Institutions, State Capacity and Economic Development -
The Political Economy of Import Substitution
Industrialisation in Brazil

Alexandre Queiroz Guimarães

Department of Politics
University of Sheffield

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For my parents, Claudino and Ana Maria

Pendant deux long mois, les consciences et les providences qui sont dans l’invisible avaient assisté à ceci: d’un côté les étendues, les vagues, les vents, les éclairs, les météores, de l’autre un homme; d’un côté la mer, de l’autre une âme; d’un côté l’infini, de l’autre un atome.

Durante dois longos meses, as consciências e as providências que existem no invisível tinham assistido a isto: de um lado, a extensão, as vagas, os ventos, os relâmpagos, os meteoros, do outro lado, um homem; de um lado o mar, do outro uma alma; de um lado o infinito, do outro um átomo.

Victor Hugo – Les Travaillers de La Mer
SUMMARY

This thesis deals with the determinants and limits of the process of import substitution industrialisation which took place in Brazil from 1930 to 1980. A first important objective is to understand the direction given to the process of industrialisation and the consequent pattern of policy making. Secondly, the thesis asks why the Brazilian state, a key agent in the process of industrialisation, was not able to adopt certain measures and to go in certain directions which could have produced a more solid and sustainable process of economic development.

Key attention is given to the concepts of state capacity and the developmental state. The concern with state capacity justifies a careful analysis of industrial policy, undertaken for the capital goods sector in the 1970s. In addition, the thesis is also centred on a comparative analysis. Through the experience of other countries, I intend to highlight the contribution of certain institutional factors to the path of economic development in Brazil.

As a conclusion, the thesis shows how institutional factors, e.g. the result of peripheral international insertion and the organisation of social forces and of the state apparatus, constrained the capacity of the Brazilian state to replicate the results achieved by the developmental states in Japan and Korea. The study of the capital goods sector shows this in detail, emphasising the negative effects of divisions inside the state and the resistance of social groups on the coherence and the achievements of Brazilian industrial policy.

An important conclusion is that the success of a substantial process of industrial transformation, which affects the interests of several economic groups, demands the construction of a strong coalition able to increase the government’s basis of support. This was an important deficiency of the military government, whose form of domination disregarded the relevance of such political mechanisms.
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Paulo Gustavo, Eduardo Lisboa, Maria Carmen, Raimundo and Lízia and other good friends. I am sure I have failed to do justice to them all.
SUMMARY

ACKNOWLEDGMENTS

ABBREVIATIONS

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2.2. The Determinants of State Capacity.
   Autonomy
   Coherent bureaucracies
   Embedded autonomy.
   State-Business relationships and the importance of business associations
   Instruments
   The power of the developmental agency
   Capacity to monitor the enterprises
   Reducing risks
   Imposition X collaboration
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</tr>
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<tbody>
<tr>
<td>ABDIB</td>
<td>Associação Brasileira para o Desenvolvimento da Indústria de Base</td>
<td>Brazilian Association for the Development of the Basic Industry.</td>
</tr>
<tr>
<td>ABIMAQ</td>
<td>Associação Brasileira para o Desenvolvimento das Industrias de Máquinas</td>
<td>Brazilian Association for the Development of the Machine Industry.</td>
</tr>
<tr>
<td>Banco do Brasil</td>
<td>Bank of Brazil.</td>
<td></td>
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<tr>
<td>BNDE</td>
<td>Banco Nacional de Desenvolvimento Econômico</td>
<td>National Bank of Economic Development.</td>
</tr>
<tr>
<td>CACEX</td>
<td>Carteira de Comércio Exterior do Banco do Brasil</td>
<td>Department of Foreign Exchange of Bank of Brazil.</td>
</tr>
<tr>
<td>CDE</td>
<td>Conselho de Desenvolvimento Econômico</td>
<td>Council of Economic Development – Geisel government.</td>
</tr>
<tr>
<td>CDI</td>
<td>Conselho de Desenvolvimento Industrial</td>
<td>Council of Industrial Development.</td>
</tr>
<tr>
<td>CEPAL</td>
<td>Comissão Econômica para a América Latina</td>
<td>Economic Commission for Latin America.</td>
</tr>
<tr>
<td>Acronym</td>
<td>Full Name</td>
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<tr>
<td>CMBEU</td>
<td>Comissão Mixta Brasil-Estados Unidos</td>
<td>(Brazil-United States Mixed Commission).</td>
</tr>
<tr>
<td>CMN</td>
<td>Conselho Monetário Nacional</td>
<td>(National Monetary Council).</td>
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<tr>
<td>CNI</td>
<td>Confederação Nacional da Indústria</td>
<td>(National Confederation of Industry).</td>
</tr>
<tr>
<td>CONCEX</td>
<td>Conselho Nacional de Comércio Exterior</td>
<td>(National Council of Foreign Trade).</td>
</tr>
<tr>
<td>CPA</td>
<td>Conselho de Política Aduaneira</td>
<td>(Council of Tariff Policy).</td>
</tr>
<tr>
<td>CREATI</td>
<td>Carteira de Crédito Agrícola e Industrial do Banco do Brasil</td>
<td>(Bureau of Agrarian and Industrial Credit of the Bank of Brazil).</td>
</tr>
<tr>
<td>DASP</td>
<td>Departamento Administrativo do Setor Público</td>
<td>(Administrative Department of Public Sector).</td>
</tr>
<tr>
<td>Eletrobrás</td>
<td>Centrais Elétricas Brasileiras S.A</td>
<td>(Holding of the Public Enterprises in the Electrical Sector).</td>
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<tr>
<td>EMBRAMEC</td>
<td>Mecânica Brasileira S.A.</td>
<td></td>
</tr>
<tr>
<td>EPB</td>
<td>Economic Planning Board.</td>
<td></td>
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<tr>
<td>ESG</td>
<td>Escola Superior de Guerra</td>
<td>(Superior School of War)</td>
</tr>
<tr>
<td>FIESP</td>
<td>Federação das Indústrias do Estado de São Paulo</td>
<td>(Federation of Industries of the State of São Paulo).</td>
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<tr>
<td>FINAME</td>
<td>Agência Especial de Financiamento Industrial</td>
<td>(Special Agency of Industrial Financing).</td>
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<tr>
<td>FINEP</td>
<td>Financiadora de Estudos e Projetos</td>
<td>(Financial Agency for Studies and Projects).</td>
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INPI  Instituto Nacional de Propriedade Intelectual (Institute National of Intellectual Property).

IPEA  Instituto de Pesquisas Econômicas Aplicadas (Institute of Applied Economic Research).

MITI  Ministry of International Trade and Industry.

NAIs  Núcleos de Articulação com a Indústria (Centers of Articulation with the Industry).

PBDCT  Plano Básico de Desenvolvimento Científico e Tecnológico (Basic Plan of Scientific and Technological Development).

Petrobrás  Petróleo Brasileiro S.A. (Brazilian Oil Company)

PND II  Segundo Plano Nacional de Desenvolvimento (Second Plan National of Development)

PSD  Partido Social Democrata (Social Democratic Party).

PTB  Partido Trabalhista Brasileiro (Brazilian Trabalhista Party).

SEST  Secretaria de Controle de Empresas Estatais (Secretary of Control of the State Enterprises).

SUMOC  Superintendência da Moeda e do Crédito (Superintendence of Money and Credit).

UDN  União Democrática Nacional (National Democratic Union).
CHAPTER 1. INTRODUCTION

The objective of this thesis is to employ an historical-institutionalist approach to investigate the political economy of the process of import substitution industrialisation in Brazil. From the 1930s, Brazil adopted a model of development centred on intense state intervention, which manipulated many instruments, including direct state investment, to the effort of developing the national industry and economy. The objective of this thesis is to show the circumstances which marked the emergence of this interventionist state, to see how it increased its involvement and shaped the pattern of development and to investigate the main obstacles to the achievement of a more consistent program of development.

The writing of this thesis was initially motivated by the intention to address two deficiencies frequently found in the arguments of the economists. Firstly, certain economists tend to interpret economic development through a radical polarisation between state and markets. It was common to find arguments which attributed the success of certain experiences to the capacity to enforce the market mechanisms and thus allocate efficiently the resources. Conversely, interventionist models of development are blamed for distorting the price mechanisms and creating an atmosphere marked by inefficiency, corruption and rent-seeking.

Secondly, these arguments tend to take policy motivation as exogenous, without an examination of the factors that lead the governments to adopt certain strategies\(^1\). This kind of approach was thus not able to understand why some countries take the right decisions, stimulating innovation and enforcing competition, while other governments permit the emergence of protectionist and inefficient industries.

Without an adequate theory which indicates how and why governments act, the evaluation of the suitability of certain programs of intervention depends on

\(^1\) In many cases, the decisions were interpreted merely as the right or wrong decision to address a specific economic problem.
prejudgements about the meaning and capacity of states. Thus, while it is common to find interventionist arguments which attribute to the state certain neutrality and capacity of action that it does not have, certain liberal arguments tend a priori to consider interventionist states as intrinsically inefficient and corrupt. As a result, both kinds of arguments are unable to explain why, in certain countries and circumstances, state intervention was effective, while in other cases it was very ruinous.

Therefore, the option for a political-economy approach is justified by its capacity to take these issues into consideration. It shows the unsuitability of a treatment centred on the dichotomy between states and markets, indicating how different historical processes brought about national institutions which characterised distinct forms of capitalism (Shonfield, 1965). The approach is also very useful to understand how different countries opted for specific paths of economic development and why certain processes of state intervention were more effective than others.

The main focus is thus on the institutional variables which explain why certain policies are adopted and on the respective capacity of the states to implement these measures and guarantee that they produce favourable results in terms of industrial development. Although economic development is very dependent on variables such as technological innovation, the rate of savings and investment, the characteristics of enterprise organisation and the features of the financial system, it is also very important to investigate the factors which, related to social structures and political organisation, influence the variables described above. As Mancur Olson emphasises, economic theories which focus the sources of economic growth in macro-economic variables “do not tell us about the ultimate causes of growth. They do not tell us what incentives made the saving and investment occur, or what explained the innovations, or why there was more innovation and capital accumulation in one society or period than in another” (Olson, 1982: 4).

Different approaches explore the relationship between institutions and economic development. Olson (1982) explores the circumstances in which the pressures from
interest groups, in the effort of defending their immediate interests, are more or less successful in their capacity to influence the course of the economic policy. Putnam et al (1993) explore the role of social capital and civic culture to understand why certain regions have better institutional performance than others. This approach emphasises how “the constitution of networks of civic engagement” favours the constitution of an atmosphere of mutual confidence, which encourages further collaboration and is thus favourable for economic development (Putnam et al, 1993: 177). A third approach explores how economic development depends on the creation of an institutional arrangement able to guarantee the enforcement of contracts and the reduction in transaction costs (North, 1981; North and Weingast, 1989).

Despite the important insights present in these theories, the kind of analysis intended in this thesis requires a more broad and encompassing treatment. This justifies the employment of an historical-institutionalist approach, as used by Skocpol (1979) to investigate the revolutionary paths adopted by France, Russia and China. One important advantage of this approach is the form in which it explores the complementary relationships between the characteristics of the state, the influence of social forces and the impact of the international events (see also Cox, 1987).

Peter Hall (1986) develops and refines the historical-institutionalist approach, making it very encompassing and useful in capturing the main variables relevant to understand a respective path of development, including the influence of the social groups, the effects of the organisation of the state, the role of the political culture and the impacts of the country’s position in the international division of labour. In this sense, the historical-institutionalist approach permits us to capture the interaction between politics and economics, highlighting the main constraints, challenges and the crucial decisions which characterised the respective process of development. In addition, it is very useful for comparative analysis, permitting, through the description of the experience of other

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2 The three approaches develop very parsimonious and elegant theories exploring how institutions have a key influence in economic development. A similar point shared by them was the view that it is not easy to produce the suitable set of institutions (see North and Weingast 1989: 831-832; Olson, 1982: 177; Putnam et al, 1993).
countries, the highlighting of the institutional features which were specific to a certain country and how they affected the process of economic development.

**State Capacity and Developmental States**

Given the central role occupied by the state in the Brazilian strategy of industrialisation, two concepts assume critical importance for the argument of this thesis: state capacity and developmental state. Although most states have the objective of developing their country, few of them are able to undertake successful programs of industrial transformation. Thus, it is crucial to understand the factors responsible for the larger capacity of certain states to promote economic development. In this sense, I believe that a systematic treatment of the concept of state capacity, as undertaken in chapter two, is a fundamental step in understanding the vicissitudes of industrialisation in Brazil and in other developing countries.

The concept of Developmental State is associated with Johnson’s analysis of the Japanese experience in the twentieth century (Johnson, 1982). Johnson shows how the existence of a strong, qualified and meritocratic bureaucracy played a crucial role in the process of Japanese economic development in the post-war period. According to Johnson, this bureaucracy, which had many channels of contact with the business groups, played the key role in the definition of key directions of the process of development and employed a range of instruments to persuade the private sector to act in the right direction.

The two concepts focus on the state as the main agent of development and are very suitable to the study of Brazilian industrialisation in the period 1930 to 1980, a period in which the state had a high discretionary power to manipulate several instruments of industrial policy. Although the employment of the two concepts requires the necessary qualification, emphasising the conditions and the limits in which they are valid, (see Pempel 1999), I believe that they are very useful to investigate the involvement of the
Brazilian state with the process of industrialisation and to evaluate why it was not able to emulate the achievement of countries such as Japan, Korea and Taiwan\(^3\).

Brazil constitutes an important case for the study of the developmental state. The role of the Brazilian state in the process of industrialisation was not emulated in any other Latin American country and the results achieved were substantial. Nevertheless, the Brazilian state suffered important constraints, which limited its capacity to achieve the intended objectives. In this sense, the investigation of the Brazilian experience constitutes an important case to analyse the obstacles and limits that the state tend to face when committed to the objective of promoting development. Similarly to Johnson (1982), who investigates the conditions which permitted the Japanese bureaucracy to lead successfully the process of development, I intend to show how the state in Brazil, although playing a key role in the process, faced substantial obstacles and was not able to adopt and enforce the measures necessary to produce a more consistent and sustainable path.

**Detailing the objectives**

There are four critical steps in the argument of this thesis. Firstly, it is important to see how a strong and interventionist state, assuming the role of promoter of development, emerged in Brazil in the 1930s. Secondly, it is necessary to show how it increased, progressively, its involvement in the economy and how it assumed the key role in the process of industrialisation in the next decades. Thirdly, it is necessary to emphasise the political obstacles faced by the state in this process. Fourthly, it is necessary to investigate the political economy of this process and understand the determinants of the path of development and of the pattern of economic policy.

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\(^3\) As the analysis is centred on the period 1930-1980, I do not intend to evaluate the events of the 1990s and the respective difficulties faced by the Japanese economic model. Despite the present impotence of the Japanese authorities in face of the crisis, the achievements of the Japanese developmental state in the post war period were indeed substantial. This makes the Japanese experience an important paradigm.
The understanding of the emergence of the *developmentalist state*\(^4\) in Brazil requires a return to the nineteenth century and to the First Republic. In the nineteenth century, the state was weak and unable to address basic issues of the development of the country. The bureaucracy, although very strong in the court and very homogeneous, was weak in the localities and insufficient in number to control many parts of the country. The exercise of public function was not dissociated from private interests and clientelism occupied a central position (Faoro, 1998; Carvalho, 1981; 1996). Despite these factors, the state played a crucial role in social issues and this period contributed to the development of a political culture very favourable to state intervention. As Faoro (1998) shows, these elements, a legacy of the Portuguese colonisation, are important in explaining why, after the decentralising experience of the first republic, the central state reoccupied important areas of economic and social life.

Similarly, the disastrous effects of the decentralising experience of the first republic played an important role in this process. Given the direction given by the oligarchies to the federalist experience, a strong centralised state was viewed as the only way to adopt the measures necessary for the development of the country. In brief, the characteristics of the state in the nineteenth century, the features of the political culture and the political events of the first republic are very important in understanding the kind of state which emerged in response to the international crisis of the 1930s.

Another important step is to investigate the characteristics assumed by the state in the 1930s. The international crisis and the weakening of the coffee bourgeoisie gave a significant degree of autonomy to the state, which increased substantially its attributions and its means of intervention in the economy. It created organs to regulate the economic sectors, corporatist mechanisms to control the labour movement and statistics institutes and economic councils to improve the knowledge of economic reality. In addition, the

\(^4\) I decided to use the expression *developmentalist state* to refer to the state that took shape in Brazil in the 1930s and occupied a central role in the process of industrialisation until the 1980s. Although this state was very active and employed a range of instruments to promote industrialisation, I decided to avoid the expression ‘developmental state’, since the state in Brazil did not have the same power and coherence which marked the strong states that emerged in East Asia. I believe that *developmentalist state* is adequate, since *desenvolvimentismo* (or *developmentalism*) is employed to mean the kind of strategy, very centred on state intervention, which took place in several Latin American countries after 1930.
instruments of economic policy were improved and a significant reform and modernisation of the bureaucracy was implemented. And finally, the state assumed the deliberate role of promoting the industrialisation of the country (see Draibe, 1985).

A key step for the argument of this thesis is to show how this state, in the following decades, became more involved and increased its capacity of promoting economic development, including the capacity to identify problems, to design and implement policies and to co-ordinate the process. Draibe (1985), Nunes (1997) and Sikkink (1991) emphasise the process of construction of a qualified bureaucracy. The initiatives adopted by president Vargas in the 1930s and the creation of ‘pockets of efficiency’ in the 1950s were very important in producing a segment of the bureaucracy dissociated from the traditional practices of patronage. Sikkink (1991) shows the importance of the administrative reforms and of institutional continuity to the creation of a bureaucracy relatively insulated from interest groups. Similarly, Leff (1977), Sola (1982) and Bielshovsky (1988) emphasise the important role of the technicians, which were allocated, in the 1950s, to key posts in the state apparatus. In addition, councils were created and a huge effort was undertaken to increase co-ordination of state action (Draibe, 1985).

In brief, the emphasis is placed on the improvement in bureaucracy and on the organs, instruments and councils created to increase co-ordination and to provide channels of consultation between the state and the economic groups. It is shown how the increasing involvement of the state in the economy was, at the same time, a pre-condition and a key part of the process of industrial development which took place in the country.

Accordingly, a key objective is to emphasise the political obstacles which accompanied the state initiatives to shape the pattern of economic development. Draibe (1985: 43) emphasises how the state was supported by a very broad coalition and had to

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5 According to Sikkink (1991), this is very important in explaining the higher capacity of the Brazilian state when compared with the Argentinian.
“re-equilibrate, inside its structures, potentially unbalanced social interests”. Similarly, Fiori (1990; 1994) argues that the pact manufactured in the 1930s is very important in understanding the fragility of the Brazilian state and its incapacity to adopt the measures necessary for a more balanced and consistent process of industrialisation.

The resistance of the social groups impeded, in the 1930s, certain government initiatives to improve the co-ordination of the economy (Draibe, 1985). Likewise, the period 1946-1964 was marked by frequent political instability, which provoked the fall of two presidents. This period shows very clearly how very heterogeneous political coalitions and the representation of very different interests in the congress blocked certain initiatives and constrained the capacity of state action. The obstacles to implementing a tax reform or to stabilising the economy illustrate very well these difficulties (Fiori, 1990; Sola, 1982).

After 1964, the military government controlled the congress and the labour movement, but faced a different set of political obstacles which limited substantially the results of the program of development. In this sense, the military period is a very appropriate period to investigate the political obstacles and the limits in state capacity. Despite the significant attainments, the divisions inside the state, the difficulties to legitimise the regime, the lack of continuity in the programs of development and the opposition of social groups impeded the military regime in achieving more positive results in terms of industrialisation and modernisation of the country (Stepan, 1971; Martins, 1985; Schneider, 1991; O’Donnell, 1979).

Another key dimension of this thesis investigation, intertwined with the process of state building and with the respective political obstacles, is the analysis of the direction given to the model of development and of the consequent pattern of economic policy. It is necessary to understand why the path of development took a form of a process of industrialisation centred on the domestic market, marked by high tariffs and a permissive treatment of inflation. In this sense, a political economy of this process, as proposed in this thesis, intends to show how the institutional factors - including the characteristics of
the state, the characteristics of the social groups and the forms of relationship between state and social groups - interacted to produce, in response to the international constrains, a specific path of development (see Hall, 1986).

Thus, the careful evaluation of the pattern of economic policy is very important, since it reveals the challenges and limits in the capacity of the state to adopt certain policies which could have given more consistency to the program of development.

In brief, I undertake a detailed investigation of the political economy of the respective governments, emphasising the main instruments and reforms, the political and economic constrains and the direction given to economic policy. In the Geisel government (1974-78), nevertheless, I go a step further and use the capital goods sector as a case study to investigate certain limits in the capacity of the Brazilian state to promote industrial development\(^6\). In this chapter, I concentrate on a careful analysis of several determinants of state capacity, including the determinants of the economic policy, the instruments of industrial and technological policy, the divisions inside the state, the opposition of the social groups, the forms of interaction state-business and the difficulties of adopting a long-term program of industrial development.

A careful analysis of the difficulties faced by one of the most determined and articulated efforts of industrial promotion is undertaken. Although the program was critically affected by the vicissitudes of the international context, the investigation permits us very clearly to see how the factors above constrained the achievement of a more solid process of development. In addition, I intend to show how institutional factors characteristic of the Brazilian development, as emphasised in previous chapters, were important to understand the difficulties faced by the industrial program. In other words, despite the significant reforms undertaken in the military government, I show how the difficulties of the Geisel government reflect important limits of the

\(^6\) The choice of this government is justified by the substantial effort of import substitution that it undertook. Similarly, the capital goods sector was chosen because of the difficulties inherent to its development and the complex range of instruments necessary for stimulating the sector. See chapter seven.
developmentalist state in Brazil, which critically constrained its capacity to defeat the difficulties and insert Brazil in the group of the developed countries.

It is necessary to emphasise that my analysis is very much centred on the works mentioned above and on other important works about the Brazilian state and its involvement in the process of industrialisation. The originality of my thesis lies in the way in which I employ the historical-institutionalist approach to the Brazilian experience, linking the process of state building, the obstacles faced by the state and the institutional analysis about the determinants of the path of development. I believe that this gives a comprehensive understanding of important directions of the process of policy making and of the limits faced by the Brazilian state to produce more substantial results.

Another contribution is the analysis centred on state capacity. Although the ‘fragility’ of the Brazilian state was emphasised by many authors (Draibe, 1985; Fiori, 1990; 1994; Diniz, 1997), I believe that the thesis shows in detail, exploring several dimensions, the difficulties faced by the Brazilian state in promoting a substantial transformation in industrial structure. Among several obstacles, the analysis reinforces, through a detailed case study, how the lack of a more consistent basis of support constrained the achievements of the developmentalist state. In other words, I show how, given the many social pressures and the divisions inside the state, measures necessary to a smooth process of development were beyond the respective governments’ capacity to deliver.

In addition, the analysis centred on state capacity contributes to the study of developmental states, showing the difficulties that they tend to face and how the specific configuration of the social forces, typical of many late industrialisation countries, blocked and constrained the action of the state.

Brazil and Latin America face nowadays very critical economic problems. The liberal and deregulation measures adopted from the 1990s, sponsored by the United
States and by the international financial community, were not able to put the countries on a steady path of economic development. Most Latin American countries suffered from problems with their balance of payments and with speculative flows of financial capital. Brazil, for example, faces serious problems in its balance of payments, which have led the main candidates to the presidency of the republic to strongly support industrial policies centred on import substitution.

In this context, I believe that the study of the anterior model of industrialisation gains significance, both to understand the vicissitudes of Brazilian economic development in an important period of recent history. The analysis of this thesis also helps to explain the changes that took place in the 1980s and certain challenges that face the economy today.

Fiori (2000) shows how the changes in the Unites States’ policies in the 1980s and the respective transformations that it brought about constituted a substantial threat to the survival of the Brazilian developmentalist model. Its capacity of survival thus depended on the reconstruction of the political coalition, as necessary to give support to the capacity of state intervention in the new international order.

Nevertheless, this project was defeated and, at the beginning of the 1990s, a new liberal coalition, strongly supported by the prescriptions of the economics main stream, promoted liberalisation and de-regulation of the economy. Fiori (2000: 35-36) shows how this marked the abandonment of the project of building an ‘emergent power’, substituted by the new emphases on the potentialities of the new emergent markets. In this new strategy, the insertion in the international division of labour, the adherence to free trade and a model strongly based on foreign capital were considered appropriate to guarantee economic development.

Given the present economic impasse, I believe that the study of this thesis is very useful to illuminate future trajectories of development. The return to a very protectionist-interventionist model of development is, for evident reasons, including the changes in
the world order, out of the question. Nevertheless, the difficulties of the anterior project, including, for example, the obstacles to produce a developed capital goods industry or to promote technological development, have important lessons for policy makers. Although the role of the state in economic development nowadays is very different, part of these lessons remain very important for a satisfactory state action.

The thesis is organised in the following way. Chapter 2 introduces the characteristics of the historical-institutionalist approach employed in this thesis. It also discusses the determinants of state capacity and makes qualifications about the concepts of state capacity and developmental state.

Chapter 3 focuses on the characteristics of the Brazilian state before 1930, emphasising certain deficiencies in state involvement to promote economic development. The characteristics of economic policy and how it hindered the development of industry are also emphasised. In addition, the chapter focuses on the features which are important to explain the emergence of a strong state in the 1930s.

Chapter 4 describes the characteristics of the new state and how it increased its capacity to promote economic development. The objective is to show how a different state emerged, concerned to promote industrial development. This chapter emphasises how important characteristics of the model of industrialisation pursued in the following decades were established in this period. In addition, special attention is given to the role of industrialists, technicians and ideology for the configuration of the new model of economic development.

Chapter 5 investigates how the state increased its capacity to promote economic development in the period 1945 – 1960. An important emphasis is placed on the political constraints and on the main determinants of the pattern of economic policy. Chapter 6 explores how the military directed the process of development. It explores the influence that certain historical characteristics of the military had on the direction given to the process of development. In addition, the chapter shows how certain political difficulties
faced by the military impeded the adoption of a long term and balanced program of
economic development. In this chapter, the analysis of the difficulties of the military to
manage social conflicts offers a very particular focus for studying the state and the
challenges inherent to the task of governing the country.

Chapter 7 analyses the program of industrial development adopted by the Geisel
government. It investigates the achievement and the obstacles faced in the effort to
develop the capital goods sector. As emphasised, this chapter tests several determinants
of state capacity and shows how they are relevant in understanding the obstacles faced
by the Brazilian pattern of development.

Finally, chapter 8 employs the historical-institutionalist approach to investigate
certain elements of the process of economic development in Korea, Mexico and
Argentina. The objective is to use these experiences to highlight certain institutional
factors which marked the Brazilian path. In addition, the chapter shows how state
capacity adds to our understanding of the different results of industrialisation in these
countries. Chapter 9 summarises the main conclusions of the thesis.

As a last point, I would like to emphasise my total responsibility for the
translations, since several quotations were extracted from texts in Portuguese. Although
I tried to preserve the original meaning, the act of translating requires always certain
arbitrariness.
2.1. The Historical Institutionalist Approach – institutions, policy making and the trajectories of economic development

As emphasised in chapter one, this thesis embraces an historical institutional approach. This means that differences in state capacity are seen as the result of different historical processes, which have built different institutions and, consequently, constituted states with more or less capacity to promote economic development. Therefore, a first important step is to characterise this approach, making clear what is understood by institutions and how they affect the capacity of states to promote industrialisation.

Peter Hall (1986) develops a wide-ranging and powerful approach which, centred on understanding the political determinants of the policy making process, is very useful in addressing development strategies and in understanding why the states did or did not adopt certain measures to promote industrial development. Hall, refusing the idea that economic policy is simply a response to economic problems, stresses the need to develop a more systematic treatment of political elements which, intertwined with economic elements, lead countries to follow a certain path of development.

With the intention of constructing a very ‘encompassing’ approach, Hall points out the insufficiencies of the other paradigms which, although relevant and making an important contribution, miss certain important points. Responding, for example, to the ‘System Theories Paradigm’, which says that the capitalist system has certain requirements which lead the governments to adopt certain policies, Hall argues that

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7 As it is not my intention to present in detail those approaches, I just emphasise briefly some observations which I consider important to understand Peter Hall’s approach (for details, see Hall, 1986: 05-20).
there are many different ways to interpret and to respond to the imperatives inherent in the economic system. Therefore, a good theory should try to explain those differences, understanding why countries respond differently to similar challenges. In addition, Hall emphasises that the ‘System Theories Paradigm’ is unable to explain, for example, the inability of the British state to adopt the necessary measures to reverse the decline of British industry. As (Hall, 1986: 68) points out, “those who explain state action as a response to the dictates of capital or the functional imperatives of capitalism cannot explain the inadequacies of British policy from the point of view of capital or the great variation in policies across capitalist nations”.

Similarly, Hall accepts the importance of political culture but stresses the insufficiency of theories centred on this factor. According to him, to say, for example, that something happened in France because of the French political culture is not to say much. According to Hall, it is necessary to understand how respective political cultures were generated, how they were transmitted and how they became embedded in institutions. Likewise, Hall emphasises that it is necessary to understand why, at different moments, the same political culture produces different policies.

In the same way, Hall recognises the important contribution of the ‘Group Theories Paradigm’. As he emphasises, the balance of power between social groups constrains the policies available, as every policy needs coalition support (Hall, 1986: 14). Hall’s point, however, is that the strength of social groups, as well as their capacity to influence a specific policy, is deeply influenced by the institutional factors which mark the organisation of the state, the organisation of social groups and the relations between them. In conclusion, as the author points out,

“we should not lose sight of the class interest at stake in economic-policy making, but to portray the policy process accurately, we should add to our outline of massive social groups a sketch of the institutional structures through which their demands are being shaped, their power is being determined, and their circumstances altered” (Hall, 1986: 15).

In other words, although Hall attributes an important role to political struggle,
which he considers in the long run to be the main determinant of social outcomes, he argues that in the meantime, “the institutions that organise inter group relations act as a kind of social memory, imprinting the conflicts of the present with the institutional legacy of the past” (Hall, 1986: 233).

Peter Hall’s observations about the theories which stress the autonomy of state as the decisive element to explain policy making are also very interesting. Although it is correct that state agents have their own interests and motivations, to stress this autonomy is far from sufficient. It is necessary to explain how the state works, which implies accepting that the state is not a coherent bloc and that its internal organisation is characterised by the existence of significant divisions and conflicts. In addition, the capacity of the state to act coherently and to implement certain policies is a function not only of the instruments available, but also of the channels of state insertion into society and of the forms of the social groups’ penetration into the state apparatus which, in turn, depend on the forms of organisation of the groups and of the state apparatus. Therefore, Hall stresses that the understanding of state action requires the capture of the state-society networks and of the several institutional mechanisms which connect state and society. This is important to explain both state capacity and the ability of the social groups to influence the course of the policies.

The best way to understand Hall’s paradigm is to see how he applies it to interpret the British and French trajectories of development in the post war periods. A key objective in Hall’s argumentation is to show why the two states have a very different involvement in promoting industrial upgrading. While the French state adopted very active policies, the British state was much less committed to industrial restructuring and failed to adopt a strategy able to reverse the trends of industrial decline.

Hall starts by presenting a brief summary of the British economic institutions and showing how they played a key role in the process of industrial decline. Making reference to Gershenkron, Hall emphasises how the timing of industrialisation had decisive effects in the shaping of the British industrial pattern. In this sense, the structure
of the shop-floor, the sectoral distribution of the industry, the managerial organisation of
the enterprises and the ‘bank–enterprise relationships’, substantially influenced by the
British pioneer industrialisation, had very significant consequences for the subsequent
course of development.

Hall emphasises how the characteristics of those economic institutions had a
negative impact on the British capacity to adjust when faced with German and American
competition, at the end of the nineteenth century. Firstly, the concentration of
investments in traditional industries delayed adjustment and investment in the new
dynamic sectors. Secondly, the power of the qualified artisans on the shop-floor and
their control of the trade unions hindered the introduction of new forms of work
organisation, delaying the introduction of more productive Fordist techniques of
production (Hall, 1986: 44). Thirdly, the enterprises, which had developed as family
organisations, were slow to adopt more modern forms of corporate organisation.

Fourthly, early industrialisation had shaped a pattern marked by the development of
short-term relationships between banks and enterprises. In contrast to Germany and
France, Britain did not develop large investment banks which, by integrating banks and
enterprises, provided financial resources at low costs and reduced the risks of
investment. Thus, the lack of integration and the enterprises’ desire to keep the
dependence on banks under control produced a more cautious pattern of investment.
Accordingly, the lack of integration contributed to the generation of different interests
between the two segments of capital. The financial system developed strong links
outside the British economy and, at the moment in which the national industry needed
resources to face foreign competition, the capital was going abroad8 (Hall, 1986: 39;40).

In face of clear signs of industrial decline, maintained in the first decades of the
twentieth century, Hall believes that a key point is to understand why there was no
consistent effort by the governments to reverse the trend. He identifies a range of four

8 Furthermore, the power of the City of London was an important element to inhibit the adoption of
policies favourable to the recovery and restructuring of industry.
factors which help to explain the resistance (and incapacity) of governments to adopt a set of policies favourable to industrial restructuring: the position in the international system, the configuration of the social groups, the institutional structure of state organisation and the nature of the political system.

The country’s position in the international economic system was very important in reinforcing the strength of financial interests and in constraining the government’s disposition to devalue the pound (Hall, 1986: 58-59). The organisation of social groups, in turn, was critical in several ways. Firstly, the difference of interests between the industrial and the financial capital impeded a co-ordinated engagement and unified support for policies able to upgrade the industrial structure. Secondly, business associations were strong but very fragmented, hindering the achievement of a more wide-ranging position of the class in dealing with the national problems. Accordingly, industrialists tended to view the actions of the government with a certain suspicion and to resist interference in their activities.

Thirdly, the labour movement, although characterised by high degree of affiliation, lacked a central confederation with the mechanisms and resources to compel members to follow its orientation. In addition, the local trade-unions were very strong and resistant to any form of state intervention which affected their autonomy. As a consequence, a strong and fragmented trade union movement was a further obstacle to the adoption of policies aiming at the reorganisation of the industrial structure. In conclusion, as Hall emphasises, the organisation and the interests of the social groups affected the government’s agenda, as well as its capacity to adopt certain measures to reverse industrial decline (Hall, 1986: 59-60).

Hall finds that the organisation of the British state apparatus, marked by the independence of the Bank of England and by the power of the Treasury – an organ with little expertise in and commitment to developing industry – did not favour a consistent policy of industrial adjustment. Similarly, the re-organisation of the state in the post-war period did not produce an organ with enough capacity to undertake a program of
industrial adjustment. As a consequence, industrial development was not considered a central priority inside the state apparatus. In addition, the government, in the immediate post-war period, missed the chance to assume control over the financial system, a measure which would have increased substantially its capacity to make industrial policy. As a result, in the 1960s, when the government found it necessary to promote industrial restructuring, it lacked the instruments to do so (Hall, 1986: 61-62).

The organisation of the political system also played an important role in explaining the government's attitudes towards industry. Firstly, there was no development of a new coalition capable of changing the existing order: there was neither a labour–green coalition, as developed in Sweden, nor a coalition between business and bureaucrats intending to increase the national industrial capacity. Secondly, the parties were tied to very rigid doctrines and were very connected to the social groups, which acted as veto powers. Thus, ultra-liberal factions within the Conservative Party formed coalitions with business groups to avoid reforms; meanwhile, Labour Party ideology refused the practice of promoting national champions and was much more inclined to defend the supply of aid to declining sectors, a kind of measure not very favourable to increasing industrial competitiveness.

In addition, as Hall emphasises, although the executive controlled the legislature and the bureaucracy showed a high degree of insularity, political parties were not insulated from the direct influence of the social groups. The Conservatives were very dependent on business for funds, personnel and advice and the Labour Party was dominated by the trade unions. As a consequence, representatives of private groups dominated the financial and industrial arenas and, since both the trade unions and the business groups were averse to state control, they worked as veto points to the construction of an arrangement which increased state capacity to intervene in industrial affairs (Hall, 1986: 63-66).

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9 It is interesting to emphasise the contrast with other countries, such as France and Japan, in which the organisation of the state apparatus was much more favourable to an active intervention to promote industrial development. In those countries, industrial development was a central priority and macro-economic policy was subordinated to the imperatives of rapid economic growth.
In conclusion, the factors emphasised above help to explain why the favourable context of the post war did not produce the changes necessary for a more firm position towards industrial promotion. Besides the political culture, very resistant to state intervention, it is important to emphasise that the organisation of the political system and the channels of the social groups’ influence had key impact on the refusal to undertake the reforms. As Hall (1986: 67) concludes, the state, to be able to change the economy, needed first to change itself; this process, however, faced many rigidities.

The importance of the historical institutional paradigm proposed by Hall is better grasped through a comparison with the French experience. The conditions present in France in the post-war period gave rise to a very distinct developmental pattern, marked by intense state engagement to promote industrial development.

When characterising the French pattern of development, in contrast to the British, one important aspect to take into consideration is the existence of a very different political culture. While in Britain the state was seen with suspicion and social groups tried to keep it away from their activities, in France people tended to have a much more ‘permissive’ view about the role of the state in social life. French political culture identified the state as the defender of the social good; as the agent responsible for promoting the general interest against the particularistic and selfish interests of the private groups. In brief, this political culture, which viewed political parties with great suspicion, was much more favourable to a high degree of state intervention in the economy.

Similarly, the conditions present in the immediate post-war period favoured the constitution of a very strong state with instruments and capacity to promote a program of economic development. The labour movement was weak, while the old elite and the

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10 The Labour Party engaged in the consolidation of the welfare state and did not demonstrate a high commitment to the creation of an organ able to manage the process of industrial restructuring, such as an autonomous planning board.
business associations were discredited because of their collaboration with the Germans during the Occupation. This gave the new political elite considerable autonomy in the program of reconstruction. In this sense, the war and the occupation were very important in breaking down the old institutional order, in reducing the influence of certain interests groups and in favouring the emergence of a very renewed and autonomous elite. This was a substantial difference in relation to Britain, where the old forces and organisations, as seen, constrained attempts to reform.\textsuperscript{11}

The first steps of reconstruction were marked by measures which reinforced the control of the state over the economy. The state assumed the control of the financial system, nationalised key industrial sectors and adopted an institutional device which gave large power to the executive, at the expense of the legislature. Accordingly, the government created an institute of analysis and collection of data and the \textit{Ecole National d'Administration} (ENA), responsible for providing “the future administrators with the skills and attitudes appropriate to the task of directing the French economy” (Hall, 1986: 140). The ENA played a key role in the formation of a new elite, which shared similar views about the role to be played by the state in the reconstruction and development of the economy.\textsuperscript{12}

A key position inside the state apparatus was occupied by the ‘\textit{Commissariat General du Plan}’, responsible for co-ordinating the process of economic reconstruction. The planning commission, considered the organ responsible for the search of technical solutions to the national problems, acquired, in the first few years after its inception, a large measure of autonomy and legitimacy. Its reputation, founding strong roots in the

\textsuperscript{11} Olson (1982) emphasises the importance of the external shocks in breaking the influence of the interest groups and, thus, in reducing the sources of rigidity and inefficiency in the society. This is very appropriate to understand the French case, although it is necessary to take into consideration that the continuity can also have positive effects. The Japanese, the Korean and the German experiences in the post-war period illustrate the positive effects of continuity (Johnson, 1982; Kohli, 1999).

\textsuperscript{12} The importance of the ENA is emphasised by Loriaux (1999: 238), according to whom the French bureaucracy in the post-war period was very powerful and pervasive, achieving an influence which was even larger than that of the East Asian countries.
national political culture, played a decisive role in cementing the social conflicts and convincing social groups of the priority to be given to economic growth. As Hall (1986: 162) emphasises, the latent function of the Plan was to reduce conflict and give a direction to the economy, conferring an aura of rationality on issues which, otherwise, would have given rise to significant political disputes.

