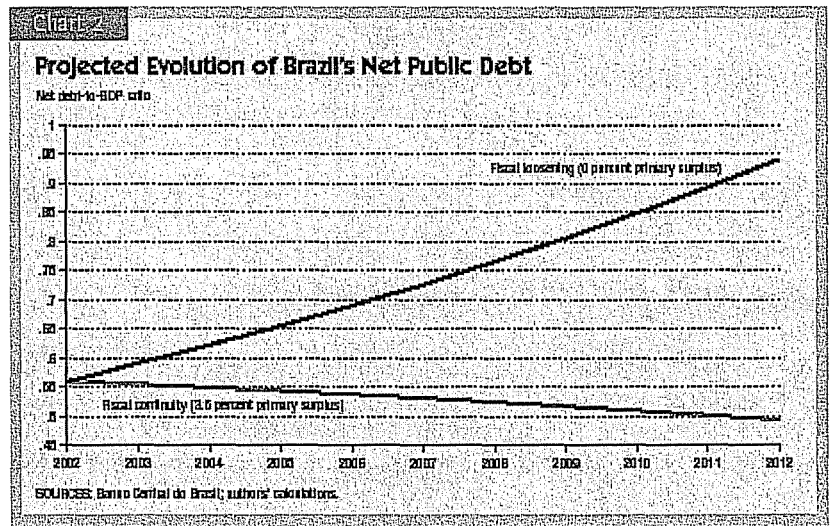
² Treasury Secretary Paul O’Neill stated shortly after Lula’s election that he still needed “reassurance that he’s not a crazy person”(Blustein 2002).

³ Quoted in Nogueira (2002).

when you don't face your realities - well, the evidence for what happens then is very clear. It's called 'Argentina'"(Blustein 2002). Similarly, Bruce Stokes (CFR) stated in 2002, "Brazil's foreign debt, except in the most implausible of positive economic circumstances, is simply unsustainable in the years ahead"(Stokes 2002). As Williamson (2003b) explains, the necessary circumstances would be a medium-term growth rate of 4 percent, an annual inflation rate of 3.5 percent, a primary surplus of 3.75 percent, and the appreciation of the *Real* to a level closer to its level before the 2002 crisis. Moreover, there would be a need for prudent policies by the Lula government and the ability to resist "pressures from parts of his core constituency for large immediate increases in public expenditure"(2003b:110).

Table 1: The chart shows that even using optimistic assumptions reducing the Brazilian debt burden will require high primary surpluses well into the future.

Assumptions: annual real GDP growth: 3,5%; average real interest rates: 9%; no further real currency depreciation.



Source: Gruben and Quintin (2002).

Whether the Brazilian debt dynamics will, in fact, prove unsustainable in the years to come remains an open question. However, what these speculations demonstrate is that the debt burden, built up under the Cardoso administration, poses a key constraint on the Lula government's ability to deliver on its campaign promises. Lula faces a clear trade off between servicing the debt and the other campaign promises of significantly expanding the state's social policies.

3.2 Restoring confidence

Once Lula was finally elected president in the second round of elections his appointments for the head of the Central Bank and the Minister of Finance made it increasingly clear that he would choose to avoid a debt default and adhere to the necessary

fiscal discipline. Consequently, even the most skeptical analysts appeared to be reassured. The *Real* rebounded and the yield spread on Brazilian bonds over US treasuries fell from a high of 24.43 in September back to 14.17 on December 20th, about a week after Lula appointed Henrique Meirelles, the former head of Fleet Boston Global Bank, as head of the Central Bank.

These events thus provide further confirmation that the neostructuralist agenda Lula was advocating throughout the campaign, i.e. his commitments to respect market discipline while investing in social programs, weren't at the root of investor fears. It was rather the fear that Lula would, in fact, discard the former part of the agenda and renege on his promises of fiscal responsibility. It was feared that Lula's commitment to tackle Brazil's social problems would override his commitment to the fiscal austerity necessitated by Brazil's debt burden. Therefore, once Lula had assembled an economic team that enjoyed the confidence of the markets, these fears dissipated and analysts were reassured that Lula's moderate stance would also prevail once he took office. In other words, once investors were confident that the neostructuralist promise to respect market discipline would override Lula's promises on social issues, they were happy to embrace the leftist.

Unfortunately, as this indicates, it is highly questionable whether market discipline and significant increases in social investments will prove to be compatible. Rather it seems that the Brazilian debt will provide the necessary external pressure to keep Lula wedded to the kind of fiscal restraint championed by neoliberals. Thus, if Lula remains committed to avoiding a default, Brazil's debt burden may well force Lula to follow a similar set of neoliberal policies as his predecessor.

4. Cooperating with the Markets

After almost two years in office, the fear and speculation surrounding the election campaign have now given way to appraisals of Lula's actual performance in office. Though some uncertainty and speculation remains, analysts have been able to redirect their attention to the results produced by the administration. Unsurprisingly, reflections on Lula's radical past, which had given rise to investor fears in 2002, have now been largely replaced by the debate on Lula's policy choices and their relevance for Brazil, Latin America and the US agenda in the region.

In this chapter, my analysis of this debate will address the domestic policy agenda. I outline the choices made by the government to this date and analyze how this relates to trends in the broader Latin American development debate as well as the debate among members of the US establishment and the IFIs. I will begin by focusing on macroeconomic policy and reforms to improve the government's fiscal position and then move on to other policy areas like microeconomic reforms and the implementation of social policy and land reform. I will conclude with perspectives on the effectiveness of the government in pushing legislation through Congress as well as fears among neoliberal policy makers related to tensions within the PT and the governing coalition itself as well as its constituencies within Brazil's civil society.

4.1 Macroeconomic policy and fiscal reforms

4.1.1 Macroeconomic policy

Once Lula took office and was able to put the policies he had advocated into practice, the widespread fear of a default was finally put to rest. By increasing the primary surplus target beyond the 3.75 percent prescribed by the IMF to 4.25 percent, Finance Minister Palocci created a "credibility shock," bringing down the country's risk rating in a matter of weeks from 2400 to 800 points. To control the risk of inflation the Central Bank only relaxed interest rates gradually thus achieving a reduction of inflation from around 18 percent in 2002 to meet its target range of 5-6 percent in 2003. In other words, Lula and his economic team were fulfilling the promises made to the financial markets before taking office. Despite its recessionary consequences for the Brazilian economy in 2003, the administration has

remained committed to a tight monetary policy and has even surpassed the Cardoso government's record in demonstrating fiscal restraint.

Consequently, the US establishment and the IFIs have been ecstatic. At the 2004 Brazil Summit organized by the Brazilian-American Chamber of Commerce representatives from the US government, WB, IMF and members of the international business and financial community celebrated the "remarkable" macroeconomic performance of the Lula government. Finance Minister Palocci was awarded the Chamber's 2004 Distinguished Leadership Award for his role in establishing "Brazil's international credibility and restoring investor confidence in the country."¹ Similarly, Lula has been applauded for his achievements by US Treasury Secretary John Snow as well as IMF director, Rodrigo de Rato (IMF Press Release No.04/186).

What was especially "amazing," as Professor Scheinkman of Princeton University as well as the IMF's Executive Director for Brazil, Murilo Portugal, noted, was that the surplus was achieved without increasing the tax burden.² In this vein, policy analysts throughout the conservative establishment have overwhelmingly stressed that Lula has represented continuity rather than the radical rupture investors had feared. In fact, Guillermo Perry, WB Chief Economist for Latin America, noted that in terms of macroeconomic policy Lula was even outperforming the Cardoso government.³

4.1.2 Fiscal reforms

In terms of fiscal reforms analysts have been especially impressed. Again Lula's advances in areas like pension reform and tax reform were hailed as important successes at the 2004 Brazilian Summit and throughout the conservative establishment in the US. After the IMF's latest mission to Brazil, Mr. de Rato described the advances in the reform agenda as "very impressive" and called the government's policies "courageous" (IMF Press Release No.04/186).

In the context of these successful reforms, Lula's leftist background is now increasingly seen as an asset rather than the liability initially expected. Lula and the PT being at the forefront of the reform agenda, many believe, has been the key to their successful passage through congress. Desmond Lachman (American Enterprise Institute – AEI)

¹ Conference Report, 2004 Brazil Summit, April 27, 2004, New York City.

² Conference Report, 2004 Brazil Summit. All subsequent references to Scheinkman and Portugal are drawn from this source.

³ Interview, May 16, 2004. All subsequent references to Perry are drawn from this source.

specifically evoked the metaphor of “Nixon going to China” - as predicted by Navia and Velasco (2003) - to describe the advancing of the “conservative agenda” under the former unionist. Lachman believes that Lula’s role in isolating the far left in the PT and bringing the party to the center has generated the necessary political consensus in Congress to implement reforms that Cardoso failed to implement, at least in part, due to the PT’s opposition.⁴ Perry (WB) similarly opined that, due to Lula’s credibility on the left, he is more able to implement the reform agenda the WB envisages for Brazil.

