
Preface

Inflation became a central problem for the capitalist economies in the second half of the twentieth century. In the days of the gold standard and competitive capitalism, inflation was a passing phenomenon that characterized either the periods of expansion and the peaks of the economic cycle or the extraordinary upheaval of the economic system caused by catastrophes such as wars. Inflation generally alternated with periods of deflation during recessions.

However, once we entered the phase of oligopolistic and technobureaucratic capitalism, beginning after World War II and especially since the 1970s when the world economy entered a period of deceleration and crisis typical of a long Kondratieff cycle, inflation began to change. It became chronic all over the world. In some countries, principally the central countries, the rates were still moderate, although they sometimes reached levels of over 10 percent a year. Beginning in 1982, they were reduced at the cost of severe recessive policies coupled with high rates of productivity increase; however, price stability definitely no longer exists.

In many of the underdeveloped countries, the rates rose and established themselves at much higher levels, often above 100 percent. They had to be accompanied by indexation systems that moderated the distortive effects of inflation but, at the same time, accentuated its autonomous or inertial nature, thus making it more difficult to reduce. In the central capitalist countries, as well as in the periphery, the periods of deflation completely disappeared. Now we only have periods in which inflation accelerates or decelerates. Based on this broad evidence and being faced in Brazil with a permanent and accelerating inflation, we started studying inflation and writing some papers on the subject. When our ideas about autonomous or

inertial inflation matured, we decided to publish this book, first in Portuguese and now in English.

During the first half of the 1980s, while Brazilian inflation rose from around 50 percent to 350 percent, to be finally stopped by a heterodox shock in February 1986, the theoretical analysis of inflation advanced significantly. Based on the Latin American structuralist theory of the 1950s and on the administered or cost push theory of the 1960s, a group of Brazilian economists criticized the monetarist and rational expectations theories and developed the theory of inertial or autonomous inflation.

The acceleration of inflation in Brazil between 1979 and 1986 did not happen gradually and linearly, but by jumps. In the second semester of 1979, inflation jumped from the 50 percent to the 100 percent level; in 1983, from the 100 percent to the 200 percent level; in the last quarter of 1984, from the 200 percent to the 280 percent level; and finally, on the eve of the shock, from the 280 percent to the 350 to 400 percent level. The theory of inertial inflation was started by making a distinction between the accelerating and the maintaining, or inertial, factors of the level of inflation. The development of the theory of inertial inflation, therefore, was deeply embedded in the Brazilian experience of inflation; however, its application can be much more generalized, including for developed economies. The basic paper, which served as matrix for the theories of this book and which corresponds to its first chapter, dealt with inflation in contemporary—technobureaucratic and oligopolistic—capitalism.

Most of the chapters in this book were first published as essays in *Revista de Economia Política*. When we got together to write Chapter 3 about the accelerating, maintaining, and sanctioning factors of inflation (1983), we decided that we would write additional essays to form a book. Its first edition was published in Brazil in 1984, with the title *Inflação e Recessão*. All chapters were written by both of us, except Chapter 2 (1981) and 6 (1980), written by Luiz Bresser Pereira, and Chapter 7 (1982), written by Yoshiaki Nakano. Chapter 4 (1984a) and Chapter 8 were written for the first Brazilian edition, and Chapter 5 (1986) for the second Brazilian edition. Chapters 1, 9, and 10 were written especially for the English edition between March and September 1986. Dates at the end of each chapter refer to the first publication except for the chapters written especially for this book for which dates refer to the moment they were completed.

The ideas developed in this book were the result of debates with many economists. To Ignácio Rangel, who developed the theory of the endogenous supply of money and gave special importance to administered

inflation in Brazil, we owe a special debt. Our friends, Adroaldo Moura da Silva, André Lara Rezende, Edmar Bacha, Francisco Lafayette Lopes, Mário Henrique Simonsen, and Pêrsio Arida developed, at the same time, ideas similar to the ones presented in this book. Albert Fishlow was the first economist to propose to us personally, in July 1983, the idea of an unorthodox shock. We both had been discussing this subject since we had written the second chapter of this book (first published in December 1983), and, in the second semester of 1983, we wrote Chapter 3 (first published in July 1984) proposing "the heroic solution to control inflation." We also have a debt to Celso Furtado, André Montoro Filho, Alkimar Moura, Fernando Maida Dall'Acqua, Fernão Botelho Bracher, Geraldo Gardenalli, João Sayad, José Serra, Luiz Gonzaga de Mello Belluzzo, Marcelo Antinori, Marcos Fonseca, Roberto Vellutini, Rudiger Dornbusch, and Werner Baer.

Along the line of thought that was initiated by Ignácio Rangel, we believe that, at certain points, the inverse relation between growth and inflation is more powerful than the direct relation for oligopolized economies like that of Brazil. When there is recession, inflation tends to accelerate rather than diminish because the oligopolistic corporations succeed in increasing their profit margins. At the same time, there is a reduction in the profit margins of the competitive corporations and the agricultural sector, but this reduction does not manage to make up for the increase of the markup in the oligopolist sector. The relationship between inflation and growth is more complex because there are other factors such as the variations in the rate of real wages, in the real exchange rate and in the prices of imported goods, and the measures of "corrective inflation" taken by the economic authorities, which accelerate or decelerate inflation. On the other hand, without underestimating the market, we consider that the administrative factors, derived from the monopoly power of the corporations, the trade unions, and the state, have a decisive importance in the contemporary phenomenon of inflation. In these terms, in this book we try to develop, within the wide boundaries of structuralism, a theory of administered inflation that is conditioned by the power of monopoly and of inertial inflation that becomes dominant as inflation reaches high rates, resulting in the appearance of the formal and informal mechanisms of indexation.

Luiz Bresser Pereira
Yoshiaki Nakano

The Theory of
INERTIAL
INFLATION