Thus, in sharp contrast to Britain, the organisation of state apparatus, marked by the central role occupied by the Plan, made industrial development a very high priority objective. The Ministry of Finance was very powerful and controlled important instruments, but it supported the directions given by the Plan\textsuperscript{13} (Hall, 1986: 173). Meanwhile, the control of economic instruments, specially the control of the financial system, gave the bureaucrats the means to promote the process of industrialisation.

Therefore, the strength of the bureaucracy, the power of the executive and the organisation of the state apparatus gave the planners substantial power to implement their program of industrial development. In order to produce powerful economic groups, able to face international competition, the French strategy of development concentrated the favours and incentives on elected enterprises and adopted an aggressive policy of mergers\textsuperscript{14}.

The strategy of industrialisation deepened the relationships between the bureaucrats and the industrialists. In addition, there was also an intense interchange of positions between the two agents, which contributed to intertwine the views and the interests between them. It is important to emphasise that, in a short time, the intensification of the ties and the construction of those networks, by giving the agents a position in the two sides, had very positive effects on the capacity of the state to adopt the strategy of development. The very favourable results achieved in the first years of the

\textsuperscript{13} As Hall (1986: 154-155) points out, “the evidence suggests that the planners are particularly dependent on cooperation from the Ministry of Economics and Finance, whose officials chair many of the key committees and control access to the banking network”.

\textsuperscript{14} This strategy showed little concern to the demands and needs of the medium and small enterprises, as well as those of other groups, such as shopkeepers, peasants and employees, whose interests were very much subordinated.
reconstruction illustrates very well the potentiality of a strong and qualified bureaucracy with many ties with the business class.

However, the further events in French development illustrates also the contingent nature of state capacity. In the long run, the Plan and the roots of its success undermined the basis of its efficiency and legitimacy. The increasing connection between the state and the business groups made the success of the policies increasingly intertwined with the business decisions, reducing state autonomy. As Hall (1986: 171) concludes, “the planners’ dependence on the cooperation of enterprise managers to implement the new industrial policies forced them to respond to those managers’ concerns.”

In addition, the practice of close contact between big business and bureaucrats, while other social groups were excluded, undermined the legitimacy of the Plan and produced increasing social opposition. The losers in the process of development, including peasants, small businessmen, employees and shopkeepers, mobilised and pressured their political representatives. As the political coalition became more sensitive to their support, the politicians incorporated their main demands, defending changes in the economic strategy. In addition, the difficulties of the Plan were aggravated by bad economic performance in certain sectors. This affected its ability to justify its policies on the basis of efficiency. In brief, in such circumstances, it became very difficult to keep the association between state action and the pursuit of the general interest. As a result, the government had to compromise and abandon many targets of its industrial program (Hall, 1986: 175).

In brief, the economic transformation and the evolution of state-society relations altered the initial arrangement, explaining why the French state lost its capacity to promote economic development. The analysis of this process, as developed by Hall, highlights the complex nature of the state apparatus. It shows that the state apparatus,

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15 This topic is explored in details in the next section.
16 This phenomenon is explored in details in section 2.3.
instead of being a unitary and impartial entity, is a complex and divided organisation, in which the bureaucratic agencies have different interests and works as important channels to insert social demands into the state\textsuperscript{17}.

In conclusion, Peter Hall offers a very comprehensive approach, able to provide large flexibility for the study of the historical strategies of development. The main emphases, as shown in this section, is on the organisation of the state apparatus, on the organisation of the social groups and on the mechanisms and connections between state and society, the institutional factors which, as emphasised by Hall, are responsible for the different ways in which the countries address similar economic challenges. As seen, the autonomy of the state in face of the social groups, the inter-state conflicts and the channels of private interests penetration into the state apparatus are important aspects emphasised by the approach. Furthermore, there is a space for the political culture and for other elements related to ideology. And last but not least, Hall’s approach is open to the forms of international insertion and to the changes in the international order.

In brief, Hall’s paradigm is very comprehensive and flexible, permitting us to focus on the institutional aspects which were more relevant for a particular historical experience. In addition, its dynamic treatment of state capacity, showing how it depends on arrangements which change in time, fits very well with the kind of analysis undertaken in this thesis. In the next section, I provide a more systematic treatment of the determinants of state capacity to promote industrial development. This treatment is very compatible with the institutional-historical paradigm introduced in this section.

\textsuperscript{17} This topic is developed in the next sections.
2.2. The Determinants of State Capacity.

The objective of this section is to investigate the factors which explain the capacity of certain states to undertake successful programs of industrial development. Although every state has the objective of developing the country and adopts measures to this end, few of them are able to undertake successful processes of industrial transformation. The following paragraphs intend to provide a systematic exposition of important factors which affect state capacity. Although there are inumerous elements which influence state capacity, I believe that the analysis below emphasises a set of relevant factors which should be taken into consideration in an investigation of historical experiences of industrial development\(^\text{18}\).

An important point should be emphasised at the beginning of the section. State capacity is a fluid concept, since it changes from time to time and from issue to issue. For example, certain states may strengthen their capacity of intervention during crises or may lose it as the result of the strengthening of social groups. Similarly, a state, weak and constrained by social groups in most sectors, may have the resources and the capacity to implement successful policies in certain areas\(^\text{19}\). Nevertheless, there are states which show much more coherence and capacity as agents to promote economic development. This justifies the intention of this chapter, centred on understanding the sources of state capacity to promote general strategies of industrialisation. The section is divided in sub-sections, each one emphasising an important component of state capacity.

\(^{18}\) The main periods of analysis is the three decades which followed the second world war. It is basically the period of the Pax Americana, in which the characteristics of the international order gave some states intense discretionary power to promote industrialisation.

\(^{19}\) The power of the Department of Agriculture in the US in the period after the first world war and the coherence of the foreign policy in that country, while most of other sectors were very penetrated by private interests, are very good examples. (Skocpol, 1985: 13).
Autonomy

A first important component of the capacity of states to promote development is autonomy. As I am interested in cases in which the states played a leading role and implemented substantial reforms, the autonomy from the economic groups is necessary not only for the capacity of adoption of measures which hurt those interests, but also to permit coherence in state action. A state very penetrated by private interests tends to concentrate on the preservation of privileges and lacks the ability to adopt certain measures which, although necessary to develop the economy and strengthen industry, harm the interests of specific interest groups.

State autonomy means that the state elite may have interests and preferences different from the main social groups and use the state resources to promote them (Geddes, 1994: 02). Even when one accepts that the state preserves a situation of domination, guaranteeing the conditions of capital accumulation, it is important to take into consideration that its actions transcend the interests of the dominant groups. As Cardoso (1979) properly points out, the role of guaranteeing a situation of class domination “requires an organization which, since it cannot be other than a social network of people, exists in its own right and possesses interests of its own” (in Rueschemeyer and Evans, 1985: 47) 20.

Autonomy requires that the bureaucracy keeps a certain distance from interest groups, which is favoured when it is not solely recruited from the dominant groups and does not have close personal and economic ties with them (Skocpol, 1985: 10). Likewise, it is important there exists a bureaucratic status which differentiates the bureaucracy from other social segments. When the bureaucracy is composed of qualified and skilled people, who see themselves (and are seen by society) as the agents

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20 As Geddes (1994) points out, state autonomy is a pre-condition to understand why, in certain circumstances, the governments adopt measures which hurt the interests of homogeneous and well organised groups while benefit the unorganised and weak groups.
responsible for promoting the national good, it is less susceptible to suffer external influence. This is very well illustrated by the Japanese experience, in which the status of the bureaucracy is reinforced by the existence of very strict entrance exams. Finally, autonomy is favoured by the existence of practices of promotion and nomination to key posts which follow the internal criteria of the corporation. This keeps the cohesiveness of the organisation and makes it less susceptible to the interference of external agents.

It is also important to take into consideration that the autonomy of the state depends not only on the coherence and resources controlled by the state elites, but also on the strength and organisation of the social groups and on the institutional mechanisms that connect them with the state and with the other groups. Therefore, the characteristics of the policy making process and the degree in which they protect the decision makers from the interest groups are also important. And last but not least, the autonomy is also affected by the international insertion of the country and by the characteristics of the world order.

The importance of state autonomy to the trajectories of economic development is very well illustrated by the classical experiences of modernisation from above undertaken in the nineteenth century. Those experiences highlight not only the importance of the initiative of the elite, but also the existence of state structures and of state–society relationships which permitted the adoption of such programs of modernisation and industrialisation.

Prussia illustrates the experience of an autonomous and strong state which, as a result of its defeat by Napoleon in 1808, perceived that a radical process of transformation was necessary for the survival of the kingdom. Thus, an important

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21 Those exams, which attract the most qualified people in the country, reinforce the claims of the bureaucracy to talk in name of the national interest.

22 As Waisman (1987) shows, state autonomy tends to increase in situations of high polarisation between the social groups. Similarly, autonomy is higher in situations of weakness or non-existence of organised social groups.

23 In the 1930s, for example, the international events gave the peripheral states an autonomy to employ certain instruments and policies which were not available during the Pax Britanica.
process of reforms, which included the emancipation of the serfs, was undertaken. According to Skocpol (1979: 106), this capacity for action of the Prussian state is explained by the characteristics of the constitution of the kingdom, which provided the rulers with the financial resources necessary to maintain a powerful army and to keep the landowners under control. Equally important was the organisation of the state apparatus, marked by the constitution of a very disciplined and efficient administrative machine. In sharp contrast to the French absolutist monarchy, the Prussian nobles did not have property in office and the state officials were subject to very rigid discipline and to a strict structure of norms. Accordingly, tax was collected by officials subject to rigid budgetary control and corruption was very strictly punished.

In brief, the Prussian state, whose rigid structure of norms resembled that of a military organisation, had financial autonomy and was very insulated from the dominant groups. Those characteristics were very important for the initiative and capacity of the elite to implement the reforms, despite the resistance of the Junkers.

Another interesting example is provided by Japan which, inspired by the Prussian model, promoted also a process of modernisation from above. The path followed was only possible because of the internal organisation of the state, characterised by an administrative class which was very insulated from the economic groups (Skocpol, 1979: 101-102). In a practice originating in the sixteenth century, the administrative functions were undertaken by the Samurai, who were isolated from their regions and submitted to formal education and impersonal meritocratic discipline. The isolation, the process of training and the values of the class produced a very insulated and well prepared bureaucracy, committed to the objective of national salvation. In conclusion, Japan, like Prussia, illustrates the role that a strong, autonomous and insulated state has

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24 It is important, nevertheless, to emphasise that the process of modernisation was only possible because of the degree of development of the economy, fruit of the previous development in trade and manufacture. Similarly, the Prussian state had channels and mechanisms which permitted the implementation and enforcement of measures. This is another important component of state capacity, introduced later. For the moment, it is important to emphasise that autonomy, although important, is not a sufficient condition.

25 It is very remarkable this bifurcation between the economic wealth and the administrative power. The landowners played administrative functions only at the local level and they were strictly controlled by the samurai.
in promoting the reforms necessary for the modernisation of the country. In both countries, the reforms were critical to produce economic modernisation and to guarantee national sovereignty.

When one analyses the successful experiences of state-led industrialisation in the twentieth century, one concludes that they were also autonomous states, strong enough to impose their programs over the society. This is true for Japan, Korea, Taiwan and France, countries characterised by strong bureaucracies which had the capacity to impose directions on the economic groups.

In Japan, the power of the bureaucracy was increased by the American Occupation, which preserved the economic bureaucracy while dismantling the Zaibatsu and the military (see Johnson, 1982). In Korea, the American Occupation reduced the power of the labour movement, while keeping intact the bureaucracy and the police, important instruments of the reconstruction. In Taiwan, the special conditions which marked the Kuomintang government favoured control over the labour movement and other forms of control of the state over society. Finally, in France, collaboration with the Occupation forces weakened the business associations and gave the bureaucracy strong power to undertake the reconstruction (Hall, 1986).

**Coherent bureaucracies**

Autonomy, although important, is not a sufficient condition for coherent state action. The state officials may use their autonomy to promote their immediate interests and those of their supporters. Evans (1992) uses the example of Zaire to emphasise how a government very insulated from social groups may be very corrupt and inefficient, unable to provide the minimal conditions for the working of the economy. Thus,

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26 Many factors contributed to this result. Regarding the three East Asian countries, for example, it is important to emphasise that none of them were exporters of commodities, which had an important impact over the relative power of the agrarian classes. Furthermore, these classes were further weakened by the imposition of land reforms.

27 In both Korea and Taiwan, the business groups were very weak.
autonomy only produces positive results in states staffed with a coherent and well prepared bureaucracy. In the absence of such bureaucracy, autonomy may produce predatory states aiming at pursuing the interests of its supporters.

Thus, the existence of coherent bureaucracies – skilful, insulated and committed to the objective of promoting national development - is a very important component of state capacity. Besides the importance of well-prepared functionaries to play the administrative functions, the existence of an insulated bureaucracy, subject to meritocratic criteria of selection and promotion, has the important effect of keeping the cohesiveness of the corporation and impeding the penetration of external influence. In other words, a coherent bureaucracy, with certain characteristics identified by Weber28, is a critical prerequisite for an efficient state intervention.

As Rueschemeyer and Evans (1985: 59) emphasise, a key element, similar in importance to the generation of the non-contractual elements of the contract, is the constitution of the “non-bureaucratic foundations of bureaucratic functioning”, or the “non-instrumental sources of cohesion of the bureaucratic apparatus”. This means the constitution of an esprit de corps and of a bureaucratic ethos marked by strong sense of meritocracy and public duty. According to the authors, it requires the reshaping “of the goals, priorities and commitments of core participants” and the inculcation of “shared assumptions and expectations on which a common rationality can be based” (Rueschemeyer and Evans, 1985: 51). However, the production of those elements is not an easy task. It requires time and a long process of institution building.

28 As Rueschemeyer and Evans (1985) point out,

“[W]eber’s ideal type identified a number of critical issues: corporate cohesion of the organization, differentiation and insulation from its social environment, unambiguous location of decision making and channels of authority, and internal features fostering instrumental rationality and activism (in particular, suitable hiring and promotion of practices as well as organizational designs that minimize obstacles to personnel replacement and to the restructuring of roles and bureaus as needed).”

Although, in real world, bureaucracies are much more complex and subject to frictions, it is important to emphasise the existence of characteristics which make a bureaucracy insulated, well prepared and ready to play satisfactorily its functions.
In the three East Asian countries, the production of a cohesive bureaucracy was the result of a long process, influenced by cultural values and by remote historical events and external shocks. In Japan, as seen, it was favoured by old practices which isolated the administrative class from the economic groups and provided a rigorous process of training and discipline. Similarly, the events which followed the Meiji restoration led to the establishment of meritocratic criteria of selection, a response to the accusations that the incumbent bureaucracy was favouring the Choshu and Satsuma domains. In Korea, the creation of a modern bureaucracy was a product of the Japanese colonisation, which dismantled the old Korean state and replaced it with a modern administrative machine (see chapter eight).

Nevertheless, in most Third World countries, such a cohesive bureaucracy was not created and the public posts are still important instruments of patronage. In this sense, the difficulties of adopting meritocratic criteria of selection and promotion, the obstacles to training the bureaucracy and to producing a strong sense of corporation identity and public duty were important liabilities of the state action in those countries.

Notwithstanding the role played by the bureaucracy in countries such as Japan, Korea, Taiwan and France, it is important not to overestimate its unity and coherence. In spite of the positive elements emphasised by Weber, the bureaucracy, in reality, is something much more complex and subject to friction. It is not a homogeneous body and is characterised by different conceptions, divergence of interests and conflicts. As Johnson (1982) shows for the Japanese experience, the bureaucratic agencies engage in fierce competition in the attempt to increase their influence over other agencies and over the policy making process. In such disputes, the agencies adopt a range of practices,

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29 These events and the high status of bureaucracy, strengthened by the impact of the Second World War, gave it high insulation and autonomy. As Johnson (1982) shows for the post war period, the prime minister in Japan had the right to make only one political appoint to each ministry, the minister, and the other appointments follow the internal bureaucratic criteria, in which seniority played important role. As Johnson (1982: 52) emphasises, the Japanese minister has the power to appoint only 20 ministers and 4 officials, while the American president, in sharp contrast, “appoints at least one thousand people to posts in the bureaucracy”.

30 In addition, the existence of a coherent bureaucracy was favoured by cultural values, by the impact of American occupation and by further reforms implemented in the 1960s.
which include secrecy in certain procedures, leaks to the press, constructions of alliances inside and outside the state apparatus and the consolidation of patron – client networks. In conclusion, the existence of those conflicts, although they do not reduce the importance of well-prepared bureaucracies, means that the process of state intervention is not a smooth process, being subject to conflicts and to sources of difficulties and inefficiency.

**Embedded autonomy.**

The existence of a cohesive bureaucracy, although necessary, is not a sufficient condition for a process of effective intervention in the economy. As Evans (1992) argues, an effective intervention demands a bureaucracy embedded in society, having ties and channels which connect it with businesspeople and other social groups. If, alternatively, the bureaucracy is isolated, it does not have the means to obtain the information necessary to design its main policies and lacks the channels to negotiate policies with the relevant actors and to implement them. As a consequence, the bureaucracy, even if coherent and competent, tends to fail if it is not significantly integrated (embedded) in society.

The importance of ‘embeddedness’ for the capacity to transform the economy is very well illustrated by the experience of the Tsarist Russian state in the nineteenth century. In spite of the autonomy of the state and of the arbitrary power of the Tsar, the weakness of the civil society and the lack of mechanisms connecting the central government to the backward economic regions contributed decisively to the very limited results achieved by the program of modernisation. Correspondingly, another very good example is offered by the communist regimes. In those regimes, the civil society was also very disorganised and the strong bureaucracies lacked the channels and mechanisms to implement the necessary reforms in the economy. According to Shue (1994), this was an important cause of the failure of the communist regimes, usually neglected by the literature.
Therefore, a very important component of a successful intervention is the existence of ties and networks which connect the bureaucracy with economic groups. These ties and networks are important to facilitate the exchange of information, the communication and the negotiation between the members of the public and private sector. Similarly, they produce a similar world view between the members of the elite, also important for the co-ordination of the economy\textsuperscript{31}.

The Japanese experience in the post war period provides an interesting illustration of the role of those networks in connecting the state and the private sector. The ties between the graduates of the Todai Law School, who staffed important posts in the public and private sectors, provided an important channel of communication between the bureaucrats and the businessmen, contributing also to the dissemination of a similar world view. Also important were the practices of early retirement of the bureaucrats, who were then allocated to important posts in the private sector and in the political system\textsuperscript{32}. Those practices favoured the inter-penetration between the members of the elite, multiplying the channels of contact and communication. And last but not least, the Japanese experience was marked by the existence of many councils and forums of discussion involving representatives of the government and of the business sector. As Johnson (1982) shows, this practice of consultation was a very important component of the Ministry of International Trade and Industry (MITI) ’s capacity to achieve industrial co-ordination\textsuperscript{33}.

\textsuperscript{31} Although these networks are important for the success of state intervention, they may, on the other hand, favour clientelism and corruption. Similarly, the increasing in ties between public and private sector tends to create, even in states marked by coherent bureaucracy, difficulties for the action of the developmental state. This is explored in the section 2.3.

\textsuperscript{32} According to Johnson (1982: 67), the Japanese top bureaucrats used to retire under 55 years old, obtaining, from then, a very well paid post in the private sector. This practice, besides keeping the bureaucracy young and energetic, was very important in strengthening the ties and producing a common view and orientation between the private and the public sectors.

\textsuperscript{33} As Johnson (1982: 196) concludes, “in the years after the occupation the economic bureaucracy began by degrees to share its power with big business, consulting it on all important issues, providing state incentives for industrial rationalisation, and blurring the distinctions between the state and the private sector by insinuating numerous ex-bureaucrats into the board rooms of the economically strategic industries”.
Schneider and Maxfield (1997: 08; 17) give many examples of the importance of those networks in Korea and Taiwan. In Korea, the practices of retirement had an important role and ex officials and military were contracted by the enterprises, interested in their influence and political contacts. Ex bureaucrats were also contracted to run the business associations. In Taiwan, ex-bureaucrats were nominated to direct state enterprises and also to occupy posts in the business associations. In addition, in both countries, informal contacts between business groups and bureaucrats and contacts via the business associations provided exchange of information and facilitated the implementation of the policies.

In conclusion, as Evans (1992) emphasises, an efficient bureaucratic intervention requires an insulated-rational bureaucracy which has ties and linkages with the society. This is the core of his concept of ‘embedded autonomy’, which insists that an efficient state should be at the same time autonomous and connected with the society. In conclusion, ‘embedded autonomy’ requires a delicate equilibrium between insulation and integration. Without autonomy, embeddedness results in a predatory cartel directed to satisfy the interests of its members; without embeddedness, a consistent bureaucracy, in spite of having a strong sense of public duty, lacks the necessary information and integration to pursue collective goals. According to Evans, Latin America illustrates a situation in which the bureaucracy is not insulated enough, which facilitates clientelism and the privileged insertion of private interests into the state apparatus. Alternatively, India illustrates the opposite situation: the country has a “more thoroughly Weberian organisational structure, but lacks the ties that might enable it to mount a shared project with social groups interested in transformation” (Evans, 1992: 176).

34 Analysing the Prussian experience in the nineteenth century, Evans (1992: 148) argues that the role played by the bureaucracy required much more than insulation. “It demands accurate intelligence, inventiveness, active agency and sophisticated responsiveness to a changing economic reality. Such argument demands a state that is more embedded in society than insulated”. 
State-Business relationships and the importance of business associations

As I emphasised in the section 2.1 and also earlier in this section, state capacity transcends the organisation of the state and the characteristics of the bureaucracy. It depends on the organisation of social groups and on the institutional mechanisms which connect state and society. As most investment in capitalist economies is made by the private sector, the capacity of the state to transform the economy and to restructure industry is critically affected by the forms of interaction between the state and business groups. Governments depend on the disposition of the businesspeople to invest and a successful program of intervention must not undermine their confidence or disposition to undertake investment.

In the relationships between state and business, business associations have an important role to play as channel of communication between public and private sectors. They can provide the information needed by the government for the design of the policies, introduce the main industrialists’ requests and facilitate the implementation of the policies. In addition, as Fields (1997: 139) argues in his analysis of Korea and Taiwan, such associations can fiscalise the commitment of the firms with determinate policies, monitor the performance of enterprises, enhance a pattern of quality for the production and help in the implementation of industrial surveys. In sum, as the associations have a better knowledge of industry than the government, they have an important role to play in the design, implementation and monitoring of policy.\(^{35}\)

As far as the associations are concerned, it is important to emphasise the important role played by encompassing business associations, able to bring together representatives of many sectors of the economy. As Olson (1982) emphasises, encompassing associations, because they include representatives of different sectors and regions, are more concerned with general policy directions and have less propensity to

\(^{35}\) The essays in the book edited by Maxfield and Schneider (1997) give very good examples of the role played by the business associations in developing countries. In Korea and Taiwan, for example, compulsory business associations were used by government as channels to supply the bureaucracy with information and to transmit orders to private firms. According to Fields (1997: 135; 137; 144;145), they worked as transmission belts used by the state to impose its direction on the economy.
defend policies which, in favouring the immediate interests of specific groups, damage the national interest. Likewise, encompassing associations, by filtering the divergence between the sectors, may act as an important instrument of consensus-building among the business class and facilitate negotiations with both the government and the trade unions.\textsuperscript{36}

The experience of the Chilean Confederation for Production and Commerce (CPC), in the 1980s, offers a very good illustration of the role of an encompassing association in increasing the effectiveness of the government’s intervention. As Silva (1997) shows, the CPC, including members of the various sectors of the economy, was very important in facilitating negotiation and gaining the agreement of businesspeople in regard to determinate policies. Its encompassing nature, implying that a consensus was only possible in terms of general principles, impeded the constitution of lobbies in favour of specific measures, such as subsidies and protection for specific sectors.

Contact and consultation with the CPC were critical for the capacity of the government to implement important policies. The first example concerns a policy to increase tax. After consulting the CPC and the Conservative Party in the Congress, the government was assured that an increase of 10–15\% in the profits tax would not negatively affect investment. In order to obtain the trust of the businesspeople, the government agreed to tie in new revenue with specific programs. As a consequence, although the increase in tax was not a popular measure, the negotiation had positive results and discouraged ‘business as capital’ from using its veto power (Silva, 1997: 174). Correspondingly, the mediation of the association was also important for the approval of the new Labour Code. The proposal was presented to the CPC and, after complains that the measure was excessively pro-labour, the government agreed to make modifications\textsuperscript{37} (Silva, 1997: 174-175).

\textsuperscript{36} This is very well illustrated by the working of tri-partite corporative models in certain countries in Western Europe.

\textsuperscript{37} The success of these negotiations was facilitated because the policy makers had access to impact studies which were shared by the businesspeople. This facilitated communication between the two sectors, permitting, for example, the government to estimate the impact that the measures would have in terms of costs to the firms. Accordingly, for each initiative of the government, the CPC undertook a technical study
In brief, the Chilean experience illustrates the importance of negotiation between a pragmatic government and an encompassing association. According to the businesspeople, their participation was very important not only to prevent government mistakes, but also to guarantee that their claims would be taken into consideration. This was very important in increasing their confidence and disposition to invest.

Besides the business associations and the ‘state–business networks’, another characteristic of the business sector, the sectoral distribution of the industry, impact upon the ability of the state to promote industrial development. According to Haggard, Maxfield and Schneider (1997: 59), the capacity of the government to monitor and regulate the action of private firms is influenced by the characteristics of the firms in the leader sectors of the economy. If those firms are marked by low barriers of entry and low economies of scale, it is easier for the government to direct their actions.38

In this sense, the strengthening of the firms may make the task of the government more difficult; large firms, with substantial capacity for collective action, may reduce the capacity of the government to adopt successful programs of intervention. According to Evans (1997: 82), this happened in Korea, where the process of development produced ‘powerful internationally-oriented groups’, with little interest in collaborating with the government in a program of domestic development. Furthermore, the privatisation of the financial system gave those groups financial autonomy, reducing their dependence on the state resources and the capacity of the Korean state to impose their initiatives.39

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38 According to Schafer (1997: 105-106), this is examplified by the Korean experience in the 1960s. According to Schafer, the capacity of the Korean state to shape the actions of the private sector was very dependent on the characteristics of the Korean industrial structure, marked by light manufacture and by the predominance of small and medium enterprises.

39 Nevertheless, state capacity may be high even in economies marked by the predominance of strong business groups. In Japan, for example, the capacity of co-ordination by the MITI was exercised over large conglomerates, being remarkable in its capacity to enforce competition. Similarly, the corporatist
In addition, the sectoral structure of the industry affects how the business class react to determinate policies, having thus a role to play in the determination and success of the economic strategy. This is very well illustrated by the impact that import substitution industrialisation had in countries such as Brazil and Mexico, producing industrial groups which pressured for protection and subsidies and opposed the adoption of liberal reforms. Conversely, the implementation of export led reforms in Korea in the 1960s was favoured by the fact that the import substitution was still in its infancy and, consequently, the resistance to liberal measures was weak (see chapter eight).

**Instruments**

Another key component of state capacity is the degree of state control over instruments of industrial policy. If these instruments are lacking, as one easily concludes, even a coherent bureaucracy, aware of the national problems, would fail to deliver the necessary policies.

As Zysman (1983) argues, a very important factor is the state’s degree of control over the allocation of financial resources, a critical instrument in influencing the distribution of the investment. Through control over financial resources, the government can offer special lines of credit, provide financial incentives and reduce the risks of investment in certain designated sectors. In other words, it can alter the relationship between risk and expected profitability, making certain investments more attractive for the business groups. Likewise, the allocation of financial resources may be utilised in order to pursue other targets, such as improving technological capacity and promoting exports.

forms of intervention in Germany and in Sweden also illustrate very good results achieved by the state through negotiation with a strong and well organised civil society. In brief, the success of the intervention depends on the type of state capacity required. This is discussed below in this section.
A second very important arm of industrial policy is composed of those instruments which enable the state to restructure declining sectors. This task demands a substantial knowledge of the economy and a wide capacity of co-ordination, fundamental to eliminate overcapacity, to close inefficient firms and to promote the necessary mergers. Industrial policy in Japan, since the 1920s, illustrates the importance of this kind of measures for the success of administrative guidance in Japan. As Johnson (1982) shows, the intervention of MITI was very centred on the control of production, on the establishment of quotas, on the promotion of mergers and on discouragement of new entrants into sectors with overcapacity.

Thirdly, the state capacity to promote industrial development is critically influenced by the state’s ability to stimulate investment in research and development (R&D), aiming at creating new technology, absorbing imported technology, developing new products and upgrading existing ones. The government can stimulate investments in R&D through the supply of financial and fiscal incentives. Moreover, it can invest directly in infrastructure, in technical institutes, in laboratories and R&D activities in general. Finally, the government can create councils and stimulate the establishment of networks connecting bureaucrats, members of the scientific community and representatives of industry.

Weiss (1998) emphasises the importance of these networks for industrial and technological development. She shows how, in Japan, MITI is integrated with the scientific community and has frequent contacts with experts in the various industrial sectors. According to her, its success in the co-ordination of the industrial policy is increased by its strategic position in an extensive information network, which allows it to play also an important role in the technological process. As Weiss (1998: 51)

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40 This is important because the failure to restructuring the declining sectors tends to increase the fragility of the economy and reduce investment.

41 In the 1970s, for example, the organisation of cartels to deal with declining sectors, the distribution of market shares among the firms, the reduction in capacity in certain sectors and the re-allocation of productive resources among the sectors were central instruments of the strategy of industrial adjustment in response to the international crisis (Johnson, 1982: 303).
concludes, “having command of a robust intelligence-gathering infrastructure has thus enabled MITI to identify new technology areas with important commercial potential and to alert companies to, and encourage them to act on, the opportunities for change”.

There are many other instruments of industrial policy and it is not my intention to present them in detail. Tariff and non tariff protection, fiscal incentives, the policy of purchase of the state enterprises, intervention in the operation of foreign exchange, control over foreign capital and the investment in infrastructure and education are examples of measures adopted by the governments to promote industrial development. In each of these areas, effective intervention requires qualified people and the capacity to supervise and enforce the policies. In addition, it is important to obtain and interpret the relevant information, which requires, besides ties with the private sector, the existence of competent organs of statistics and a qualified body of technicians.

**The power of the developmental agency**

The control of the instruments of industrial policy by the agency responsible for promoting development is a key component in the state’s capacity to transform the economy. In addition, it is very important that this agency occupy an important role in the state apparatus. As Johnson (1982) shows, the bureaucracy, even when coherent and cohesive as in Japan, is characterised by the dispute between the agencies aiming at increasing their control over other agencies and their influence over economic policy. As a consequence, the capacity of the state to promote industrial development depends on the power and autonomy possessed by the ‘developmental agency’ and on its capacity to face the other agencies and implement a coherent program of development.

As Johnson (1982) shows, the Japanese process of industrialisation in the post war period was only possible because of the MITI’s control of a range of instruments, which

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42 My objective is only to emphasise, in general terms, the importance of the instruments as components of state capacity.

43 Otherwise, their projects of industrial development would be blocked by the priorities of other ministries and agencies.
included the operations of foreign exchange, control over the operations of foreign capital\textsuperscript{44}, the supply of fiscal incentives and the control over an important source of credit\textsuperscript{45}. They were central components of the process of co-ordination played by the organ. Similarly, in Korea, the control of financial system, the autonomy to allocate import licenses, tax exemptions and foreign loans and control over foreign investments were important tools which enabled the Economic Planning Board (EPB) to shape the national distribution of investment (see chapter eight). In addition, the EPB concentrated budgetary, planning and managerial functions, which gave it substantial leverage over the activities of the ministries. Likewise, the EPB, unconstrained by the legislature, was also very insulated, since it did not have direct contacts with private groups.

Alternatively, Britain illustrates a situation in which the Treasury had large influence and there was no powerful agency concerned with promoting industrial development. As Hall (1986) shows, this hindered the adoption of a program to reverse the industrial decline (see section 2.1). Similarly, as chapter eight explores, the privileged position occupied by the ministry of finance in the state apparatus, in Mexico, constrained the adoption of further interventions to promote industrialisation.

**Capacity to monitor the enterprises**

As Weiss (1998) emphasises, another important component of state capacity is the government’s ability to guarantee that incentives and subsidies produce the results

\textsuperscript{44} The power to supervise the foreign exchange budget and the instruments of trade control constituted, according to Johnson, key tools of industrial guidance. MITI used its monopoly over the operations of foreign currency and control of import of raw materials to force the firms follow its directions. Furthermore, control over foreign investment operations and imports of technology allowed the MITI to follow a coherent and integrated policy concerning the foreign capital. The combination of these controls was very important in providing MITI with the bargaining power necessary to make the foreign enterprises follow the desired directions (Johnson, 1982: 194).

\textsuperscript{45} As Johnson (1982: 209-210) emphasises, the Japanese Development Bank (JDB), created in 1951, became a very important tool of industrial policy. The bank was controlled by the Finance Minister, but it was MITI’s role to screen loan applications and to estimate the resources demanded by each sector. Another important instrument was the creation of the Finance Investment and Loan Plan (FILP), which administrated a very substantial amount of resources. This fund was authorised to supply resources to the JDB, which allocated them according to MITI’s orientation.
desired by policy makers. This requires a strict process of monitoring, to be accomplished through routine meetings, exigency of mandatory reports, the setting of targets for production and exports and other practices of supervision. As Weiss (1998: 73) concludes, making reference to the Korean experience, “systematic monitoring, through mandatory reporting and regular meetings with the companies involved, accompanied by tough penalties for persistent failure, did much to encourage beneficiary firms to meet policy expectations”.

This capacity to monitor is very well illustrated by the experiences of Japan, Korea and Taiwan in the post war period. In those countries, the respective governments controlled certain instruments - such as industrial licenses, raw material imports, foreign exchange operations and source of financial resources – which increased their capacity to monitor the activities of firms. In order to enforce the performance of the firms, the governments set targets for the quality of the production, for innovation and for a favourable export performance. In addition, the policy-makers adopted timetables for the reduction and elimination of the tariffs.

In Korea, the government offered a wide range of incentives but had also the mechanisms to monitor performance and compel the groups to invest in designated sectors. The concession of import licenses was conditioned to a satisfactory export performance and export targets were established as a form to guarantee that the firms improved productivity.

In Japan, the MITI utilised its control over a wide range of instruments as a means of co-ordinating production, avoiding over-capacity and enforcing competition among the economic conglomerates. Similarly, as Weiss shows, the MITI pressured the firms to adopt the most up-to-date productive techniques. In addition, the government tended to

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46 According to Weiss, the MITI, as a precondition to authorise increase of capacity, required that firms demonstrate efficiency and employ the most advanced equipment.
refuse the demands for the postponement of liberalisation targets, as a way of compelling the enterprises to increase productivity (Weiss, 1998: 73-74).  

**Reducing risks**

Finally, another important component of state capacity, as Weiss emphasises, is the ability of the state to socialise risks and, thus, encourage the industrialists to invest. As Weiss shows in her analysis of the East Asian countries, the state contributes to reducing business risks in the development of new products, training of engineers and workers, finding of new markets and raising of capital. According to Weiss (1998: 48), a significant proportion of the costs “is shared by, or embedded in, a thick network of state-informed (i.e. public-private) institutions”. Accordingly, the public sector, by acting as mediator between the producer and the user, absorbs a significant part of the risks.

**Imposition X collaboration**

Despite the importance that the monitoring practices had in East Asian countries industrialisation, Weiss (1998) emphasises that the capacity to impose policies is not the best indicator of state capacity. According to her, the most important is the capacity of the state to use its resources and instruments to establish a collaborative relationship with the private sector. In this sense, Weiss rejects the idea that state capacity declines with the strengthening of the business groups. According to her, the result is a transformation in state capacity. The practice of top-down decision-making loses importance and is replaced by a pattern marked by an institutionalised process of consultation and collaboration with the private sector.

Likewise, in Taiwan, the offer of subsidies was, since the 1950s, conditioned to the ability of the firms to achieve certain results in terms of size and quality of the production. As Haggard (1990: 95) shows, the government made protection conditional upon the capacity of the national producers to supply the national demand at a price which did not exceed a certain margin over the international price. In addition, a schedule was established determining the future reduction of this margin and targets were set for exports.
Weiss emphasises that, depending on the main tasks and obstacles, different kinds
of state power are necessary for effective state intervention. In certain situations, for
example, the state may require power to fight against powerful interests. This is
illustrated by the power necessary to implement agrarian reforms, which were
undertaken, in Japan and Korea, by the ‘Occupation government’. In the immediate
post-war period, when the private sector was weak, the state capacity to impose
directions and monitor the results had very good results. Nevertheless, Weiss believes
that in the last two decades the kind of necessary intervention changed. Given the
development of technology and the strengthening of the business groups, the
effectiveness of intervention became more dependent on the capacity to achieve co-
ordination through consultation and collaboration with the private sector. As Weiss and
also Johnson (1982) show, this is very well illustrated by the characteristics of
administrative guidance practiced by MITI in Japan, in which the control of instruments
by the organ is widely combined with practices of consultation and collaboration with
the private sector.

**Politics and legitimacy**

Another very important component of state capacity is the legitimacy of state
intervention. Governments are symbolically associated with the pursuit of the national
interest and, consequently, their policies should be interpreted as those appropriate to
promoting the national good. In this sense, in countries in which the bureaucracies are
seen as the representative of the national interest, such as in the East Asian countries and
in France in the immediate post war period, a strong process of intervention is more
easily legitimised and implemented. Nevertheless, policies of development may suffer
strong opposition if they were perceived as favouring certain groups and hence as
dissociated from the national good\(^48\).

\(^48\) As seen, this is also very well illustrated by the French experience in the post war period (see section 2.1)
The importance of legitimacy for state capacity is very well illustrated by the Japanese experience. As Johnson (1982) shows, the role of parliament in Japan was very important to accommodate certain interests and to legitimise the action of the bureaucracy. In addition, it acts as a mediator between state and society, stressing the relevance and preventing the bureaucracy from disregarding certain social issues. As Johnson shows, the capacity of the Japanese political system to give legitimacy to the bureaucracy was a key advantage of the Japanese developmental state over authoritarian regimes, which are dependent on high rates of economic growth to achieve legitimacy. In Korean authoritarian regime, for example, the lack of a party system was a clear liability. The regime became very dependent on the chaebols for electoral funds and on their economic performance for legitimacy. This negatively affected the capacity of the state to confront the chaebols at the beginning of the 1980s (see chapter eight).

In brief, the political system and the parties have an important influence on state capacity. A democratic political system is very important to legitimise the program of development and also to accommodate interests which could destabilise the government. Accordingly, the political parties constitute important channels of connection between state and society. The next paragraphs present two examples which explore the role of the political parties and of the channels of connection between state and society.

Kohli (1994) investigates the importance of the political parties to the capacity of the governments to adopt distributive programs in developing countries. Analysing the recent experience of India, he shows how political parties, as well as the association of the mandate with a specific program, are very important components of the capacity of the governments to adopt programs which oppose the interests of the dominant groups.

Kohli investigates the difficulties faced by the government of Indira Gandhi which, although obtaining substantial electoral support, failed to successfully implement a

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49 Alternatively, politicians who won the election in a populist–personalist basis, without the support of political parties and with a mandate unconnected to any specific program, tend to face substantial difficulties to implement successful programs of transformation.
A redistributive economic program. The author emphasises how the task was not an easy one, given the capacity of the powerful groups to mobilise against measures which harm their interests. In the face of this opposition, Kohli (1994: 99) argues that the bureaucratic arm of the state is usually unable to sustain the program in the name of the weaker groups.