Lula’s ability to advance these kind of second-generation reforms is further enhanced by his efforts to construct what he calls a social pact between business, labor, and government. He has created a forum consisting of Brazilian civil society called the Social Economic Development Council, which is charged with the task of formulating policy recommendations on issues, such as the above mentioned pension and tax reform. According to the WB, it represents a “promising initiative for galvanizing the political and social support needed for reforms.”⁵ However, as Petras and Veltmeyer (2003a) point out, this forum is heavily dominated by business representatives. Considering its policy outcomes, it has thus primarily facilitated the further implementation of neoliberal fiscal reforms rather than allowing real input from its labor representatives. WB Senior Economist for Brazil, Mark Thomas, therefore, believes, it isn’t the outcomes of Lula’s policies that differ from Cardoso’s, it is rather the policy making process that has become more participatory.⁶

On the macroeconomic level, Lula’s leftist background and more “inclusive” decision making process has, therefore, become a strategic asset for the neoliberal development agenda represented by the WB and the US establishment. Though his reform agenda may be part of a broader neostructuralist agenda, de facto it has produced precisely the results envisaged by neoliberals. As the responses in the US and the IFIs indicate, rather than adjusting Cardoso’s course, Lula is in fact continuing and deepening the reform process expected by neoliberal policy makers.

4.1.3 Political implications of Lula’s macroeconomic orthodoxy

Furthermore, beyond the actual implementation of a neoliberal macroeconomic agenda, Lula is also cherished by conservative policy analysts for his role in restoring

⁴ Interview July 26, 2004. All subsequent references to Lachmann are drawn from this source.

⁵ Country Assistance Strategy 2004-2007: A More Equitable, Sustainable and Competitive Brazil. Washington, DC: World Bank, 17.

⁶ Interview August 4, 2004. All subsequent references to Thomas are drawn from this source.

credibility to the neoliberal course he has taken. Due to his personal integrity and leftist image, Lula's presidency has made an important contribution towards restoring political legitimacy to orthodox macroeconomic policies and neoliberal fiscal reforms in Brazil and Latin America. According to Miguel Diaz, Head of the South America Project at the Center for Strategic and International Studies (CSIS), Lula's macroeconomic agenda is the beginning of a market-friendly left in Latin America. Though pioneered by the Concertacion governments in Chile, Lula, he believes, confers democratic legitimacy on the model of a responsible left, previously deprived of broader acceptance, due to its association with the Pinochet dictatorship.⁷ A representative of the IMF's Brazil team declared Lula's responsible macroeconomic policy a milestone on the path to developed country status. According to him it provides assurance that the election of a leftist government would no longer affect the overall investment climate and thus indicated the maturity of the Brazilian state.⁸ In other words, Lula's government is viewed as an important step towards the consolidation of the neoliberal macroeconomic model. By extinguishing the leftist threat to the model, Lula is able to guarantee its political sustainability.

On a political level, Lula's reform agenda and macroeconomic policy has thus been hailed as a watershed in terms of the Latin American left's coming of age. Lula's Brazil is now deemed safe for capital and, with the conversion of the more radical PT of the past to Lula's moderate agenda, is expected to remain so in the foreseeable future. Considering Brazil's importance for Latin America's economic well-being as well as its hemispheric leadership role, Lula's shift to the center is viewed as an important precedent for the future of the Latin America. Experts, like Williamson⁹ and Perry, agree that Lula's presidency will be of great significance in restoring credibility to the market reforms that have come under increasing attack in Latin America.

4.2 The microeconomic agenda, industrial policy and the role of the state

On the microeconomic level, the record is slightly more ambiguous. Though this dimension of Lula's economic policy is clearly of secondary importance on the conservative agenda, his performance is also viewed with more caution than on the macro level. On the other hand, parts of Lula's microeconomic agenda, which were unpopular with the

⁷ Interview August 11, 2004. All subsequent references to Diaz are drawn from this source.

⁸ Interview August 12, 2004.

⁹ Interview July 19, 2004.

international financial community, have also been revised and hence realigned with conservative expectations.

4.2.1 Microeconomic reforms

Partly, worries on the microeconomic level reflect analysts' impression that the market-oriented agenda followed by Lula and Finance Minister Palocci has significantly less backing outside the Ministry of Finance. Thus there are some worries about the implementation of desired reforms by other ministries. As Professor Scheinkman stated, though the government is proposing microeconomic reforms he supports, he is worried that "once you get out of the Ministry of Finance [...] the Government has been incapable of displaying the kind of action [...] that will lead to really effective measures." Confirming this assessment, responses to the microeconomic reforms falling within the sphere of the Finance Ministry's competence have met with great enthusiasm, while actions taken by other ministries have been received with more cautious optimism.

For instance, the new bankruptcy law launched by the Finance Ministry has been cheered by Otaviano Canuto (WB) as "a landmark in terms of progress."¹⁰ Thomas (WB) calls the new law "international best practice," and US Undersecretary of the Treasury, John Taylor views it as "very promising,"¹¹ a view shared by Phil Gerson of the IMF.¹² Moreover, Murilo Portugal (IMF) and Canuto (WB) extend this judgment to a series of other microeconomic reform proposals presented at the 2004 Brazilian Summit by Brazilian Treasury Secretary, Joaquim Levy, including an improved regulatory framework for private-public partnerships (PPP), a housing finance law and reforms to the securities and exchange commission. In fact, Thomas notes that, as a part of its current Country Assistance Strategy (CAS) for Brazil, the PPP-law was developed in close consultation with the WB itself. Like the new bankruptcy law and a range of other reforms outlined in the CAS, the implementation of the PPP-law was, in fact, a precondition for further access to WB lending.

The more controversial aspects of Lula's microeconomic policy agenda, as noted above, are located outside the direct influence of the Finance Ministry. Most prominently, there has been controversy about the government's views on regulations in the utility sector, a point raised by Perry (WB), Lisa Schineller of Standards and Poor's as well as within the

¹⁰ Conference Report, 2004 Brazil Summit, 22. All subsequent references to Canuto are drawn from this source.

¹¹ Conference Report, 2004 Brazil Summit, 32.

¹² AEI Conference Report, Brazil: One Year after Lula, January 2004. All subsequent references to Gerson are drawn from this source.

conservative Brazilian establishment (Sader 2004). Schineller worries that the Lula government isn't willing to grant these agencies the necessary independence, which are "important from the investor climate perspective, especially abroad,"¹³ while Perry states that the Lula government has exerted distrust for autonomous regulatory agencies.

The energy sector is deemed especially important, and as *The Economist* reports, "private investors have damned the [government's] model as 'statist'" (January 3, 2004) because it doesn't allow for the privatization of the electric generator, Eletrobras. But not everyone agrees. Otaviano Canuto (WB) and Riordan Roett (Johns Hopkins School for Advanced International Studies - SAIS) have defended the government's plans for the energy sector. Roett says that, in fact, privatization plans wouldn't be politically feasible anyhow, due to "powerful regional interests." Nonetheless, he believes the government's plan "is not hostile to private participation" and "will utilize the private sector for the bulk of the new investment needed in generation" (Roett 2004). Moreover, as *The Economist* has reported, the government has also adjusted initial proposals to accommodate investor demands. It "dropped the contentious idea of making regulators' tenure to coincide with the president's" and has added the PPP-law mentioned above, which is "designed to lure private investment into such public works as roads and electricity" (November 8, 2003). On July 30th, 2004, when Lula signed the decree to implement the new regulatory framework, Juliette Kerr from the World Markets Research Centre wrote that, "[d]espite ongoing concerns that the new power model will increase the role of the state and reduce that of the regulator, the implementation of the new model should reduce regular uncertainty in the sector" (Kerr 2004).

As this example demonstrates, the government's greater reliance on the state and hence more reluctant approach to privatization is an issue where analysts have expressed reservations. Nevertheless, Lula has been able to appease worries. As Williamson stated on the issue of privatization, "Lula is not an enthusiast," but he continued by acknowledging that Lula has made some progress. Ultimately, Williamson noted, though he disagrees with the government's approach, he is not particularly worried if "not much happens."¹⁴

The responses on the microeconomic agenda are, therefore, more mixed. While the reforms undertaken by Minister Palocci have met with resounding approval, in other areas like utility regulation, some analysts worry about the government's perceived distrust of the private sector. Nevertheless, even in those cases, responses have become more positive as the government has shown its willingness to incorporate proposals made by the private sector and the WB. Overall even the more critical voices have remained moderate in their criticism.

¹³ AEI Conference Report, January 2004, 3.

¹⁴ Interview July 19, 2004.

4.2.2 Industrial policy

The possibility of a more active industrial policy under the Lula government has evoked similarly divergent opinions. Again Williamson, who rejected the need for a revival of industrial policy in his book *After the Washington Consensus*, has expressed his concern about such a prospect, referring to the role of state-owned banks in extending preferential credit lines.¹⁵ More specifically, worries about the role of the National Economic and Social Development Bank (BNDES) have also been raised in *Latin Finance*, an English language financial monthly, and the *Wall Street Journal*. Analysts have expressed their doubts about Lula's recent appointment of Carlos Lessa as head of the national development bank. According to these reports, investors are skeptical about Lessa's explicit support for an industrial policy in the "national interest" (Samor 2004). Ironically, this appointment was made as a political payoff to the centrist PMDB and opposed by Lula's Trade and Industry Minister, Luiz Furlan (*Latin Finance*, March 2004). Nevertheless, to critics it displays Lula's openness to an active industrial policy. On the other hand, the issue of industrial policy is not viewed as particularly worrying by a range of analysts. Thomas (WB), for example, says that the pursuit of an industrial policy isn't a contentious policy issue but merely a matter of national preference. In his eyes the dichotomy of an active industrial policy versus the market is false. Rather, he believes, a business friendly environment is necessary, which is possible with or without an industrial policy.

4.2.3 The role of the state

Clearly, like the issue of utility regulation, the controversy surrounding industrial policy reflects the differing approaches to the role of the state between the neoliberal establishment in Washington and the neostructuralists in Latin America. Despite acceptance of the neoliberal doctrine on macroeconomic stability, neostructuralists remain more reluctant to cede control over the microeconomic management of the economy, which worries investors seeking long term security for their investments and isolation from the political process. Lula's neostructuralist approach, therefore, retains a certain degree of control over key areas of the economy, which investors and neoliberal policy analysts find intrusive. Nevertheless, here Lula has also found a way to edge slightly closer to the demands of the international

¹⁵ Ibid.

financial community. He has amended reform proposals to allow more independence from the government to regulatory bodies. In those areas that fall under the competence of the Finance Ministry the relationship with the international financial community is even more congenial. Overall, the result has, therefore, been guarded optimism by the neoliberal establishment about Lula's microeconomic agenda, while agreeing to disagree about certain details of the government's policy choices.

This continued confidence in the Lula government, despite disagreements on specific policy choices reflects, on the one hand, confidence in Lula and Minister Palocci's individual commitment to improving the investment climate in Brazil, i.e. holding the neoliberal course. On the other hand, it displays that Lula's orthodoxy on the macroeconomic level has improved his ability to pursue a slightly more nationalist microeconomic agenda without jeopardizing the country's financial stability. Though Lula has also made concessions to the international financial community on the micro level, he has also pursued a range of policies that diverge from the neoliberal agenda as well as from the markedly pro-privatization agenda of his predecessor. From this perspective, Lula's promise to gradually build a consensus for a new development agenda has shown some success.

4.3 Social policy

Embedded in Lula's strict adherence to fiscal discipline, social policy is a rather uncontroversial policy area. In fact, conservatives welcome Lula's strong commitment to social policy. It reflects the change in thinking that has taken place within the WC, where a special focus on poverty alleviation and tackling social ills has regained importance. Across the board, analysts are, therefore, strongly supportive of Lula's agenda to address these social concerns. In light of Brazil's staggering inequality, some analysts, like John Williamson, have even endorsed some redistributive measures.¹⁶ The special attention to social programs within a stable macroeconomic environment is what conservatives see as Lula's contribution to the establishment of a responsible left in Latin America. As Peter Hakim (Inter-American Dialogue) states, Lula's is a man with a social agenda, yet he does this without yielding to populist demands.¹⁷ In fact, the most enthusiastic support for this allegedly new agenda has come from the WB. WB Vice President for Latin America, David de Ferranti, and Brazil's Country Director, Vinod Thomas, have hailed Lula's policies as a "new model of growth" based on the realization "that economic and social progress are inseparable." They continue

¹⁶ Interview July 19, 2004.

¹⁷ Interview July 28, 2004.

by praising Lula's "important steps to strengthen the impact of cash transfer programs for the poor"(Ferranti and Thomas 2003:1).

This overwhelmingly positive assessment of Lula's performance comes despite early blunders in Lula's social agenda. In fact, critics from the left and right alike have been disappointed with a relatively bumpy start of Lula's Zero Hunger program, promoted as the center piece of Lula's ambitious promise to eradicate hunger within his four year term. As many commentators have noted, initially the government's social agenda was muddled by bureaucratic inefficiency and an outdated food stamp program at the center of the Zero Hunger. However, Perry (WB) explained that these early attempts "to reinvent the wheel" have been replaced by a pragmatic willingness to learn and adjust its social policies in close cooperation with the WB. Accordingly, Lula's program now follows proposals of the WB Country Assistance Strategy (CAS) and focuses on improving and expanding cash transfer programs pioneered by Cardoso.

In other words, rather than a radical departure from the past government's social policies, Lula's social agenda also represents the kind of continuity expected by members of the conservative establishment.

4.4 Land reform

Land reform was another area where Lula's government was expected to expand the government's efforts. His promise was to settle 60,000 landless farmers in the first year. However, after one year the count was only 10,000, amounting to only 25 percent of Cardoso's average.¹⁸ Clearly, moderation and respect for budgetary constraints have thus also dominated this aspect of Lula's agenda. Consequently, conservatives have had little reason to complain. In fact, it has received scant attention by commentators on the right.

The Brazilian landless movement (MST), on the other hand, faces a precarious situation, exemplifying the contradictions of Lula's moderate agenda. The MST leadership, which has viewed the PT as an ally since the party's founding and which supported Lula's candidacy, chose to collaborate with the Lula government and grant Lula a grace period by reducing land invasions for an initial period. Declaring the *latifundio* rather than the government the cause of Brazil's landless problem, they even accepted posts in INCRA, the Brazilian land reform agency, and began negotiating a proposal for what they hoped to be a genuine land reform.

¹⁸ Statistics drawn from Petras (2004).

However, despite an agreement with the government to resettle 400,000 families in three years, this agenda, as MST leader, Stedile (2004), puts it, hasn't "come off the paper." Instead as Petras (2004b:6) states, "For nearly 15 months the agrarian movements stagnated [...] waiting for Lula to respond to the "pressure" of the "left" PT and other "friends of the MST" in the regime." In March/April 2004 the movement's base finally lost its patience and began a new wave of land invasions - however, with little success in furthering their cause. Rather they face Lula's directive for INCRA "to follow the law"(Petras 2004b:5), thus essentially blocking any further expropriations in the MST's favor.

As analysts have noted, this is hardly surprising, as Lula's commitment to service the debt is heavily dependent on the export earnings of Brazil's booming agro-business sector (Braga 2004; Branford 2003b; Fishlow 2004; Petras 2004a/b). The constraint on agrarian reform emerging from the repayment of the debt is thus twofold. Not only does Lula face severe budgetary constraints, but he is also obliged to cater to Brazil's agro-export sector rather than the MST's locally oriented model. Lula's commitment to promoting Brazil's large agro-businesses is further underlined by his Minister of Agriculture, Roberto Rodrigues, a *latifundista* and member of the ultra-conservative UDR (*União Democrática Ruralista* – Democratic Ruralist Union).

In conclusion, Lula's leftist past and close ties with the Brazilian social movements have thus not translated into progressive land reform policies. Rather land reform witnessed a period of stagnation, while the landless movement remained committed to cooperating with the government rather than engaging in active struggle.

4.5 The radical wing of the PT and electoral pressures

The MST and other social movements may have hoped that the left-wing faction in the PT as well electoral pressure from voters expecting more substantial change would create the necessary conditions for Lula to promote a more radical agenda. Indeed, critics within the PT have increasingly lashed out at the macroeconomic orthodoxy championed by Minister Palocci. Even Lula's Vice President, Jose Alencar and his conservative Liberal Party have voiced their criticism about Lula's fiscal austerity, calling for more spending to stimulate the economy.

Until now, however, Lula has resisted these pressures. Nevertheless, they have posed a concern for neoliberals in Washington. The apparent rift in the ruling coalition and within the PT itself has at times caused apprehension among conservative analysts. In January 2004,

Roett (SAIS) was still confident that “Lula has masterfully constructed an alliance,” so that “compared to previous administrations, this one has been far more successful in [...] building around it a relatively coherent working majority in the congress.”¹⁹ However, after a corruption scandal surrounding Lula’s chief of staff, Dirceu, and declining popularity ratings for the government in the first half of 2004, conservative analysts worried that Lula’s early momentum may have collapsed. Though most analysts don’t question Lula’s personal commitment to the “right” policies, his ability to manage the difficult task of pushing legislation through Brazil’s notoriously fractured Congress was increasingly viewed with skepticism.