In order to circumvent these obstacles, Kohli stresses that politicians need to build a strong and consistent coalition. As certain programs require a long-term commitment from their supporters, he believes that such coalition would be better achieved through the action of a political party. As Kohli (1994: 101) argues, political parties can be important in many ways, strengthening the weaker groups, mobilising political support, channeling diffuse social support to a specific program, attaching the supporters to programs and, therefore, increasing the government’s capacity to confront powerful groups.

According to Kohli, the lack of a center-left party was crucial in the failure of Indira Gandhi to successfully implement her distributive program. In spite of the electoral support and of her intention to adopt a program in name of the poor groups, Indira lacked a mechanism to link state and society and to transform her goals into outcomes. Kohli arrived at similar conclusions by analysing the failure of Rajiv Gandhi to implement a liberal program of reforms. The difficulties faced by Rajiv Gandhi are explained by the fact that the liberal measures he proposed threatened the interest of many groups in society, some of them with a high capacity of mobilisation. Thus, measures such as the reduction in public expenditure and in subsidies to essential goods faced strong opposition. Likewise, his initiative to increase the facilities to attract foreign capital was substantially opposed by the interests of the import substitution industries.

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As Kohli (1994: 106) emphasises, parties tend to be specially important in developing countries, where the political communities are not established and there is a lot to be done by the state.
In the face of this opposition, Rajiv Gandhi lacked the support necessary to adopt his liberal program, a result of the fact that he had not been elected to adopt the respective program⁵¹. Accordingly, without a strong and encompassing party, he was not able to incorporate the rural groups, which were important source of opposition to his liberal program. According to Kohli (1994: 104), Rajiv Gandhi’s experience, similarly to that of Indira Gandhi, illustrates the difficulties which emerge when there is a gap between how the power is won and how it is used.

In conclusion, Kohli’s analysis reinforces the view that, in order to understand state capacity, it is necessary to go beyond the bureaucratic structures and understand the inter-connections between state and society. A similar conclusion is achieved by Hagopian (1994), who shows how traditional politics and the lack of mediation between state and society constituted a substantial obstacle to the capacity of the Brazilian military regime to transform the structure of Brazilian politics, which therefore had important consequences for the coherence of the economic program.

As Hagopian shows, one key objective of the military, when they seized the power in 1964, was to reform Brazilian politics, purging corrupt politicians and eliminating clientelism. They defended the view that the administrative capacity could be substantially improved via the de-politicisation of the state and the replacement of the traditional politicians with bureaucrats. In addition, they believed that, through fiscal centralisation, they would reduce clientelism and 'depoliticise' the allocation of resources. Hagopian shows why this project of transformation failed. According to her, the military project was constrained by the way in which the society was organised politically, as well by the lack of an efficient channel of mediation between the state and society.

In 1974, elections were held to renew part of the seats in the regional assemblies, in the congress lower chamber and in the Senate. The military believed that the elections

⁵¹ Although he had substantial electoral support, this support was diffuse.
could increase the legitimacy of the regime and the support for its programs. Nevertheless, in spite of the substantial economic growth in the previous six years\(^52\), the government suffered a very significant defeat. According to Hagopian, the defeat occurred because of the lack of connection between the federal government and the local elites. It showed to the military a fact that was very well known in the period before 1964: the federal government’s electoral dependence on the traditional local political elite.

The electoral defeat represented a substantial blow in the government’s legitimacy and put at risk its economic and political programs, which included a slow and gradual process of democratisation. As a consequence, the government realised that changes were necessary, including the necessity to increase electoral support. As a result, it increased the use of patronage in order to strengthen its ties with the local elites and attract local leaders from the opposition party\(^53\).

As a consequence, despite the initial project, the military, in the effort to obtain support for its programs, surrendered to the effectiveness of traditional politics. In other words, as the traditional elite had control over the electoral networks, the government found it necessary to use the practices which had been the core of Brazilian politics for many decades. In sum, the military increased the practices of patronage and the distribution of resources in a politicised way. Although they controlled the fiscal resources, which had been significantly centralised, they failed to create a new political elite. The traditional elite managed to survive and to occupy important posts in the regime\(^54\).

\(^{52}\) The average rate of economic growth, from 1968 to 1973, was superior to 11%.

\(^{53}\) The use of patronage was favoured by the fact that the state had substantially increased its role in the economy, multiplying the points of contact with the social groups.

\(^{54}\) According to Hagopian, as far as the participation of the traditional politicians is concerned, the military regime did not show radical difference with the previous regime.
In conclusion, Hagopian’s analysis reinforces the importance of taking into consideration the interaction between state and society. As Hagopian (1994: 55) concludes,

“a more disaggregated view of the state (...) and an examination of the mediations between the state and society, help illuminate the failure of the Brazilian Bureaucratic Authoritarian regime to transform a state it ostensibly controlled and to explain the direction in which politics evolved under the dictatorship”.

Final remarks

The paragraphs above emphasise important points which should be taken into consideration in an analysis centred on state capacity. Nevertheless, before passing to the next section, it is important to reinforce how state capacity is fluid and dependent on the issue (Skocpol, 195; Smith, 1993; Weiss, 1998). A state can be very successful in implementing a policy in agriculture, for example, but may lack the information, the resources and the capacity to promote industrial restructuring. Similarly, a state may be very successful in promoting the liberalisation or the stabilisation of the economy, but may be unable to improve industrial capacity in strategic sectors.

Likewise, government’s intervention may be effective in promoting certain industries but fail to develop others. This is very well illustrated by the Soviet experience which, while very effective in promoting heavy industrialisation from the 1930s to the 1950s, did not exhibit similar success in a subsequent and more innovative phase of industrialisation. Similarly, as Weiss shows, states may be effective in a moment when it is necessary to impose directions, but achieve much inferior results when it is necessary to adopt a more collaborative pattern of relationship with the private sector55.

In addition, state capacity changes from time to time. It changes, for example, because it depends on the relative power of the state in relation to other agents and on

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55 As another example, Louriaux (1999: 273) emphasises how the French developmental state was much less effective in the promotion of industries which were less dependent on state demand.
the support of the social groups. As an example, the business groups may strengthen and reduce the disposition to co-operate with the government. Similarly, the government may lose the control over instruments and its ability to influence business behaviour, as happened in Korea at the beginning of the 1980s. Furthermore, state capacity depends on the construction of alliances and on the achievement of political support, which may be created and modified as a result of the change in political interests and in the relationships and negotiation between the bureaucracy, the politicians and the business groups. This interaction is unpredictable, influenced by the relative power of the agents and by their capacity of making alliances and increasing support. The specificity of the strategies of development in countries such as Japan and Korea was the power and prestige possessed by the bureaucracy, which increased the propensity of the other agents to accept and support its intervention. Nevertheless, this prestige was not a guarantee that its initiatives would receive the necessary support (see, for example, Johnson, 1982: 259-260).

Finally, it is important to emphasise that it is not possible to analyse state capacity without a reference to the world order and to the international insertion of the country. As the section 2.3 explores, many actions of the developmental states in East Asia were only possible because of the geopolitical strategic position of those countries. Similarly, certain practices of intervention were only possible under the conditions of the Pax Americana.

Despite these necessary qualifications, important points were established in this section. As seen, factors such as state autonomy, the existence of coherent-insulated bureaucracies, the connections between state and society, the existence of adequate instruments and the role of the political system are important to explain why certain states are more successful than others in promoting economic development. Autonomous and coherent bureaucracies, embedded in society, controlling the necessary instruments and having legitimacy, are more capable of detecting and implementing the necessary policies. In this process, the characteristics of the social groups and the international insertion of the country are also important variables.
2.3 Further qualifications: the limits of the concept of developmental state and difficulties inherent to state intervention in the economy

The objective of this section is to make qualifications to the concepts of developmental state and state capacity. Firstly, attention is given to the concept of developmental state and to its important but limited capacity to explain the success of the experiences of industrialisation in East Asian countries. Secondly, observations are made regarding certain difficulties inherent to state intervention in the economy, which tend to assume significance in the case of the developmental states.

As argued above, the characteristics associated with the concept of developmental state played an important role for the success of the economic models in Japan, Korea and Taiwan. The three countries had autonomous, meritocratic and powerful bureaucracies, insulated from interest groups and controlling a wide range of policy instruments. In addition, these bureaucracies were very much embedded in society, given the range of networks which connected state and society and blurred the borders between the public and the private sectors (Pempel, 1999: 160).

Nevertheless, other features, which transcended the concept of developmental state, played an important role for the success of the respective models of development. Firstly, none of the countries was a large exporter of commodities and all of them undertook agrarian reforms, which reduced the influence of the landowners as relevant political actors. Secondly, the three countries shared hegemonic projects of development centred on the achievement of national targets, such as rapid economic growth, an increase in productivity and the conquest of foreign markets. These projects, adopted by regimes which rejected communism strongly, tended to ‘de-politicise’ the national objectives and so hinder the strengthening of the opposition (Pempel, 1999: 160; 171).

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56 Given the influence that agrarian groups had in most developing countries, hindering the adoption of necessary reforms, the weakness of this class was a very positive factor for economic development in Japan, Korea and Taiwan.
Social support for this kind of hegemonic projects was favoured by the characteristics of the population. The three countries have very homogeneous populations, without ethnic conflicts and doubts about nationhood. This homogeneity, combined with the possibilities of social mobility provided by the democratic education system, contributes to the solidification of the idea that success or failure is a result of the individual effort. In addition, values such as nationalism and unity are widely shared (Pempel, 1999: 169) Therefore, those values, components of a culture of consensus, were very favourable for the legitimacy and success of hegemonic projects aiming at promoting certain national targets of development.

Furthermore, all three countries were closely linked, in economic and security terms, with the USA. Their strategic position in the Cold War and the constant communist threat helped to mobilise those countries towards a process of rapid industrialisation, favouring the adoption of the hegemonic projects mentioned above. This facilitated the elimination of the opposition and the imposition of certain ‘unity’ to deal with issues such as national security and economic development.

In addition, United States aid was fundamental, providing the foreign exchange necessary during very critical periods. In Japan, for example, US aid, in 1947, paid for 2/3 of the imports (Pempel, 1999: 154). In Korea, in the period from 1953 to 1958, the foreign aid accounted for 15% of the Korean average annual GNP and 80% of total foreign exchange (Pempel, 1999: 153-154). Furthermore, the US military demand, which increased substantially during the Korean and Vietnam Wars, constituted a substantial stimulus to the recovery of the industry in Japan.

Correspondingly, the American market was opened to the products from Japan, Korea and Taiwan, while the United States permitted these countries to apply discriminatory policies against American exports and foreign investment. As Pempel

57 It is difficult to overestimate the importance of those resources, especially when one takes into consideration the critical role played by balance of payments difficulties in the economic policy of other developing countries in the same period.
emphasises, American ‘generosity’, motivated by geopolitical-strategic factors, was crucial in allowing these countries to control foreign investment and impose conditions regarding the transfer of technology. In sum, as Pempel (1999: 174) concludes, the US aid, the discriminatory policies, the opening of the American market and the special demands made by the Americans worked as catalysts to the development of the three East Asian countries, facilitating the take off and the first steps towards a stable process of economic development.

In conclusion, although the characteristics attributed to developmental states played an important role, the success of the respective strategies of development was critically affected by the other factors emphasised above. This is an important qualification for analyses which employ the concept of developmental state. In addition, it is very important to emphasise that the success of the policies of the developmental states took place in a very specific international context, marked by the institutions of the Pax Americana. This context permitted the adoption of a range of controls and mechanisms of intervention which were no more available after the events of the 1970s and early 1980s.

Loriaux’ analysis of the French experience illustrates very well this point (Loriaux, 1999). Loriaux shows how the practices of economic nationalism financed by inflation, as adopted in the post war period, was only possible in the context of American hegemony. The Pax Americana provided high growth in the world trade and allow the countries to devalue their currencies, a crucial requirement to French inflationary economic policy. According to the author, this dependence on the Pax Americana becomes evident after the change in the exchange rate system, the deepening in European integration and new trends in international trade, events which weakened the

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58 In other words, the American security agenda permitted the three East Asian countries to adopt policies which would not be accepted if American decisions were based on the objectives of the trade agenda.

59 As Hall (1986: 245) shows, the prices in France, between 1950 and 1975, increased 42% more than in Germany.
French developmental state and made ineffective many of the anterior practices of intervention \(^60\) (Loriaux, 1999: 267-268).

**Difficulties inherent to state intervention**

It is also very important to emphasise certain difficulties and distortions which tend to mark the action of the developmental states. Firstly, as emphasised in section 2.2, even coherent and well prepared bureaucracies, concerned with national development, are subjected to internal divisions and conflicts, which hinder unified action by the state. As Rueschemeyer and Evans (1985: 47) argue, state managers, although favourable to coherent action, tend to have different conceptions and to diverge both in relation to the goals and to the means to achieve them. Secondly, the state, besides being an administrative machine, is also an arena of interest conflict, which is thus penetrated by interest groups.

These obstacles tend to increase when the state intensifies its intervention in the economy. In order to efficiently perform the new functions, to improve the decision-making process and to construct the necessary political networks, the state agencies need a certain autonomy and independence from the central bureaucracy. This autonomy, however, exacerbates the difficulty of achieving co-ordination. Firstly, because the conceptions and the interests of the managers of those agencies may differ from those of the central administration \(^61\). Secondly, because increasing decentralisation, an inevitable consequence of the increase in state intervention, intensifies the contacts with the social groups and creates new channels of private interest penetration into the state apparatus. As a result, the antinomies of the civil society penetrate into the state apparatus, negatively affecting its attempts at unity (Rueschemeyer and Evans, 1985: 55-56).

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\(^60\) As the author emphasises, the inability of the state elite to deal with globalisation is a good indicator of the limits of the capacity of intervention of the French developmental state, bringing into question the myth, inherent to the French political culture, that the general interest is better achieved through the ‘rational’ intervention of a qualified body of civil servants.

\(^61\) Characterising a principal – agent problem, as emphasised by Williamson, 1985.
These difficulties inherent to state intervention in the economy are very well illustrated by the French experience in the post-war period. As Louriaux (1999: 240) shows, the French bureaucrats assumed substantial power, derived not only from the instruments that they controlled, but also from the networks and ties developed among the graduates of the Ecole National d’Administration, who occupied eminent posts in the government, in the state enterprises, in the public banks and in the private sector. As seen, the existence of those networks facilitated co-ordination and was an important component of the success of the Plan in its early years.

In addition, the strategy of development adopted by the bureaucracy was deliberately marked by an increase in the ties and contacts with the large industrial groups. As Rosanvallon argues, the latent function of the Plan was to facilitate the construction of alliances between civil servants and business people (in Loriaux, 1999: 242). As a consequence, as Hall points out, “‘to a degree present in few other nations, the management of French industrial strategy became a cooperative endeavor between civil servants and industrialists’” (In Loriaux, 1999: 240). This reduced the autonomy of the bureaucracy and facilitated penetration by private interests into the state apparatus. According to Loriaux (1999: 264), an important result was the creation of an ‘overdraft economy’, which inhibited market forces, produced an industry very dependent on public funds and hindered the adoption of the measures necessary to restructure the troubled sectors.

As Loriaux emphasises, the process was marked by the fragmentation of the state, by an increase in inter-bureaucratic conflict and by the generation of ‘policy-making subsystems’ (Loriaux, 1999: 264). The increasing ties between the bureaucratic agencies and their respective clienteles intertwined the objectives of public and private agents and led the agencies to advocate the interests of the clienteles (Hall, 1986; 171-172). As Louriaux concludes, this structure, marked by mechanisms which facilitated troubled

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62 Louriaux characterised the graduates of the ENA as a new caste, based on the holding of a diploma.

63 As Loriaux (1999: 264) argues, the halting in the market constraints “facilitated the ‘capture’ of the ministries by industrial clienteles”.

firms’ access to public funds, created a context of moral hazard which had very negative effects on the industry. The situation became insupportable when the international context changed, economic difficulties emerged and international competition became more aggressive.

In conclusion, the French experience illustrates how increasing state intervention and growing contacts with the private sector facilitated the penetration of private interests into the state apparatus, negatively affecting the autonomy, the coherence and the attempts of co-ordination by the state. According to Loriaux, this is a kind of pathology that is inherent to every developmental state. Nevertheless, it is necessary to be cautious in this conclusion. As Rueschemeyer and Evans (1985) emphasise, some characteristics of the bureaucracy, such as a strong esprit de corps and the coherence of the corporation, the non bureaucratic elements of the bureaucracy, may act as countervailing factors, permitting conciliation between increasing decentralisation and the intended unity of state action. In this sense, the characteristics of the bureaucracy may explain the difference in the results achieved by the developmental states. They may explain, for example, why the fragmentation of the state and its capture by the social groups was much stronger in France than in Japan.

In conclusion, this section makes qualifications to the concept of developmental state and indicates difficulties which tend to emerge when the state increase significantly its involvement in the economy. These qualifications do not reduce the importance of the determinants of state capacity, as discussed in the previous section. Nevertheless, they are important to demystify the idea of ‘super states’ and to indicate certain difficulties which, in low or high degrees, tend to mark the state-led strategies of development.
CHAPTER 3. STATE - SOCIETY RELATIONS AND ECONOMIC DEVELOPMENT - FROM THE NINETEENTH CENTURY TO THE REVOLUTION OF 1930

3.1. Introduction

This chapter investigates certain characteristics of the political institutions and of the organisation of the Brazilian state in the nineteenth century and in the first three decades of the twentieth century. One central objective is to analyse the involvement of the state in the economy and to highlight the main obstacles to a more active intervention. Given the economic backwardness of the country, it is very important to understand why the state was not able to promote the reforms necessary to put the country on a steady path to economic development.

The study of these political characteristics is also important for the objective of this thesis because of the influence that they had in the consolidation of the state and of the political institutions. Important obstacles to state action in the nineteenth century, such as the power of the landowners, the existence of political patronage and the limited capacity of the bureaucracy, continued into the twentieth century and constituted significant constraints on coherent intervention to promote development. Therefore, an understanding of these political characteristics is very important in explaining the path of development followed by Brazil. Besides the obstacles mentioned above, important characteristics of the political culture were constituted at that moment and, thus, played an important role in the subsequent course of development (see section 2.1).

In addition, an investigation of the main characteristics of the political system, especially the relationship between the central state and powerful regional economic groups, is crucial to understanding the process of political transformations and the events which led, in the 1930s, to the emergence of the developmentalist state.
3.2. The state, the landowners and economic development in the nineteenth century

Introduction

A key aspect of Brazilian politics in the nineteenth century is the complex relationship developed between the political elite and powerful economic groups. Brazil inherited from Portugal a very centralised and patrimonialist state apparatus and a very homogeneous political elite, formed in the Portuguese mercantilist tradition (Carvalho, 1981). This elite supported an active role for the state in the regulation of economic and social issues. On the other hand, the political elite faced the challenge of administering a vast country, characterised by the existence of very powerful landowners. As a result of the colonial policy of land distribution, vast quantities of land were concentrated in the hands of a few individuals, giving them strong influence over local political affairs.

Consequently, tendencies of centralisation, a result of the characteristics of the political elite, were combined with centrifugal forces, as a result of the power of the landowners and of the difficulties in controlling and administering such a vast territory. Likewise, while the characteristics of the political elite and several institutional mechanisms of the monarchical system favoured a certain degree of state autonomy, its dependence on the economic groups for financial resources, as well as the representation of those groups in the political system, gave economic interests a veto power that defeated important initiatives of the political elite.

This combination of centralising and decentralising tendencies, between factors favourable to the autonomy of the state and the influence of the powerful economic groups, is central to understanding the dynamics of Brazilian politics in the nineteenth century. Initially, it is important to emphasise that, given the large territory and the demand of the provinces for autonomy, the maintenance of national integrity was a very substantial achievement of the Brazilian political elite. Accordingly, this elite, in

\[64\] As Carvalho (1981) shows, the contrast with Spanish America was striking. In the Spanish colonies, a
important issues, tried to introduce reforms which could have had important effects in the national economy. Nevertheless, its autonomy was limited and the veto power of the economic groups was a critical constraint upon its initiatives.

In brief, it is through the investigation of the forms of interaction between the powerful local landowners and the central government that it is possible to capture key characteristics of the Brazilian state in the period. Initially, I introduce important events and reforms which followed independence, in 1822. These were very important for the constitution of the institutional arrangements which persisted until the end of the empire. Secondly, I explore a key obstacle to economic development in the period and enquire into the reasons for the limited involvement by the state to defeat it. Finally, I investigate certain characteristics of the political elite and its position in regard to forms of developing the country.

**Decentralisation, centralisation and the organisation of the Brazilian state in the nineteenth century**

The years which followed national independence, in 1822, were marked by large-scale instability and by intense disputes about the basic institutions of the political system. The authoritarian tendencies of the emperor, Pedro I, were not well received by the national groups. As Mendes (1997: 115) points out, these disputes were centred mainly on the political representation of national groups and on the degree of autonomy of the provinces. In addition, according to this author, Brazil lacked a set of shared values and a mechanism to regulate political competition. In this context, “neither the personality of the emperor nor the rivalries between the political factions, in fight, were favourable to produce political stability” (Mendes, 1997: 116). Disputes were common during the whole period and only finished with the abdication of the emperor, in 1831.

similar political elite was not created and there was a strong dissociation between the colonisers and the native elite. The result was the fragmentation of the empire and the political instability which marked most of the nineteenth century.
From 1827, under pressure from the liberal political groups, the emperor agreed to adopt decentralising measures and to increase the autonomy of the provinces. An important innovation was the introduction of the ‘Juízes de Paz’ (Judges of Peace) who were elected locally and combined judicial, administrative and police functions. In 1831, the return of the emperor to Portugal brought about the period known as ‘Regencia’ (Regency), marked by the first experience of Brazilians in power. The Regency intensified the decentralising measures. It created provincial assemblies and transferred many judicial and administrative powers to the provinces.

The army, responsible for revolts in the period, suffered substantial reduction in its functions and became subject to strict control. In order to guarantee stability, the government created the National Guard, a voluntary service which became responsible for the security of the municipalities. The posts of the National Guard, initially elected locally, were non-remunerated and significant part of their equipment, including arms and horses, had to be provided by the volunteers. As a consequence, the posts of National Guard officials were controlled by the large landowners as they were the only ones who had sufficient financial resources and authority to impose order and discipline. The introduction of the National Guard, determined by the incapacity of the federal government to finance and maintain a loyal army, gives a good indication of the influence of the powerful local groups in the political life of the period.

The decentralising experiences of the Regency did not have positive results. The country suffered many regional revolts and faced a real threat of fragmentation. Thus, the regime’s incapacity to guarantee order produced support for reversal in decentralising tendencies and subsequently the adoption of

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65 The Juízes de Paz were viewed by the liberals as a form to counterbalance the power of the professional magistrates. According to Mendes (1997: 117), they represented a direct challenge to the emperor’s claim of a monopoly over all the judicial attributions.

66 The Regency lasted until 1840, when Pedro II, at only 15 years of age, became emperor.

67 The importance of the National Guard is very well illustrated by the following numbers. According to Carvalho (1996: 253), while, in 1880, the police force in the provinces was composed of 7,410 men, the National Guard had a number of 918,017. According to the author, although these numbers are in large part fictitious, they are also very impressive.
centralising reforms. In addition, the re-introduction of the monarchy was viewed as a means to guarantee national unity.

The return of the conservative factions to power, in 1837, paved the way for a more stable form of domination, centred, as Carvalho (1996: 229) points out, “on an alliance between the king and the high magistrates, on one side, and the large commerce and large property, on the other side”. At the beginning of the 1840s, important reforms were adopted in order to reassert the power of the central government. The provinces and localities lost many of their functions and financial resources were concentrated on the central government. The *Juízes de Paz* lost most of its functions, which were assumed by the delegates and sub-delegates of police, controlled by the central government. Furthermore, the government created a national police force, controlled, in each province, by a chief of police appointed by the central government (Mendes, 1997: 124). In brief, the justice and police functions were centralised and subjected to the control of the Minister of Justice.\(^{68}\)

In 1850, a reform of the National Guard reinforced the tendency towards centralisation. The elections were abolished and the federal government assumed control over the appointment of officials. In brief, As Mendes (1997: 126) concludes, at the middle of the nineteenth century the imperial bureaucracy achieved a high degree of centralisation. The main posts of the political life of the provinces, including the president of the provinces and the chiefs of police, were under the control of the central government.\(^{69}\)

The control of power by the conservatives, at the beginning of the 1840s, was very important in convincing the landowners of the advantages of the monarchy. According to Carvalho (1996: 234), the position of the emperor was particularly important when in

\(^{68}\) Nevertheless, the posts of delegates and sub-delegates of police in the localities became voluntary and had large discretion in the exercise of their functions. This is an indication of the limits in the capacity of the bureaucracy to centralise and control the judicial and police functions of the municipalities.

\(^{69}\) Nevertheless, the government did not have resources to exert strictly control over the localities and the local groups continued to exercise considerable influence in the administrative and police affairs.
1844, he indicated that the rebels could come back into government and, thus, that there was space in the regime for the divergences between the oligarchic groups. This was a key point for the legitimacy of the monarchy: by acting as a mediator in the conflicts between the dominant groups, it solved a problem that was at the core of the instability of the Regency. As a consequence, the functionality of the monarchy was recognised even by the liberals, who had initially opposed the centralising measures (Carvalho, 1996: 235).

As Carvalho (1996) shows, the centralising reforms were very important in allowing the government to face up to one critical issue, the end of the slave trade. The abolition of trafficking, in 1850, was strongly opposed by the dominant economic groups, because slavery was a key component of the economy of the country. Therefore, the abolition of the slave trade required energetic action by the government. In this sense, control over the judicial and the police functions, as permitted by the reforms of the 1840s, was very important in curbing the illegal trade, permitting the trial and the punishment of the traders and even the punishment of certain landowners involved (Carvalho, 1996: 274). As Carvalho (1996: 126) emphasises, “for the first time, the imperial state was able to implement a decision which was directly in opposition to the interests of the large groups of slave-owners”.

It is important to emphasise that the centralisation promoted in the 1840s and 1850s was not marked by the constitution of a modern bureaucracy, insulated from the social groups and sharing a strong sense of corporation and public duty. As Carvalho (1996: 125) emphasises, the Brazilian imperial bureaucracy was not a 'Weberian bureaucracy', characterised by precision, regularity, impersonality and predictability. According to Carvalho (1981: 125), “its classification of posts was precarious, the division of

70 During this period, the conflicts between the dominant groups were at the root of the revolts which had put at risk the integrity of the national territory.

71 When they returned to power in 1844, they did not exercise any significant opposition to the centralising reforms and to the new institutions.

72 The end of the traffic was strongly affected by the British pressures, which included the arrest of Brazilian ships in Brazilian territory. See Carvalho (1996) for an analysis of the circumstances which marked the end of slave trafficking.
functions was not very clear”. (...) Appointments were made on the basis of personal patronage and careers were badly structured. Furthermore, the administrative structure was concentrated in the court and did not have the capacity to control activities at the local level. As Carvalho (1996: 384) emphasises, the bureaucracy had a big head but very small legs and arms, a reference to the fact that, although very strong in the capital, it did not reach the localities.

In addition, political parties used the appointments to the magistrature and the public administration as important instruments of patronage. As Mendes (1997: 132) emphasises, the rotation of parties in power provoked intense replacement in public posts, which encompassed a wide range of positions, from the caretaker to the judges and magistrates. According to this author, the strong mobility in the posts impeded the development of a class of bureaucrats with experience in public administration. In brief, the result of the reforms was not the emergence of a coherent bureaucracy, but the centralisation of the network of patronage, transferred from the provincial to the central government.

In addition, the limits of the imperial bureaucracy are also very well illustrated by the administrative role played by the National Guard. The National Guard, a volunteer and patrimonialist institution, was marked by the intertwining between the public functions and the private interests, as seen by the fact that the instruments and resources were private. Thus, the actions of the national guard were critically influenced by the interests of the local powerful groups, which administered it as their property and failed to clearly differentiate between the functions of the organ and their own interests.

73 Similarly, the presidents of province were also subject to high mobility. They had a strategic role to play in the elections, using the mechanisms under their control to guarantee results favourable to the incumbent party.
74 As Uricoechea (1978) shows, the national guard made an important contribution to the administrative functions of the empire. Despite the mixture between public and private attributes, which reduced the efficiency of the organisation, the state had no other option, but accept the liturgical forms of co-operation.
Economic stagnation and the limits of state intervention

The performance of the Brazilian economy in the eight decades which followed independence was very poor. As Leff (1997: 34) emphasises, the percapita income, from 1822 to 1899, grew slowly, a tendency only reversed at the turn of the century. In the face of this very poor performance, it is important to understand the incapacity of the state to adopt the measures necessary to stimulate economic development.

According to Leff (1997: 44), the poor performance of the economy is in great part explained by the poor performance of agriculture, whose productivity was practically constant until the end of the century. The low productivity of the activity reduced the marginal product of the work. The low income generated in the sector hindered the development of a domestic market which could have stimulated the development of manufacturing.

Leff considers that the bad performance of the agriculture was also strongly related to the precarious conditions of transport. In the large distances inherent to the Brazilian territory, the lack of an appropriate transport infrastructure limited substantially the market available for agricultural produce. As a consequence, a substantial part of agriculture was cultivated for subsistence, using ‘land extensive techniques’. In this sense, better conditions of transport, increasing the market available for the producers, could have encouraged investment and stimulated the adoption of more advanced techniques and of further specialisation.

Leff pays special attention to the negative impact of the bad conditions of transport over the supply of foodstuffs. According to him, the fact that the supply of foodstuffs was not able to respond adequately to the increase in the demand, a result of the large distances and of the low productivity, tended to provoke increase in prices and, consequently, slowed down economic development.

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75 As well as being a vast territory, Brazil did not have a network of navigable rivers which could have facilitated the transport.
These difficulties were related to the low level of investment in transport in the period. Investment in the construction of canals was negligible, while investment in highways and railways was slow and insufficient. The construction of railways, although considered a priority by the government, was also very slow and was not sufficient to reverse the stagnation of the economy. In 1884, for example, Brazil had only 6,240 km of railway, a ratio of 0.7 km of track per 1,000 square km. The comparison with the United States is instructive: in 1900, the American railway network was 20 times larger than the Brazilian one; in 1914, Brazil had 26,060 km of track, a number achieved by the United States in the 1850s (Leff, 1997: 45). Why were the investments in transport, critical to revert the stagnation of the economy, so timid and insufficient? Although the costs were high, the benefits would also have been substantial.

It is not difficult to understand the obstacles to private investment in the construction of railways. Investment in railways is a typical example of a public good, in which the social return substantially exceeds the private rate of return. Funding might have coming from foreign capital, but the profitability of the railways in Brazil was not high enough to attract British capital. Therefore, the investment in railways required an extensive state participation. Given their relevance for the development of the economy, it is very important to understand the factors which hindered the Brazilian government in undertaking the required investments and in offering the subsidies necessary to encourage foreign capital investment in such a project.

Leff emphasises that the traditional groups, who produced for the market, did have an interest in railway investment. Similarly, Leff argues that the political elite did not hold *laissez faire* doctrines and was ready to support the intervention of the state to stimulate the development of the economy. Therefore, the solution for the puzzle is found on the precarious situation of public finances, given the difficulties faced by the government to increase tax revenue. The public resources, which grew very slowly during the period, were insufficient to permit the state to increase public investment and subsidies that were needed to improve the transport infrastructure. As a consequence, the
government’s per capita expenditure grew very slowly during the nineteenth century\(^76\) (Leff, 1997: 52-53).

Consequently, the economy was trapped in a vicious circle. Although investment could have produced very positive results for the economy, increasing production and, consequently, tax revenue, it was not undertaken because of the incapacity of the government to obtain the resources necessary to finance it. In other words, the state had no way to make the powerful economic groups pay more tax, despite the fact that those groups had much to benefit from investment in transport.

The difficulties of tax collection are illustrated by the non existence of a tax on property, a result of the opposition of the landlords to the initiatives of the political elite. In the 1840s and 1850s, the government attempted to promote a reform in the land structure and to introduce a tax on property, but the initiative was vetoed by the landowners (see details below ). As a result, tax was concentrated on foreign trade, specially on imports\(^77\). This kind of tax was easier to collect and faced less opposition than tax on income or on property. As the government was unable to collect more tax, it turned frequently to loans, both domestic and foreign. During the whole period, the budgets were permanently in deficit.

In brief, this fragile financial situation explains the limited capacity of the state to invest in transport infrastructure. Carvalho (1996: 258 ) shows how investment in the construction of railways represented a significant part of the government’s expenses. According to him, 85% of the capital employed in the railways, in 1888, was public or had the guarantee of interest rates by the state or by the provincial governments. Nevertheless, those expenses were totally insufficient to meet the national need.

\(^76\) It is not easy to find precise data about public finances in the nineteenth century. Leff (1991: 118) gives a good indication of the low capacity of expenditure of the central government. In 1862-71, for example, the annual per capita expenditure in constant prices was inferior than one pound sterling (prices of 1880).

\(^77\) In the period 1841-1889, the participation of foreign trade tax on government revenue achieved the maximum level of 79%, in 1850-51, and the minimal level of 64.8%, in 1889 (Carvalho, 1996: 245).
The difficulties in increasing revenue indicate the conflict between the central bureaucracy, concerned with the strengthening of the state and with national needs, and the landowners, who were responsible for the control of the means of production. As Carvalho (1996: 241-242) emphasises, the tax issue illustrates “the internal conflict of a political elite which hesitated between the needs of the government, which it directed, and the interests of the landowners, which it should represent”.

As Carvalho shows, the veto power of the landowners played also a very important role in another important issue, the attempts of the political elite to undertake land reform\(^\text{78}\). According to Carvalho (1996: 317), the project, approved in the lower chamber of the parliament in 1843, “implied an authentic agrarian reform”. The reformers, by making possible the new cultivators’ access to land, had the objective of increasing incentives for immigration to Brazil\(^\text{79}\). Nevertheless, the project, which included the introduction of a tax on property, faced strong opposition from the landowners and was not implemented during the imperial period.

Besides the opposition of the landowners, the difficulties of changing the structure of land is also a very good illustration of the weak capacity of the state bureaucracy to implement reforms. Firstly, the bureaucracy lacked knowledge about the land structure, because no rural register existed\(^\text{80}\) and undertaking such an inventory would have been very costly. Secondly, the state lacked qualified people, such as engineers and agronomists, to undertake the required tasks. Thirdly, the administrative capacity was very poor in the localities, as illustrated by the fact that the only records about certain areas were kept by the church (Carvalho, 1996: 248). Fourthly, the government lacked the means to supervise and enforce certain decisions. In 1855-56, for example, the provinces and municipalities refused to send the information required by the law or sent

\(^{78}\) As emphasised, land was concentrated in the hands of a few landowners, while the majority of the peasants did not have access to the land. A report written at the time of independence (1822), cited by Carvalho (1996: 303), “stated that all the productive lands were already taken in a country which was almost desert”.

\(^{79}\) The political elite perceived that the import of slaves would not continue for much longer and that it was necessary to adopt alternative mechanisms to attract a work force.

\(^{80}\) The first national land survey was only undertaken in 1872.
false and incomplete information. Another interesting example regards the government’s failure, in 1878, to promote the register of properties. Although the government imposed fines on those who refused to register their property, the measure was ineffective, since the landowners simply did not pay and the government did not have mechanisms to force them to do so (Carvalho, 1996: 314).

In conclusion, this sub-section emphasises how the low productivity of agriculture and the slow investments in transport were very important causes of the poor performance of the Brazilian economy in the nineteenth century. According to Leff, the situation would have been very different if the government had invested more in infrastructure. However, as seen, there were important obstacles to increasing tax revenue and government expenditure, as well as to the adoption of deep reforms.

**The political elite and the autonomy of the state in the nineteenth century**

An important characteristic of the state elite in this period is its high degree of homogeneity. According to Carvalho, the Portuguese political elite, which was very homogeneous in ideology and in training, produced in the colony another elite with the same characteristics. This was possible because of the prohibition of universities in the colony, which forced the future members of the elite to study in the University of Coimbra. That formation was strongly based on the canons of the Roman Law and on the Portuguese mercantilist tradition, while the students were 'protected' from the subversive ideas which came from France. In brief, as Carvalho (1981: 35) emphasises, the ties with the Portuguese University and the training of the individuals in the same tradition resulted in the “transposition of a ruling group, a phenomenon unique in America which was probably more important than the transposition of the Portuguese court.”

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81 Later, the two Universities of Law created in Brazil adopted a similar educational program.
82 According to Carvalho (1981), this common education of the members of the elite produced similar views about important issues, such as the need of the preservation of the country's unity, the reproduction of a ‘democracy of free men' and the rejection of military governments. For Carvalho, the consensus in such issues was very important for the preservation of the national integrity in the nineteenth century.
The formation in the Portuguese–mercantilist tradition gave the elite a view which was sympathetic towards the intervention of the state in social affairs. According to this tradition, the state was seen as an autonomous agent which should be responsible for regulating social issues and promoting economic development. As Carvalho (1981: 180) emphasises, the state, “following the tradition of its Portuguese antecedent, constituted itself a source of power, both as a large employer (...) and as the regulator of the society and the economy”.

Important characteristics of the political elite are captured by Carvalho’s investigation of the Council of State, an organ which had an important influence on many decisions taken by the executive and by the Poder Moderador (see below) during the period. According to Joaquim Nabuco, an eminent political figure and intellectual of the period, the Council of State was the brain of the monarchy (Carvalho, 1996: 238). The members of the council were chosen very carefully by the emperor, who selected eminent individuals who had a long experience in the administration and in the legislature\(^{83}\).

According to Carvalho (1996: 327), the Council of State summarised “the political vision of the main leaders of the two large monarchical parties and of some of the main public servants not connected to the parties”, which made its ideas not very different from those of the government\(^{84}\). For all those reasons, an analysis of the positions defended by the members of the council provides important information about the thought of the Brazilian political elite during the empire.

\(^{83}\) According to Carvalho (1996: 327-328), 53 of the 72 members of the council, in the period from 1841 to 1889, were ex ministers, senators and deputies; a further 47 of the members had already been president of the province.

\(^{84}\) Although the consultation with this organ was not compulsory, the council had large influence over ministers. Similarly, the emperor consulted the council in most cases and, often, followed the opinion of the majority (Carvalho, 1996: 328).
Although the references to European countries were frequent in the meetings of the Council, Carvalho finds that its members had very pragmatic position regarding the specifics and necessities of the country. He finds, for example, a very sceptical position in relation to economic liberalism and a very pragmatic defence of state intervention to promote development. Investments in infrastructure, credit to agriculture, protectionism and other measures to stimulate industry were supported by a substantial part of the members of the council (Carvalho, 1996: 337-339).

Likewise, Carvalho finds a strong commitment to the ‘interests of the state’, as well as a concern to put Brazil on the path of civilisation and progress. Although influenced by the landowners, the members of the Council did not consider themselves representatives of this class and in important issues they diverged from its interests. Important and polemical projects, such as the Law of Property and the Law of Ventre Livre\textsuperscript{85}, which directly opposed the interests of the landowners, had their origins in the Council\textsuperscript{86}.

Therefore, since the Council of State demonstrated a certain autonomy from the economic groups, an interesting question is to understand why it did not propose a coherent project of economic development addressing the main national necessities. According to Carvalho, one important difficulty derived from the fact that there were no other experiences which could act as a model to be emulated. Although the United States was a possible point of reference, it is important to emphasise that the differences were considerable and that the attempt to introduce decentralising reforms, in the 1830s, had been very inappropriate to the national conditions\textsuperscript{87}.

\textsuperscript{85} The Law of Ventre Livre, adopted in 1871, decreed the freedom of the slaves which, from that date, were born in Brazil.

\textsuperscript{86} The large part of the councillors opposed slavery and supported land reform, considered necessary to attract immigrants. Similarly, they defended industrial development and considered that “agriculture was not the ideal path to the progress” (Carvalho, 1996: 352).

\textsuperscript{87} As seen, they provoked instability and threat of fragmentation, providing a good example of the difficulties of importing institutions.
In parliamentary debates, the main references were centred on Britain and France, experiences which diverged considerably from the Brazilian conditions of the period. According to Carvalho (1996: 344), the German model of modernisation, promoted by the state, could have given some direction to the Brazilian elite. Nevertheless, the influence in the national debate was minimal, which may be explained by the ‘obstacles’ of the German language and by the lack of cultural ties between the countries.

Correspondingly, Carvalho believes that another obstacle came from the lack of a national tradition of political thought, which hindered the emergence of a fertile debate about the national path of economic development. Furthermore, this author accentuates how the members of the council, concentrated on the court in Rio de Janeiro, were at a very substantial distance, geographically, socially and culturally, from most of the Brazilian population. As Carvalho (1996: 345) argues, the Brazil that they saw and believed that they represented was a very specific one; their particular focus on national problems was inevitably influenced by the main issues and concerns of the conservative classes.

Therefore, although demonstrating a certain autonomy and concern about the development of the country, the political elite was not dissociated from the national reality, which influenced the way the national interest was addressed. Thus, it tended, in its projects and debates, to reflect the needs of the national economy and of the coffee bourgeoisie. This is illustrated by the components of the government economic expenditure, concentrated on the construction of railways, on the guarantee of interest rates and on the supply of favourable credit conditions to the farmers. As Carvalho (1996: 261) concludes, “the large investment expenses, undertaken from the middle of

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88 Similarly, in Prussia, the political elite, although emulating aspects of foreign experiences, did not adopt a program dissociated from the national reality. As Carvalho emphasises, behind List there was a class of merchants and industrialists with interests in national unification and in development. In this sense, it is difficult to imagine a project of industrial development in the imperial Brazil, a country whose economy was essentially agrarian.

89 The coffee bourgeoisie, which included the farmers and the commercial and financial segments which developed around these activities, was the most influential economic group, a result of the key role occupied by the product in the national economy.
the century, always had direct or indirect relations with the promotion of agrarian interests”.

In addition, the reality that surrounded the elite is also important in understanding the decision to recruit immigrants, instead of facilitating the migration of workers from the Northeast region. As Leff (1997: 36) shows, the 'advantages' of this second option, related to the creation of a substantial domestic market, did not appeal to the members of the political elite\(^\text{90}\). In brief, although concerned with the progress of the country, the form of development conceived of by the elite was strongly influenced by its conservative focus and by the backward situation of the national economy.

Besides the common formation and the ideology, Carvalho emphasises other factors which favoured the interests of the political elite in the strengthening of the state. Firstly, many civil servants were elected as deputies, producing the paradox that the representatives of the state were also its functionaires (Carvalho, 1981: 182). Similarly, Carvalho’s analysis of the political elite’s composition finds significant participation by members of the liberal professions and other segments whose interests were in part dissociated from those of the propertied classes\(^\text{91}\). And last but not least, the bureaucracy was an important source of employment for many social groups, including the descendants of the landowners, who could not find employment in export-oriented agriculture (Carvalho, 1996: 180)\(^\text{92}\).

\(^{90}\) An interesting puzzle is to understand why the Brazilian authorities did not stimulate the internal mobility of the labor force, diverting the workers from the decaying northeast region to the prosperous coffee economy of the southeast. The main obstacle to the mobility of the work force was the lack of a capital market to finance the main costs of moving and settling the workers. Given the high costs implicit in the immigration of workers from Europe, it is very interesting to ask why the government did not consider the possibility of bringing them from other regions of the country.

\(^{91}\) Although recognising the importance of export activity, those members, in many situations, fell relatively free to form coalitions and to support reforms which opposed the interests of the agrarian aristocracy.

\(^{92}\) The economic characteristics of the empire, strongly affected by slavery, inhibited the development of commercial and industrial activities and made the state the only professional option for many segments of society.
Accordingly, the autonomy of the state elite was favoured by the attributions of the ‘Poder Moderador’, exercised by the emperor. This power, an absolutist mechanism of the political system, allowed the emperor to dismiss ministers and dissolve parliament in the cases of ‘salvation of the state’ (Carvalho, 1996: 341). Furthermore, the Senate and the Council of State were also appointed by the emperor. These mechanisms gave the emperor the capacity to interfere in the composition of the elite, as well as the power to mobilise other social groups (Carvalho, 1996: 297).

One important consequence of the Poder Moderador was that it increased the capacity of the state to adopt measures which opposed the interests of the dominant groups, as very well illustrated by the Law of Ventre Livre. Similarly, the role of the emperor and of the Poder Moderador was also important for the abolition of the slavery, proclaimed in 1888, despite the opposition of a significant part of the propertied classes.

The formation of the elite, the role of the bureaucracy as employer, the composition of the political elite and the role of the Poder Moderador were elements which favoured the autonomy of the state in relation to the economic groups. Although the influence of these groups was considerable and their veto power blocked important reforms, the state had a certain degree of autonomy and several initiatives of the political elite had significant consequences, as illustrated by the slavery issue. Thus, those elements had an important role in distinguishing the Brazilian imperial system from other regimes controlled by the agrarian aristocracies, such as the Argentinian state in the nineteenth century. The comparison with Argentina emphasises the importance, in Brazil, of the emergence of a political and bureaucratic class whose interests coincided with the strengthening of the state. While in Argentina the state was staffed, in large part, with representatives of the economic elites, in Brazil the political elite demonstrated higher autonomy and concern with the strengthening of the state. This is a very important

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93 In addition, as seen, the ‘Poder Moderador’ played an important role in the arbitration of the conflicts between the members of the elite. As the elections were marked by extensive fraud, the Poder Moderador provided an essential mechanism to permit the rotation of the parties in power.

94 According to Carvalho, the approval of the law was favoured, besides the support of the emperor, by the large participation of civil servants in the chamber of deputies. According to him, 81% of the civil servants voted in favour of the measure.
difference, which explains the larger autonomy of the Brazilian state and its subsequent role in economic and social affairs.

In conclusion, the Brazilian political elite, in the best Portuguese-mercantilist tradition, viewed the state as an autonomous agent which had a central role in social life. It is very important to emphasise this aspect which, as it became part of political culture, favoured the emergence of the developmentalist state in the twentieth century. After the First Republic, a period in which the regional aristocracies controlled the state and used it to promote their interests, the idea of an active state responsible for promoting the needs of society re-emerged at full power. At that time, the political elite considered it the responsibility of the state to solve many problems and imbalances which had become too explicit during the 'government of the regional oligarchies'.
3.3. State-society relations during the First Republic

Federalism and the republic of the oligarchies

The advent of the Republican regime, in 1889, brought about a substantial transfer of power to the states. In the last years of the empire, the high degree of heterogeneity and the conflict of interests between the states came to be seen as a substantial problem. Therefore, in reaction to the high centralisation that marked the anterior regime, the new political elite supported the adoption of a federalist arrangement, able to give the states more autonomy to deal with their own affairs. This goal was strongly supported by the powerful economic groups, who were keen to have more control over the public resources and utilise them to promote their immediate interests.

Under the new constitution, the states obtained autonomy to organise their own militia, to control the levying of export tax, the second most important national source of revenue, and to contract foreign loans. This autonomy to increase tax and contract loans was very important in increasing the capacity of certain states (but not of all) to increase investment in infrastructure.\(^95\)

The autonomy varied considerably among the states. The richest states, able to obtain financial resources, kept strong militia and substantially increased their independence from central government. As an example, Sao Paulo, the most rich and dynamic state, used its great participation in exports to improve considerably its urban infrastructure and to make resources available to the coffee activity. Nevertheless, the small states, with insignificant revenue from exports, became extremely dependent on the transfer of resources from the central administration. Given the lack of

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\(^{95}\) Accordingly, the states substantially increased their control over the affairs of the municipalities. In the words of Faoro (1998: 625), the constitution of 1891 delivered the municipalities to the states.
institutionalisation of a mechanism for resource transfer, those states became very dependent on the arbitrary decisions of federal government\textsuperscript{96}. Therefore, the poor states had no option but to obey the federal government, which increased the power of the president and its capacity to build and administer a national network of patronage. This was an important component of the process which permitted the oligarchies of the two most powerful states, Sao Paulo and Minas Gerais, continue to hold power\textsuperscript{97}. They utilised the federal resources to buy the loyalty of the states and to guarantee the victory in the elections.

Despite decentralisation, the federal government still controlled 60\% of fiscal resources and there were important areas which escaped the control of the states. Besides the allocation of the federal resources, issues such as the level of tariffs, the determination of exchange rate, immigration policy, monetary policy and the negotiations of foreign loans - all attributes of the federal government - substantially and differentially affected the interests of the states. For this reason, the dominant oligarchies had a strong interest in controlling the federal government.

A very important component of the political life of the First Republic (1889 – 1930) was the phenomenon known as Coronelism. This referred to the relationship developed between the governors of the states and the local landowners, the coronéis (colonels). The governors, in exchange for support in the elections, gave the coronéis access to public posts and arms, which were used by them to strengthen their position at the local level\textsuperscript{98}. The coronel owed obedience to the state’s elites and employed the arms and the

\textsuperscript{96} In addition, their competition for federal funds prevented the poor states from combining to exert pressure on central government.

\textsuperscript{97} The alliance between Sao Paulo, the most developed state, and Minas Gerais, the most populous, guaranteed the control of power by the respective oligarchies. The candidate nominated by them was virtually assured of electoral success.

\textsuperscript{98} Coronelism was not a phenomenon of the republic. The existence of federal nets of patronage, connecting the local landowners to the parties, was already an important phenomenon of the empire. The innovation of the republic was the decentralisation of those nets of patronage, which became controlled by the state governors.
resources conceded by the government to guarantee the victory in the elections. The state militias were used to certificate that the coronéis were respecting the hierarchy and were fulfilling the expectations of the government. When a coronel frustrated these expectations, he was replaced by another local chief, eager to have access to public resources and instruments.

In brief, the coronéis had to obey, a pre-condition to having access to the resources which guaranteed their domination at local level. Therefore, independent on the political disputes at the local level, the coronel, in most of the cases, supported the government. As the Coronel Manuel Inácio, from the state of Pernambuco, stated: “the government changes, but I do not change: I support the government” (Faoro, 1998: 631).

As Faoro argues, an important characteristic of Coronelism was the lack of dissociation between public functions and private resources and interests. Similarly to the patrimonialist experiences of the empire, the border between them was very fluid. The coronel was responsible for the electoral expenses and employed his private resources to win the elections for the government. In exchange, he obtained discretionary power over the allocation of financial resources and access to public posts, which were used to reward allies and to strengthen his position. Thus, it is important to emphasise that there was no space for the abstract notion of an impersonal law which must be followed. The local authorities have substantial discretion and no accountability, except to their patrons.

99 However, the coronel, although obedient, was not passive and in certain circumstances his autonomy increased, especially when he had a solid economic situation, controlled his own militia and was less dependent from public credit. Nevertheless, the tendency, with the increase and organisation of the state militias, was the reduction in the coronel’s autonomy.

100 In addition, it is important to emphasise that the coronéis played an important role as intermediary between the population and the state authorities. In order to demand a public work, such as the construction of a road or a school, or to deal with the police or the justice, the ordinary Brazilian, who was likely to be illiterate, needed someone to recommend them to the respective authority. Such society was not familiar with notions such as individual rights and representation. The relationships were structured in personal terms and the individuals needed the support of the powerful men in order to have access to the state services. These individuals had no idea about what the state was or how it worked. In their understanding, the president and the governors were powerful men who controlled the wealth and the land. They knew that there are bosses and that their duty is to obey. (Faoro, 1998: 633).
There was substantial electoral fraud\textsuperscript{101}. As Faoro argues, elections were a mere instrument to give legitimacy to power and had no commitment to the will of the electors. The consequence, thus, was a massive victory of the incumbent government. In this sense, in opposition to the imperial period, in which the \textit{Poder Moderador} guaranteed the rotation of the elites in power, the institutional characteristics of the Republican regime facilitated the monopoly of power by certain segments of the oligarchy.

Finally, the way elections were carried out illustrates very well the characteristics of the public authorities. As seen, their behaviour was founded in personal ties of loyalty and their duty was interpreted as the promotion of the victory of the government in the elections. It is easy to see how far those civil servants were from an impersonal bureaucracy concerned with the following of procedures determined by the law.

\textbf{Economic policy}

The economic policy of this period was strongly influenced by the interests of the coffee bourgeoisie, the most powerful economic group. Nevertheless, the coffee bourgeoisie did not have a hegemonic position and different demands in favour of protection of and incentives for the national industry emerged during the period. Despite the official position, which considered agriculture the national vocation and viewed with suspicion the incentives to certain industries, the period was marked by a substantial development of industrial activity.

The first years of the republic were marked by a substantial expansion in credit, a policy adopted as a form of compensation to the landowners damaged by the abolition of

\footnote{The control of the municipal posts by the governor gave him substantial capacity to influence the results of the election. Key functions in the realisation of the elections, such as the qualification of the electors and the counting of the votes, were realised by authorities nominated by the president of the municipal chamber who, in turn, was nominated by the state governor. In addition, the governors controlled the police authorities, who used the threat of retaliation and other means to guarantee the results of the election (Faoro, 1998: 628).}
slavery and, thus, as an attempt to increase political support. The result of this policy, known as *Encilhamento*, was to provide a substantial stimulus to economic activity. It proved very efficient in stimulating the modern agriculture of the state of Sao Paulo, and also in stimulating industrial activity.

The rapid growth in the coffee production led eventually to overproduction. Consequently, the international price of the product, which was substantially influenced by Brazilian production, plummeted. This led to a substantial change in the economic policy. From 1896, the government attempted to control the money supply, strengthen the value of the currency and, consequently, guarantee a high price for the product.\(^\text{102}\)

This radical change in monetary policy had a substantial impact on industrial activity which, after substantial growth, suffered significant crisis. This sudden change in policy illustrates very well the subordinated situation of industry in the period, subject to policies that damaged their interests. The marginal position of industry was very clearly emphasised in the official discourse of the period which, defending agriculture as the natural vocation of the country, condemned the concession of incentives to ‘artificial industries’.\(^\text{103}\) Protectionism was also condemned, given the fear that such a policy would provoke retaliation against Brazilian exports.

The restrictive monetary policy, adopted to preserve the high price for coffee, was not kept for a long time. The federal government came under substantial pressure and demands for expenditure and did not have the resources necessary to finance these expenditures without increasing the money supply.\(^\text{104}\)

Nevertheless, another mechanism was created to protect the interests of the coffee bourgeoisie. In 1906, the ‘*Convênio de Taubaté*’ (Taubaté’s Agreement) fixed a price

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\(^{102}\) Foreign capital, it is important to emphasise, had also interest in this kind of policy.

\(^{103}\) Artificial industries, in opposition to the natural industries, were those that do not process national raw materials.

\(^{104}\) The difficulties were increased by the rotation of presidents in power, since the election of presidents outside from Sao Paulo increased their vulnerability to pressure and reduced their disposition to keep a restrictionist monetary policy.
for the product and guaranteed the commitment by the government to buy and stock the production not absorbed by the market. A supplementary tax was created to finance the operations, while foreign loans and credit from the Bank of Brazil were contracted to guarantee the operation. In the short term, the results were very positive and kept the price of the product high. Nevertheless, this mechanism had the disadvantage of not encouraging further reductions in the supply of the product. As a consequence, in the long term, the government’s stocks grew rapidly, as did the amount spent to sustain the price of the product. The policy had very negative impact on the government finances and became an important source of inflation\(^{105}\).

An important consequence of the Taubaté Agreement was the increase in the federal government’s intervention in the economic affairs of the states. In this respect, it is important to notice, as pointed out by Reis (1982: 339), that the pressures from the states' oligarchies for state intervention sowed the seeds of their future loss of autonomy. As Reis argues, “the state, by answering the demands of the landowners, consolidated a ‘disciplining’ function over the economy, an aspect which, given the limited rules of the political game of the period, came to have substantial consequences”. Therefore, the policy of maintainence of the prices of coffee, as well as the policy of immigration, “revealed the extent of the landowners dependency on the political solution rather than a market one”.

Despite the official discourse and the vicissitudes of the economic policy, manufacturing grew substantially during most of the First Republic. In spite of the crisis that followed the Encilhamento, industrial growth was substantial, constituting, according to Faoro, the first significant industrial wave verified in the country, responsible for the creation of an industrial basis which made possible the subsequent cycles of expansion. Industrial expansion was also substantial in the subsequent decades. From 1907 to 1920, the number of people employed in industry increased from 150,841

\(^{105}\) From 1913 to 1920, the money in circulation increased more than 100 percent, growing from 897 thousand to 1,848 thousand contos de réis, a tendency which was kept in the next years (Faoro, 1998: 517).
to 275,512 (Faoro, 1998: 530). Growth was also very rapid in the 1920s and, by 1928, the value of industrial production was half of agrarian production\textsuperscript{106}.

Industrial growth was accompanied by the strengthening of the industrial class and by the consolidation of a discourse in defence of a program of industrial development. This movement, which took place especially in São Paulo, demanded protection and incentives and contested the economic policy centred on the interests of the coffee bourgeoisie.

In conclusion, it is important to emphasise the influence that the coffee interests had in the economic policy of the period. As seen, the government's intervention to sustain the prices of the product assumed a substantial magnitude and had a significant impact on public finances. Accordingly, protectionism and incentives to the industry were seen with suspicion. Nevertheless, it is very important to emphasise that those interests were not hegemonic and that the period was marked by the emergence and strengthening of alternative economic programs\textsuperscript{107}. Furthermore, the strengthening of the industrial groups represented a new focus of opposition to the main lines of economic policy.

**Sources of opposition to the regime and the Revolution of 1930**

The regime of the oligarchies failed to achieve legitimacy. Although espousing a liberal discourse, it was marked by extensive fraud and state funds were widely utilised to defend the interests of the coffee bourgeoisie. Meanwhile, the federal state, constrained by the veto power exercised by the oligarchies, lacked the resources necessary to invest in infrastructure and to assist the poorer states. This is very well illustrated by the dilemmas faced by Epitacio Pessoa, President of the Republic from 1919 to 1922. Although Pessoa opposed creating money to sustain the price of coffee, he

\textsuperscript{106} As Faoro (1998: 533) emphasises, the production, concentrated on textiles and foodstuffs, was undertaken mainly in small factories.

\textsuperscript{107} In the state of Minas Gerais, as early as 1903, sections of the elite criticised economic liberalism and the official ideology and defended protectionism and the stimulation of national production, both industrial and agrarian.
had no option but to submit to the pressures of the São Paulo oligarchy. Similarly, his
intention to impose a tax on the internal circulation of goods, considered necessary to
increase the federal revenue, also faced the resistance of the Minas Gerais' oligarchies.
As a consequence, the federal government lacked the resources necessary to address
certain basic issues, as demanded by the states and by certain segments of society

Therefore, in spite of the rhetoric that ‘coffee sustained the country’, the oligarchies
were not able to reconcile their interests with more general interests of the nation. The
pact of power disregarded the interests of the urban and medium groups which were
rapidly expanding in this period. Accordingly, the federalist arrangement, reproducing
the interests of the most powerful states, failed to address the needs of the smaller and
poorer states. And last but not least, the commitment to the 'coffee policy' provoked
inflation, increasing the cost of living and affecting many sections of society.

It is possible to identify two groups as the main opponents of the ‘republic of the
oligarchies’. Firstly, an important focus of opposition to the regime came from the elite
of the state of Rio Grande do Sul. A very dynamic state, characterised by a very
prosperous agriculture destined for the domestic market\textsuperscript{108}, the elite of Rio Grande do
Sul was a strong critic of the monopoly of power exerted by São Paulo and Minas
Gerais. Its principal product, jerky beef, was destined for the poor segments of the
population and so the state suffered from the inflationary policies sponsored by the
coffee oligarchy, which reduced the purchasing power of the population. Moreover,
along from its economic vigour, the power of the state was strengthened by its military,
the most powerful segment of the Brazilian army\textsuperscript{109}.

Likewise, the military was a substantial source of opposition to the regime during
most of the first republic\textsuperscript{110}. Its positivist formation and view of the Brazilian problems

\textsuperscript{108} It was the second richest state of the federation, after Sao Paulo.
\textsuperscript{109} This result is explained by the geographical position of the state, which bordered Argentina and
Uruguay, the most serious area of conflict during the nineteenth century.
\textsuperscript{110} Having commanded the proclamation of the republic, the military had strong influence and
were in direct opposition to the practices adopted by the oligarchies. The military, having a solid positivist and technical formation, took upon themselves the responsibilities of civilising the country, integrating the population and strengthening national unity. In addition, it supported an autonomous judiciary and, in the economic field, demanded investment in infrastructure, incentives to industrialisation, reduction in regional inequalities and assistance to the poor states. In brief, the military believed that those objectives required a strong and centralised state, with the instruments and capacity to play a more active role in national development.

The military dissatisfaction with the oligarchies' practices led to two serious revolts, in 1922 and 1924, movements which, given the key participation of lieutenants (tenentes), became known as Tenentismo (see chapter six). Although military discipline was re-established, Tenentism had substantial impact. The military continued to be very critical of the practices of the regime and its participation and support were very important for the movement which ejected the oligarchies from power, as well as for the organisation of the new regime.\footnote{Many of the tenentes occupied important posts in the new regime. According to Faoro (1998: 693), at the beginning of the 1930s, all officials, from the lieutenants to the generals, were tenentes, a reference to the sympathy to the ideas present in the Tenentism.}

Opposition to the regime intensified during the 1920s, as a result of rapid urbanisation, the increase in social demands and the unsuitability of government policies. The urban middle classes, strengthened by urbanisation, criticised their lack of participation and demanded policies which take into consideration their necessities. Accordingly, the commitment to sustain the prices of coffee failed to restrain production and provoked a substantial increase in the government’s expenditure and in inflation.

Dissatisfaction with the regime was translated into the emergence of an elaborate discourse of opposition. Given the characteristics assumed by the ‘liberal’–federalist arrangement, distorted at the hands of the oligarchies, this discourse assumed a very
conservative nature. It defended centralisation and the constitution of an autonomous and strong state able to address the main necessities of the country. In certain authors, the criticisms assumed a very authoritarian flavour. As an example, they considered the separation between state and society, between the people and the governments, as a matter of fact, inherent to the national culture (Faoro, 1998: 675).

One very important (and pioneering) critic of the oligarchies was Rui Barbosa, an eminent intellectual who was a candidate for the presidency in 1910 and 1919. Rui Barbosa had been an advocate of federalism. Nevertheless, given the characteristics assumed by the federalist regime, his position changed radically. He came to believe it was fundamental to protect individuals against the groups which, in the name of liberalism, had assumed the control of the regime. This task required a strong state, as the only actor which could challenge the power of the oligarchies (Faoro, 1998: 671-672).

Therefore, the criticisms of Rui Barbosa illustrate an important tendency verified in the 1920s. Once the ‘liberalism’ of the constitution had led to the tyranny of the oligarchies, the critics defended the strengthening of the federal government as the solution to national problems. The same tendency was observed in respect to economic issues. The critics, which associated economic liberalism with the politics of the oligarchies, defended the growth in state intervention, protectionism and stimulus to the national production.

As Faoro (1998: 671) emphasises, the emergence of conservative thought was a reaction to the federalist experience and to the failure of delivering “the nation to a society which, not free, lacked lively mechanisms of cohesion”. In contrast to the United

112 According to Rui Barbosa, an autonomous judicial power was the key requirement for the preservation of justice, the respect to law and the protection of the individual, important characteristics of the United States system. In the absence of this important condition, the result would be caudilhism, as well illustrated by the experiences of other South American countries.

113 In 1919, despite the fraud, which, as seen, guaranteed the victory of the candidates of the government, Rui Barbosa had substantial electoral support, an indication that his ideas had appeal to part of the population.
States, there was no organised political life at the local level and there was no juridical system able to guarantee respect for and enforcement of the law\textsuperscript{114}. In brief, the discourse of the *progressists* assumed a conservative flavour, defending a strong state able to undertake the necessary reforms.

Although opposition to the regime was considerable throughout the 1920s, the movement which ejected the oligarchies from power only happened in 1930. It was ignited by the rupture between the elites of São Paulo and Minas Gerais, who disagreed about presidential succession, and its emergence was favoured by the international crisis.

In the election of 1930, the Liberal Alliance, a coalition between the states of Minas Gerais, Rio Grande do Sul and Paraíba, challenged the candidate indicated by the president, from Sao Paulo. The election, characterised by large-scale fraud from both sides, finished with the victory of the candidate of São Paulo\textsuperscript{115}. However, the opposition, which during the campaign had mobilised many segments of the society, contested the legitimacy of the process. Reporting the use of fraud and representing incumbent government as enemies of the nation, it advocated ‘revolution’ as the only way to protect the interests of the population. Then, on 3 November, the defeated candidate, Getúlio Vargas, supported by the military\textsuperscript{116}, was declared leader of the provisional government (Fonseca, 1989: 136)\textsuperscript{117}.

It is very important to emphasise the conservative nature of the Liberal Alliance. Although having the support of the military and of the segments of the middle classes, the alliance represented mainly the aristocracies of the states of Minas Gerais, one of the

\textsuperscript{114} As seen, the written law was a mere formality, manipulated by the *coronéis* and by the state oligarchies.

\textsuperscript{115} As seen, the president controlled a significant network of patronage, which substantially increased his chances of electing his successor.

\textsuperscript{116} The military’s support for the coup was much stronger than that given, earlier, to the Liberal Alliance. This is explained by their perception that a change in constitutional rules, in contrast to the mere shift of oligarchic groups in power, could produce significant change.

\textsuperscript{117} In spite of some combats, the cohesion of the military impeded the outbreak of a civil war and the movement, as typical of Brazilian ‘revolutions’, was peaceful.
protagonists of the old regime\textsuperscript{118}, and Rio Grande do Sul. Given the importance of Minas Gerais for the coalition, the groups of Rio Grande do Sul knew that they did not have a high degree of liberty to make substantial reforms. In other words, the ‘commitment’ to the interests of Minas Gerais made the objectives of the Liberal Alliance very moderate and reduced the capacity of the movement to undertake reform.

Nevertheless, the popular manifestation in the campaign was so enthusiastic, as well as the demands for changes, that Getúlio Vargas felt that the ‘revolution’ could go further than expected by the oligarchies of Minas Gerais. As Faoro (1998: 692) emphasises, Vargas “started to feel that he was not the candidate of a segment of the dissident oligarquies, but the candidate of a country in protest”. Thus, he perceived not only intense demands for changes, but also that the conditions were right to undertake them. Besides the support of public opinion, Vargas had in the military a strong basis of support to keep the power and adopt the reforms considered necessary.

Vargas’ reforms, it is important to emphasise, were not radical and did not imply a transfer of power to the popular segments. The interests of those segments were to be taken into account, but through the initiative of an autonomous and strong state, acting as an arbiter of the relations between the social groups. In this sense, the transformations were undertaken under the premisses of the official discourse, strongly influenced by positivism, which was embraced both by members of the Rio Grande do Sul elite, including Vargas, and by the military (see chapter four).

Finally, it is important to emphasise the meaning of the movement of 1930, a landmark in Brazilian history. Firstly, it is important to stress that it was not a movement of bourgeois revolution, as claimed by some old-fashioned interpretations. Accordingly, it is wrong to interpret it as a dispute between the industrial bourgeoisie and the agrarian aristocracies, which resulted in the victory of the industrial interests. A correct

\textsuperscript{118} The demands of the Minas Gerais’ elite, as seen, was basically to eject the groups of Sao Paulo from power. It did not demand any substantial alteration in the rules of the regime.
interpretation of the movement, as incorporated in many analyses (Cardoso, 1975; Diniz, 1978; Fonseca, 1989; Reis, 1974), requires the refusal of easy dichotomies and the necessity of constructing an analysis which integrates state and society. As those authors emphasise, it is important to reject the interpretation of the event as a mere reflex of the interests of the economic groups or as the result of the arbitrariness of a bureaucratic class dissociated from the social groups. Therefore, it is necessary to recognise the role of the state elite, which conferred a certain autonomy on the state, but it is also essential to acknowledge that there are social groups behind the state.

This section shows how the movement of 1930 was a reaction to the distortions caused by the ‘republic of the aristocracies’. It was decisively influenced by regional conflicts and by the opposition of the military. Nevertheless, the movement was promoted by the aristocracies of two important states, a good indication of its conservative nature. The weakening of the coffee bourgeoisie, strongly hurt by the international crisis, and the lack of a strong industrial bourgeoisie permitted the emergence of an autonomous state which, supported by the military, carried out the process of transformation. In this process, the political culture, as inherited from the nineteenth century and manifested strongly in the 1920s, legitimised the strengthening of the state and the central role that it came to play in national affairs.

Overall, the movement of 1930 was decisive in the gestation of a new form of state: one which was more powerful and had a different view of its responsibilities. As a key achievement, the revolution produced a substantial centralisation of power, re-organised the state apparatus and created the instruments for a substantial degree of state intervention in the economy. Fausto (1986: 829) summarises very well, stressing the main attainments of the revolution:

“the expansion and centralisation of the power of the state was the main feature of institutional change during the years after the Revolution of 1930. It was a move which was dictated by the requirements of the new economic and financial order, but it also corresponded to the interests and concepts of some of those forces, not least the military forces, which had been responsible for the revolution. The central bureaucracy
was expanded and virtually transformed into a new social category with its own interests, apart from carrying out its function as the mouthpiece of the interests of the dominant class".
3.4. Conclusion

It is very interesting to interpret the course of these events in the light of the arguments developed in the analysis of the imperial period. A key dimension of the political system at that period, I have argued, was the relationships developed between the state elite and the landlords. The period was marked by the alternation between centralising and decentralising measures, by autonomous initiatives of the political elite and by the capacity of veto exercised by the landlords. The institutional structure of the imperial regime, including the role of the *Poder Moderador*, increased the autonomy of the central state.

The proclamation of the republic extinguished the centralising mechanisms of the empire. Accordingly, the constitution gave very substantial power to the states, enabling them to establish militias and to increase their control over the financial resources and over the affairs of the municipalities. The result of this arrangement, nevertheless, was the monopoly of power by the two most powerful states. The states' aristocracies built a wide network of patronage and controlled the elections through fraud and violence. Furthermore, they used the instruments of economic policy to promote their immediate interests, to the detriment of the interests of the poorest states, of the urban segments and of the large part of the population.

As the last section investigates, the reaction to this regime involved many sources of opposition, which included regional groups, the military and the middle classes. The 1920s were marked by the consolidation of conservative thought, which supported a strong and centralised state able to put into practice the necessary reforms and to protect the individuals against the oligarchies. In this sense, a powerful state was seen as the means to modernise the country and take the necessities of the population into consideration.\(^{119}\)

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\(^{119}\) According to Faoro, Washington Luís, the president in the period 1926-30, had a project of development which intended to extend the model of development existent in São Paulo, centred on the private initiative, to the rest of the country. Nevertheless, his candidate, as well as his proposals, were defeated.
The new regime installed in 1930 promoted the centralisation and the strengthening of the state, preparing it to play a very active role in addressing national problems. In the following years, it regulated the labour movement and created important organs and councils to intervene in the economy. The political culture, as inherited from the nineteenth century, was very important in legitimising its new role. In brief, the scene was set for the emergence of the developmentalist state. In the following decades, the Brazilian state, its technicians and bureaucracy, played a central role in the task of promoting economic development.

The impacts of the crisis of 1930 were felt throughout Latin America, putting in check models of economy centred on the export of agriculture products. Nevertheless, the responses of different countries to the crisis varied significantly, depending on the internal configuration of forces. In Colombia, for example, the weakness of the urban middle classes and the hegemonic power of the export sector led to responses to the international crisis which did not significantly affect the structure of the economy. According to Cardoso and Faletto (1970: 70-73), the rural aristocracy maintained its dominance until the end of the Second World War, blocking the development of a productive system centred on the domestic market. In Chile, the rural oligarchies used the state to soften the effects of the crisis and permitted the constitution of a simple industrial sector as an extension of the export structure. The power continued to be controlled by the agrarian groups and the expansion of the internal market was limited. Similarly, in Argentina, the agrarian elites, which controlled power, permitted a process of industrialisation in sectors which processed raw materials available domestically (see chapter eight).

In Brazil, the response was different, a result of the characteristics of the state elite, of the political culture and of the balance between the social forces. As this chapter argues, an important factor was the existence of a political culture favourable to state intervention in national affairs. Equally important was the emergence of a political elite concerned with the strengthening of the state and with the development of the country.
And last but not least, the military played an important role, as did the existence of divergences between the aristocracies and the emergence of an industrial class which supported the new regime.

4.1. Introduction

As the last chapter shows, the movement of 1930 was a turning point in Brazilian history. It marked the end of the ‘Republic of the Oligarchies’ and the emergence of a state which assumed a much larger role in the regulation of the social conflicts and in the promotion of economic development. Following the coup of 1930, the new regime undertook a range of reforms, which included the strengthening of the federal government, the creation of organs to intervene in and regulate the economy, the creation of corporatist mechanisms to control the labour movement and the adoption of economic policies which favoured industrialisation. From then, the state assumed, as its attribution, the task of addressing and defeating the obstacles to national economic development.

The main objective of this chapter is to encapsulate this new orientation and describe certain characteristics of this new state. As will be clear at the end of the chapter, the regime emerging after 1930 promoted substantial transformation in state organization, in the relationships between the state and social groups and in the involvement of the state in the economy. The core of those transformations were maintained and gradually became institutionalised in the following decades, eventually coming to constitute critical characteristic of the model of industrialisation adopted in Brazil.

In the section 4.2, I explore the reasons for the autonomy of the state in the reform process and delineate the general transformations promoted by the new regime. In the section 4.3, I investigate the new orientation given to the economy, favourable to industrialisation. Section 4.4 examines the corporatist arrangement adopted. Section 4.5
explores the role of the ideology in the process. The section 4.6 addresses the limits and
the obstacles to a more coherent action by the state. Section 4.7 summarises the
relationships between the autonomy of the state and the influence of the social groups.
And finally, section 4.8 draws out the main conclusions.
4.2. The autonomy of the political elite and the emergence of a new state.

The autonomy of the state

The previous chapter has already discussed the causes of the movement of 1930. The anterior regime, I argued, was marked by many contradictions and faced significant opposition from important segments of society. In a context characterised by the international crisis - which destabilised the export-agrarian economy - and by the divergence between the two main regional oligarchies, the conditions were present for the emergence of a new regime, which substantially re-shaped the characteristics of the state and its involvement in social and economic life.

It is important to emphasise the conditions which gave the political elite the autonomy necessary to undertake reforms which went much beyond the interests of the dominant groups. In this respect, several factors favoured the autonomy of the state. Firstly, the state elite occupied a vacuum left by the lack of a hegemonic group in the dominant class. The economic crisis weakened the export-oriented agrarian groups and the industrial bourgeoisie was not strong enough to command the process of transformation. As a result, the conflict between the main economic groups increased the autonomy of the state elite. Similarly, the autonomy of the state was increased by the ascendance of the urban middle and working groups, whose interests had to be accommodated. The new government established direct mechanisms of contact with the masses, which strengthened its claim of speaking in name of the national interest (See Draibe, 1985: 22).

Secondly, strengthening state autonomy was favoured by the characteristics of the national political culture and by the ideology of the political elite. The political culture, as seen in the chapter three, attributed to the state a central role in the addressing of national problems. Accordingly, positivism, as embraced by the military and by members of the Rio Grande do Sul oligarchies who seized power, supported a
substantial role for the state in the arbitration of social conflicts and in the promotion of economic development.

State autonomy was further favoured by the characteristics of the world order and by the restructuring of the international division of labour. The international crisis had a strong impact on the peripheral countries, leading to the emergence of similar regimes in many countries. According to Cox (1987: 236), those states were marked by the lack of hegemony of a social group or a vanguard party; by the introduction of corporatist mechanisms to control the popular forces and obtain the support of the workers; by the state control of important economic instruments; by state investment in production and by the use of public resources to accommodate very broad coalitions. In brief, the emergence of similar regimes in different countries is a very good indication of the influence of the transformations which were occurring in the international order.

Similarly, the collapse of the institutions of the *Pax Britannica*, the reduction in world trade and the emergence of autarchic regimes in Europe and other parts of the world increased the autonomy of the peripheral states to adopt indigenous programs of development, based on the increase of tariffs and on the concession of incentives to national producers.

In brief, the beginning of the 1930s was marked by the existence of a space which was occupied by the emergence of a sophisticated and centralised state. The crisis of the economy, the characteristics of the world order, the disputes between the economic groups and the ideology of the elite favoured the strengthening of the state which, as Draibe (1985: 78) points out, “came to act over key points of the economic and social life, elaborating policies at national level characterised by a high degree of interpenetration and interdependence”.

Nevertheless, it is important to emphasise that this state, although autonomous, did

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120 According to Cox (1987: 236), the state was “the only basis for the project of an indigenously inspired, populist-flavoured, autonomous direction to national development”.
not move in a vacuum and could not totally disregard the interests of the economic groups which made up the coalition. The pressures and interests of those groups - which included the industrialists, the export-agrarian groups, the groups engaged in the foreign trade and also segments of the urban middle classes - delimited the borders in which the state could move and imposed important constraints on its autonomy. As the sections 4.6 and 4.7 explained, they constrained the capacity of the state to intervene in the economy and negatively affected the coherence of its actions.

The emergence of a new state

One important characteristic of the new state was the strengthening of the federal government in relation to the states and municipalities. Reversing the federalist characteristics of the first republic, the federal government increased its powers and its participation in the total national revenue, which increased from 51.2% in 1930 to 56% in 1940 (Fonseca, 1989: 197). The executive became stronger through this process, as it concentrated in its own hands the instruments necessary to implement economic and social policies.

In order to increase its capacity to intervene in the economy, the state created various organs and instruments in different areas. These enabled the state to organise and centralise the budget, to control basic economic variables, to stimulate economic activity, to supervise public services and to regulate important prices and wages and the exchange rate (Fiori, 1990: 08). In brief, the creation of these mechanisms marked a new phase of state intervention which, conscious of the shortfalls of the First Republic, took into account the necessity of planning and evolved, later, to direct investment in production (Draibe, 1985: 149).

In order to increase its capacity to determine economic policy, the government created, in 1934, the Conselho Federal de Comercio Exterior (CFCE – Federal Council of Foreign Trade), which was mandated to centralise foreign trade policy, undertake studies and propose solutions in such areas as the elaboration of commercial treaties, the
promotion of national industries and the regulation of the mineral and agrarian sectors (Diniz, 1978: 151; Ianni, 1977: 25). As Draibe (1985: 91) emphasises, the CFCE became the advisory organ of the President of the Republic. Another critical organ of economic policy was the *Conselho Técnico de Economia e Finanças do Ministério da Fazenda* (CTEF – Technical Council of Economic and Finances of the Ministry of the Finance), created in 1937. The CTEF main duties were to undertake studies and formulate technical assessments in areas such as the monetary system, the organisation of banking, exchange rate policy, public borrowing and transference of resources abroad (Diniz, 1978: 151; Draibe, 1985: 91). Although they did not have decision-making power, these two organs had substantial influence in policy making through the elaboration of pre-projects, “suggestions and evaluations of decrees which were submitted to superior agencies” (Diniz, 1978: 116).

The period was also marked by the substantial improvement in the services of statistics. The *Instituto Nacional de Estatística* (National Institute of Statistics) was founded in 1934 and the government created the *Instituto Brasileiro de Geografia e Estatística* (Brazilian Institute of Geography and Statistics) in 1938. Improving the collection and analysis of data was seen as a critical tool to increase the government’s capacity for intervention.