Some analysts feared that the political game of horse trading would force Lula to make costly concessions to the opposition as well as his own party. Indeed, several recent initiatives have displayed Lula’s difficult balancing act of maintaining his governmental alliance without giving in to pressure to depart from his market-friendly course. Lula was forced to fight a tough battle in Congress to keep the minimum wage to the level Minister Palocci had prescribed, in order to meet the government’s fiscal targets (*Economist*, June 24, 2004). Furthermore, in April 2004 the government offered unbudgeted pay rises to civil servants threatening to strike, and it was forced to abandon legislation to grant independence to the Central Bank.

However, Roett puts the latter issue in perspective. He states that the decision was “a pragmatic role of the dice [...] to avoid an unnecessary battle,” and that, according to Lula, “the Central Bank acts autonomously already”(Roett 2004). Moreover, analysts and investors remain confident that Lula will adhere to the primary surplus target. Lisa Schineller (Standard and Poor’s) believes, the pay rises will be compensated with budget cuts elsewhere.²⁰

Moreover, increasingly robust economic growth has restored public confidence in the president, a development welcomed by analysts in Washington. In the run up to municipal elections on October 3rd, analysts, therefore, hoped that Lula could secure a decisive victory, in order to broaden his power base and improve his effectiveness in Congress. Indeed after the first round of elections the PT did manage to increase the number of mayorships from 160 to over 400, which lead to the assessment that “no major changes are expected in terms of economic policy”(*Economist Intelligence Unit*, October 11, 2004). In the second round the PT then suffered two damaging defeats in Porto Alegre and Sao Paolo, which has made analysts more apprehensive that conservatives, with their eyes on the 2006 presidential race, could

¹⁹ AEI Conference Report, January 2004, 1.

²⁰ Quoted in *Economist*, April 22, 2004.

become less cooperative partners in Congress. Nevertheless, Ashwell (2004) of the World Markets Research Centre predicts a return to “business as usual.”

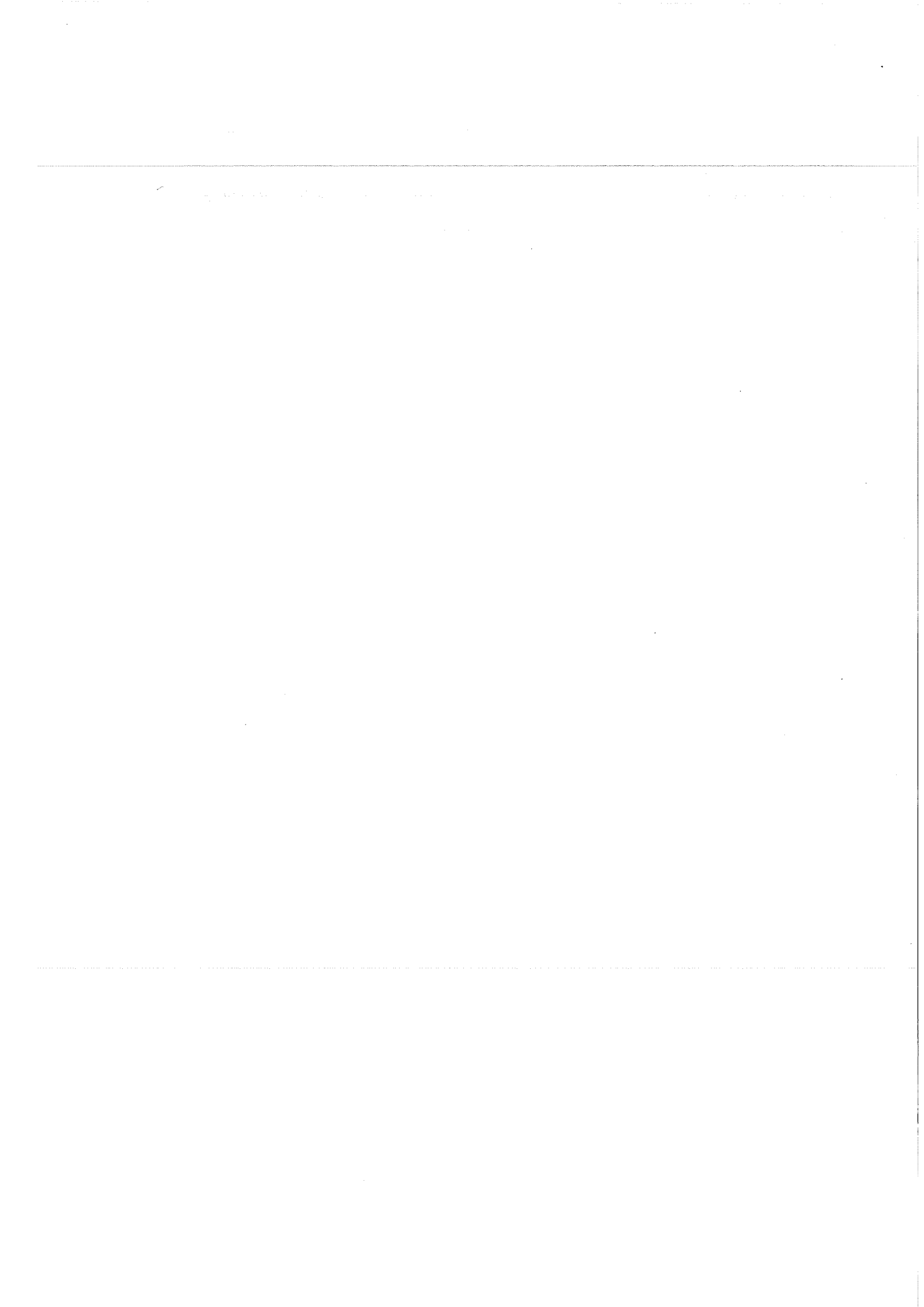
What these assessments once again confirm is that there is a remarkable confidence in Lula and Minister Palocci’s commitment to the fiscal discipline and market-friendly policies delivered to date. It is rather the worry that Lula has lost some of the political backing he needs to push through reforms against an increasingly hostile Congress and the radical wing of the PT. Ironically, as Sader (2004) explains in his article entitled *The Brazilian Right and the Lula Administration*, it is, in fact, the political right that has attempted to block legislation that it would traditionally support for pure electoral gain. He states, “[...] although the business community supports practically all of the economic policies, the political right puts the brake on the government whenever it can”(2004:2). In other words, from the perspective of the international financial community, it is, in fact, desirable that Lula increases its grip on Congress at the expense of his conservative opponents.

4.6 Conclusion

Overall, Lula has clearly won the support of the conservative establishment in the US. The key to this has been his strict adherence to macroeconomic orthodoxy, even surpassing the Cardoso government in this respect. On microeconomic reforms he has delivered some results that have been warmly welcomed, while on certain issues, like industrial policy and utility regulation, he has clearly pursued a more nationalist stance with more emphasis on the state role. On social policy and land reform, Lula has remained severely constrained by the budgetary constraints of his macroeconomic orthodoxy. In terms of implementation of social programs, he has essentially fallen back to the programs of the Cardoso government, thus representing continuity rather than the radical change he had promised. To conservative analysts this has reaffirmed their belief that Lula is essentially a pragmatist rather than an ideologically driven president.

Like Cardoso, Lula is also confronted with a Congress that is hostile to the president’s ambitious reform agenda, expecting to capitalize on Lula’s decrease in public support. This has at times created fears that Lula may give in to so-called “populist” demands. However, this hasn’t happened yet. Moreover, with growth picking up and Lula’s popularity increasing, the president’s leftist image will help restore legitimacy to the neoliberal development agenda. Simultaneously, Lula has successfully revived the role of the state in certain key sectors of the economy and supported a more active industrial policy without damaging confidence among

the international financial community in Brazil's economic development. This reflects both the fact that the neoliberal paradigm has itself incorporated a slightly enhanced role of the state but also the fact that Lula's unwavering macroeconomic discipline has provided some additional room for maneuver on the microeconomic level.



5. Alternatives to Neoliberalism and US Foreign Policy

Arguably, Lula's macroeconomic orthodoxy has also provided him with the kind of international credibility, which has allowed him to effectively pursue a very proactive foreign policy agenda. In fact, Lula's foreign policy has been one of his top priorities during his first year and a half in office, making at least one trip per month to advance Brazilian interests abroad. Moreover, in many ways Lula's assertive stance on the global stage has counterbalanced the disappointment among many supporters about Lula's moderate policies at home. Lula attempts to strengthen Brazil's status as a global player and his revival of South-South cooperation have played an important role in preserving his popularity at home and his image as a representative of the Global South. As outlined in Section 2.2, this more assertive foreign agenda also reflects one of the divergences of neostructuralism from the PWC.