Important progress was also achieved in the ‘monetary – credit’ area, which had already been centralised in response to the crisis of 1930. During the period, the *Banco do Brasil* consolidated its position as the most important organ in the monetary-credit area. In 1937, the government created the *Carteira de Crédito Agrícola e Industrial do Banco do Brasil* (CREAI - Bureau of Agrarian and Industrial Credit of the Bank of Brazil), which was responsible for supplying short and long term loans to agriculture and industry. At the beginning of the 1940s, it played a very important role in providing credit for the establishment of basic industries in areas such as paper and cellulose, aluminium, metallurgy and steel (Fonseca, 1989: 261; Silva, 1999: 149).
As a result of the new measures, at the end of the period, in 1945, the state had control over important economic variables, such as the exchange rate, interest rates, and wages. In the same year, the Superintendência da Moeda e do Credito (SUMOC – Superintendence of Money and Credit) was created, increasing the government’s capacity for co-ordination of and control over the monetary system\footnote{Despite the substantial improvement, the SUMOC had no control over certain operations of the Banco do Brasil and, thus, was not able to control the supply of money. A Central Bank was only created after the military coup of 1964.}

Accordingly, the whole period from 1930 to 1945 was marked by the creation of a range of organs and agencies aimed at controlling sectors and increasing the co-ordination and regulation of the economy. These organs not only permitted the deepening of state intervention in the economy; they also introduced a new form of relationship between the bureaucracy and the economic groups, which found in the respective organs and councils an arena of dialogue and negotiation and a forum where they could lobby for their interests to be taken into consideration\footnote{Among the many other organs created (see Ianni, 1977: 23,24 for a full list of them), several provide useful examples of the government’s tendency to regulate and intervene in the economy. These included the Ministerio do Trabalho, Indústria e Comércio (Ministry of Labour, Industry and Trade - 1931), The Conselho Nacional do Petróleo (National Council of Oil - 1938), the Conselho de Águas e Energia Elétrica (Council of Water and Electrical Energy - 1938), the Conselho Nacional de Minas e Metalurgia (National Council of Mining and Metallurgy – 1940), Comissão Executiva do Plano Siderúrgico Nacional (Executive Commission of the National Steel Plan – 1940), the Comissão Executiva Têxtil (Textile Executive Commission – 1942) and the Comissão de Mobilização Econômica (Commission of Economic Mobilisation - 1943).}

The same tendency was observed in agriculture, where a range of organs were established to provide information, carry out studies and stimulate economic activity\footnote{The Instituto do Cacau da Bahia (Cocoa Institute of Bahia - 1931), The Instituto do Açúcar e do Álcool (Institute of Sugar and Alcool - 1933), the Departamento Nacional do Café (Department National of Coffee 1933), the Instituto Nacional do Mate (Institute National of Mate - 1938) were good examples.}. Those organs, by representing both the government and the producers, constituted important channels for listening to the producers’ claims and addressing their immediate demands. As Draibe (1985: 194) points out, they thus constituted a new arena in which the economic groups could introduce their demands, replacing the formal liberal democratic channels of the political parties and of Congress. Nevertheless, these agencies were also a mechanism to regulate and control the action of the economic
groups, thus reducing their autonomy\textsuperscript{124}. Therefore, through the introduction of these sectoral organs, the government could also subordinate agriculture policy to its general economic objectives.

The government increased its participation in the economy from 15.2\% of GDP in 1929 to 19.2\% in 1939. Despite the difficulties and the opposition from the social groups, the tax structure was reformed and the fiscal basis was increased. In 1937, the federal government had the attribution of “decreeing tax over import of goods, consumption, income and transference of resources abroad” (Fonseca, 1989: 254)\textsuperscript{125}. In addition, after 1937, the government created earmarked funds for specific projects, such as the improvement of transport infrastructure, the expansion of research into new reserves of oil and investment in electrical energy and coal. In brief, as a result of the new taxes and funds, the government significantly increased its spending capacity\textsuperscript{126}.

A very important achievement of the period was the creation of the Departamento Administrativo do Setor Público (DASP - Administrative Department of Public Sector), in 1938. The DASP had the objective of “defining, rationalising and controlling the career of the civil servants and the organisation of the administrative structure” (Draibe, 1985: 85). In other words, it intended to rationalise and upgrade the public bureaucracy through the establishment of a career civil service, the adoption of training programs and the introduction of meritocratic criteria for both the selection and promotion of the civil servants. According to Draibe, the DASP had “partial success in defining norms and rules of admission and recruitment based on merit criteria and public exams, which were competitive and compulsory”. Therefore, although the selection of a substantial proportion of the public posts continued to be outside DASP’s control, as they continued to be used by politicians as instruments to build their nets of patronage, the DASP did

\textsuperscript{124} This is specially valid for the coffee producers, given their power in the anterior period.
\textsuperscript{125} In this period, income tax became the most important form of tax, while the tax on imports, responsible in 1929 for 42\% of the revenue, had dwindled to 11.5\% by 1945 (Draibe, 1985: 120).
\textsuperscript{126} The revenue of the federal government increased 58.2\% from 1929 to 1939, while its expenditures increased 94.9\%. Inflation in this period, according to the index of prices of the city of Rio de Janeiro, was 32.2\% (IBGE, 1987: 617).
have very positive effects on the efficiency of the administrative machine (Geddes, 1994: 52,53).

In brief, the new state which emerged after 1930 was also marked by the concern with the modernisation and rationalisation of the bureaucratic apparatus. As Draibe (1985: 62) emphasises, old organs and agencies were modernised, careers were restructured and “the procedures were gradually subjected to the rational legal logic”. Similarly, important advances were achieved in the judicial system, in which measures were adopted to increase the independence of the judiciary, to unify the judicial codes and to follow an ‘universal juridical orientation’ (Draibe, 1985: 65; 77). Furthermore, the universal right to vote was guaranteed and electoral justice was substantially strengthened. And last but not least, significant progress was achieved in the social area, marked by the increase in investments in public health, by the expansion of opportunities in education and by improvements in the social security system127 (Draibe, 1985: 67-76).

In conclusion, the state that emerged in the 1930s was very different from the previous regime which, until the end of the 1920s, had few instruments of intervention and had, as its main economic attribution, the policy of guaranteeing the prices of coffee. The reforms adopted after 1930 increased the state’s capacity to regulate the economy, to design and execute economic policy and to stimulate economic development. Furthermore, parts of the public service were modernised and became subject to meritocratic criteria of selection and promotion. This created the conditions for the formation of a body of competent technicians, who would prove very important for the future capacity of the state to intervene in the economy.

As Draibe (1985: 95) argues, many of the tendencies inaugurated at the beginning of the 1930s were consolidated in the period of the Estado Novo (1937-1945), in which

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127 Although the expansion of expenditure was substantial, the involvement of the state in those areas and the results of the policies were very limited.
Vargas, with the support of the military, headed a dictatorial regime\(^\text{128}\). According to her,

> “the Estado Novo inaugurated a new phase in which the government assumed the responsibility of co-ordinating, disciplining and stimulating the productive activities in an unprecedentedly deep way, acting as if there were a conscious project delineated in basic lines and aimed at achieving certain objectives”.

\(^{128}\) During the *Estado Novo*, the government was able to adopt many measures and directions, which would have faced serious obstacles under a democratic regime.
4.3. Economic policy: industrialisation as the project of development

As seen in the last chapter, Brazil’s economic policy before 1930 was mainly directed towards promoting the interests of the coffee bourgeoisie. Although certain political leaders supported the adoption of measures to stimulate manufacturing, there was no deliberate program to promote industrial development. As seen, industrial development took place on the fringes of coffee activity, benefiting from the demand generated by this activity on the one hand, but also suffering from the vicissitudes of a policy whose main objective was to preserve the world price of coffee.

This orientation changed at the beginning of the 1930s. The government which took power after the revolution demonstrated a much greater concern with promoting industrial development. The argument in favour of ‘natural industries’ was gradually abandoned and the government progressively adopted measures to stimulate industrial development. The objective of this section is to show this turning point in the main orientation of the economic policy and to identify its causes.

There is a fierce debate in the literature about whether or not the lines of the economic policy changed after 1930. Authors such as Pelaez (1972) and Villela and Suzigan (1973) argue that 1930 was not a turning point and that economic policy continued to be conducted along traditional lines. On the other hand, authors such as Fonseca (1989) and Draibe (1985) emphasise the new orientation in favour of industrialisation. Fonseca (1989: 178-181) carries out a literature review about this question and concludes that, in spite of the official position in favour of a balanced budget, economic policy had clear expansionist effects, stimulating economic activity and industrialisation. Besides the expansionist monetary policy, Fonseca emphasises the policy of exchange rate devaluation and the control of imports as further measures in favour of industrialisation.

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130 Silber (1977). calculates that in 1939 the means of payment were about the double of those existent in 1929 (In Fonseca, 1989: 181).
The difficulties of evaluating the motivations behind economic policy are explained by the fact that certain measures can be interpreted as a mere reaction to the immediate effects of the international crisis. Thus, although currency devaluation and the quantitative restrictions on imports proved favourable to industrial development, the adoption of these policies could have been merely an immediate response to the crisis and not a deliberate measure to promote industrialisation. According to Silva (1999: 149), the government adopted deliberate measures of industrial policy only at the end of the 1930s, via the activities of the CREAL. According to Silva, the supply of long term loans to finance industrial investments increased substantially between 1937 and 1945.

Deliberate or not, the import policy, influenced by the business groups, had clear favourable effects on industrialisation. The tariff established in 1934 guaranteed substantial protection for industry in the coming years. Particularly important was the adoption of a criteria of essentiality which reduced the tariffs on machinery and equipment, while increasing the protection on domestically produced goods. Similarly, the government, through the control of the allocation of foreign exchange, guaranteed the import of essential products, at the same time that the shortage of foreign exchange protected Brazilian industry from foreign competition. As a result of these policies, the proportion of total imports accounted for by traditional goods, such as textile and foodstuffs, decreased substantially during the period 1933 - 1939, while the proportion accounted for by items such as machines and equipment increased significantly\(^\text{131}\) (Diniz, 1978: 64).

\(^{131}\) The 1930s were years of rapid industrial growth and from 1932 to 1939 industrial production grew at the annual average rate of 10.1% a year. This rapid growth increased the proportion of the national product accounted for by industrial production. According to data collected by Vilela and Suzigan (in Fonseca, 1989: 202), in the 1920s the ratio of agricultural to industrial production was 79:21. In the period from 1933 to 1939, the respective proportions were 57:43. The 1930s were also marked by a change in the sectoral composition of industry. The non-traditional sectors, such as steel and cement, increased the participation in the total product of the industrial sector by 15%. (Silva, 1999: 146). Diniz (1978: 66) also emphasises this tendency, indicating the increase in the production of the mechanical, metallurgic, electrical materials and transport material sectors, which almost doubled their participation in the value added in the industrial sector.
In contrast to the ambivalence at the beginning of the 1930s, the directions followed after 1937 did not leave any doubt about the government’s intention to promote industrialisation. Protection of the national production was maintained and the government, as mentioned, created the CREAI to provide long-term loans to industrial projects. Similarly, the *Estado Novo* defined a more articulated and co-ordinated program of industrialisation, which included heavy industry. Given the fragility of national private capital and the resistance to foreign capital, a critical role was reserved for the state in investments in infrastructure and in basic industry. In subsequent years, a range of public enterprises was created in the areas of steel, electrical energy, heavy chemistry, mining and automotive motors (Draibe, 1985: 125). Those enterprises, such as the *Companhia Nacional Siderúrgica* (CSN – National Steel Company), created in 1941, represented a landmark in the country’s industrial development.

As Draibe points out, the orientation given to the economic policy after 1930 was just one among many possible alternatives. The state, by promoting it, established a policy of economic development which saw industrialisation as a priority (Draibe, 1985: 100). It is important, therefore, to understand the origins of this orientation.

One important cause was the effects of the international crisis, which exposed the fragility of economies which were very dependent on the export of primary products. Another element that favoured the industrialisation option was the ideology of the elite. This ideology, influenced by the ‘conservative thought’ which emerged in the 1920s, supported substantial state engagement to promote industrialisation. In the 1930s, as a response to the international crisis, this ideological position favourable to industry assumed more concrete forms. Fonseca (1989) shows how the discourses of President Vargas were marked by the abandonment of the thesis of ‘artificial’ industries and by increasing support for a project of industrialisation (See Fonseca, 1989: 267).

As Diniz (1978) and Leopoldi (2000) show, the industrialists also played a very important role in the definition of a strategy in favour of industrialisation. Although their pro-industrialisation action started much earlier, the industrialists’ movement advanced
substantially in the 1920s and was very influential at the beginning of the 1930s, favoured by the international crisis and by the weakening of the agrarian aristocracy (see section 4.7).

Finally, the option for industrialisation is explained by the need to incorporate the working classes into the economic system and to prevent possible sources of instability. This is a point emphasised by Cardoso and Faletto (1970: 93), according to whom a critical challenge to the policy of industrialisation was how to make compatible the economic measures necessary to accommodate the groups which made up the power coalition, on the one hand, and to create “opportunities for social and economic inclusion for the new medium and poor segments”, on the other hand.

In conclusion, from the time of the Estado Novo onwards, the objective of industrial development, including the development of heavy industry, became a key objective of Brazilian governments. It is, therefore, correct to conclude that the 1930s marked the genesis of the developmentalist state in Brazil. Although there were significant limits to state action, the 1930s marked a new disposition of the political elite. Through a range of economic policy instruments, reforms, councils, organs of regulation and direct investment, the state assumed the role of promoting the industrialisation of the country.

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132 This objective was attenuated during the government of Dutra (1946-1950), but it re-emerged at full power during the second Vargas Government (1951 – 1954).
4.4. The adoption of a corporatist pattern and its impacts

Another important characteristic of the regime which emerged after 1930 was the adoption of a corporatist pattern of interest representation. This solution, it is important to emphasise, was in tune with the positivist ideology embraced by the members of the political elite. This ideology denied the existence of class conflict and supported a strong role for the state in the arbitration of relationships between classes.

Stepan (1978) offers an interesting interpretation of the adoption of corporatist regimes in Latin America. As the author argues, the introduction of corporatist patterns of interest representation was a deliberate policy adopted by the political elite as a means of incorporating emerging social groups and achieving stability (Stepan, 1978: 47; 55). According to him, although cultural factors may have favoured the adoption (and success) of corporatism, it is wrong to interpret the phenomenon as a result of cultural values and of the forms in which societies were traditionally organised.

This interpretation is also shared by Cardoso and Faletto, who view the adoption of corporatism in Latin America as a response to the necessity of incorporating the newly-emerging working class into the capitalist economy. As Cardoso and Faletto (1970: 32) suggest, this kind of response is related to the fact that, in contrast to the countries which had industrialised in previous centuries, the Latin American nations faced a potential threat of revolts from the popular classes before industrialisation had even taken place.

The key achievement of corporatism in Brazil was to eliminate the autonomy of the labour movement and to tie the trade unions to the state. The government promulgated legislation which allowed only one trade union per sector, which, furthermore, had to be

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133 As Stepan (1978: 58) points out, the Iberian-Catholic tradition and the symbolic forms of viewing the relations of power, influenced by the patrimonialist pattern of social organisation, explain why corporatist arrangements were more common in Latin America than in other peripheral countries.

134 This was achieved through the concession of several benefits to the working class. Vargas regulated the capital-labour relations, fixed the working day in eight hours, approved the right of vacations and created the first institute of pensions. In addition, he regulated the work-conditions for people under 18 years old (Bojunga, 2001: 96).
authorised by the Minister of Labour. Accordingly, *Juntas de Conciliação e Julgamento* (Organs of Conciliation and Judgement), composed of a representative of the workers, a representative of the businesspeople and by a neutral member appointed by the Minister, were established to address and solve disputes (Fonseca, 1987: 228).

As Fonseca argues, the objective of the legislation was to avoid overt conflict between the classes. According to official discourse, the interests of the profession were above the interests of the classes and issues related to the profession should therefore be addressed by the collaboration between the parties involved. Thus, as seen, public organs, comprised of representatives of the two parties and of the state, became responsible for achieving a ‘negotiated solution’.

There was a very large difference between the control exerted by the state over the trade unions and the control exerted over the business associations. The government also required the ‘official registration’ of the business associations. However, although subject to legislation, they enjoyed considerable autonomy. According to Leopoldi (2000: 80), the business associations had a status very different from that of the trade unions. They were considered advisory organs of the state, had the right to voice their opinions on issues which concerned their class and also had the right to appoint representatives to the main councils responsible for economic policy. Therefore, as Leopoldi (2000: 31) concludes, corporatism for the industrialists “meant more the access to the table of negotiation than the submission to the control of the state”.

The pattern installed after 1930, by adopting a corporatist arrangement and by creating many regulatory organs and councils, had significant consequences for the degree of state intervention and the forms of private representation. One immediate

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135 In addition, the legislation of 1934 allowed each industrial sector to have more than one union and more than one regional association. As a consequence, in 1937, the influential *Federação das Indústrias do Estado de São Paulo* (FIESP – Federation of Industries of the State of Sao Paulo) split into two, one official and one private association. In doing so, it inaugurated one practice which became common in the subsequent history of the business movement: while the official association negotiated in the patterns established by the government, the private association had the autonomy to work for business class’ interests.
result, as has been indicated, was the increase in the government’s control over economic activity. By strengthening the role of the new organs and disregarding traditional forms of political representation, the new pattern of state organisation increased the power of the executive. Similarly, the action of the new organs and agencies, which came to control the respective sectoral issues, increased the influence of the bureaucracy over the economic groups. The control over resources and over important economic variables allowed the bureaucrats to co-opt, reward and constrain the main economic groups involved.136

The other face of the corporatist pattern was the opening of many channels of business influence. As seen, many of the councils and sectoral organs had business representation and constituted privileged ways for the private sector to introduce their demands, persuade the public authorities of the importance of certain issues and to exert clientelistic pressures. As Leopoldi (2000: 131) shows, the industrial leaders, who controlled information about the working of the economy, were in a strategic position to influence the course of industrial policy.

Consequently, the pattern of state organisation and interest representation also had come to have significant consequences for the autonomy and effectiveness of state intervention. The permeability of the bureaucratic organs, marked by the constitution of networks of mutual interests between the bureaucrats and the private agents (Diniz, 1992: 37), limited the autonomy of the state to define economic strategy. In brief, the capacity of the state to promote coherent programs of development became limited by the businessmen’ insertion into the state apparatus, as well as by the state’s need to balance the interests of the different groups which made up the broad coalition.

In conclusion, corporatism had important consequences for the future course of industrialisation. Firstly, it kept the labour movement under control and guaranteed the stability necessary for the process of capital accumulation. Secondly, it increased the

136 As seen, this is very well illustrated by the organs created in the agriculture, such as the Conselho Nacional do Café (National Council of Coffee).
capacity of the bureaucracy to co-opt certain social groups and also increased its autonomy to address certain issues. And finally, the corporatist arrangement opened privileged channels of influence to the private sector, thereby reducing the state autonomy and negatively affecting state capacity to pursue a coherent plan of action.
4.5 Ideology and political culture

The objective of this section is to show the influence of the political culture and of the ideology of the political elite in the forms assumed by the state in the 1930s. Although the relationship between facts and ideas is very complex and it is impossible to determine precisely the causal agent in the relationship, I believe that the political culture and the ideology of the elite were important components of the process which led to the construction of a new pattern of state organisation after 1930. Although the organisation of the state reflected the general challenges and the specific interests of the social groups, the political elite had a certain degree of autonomy, which increased the influence of the values and ideas embraced by the politicians and technicians.

Several authors who investigated the features of the Brazilian political culture found the existence of an hierarchical and harmonious view of social relations and a ‘Rousseaunian’ view of the state. (Leff, 1977, Schmitter, 1971 and Diniz, 1978). The majority of the individuals interviewed by those authors did not refer to the existence of conflict between social groups and viewed the state as a neutral organ concerned to promote the interests of the society as a whole137 (Diniz, 1978: 104; Leff, 1977: 100).

This national political culture, strongly influenced by positivism, had important implications. Initially, it tended to favour the intervention of the state in the economy. As Sikkink (1991: 185) claims, “the more the state is viewed as an agency favouring the general interests of the nation, the more likely action will be taken to strengthen state apparatus”. As this author emphasises, an investigation of Brazil's contemporary political culture is important not only to explain the substantial involvement of the state in the economy, but also the support of social groups and the success of state initiatives. Secondly, the political culture, by believing in a harmonious and hierarchical relationship between the classes, was also supportive of the adoption of corporatist

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137 In such an organic view of politics, the efforts of interest groups to participate and influence economic policy were seen with suspicion. The general opinion considered those groups corrupt, condemning a kind of behaviour which, instead of supporting the fair and right measures capable of leading to the general good, concentrate on exerting pressure to achieve its egoistic interests.
arrangements (Stepan, 1978). And last but not least, as Leff (1977) argues, such a political culture - by viewing the state as a neutral organism concerned to the general interest and considering political parties as corrupt - tends to support technical solutions with great enthusiasm. Far from being considered anti-democratic, technocratic solutions are viewed as the best way to achieve social objectives.\(^{138}\)

It is easy to identify the echo of these ideological features in the discourses of President Vargas. The president espoused an organic view of society and embraced the conception of harmonious social relations, strongly rejecting the idea of conflict between the social classes: “‘the state does not want, does not recognise class conflict; the labour laws are of social harmony’”\(^{139}\). Another important point was the emphasis on the search for technical solutions to social problems. According to Vargas, “it is the time of specialised assemblies and of technical councils integrated into the administration. The pure political state, in the old meaning of the term, should be considered an amorphous entity which has lost, continually, its value and significance.”\(^{140}\). This emphasis on technical decisions, in opposition to political ones, was an important mark of the political ideology of the period, which contributed decisively towards the legitimation of increasing state regulation of social affairs.

This reference to the discourses of Vargas does not imply that his ideological positions were determining factors. They may also be interpreted as a form of post hoc rationalisation of the measures adopted. Nevertheless, it is important to emphasise that the same ideological positions were present in the discourses of Vargas many years before he took power (See Fonseca, 1989). Similarly, as seen in the chapter 3, they were part of the trends in conservative thought, which emerged as a discourse of opposition to the practices of the First Republic, and were also defended by positivism. This is, in my opinion, an indication of the influence of the ideology of the elite, as well as of the

\(^{138}\) According to positivism, the law should not be a result neither of the discretion of the ruler nor of the deliberation of assemblies. The role to find the best laws of social development should be played by science, being a duty of the ruler to act according to it.


political culture, in the pattern of state configuration after 1930. Nevertheless, to accept it does not imply, as I have strongly emphasised in this chapter, that the influence of social forces was unimportant.

In conclusion, this section emphasises how the political culture had an important influence on the pattern of state organisation established after 1930. It stresses how important characteristics of the organisation of the state after 1930 were in tune with the features of the national political culture. As seen, the high degree of state intervention in the economy, the adoption of corporatism and the emphasis on technical solutions were all notions embraced by the political culture and by eminent members of the political elite which took power in 1930. Thus, although it is not possible to determine precisely if the ideology was an autonomous factor or a justification for the measures adopted, I believe that it was an important component of the complex political process which led to the emergence of a specific pattern of state intervention in the economy after 1930.
4.6. Obstacles to co-ordination and limits to a coherent state action

The expansion of state intervention in the economy was not a smooth process. As Diniz (1978: 203) points out, the process was marked by an excessive and disordered multiplication of institutions without the establishment of an adequate hierarchy and co-ordination among them. Similarly, Draibe (1985: 85) emphasises how the organisation of the state was characterised by limited administrative capacity, overlapping of competences, intra-bureaucratic disputes and different orientations inside the state, introducing characteristics which accompanied the process of state intervention in the economy in the next four decades.

It is important to understand the obstacles faced by the state in its attempts of introducing a more effective mechanism of co-ordination. A very important issue was the inability of the government to establish a central organ of planning, revealing the degree of social opposition to the intensification of the state control over the economic process. In the next paragraphs, I emphasise several obstacles faced by the state in its effort to increase the co-ordination of the economic process.

As seen, the new direction adopted in 1930 revealed the intention to increase state intervention in and regulation of the economy. Despite the creation of new organs and councils, the capacity for co-ordination in the first years of the 1930s was very limited. The increase in the functions of the state had not been accompanied by the creation of instruments which allowed it to co-ordinate its activities and to obtain agility in the execution of its new functions (Draibe, 1985: 225). In addition, before the Estado Novo (1937), the state lacked a program of co-ordination of public investments and mechanisms which articulated effectively the public and the private expenditure in the new projects (Draibe, 1985: 103-104).

Important advances were made by the DASP, which pioneered attempts to discipline and co-ordinate the programs of public investment. In 1939, the DASP elaborated the *Plano Especial de Obras Públicas e Aparelhamento da Defesa Nacional*
(Special Plan of Public Works and Instrumentalisation of the National Defence), aiming at ordering the priorities of the public expenditure and organising the economic activities of the state (Draibe, 1985: 104). Likewise, in 1943, the DASP elaborated the Plano de Obras e Equipamentos (Plan of Works and Equipment), which had similar intentions.

These attempts of co-ordination, although successful in achieving the rationalisation of the budget, had significant limits. Firstly, the DASP lacked an organ to control the setting of targets and the monitoring of their achievement. Secondly, the financial resources necessary to achieve the targets set in the plans were not available. Thirdly, there were no effective mechanisms to channel private investment to the target sectors. Fourthly, the plans “did not discriminate between the works to be carried out and the equipment to be acquired and did not establish a time-table of activities” (Draibe, 1985: 107). According to the technicians of the DASP, these difficulties could have been solved through the establishment of a central organ of co-ordination and control. However, economic groups opposition to this alternative was substantial (Draibe, 1985: 104-108).

Similarly, the CFCE (Federal Council of Foreign Trade), the most influential organ in the elaboration of the economic policy, undertook a range of studies and sectoral plans in many areas. However, none of these constituted an integrated program of economic development. According to Draibe (1985: 109), this is explained by the limits in the internal structure of the organ and by the lack of control over policy instruments and over the strategic economic areas required to undertake such a task.

During the Estado Novo, the attempts at co-ordination, centred on sectoral and partial planning, gave signs of exhaustion. Although important advances were made in budget control and in the allocation of resources, the plans had many limits and the co-ordination was hindered by the lack of a central organ of control and co-ordination. This deficiency was addressed at the end of the period, when the government made important progress towards a process of planning of the economy\textsuperscript{141}. Reforms were adopted which

\textsuperscript{141} During the war, the Comissão de Mobilização Econômica (Commission of Economic Mobilisation)
indicated that the government was disposed to introduce a process of planning (see Draibe, 1985: 113-116). Nevertheless, Vargas was ejected from power in 1945 and the new government had a very different orientation.

In brief, the difficulties faced by the government are explained by the opposition exerted by many social segments to the increase in state intervention to promote industrialisation. The opposition included groups against industrialisation, groups which supported a moderate process of industrialisation and even segments of the industrial class which feared that an excessive expansion of the state could reduce its own participation in the process of industrialisation. In addition, there was an ideological resistance to a process of planning, which was associated with the communist economies. As a consequence, despite the efforts to increase the co-ordination of the public intervention, which were intensified during the Estado Novo, opposition to the government’s initiatives was substantial. As Draibe (1985: 118) concludes, the state, although authoritarian, faced the “insurmountable limits established by the unstable nature of the coalition of forces which supported it”

Those difficulties also indicate how the existence of divergent interests inside the state apparatus was an important constraint on the pursuit of a more coherent program of industrialisation\(^{142}\). Furthermore, there were substantial divergences, inside the bureaucracy and also inside the military, concerning decisive issues such as the nature of state intervention, the role of the public enterprise, the participation of the foreign capital and the sources of financing\(^{143}\) (Draibe, 1985: 102-103).

\(^{142}\) Draibe (1985: 116) gives interesting examples. The Finance Minister Souza Costa, for example, was a banker and a strong defender of economic liberalism. Accordingly, Souza Dantas, director of the *Carteira de Câmbio do Banco do Brasil* (Exchange Rate Bureau of the Bank of Brazil), believed in the identity between the interests of the nation and the interests of the exporters.

\(^{143}\) Those divergences, inherent to every state, indicates the difficulties for a unified action by the state. In the Brazilian case, the lack of political parties and of political mechanisms to define the directions of the process of economic development hindered a higher degree of coherence of the bureaucracy. As seen, the
In addition, the objectives of implementing substantial reforms, as present in the positivist ideology and supported by many members of the political elite, directly conflicted with the interests of the different groups which composed the coalition of power. A very good example was the lack of any attempt to promote agrarian reform or to extend social legislation to the countryside. Those measures, which would have had favourable effects to the objectives of promoting industrialisation and strengthening the domestic market, objectives supported by the political elite, were completely disregarded. According to Fonseca (1989: 276), this is a good indication of the influence of the traditional forces in the coalition of power.

The limits of state action were also found in the lack of more effective instruments of control over different areas of the economy. As an example, the lack of a central bank and of adequate agencies of funding hindered the control of the monetary supply and the adoption of a consistent national policy of money and credit (Draibe, 1985: 132) In addition, a critical limit to the process of state intervention was the difficulty the state experienced in increasing fiscal resources. Despite the increase in tax and the creation of earmarked funds, the fiscal resources of the federal government grew slower than the national income\(^\text{144}\) (Draibe, 1985: 79). Finally, another critical limit was the only partial rationalisation of the public service. As emphasised, a substantial part of the bureaucracy continued to be subject to clientelistic practices.

\(^{144}\) As seen, the revenue of federal government increased 58.2\%, while the expenditures increased 94.9\%.
4.7. The autonomy of the political elite and the influence of the social groups

A central issue in this chapter is to understand the factors that explain the emergence of a different state in the 1930s, which increased substantially its powers and became a central agent in the promotion of industrialisation. There is an intense debate in the literature about the main determinant of the new pattern of state involvement in the economy. Certain analyses emphasise the importance of the autonomy of the political elite, while other authors concentrate on the influence of the economic groups. The objective of this section is to show how these two factors both had a very important influence in the model adopted and to define more clearly the relationships between them.

As emphasised in the section 4.2, the lack of a hegemonic fraction of the dominant class and the disputes between the economic groups favoured the autonomy of the state. Nevertheless, it is important to stress that the state did not act in a vacuum; it had to conciliate, through its policies, the different interests which were present in the very broad coalition built in 1930. In addition, the policies had also to include the mass of the populace in order to accommodate potential sources of instability.

As Draibe (1985: 32) shows, the orientation adopted after 1930 was very influenced by the social forces which emerged from the ‘export economy’ and by their capacity to defend their interests and offer an alternative model of development for the country. According to the author, different directions were possible and the model adopted – based on centralisation, expansion of the state and industrialisation – was only one of them.

As an example, the coffee bourgeoisie could have retained its leadership and adopted a model of adjustment which preserved its main interests. In this case, it could have promoted a process of import substitution in the natural industries, keeping a more or less liberal orientation for the exchange rate and the tariffs. In fact, a similar model was adopted in Argentina, where the agrarian aristocracy managed to control the power
through a *coup d’etat*. The orientation given to the economic policy promoted the interest of the exporters. Manufacturing, although stimulated, suffered following the signing of an international treaty which, in order to guarantee market to the exports, opened the domestic market to the import of manufactured goods (see chapter eight).

As seen, the direction adopted in Brazil was different. The agrarian aristocracy was not as powerful as in Argentina and the industrial bourgeoisie was not strong enough to promote a project of development under its hegemony. As a result of the balance between the dominant forces, the state had a certain autonomy in the process. As seen, the ideology of the political elite and the necessity to incorporate the medium and poor groups, besides the pressures of the industrial groups, were elements which explain the options for a project of industrialisation. Tariffs were high during the 1930s and, after 1937, the government engaged in a program of heavy industrialisation.

According to Draibe, if the disputes between the classes gave autonomy to the state, the composition and relative power of those classes established the limits of this autonomy and determined also the possible directions to be given to the economic policy. As seen, the same organs which promoted an increase in the regulatory capacity of the state were also utilised to accommodate those unbalanced social interests present in the power coalition. The organs became thus arenas of interest representation, negatively affecting the capacity of the state to impose a coherent program of action.

Consequently, Draibe argues that the process of construction of the state after 1930 was neither a mere response to the needs of the process of accumulation nor a result of the preferences (and interests) of the bureaucracy. According to her, in a point widely emphasised in this chapter, the influence of the social groups which composed the political coalition had a critical influence on the forms assumed by the state. This key influence, nevertheless, does not eliminate the importance of the autonomy of the state. Although the state brought together different interest groups, it was not limited to them (Draibe, 1985: 99).
The importance of the autonomy (and ideology) of the technicians to the pattern of economic development is emphasised by Leff (1977). According to him, the first echelon and the press were very insulated from the interest groups’ pressures. Accordingly, he believes that the clientelistic nature of the political system and the complexity of the tasks increased the autonomy of the technicians. Thus, he considers that ideology had large influence in the model of industrialisation adopted in Brazil.

Leopoldi (2000) believes that Leff overestimates the autonomy of the technicians in the policy making process. According to Leopoldi, variables such as tariffs and exchange rate were critical to the fate of the national industry and became a central object of business pressure. Thus, she believes that the action of the business class had a crucial influence on the adoption of a model of industrialisation marked by high tariffs and, in certain periods, by an overvalued exchange rate.

Leopoldi insists that her argument does not assume the existence of an autonomous bourgeoisie. According to her, it was the fragility of the industrial bourgeoisie which explains the kind of articulation developed with the state. Nevertheless, she insists that the relationship was not one of submission, but of “tense negotiation” between the two sides (Leopoldi, 2000: 76). According to her, the business class was very influential and the degrees of autonomy of the state were increased in the moments in which the business class was divided. Similarly, she believes that the adoption of measures which hurt the industrialists was only possible because the government adopted compensatory measures which took their interests into account (Leopoldi, 2000: 284).

In brief, the understanding of the pattern of state organisation and of economic development adopted after the 1930s points to the acceptance of the autonomy of the state and also of the influence of the social groups. As chapter five explores, the main characteristics of the model of development were influenced by the conceptions of the technicians, which had certain insulation and autonomy. Nevertheless, the economic policy also reflected the influence of the industrialists, which had privileged channels to introduce their demands and pressure for their interests. In conclusion, both factors
played an important part in the complex process which led to the definition of a national pattern of economic policy.
4.8. Conclusion – the emergence of a new state

The main objective of the present chapter was to demonstrate that a different type of state emerged in the 1930s: a state which significantly increased its functions and assumed the role of developing the country. Many instruments of intervention were created, the state apparatus was substantially reformed and the state increased substantially its capacity to play a new role in the economy. For all those reasons, the 1930s marked the beginning of the developmentalist state in Brazil, when the state assumed the responsibility of defeating the obstacles to economic development and became a central agent in the process of industrialisation.

Important characteristics of the model of industrialisation, as pursued in the following decades, were defined at that moment. The strong involvement of the state, the creation of public enterprises, the protection and incentives to the national industry and the opening of new channels of business influence were innovations of the first Vargas government which accompanied the process of import substitution in the next four decades.

The 1930s were also characterised by the existence of many obstacles to the coherent intervention of the state in the economy. As seen, the coalition of power was very broad and the influence of the respective groups reduced the coherence of the government’s programs. The business groups obtained privileged channels of access to the state apparatus, which increased their influence and reduced the insulation of the bureaucracy. Furthermore, although important advances were achieved in the civil service, reform was only partial and part significant of the bureaucracy remained instruments of patronage. And finally, the state faced insurmountable obstacles to the establishment of a central organ of co-ordination and control.

Several of those obstacles were addressed in the following years, when further reforms in the bureaucracy were undertaken, new instruments of economic policy were created and the state found new means of increasing its fiscal resources and co-
ordinating the process of economic development. Nevertheless, several of those limitations remained, including the difficulties in undertaking a broad fiscal reform, the influence of many groups inside the state apparatus, the clientelistic nature of part of the bureaucracy and the existence of divergent conceptions and orientations inside the bureaucracy. Those factors, which affected the cohesiveness of the bureaucracy and reduced the capacity of the state to achieve the objectives of the process of industrialisation, are key issues in this thesis and are explored in forthcoming chapters.

In brief, the first Vargas government produced very important transformations in the organisation of the state and in the national economy, leaving a very important legacy for the years to come. The next chapter explores the advances of, and limits faced by the developmentalist state in Brazil in the period 1946 – 1961. The chapter concentrates on the reforms and instruments which increased the capacity of the state to promote industrialisation and also in the obstacles and limits found. The objective is to see how the characteristics of the political institutions, as defined by Hall (1986) and introduced in chapter two, affected the vicissitudes of the process of development. Furthermore, special attention is given to the pattern of economic policy defined in that period.
CHAPTER 5. INSTITUTIONS, STATE CAPACITY AND ECONOMIC POLICY IN THE PERIOD 1946-1960

5.1. Introduction

The objective of this chapter is to investigate state involvement in economic development in the democratic period that followed the end of the Vargas dictatorship, in 1945. The intention, following on from the last chapter, is to examine the evolution of economic policy and the main institutional and instrumental reforms which increased state capacity to promote and co-ordinate the process of development.

In section 5.2, I present very briefly several general trends present in the Dutra government (1946-50). This government was marked by the emergence of liberal forces against the statist project of development delineated in the 1930s. In this section, I intend also to emphasise the analyses of the Brazilian economy made by two international missions. The intention is to stress the main deficiencies of the economy and the challenges faced by the economic policy at that moment.

Section 5.3 shows how the second Vargas government (1951-54) was marked by a return to developmentalism and by efforts to equip the state to play a more active role in industrialisation. The main emphasis is given in the reforms that increased the coherence of state action and its capacity to promote industrialisation. It also explores the political difficulties faced by the Vargas government.

Sections 5.4 to 5.6 investigate the Kubitschek government, a period marked by a huge program of industrialisation, which transformed completely the national economy. The analysis of the program of investment, promoted by the state, illustrates the importance of instrumental innovations and the process of construction of state capacity. Nevertheless, the obstacles and contradictions faced in this period also reveal the limits

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145 Developmentalism, as emphasised, is the term used to characterise the experiences of development in Latin America marked by strong state intervention in the economy, including public investment and 'manipulations' of the market prices.
in state capacity to successfully transform the economy. Section 5.4 summarises the main characteristics and achievements of the government. Section 5.5 centres on the instruments responsible for the increase in state capacity. Finally, section 5.6 explores the factors responsible for political stability and also the obstacles and limits faced by the program of development.

Besides emphasising creation of instruments and rationalisation of state action, the chapter also has the objective of exploring the political obstacles which accompanied the programs of industrialisation. This objective is important because these obstacles were related to structural characteristics which marked the organisation of the state and the process of industrialisation in Latin America. In this sense, an investigation of these factors is very important if one is to understand the obstacles to the success of state-led models of industrialisation in the continent. This relationship between the characteristics of the state and the political difficulties that emerged in the process of industrialisation is explored in section 5.7.

Finally, another important objective of this chapter is to explain the determinants of the pattern of policy making which marked this stage of import substitution in Brazil. Sections 5.8 and 5.9 explore, respectively, the influence of technicians and industrialists over economic policy. Section 5.10 summarises the characteristics and determinants of the pattern of economic policy. Finally, section 5.11 presents briefly the conclusions of the chapter.
5.2 Diagnostics of the Brazilian economy in the post war period and the ‘liberal’ orientation of Dutra Government (1946-1950)

At the end of the 1940s and beginning of the 1950s, two international missions undertook studies and made recommendations about the Brazilian economy: the Abbink Mission, in 1948, and the *Comissão Mixta Brasil-Estados Unidos* (CMBEU – *The Brazil-United States Mixed Commission*), from 1951 to 1953\(^{146}\). The analyses and prescriptions of these missions permit a very clear glimpse of the obstacles faced by the Brazilian government in the period.

The Abbink Mission emphasises, as key obstacles to economic development, the deficiencies in energy and transports, the low productivity of the economy, the regional and sectoral imbalances, the difficulties of combating inflation, the lack of a capital market and the disarticulation of the financial system (Draibe, 1985: 159). A strong emphasis was given to the problems of infrastructure, leading the Mission to support the active involvement of the state, including investment in productive activity. Furthermore, a very special emphasis was given to the deficiencies of the financial system. The Abbink Mission supported the creation of a central bank and the organisation of the banking system, both of which it considered fundamental to curbing inflation and to keeping the foreign accounts balanced. Similarly, it prescribed an increase in taxation and the creation of public bonds.

The diagnostics of the Brazilian economy was substantially improved by the works of the CMBEU which, from 1951 to 1953, elaborated careful analyses of the problems of the national economy and presented 42 specific sectoral projects. The CMBEU prioritised the overcoming of bottlenecks in energy and transport and an increase in the utilisation of national sources of fuel (Bielschowsky, 1988: 444). From the 42 projects elaborated, 38 were concentrated in the areas of energy and transport. The necessity of

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\(^{146}\) These missions were contracted by the Brazilian government with the intention of presenting a diagnostics of the main obstacles to the national development. The governments had also the objetive of using the authority of these missions to obtain foreign credit to projects of national interest.
overcoming shortfalls in infrastructure was reinforced by the analysis of the causes of the increase in food prices in the period from 1939 to 1950. As production had increased significantly, CMBEU concluded that the increase in prices was related to deficiencies in transport, commercialisation and stocking of products.

Another important point emphasised was the absence of a financial institution capable of supplying long term loans. The Commission suggested the creation of a special fund to mobilise sums of internal resources equivalent to the value of the foreign loans. This was a pre-condition to obtaining loans from the World Bank and Eximbank. These prescriptions had very important consequences: they supported the creation of the Fundo de Reaparelhamento Econômico (Fund of Economic Equipping) and of the Banco Nacional de Desenvolvimento Econômico (BNDE - National Bank of Economic Development), which played a decisive role in the subsequent process of economic development.

Special attention was given to inflation and to balance of payments problems. The report of the Commission indicated many causes of the inflationary process. Firstly, it emphasised the effects of the rapid process of industrialisation, which created opportunities for investment but did not stimulate an increase in savings. (Bielschowsky, 1988: 444). Other factors, such as bottlenecks in infrastructure and transport, distortions provoked by the war and the deficits of the government were also listed as sources of inflation (Sola, 1982: 75). Although not prescribing contractionist measures, since the CMBEU supported also the necessity of increasing investments and defeating the problems in infrastructure, the Commission emphasised the problems caused by inflation. It stressed that inflation had lost its functionality as an incentive to channelling resources into investment and had become an important source of distortions.

The CMBEU recognised the positive effects of the foreign exchange policy for the national industry. The exchange rate had been kept constant since 1939, despite the substantial inflation in the meantime. Overvalued exchange rate, combined with quantitative restrictions on imports, at the same time stimulated the import of equipment and protected the national industry.
process of industrialisation that was very dependent on imports. Similarly, the report concluded that the exchange rate regime was exhausted. It emphasised that the exchange rate, by stimulating imports and the remittance of profits abroad and discouraging exports and the entrance of foreign capital, could transform the imbalance in the foreign accounts into a chronic problem (Bielschowsky, 1988: 445-446).

The diagnostics elaborated by the foreign missions gave a very good indication of the problems and challenges faced by the Dutra government (1946-1950) and by Vargas on his return to power in 1950. Addressing infrastructure deficiencies demanded an increase in public investment. On the other hand, increasing inflation and the problems of the balance of payments constrained government action. Those dilemmas marked the economic policy of the two governments, which oscillated between the investments necessary and the necessity of addressing short term imbalances.

The Dutra government (1946-1950) marked the return to a democratic regime. The Congress assumed the important attributes of approving the budget proposals and the accounts of the executive, of introducing changes in the 'Law of Means' of the Executive and of authorising the supply of extra credits. As the practices of the political parties were strongly centred on clientelism, control of the state budget gave the politicians an important instrument to feed their nets of patronage. As a consequence, the power of Congress represented a significant constraint on the capacity of the executive to promote industrialisation. Although the executive, in the following years, created many mechanisms to circumvent the interference of Congress, it became dependent on its deliberations and had to negotiate and compromise to achieve the necessary resources.

The Dutra government marked a discontinuity with two key lines introduced during the previous Vargas government: the attempts to co-ordinate economic development and the efforts to promote an integrated program of industrialisation. Organs which, at the

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148 Dutra government presented, in several issues, a liberal orientation, which is explained, in large part, by the international context and by the belief that a new liberal world order would provide resources and conditions for the development of the country. In addition, this position was also influenced by the reaction against the previous Vargas dictatorship.
end of Vargas government, pursued an increase in co-ordination, such as the *Conselho Nacional de Política Industrial e Comercial* (CNPIC - Council National of Industrial and Commercial Policy) and the *Comissão de Mobilização Econômica* (CME - Commission of Economic Mobilisation), were abolished. Similarly, DASP, a central organ in the co-ordination of state action during the *Estado Novo*, was a special target of the ‘liberal’ groups and had many of its functions reduced\(^{149}\).

Another remarkable characteristic of the Dutra government was the lack of a program of industrial development. The *Salt Plan*, the main government program, was centred on the modernisation of agriculture and on programs of investment in infrastructure, provision of foodstuffs and public health. The challenges of the process of industrialisation, a critical economic issue, were not contemplated. In addition, the plan had problems of co-ordination and was very vulnerable to clientelist practices, while the government faced a shortage of financial and administrative capacity (Draibe, 1985: 152-157).

The Dutra administration illustrates very well the opposition of social forces to increasing state intervention in the economy. Those forces were able to introduce liberal measures which reversed the previous attempts to increase state intervention and co-ordination of the economy. Similarly, promotion of industrialisation ceased to be the central objective. This orientation, nevertheless, failed to produce positive results. Although industrial growth was substantial in the period\(^ {150}\), it took place in a very indiscriminate and unbalanced way, producing serious distortions in the structure of production and making the composition of imports very rigid\(^{151}\). Similarly, the problems in infrastructure persisted.

\(^{149}\) However, DASP was not closed and its continuity was important to infuse the state with groups of technicians moved by meritocratic criteria.

\(^ {150}\) From 1945 to 1950, GDP grew at the average annual rate of 7.6%, while industrial production grew at the annual rate of 11.5%. Inflation, which had reached 21.8% in 1947, was substantially reduced in the next two years and achieved 3.4% in 1948 and 4.3% in 1949. In 1950, however, economic policy changed and inflation increased to 9.4% (Abreu, 1990: 398-401).

\(^ {151}\) This means that a substantial part of the national capacity to import was employed in imports of raw materials and capital goods, items essential to the national industrialisation. Thus, the process of
In this sense, the results of the Salt Plan indicated that the difficulties inherent to the national economy required a much more firm and intense state intervention. Whatever kind of intervention was adopted, it would have required resources, investments and a program of development, which were notably absent during the fragile Dutra government. In brief, the main problem of the Dutra government was not its departure from the previous lines of economic policy, but rather its inability to present a coherent program which addressed the necessities of national development.

industrialisation was very vulnerable to difficulties in the balance of payments.
5.3. The Second Vargas Government (1951-1954): institutional innovations and increase in state capacity

In 1951, Getulio Vargas, elected in the previous year with 48% of the votes, returned to power. His government marked the return to a developmentalist program of industrialisation, as introduced in the 1930s. Vargas supported strong state participation in the economy and his government was marked by efforts to equip the state to undertake the functions required by the new stage of capitalist development.

In his message to Congress in the first legislative section of 1951, Vargas made clear his government’s commitment to deepening the process of industrialisation. The development of basic industry, including steel, chemical, electrical and transport material sectors, and the improvement of transport, energy and communication infrastructure were declared key objectives of his government. In his Presidential address, Vargas also mentioned the risks of high dependence on foreign markets and supported import substitution as the most appropriate model of economic development (Bielschowsky, 1988: 393-394).

His government had to address the problems of a state which had grown in a disordered way and lacked the institutional capacity and the instruments necessary to play an important role in the new phase of economic development. The process of expansion of the state, as initiated in the 1930s, had been marked by many problems of co-ordination: overlapping of functions, bureaucratic conflict and excessive number of organs subordinated to the presidency were characteristics that reduced the coherence of state action. After the liberal setback of the Dutra period, it was necessary to increase the capacity of co-ordination of state action.

Despite a high degree of improvisation, the second Vargas government was marked by significant institutional innovations. The creation of councils bringing together businessmen and representatives of the relevant public agencies helped to increase co-ordination in economic policy (Draibe, 1985: 230). This is very well illustrated by the
creation of the Comissão de Desenvolvimento Industrial (CDI - Commission of Industrial development), in 1952, responsible for the co-ordination of the industrial policy. As Draibe (1985: 217) points out, "...[the] CDI did an important job in the classification of basic industry and elaborated a General Plan of Industrialisation".

Another important advance was the creation of the Assessoria Econômica (Economic Adviser Organ), a body composed of qualified technicians, which was responsible for elaborating studies and projects and for supplying direct advice to the president. It played an important role in increasing the co-ordination of state action, thereby compensating for certain deficiencies provoked by the lack of an organ responsible for the planning of the economy.

The Assessoria Economica further illustrates a very important achievement of the Vargas government, the allocation of a group of qualified technicians to key posts in the state apparatus. As seen, the period had also been marked by the work of the CMBEU, which brought together technicians from Brazil and the United States. The CMBEU had a very positive impact in the qualification of a group of Brazilian technicians: the contact with the American team, the participation in the sectoral projects and the training in techniques of social planning produced technicians with the knowledge and experience to deal with Brazil’s national problems.

The period was also marked by the creation of BNDE\textsuperscript{152}, which had very significant consequences for the increase in state capacity of intervention in the economy. The BNDE was designed as an investment bank and its activities were concentrated on the supply of long term credit to strategic projects. The bank administered its resources autonomously and its internal statute determined that the majority of the directors must be employees of the organ. Furthermore, the bank had a qualified group of technicians, selected and promoted according to meritocratic criteria. In brief, those mechanisms

\textsuperscript{152} The BNDE was created to administer the Fundo de Reaparelhamento Econômico (Fund for Economic Equipping), created through an additional compulsory tax loan of 15% over the income tax and through an extra tax of 3% over the reserves and profits non distributed, subjected to renewal by the Congress five years later (Lessa, 1981: 104; Sikkink, 1993: 568).
provided a high degree of insularity, autonomy and coherence to the action of the BNDE, which became a central agent for the co-ordination and promotion of the process of economic development. In addition, being allocated the role of supplying long term loans gave the BNDE a significant influence over the allocation of investments in the economy (Sikkink, 1993: 568-571; Lessa, 1981).

Similarly to the Assessoria Econômica, the BNDE illustrates the government’s effort of creating an insulated and qualified segment of the bureaucracy. Given the political obstacles to undertaking a radical reform of the civil service, the government opted for improving sectors of the administration through the creation of ‘pockets of efficiency’, while the traditional bureaucracy continued to be ruled by political appointments and by patronage. As Nunes (1997: 91) emphasises, the search for efficiency implied the necessity to circumvent the parties and the Congress, creating a substantial segmentation inside the bureaucracy.

In 1953, the Grupo Misto CEPAL-BNDE (CEPAL-BNDE Joint Group) was formed, joining together members of the bank of investment and technicians of the Comissão Econômica para America Latina (CEPAL – Economic Commission for Latin America). CEPAL, created in 1948 by the United Nations, supported a substantial involvement of the state in the promotion of industrialisation in Latin America. The CEPAL-BNDE Joint Group, responsible for the realisation of a diagnostic of the Brazilian economy and for proposing a program of development, had an important influence on the technicians of the BNDE, who became more sympathetic to the developmentalist ideas of CEPAL.

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153 Sikkink (1993: 568-571) emphasises how BNDE was very effective in concentrating its resources in the sectors considered strategic to economic development. In the period 1952-56, 68% of the resources were allocated in investments in transport and 19.5% in energy. In the period 1957-63, 48.6% of the resources of the bank were destined to investments in the basic industry and 48.5% to infrastructure.

154 In this sense, Vargas gave sequence to the work initiated with the creation of DASP in the 1930s. The improvement in technical bureaucracy was an essential characteristic of the developmentalist experience in Brazil, permitting the state, in spite of the obstacles put by congress, to pursue a coherent strategy of development and obtain significant progress in the process of industrialisation.
The importance of qualified technicians staffing key posts of the bureaucracy is strongly emphasised by Sikkink (1991) in her comparative analysis of Brazil and Argentina. The author stresses the importance of administrative reforms and of institutional continuity to explain the relative larger capacity of the Brazilian state. Sikkink notices that, in contrast to Argentina, the organs and the technicians in Brazil tended to survive changes of president\(^\text{155}\) (Sikkink, 1991: 186). She shows how the segments of the Brazilian economic bureaucracy were much more insulated from private groups than was the case in Argentina. Consequently, they were also much more successful in achieving their objectives\(^\text{156}\).

In brief, the Vargas government was marked by important improvements in the organisation of the state. Co-ordination was increased through the role of the Assessoria Económica and of the Commission of Industrial Development. Accordingly, pockets of efficiency were created to run key areas and qualified technicians increased their role in the economic policy process. And last but not least, the capacity of articulation between private and public sectors was improved by the creation of councils and by the institutionalisation of consultation. Although there was no radical administrative reform and several of the problems of the previous administration persisted, the innovations increased the capacity of state to govern the process of development.

The second Vargas government was also marked by an intensification of state action to promote economic development. Public investments in infrastructure and heavy industry were substantially increased\(^\text{157}\). The period was marked by substantial

\(^{155}\) In Argentina, administrative reforms were less frequent and the governments were not able to generate a bureaucratic segment dissociated from the main interest groups. Similarly, there was no continuity in public administration. At the end of Peron administration, for example, the technicians were dismissed and the agencies responsible for the elaboration of economic policy were closed.

\(^{156}\) This difference between Brazil and Argentina is very well illustrated by the performance of the respective Banks of Development. In Brazil, BNDE, staffed with qualified technicians and marked by an administrative structure which guaranteed its insulation, was very successful in allocating the bulk of the resources to the strategic sectors. In Argentina, by contrast, the Industrial Bank was dependent on other ministries and their directors were representatives of economic sectors. As a result, the bank failed to play a role as an agent of development. It allocated a large proportion of its loans to agriculture and light industry, sectors which could have been financed by the existing commercial banks, and only a modest part of its resources was destined to infrastructure and heavy industry (Sikkink, 1991: 199-201).

\(^{157}\) According to data cited by Baer (1966: 84), public investment increased from 15.8% of total
growth of investment in generation, modernisation and distribution of electrical energy. In addition, post and telegraph services and telephony network were modernised and significant investments were undertaken in highways and railways. These investments in transport, energy and communication created demand and opportunities for the national industry that supplied material and equipment to the respective sectors. In addition, the steel industry, centred on public capital, made significant advances and the creation of Petrobrás, the state oil enterprise, gave significant impulse to the production, storage and refining of oil, besides stimulating research of new deposits of the product. The chemical, shipbuilding and cement industries also developed significantly\(^{158}\).

An important instrument to stimulate industrialisation was the exchange rate policy. Until 1953, the combination of an overvalued currency and quantitative controls stimulated imports of raw material, capital goods and essential goods. The reform of the exchange rate regime, in 1953, gave continuity to this process: instruction 70 of SUMOC created five categories of exchange rate, allowing the government to distribute goods in each one according to its essentiality to the economic policy. The new exchange rate system had many advantages in relation to the previous fixed exchange rate system. The new regime was more flexible and permitted the stimulus to the exports of certain products, which became also subjected to favourable exchange rates\(^{159}\). Finally, the multiple exchange rate system also worked as an additional source of tax, permitting the increase in fiscal capacity without undertaking a process of tax reform, which would have faced resistance in the Congress\(^{160}\).

Nevertheless, despite the advances permitted by the new exchange rate system, the situation of the balance of payments, in 1954, was very critical. According to Leopoldi

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\(^{158}\) From 1951 to 1954, industrial production grew 32.8% and GDP grew 27%. The average inflation rate in these four years was 16.5% (Abreu, 1990: 403;406).

\(^{159}\) At the same time, the multiple exchange rate system applied high exchange rate to the exports of coffee. The policy makers believed that the demand for the product was inelastic and that an overvalued exchange rate would maximise the coffee planters income.

\(^{160}\) For a detailed description of the functions of Instruction 70, see Lessa (1981). The mechanism suffered the criticism of certain economic sectors, which blamed the government for confiscating resources and transferring them to other sectors.
(2000: 213), the import of raw materials, fuel and capital goods were equivalent to 90% of the total exports\(^\text{161}\). In face of these difficulties, the industrialists of FIESP (Federation of Industry of the State of São Paulo) demanded a program of import substitution able to increase the national capacity of production in sectors such as chemicals, the metal industry, fuel and cellulose. The resources for this program were to come from the state and from foreign capital. As Leopoldi points out, this was the program adopted by the Kubitschek government in the period 1956-1960.

A critical instrumental innovation, which permitted the government to face these constraints on the balance of payments, was Instruction 113 of SUMOC, adopted in 1955 during the Café Filho government (1954-55). Instruction 113 authorised the importation of machine and equipment without exchange rate cover, thus registering these imports as foreign investment. Given the shortage of foreign exchange, such a measure was intended to alleviate the constraints on the balance of payments and to create an additional incentive to foreign investment.

The architect of instruction 113 was the neoliberal economist Eugenio Gudin, Finance Minister during the Café Filho government. Gudin was a strong critic of developmentalist ideas and of the high protection which was given to the national industry (see section 5.8). He criticised developmentalism for benefiting inefficient producers and harming consumers. Therefore, instruction 113 reflected his attempts to increase competition and reduce protection of national industry. Gudin considered a model of development centred on foreign capital much preferable to a model centred on high protectionism.

Indeed, Instruction 113 deeply affected the model of industrialisation. The substantial leap in industrial development, promoted under the Kubitschek government, was only possible because of the massive penetration of foreign capital, permitted by instruction 113. Although benefiting from substantial economic growth, national private

\(^{161}\) This is a good evidence of the country’s limited capacity to import.
capital became the subordinate partner in a pattern of development marked by the strong presence of both public and foreign capital.

The project of development of the second Vargas government faced important limitations. Although the fiscal capacity of the government was increased through the creation of earmarked funds and other mechanisms, the conservative structure of Congress blocked a tax reform which would have given the government the resources necessary to finance its participation in the process of economic development. The result was an increase in the rate of inflation\(^\text{162}\). Accordingly, despite the significant advances, the government still faced obstacles to co-ordinate its expenditure and to integrate private and public investments. And finally, despite the important creation of the BNDE, the government was not able to produce a substantial reorganisation of the financial system.

The lack of institutional capacity is very well illustrated by the government’s inability to control the money supply. Despite the creation of SUMOC, in 1945, the government lacked the instruments necessary to exercise strict control over monetary policy. The autonomy of the *Banco do Brasil*, which combined the functions of commercial bank and monetary authority, prevented SUMOC from controlling the liquidity of the economy. The *Banco do Brasil* had a large number of agencies throughout the country and was a strategic instrument of patronage. As a result, Congress was ready to block every measure that attempted to reduce its autonomy. In brief, as Octávio Bulhões, the economist responsible for the creation of SUMOC, concluded, the creation of an autonomous monetary authority in such a democratic context was a very hard task (Nunes, 1997: 99).

\(^{162}\) From 1947 to 1954, the revenue of the federal government increased 235% (in current prices). The expenditure increased 267%. Inflation, in this period, was 117%.
Political difficulties

Vargas suffered significant political difficulties, the fruit of the polarisation created around his name\textsuperscript{163} and of the heterogeneity of the political alliance that supported him, which brought together the conservative segments of the Partido Social Democrata (PSD – Social Democratic Party) with the trade unionists of the Partido Trabalhista Brasileiro (PTB – Brazilian Trabalhista Party). In addition, Vargas based his campaign on a direct appeal to the popular masses, using his reputation of ‘father and protector of the poor’, constructed during his previous period in government. As a consequence, Vargas, although initially forming a conservative cabinet, could not disregard the populist and popular demands from those factions which supported him. This led him to adopt a permissive position in relation to the labour movement\textsuperscript{164}, which was strengthened in the period and released from state control.

The crisis faced by Vargas was in large part related to the threat that his government represented to conservative political forces. The role of the PTB, the adoption of populist measures, the strengthening of the labour movement and the concessions made to the workers increased the fears that Vargas could attempt to install a trade union republic, as Peron had done in Argentina. The increase in strikes and the substantial concessions given to the trade unions contributed to the alarm felt by the conservative groups and increased their opposition to the government (Bielschovsky, 1988: 425; Fonseca, 1989: 445).

The pressure from the conservative groups, including the fierce campaign of the UDN, made Vargas’ position untenable. His attempts at reconciliation became

\textsuperscript{163} The political parties were created during the Estado Novo and reflected strongly the polarisation between the supporters of the dictator and those against his government. In the second Vargas government, segments of the União Democrática Nacional (UDN – National Democratic Union), a party which joined the opponents of the Vargas dictatorship (1937-45), exerted fierce opposition against the president, having very destabilising effects.

\textsuperscript{164} The government did not repress the movement and indeed made significant concessions to it. In 1954, the minimal wage was doubled.
impossible in face of the strengthening of both the labour movement and conservative pressures. In certain events, Vargas seemed inclined to repress the strikes, but the magnitude of the movement and the pressures from segments of the PTB led him to reverse his position and to try to obtain political gains through a negotiated position. However, the degrees of liberty and space for manoeuvre were becoming progressively narrower.

In conclusion, the political difficulties of Vargas government, the result of the contradictory nature of the political coalition which brought him to power, reduced the government’s capacity to deal with the challenges of the process of capital accumulation. Vargas’ policies, which attempted to take into account the different interests of its supporters, had the consequence of generating distrust and instability, leading the government to a deadlock.\(^{165}\)

\(^{165}\) The role of UDN and of one of its leaders, Carlos Lacerda, played key role in the fall of Vargas. See Bojunga (2001) for the events which led to the political crisis and to the suicide of Vargas.

The five years of the Kubitschek administration were marked by substantial progress in industrialisation. From 1956 to 1961, GDP grew at the annual average rate of 8.1%, while *per capita* income grew by 5.1%. Likewise, investment achieved an average annual rate of 14.5% of GNP and the industrial structure was radically transformed and diversified. In constant prices, industrial production grew by 80% during the five years of government\(^{166}\).

Investment in infrastructure was substantial\(^{167}\). The capacity of production and distribution of electrical energy was increased in 47%\(^{168}\) and the production of oil expanded 600%, increasing its participation from 5% to 31% of national demand. The capacity of oil refining expanded 200%. The highway network was expanded by 12,169 kilometers and significant investments were undertaken in harbour infrastructure.

The performance of heavy industry was also outstanding. Mechanical industry grew by 125% and there was a substantial improvement of the industries of basic inputs and capital goods. The industry of tools and machines grew 100%, heavy electrical material grew 200% and there was a substantial development of production of turbines, generators and motors. As a result, according to Lessa, this effort reduced the imports of equipment to one-third of the national demand (Lessa, 1981: 34 – 55; Benevides, 1979: 204). Similarly, production of steel almost doubled and, by the end of 1960, around 80% of the national demand was met domestically. Furthermore, the production of cement increased by 71%, and was therefore able to completely meet domestic demand.

One of the main achievements of Kubitschek program was the development of the automotive industry, centred on the entrance of foreign companies. From 1957 to 1960,

\(^{166}\) The data is extracted from Lessa (1981: 34-55) and from Orenstein and Sochaczewski (1990).
\(^{167}\) Transport and energy responded for 71% of the total investments of the Target Plan (or Target Program), the program of investment of Kubitschek government.
\(^{168}\) The capacity of generation and distribution increased from 3.500.000 Kw in 1956 to 5.200.000 Kw in 1961.
321.2 thousand vehicles were produced, achieving an index of national participation, in weight, of around 90%. This means that the national industry of components was significantly stimulated.

As a result, at the end of the period Brazil had addressed many infrastructure bottlenecks, substituted imports in many sectors and generated a vertically integrated industrial structure. In spite of the imbalances and of the dependence on imports in high technology sectors, the Target Plan had achieved very significant results, producing a substantive qualitative transformation in national industry.\textsuperscript{169}

In this major effort of industrialisation, a central role was played by the state, which undertook a substantial program of public investment and mobilised instruments to stimulate private investment. The participation of the public sector in national investment increased from 27.5% in 1950-56 to 37.1% in the period 1956-60. Adding to these numbers the investments of the public enterprises, which were not registered in the national accounts as part of the public sector, the direct state contribution to the investment effort was equivalent to 47.8% of the GNP\textsuperscript{170} (Lessa, 1981: 70). In addition, the government, through BNDE loans, incentives to the import of equipment, tariff exemptions and other forms of incentives, transferred a substantial amount of resources to the private sector in an effort to shape investment according to the priorities identified by the Target Plan.

In the face of the extraordinary results achieved by this strategy, it is very important to see how the state increased its capacity to promote and co-ordinate the program of investments. In this sense, the Kubitschek period illustrates well the actions of the developmentalist state in Brazil. This included a wide creation of instruments, important institutional innovation and a substantial effort to give coherence to the

\textsuperscript{169} According to Benevides (1979: 204), the “effective Brazilian per capita growth in the decade of 1950 was about 3 times larger than that of the other Latin American countries”.

\textsuperscript{170} Public investment was concentrated in infrastructure and in heavy industry, in sectors such as steel and chemical industry.
program of development. Similarly, it illustrates the importance of administrative continuity and of political stability to the success of state intervention.

Kubitschek benefited strongly from administrative continuity and from the existence of a qualified group of technicians, inherited from previous governments. He allocated technicians from SUMOC, BNDE, Assessoria Economica and CMBEU to central posts of his ‘parallel administration’. In addition, Kubitschek benefited from the studies of the national economy undertaken by the CMBEU and by the Joint CEPAL-BNDE Group (see sections 5.2 and 5.3). The Target Plan was conceived utilising the concepts of ‘bottleneck’, 'growing points' and linkages, present in the report of the CMBEU. In addition, one of its central objectives was to deepen the process of import substitution, as prescribed by the Joint CEPAL-BNDE Group. Finally, the Target Plan, in defining many sectoral targets, was merely updating the analyses made by previous teams, especially the CMBEU (Sola, 1982: 138).

The Target Program, it is important to emphasise, was only possible through the high penetration of foreign capital, encouraged by the incentives provided by Instruction 113 of SUMOC. As Brazil had a very fragile balance of payments position and the international agencies refused to finance the investments, the entrance of foreign capital was crucial for the intensification of import substitution. In addition, foreign investment played a very important role in providing the technology and organisational structures essential to the installation of sophisticated industries. The next sections explore the factors responsible for the success of the Target Plan, emphasising the construction of state capacity and also the problems and limits of the strategy.
5.5. Constructing state capacity – the instruments of economic policy

One key feature of Kubitschek administration was the creation of an articulated set of instruments that increased the capacity of the state to co-ordinate the program of development. Benefiting from the instruments, agencies and studies inherited from the previous governments, Kubitschek created new organs and instruments which increased the coherence of the program of investments articulated under the Target Plan.

The creation of the 'parallel administration' was the form found to increase administrative rationality, given the impossibility of undertaking a wide administrative reform. An informal and non-institutionalised structure of power, directly linked to the president, the parallel administration circumvented the traditional obstacles present in the political system and provided co-ordination to the action of the executive (Draibe, 1985: 244). It had the advantage of combining efficiency with conciliation, creating the means necessary to a rational management of economic policy without a direct confrontation which could have reduced support for the government program.

In spite of the high degree of improvisation, the Target Plan constituted a substantial effort to reduce areas of uncertainty and to give rationality to economic policy-making (Benevides, 1979: 211). Five bodies were key participants in the program of investments: BNDE, SUMOC, CACEX (Department of Foreign Exchange of Bank of Brazil), CPA (Council of Tariff Policy) and CDE (Council of Development). In addition, the government created Grupos de Trabalho (Working Groups) and Grupos Executivos (Executive groups), responsible respectively for the elaboration of studies and execution of projects in specific sectors. The CDE was the organ responsible for the coordination of the implementation of the Target Plan (Lafer, 2002).

The Bank of Development (BNDE) played a key role in the execution of the Target Plan. The Bank was the organ responsible for the concession of long term loans and its

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\[171\] The CDE was headed by the president of the BNDE and was formally responsible for the Executive Groups.
guarantee was a pre-condition to access to foreign loans. The control over these two sort of resources gave the Bank substantial influence over the allocation of flows of investment towards the sectors considered strategic. Its performance, as emphasised, was very positive, directing the bulk of its loans to the priority sectors. Likewise, as Benevides points out, BNDE was also very successful in directing the foreign resources in accordance to the objectives of the Target Plan. According to Benevides (1979: 236), from the 2.1 billion dollars which entered in the country between 1955-61, less than 5% were allocated to non-strategic sectors.

Other key tools of the Target Plan were the multiple exchange rate system, administered by SUMOC, and the tariff policy, administered by CPA. The exchange rate system, as seen, was used to stimulate the import of essential goods and to protect domestic industry. The Council of Tariff Policy (CPA), created in 1957, gave agility and flexibility to the tariff policy, which was also employed to stimulate imports of equipment and raw materials and to protect national industry from international competition. The organ had the power to reduce tariffs on equipment whenever the importer demonstrated that domestic industry was not capable of supplying the item. In addition, when a producer showed capacity to supply with quality the internal demand of a determinate product, the Council issued a ‘certificate of maturity’, which impeded the concession of any kind of incentives to the import of the respective good.172

The CPA had representatives of agricultural, industrial and trade sectors and worked as an important channel of consultation between the policy makers and the productive sectors. Accordingly, it had sufficient flexibility and capacity to make automatic changes in tariff policy, thereby constituting an important forum of pressure from the producing sectors, especially the industrialists. As Lessa (1981:106) emphasises, the council demonstrated substantial coherence and internal organisation, permitting consultation with the economic sectors and facilitating the adoption of negotiated decisions.

172 This principle, known as the “Principle of National Similarity”, was widely used during most of period of import substitution.
A very ingenious innovation of the Target Plan was the creation of the Working Groups and Executive Groups. The Working Groups were consultative organs responsible for the elaboration of specific sectoral studies. They included the elaboration of analyses about the law and regulation of the respective projects, necessary to “achieve more efficiency in the standardisation of the supply and manipulation of incentives” (Benevides, 1979: 228). The Working Groups brought together representatives of the key economic policy organs, including BNDE, CACEX, SUMOC and the Banco do Brasil, and representatives of the industry. The specific composition of the groups was very important, since the studies and suggestions were elaborated already having the support of representatives of the organs responsible for their future execution. (Benevides, 1979: 228).

The executive groups were administrative structures which, bringing together business representatives and members of the main economic organs, had the objective of deliberating and taking decisions at sectoral level. They were created by decree, circumventing the Congress, and obtained financial independence and autonomy to recruit their staff. The Executive Groups worked as important forums of consultation and negotiation, permitting the exchange of information and communication necessary to bring about a reduction in uncertainty and the definition of sectoral targets. Furthermore, by including representatives of all the organs of economic policy, the executive groups permitted a co-ordinated policy of incentives in accordance with the sectoral objectives defined in each group (Lessa, 1981: 109).

The action of the Executive Groups increased agility in the implementation of the policies. The examination of the objectives inside the group gave the business representatives the opportunity to introduce the difficulties, to suggest complementary investments and to demand incentives and other facilities. The presence of representatives of the main economic policy agencies guaranteed the immediate address of such issues. For example, if there was demand for special import licences or for long-
term loans, the organs responsible were present to discuss the issue and propose solutions\textsuperscript{173}.

Lessa highlights the example of the Executive Group of the Automotive Industry (GEIA), the most successful of them, which brought together representatives of the BNDE, SUMOC, CACEX, CPA and of the related ministries. He emphasises how GEIA adopted a strategy of ‘picking the winners’, conceding favours to the enterprises which achieved its objectives of production and other targets. These favours included incentives to the import of equipment, payment of foreign debt at favourable rates and long term loans at favourable interest rates\textsuperscript{174}.

The Executive Groups also had an important political role and worked as an arena in which the business groups introduced their main requests. As Draibe points out, they were an important forum to guarantee the harmonisation between the different spheres of capital. They utilised a range of instruments to regulate the entrance of foreign capital and guarantee that the interests of the national industrialists were taken into consideration (Draibe, 1985: 243). In brief, the Executive Groups, by providing exchange of information and negotiation, reducing uncertainty, evaluating the need of complementary projects and co-ordinating the decisions of the economic agencies, illustrate very well several components of state capacity presented in the chapter two. They played a very important role in the successful program of transformation of the industrial structure.

\textsuperscript{173} Lessa (1981: 110-111) emphasises the agility provided by the Executive Groups. He shows how, before their creation, a project had to follow an intense bureaucratic way which slowed its approval and impeded a consistent evaluation of its merit. The steps included the evaluation by the CACEX of the existence of national similar, the assessment by the Minister of War of the project’s implication to national security and the evaluation of the availability of foreign exchange by the Exchange Department of the Bank of Brazil. The creation of the Executive Groups eliminated this long bureaucratic process, producing agility in decisions vital for the objectives of the Target Plan.

\textsuperscript{174} Other interesting examples were the Grupo Executivo da Construção Naval (GEICON - Executive Group of the Naval Industry) and the Grupo Executivo da Indústria de Maquinaria Pesada (Geimape – Executive Group of the Heavy Machinery Industry). See Lafer (2002: 102-103).
5.6. The importance of the political coalition and the limits of the arrangement

The success of the Target Plan was only possible because of Kubitschek’s ability to accommodate different social forces and to circumvent the influence of Congress. Kubitschek, elected through a PSD-PTB alliance, used the nomination of posts in the traditional bureaucracy to accommodate interests and obtain support. Meanwhile, he created an insulated parallel administration to give rationality to the main economic policy decisions.

The PSD-PTB alliance was very important for the stability of the Kubitschek government\textsuperscript{175}. The party of the president, the PSD, was a traditional party, which included conservative local landowners and segments of the industrial bourgeoisie. It found in the PTB a suitable ally to keep control of the labour movement\textsuperscript{176}. The PSD controlled the ministries responsible for issues of interest to its clientele, such as the Ministry of Transport and Public Works, fundamental to local interests, and the Ministry of Finance, crucial to the interests of the industrialists. The PTB controlled the Ministry of Labour, Industry and Trade and the system of social security, which gave the party posts and resources and were used to increase its basis of support.

The coalition played a critical role in the success of the program of investment. In spite of the creation of special funds, the Target Plan did not earmark all its resources and depended on the Congress for the approval of extra funds. The alliance allowed the PSD to control the budget commission and permitted the approval of practically everything which interested the executive\textsuperscript{177}. In brief, the co-ordination between congress and executive, very rare in Brazilian history, was crucial for the performance of the Target Plan. Besides the approval of the funds, the control of the commissions was

\textsuperscript{175} The same alliance, it is important to emphasise, had produced instability under Vargas.

\textsuperscript{176} As Benevides (1979: 84) points out, this coalition was only possible because of the ‘distance’ between the backward countryside and the urban centres, which permitted the reconciliation of the interests of the conservative local colonels with those of the “populist politicians which controlled the urban clientele”.

\textsuperscript{177} In 1958, for example, the Congress approved 131 projects demanded by the executive, having rejected only six; it renewed the fund administered by the BNDE, altered the tax on fuels and approved all the extra credits required for the construction of the new capital, Brasília (Benevides, 1979: 80).
very important to avoid delay in the voting of projects, which could have hindered the continuity of investments.

Another decisive function played by the alliance was the control of the demands of the labour movement. For this objective, the action of the vice-president João Goulart, from the PTB, was fundamental, since he used his prestige with the workers to guarantee the unity of the movement. Likewise, the distribution of posts in the public administration was an important tool to co-opt the trade union leaders and preserve stability. As a result of the regulatory action of the PTB, the requests of the movement were managed inside the structure of the party; in spite of the strikes, used politically by Goulart, Kubitschek knew that the movement was under control.

The emphasis on conciliation was also present in Kubitschek’s policies towards the conservative groups. Through the policy on credit, controlled by the PSD, the interests of traditional economic sectors were taken into consideration. Accordingly, the interests of the coffee producers were protected through the purchase of the surplus of the product and the guarantee of minimum prices (Sikkink, 1991: 161-163). In addition, the structure of the countryside was protected from any substantive change; the PSD and the conservative forces in the Congress were very successful in blocking the extension of the labour legislation to countryside, a measure which would have provoked a strong reaction from the landowners (Benevides, 1979: 77). And finally, Kubitschek was very careful in not adopting measures which could have outraged the military, such as the entrance of foreign capital in strategic areas.

In conclusion, Kubitschek was able to obtain the maximum from the political arrangements adopted by his government. Although its success depended on the possibility of intensifying economic development without radical reforms, his political ability to accommodate the social forces and to improve the capacity of state apparatus was decisive. Such an arrangement, however, was marked by a large degree of improvisation and its limits appeared very clearly at the end of his government.
Despite the rationality of many instruments, the Target Plan had many deficiencies. A very serious one was its incapacity to generate the financial resources required. The earmarked funds and the extra resources voted for by Congress were insufficient and the government had to use permanently the printing of money to finance its expenditure. The situation was aggravated by the incapacity of the government to create non inflationary forms of financing its deficits 178.

Although the tax structure was sufficiently flexible to rise in tandem with prices, charges for public services, used as instruments to contain inflation, were not adjusted and contributed substantially to the increase in the deficit of the public sector 179. Another difficulty was the substantial increase in expenditure with the purchase of coffee surplus, as a result of the fall in the international demand for the product in 1958 180. In addition, the policy of subsidies to imports of products such as wheat, oil, paper and fertilisers, employed as a means to soften the impact of inflation, also had substantially worsened the government's financial difficulties.

Inflation grew from 7% in 1957 to 24% in 1958, leading the government to elaborate a program of stabilisation in 1958. The program prescribed reduction in Treasury spending, decrease in the expenses programmed by Congress, postponement in readjustment in civil servant wages, restriction in expansion of rural credit, limits on minimal wage adjustment and a mini-fiscal reform. Such unpopular measures, nevertheless, were blocked by the congress, whose resistance impeded the achievement of a balanced budget. The expenses exceeded the level intended by 13 percent and the resources were very below the amount estimated. Finally, credit policy, in spite of the restriction in liquidity in the two initial months, was expanded substantially in the following months (Sola, 1982: 157; 160).

178 The increase in voluntary public debt required reforms which were not possible at that moment.
179 According to Lessa (1981: 81), the deficit in transport services alone accounted for around 50% of the federal government deficit. The deficit was particularly high in railway services, since the government, for political reasons, refused to increase the prices (see Orenstein and Sochaczewski, 1990: 183).
180 According to Sikkink (1991: 163), the cost of stockpiling the product reached 2.77% of GDP in 1959.
The difficulties faced by the program of stabilisation illustrate very well the limits of the political arrangement constructed by Kubitschek. At the end of his government, Kubitschek emphasised the difficulties of reconciling development and democracy, a reference to the obstacles that the control of the budget by the congress caused to his program of development. According to Kubitschek, only 40% of the Target Plan was financed via budget resources and a great part of the expansion in expenditure, which had direct effects on inflation, was a result of the clientelistic expenses of the Congress (Sola, 1982: 192).

In addition, the political coalition became very complicated after the five years of government. The difficulties were a result of the strengthening of PTB which, through the control of the ministry of labour, trade and industry and of the system of social security, expanded considerably its basis of support. Likewise, it strengthened its position in the municipalities through the recruitment of mining workers, small shopkeepers and other popular segments. The party also encouraged the strengthening of peasant leagues and rural trade unions, threatening frontally the conservative interests of the landowners, political basis of PSD. (Benevides, 1979: 111).

Those events highlight the contradictory nature of the PSD-PTB alliance, contradictions which had already provoked instability during the second Vargas government. Under Kubitschek, after a period in which the coalition worked very well, the concessions made to the PTB made the continued survival of the alliance impossible. Given the very different composition of interests which supported each party, competition in the same areas made the coalition impossible to sustain. As Benevides (1979: 132) points out, “The PTB could be allied with the PSD as an expression of the state trade unionism, but never as an expression of popular demands”.