However, though Lula has stepped up the rhetoric on foreign policy and trade issues, it is less clear how far his agenda has gone in challenging the US goals in Latin America, most notably its neoliberal vision of hemispheric integration embodied in the FTAA. This chapter, therefore, briefly reviews US foreign policy objectives in Latin America since the end of the Cold War as well as Brazil's particular role within this agenda. It will address the question of how relevant a more assertive foreign policy stance by Brazil can be in the current regional context. In particular it will focus on the developments in the hemispheric trade agenda and raise the question of how significant Lula's negotiating stance has been in promoting an alternative to neoliberalism and the US vision for Latin America. Furthermore, it analyzes action taken by the Lula government in the WTO and other issues of hemispheric relevance.

5.1 US post-Cold War foreign policy in Latin America

A decade of market-oriented reforms in Latin America has provided the US with a very favorable playing field for consolidating its interests in the region. Consequently, the establishment of so-called market democracies throughout Latin America (with the exception of Cuba) has put an end to the strongly interventionist policies experienced until the Reagan administration. With the disappearance of the perceived Communist threat, the majority of US policy makers are no longer concerned with potential ideological challenges posed by regimes throughout the hemisphere.

The consolidation in Latin America of market democracies, or what Robinson (2000) has termed capitalist polyarchy, has produced an environment, which is highly conducive to the interests of the US government and its constituencies in the business world. While structural adjustment policies with their largely authoritarian origins have opened Latin American countries to US investment and trade, the transition to liberal democracy throughout the hemisphere has guaranteed the continuity of the neoliberal model. As Russell (2003:68) asserts:

[...] democratic consolidation in Latin America is an objective that coincides with and reinforces the value system of the United States and its political and economic interests. It strengthens stability in the region, more strongly guarantees continuity of the market-oriented economic policies adopted in the 1990s, and facilitates business as it promotes greater transparency and accountability than authoritarian regimes do.

Moreover, with the accomplishment of significant advances in trade and financial liberalization, *king capital*, as Crandall (2003) calls it, exerts the necessary pressure to guarantee the continued adherence to the economic policies favored by the United States.

Arguably, in this context, Latin America no longer poses any threat to US ambitions. According to many analysts, these favorable circumstances have even lead to a state of benign neglect by the world's superpower towards its most immediate neighbors. Though never the central focus of US foreign policy, with the end of the Cold War US Latin America policy has been characterized as "the forgotten relationship"(Castañeda 2003). Tellingly, Bill Clinton was the first president since Herbert Hoover who failed to visit Latin America during his first term. With the excessive focus on security matters and the threat posed by Islamic fundamentalism in the aftermath of September 11, this neglect of Latin America in the US foreign policy agenda has been further exacerbated. With US interests largely unchallenged by Latin American countries, Washington can afford to focus its attention elsewhere.

5.2 Brazil, the FTAA and the US Agenda in Latin America

Nevertheless, Lula's Brazil, as the most significant regional power, remains of special concern to the United States. After a decade of economic stagnation and a series of financial crises in the region, public confidence in the free market model and the liberal democratic model championed by the US has eroded. As South America's largest economy, Brazil's economic policies and performance are, therefore, crucial for the continuation of the post-Cold War order. Moreover, Brazil's posture on several critical regional issues is vital for the

US to pursue its interests (Hakim 2004a). In particular, progress in the FTAA negotiations stands out as the most significant source of potential conflict with Brazil.

The FTAA, which was initiated formally in Miami in 1994, represents the central pillar of US Latin America policy in the post-Cold War era. The project is based on the far reaching market reforms that were undertaken in the 80s and 90s, and, if successfully concluded in the form envisioned by the US, will act as a powerful tool to consolidate and further deepen the free market model in Latin America. One of its central goals is to provide an “insurance policy” against new protectionist impulses in Latin America by locking in domestic reforms through international obligations, and substantially raising the cost of policy reversals”(Carranza 2004:324). Additionally, the creation of this regional trading bloc has the function of strengthening the US position on a global level vis-à-vis its economic rivals in Europe and Asia (Prevost and Weber 2003). If successful, it will create the world’s largest free trade zone with a population of 800 million and a GDP of approximately US\$13 trillion, thus acting as a counterweight to the expanding European Union and regional integration efforts in Asia.

According to its most vocal critics, the FTAA is the US government’s current instrument of choice to consolidate its ‘informal empire’ in the Western Hemisphere (Petras 2003a). Similarly, the PT Manifesto (2002:13) states that the FTAA “as currently being discussed, is not a free-trade agreement but a process of economic annexation of Latin America by the United States.” With the exception of certain sectors of the Latin American business community, this view is shared by large parts of Latin American civil society. Based on the NAFTA experience, the FTAA is anticipated to be a highly asymmetrical agreement, which imposes costly concessions on the Latin American countries with little in return. Agreements in areas like investment and services would signify a significant loss of sovereignty in formulating development policy, while it is feared that key trade barriers used by the US, such as the recently increased agricultural subsidies, would remain intact. Moreover, there is great concern that the dispute settlement mechanism would give US and other TNCs unprecedented power at the expense of local and national authorities seeking to protect workers’ rights and the environment.

This widespread view has encouraged the formation of the Hemispheric Social Alliance opposing the FTAA. Staging protests at successive summit meetings and organizing parallel People’s Summits, this well-organized opposition reflects the growing disenchantment with the neoliberal agenda inherent to the FTAA. It has raised the political costs to Latin American leaders of signing an FTAA and has thus contributed to the

deteriorating climate surrounding the negotiations. From the optimistic tone of the first summit in 1994 the negotiations have become increasingly plagued by disagreements and, as its opponents hope, may now stand at the brink of becoming meaningless. With the adoption of a new negotiating format in 2003, referred to as FTAA-lite or FTAA-à-la-carte, the stakes have been significantly lowered, as it is no longer necessary for countries to adopt all measures of a final FTAA. Instead countries will be able to disengage from negotiating in areas where they see their interests threatened.

5.3 Lula and trade

On the left many view these developments as a significant victory in the struggle against the neoliberal model of hemispheric integration, and Lula is credited with playing a significant role in achieving this success (Anderson 2003). Lula's heightened rhetoric on the need for developed countries to remove agricultural subsidies as well as his promotion of enhanced cooperation among Brazil's MERCOSUR partners are viewed as important tools to improve the capacity of Latin American countries to resist the imposition of a US-driven FTAA. This strategy reflects the neostructuralist open regionalism approach to trade integration. By pursuing a policy that seeks to further consolidate MERCOSUR with the possibility of further expanding to the Andean Pact countries,¹ Lula is attempting to build a stronger position for Brazil and its Latin American neighbors in negotiations with the US.

5.3.1 Lula, MERCOSUR and South-South cooperation

More radical critics contend that Lula's renewed commitment to MERCOSUR represents no more than heightened rhetoric with no gains for his constituency among the poor. Petras states that "Brazilian policymakers, policies, and alliances are neither anti-globalization and even less anti-imperialist." He suggests instead that MERCOSUR is no more than "a means of pressuring the US to secure advantages for local agro-export elites within the FTAA"(Petras 2003b:12).

Indeed the prioritization of MERCOSUR is also a continuation of Cardoso's regional integration policy. Since the launching of the FTAA negotiations in 1994, the Brazilian government has consistently prioritized MERCOSUR and the WTO as forums for negotiating trade liberalization. At the Third FTAA summit in Quebec in 2001 Cardoso stated that the

¹ This process has recently been formalized with a first preferential trade agreement between the two blocks.

FTAA would be “irrelevant, or worse, undesirable,”² unless the US made several concessions to the Brazilians. Similarly, Cardoso would often say that MERCOSUR is Brazil’s “destiny,” whereas the FTAA is just an “option”(Weintraub 2001). Despite Lula’s more assertive stance, one may argue, his approach represents a continuation of Cardoso’s trade policy.

Moreover, few analysts in the US view Lula’s support for MERCOSUR as contradictory to US interests. Schott (2003b:16), for instance, has suggested that the US should welcome MERCOSUR as a negotiating partner:

[...] “4&1” [MERCOSUR+US] talks also are desirable, since they would encourage policy coordination within the Mercosul and thus help catalyze deeper regional integration. Here, it would be useful to pursue *inter alia* negotiations on investment policies and government procurement rules; indeed, the North-South talks could provoke the Mercosul partners to forge common policies in these areas. Such actions also would help revive intra-Mercosul trade and investment, and contribute importantly to economic development and political stability in the region. From the US perspective, it would make the Mercosul an even more attractive trading partner.