Serious difficulties emerged also from the strengthening of the labour movement and from the incapacity to keep it under control. The trade union leaders increased their autonomy, circumvented government representatives and used their influence over the rank and file to press for economic concessions. The movement dissociated from
Congress and increased the number of strikes and protests against the government. The PTB benefited from the strengthening of the movement and, at that stage, had no interest in making a strong effort to keep it under control. As a result, Kubitschek lost the capacity to manage the situation and the strengthening of an autonomous labour movement became an important source of instability.
5.7 Social forces, political instability and limits of state capacity in the democratic regime

As seen in the last section, the strengthening of the PTB and of the labour movement caused serious difficulties to Kubitschek at the end of his government. They became important sources of instability and were key components of the political impasse which led to the military coup in 1964. They also need to be understood in relation to the structure of the state which emerged in the 1930s. The political difficulties faced by Vargas and Kubitschek transcended the specifics of these governments, indicating the existence of structural factors. This conclusion is reinforced by other experiences in Latin America, in which similar crises led to the fall of democratic governments and to the installation of military dictatorships.

Guilhermo O’Donnell (1973) developed a theory which related the structure of the Latin American states to the emergence of bureaucratic authoritarian regimes on the continent. According to O’Donnell, the effort necessary to intensify industrialisation, once the first and easy phase of import substitution was over, tended to aggravate the tensions among the social groups represented in the political system, especially the tensions between the conservative and popular factions. Consequently, these social forces blocked the adoption of measures necessary to the continuity of industrialisation, such as policies of stabilisation, increase in savings and the production of a safe and transparent environment to attract foreign capital. According to O’Donnell, the process of industrialisation led to the accumulation of political tensions and economic problems, provoking ungovernability and preparing the conditions for the seizure of power by the military.

Although this process indicates the existence of regularities related to the common international insertion and to the timing of industrialisation, it is necessary to emphasise

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181 ‘Bureaucratic authoritarian regimes’ is the term employed by O’Donnell to describe the particular kind of authoritarian regimes that emerged in Latin America in the 1960s and 1970s. For a detailed presentation of the argument of and criticisms about O’Donnell’s thesis, see the essays of the book organised by Collier (1979). The treatment in this section is very brief and does not do justice to the complex arguments developed by O’Donnell.
that it was influenced by domestic variables, especially the relative power of the social groups *vis-à-vis* the state. Kaufman (1982) emphasises how Argentina, Chile and Uruguay, in spite of the differences in size and resources, faced similar populist pressures and difficulties in managing their democratic regimes in the 1950s and 1960s. According to Kaufman, this is explained by the power of civil society which had come about as a result of the vicissitudes of the process of economic development in the nineteenth century and of the development of institutionalised competitive political systems. In the absence of institutions capable of achieving negotiated solutions, the demands from these social groups to protect and expand their participation in the national income constrained state autonomy and the degree of freedom of the economic policy. Similarly, the conflicts between a powerful agrarian aristocracy and well organised urban groups provoked political instability and deadlock.

The situation was very different in Brazil and Mexico, where civil society was weaker and the political elite had more autonomy. A key difference was the capacity of the political elite to rigidly control the labour movement. According to Kaufman (1982: 207), this was a crucial variable in explaining the capacity of the regimes to manage the political difficulties and tensions which emerged with industrialisation. Similarly, he believes that control over the labour movement is critical to any explanation of the differences in economic growth between Brazil and Mexico and the three southern Latin American countries.

Mexico constitutes an extreme case in which the institutionalisation of corporatist mechanisms of labour control and a dominant party structure gave the regime substantial capacity to resist social pressures and to adopt the policies required to correct the imbalances produced by the process of industrialisation\(^\text{182}\) (Kaufman, 1982: 208). This allowed Mexico to intensify the process of import substitution without a break in the democratic regime (Collier, 1979: 26).

\(^{182}\) As Kaufman points out, Mexico was unique among the countries mentioned above in adopting successful plans of stabilisation and measures to correct balance of payments deficits. As chapter eight explores, this is related to the power of financial interests *vis-à-vis* industrial interests.
In Brazil, as seen, the measures adopted in the 1930s, which included corporatist mechanisms of labour control, increased the autonomy of the political elite to promote industrialisation. Nevertheless, the democratic system inaugurated in 1946 increased, via the electoral process and the role of Congress, the influence of traditional groups. Furthermore, the labour movement was strengthened by industrialisation and managed to weaken the mechanisms of state control. In such a context, the deepening of the process of import substitution, as undertaken by Kubitschek, was possible because of the construction of an ingenious political arrangement. As seen, this arrangement permitted the implementation of a program of industrialisation unique on the continent, but at the cost of accumulating contradictions and aggravating social instability.

In brief, it is possible to identify in the composition of social forces which had resulted from the process of state organisation and from the timing of industrialisation, an obstacle to the deepening of the process of import substitution in Latin America. These social forces, when not properly controlled, blocked economic policies, produced instability, put at risk democratic regimes and constrained the success of state-led processes of industrialisation. The argument, nevertheless, does not imply a rigid causal relation and depends on the specific national circumstances. As Kaufman (1979: 247) points out, the argument should be accepted by its

“capacity to identify at least some common patterns of change: it was expected that the reciprocal interactions between ‘politics’ and ‘economics’ would vary within predictable limits and that this variation, in turn, would contribute systematically to an understanding of why bureaucratic authoritarian rule emerged when and where it did”.
5.8 The role of the technicians

Chapter four shows how political culture and the ideology of the political elite favoured the influence of the technicians in the policy making process. This influence was increased by the reforms undertaken in the 1930s, which augmented substantially the number of public organs and their role in the addressing of social conflicts. The constitution of 1946 re-established the democratic system but the role of the technicians was not significantly reduced. The executive retained substantial autonomy and created, in the following years, many forms to circumvent the influence of Congress. As section 5.3 shows, ‘pockets of efficiency’ were created and the technicians occupied important posts in key agencies of the policy-making process.

According to Bielchovsky (1988: 427), the period 1953–55 was marked by the technicians becoming conscious of "the importance of political struggle in the intellectual field". This led to an intensification in their attempts to influence the course of economic development. Sola (1982) shows in details the involvement of the technicians in this process; according to her, they were much more than technocrats. They organised in clubs, in order to debate ideas and to consolidate ideological and political positions, and edited journals, which promoted the exchange of ideas and dissemination of the respective positions. The other activities of the technicians included giving lectures in universities and military schools, contacting business organisations and taking direct action inside public bodies. And finally, they worked as advisors to political parties and economic groups.

Sola (1982) and Bielschowsky (1988) classified these technicians into three main categories. Their main issues of divergence were the degree of protectionism, the role of foreign capital, the degree and nature of state intervention in economy and the priority to

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183 According to Sola (1982: 127-129), the political position was a key element in determining the insertion of the technicians into a team or organ.
184 Sola shows how the technicians, although engaged in significant political mobilisation, did not join political parties. This is because they considered the clientelistic nature of the political parties incompatible with their activities, which were centred on the pursuit of technical rationality.
be given to the combat of inflation *vis-à-vis* economic growth. It is very important to summarise the main ideas of these groups, since they indicate alternative paths of economic policy available at that moment.

The first group, the neoliberals, emphasised the necessity of controlling inflation, reducing state intervention, ending prices control and giving a central role to private initiative, including foreign capital. This group was very critical of the model of development adopted since the 1930s, which had been marked by strong government intervention, very high rates of protectionism and a permissive treatment of inflation.

According to the neoliberals, the economic problems were caused by excessive state investment, which spent at levels far above society’s capacity of saving. The public deficit was seen as the main cause of inflation, which, in turn, was responsible for the main distortions present in the economy. According to this group, high inflation also bore a key responsibility for the imbalances in the foreign accounts, since it discouraged savings and foreign investment.

The neoliberals strongly criticised the thesis which viewed Brazil’s problems as a result of structural causes, related to the peripheral position of the country in the world economy. Instead they argued that the national problems were caused by the bad management of the economic policy, which was responsible for inflation and other distortions that negatively affected productivity. Neoliberals blamed low productivity for causing unemployment, rejecting the nationalist economists’ classification of joblessness as ‘structural unemployment’.

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185 Thus, they were very critical of the thesis which attempted to reconcile economic growth with high inflation.

186 Eugenio Gudin, Finance minister during the Café Fhio government (1954-55), was one of the main representatives of this group. In the occasion, he emphasised that the solution of the national problems required " a substantial reduction in investment and a stop in increase in consumption. However, in this time of demagoguery, who is brave enough to say that to the masses?" In Bielschowsky (1988: 426).
A second group of technicians, the ‘developmentalist cosmopolitans’\(^{187}\), shared some points with the neoliberals, such as the important role attributed to foreign capital and the necessity of keeping inflation under control. Nevertheless, in contrast to the neoliberals, they supported planning and believed that the state had a critical role in guiding the process of industrialisation. The cosmopolitans, although not a numerous group, were very influential, as a result of the quality of the members and of their high capacity for intellectual mobilisation. They occupied key posts in the CMBEU and were key participants in the creation of the BNDE.

The ‘Developmentalist Cosmopolitans’ identified three important forms of state intervention: the provision of incentives to private investment, including the attraction of foreign capital; playing an entrepreneurial role in high risk sectors and the undertaking of institutional reforms “aimed at mobilizing and channelling both the human and financial resources to priority targets” (Sola, 1982: 113). Roberto Campos, the main representative of the group, supported a process of sectoral planning concentrated on the identification of sectors which, requiring massive investment, irradiated linkages to other sectors of the economy. This was the core of the Target Program, which was adopted with substantial success during the Kubitschek government (Bielschowsky, 1988: 447, 448).

The cosmopolitans occupied an intermediary position between the neoliberals and the nationalist developmentalists. They rejected a strict orthodox position and emphasised the key role for the state in promoting development. Nevertheless, they were more sensitive to the distortions in the economy than the nationalists. Despite certain differences in relation to the priority of combating inflation and the role of foreign capital, the cosmopolitans had important points in common with that group. Both groups supported a central role for the state in centralising financial and administrative resources and in planning the process of development (Bielschowsky, 1988: 398). Given the importance assumed by planning in the 1950s, the divergences lost importance and

\(^{187}\) For simplification, I shall call this group cosmopolitans
the two groups worked together in the programs of development of Vargas and Kubitschek.

The third group of technicians, the 'nationalist developmentalists'\textsuperscript{188}, centred their argument on the structural problems inherent to peripheral countries which were, for a long time, primary export economies. The argument emerged more consistently in the 1930s, when a group of industrialists, led by Roberto Simonsen, demanded government support for a program of industrialisation centred on the domestic market. According to the industrialists, this support was fundamental to industrial development in a country marked by a colonial past and agrarian tradition. Likewise, high tariffs were requested to protect an infant industry from competition from more advanced countries.

The nationalist developmentalists' theses were strengthened in the following years, since they benefited from the increase in public bodies and from the interpenetration between bureaucrats and industrialists within these bodies. At the beginning of the 1950s, the group identified serious structural deficiencies in the national economy, which included low productivity, limited diversification, shortfalls in capital and technical resources and a lack of basic infrastructure services. They further identified the existence of structural problems in the balance of payments, a result of the slow increase in the international demand for primary products and of the deterioration in the terms of exchange against these products. As a result of these factors, which escaped from the national control, they argued that the increase in the domestic investment and the pursuit of high rates of economic growth tended to provoke problems in the balance of payments (Bielschowsky, 1988: 438-439).

According to the nationalists, the possibility of economic development thus required a process of industrialisation led by the state. Industrialisation, by permitting the substitution of imports and the export of goods with high income elasticity, was supported as the only way to reverse the structural difficulties in the balance of payments. Likewise, state intervention, through a process of planning, was supported as

\textsuperscript{188} For simplification, I shall also call this group nationalists or developmentalists.
necessary to the creation of external economies and to the generation of rationality in the absorption and allocation of resources (Bielschowsky, 1988: 386).

The developmentalists opposed the orthodox programs of stabilisation. As the difficulties in the foreign accounts were identified as structural, a result of variables over which the country had no control, the group believed that contractionist policies would not address the source of the difficulties. A similar argument was valid for inflation, which, according to them, was also affected by structural factors. Consequently, the developmentalists believed that contractionist policies would condemn the country to permanent stagnation, without attacking the real problems. In conclusion, the defeat of economic imbalances required a program of industrialisation promoted and co-ordinated by the state.

One important consequence of the developmentalist argument was the permissive treatment of inflation. Once the solution of the structural problems and bottlenecks demanded increase in public investment, a certain level of inflation and of deficits in the foreign accounts would necessarily have to be tolerated. In other words, an increase in investment and in production, despite producing inflation in the short term, was supported because of its capacity to defeat the real and long term problems of the economy.

The developmentalists showed a high degree of mobilisation and had substantial influence in the policy-making process. Many factors were responsible for their success. Firstly, they were supported by the industrialists, who created technical organs and sponsored studies to advance their respective positions. Secondly, a nationalist program of industrialisation was supported by the military, which was concerned to keep control of strategic industries in Brazilian hands. Thirdly, a thesis which valued the action of the state and a process of planning tended to receive support from a substantial parcel of the bureaucracy. And last but not least, a thesis which supported investment and was tolerant of inflation tended to receive enthusiastic acceptance by the politicians. Kubitschek for example, suffered strong opposition to his inauguration and was not
willing to renounce his plans of modernisation to support a program of stabilisation (Bojunga, 2001: 331).

In addition, the position of the developmentalists was strengthened by the publication of the theses of CEPAL (Economic Commission for Latin America), in 1949 and 1950. CEPAL, an organ created by the United Nations, which enjoyed considerable international prestige, produced sophisticated analyses which supported the developmentalists’ theses, thereby contributing to their legitimacy and acceptance. As Furtado (1997: 208) points out,

“as a result of the works of the Abbink Mission, the position of those who defended the need to ‘eliminate the distortions of an industrialisation of high costs was strengthened’. In that context, the ideas of CEPAL gave ideological support to the opponents of that doctrine: industrialisation was not simply an option, but the only alternative to pursue the process of development”.

The different positions espoused by the three groups of technicians illuminate important issues concerning the program of development. During the Vargas and the Kubitschek governments, the cosmopolitans and the nationalist developmentalists occupied key posts in the government and had substantial influence in the policy making process. The government’s main priority was to promote development and technicians were brought into the policy-making process in an effort to give rationality to the process. Combatting inflation was put in a second plane, despite the criticisms of the cosmopolitans such as Roberto Campos and Lucas Lopes, the architects of the program of economic stabilisation in 1958.

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189 Bielshovsky (1988: 452) argues that CEPAL techniques of global planning, although not applied, contributed to the increasing acceptance of planning in Brazil.
5.9. The industrialists and the model of development

An important element in shaping the economic policy during this period was the role played by industrial businessmen. Although the state increased its interventionary capacity and became more insulated in certain areas, the industrialists had important channels through which to introduce their demands and thereby exerted significant influence in economic policy.

Leopoldi (2000: 182) shows how, during the Dutra government, the business influence was much more considerable than is usually accepted. The Minister of Labour, Industry and Trade was a leader of FIESP (Federation of Industries of São Paulo) and the businesspeople were very active in attempting to impose their directions through campaigns and personal contacts. Accordingly, Congress was very frequently lobbied and pressurised.

One important objective of the industrialists during the Dutra government was to guarantee that the foreign exchange accumulated during the war would only be utilised according to defined criteria. In addition, they engaged in fierce mobilisation against the main conclusions of the Abbink Mission, which prescribed an orthodox program of stabilisation centred on credit control. The economists and advisers of the business associations disqualified the conclusions achieved by the Mission\(^\text{190}\) and, employing developmentalist theses, supported expansion in credit as necessary to increase national production and defeat the structural problems of the economy (Bielschowsky, 1988: 385). The industrialists’ position against programs of stabilisation was maintained in the following years\(^\text{191}\).

\(^{190}\) According to them, the Abbink Mission extracted its conclusions from the wrong hypothesis that the economy was in full employment.

\(^{191}\) During the Café Filho government (1954-55), the industrialists were strong opponents of the program of monetary stabilisation proposed by the Finance Minister, Eugenio Gudin. They pressured the governor of São Paulo and led President Café Filho to change the policy on credit. This interference provoked the resignation of Gudin and the appointment of a new Finance Minister, who accepted the demands of the industrialists and loosened control over the monetary policy (Leopoldi, 2000: 242).
Another position of the industrialists during the Dutra government was the opposition to currency devaluation. This is explained by the fact that the quantitative control of ‘non-essential’ imports protected national producers, while the overvalued exchange rate constituted a significant incentive to the imports of raw materials and equipment. Consequently, instead of devaluation, the business class supported ‘protection’ against devaluation of other currencies, participation of the class in international trade agreements and incentives to exports (Leopoldi, 2000: 186). Furthermore, a program of import substitution was supported as the best way to solve the structural problems in the balance of payments.

Business influence was strengthened during the Second Vargas government. The nationalist position of the President, who espoused an economic policy very favourable to national industry, put the industrialists in a very privileged position, from which they could influence the model of economic development. The creation of the Assessoria Econômica, staffed with several nationalist technicians who had previously worked in the business associations, also contributed to increasing the industrialists’ voice in the government.

Business influence was particularly important in policy on tariffs and foreign trade. The industrialists had many contacts and easy access to those government bodies responsible for the respective policies, Carteira de Exportação e Importação (CEXIM – Bureau of Exports and Imports) and the department of foreign exchange of the Bank of Brazil. The president of the Confederação Nacional da Indústria (CNI – National Confederation of Industry), Euvaldo Lodi, had weekly meetings with President Vargas and also had very frequent contacts with authorities of the Banco do Brasil, CEXIM and SUMOC (Leopoldi, 2000: 194). Finally, the industrialists gained access to Itamaraty, the organ responsible for foreign policy, and won a guaranteed right to participate in the consultative commission on trade agreements (Leopoldi, 2000: 139).

The following examples illustrate the influence of the industrialists during the

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192 CACEX (department of foreign trade of Bank of Brazil), created in 1953, was more insulated.
period. On the eve of the Korean War, they lobbied intensively within the government and participated in a definition of the imports necessary to protect the country against the risk of a long war. Accordingly, given the lack of installations and administrative resources, the works of the commission for revision of tariffs were realised inside the CNI (Leopoldi, 2000: 144; 191). In 1953, the industrialists criticised strongly the adoption of Instruction 70 of SUMOC\textsuperscript{193} without previous consultation with the representatives of the class. After that, the class had access to important issues of the foreign exchange policy, including changes in Instruction 70.

During the Café Filho government (1954-55), the industrialists strongly criticised Instruction 113 of SUMOC, adopted to stimulate foreign investment (see section 5.3). The industrialists accused the measure of giving substantial advantage to foreign enterprises in the import of capital goods and, consequently, of provoking the increase in foreign control over national economy. According to them, it gave the national producers only two options: to import under disadvantageous conditions or to associate with foreign capital (Leopoldi, 2000: 257).

An important consequence of Instruction 113 was that it reduced the influence of the business class over the foreign investment policy. During the second Vargas government, the industrialists were consulted with regard to the necessity or otherwise of foreign projects. In addition, they could make representations about the capacity of the national industry to produce similar goods and thus to block the concession of incentives to the foreign project. This was significantly changed by Instruction 113. After that, CACEX increased insulation and conceded incentives to foreign capital without listening to the business groups (Leopoldi, 2000: 247-248).

During the Kubitschek government, the industrialists maintained important channels to introduce their demands and had access to an area that was strategic to their interests, that of tariff policy. Although the foreign exchange policy became more insulated, the industrialists had a seat in the CPA. Furthermore, the communication

\textsuperscript{193} Instruction 70, as seen, modified the exchange rate regime.
between business groups and government was favoured by the creation of the Groups of Work and Executive groups, which, as seen, brought together representatives of the public and private sectors to elaborate and implement industrial policy in the respective sectors (see section 5.5).

In conclusion, this section shows how business influence was intense during the period. Although the state increased insulation in certain areas, the industrialists had important channels to introduce their demands and pressure for their interests. As Leopoldi (2000) shows, the industrial bourgeoisie, although not a hegemonic force, had influence and the government could not disregard their interests. Although the bureaucracy achieved autonomy in certain issues and was able to adopt unpopular measures such as Instruction 113 of SUMOC, it had to negotiate with the industrialists and offer concessions in other areas, such as in the tariff policy. In brief, as Leopoldi (2000) shows in detail, the industrialists’ influence is an important element to understand the economic policy in the period 1930–1964. Their interests played an important role in the definition of a pattern of economic policy marked by high tariffs, overvalued exchange rate and a permissive treatment of inflation (see section 5.10).
5.10 The pattern of economic policy

The objective of this section is to consider the pattern of economic policy adopted in Brazil in the period 1930-1960. As seen, a project of industrialisation, based on import substitution and marked by strong state intervention, was defined in the 1930s and solidified during the *Estado Novo* (1937-1945). The main characteristics of the pattern were confirmed and consolidated in the second Vargas government, when the state strengthened its role as direct investor in infrastructure and basic industry. As argued above, the capacity of the state to stimulate and co-ordinate the economy also increased.

Other important characteristics marked the pattern of economic policy, which was characterised by intense employment of tariff and non-tariff forms of protection. In the period 1939–1953, the exchange rate became overvalued and a system of imports licenses guaranteed the protection to national industry. After 1953, a multiple exchange rate regime was introduced as a mechanism to discriminate imports and stimulate the exports of certain products. In addition, all this period was characterised by a permissive treatment of inflation. Divided between the investments and projects necessary to develop the country and the short-term unbalances, the governments opted for postponing the policies of stabilisation. Inflation was only seriously combated after achieving such high levels that became an obstacle to the process of accumulation and an important source of instability.

This pattern was characterised by important distortions, properly emphasised by the neoliberal technicians (see section 5.8). Eugenio Gudin, for example, criticised strongly a system of previous licences which, according to him, forbade the import of any good which could compete with national industry. According to Gudin, the high degree of protection practically eliminated the risks of investment, benefiting specific interest groups at expense of the large majority of the consumers. (Diniz, 1978: 207). The

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194 According to Gudin, “the national interest is the increase in technical productivity stimulated by free competition. By contrast, the interest of the negociators (...) is the defense of acquired positions and the conservation of the status quo through the fixing of quantities and prices based on the production costs...
criticisms were also concentrated on the high rates of inflation, which discouraged saving and public investment and distorted the system of prices. And finally, Gudin emphasised how the model of development completely neglected agriculture, an activity in which the country had natural advantages and which had a key role to play in increasing exports and reducing balance of payments problems.

These distortions are widely emphasised by analyses centred on the difficulties of development in Latin America (see, for example, Balassa, 1982). They stress that high tariffs produced an inefficient industry, unable to conquer foreign markets. Similarly, the overvalued exchange rate inhibited exports, both in the primary sector and in new industries. Consequently, the capacity for industrial growth became limited to the expansion of the domestic market, while poor export performance tended to provoke constant problems in the balance of payments. Furthermore, high inflation, intense state intervention and complex regulation were blamed for producing distortions and hindering the efficient allocation of resources in the economy. These characteristics put Latin American countries in a vicious cycle, marked by inefficient industry, high inflation, poor export performance, balance of payments problems and constraints to economic growth.

These distortions of the model of development are contrasted with the virtues of the export-led industrialisation adopted by the East Asian Newly Industrialised Economies (NIEs). The analyses highlight how Korea and Taiwan, by adopting more realistic exchange rates and being less permissive with inflation, achieved a virtuous circle characterised by high productivity, export growth, expansion in the market, rapid economic growth and an increase in real wages. In these countries, the conquest of foreign markets increased the markets available for industrial development and the country’s capacity to import. Likewise, control of inflation and productivity growth produced an increase in real wages and reduction in social inequalities.

of the less capable” (In Diniz, 1978: 208).
In view of the distortions emphasised above, which negatively affected Brazil’s capacity for economic development, it is very important to understand how this pattern of economic policy came to be adopted. These factors are also important to understand why, in the face of the evidence of economic difficulties, corrective policies were not immediately adopted.

**Latin America regularities**

Before emphasising certain specifics of the Brazilian process, I believe that it is important to explore some characteristics that were common to many experiences of development in Latin America. I believe that these regularities indicate the influence of geopolitical factors, reflected in US foreign policy, and also the consequences that the form of international insertion had in the economies of the countries analysed (Cardoso and Faletto, 1970).

In the immediate post war period, the Latin American countries demonstrated high support for the emergence of a liberal economic order, marked by low tariffs and free trade. The International Conference of Rye, in November 1944, supported a reduction in tariffs, the elimination of quotas and an end to discriminatory practices (Diniz, 1978: 214). Similarly, in 1945, the Inter American Conference prescribed a reduction in tariffs and the adoption of policies favourable to attract foreign capital, while nationalist practices and the creation of public enterprises were condemned (Thorp, 1992: 190).

Nevertheless, few years later, liberalism was abandoned and protectionism was again on the agenda. The common reaction indicated the frustration with the United States foreign policy, marked by the lack of any program of economic support to the region. Accordingly, protectionist measures were motivated by the difficulties in the

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195 According to Thorp (1992: 191), Latin America was the only area which did not receive a program of international assistance. Thorpe shows that the continent received, from 1945 to 1951, an amount less than that received by Belgium and Luxembourg.
balance of payments, not addressed by the new world order institutions created at Bretton Woods.

Another interesting similarity was the decision of many Latin American countries not to devalue their respective currencies after the Second World War. A fixed exchange rate was maintained for a long period, despite the high inflation which marked most of the countries. Several factors help to explain this decision. Firstly, the inelasticity in international demand for primary products eliminated the advantages of devaluation to the exporters. Secondly, the governments were afraid that devaluation would have an explosive impact on inflation. Thirdly, in several countries, the combination of overvalued exchange rate and a system of import licences provided important gains to the industrialists. Fourthly, the system of import licenses, by inhibiting competition, provided large opportunities of profits to import traders (Thorp, 1992: 190-194).

In brief, overvalued exchange rates were adopted in a context marked by high domestic inflation, inelasticity of international demand for these products and the absence of a program of aid to the region. Consequently, foreign investment became a very attractive alternative, constituting another common characteristic of industrialisation in these countries. Foreign direct investment permitted not only the balance of payments relief, but also allowed the ruling groups to deepen the process of economic development without undertaking a politically costly process of adjustment (Thorp, 1992: 195). Thus, the advantages offered by foreign investment explain why, despite the nationalist ideology present in many countries, it was very welcome on the continent. As Thorp points (1992: 194-195) out, “the majority of Latin American countries were not in a position to resist the pressures of the international system, not to mention the obvious short-term advantages”.

As a result, the difficulties of the national economies and their dependence on foreign capital gave foreign enterprises substantial bargaining power; this is an important factor in explaining the apparent incapacity of the local governments to regulate and monitor the entrance of foreign investment. One interesting exception, as
Thorp (1992: 194-195) emphasises, was Colombia, where the power of coffee planters impeded the adoption of over-valuated exchange rates. This alleviated balance of payments pressures and increased the government’s bargaining power in negotiations with foreign capital.\textsuperscript{196}

The model of development adopted in Latin America was also very influenced by ideological factors. Sikkink emphasises how the effects of the crisis of the 1930s, which severely hit those economies that were very dependent on the international market, influenced the political elites towards models of development centred on the domestic market. According to her, this pessimism in relation to foreign markets is important to explain the option for import substitution, although export promotion strategies would have received much more financial support from international agencies (Sikkink, 1991: 51). After the Second World War, the ideas of CEPAL, which attempted to theorise about the specifics of development in Latin America, gave legitimacy to programs of development centred on import substitution and marked by high tariffs and elevated state intervention (see section 5.8).

This influence of ideology is apparent when one observes the differences in the pattern of economic policy adopted in Korea and Taiwan. In the first decades after the Second World War, these countries developed many characteristics typical of import substitution industrialisation.\textsuperscript{197} Haggard (1990) shows how the process was marked by clientelism, multiple exchange rate regimes, high regulation and lobbying from the import substitution industries aiming at reducing the entrance of competitors.\textsuperscript{198} Accordingly, the respective governments demonstrated resistance to currency

\textsuperscript{196} In brief, this autonomy of foreign capital, a result of the timing and conditions of entrance, was another interesting characteristic shared by the Latin American countries. This was an important divergence between the Latin American and the East Asian new industrialised countries. In Korea and Taiwan, foreign capital came later, had much less importance and was subjected to strict regulation, which favoured the transfer and absorption of technology by local enterprises.

\textsuperscript{197} The analysis of the Korean experience is undertaken in details in the chapter eight.

\textsuperscript{198} In Taiwan, in 1957, industrial associations appealed to the Ministry of Economic Affairs demanding restrictions on competition and the prohibition of installing of new plants, measures considered necessary to solve the excess of capacity which marked the industry (Haggard, 1990: 90 ).
devaluation, a simplification of the exchange rate regime and the curbing of inflation. As a consequence, the process was marked by the emergence of several distortions characteristic of import substitution industrialisation, such as high inflation, inefficiency and disincentives to exports. Similarly with Latin America, these experiences illustrate the existence of forces and impulses favourable to the perpetuation of import substitution measures (Haggard, 1990: 57-59; 85-90).

As Haggard (1990: 68-71; 91-93) shows, a turning point was the capacity of the American advisers to impose changes in the strategy of development. Korea and Taiwan were very dependent on United States’ aid resources, which substantially increased the capacity of the American advisers to impose programs of stabilisation, currency devaluation and a simplification of the exchange rate regime. Thus, this influence of American authorities was critical to the shaping of economic policy and to the adoption of measures which favoured an increase in exports.

As argued above, the situation was very different in Latin America, where orthodox economic ideas were viewed with distrust and considered unsuitable to the reality of the continent. CEPAL developed an alternative theoretical interpretation that won support among politicians and technicians. Consequently, although CEPAL condemned many distortions practised in these countries, its ideas legitimised a model of industrialisation centred on high tariffs and permissive treatment of inflation. As a consequence, they increased the capacity of politicians to adopt directions that aggravated the distortions.

In Korea, for example, Haggard (1990: 68) shows how President Park’s attempts to adopt a policy of high prices in agriculture, aiming at obtaining the support of rural groups, were blocked by the Americans, who forced “the government to bring spending and income into line”. Furthermore, devaluation and the adoption of a floating unitary exchange rate regime were critical to increase Korea’s capacity to export (Haggard, 1990: 101). Similarly, in Taiwan, an agreement with the IMF led the government to devalue the currency, to replace quantitative restriction for tariffs and to abandon the bias against export (Haggard, 1990: 91).

CEPAL ideas were seen as progressive and nationalist, while orthodox neoclassical ideas were associated with foreign influence in national affairs. This is an important point to emphasise. The distortions in Latin America were much further than forecast and accepted by the models developed by CEPAL. The leaders of the organ condemned disincentives to exports and very high inflation. Nevertheless, it is not my intention to evaluate the suitability of CEPAL ideas, but to emphasise its influence in policy making. And there is no doubt that its ideas strengthened the developmentalist theses and favoured a model of industrialisation which produced...
Finally, it is also important to emphasise another important difference between Latin American and East Asian new industrialised countries (NIEs). In countries such as Brazil and Mexico, political elites were much more constrained by social forces than their counterparts in Korea and Taiwan. In these last countries, the agrarian groups and labour movement were much weaker than in Latin America, a result, respectively, of agrarian reform and strong repression (see chapter two). Accordingly, the groups whose interests were connected to import substitution were also much weaker than in Brazil and Mexico, where import substitution was very intense during the 1930s and during the war period. Consequently, while the American pressure was fundamental to explaining the disposition of the government to produce changes in economic policy, the weakness of social groups increased their capacity to do so. Similar changes would have faced very intense opposition in Latin America.

**The technicians and the role of ideology in Brazil**

Sikkink (1991) and Leff (1977) show how ideology and political culture are critical variables in understanding the specific model of development adopted in Brazil. According to the two authors, the formation of a group of technicians, insulated from social groups and involved with the causes of state, played a critical role in determining the pattern of economic policy.

According to Sikking, political culture in Brazil was very favourable to state intervention and facilitated the acceptance of developmentalism by the different social groups. The author also emphasises the role of technicians in explaining the high support for developmentalism in Brazil. According to Sikkink, the creation of public bodies of economic studies, in the 1930s and 1940s, produced technicians who, concerned with the best alternatives of economic development, contributed to increasing the distortions emphasised above.

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202 Sikkink shows how the situation was very different in Argentina, where state intervention was viewed with distrust (see chapter eight).
the support for programs of industrialisation promoted by the state and aimed at reducing foreign dependency.203

Similarly, Leff (1977) gives considerable importance to the autonomy of technicians204 and to the role of ideology in the economic policy making process (see section 4.7). Leff (1977: 135) emphasises how the existence of technicians with similar views, staffing important organs in subsequent governments, explains why the lines of economic policy, despite the change of governments and regimes, “have been relatively constant since the end of the 1940s”.

According to Leff, this strong influence of technicians explains also the distortions which marked the process of industrialisation. According to him, the policy-makers shared points of view that were considered so self-evident that they were incorporated as axioms, without an accurate analysis of the alternative lines of economic policy. As Leff (1977: 127) points out, “because of ideology, there were no debates about issues such as industrial development versus development of agriculture; light industry versus heavy industry; or import substitution versus the promotion of exports”.

The political elite defended a priori an import substitution model based on heavy industry.205 As these ‘self-evident truisms’ do not necessarily coincide with reality, this process was vulnerable to the adoption of inconsistent policies. According to Leff, this is very well illustrated by the adoption of an export policy which, as it was considered secondary by the economic policymakers, was inadequately conceived and contributed

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203 Sikkink (1991: 186) shows how the process was very different in Argentina, not producing a group of stable technicians concerned to the challenges of economic development. Consequently, while the private groups were resistant to state intervention, Argentina also failed to produce a group of permanent technicians concerned to the causes of the state and which could have supported developmentalism.

204 As shown in section 4.7, Leff, by carrying out interviews with people who occupied important posts in public administration, concludes that the technicians had substantial autonomy in the definition of the main lines of economic policy.

205 According to Leff (1977:124), the policy-makers, having to choose between economic growth of 7% centred on textile industry or 3% centred on steel industry would have opted for the latter.
significantly to the imbalances which marked the strategy of industrialisation\textsuperscript{206} (Leff, 1977: 126-127).

Leff (1977: 143) also emphasises the implications of an ideology that was very permissive in relation to inflation. According to him, the trade-off embraced by the policy makers was not between inflation versus stability, but between inflation and development versus stabilisation and stagnation. This was, as seen, a result of the substantial influence of the developmentalists’ theses. Kubitschek, for example, believed that to address the national problems with stabilisation was to use the wrong medicine (Sikkink, 1991: 123). Instead, he believed that expansion in expenditure via printing of money, if used to produce investment, would not provoke inflation. Vargas espoused similar conceptions (Fonseca, 1989: 383). Consequently, as seen in section 5.8, a certain amount of inflation was seen as inevitable, as a small cost to be paid in order to pursue economic development.

According to Leff, those distortions produced by ideology were possible because Brazil was always able to obtain the resources necessary to finance the program of industrialisation from abroad. The country was able to resist the prescriptions of IMF and to obtain alternative sources of credit\textsuperscript{207}. Latin America, in contrast to East Asia, did not have the same geopolitical strategic importance that East Asia had for the United States. This helps to explain its autonomy to adopt ‘alternative’ lines of development.

**Further considerations**

The factors emphasised above, such as ideology and the constraints of the international system, are very important to an understanding of the lines of economic policy adopted in Brazil. In order to complete an account of the determinants of the process, it is also necessary to take into consideration the role of industrialists,

\textsuperscript{206} According to Leff, this failure to conceive a coherent export policy of exports is explained by the belief that a program of import substitution could solve the main difficulties of the balance of payments.

\textsuperscript{207} As seen, foreign private investment was critical to this process.
emphasised in sections 4.7 and 5.9. As I insisted in those sections, following the conclusions of Diniz (1978) and Leopoldi (2000), the industrialists had many channels to introduce their demands. Respective governments depended on their support and they had power and mechanisms to destabilise administrations and to press for modifications in the economic policy. Although they were not hegemonic, they were a key force in the political system and their interests had to be taken into consideration. In this sense, as Leopoldi (2000: 132) concludes, the adoption of a developmentalist program of industrialisation “should also be seen as the result of a process of negotiation between the industry and the government”.

Finally, it is important to emphasise the challenges and difficulties which marked the first decades of industrialisation. In the 1930s, in face of the serious crisis that shook the structures of the agrarian export economy, the state was called to play many functions in the restructuring of the economic system. In the following years, the state deepened its intervention in the economy, addressing issues considered critical to national development. In those years, the international context remained highly complicated, a reflection of the effects of war and of the immediate period of reconstruction. These characteristics of the world order eliminated the possibility of a smooth integration of Brazil into the international market and of a program of international aid necessary to finance a balanced process of development. In that context, liberal tendencies, as they emerged at the end of the Second World War, did not last more than a couple of years.

I believe that the respective challenges, which included the urgent necessity of public investments in infrastructure, were very important in determining the choices of the Brazilian presidents and the characteristics of economic policy in the postwar period. That context, as the failure of the Dutra government illustrates, demanded a strong state and a consistent program of industrial development (see section 5.2). Meanwhile, the industrialists, workers and conservative groups pressured the government and the Congress vetoed necessary reforms and policies. Furthermore, the governments faced the risk of military coup, in a democratic system which did not have deep roots.
In such a context, it is not difficult to understand the option for accelerating the process of economic development. The respective presidents, who believed in the critical role of state in the modernisation of the country, prioritised increasing public investments and incentives to private capital. Kubitschek, for example, had been a very entrepreneurial governor and had ambitious plans, as well as the initiative and ability to promote a substantial leap in economic development. After the political difficulties and the attempted coup which marked his inauguration, he was not willing to give up his target program in order to promote a program of stabilisation.

In conclusion, these challenges of the process of industrialisation, although not reducing the importance of the other factors emphasised above, add to the understanding of the characteristics of the model of industrialisation. In the face of the challenges and of the political pressures, a very strong external influence was necessary to force the policy makers to change the directions. As seen, the international community did not do this, at the same time that the developmentalist ideology gave legitimacy to practices which gave stabilisation and adjustment secondary importance.
5.11. Conclusion

This chapter shows how, after the temporary impasse of the Dutra government, the involvement of the state in the process of economic development was intensified by Vargas and Kubitschek. These governments undertook important reforms, which increased state capacity to promote and co-ordinate economic development. The creation of 'pockets of efficiency', bureaucratic agencies insulated from the traditional political forces, increased administrative capacity and the coherence of state intervention. In addition, qualified technicians were allocated to important posts in the bureaucracy.

Accordingly, the output of studies and elaboration of recommendations increased the capacity of governments to design policies of intervention. The creation of BNDE, by permitting the financing of long term projects, was very important in increasing the state’s capacity to shape and influence the allocation of investments. Other instruments, such as the multiple exchange rate regime, the policy of foreign capital and the tariff policy, were also key components of the program of industrialisation.

The period was also marked by the creation of councils and improvement in the process of consultation between public and private sectors. The success of the executive groups, under Kubitschek, illustrates the important results achieved through public-private consultation and co-ordination among the organs of economic policy. In this sense, the Kubitschek government was marked by a substantial improvement in the coherence of the industrial policy, which played key role in the success of the program of industrialisation. As seen, it is difficult to underestimate the achievements of the Target Plan, which transformed Brazil into an industrialised country.

The period was, nevertheless, also marked by serious obstacles. The traditional forces present in the Congress reduced the efficiency of state action and impeded the adoption of measures necessary to correct the imbalances of the process of industrialisation. Similarly, the tensions between the conservative political forces and the emergent industrial working class provoked instability and put democracy at risk. In
the 1960s, political instability became very serious and prepared the conditions for the military coup of 1964.

Another important achievement of this chapter was to investigate the characteristics and determinants of the pattern of economic policy-making that emerged in that period. The role of the technicians, the political action of the industrialists and the influence of the developmentalist ideology were important determinants of this pattern. Despite important advances in the process of industrialisation, the pattern was marked by serious distortions, which negatively affected the capacity of development.