Essentially, what this analysis suggests is that MERCOSUR can be a stepping stone for deeper integration within the whole region, as desired by the US. Nevertheless, it simultaneously suggests that by pursuing sub-regional integration before committing to free trade with the US, Brazil will increase its bargaining power. Though MERCOSUR is not viewed as a challenge to US ambitions in the hemisphere, it would achieve the objective of improving Brazil’s position in negotiations with the US.

Similarly, Lula’s active pursuit of closer economic cooperation with other developing country heavyweights, including South Africa, India and China, is not viewed with any significant concern. In fact, it has been largely absent from the analysis of the US political establishment. Rather, as stated in the *Wall Street Journal*, from an investor’s viewpoint, Brazil’s efforts to further diversify its export structure is, in fact, welcomed (Millman and Samor 2004).

5.3.2 Lula and the FTAA

Similarly, US policy analysts also view Lula’s negotiating stance within the FTAA process as little more than a continuation of Cardoso’s policies. As Hakim (2004:117) states, “Lula’s stance on the FTAA reflects his country’s politics.” As he explains, Brazil wants the US to reduce agricultural subsidies and repeal protectionist

² Quoted in Carranza (2004), 322.

antidumping and countervailing duty policies, which hurt Brazilian exporters. However, the US isn't willing to negotiate these issues within the FTAA framework, relegating these discussions to the WTO. Brazil, therefore, stands to gain little in the medium term from a comprehensive FTAA and thus likewise prefers to defer issues of concern, like trade in services, government procurement, and intellectual property rights, to the WTO.

In this light, Lula's negotiating stance is viewed by the US establishment as a legitimate policy in the national interest rather than a challenge to the status quo. As Fishlow (2004) has stated, the more assertive stance demonstrated in recent trade negotiations isn't related to a more radical approach to foreign policy but rather reflects a strengthening of the Brazilian position, due to its domestic economic recovery. This, Fishlow (2004:291) believes, "has enabled Brazil to express its external preferences more effectively now than in the past, and much of the current restatement of policy reflects that new ability."

Whether this reluctant approach to the FTAA ultimately means that Brazil will block a hemispheric free trade agreement is unclear, and opinions diverge about Brazil's obstructive role in the FTAA process. Some policy makers remain confident that the US will achieve a satisfactory agreement, while others remain more skeptical. Hakim has commented that the new FTAA-lite is no longer an attractive option for the US, and he fears that the FTAA talks could collapse. Miguel Diaz (CSIS)³ and Christina Sevilla (2004), former Head of Intergovernmental Affairs of the US Trade Representative's Office (USTR), on the other hand, believe that Lula has shown improved cooperation in the FTAA process, and they are confident that the new negotiating framework will yield a satisfactory agreement.

Similarly, Caleb McCarry,⁴ foreign policy aid of Congressman Hyde and Congressman Ballenger, is convinced that Lula will sign an FTAA with the US. In his opinion an FTAA-lite approach is sufficient to further US interests for the moment with a series of bilateral trade deals filling the gaps. Furthermore, he mentioned that on the agricultural question there were a number of US businesses invested in Brazilian soy production that are strongly supporting the Brazilian quest for agricultural reform in the US. In fact, as Branford (2003b) states, seventeen international companies control 43 percent of Brazilian agricultural exports. In other words, the Brazilian trade agenda is in part driven by US and other foreign multinationals. Rather than being a dispute over

³ Interview August 11, 2004. All subsequent references to Diaz are drawn from this source.

⁴ Interview July 28, 2004. All subsequent references to McCarry are drawn from this source.

differing economic models for the region, this suggests that US-Brazilian differences over trade simply reflect different vested interests. As McCarry states, Brazilian and US economic interests are in competition rather than conflict.

Moreover, some US analysts have placed the blame for the stalling of FTAA negotiations with the US government rather than the Brazilians. While Princeton Professor Scheinkman praised the Lula government's openness to international trade, he was concerned about the Bush administration's protectionist tendencies. He stated:

[...] I have become very pessimistic about the US administration. The current administration has shown very little appetite to face groups that benefit from existing subsidies and protection. Of course, the most glaring example was the imposition of tariffs on steel. [...] So I'm not very optimistic about progress [on trade liberalization] in the short run.

Feinberg (2002), the US official who organized the 1994 Summit of the Americas to launch the FTAA negotiations, has expressed the view that, in fact, the US Congress is the central obstacle to hemispheric integration. Moreover, he argues that as the two largest countries of the Americas, it comes as no surprise that Brazil and the US are the most reluctant to sign a hemispheric free trade agreement. Ultimately, however, he believes that "Brazil will not want to be excluded from a hemispheric accord"(2002:147).

5.3.3 Lula and the WTO

From a US perspective, one of the most controversial aspects of Lula's trade policy may have been his role in WTO negotiations in Cancun in assembling a group of developing countries known as the G20+ to press the US and the EU to reduce their agricultural subsidies. Eventually the talks collapsed, largely due to the inability of the G20+ and the developed countries to reach an agreement on the agricultural issue. Lula, who was widely seen as the leader of the G20+ initiative, was, therefore, also perceived by a range of commentators as the spoiler of the talks.

Initially, the Office of the US Trade Representative (USTR), which was clearly caught off guard by the collapse of the talks, responded with rather unrestrained hostility. Sevilla (USTR) accused Brazil and its allies of building up a "North-South divide" reminiscent of the G77 and its call for a New International Economic Order in the 1970s. She complained that their inflammatory North-South rhetoric was jeopardizing the continuation of the entire WTO process, which was vital not only for economic reasons but also to "help promote the rule of law, transparency and greater economic freedom and choice for individuals

worldwide”(Sevilla 2003). In other words, she viewed the Cancun meltdown as a threat to vital US interests in promoting market democracies in the developing world. Zoellick himself criticized Brazil and the G20+ for its “increasingly radical rhetoric” and accused it of emphasizing “north-south division not global agricultural reform”(Zoellick 2003).

Clearly, Lula had taken on a very visible role in what later became a major setback for the US, in terms of furthering the multilateral agenda. However, more nuanced assessments in the US soon emerged. As mentioned by adamant free trade advocate, Bhagwati (2004), it has been argued that the US committed a major strategic error by proposing a more ambitious reduction of agricultural subsidies in the run up to the Cancun Ministerial, only to backtrack on that offer, in order to align itself with the less ambitious proposals of the EU. This poisoned the talks by creating the kind of mistrust, which led to the formation of the G20+, a view also promoted by Schott (2004). Furthermore, Bhagwati has suggested that Mexico’s Foreign Minister Derbez may have prematurely ended the negotiations. Accordingly, Hakim (2004:118) writes that “the parties were not that far apart and could have reached agreement had they continued negotiating.”

Moreover, many analysts see Brazil’s efforts to push agricultural reform in the North as a legitimate interest. Fishlow (2004) has mentioned Brazil’s need of a strong export performance to spark a domestic recovery with agro-business playing a major part in this strategy. Furthermore, Scheinkman stated that “there have been a lot of studies recently that try to simulate the impact of trade agreements on Brazil and they show that if you don’t have any discussion on agricultural subsidies and agricultural protection, Brazil gains very little.”⁵ Similarly, Schott (2003a) states that Brazil and other agricultural exporters “were understandably dissatisfied with the commitment of industrial countries to agricultural reforms.” Consequently, Schott believes that the US, not Brazil and the G20+, “holds the key to unlocking the talk’s potential” by supporting substantial progress on agricultural reform.

After the initial shock of the Cancun debacle, assessments of Lula and the G20+’s role in forcing the breakdown of talks have, therefore, become more measured. Many analysts agree that Lula may have adopted a more confrontational rhetoric than his predecessor, however, in terms of policy, little has changed.

⁵ Conference Report, 2004 Brazil Summit (2004). All subsequent references to Scheinkman are drawn from this source.

5.3.4 Trade policy: continuity among heightened rhetoric

Overall, there has, therefore, clearly been the impression that Lula has essentially continued Cardoso's trade agenda. Simultaneously, it is recognized that this has come with a more assertive stance. This slightly more confrontational policy may be attributed in part to Lula's greater reluctance to integrate with the US. On the other hand, as indicated by Fishlow it may merely reflect Brazil's strengthened economic position that provides with greater confidence to pursue its interests. These interests, most will agree, are fundamentally rooted in the need to increase exports, most importantly in its competitive agricultural sector. Therefore, Brazil's primary interest is in the reduction of agricultural subsidies, an issue most effectively addressed within the WTO rather than the FTAA. However, few analysts believe that Brazil will take a radical stance on the FTAA, which would lead to its failure. Rather it is biding its time to acquire the most favorable deal.

In other words, Lula's approach to trade liberalization has taken, like his predecessor, the neostructuralist route of open regionalism to enhance Brazil's negotiating capacity. This implies blocking the US agenda in strategic ways to increase its own bargaining power. However, as suggested by Schott's analysis of MERCOSUR, ultimately sub-regional integration provides the necessary precondition for deeper regional integration, albeit on slightly better terms.

5.4 Lula's Brazil: the regional superpower

Beyond trade Lula has also intensified Brazil's efforts to establish a more active role in regional politics and establish itself as the regional superpower with the ability to counterbalance US hegemony. Again this reflects an ongoing project, which Lula has taken up with renewed commitment. As Hakim (2004:122) explains, although "Brazil has never aggressively challenged US goals in Latin America, [...] it has repeatedly demurred at Washington's ideas on how specific proposals and initiatives should work in practice." This approach has clearly continued under Lula. However, Hakim goes on to say that "although balanced by striking pragmatism, the Lula presidency adds an ideological twist to the bilateral relationship, particularly in contrast to Bush's conservative government." This he believes could be source of contention "but it could also serve US interests"(2004:122). Due to Lula's broad support on the left, Hakim (2004:123) believes that "Lula can do more than anyone else

to rebuild Latin America's confidence in market-reform programs, restore credibility to IMF and WB policies, and open the way for a comprehensive hemispheric trade pact - all of which are central elements of the US agenda in Latin America."

As argued in previous chapters, in many ways Lula has, from a US perspective, delivered quite satisfactory results on macroeconomic policy and market reforms. This has reassured the US that Lula poses no threat to its Latin American and largely given way to the positive scenario mentioned by Hakim. Diaz (CSIS) and McCarry agree that Brazil has developed from a potential problem to a source of stability. In fact, McCarry welcomes Brazil's more active role in hemispheric political and security matters, as it reduces the pressure for the US to involve itself in regional politics.

Most importantly, McCarry mentioned Brazil's involvement in managing acute crises in Haiti and Bolivia as well as the ongoing problems in Venezuela and Colombia. In Haiti, Brazil's offer to send troops is important from a purely economic perspective, thus relieving the burden for the US. This seems also to be the viewpoint of the US administration. The *Latin American Weekly Report* (October 12, 2004) reported, "Visiting Brazil, US Secretary of State Colin Powell gushed about 'two great democracies [that] have so much in common' and said that he was 'especially appreciative of the leadership role that Brazil is now playing in Haiti, by being willing to take on the leadership of the military organisation that is helping the United Nations and the Haitian people to a better life.'" Moreover, during the same visit Powell openly voiced his support for Brazil's efforts to gain a permanent seat in the UN Security Council.

In Bolivia, Lula's support for a referendum launched by President Mesa on the commercialization of Bolivian natural gas resources was welcomed by both Diaz and McCarry as an important contribution in strengthening pro-establishment forces. In Colombia both McCarry and Hakim agree the US should also be pleased with Brazil's more activist approach. It has offered to host negotiations between the UN and the FARC, and Lula has indicated to Uribe that he is willing to contribute more actively to security operations. Though this partially comes as a response to Brazil's wariness of increased US troops in its neighbor country, McCarry again welcomes Brazil's offer. The Brazilians, he believes, would essentially pursue the same goals as the US, while relieving troops desperately needed elsewhere. Finally, in Venezuela, Lula has chaired the "friends of Venezuela" group, which includes the US and has urged the Venezuelan government and the opposition to resolve their differences by conducting the recall referendum finally held in August 2004.

Overwhelmingly, Brazil's more active engagement as a hemispheric leader has, therefore, worked in favor of US interests. Nevertheless, Hakim maintains, that the "ideological twist" has also left its mark on Brazilian foreign policy. Most obviously, Lula has engaged in a friendly relationship with Cuba, the remaining ideological foe of the US in the hemisphere. Unsurprisingly, this doesn't particularly worry most US analysts with the exception of the Cuban right-wing and the remaining Cold War ideologues. Furthermore, Lula has maintained close bilateral economic ties with Venezuela, extending a US\$1 billion export credit line to its neighbor in 2003 with further talks to expand it. Again, however, McCarry isn't worried, focusing rather on Brazil's commitment to resolve the Venezuelan conflict on a political level. Finally, Lula has been a very vocal critic of the US war in Iraq. However, here Brazil's policy hasn't differed significantly to the approach taken by Chile and Mexico, the US's closest Latin American partners. Consequently, though it hasn't helped the relationship, it also didn't harm it with Washington largely ignoring Brasilia's objections.

5.5 Conclusion

Lula's commitment to macroeconomic stability and market-oriented reforms as well as his cooperation with actors like the IMF and the WB has, therefore, gained Brazil the necessary credibility to pursue a more activist foreign policy in the region without endangering its warm relationship with the US. Despite the differences in ideological orientation and despite Brazil's objections to the war in Iraq, Lula's assertive foreign policy is, in fact, viewed as an asset by US foreign policy experts. It allows the State Department to sit back, while Brazil takes on a bigger role in tackling the region's problems. Lula's moderate approach at home has, therefore, played an important role in successfully advancing Brazil's foreign policy objectives in the hemisphere. Of course, these advances remain conditional to the stabilization of the kind of market democracies established in the 80s and 90s in Latin America. Nevertheless, it should be noted that this hasn't stopped Lula from engaging in economic cooperation with Cuba and Venezuela, the region's pariah states.

On trade, Lula has also shown little fear in confronting the US agenda when this serves Brazilian economic interests. Again, based on Brazil's commitment to repaying its foreign debt, this has been met with respect by Washington policy circles. It is acknowledged that Brazil requires increased export earnings to bring its debt burden to sustainable levels. Lula's willingness to attract foreign investment and boost its exports to repay the debt has been met with increasing confidence in the Brazilian government and its ultimate

commitment to further trade liberalization. In other words, since Lula has opted to sustain the US's chosen model for Latin America, some opposition on specific policies is accepted by the US establishment.

6. Conclusion

Lula, the neostructuralist, has not adopted all the tenets of neoliberalism, whether in the form of the WC or the PWC. On the microeconomic level, he has chosen to rely more strongly on the state than representatives in the neoliberal establishment are comfortable with. In the domain of economic integration with the US, whether through the WTO or the FTAA process, Lula has also displayed a more reluctant approach than would be expected from a president with a neoliberal agenda. Though this approach doesn't fundamentally differ from Cardoso's trade agenda, Lula's heightened rhetoric has at times irritated the US trade negotiators and it has made some analysts more skeptical of a successful FTAA.

Simultaneously, however, Lula has displayed a strong commitment to fiscal austerity and the neoliberal faith in macroeconomic stability. This doesn't signify a break with a neostructuralist policy agenda. However, in light of Brazil's debt and the crisis situation that emerged during the run up to Lula's presidency, this has obliged Lula to adopt even tighter fiscal restraint than Lula's predecessor, and it has forced Brazil into a recession during Lula's first year in office. Leftist critics call for a default on the Brazilian debt, but Lula has opted for the disciplined route, respecting government contracts and thus providing the basis for an investor-friendly environment. While this has gained him the respect of the international financial community and the US establishment – if continued - it also implies little room in the years to come for change on the level of macroeconomic policy.

Progress on several so-called second-generation reforms promoted by the PWC, including pension reform and tax reform, has further improved Lula's standing on the right. In the first 20 months of the Lula presidency, the analogy of Nixon going to China seems appropriate to describe Lula's implementation of a set of conservative fiscal reforms that had even eluded his widely respected predecessor. In other words, on certain issues Lula, the leftist, has been a more effective implementer of a market-oriented reform agenda than a more conservative candidate. Furthermore, with Lula's popularity still relatively high and his continuing respect among the Latin American left, he will provide certain neoliberal policies with renewed credibility. On the macroeconomic level, Lula is thus not only deepening the neoliberal reform process, he is also providing it with a new source of legitimacy.

Lula's social policy, a central element of his electoral platform, has also largely adhered to the prescriptions of the neoliberal establishment. After initially launching Zero

Hunger, which analysts labeled an outdated food stamp program, he has heeded the advice of WB specialists and has fallen back on the programs initiated by Cardoso. Land reform, another important issue on his pre-election agenda, has witnessed a similar fate. Rather than expanding efforts, Lula has actually resettled less farmers in his first year in office than Cardoso's average. As confirmed by the US establishment's positive responses, social policy and land reform will, therefore, hardly progress beyond the pace set by the Cardoso administration.

Finally, on trade and foreign policy, Lula's assertive stance has allowed him to sustain some of his popularity on the left. However, at present, this assertiveness hasn't come with real policy changes. Though possibly employing a more confrontational rhetoric than Cardoso, Lula is essentially continuing a policy that explicitly caters to the interests of the Brazilian export sector, while gradually deepening the level of economic integration. Since Lula has thus accepted the basic framework for increasing trade liberalization, Brazilian efforts to assert its political influence in the region are, in fact, welcomed by the US. Brazil is seen as an important ally in further consolidating the market-oriented model.

The greatest divergence from neoliberalism, as mentioned above, is, therefore, on the level of microeconomic policy. Rather than catering exclusively to international investors, Lula has shaped policies that allow the state to promote industrial development in the national interest. Though the PWC has also called for some industrial policy, Lula's approach promises to go beyond the limited neoliberal interpretation. Moreover, Lula has essentially halted the process of privatization and has stopped short of complete deregulation of important sectors, like energy and other utilities. In other words, in some key sectors of economic policy Lula has halted the further deepening of neoliberal structural adjustment. The fact that Lula has been able to pursue such an agenda without reaping the wrath of the neoliberal establishment, displays that his macroeconomic orthodoxy hasn't exclusively served the purpose of consolidating the neoliberal agenda. It has gained Lula room to implement neostructuralist policies that don't conform to neoliberal concepts of development policy.

Nevertheless, these policies clearly don't indicate the kind of "rupture" with neoliberalism promised by Lula during his campaign. Rather they display an agenda, which seeks to advance Brazilian interests more effectively within the existing neoliberal framework. Rather than being a pawn in the game of neoliberal globalization, Lula has increased Brazil's efforts to become an active player. Within this framework based on continuing economic integration, the WB actually encourages Lula to address the immense

social problems facing Brazil, i.e. to create a social framework for neoliberalism. However, as Lula's current record indicates, the space for social progress remains severely limited by the fiscal constraints imposed by the necessity to repay the Brazilian debt. Moreover, it will take decades of sustained economic growth and extreme fiscal restraint to reduce the Brazilian debt burden to a sustainable level where the government can again take relatively autonomous decisions without risking a financial crisis as occurred in 1999 and 2002.

Coming back to the debate on "anti-neoliberal strategy," at this stage the assessment must, therefore, be that with the circumstances facing Lula in Brazil, his approach to lead an electoral alliance with centrist and center-right parties hasn't offered the kind of opportunity envisioned by Harnecker; Lula hasn't been able to demonstrate the feasibility of alternatives to neoliberalism. Rather on macroeconomic policy it has further consolidated the dogma of "There is no alternative." Moreover, it has, for the moment, not only robbed the Brazilian political landscape from a strong leftist opposition, but it also temporarily pacified the Brazilian social movements who initially remained hesitant to confront the Lula administration head on.

Nevertheless, as Lula's microeconomic policy demonstrates there are some policy changes that have slowed the process of neoliberal structural adjustment. Moreover, unlike Cardoso, Lula has to answer to a much more radical, left-wing constituency, which, as fears among conservatives confirm, may signify more radical steps in the future. On the other hand, this hasn't occurred yet and thus bears the danger of pacifying the opposition to neoliberalism, while its core principles are left in place and even further consolidated.

It is still too early to make a final judgment, whether Lula's leftist constituency will be able to steer him towards a more distinct break with neoliberalism. However, equipped with a neostructuralist policy framework and facing the present circumstances in Brazil, Lula will be unable to promote any far-reaching structural change from the position of the central government. As Lula's efforts are demonstrating in practice, the left's hope to reconcile the adoption of market-friendly policies with tackling the social debt of a highly unequal country like Brazil implies little more than the adoption of what critics have called "neoliberalism with a human face" or what Jayasuriya calls "neoliberal sociability." By transforming the left into administrators of neoliberalism, it promotes a depoliticized social framework, which sustains the market-oriented model into the future.

Consequently, the challenge for the radical left in pursuing an "anti-neoliberal strategy" will be to support Lula's more nationalist foreign and industrial policy, while maintaining the necessary pressure to simultaneously promote more radical steps in the future.

Moreover, it will be essential to develop a more radical yet coherent alternative agenda to replace neostructuralism. At present, this means, among other things, to increase efforts to promote radical initiatives on the local level. An important issue for future research on the Lula government will, therefore, also be an analysis of the central government's relationship to such local initiatives, including the work of the PT itself. While improvements on the federal level will remain limited in the years to come, it will be essential to evaluate, whether the Lula government is providing additional political support for the promotion of alternatives on the local level.

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Appendix 1 - Interviews

Name	Date & Place	Current and Previous Positions
Diaz, Miguel (CSIS)	August 11, 2004, Center for Strategic and International Studies, Washington, DC	<p>Head of South America Project, Center for Strategic and International Studies; Director, US-Argentine Caucus (business forum); Columnist for <i>Latin Finance</i> and <i>Economist Intelligence Unit</i></p> <p>Previously: Senior Latin American Economist for Nikko Securities Inc., New York</p>
Gelos, Gaston (IMF)	August 12, 2004, International Monetary Fund, Washington, DC	<p>Economist, Western Hemisphere Department, International Monetary Fund</p> <p>Previously: not available</p>
Hakim, Peter (Inter-American Dialogue)	July 28, 2004, Inter-American Dialogue, Washington, DC	<p>President, Inter-American Dialogue; Member of World Bank Advisory Committee; Member of Inter-American Development Bank Advisory Committee; Member of Board of Directors, Group of Fifty (US-Latin American business forum); Member, Council on Foreign Relations; Member, Human Rights Watch Advisory Committee</p> <p>Previously: Vice-President, Inter-American Foundation</p>
Lachman, Desmond (AEI)	July 26, 2004, American Enterprise Institute, Washington, DC	<p>Resident Fellow, American Enterprise Institute</p> <p>Previously: Managing Director and Chief Emerging Market Economic Strategist, Salomon Smith Barney; Deputy Director in Policy Development and Review Department, International Monetary Fund; Division Chief in Western Hemisphere Department, International Monetary Fund</p>
McCarry, Caleb	July 28, 2004, Ford House Office Bldg, Washington, DC	<p>Foreign Policy Aid to Congressman Hyde (Chair, Committee on Foreign Relations) and Congressman Ballenger (Chair, Western Hemisphere Subcommittee)</p> <p>Previously: not available</p>

Name	Date & Place	Current and Previous Positions
Perry, Guillermo (World Bank)	May 16, 2004, Institute of Social Studies, Den Haag	World Bank Regional Chief Economist, Latin America and Caribbean Previously: Colombian Minister of Finance and Minister of Mining and Energy
Thomas, Mark (IMF)	August 4, 2004, World Bank, Washington, DC	World Bank Senior Economist, Brazil Previously: not available
Williamson, John (IIE)	July 19, 2004, Institute for International Economics, Washington, DC	Senior Fellow, Institute for International Economics Previously: Project Director, UN High-Level Panel on Financing for Development; World Bank Chief Economist for South Asia; Professor, Pontifica Universidade Católica do Rio de Janeiro

Appendix 2 - Conference Reports/Transcripts

1. Brazil-American Chamber of Commerce - 2004 Brazil Summit, April 27, 2004, The Waldorf-Astoria, New York City. Retrieved from www.brazilcham.com on August 25, 2004.

Name of Expert Cited	Position
Canuto dos Santos Filho, Otaviano	Executive Director for Brazil, World Bank
Portugal, Murilo	Executive Director for Brazil, International Monetary Fund
Scheinkman, Jose Alexandre	Theodore Wells '29 Professor of Economics, Princeton University; Co-organizer and author of document <i>Agenda Perdida</i> (2002) on Brazilian economic and social policies for the Instituto Futuro Brasil
Taylor, John	Under Secretary for International Affairs, US Department of Treasury

2. Brazil: One Year after Lula, January 2004, American Enterprise Institute, Washington, DC. Retrieved from www.aei.org on May 24, 2004.

Name of Expert Cited	Position
Gerson, Phil	Chief of the Atlantic Division in the International Monetary Fund's Western Hemisphere Department
Roett, Riordan	Sarita and Don Johnston Professor of Political Science and Director of Western Hemisphere Studies and the Latin American Studies Program, Johns Hopkins Paul H. Nitze School of Advanced International Studies (SAIS); Member, Council on Foreign Relations
Schineller, Lisa	Director, Sovereign Ratings Department, Latin America and Primary Analyst for Brazil, Standard and Poor's

3. Brazil: Political and Economic Challenges Facing the President-elect and the Implications for U.S. Policy in Latin America, Council on Foreign Relations, Washington, DC, October 30, 2002. Retrieved from www.cfr.org on March 23, 2004.

Name of Expert Cited	Position
Maxwell, Kenneth	Nelson and David Rockefeller Senior Fellow for Inter-American Studies; Director, Latin America Studies, Council on Foreign Relations
Molano, Walter	Senior Managing Director, Head of Research, BCP Securities