The next step is to see how the military addressed the political obstacles and continued the program of industrialisation. Although important obstacles of the previous democratic regime were eliminated, the military faced a range of political obstacles which limited the achievements of the program of industrialisation. Similarly, although the government adopted a deliberate policy of stimulating exports, important characteristics of the anterior pattern of economic policy were retained. The next two chapters investigate the direction given to economic development and the obstacles faced by the developmentalist state to achieve the intended objectives.
CHAPTER 6. THE MILITARY IN POWER: INTERVENTION, CHALLENGES AND THE ECONOMIC DIRECTION AFTER 1964

6.1. Introduction

The last chapter showed how Vargas and Kubitschek promoted a range of measures aiming at increasing the rationality of the action of the executive. However, the traditional political forces and clientelist practices set limitations on the outcome of that effort. As a result, necessary reforms were not undertaken and the process of industrialisation was marked by the accumulation of many imbalances. Meanwhile, high inflation, economic difficulties, intensification of strikes and aggravation of political tensions marked the context of instability which resulted in the military seizure of power in 1964.

The seizure of power by the military led to the dismantling of the institutions of the previous political system. Congress was emasculated, the influence of traditional forces was reduced and the labour movement was strongly repressed. A range of policies and reforms were adopted in the attempt to correct imbalances and increase the financial and instrumental capacity of the state (see section 6.5).

In the face of the transformations undertaken by the military, the objective of this chapter is to investigate how the new regime gave continuity to the process of economic development. Since important obstacles of the previous regime had been eliminated, it is very relevant to examine the direction given to the program of development and also the capacity of the state to play a new role in this process. In other words, the objective is to see how the military tried to shape the process of industrialisation and which were the obstacles and difficulties that impeded the achievement of better results.

Such an investigation requires the study of the characteristics of the military and its suitability to govern the country. Accordingly, it requires a historical description of the involvement of military in politics in Brazil. These factors are very important to gaining
an understanding of their disposition to eject Goulart from power, the direction given to economic policy and also several obstacles faced by the military regime.

As emphasised in chapter three, the military, which had a strong positivist formation and brought together members of the middle and lower classes, emerged in the nineteenth century as a natural source of opposition against the exclusionary regime controlled by the oligarchies. During the first republic (1889-1930), the military was a key source of opposition and a key component of the movement which defeated the rural oligarchies. Given this history of contestation, opposition and reformism, it is a very stimulating task to understand how the military, once in power, conducted the process of economic transformation. It is important, for example, to understand why the armed forces, composed of different social segments and embracing a reformist ideology, did not adopt a radical reformist social program aiming at transferring resources to the mass of the people and reducing economic inequalities. The response to this question requires a historical investigation of the main values embraced by the military. Furthermore, the analysis of the military in power permits the elucidation of important issues related to the exercise of government and to the relationships between state and society. And last but not least, it illuminates critical aspects related to the state’s capacity to transform the economy.
6.2. The military doctrine and the involvement in politics

Many factors contributed to the end of the democratic regime in 1964. In the last chapter, I highlighted the difficulties inherent in the social coalition which had supported Vargas and Kubitschek. Industrialisation aggravated the tensions between conservative groups and the emerging labour movement, reducing the degrees of freedom of economic policy. In the first years of the 1960s, the difficulties attained a critical level: increase in inflation, reduction in economic growth, exacerbation of the labour protests and other demonstrations were all symptoms of the ungovernability which brought about the military coup. Accordingly, the fear that Goulart would capture the votes of the peasants, thereby increasing his basis of support and prolonging the duration of his government, led the conservative groups, including industrialists, landowners and sections of the middle classes, to mobilise against the government.

Therefore, there is no doubt that the economic crisis and the social instability were important ingredients in the ‘revolution’ of 1964. The behaviour of Goulart, including acts which outraged the conservative groups and contributed to bringing together opponents to his government, also played an important role in the emergence of the movement. Despite the relevance of all these factors, understanding the movement which ejected Goulart from power requires the study of certain characteristics of the Brazilian military. Although the support of civil groups was very important, the change of regime only occurred because the military mobilised and united against Goulart. Therefore, it is important to understand why and how the military acted in that specific situation.

As seen in chapter 3, the military’s conflict with the political elite had its roots in the nineteenth century. In the first decades of the twentieth century, the military was continually dissatisfied with governments that remained in power through fraud, governed in the interests of the oligarchies and did not give ‘fair attention’ to the needs of the armed forces. In the 1920s, a group of young officers, influenced by their experience in the German army, revolted and requested more professionalism and better
qualification for the army. The movement criticised the ‘apoliticism’ of the military armed forces which, although a good principle in theory, was used by politicians to co-opt the military leaders and keep the military forces under their control (Coelho, 1976: 80-81).

The revolts of the lieutenants, in 1922 and 1924, had the same motivation. In 1922, the revolt was triggered by a letter, attributed to Arthur Bernardes, the presidential candidate supported by the oligarchies, which showed disdain for the military. Although the letter was a forgery, the movement reflected the resentments of the military with the treatment received from the oligarchies.

In 1924, a second movement was triggered by the juridical decisions which punished the insurgents of 1922. According to the lieutenants, the decision was a result of the manipulation of the judiciary by the oligarchies, a common practice of the period. Therefore, the lieutenants expressed their protest against the characteristics of the political system which, according to them, encouraged corruption and impeded the modernisation of the army. As a prescription, they supported the control over the autonomy of the executive, elimination of electoral fraud in order to produce a more reliable legislature and the guarantee of an independent judiciary (Coelho, 1976: 86-87).

Military criticism in the nineteenth century, in the 1920s and later was characterised by distrust of the political elite, which was considered corrupt and accused of disregarding the national interest. This suspicion, as well as its implications to the armed forces, is very well emphasised by Juarez Távora, a participant of the lieutenants’ movement (tenentism) who occupied important posts in the government after 1930. According to Távora, although it was not a function of the military to judge the fitness of the government actions, since there was a political tribunal responsible for this task, the nature of the political system in Brazil made these tribunals suspect and thus the military was under no obligation to accept their decisions. Therefore, it is implicit in Tavora’s argument that there was an important distinction between the military duty before the nation and the obligation to obey the incumbent government: “the armed forces do not
swear unconditional fidelity to the agents of power. They swear obedience to the Constitution. Their role in the internal mechanism of the Republic is the guarantee of the law”208 (In Coelho, 1976: 89). According to Finer (1962: 26), this distinction, which allows the military to elaborate their own interpretation of the Constitution and of the national interest, is decisive in explaining their disposition to intervene in politics.

The 1930s were years of change and re-definition for the military. After the rebellions of the 1920s and the participation in the ‘revolution’ of 1930, the military faced the crucial task of redefining its identity and role in society. Tenentism and the ‘revolution’ of 1930 played an important role in this, since they removed the senior officers and paved the way for the ascendance of a new generation of officers, committed to rationalisation and modernisation of the military armed forces.

A member of this generation, General Góes Monteiro, played a crucial role in the delineation of a new identity for the armed forces. Monteiro emphasised the sad history of the military armed forces in Brazil, marked by ‘factionalism’ and by permanent co-optation to defend the causes of political leaders. According to Góes Monteiro, the reversal of this situation required a substantial re-organisation of the military. In his words, it was necessary to end ‘politics in the army’, a reference to its co-optation by the political interests, and to start to promote the ‘policy of the army’. This direction required not only modernisation, training and qualification of the institution, but also the adoption of measures in the adjacent areas, including economic, industrial and educational policies. As Góes Monteiro points out,

“the Army’s policy is preparation for war and this preparation involves all the manifestations and activities of national life, both in the material field – including the economy, production and resources of different kinds – and in the moral field, especially in what concerns the education of the people and the formation of a mentality which emphasises, above all, the interests of the motherland”209 (In Coelho, 1976: 103).

208 In Juarez Távora, À Guisa do Depoimento sobre a revolução brasileira de 1924. São Paulo: o Combate, 1927: 98.
Thus, besides the above mentioned distinction between loyalty to the national interest and obedience to the incumbent government, the emphasis on the interdependence between the military objectives and the material and moral fields was fundamental to prepare the military to play a more substantial role in politics. As Finer (1962: 47) emphasises, the military is “very jealous of its corporate status” and demands autonomy in every issue which concerns the armed forces, such as the internal policy of training, recruitment, equipment, etc. Nevertheless, military practice is not insulated from society and its objectives depend on areas which transcend the limits of the military. This explains the concern with the general direction adopted by the governments.

Participation in the civil war against the state of Sao Paulo, in 1932, demonstrated the vital importance of industrial production to warfare. Similarly, the foreign fragility of the country, very exposed in that decade\textsuperscript{210}, revealed to the military officials the need for an economic policy adequate to the objectives of national security. In this sense, as seen in chapter four, the military's strong participation in the \textit{Estado Novo} (1937-1945), acting as 'guarantor' of Vargas government, increased support for a strategy which expanded state involvement in the promotion of industrialisation\textsuperscript{211}.

At the end of the 1930s, the military had a very solid vision about its place in social life. As Coelho (1976: 104) suggests, the doctrine developed by Goes Monteiro, although very simple, provided a very direct, coherent and persuasive view of the role of the military in social activities. From that time onwards, the military demonstrated careful attention to politics and a disposition to influence the programs of government and economic policy.

\textsuperscript{210} According to Coelho (1976: 107), oil reserves were sufficient for just one week, making clear the total incapacity to a serious war mobilisation.
\textsuperscript{211} According to Coelho (1976: 111), the \textit{Estado Novo} was marked by large military influence and was \textit{in essentia} a military dictatorship. He also shows how the period constitutes a valuable process of apprenticeship for the military.
Another important element in the definition of the military doctrine was the struggle against communism. In the 1930s, the officials realised that communism had become a real threat, a result of both the wide dissemination of the doctrine and of the lack of unity inside the military. Luís Carlos Prestes, one of the eminent leaders of the tenantist movement, had become an active supporter and disseminator of communism, constituting a negative influence for the members of the armed forces. In addition, in 1935, a group of rebels took control of two military bases in Rio de Janeiro, declaring the uprising of a popular and revolutionary government. Although quickly controlled, the attempted rebellion inside the institution demonstrated that the communist threat was real (Coelho, 1976: 109-110).

The mobilisation against communism played a very important role in bringing cohesion to the military. In this sense, communism was at the same time a threat and a powerful element in the production of solidarity. As Coelho (1976: 111) points out, the military leadership perceived its capacity to produce unity and the “semantic of anti-communism in the military area acquired progressively characteristics of ‘dramatisation’, constituting a strategy of communication very effective to unite the components of the organisation around the same principle”.

The influence of ESG

After the Second World War, the core of the principles emphasised by Góes Monteiro in the 1930s were maintained and deepened through the creation of the Escola Superior de Guerra (ESG - Superior School of War). ESG was instituted to solidify and disseminate those values considered crucial to national security and development. The military was very critical of the political elite and political institutions and attributed to ESG the key role of forming an elite prepared to govern the country satisfactorily.

To this end, the ESG syllabus strongly emphasised the economic, political and social history of Brazil and covered a broad range of subjects, including the causes of inflation, agrarian and bank reforms, electoral systems, transportation, education and, of
course, warfare (Stepan, 1971: 180). In addition, the ESG courses, which were open to both civil and military candidates, had the important role of disseminating the armed forces’ views to other sections of civil society. The inclusion of bureaucrats and of representatives of industrial and commercial activities permitted the building of networks which were very important to the conspiracy against Goulart and to the organisation of the military government after 1964.

Besides the similarity with the military thought which emerged in the 1930s, the principles espoused by ESG were strongly influenced by Brazilian participation in the Second World War. The experience of the Força Expedicionária Brasileira (FEB - Brazilian Expeditionary Force), which joined the allied forces to fight the Germans in Italy, had a key impact on the ideas espoused by an influential segment of the Brazilian military. This contact with Americans had a very positive influence in the way in which these Brazilian officials viewed both capitalism and democracy. The achievements of the American society, reflected in the power and organisation of its army, demonstrated to the Brazilian military the potential of capitalism to produce a powerful nation. Likewise, participation in the campaign persuaded the military of the advantages of democracy and of the risks of ‘emotional demagogic nationalism’ and of irresponsible forms of authoritarianism (Stepan, 1971: 239).

These principles were institutionalised in the ‘Doctrine of National Security’, which attributed to private capital, including foreign capital, an essential role in the strategies of economic development and national security. It is difficult to underestimate the magnitude of this innovation, considering that the military in Latin America had tended to view the interests of private capital with distrust and to oppose the penetration of foreign capital into strategic sectors. The point is very well illustrated by ESG position concerning the monopoly on prospecting for oil. Although it considered that prospecting for oil must be a state activity, ESG did not endorse a national monopoly of production and thus accepted participation of private and foreign capital (Stepan, 1971: 246). This position represented a substantial rupture with traditional military view, which had strongly opposed the participation of foreign capital in areas of national security.
Brazil’s participation in the Second World War also had consequences for the way that the military viewed the international role of Brazil and, consequently, for the doctrine of national security. In the face of the Cold War, ESG considered that Brazil had to engage in the support of the values of the western world, including freedom, civilisation and democracy\footnote{In this sense, it is very curious to notice that the Doctrine of National Security (DSN), the ideological basis for the emergence of an authoritarian regime which lasted 20 years, considered democracy an important target to be achieved.}, against the communist threat. Furthermore, as Oliveira (1976: 27) points out, the Second World War was also a landmark in the re-definition of the principle of national security. While before the war national security was usually related to the exploration of strategic resources, such as oil and coal, and to the production of basic products, such as steel, “‘from the Second World War it came to be essentially a political concept, related to the participation of Brazil in the Western world and to the continuity of the capitalist society’”.

Thus, according to the ESG doctrine, the Cold War put the security policy in a prominent position, since the war against communism implied impeding the penetration of communism in civil society. In addition, ESG maintained the emphasis on the 'security imperatives' of the process of economic development and reinforced the necessity of a strong involvement of the state through the realisation of investments in infrastructure and the promotion of heavy industry. According to the ‘Doctrine of National Security’, no plan of development could be designed without taking into consideration the imperatives of national security (Oliveira, 1976: 29).

A crucial consequence of the ‘Doctrine of National Security’ was to increase the identification of the objectives of the military with those of big business. While the labour movement was viewed with great distrust, since it was a potential focus for the penetration of communist ideas, ESG emphasised the importance of free enterprise and of entrepreneurship to national development. This ideological position is very important to understanding economic policy after 1964, a result not of military commitment to
defend the interests of big business, but of a certain congruence between the military project and the interests of capital.

However, if ESG was innovative on many counts, presenting a defence of democracy and free enterprise, it is necessary to emphasise that it retained many aspects of the traditional authoritarian thought which had emerged in the 1920s and 1930s (see chapter three). Like the arguments in favour of the ‘revolution’ of 1930, the doctrine of national security highlighted the incapacity of the national political elite, the inability of the Brazilian people to form stable associations and the idea of a strong and impartial state which, above the interests of parties and factions, must be the arbiter of the disputes and act as the representative of the national interests. Likewise, ESG kept the emphases on technical - rather than political - solutions and believed that a rigorous study of the Brazilian issues could provide solutions for the main national problems.

This position shared by the military doctrine and the authoritarian thought, explained by the same roots found in positivism, also had interesting implications for the design of the economic programs. Important principles which motivated the reconstruction undertaken by Vargas, in the 1930s, were also present in the ESG doctrine. This includes support for a high level of state intervention to promote economic development and the priority given to the development of heavy industry.

In conclusion, this section shows how the military defined a new and more active role in the 1930s, which included the possibility and legitimacy to interfere in the political process in order to promote the national interest. This position was consolidated in the post war period, when ESG offered a cohesive treatment of topics such as economic development, political institutions, foreign policy and national security. It is important to emphasise the role played by ESG in the movement which ejected Goulart from power. Although only a section of the military attended classes in the ESG, this group had a key role inside the army and was very involved in the plot of 1964. According to Stepan (1971: 184), 60% of the military who attended ESG were active plotters compared to only 15% of those who did not attend it.
addition, ESG produced important links with the private sector, disseminating a view favourable to military intervention. In brief, ESG contributed to the definition of a cohesive program of development embraced by important sections of the armed forces and supported also by members of the bureaucracy and of the bourgeoisie. The institutionalisation of this project was the objective of the military group which took power after 1964 (Coelho, 1976: 164).
6.3. Internal conflicts, legitimacy and challenges faced by the military in power

As seen, ESG ideas had a significant influence in the coup which ejected Goulart and also played an important role in the re-organisation of the state and of the economy after 1964. The seizure of power by the military was marked by the tackling of several factors which provoked instability during the democratic regime: the labour movement was repressed, Congress was emasculated and measures were adopted to control inflation and recreate the conditions of capital accumulation. In addition, reforms were undertaken to modernise the state and increase its capacity to conduct the process of development (see section 6.5).

In other words, while the doctrines of ESG indicated a pragmatic orientation in the process of development, rejecting extreme forms of nationalism, the reforms prepared the state to promote a more balanced process of development. Nevertheless, the team of President Castelo Branco (1964-1967), although defeating many of the previous obstacles, faced new difficulties, several of them related to the characteristics of the armed forces. As explored below, the military is not as coherent and united as its doctrines suppose and the lack of mechanisms to manage the conflicts put important obstacles in the way of a cohesive strategy of development.

The objective of the present section is thus to emphasise the difficulties that the military face in politics, highlighting the emergence of conflicts, the difficulties in solving them and also the obstacles to the legitimisation of the regime. Then, section 6.4 illustrates how these difficulties emerged in the first military government after the ‘revolution’, having important consequences for the direction of economic policy. In this sense, the study of the military and of its difficulties to manage different social views and interests offers a privileged focus from which to study the state and its capacity to adopt certain programs of development.

The point of departure is to investigate how the organisational characteristics of the military fit with the task of governing the nation. Stepan (1971: 214) puts the point
precisely, questioning whether “for organisational reasons a military government is less subject to some of the weaknesses most characteristic of civilian governments”. In order to answer this question, it is important to examine the capacity of the military to manage the social conflicts which tend to emerge in the task of governing the nation. At a first glance, the cohesion and discipline attributed to the military corporation, its emphases on obedience, denial of conflict and the search for technical solutions, seem to constitute a significant advantage. However, as Stepan shows, the substantial challenges inherent to the functions of government require certain attributes which were not satisfactorily fulfilled by the military. The state is not a mere bureaucratic agency, but is also economic regulator and direct producer, the decisions of which involve complex political considerations (Cardoso, 1975: 218) Therefore, an ideology which denies the existence of conflicts is not suitable to administrate the conflicts and disagreements which tend to emerge (Stepan, 1971: 262).

A substantial difficulty for military governments then is how to manage the conflicts which are permanent components of political decisions. Initially, it is important to emphasise that the conflicts are present inside the military itself. Despite the common military formation, there are many sources of divergences among the officials, as a result of differences in social background, personality, careers and educational experiences (Stepan, 1971: 238). These differences tend to increase when the military expands its role beyond its traditional functions.

The military demonstrates a critical incapacity to deal with this diversity. As Finer (1962: 26) argues, this is related to the military refusal to tolerate different internal political positions and to its claim of representing the general interest. However, as the author points out, “they have no uniform notion of this national interest”, which implies that such a position does not help to solve the conflicts inherent in defining the means to achieve the national objectives. As I explore below, there are topics which are especially controversial, such as the duration and radicalism of the military intervention, the treatment to be given to foreign capital and the degree of state intervention in the economy. Institutions such as ESG, responsible for the dissemination of a cohesive view
of the national issues, worked as a mechanism to produce consensus. Nevertheless, their reach was limited to certain segments of the corporation.

Correspondingly, the military, by refusing to recognise the existence of internal divergences, lacks the flexibility necessary to construct coalitions with sections of civil society. As Stepan (1971: 262) points out, “military concern for unity and unanimity thus leads to progressive self-isolation”. Meanwhile, the possibility of any group turning to civil society to get support and improve its position tends to be seen with distrust, generates jealousy and increases tension. The practice of purges provokes resentment and also works in the same direction. The instability is amplified by the absence of ‘institutional legitimacy’ of the regime which, having its foundations in an act of force, gives the opposition the possibility to utilise the same means (Finer, 1962: 193). Furthermore, as the military are usually bad politicians, creating frictions with the Church and other social groups, there is a substantial amount of social dissatisfaction which may be used by the opposition against the incumbent government.

Another source of difficulties faced by the Brazilian military government arose from the characteristics which, according to O'Donnell (1979), are inherent to the Bureaucratic Authoritarian regimes (BAs) which emerged in Latin America in the 1960s and 1970s. As O'Donnell shows, this kind of authoritarian regime had very specific characteristics, being different from both Caudilhismo, military governments supported by the local oligarchies in the nineteenth century, and Fascism. Cardoso (1979) accentuates one important difference between the BAs and fascist regimes. According to him, the BAs did not develop efficient channels of contact with civil society. In contrast to Fascism, there was no political party to disseminate the principles of the government, obtain support and increase legitimacy. Similarly, the BAs did not stimulate the formation of encompassing class associations able to channel and discipline the demands of social groups. In brief, the BAs refused to establish a corporatist domination capable of creating ‘stable pressure groups’ (Cardoso, 1979: 37). As a result, in spite of the
measures adopted to increase the power of executive, the absence of institutionalised links with civil society reduced substantially the strength of the regime.\(^{214}\)

Another important obstacle faced by the Bureaucratic Authoritarian regimes stems from its difficulties in obtaining legitimacy. As seen in the last chapter, the BAs emerged in a context of economic crisis, marked by strong labour mobilisation and by high levels of inflation. Thus, the first measures were destined to repress labour and other popular movements, to stabilise the economy and to recreate the conditions necessary for a new cycle of productive investment. In brief, the conditions which brought BAs to power led them to adopt very unpopular measures.

As O'Donnell (1979) argues, these measures hindered the association of the regime with the interests of the nation and, consequently, created serious difficulties for its legitimisation. O'Donnell emphasises how the ideas of ‘nation’ - implying a common national past and identity - ‘citizenship’ and ‘popular’ have been utilised, since the French Revolution, to make the state appear as the defender of “the general interest of a ‘we’ that stands above the factionalism and antagonisms of civil society” (O'Donnell, 1979: 289). The BAs, by employing coercion and basing their support on a group of technocrats, on the army and on big business - a narrow range of society which can not be associated with the idea of nation -, had substantial difficulties in convincing public opinion that its actions reflected the national interest.

In addition, as O'Donnell emphasises, the action of the BAs, engaging in the recovery of the conditions of capital accumulation, revealed in a very crude way the characteristics of domination inherent to capitalism. It showed in a very explicit way the

\(^{214}\) Cardoso (1979) highlights how, for this reason, the president in the institutionalised party authoritarianism existing in Mexico was more powerful than the general in the authoritarian regimes emergent in South America. Likewise, Hagopian (1994) emphasises how the lack of efficient channels of communication with civil society was critical to the failure of the military regime to achieve many of its political objectives (see chapter two).

\(^{215}\) The potentiality of these ‘notions’ were very clearly perceived by Napoleon, who considered that the appeal to the people had the double function of purifying the origin and legitimising the continuity of the revolution (Finer, 1962: 212).
privileged position occupied by the business groups, which is a result of the fact that the material conditions of the whole society depend on their calculations of profitability and disposition to invest. Thus, this position of dominance, which is underlying in the democratic regimes, emerged very clearly in the BAs (O'Donnell, 1979: 309).

Another significant problem faced by the BAs was the difficulty of reconciling the requirements of economic recovery with the interests of the social forces which supported the regime. The measures necessary for stabilisation included recession, wage restraint, credit restrictions, correction of public prices and, in the short term, reduction of state participation in the economy. These policies, besides aggravating the immediate economic difficulties, led many weak enterprises to bankruptcy, while others were incorporated by larger national firms and foreign groups. These measures provoked strong criticisms from civil society, including the middle class and the sections of the national bourgeoisie which had supported the coup. The increase in foreign capital control of the economy had, in particular, serious implications, given its capacity to outrage sections of the military, an institution ideologically committed to nationalist causes.216

As a result, the incumbent government tended to face strong opposition, which reduced its basis of support and increased the costs of those committed to backing the regime. The respective policies tended thus to produce both isolation of the military and the development of a focus of opposition within it, permitting the aggregation of the diverse segments unsatisfied with the direction of the ‘revolution’.217 This opposition, as

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216 Policies adopted to recover the conditions of capital accumulation tended thus to clash with many of the values embraced by the military. Consequently, many beliefs about the meaning of the military coup, which included the achievement of targets such as the reinforcement of national sovereignty and the combating to poverty, were frustrated by the results of the policies of adjustment.

217 A possible measure to soften those tensions, as adopted in Brazil, was the expansion of the state and its transformation into the central actor in the process of capital accumulation. This was a way of reconciling the requirements of economic growth with the protests against foreign control of the economy and the demands of the sections of the national bourgeoisie. This was also a way to re-establish the internal unity of the military and, through the expansion of the state enterprises and the strengthening of the national capital, to recover the 'idea of nation' necessary to legitimate the regime.
stressed, tended to be more serious because of the lack of mechanisms to soften and solve the conflicts.

The experience of the authoritarian regime in Argentina, in the period 1967-1970, illustrates very well this kind of dilemma faced by the BAs. In this country, pressures from social groups, strongly supported by sections of the armed forces, emerged very early. The Opposition pressured for the abandonment of orthodox policies and for the adoption of measures which would have limited the entrance of foreign capital and favoured sections of the national bourgeoisie. Given its weak political situation, strongly aggravated by the conflicts inside the military, the government had no option but to comply and to radically change the economic policy. This inflection, however, exacerbated economic problems, provoking an outflow of capital and the re-emergence of the difficulties which had justified the military intervention (O’Donnell, 1979: 304).

As O’Donnell (1979: 305) emphasises, the tendency for those pressures to come to the fore was an important characteristic of the BAs. The timing of crisis, however, depended on a range of factors, including the severity of the situation before military government, the degree of organisation of civil society and the velocity of the first results of the stabilisation policies. In addition, as soon as the first signs of stability appear, indicating the possibility of recovering economic growth, there was a strong pressure to abandon orthodox polices and to pursue rates of economic growth much higher than the technocrats responsible for the previous reforms consider prudent.

In conclusion, the factors introduced above, highlighting important characteristics and constraints faced by the BAs, are very relevant to understanding the direction followed by the military regime in Brazil, including the critical inflection in the economic policy. Initially, economic policy demonstrated high concern with curbing inflation, attracting foreign capital and producing a balanced process of economic development. From 1967, however, the credit policy became very expansionist, the investments of state enterprises were substantially increased\(^\text{218}\) and several policies were

\(^{218}\) According to Lago (1990: 244), the investments of state enterprises, in real terms, increased by 20% in
adopted in favour of the national bourgeoisie. In this sense, the expansionist monetary policy and the permissive treatment of inflation reflected the concern to please the other sections which composed the alliance and the objective of legitimising the regime.

the period from 1967 to 1973.
6.4. 1964 - 1969 - difficulties of the military government and changes in economic policy

The next paragraphs show how the difficulties described above were manifested in the Brazilian experience after 1964. As explored below, the propensity to the emergence of conflicts was amplified by the characteristics of the military group which took power after the coup.

Stepan (1971) highlights the peculiarity of the officials who composed the team of the president Castelo Branco\textsuperscript{219}. According to him, the comparison between the ten generals who supported Castelo with the other 92 generals points to substantial differences concerning career pattern, involvement in the ESG, performance in the respective classes and attendance of schools abroad. According to Stepan, 100% of the core group of Castelo’s supporters had graduated as the number one in their respective classes and 100% had attended courses abroad, 80% in the United States. By contrast, only 24% of the other generals had attended foreign military schools. Thus, as Stepan (1971: 246-248) concludes, the group who supported Castelo Branco had a very specific formation and career experiences, which gave it a very distinctive view of the national problems and of the best strategy to develop the country.

The nomination of Castelo implied thus a program of government in accordance to the lines of the ‘Doctrine of National Security, as elaborated by ESG. Castelo reiterated the military’s commitment to re-establish law and order, combat communism, protect military institutions and undertake the required reforms (Oliveira, 1976: 58). In accordance to ESG doctrine, he demonstrated resistance to strong authoritarianism and to excessive participation of the state in economy. Castelo Branco believed in the virtues of democracy and decided not to close the congress and keep the political parties which

\textsuperscript{219} The nomination of Castelo Branco, one of the four star generals, is explained by his participation as leader of the conspiracy against Goulart. In addition, Castelo had a reputation for being legalistic and apolitical. These were ideal characteristics to obtain support from politicians who expected a short revolution which purged the immediate obstacles and led the country back to to democracy (D’Araujo and Castro, 1997: 167-168).
existed before the coup d’etat. His objective was to adopt the necessary reforms and return to civilian rule as soon as possible.

The nomination of Otávio Bulhões and Roberto Campos to lead his economic team resulted in a more liberal orientation. Economic policy was centred on abolishing obstacles to free enterprise and stimulating private investment, including foreign capital. Therefore, Castelo Branco demonstrated his “preference for a semi-free-enterprise system supported and guided by a strong central government” (Stepan, 1971: 230). Keeping the emphasis on pragmatism and technical solutions, he believed that combating Brazil’s problems required a substantial improvement in organisation, technology and industry.

Castelo Branco viewed with distrust nationalist arguments used to justify protectionism. According to him, nationalism had an important role to play by promoting national unity and preparing the people to the effort and abdication necessary for the development of the nation. However

“‘when it is manipulated by certain groups to avoid competition and maintain privileged positions in the market, when it is used to hinder the import of technology and to keep mineral resources unexplored, (...) when it is manipulated by the irresponsible left to impede the strengthening of the capitalist economic system and of the democratic institutions – this vicious nationalism is very negative to both economic development and national security’” (In Oliveira: 1976: 79).

Castelo’s efforts to govern with Congress faced, as expected, substantial difficulties, since the reforms judged necessary to correct the imbalances and purge the vices of the political system tended to face strong opposition. The decision to suspend the political rights of several politicians, including the ex-president Kubitschek, provoked strong condemnation from the PSD, which withdrew its support from the government. The tensions with the political community were aggravated by the decision

220 Despite these difficulties, Castelo tried to preserve several democratic features. The Ato Institucional II (Institutional Act II) was promulgated to regulate the time of vote and prevent Congress from postponing the approval of executive projects. Castelo also maintained the direct election to the government of the states.
to postpone the elections\textsuperscript{221}. This provoked strongly reaction from the prospective presidential candidates and affected the commitment of the UDN to support the government.

The elections for state governors in 1965 were marked by an atmosphere of tension. The victory of the opposition candidates in the important states of Rio de Janeiro and Minas Gerais provoked immediate protest from the ‘military 'hard-liner’. Castelo, however, maintained his commitment to legality and guaranteed the inauguration of the candidates. Similar protests emerged in response to the decision of the Supreme Federal Tribunal to concede \textit{habeas corpus} to political prisoners involved in processes of investigation by the \textit{Serviço Nacional de Informação} (National Service of Information). The ‘hard-liners’ refused to accept \textit{habeas corpus}, but Castelo guaranteed the fulfilment of the legal measures (D’Araujo and Castro, 1997: 190).

Those two events provoked reactions, which brought the internal military divisions to the fore. Ernesto Geisel, president from 1974 to 1978, relates to D’Araujo and Castro (1997: 190) how Castelo’s support for the decision of the supreme federal tribunal was followed by a speech of Costa e Silva, the Minister of War, criticising the position of the government\textsuperscript{222}. The reaction against the results of elections in Minas Gerais and Rio de Janeiro brought about a more serious reaction. The rank and file mobilised against the decision, putting the garrisons of the \textit{Vila Militar}, an important military basis, on a state of alert to move against Castelo (Stepan, 1971: 255). The rebellion was controlled by the interference of Costa e Silva, who promised to bring the rebels' demands to the President. Castelo Branco realised the gravity of the situation, which could lead to a division of the armed forces and to a coup against his government. Thus, he decided to yield to pressure and increase the power of the military regime. Castelo abolished

\textsuperscript{221} This measure was justified by the necessity of more time to extirpate corruption and other problems and by the negative electoral impacts of the stabilisation program which was being implemented. In other words, the military feared that an early election would bring back to the power the political forces ejected by the coup.

\textsuperscript{222} Geisel emphasises how this discourse, realised in a military event in the presence of many officials, was very inappropriate for a body which defended cohesion and discipline as important values.
political parties, cancelled direct elections and strengthened the government power to suspend political rights and punish opponents of the regime (Stepan, 1971: 255).\footnote{223}

Another source of divergences stemmed from the economic policy. The program of stabilisation hurt the interests of several groups that had supported the military. Accordingly, the policy of attracting foreign capital threatened established interests and provoked reaction from segments of the military. Its polemical nature provided a strong motto to mobilise the interests hurt by the economic policy. The protests of civil society against Castelo’s foreign capital policy are very well illustrated by the following letter of Magalhães Pinto, the governor of the state of Minas Gerais, to the President:

“the people and the government of this State watch, with melancholy and a growing sensation of frustration, the free transfer of its resources to groups which do not share their interests. (...) In one word, the foreign group (Hanna) is appropriating the mineral riches of this state without paying anything”\footnote{224} (In Oliveira, 1976: 61).

The fate of the Castelo government and of its economic policy orientation is in significant part explained by the difficult task of the Bureaucratic Authoritarian State and by the ‘political difficulties’ inherent to the military corporation (see section 6.3). However, as this section has argued, one important additional factor was the peculiar character of his group, which had a view of political and economic issues not shared by the rest of the military. The large part of the military, which had been “socialised into national politics in the controversy about Petrobrás”\footnote{225}, did not agree with the penetration of foreign capital in strategic areas and with the increase in foreign capital control of the economy (Stepan, 1971: 248). In addition, in contrast to the pragmatism of the ESG group, the military contained certain factions which espoused a much more radical view about the meaning and objectives of the coup. Stepan (1971: 251) mentions a manifesto of a group of junior officials which listed, as targets of the revolution, the

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\footnote{223}{As Stepan shows, the pre-conditions for a coup against Castelo were present. It did not happen because the crisis, strengthening substantially the position of Costa e Silva, provided the solution for Castelo’s succession.}

\footnote{224}{Letter of Magalhães Pinto to Castelo Branco – 16-10-1964 (In Oliveira, 1976: 61).}

\footnote{225}{The creation of Petrobrás, the national oil company, provoked intense debate concerning the monopoly of oil exploration by the state.}
following aims: the confiscation of illicit fortunes; the distribution of all uncultivated lands to peasants; the combat of inflation through state intervention in the means of production; the control of the remission of profits abroad and their compulsory re-investment in domestic development and the adoption of a mass education program for poor students. It is easy to see how this group became disappointed with the policies and the results of the first government of the ‘revolution’.

In brief, the paragraphs above show how the program of government of President Castelo Branco suffered substantial opposition. Although attempting to conserve democratic institutions, the reforms implemented by his government led to the aggravation of civil opposition and to the progressive isolation of the military corporation. The military segments that opposed Castelo, intending to strengthen its position, approximated from social groups and embraced part of their demands.

As Castelo refused the idea of continuing in power and the previous crisis eliminated his capacity to groom a successor, Costa e Silva emerged as the ‘natural’ successor. Costa e Silva was not a radical nationalist; in Castelo’s government, he had acted as a bridge between the government and the more radical groups. One remarkable characteristic of his government was its initiative to reverse the government’s isolation and to obtain support from the middle classes and segments of the national bourgeoisie. Another characteristic was the lack of a coherent line of government, since it was supported by heterogeneous segments of the military and of the civil society whose factor in common interest was the opposition to Castelo Branco’s policies.

Economic policy was marked by the substantial expansion of credit and subsidies, in the effort to stimulate exports and economic growth, by the end of the readjustment of public prices and tariffs and by the increase in tariff protection over manufactured

\[\text{In contrast to the Castelo government, in which the links with the ESG guaranteed homogeneous views about the national issues, the Costa e Silva government did not have such an institutional connection able to produce consensus.}\]
It is important to emphasise this rupture in economic policy, since the pursuit of high rates of economic growth was adopted at the costs of damaging the substantial effort of stabilisation and adjustment undertaken by Castelo Branco. Roberto Campos, Minister of Planning under the Castelo government, emphasised that the Decimal Plan, elaborated during his period in office, had established that the maximum rate compatible with a balanced process of economic growth was 5.5%. The economic growth under the Costa e Silva and Médici governments was far in excess of this. In the period from 1967 to 1973, the average annual rate of economic growth reached 11.2%.

Likewise, Campos (1993: 669) shows how the institutional design of an independent central bank, justified by the argument that both Congress and the Executive suffered strong pressures to increase expenditure, was frustrated by firm opposition from Costa e Silva, who disregarded the rules established by the previous administration. Campos (1993: 669) relates how, at the beginning of 1967, he was sent by Castelo to explain the economic chapters of the new constitution to the future president. He commented with Costa e Silva the necessity of respecting the mandate of the directors of the central bank and emphasised the importance of such a decision to preserve the role of the bank as the guarantor of the stability of the currency. Costa e Silva, nevertheless, did not agree and responded: “I am the guardian of the currency”.

An important point is to understand why the Costa e Silva government did not follow a more ‘social popular’ orientation. As seen, there were radical sections of the military which favoured the adoption of radical measures, including confiscation of goods. The average tariff on manufactured goods increased from 48% in April of 1968 to 66% in 1969 (Abreu, 1994: 183).

The rate of inflation did not grow significantly in the years after 1967 and only in 1973 there was a significant acceleration. As the monetary and credit policies were expansive, this result is explained by the existence of significant idle capacity. From the end of 1972, the exhaustion of idle capacity and attempts to keep economic growth provoked inflationary pressures, which the government addressed through price controls. In this sense, the policy makers missed the opportunity to benefit from the reforms and from the anterior adjustment to guarantee a balanced process of economic growth. The rapid process of expansion of the economy provoked unbalances and transmitted very difficult conditions to the next government. See Lago (1990: 245-252).
‘illicit’ fortunes and the distribution of unproductive land to the peasants. According to Stepan (1971: 252), the complexity of Brazilian society, resulting from the previous process of industrialisation, impeded the adoption of a 'popular-social' orientation like that adopted in Peru: “the great size of the industrial sector in Brazil, and the complicated web of interest group politics, made Brazilian society too developed and complex for military Nasserism even of a Peruvian variety”. Accordingly, the military was dependent on the business groups to achieve rates of economic growth necessary to legitimate the regime.

In 1969, Costa e Silva had serious health problems and left the government. The higher–echelons of the military found in the nomination of General Médici a compromise solution to restore unity. Médici’s nomination represented a victory of the higher echelons against the young and more radical officials (Oliveira, 1976: 104-105). The Médici government preserved the Ministry of Finance and maintained the basic lines of economic policy adopted during the Costa e Silva administration.

As the Brazilian experience highlights, the military, instead of being homogeneous and cohesive, is a very complex and heterogeneous group. As a consequence, the possibility of a group, especially when it has views different from the rest of the corporation, to stay in power requires a substantial engagement “in effective political persuasion” (Stepan, 1971: 249). Castelo Branco, nevertheless, was apolitical. He believed that Brazilian problems required technical solutions and tended to view politics with suspicion. This position impeded an engagement to maintain the orientation that his group judged necessary to develop the country.

In conclusion, as this section has emphasised, the first military government, despite its capacity to repress the labour movement and to control the Congress, faced many obstacles in implementing the program it considered appropriate to the development of the country. The divisions inside the armed forces, the pressures of the social groups and

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229 Médici had a good relationship with Costa e Silva, he was not a radical nationalist and was accepted both by the ESG group, which agreed to occupy posts in the government, and by the financial community.
the constraints which stemmed from the need of legitimising the regime reduced substantially the degree of freedom of the government. The absence of channels to shape and control the demands of civil society also contributed to reducing its capacity to obtain better results.
6.5. The Castelo Branco government: stabilisation and reforms

A brief summary of the policies adopted in the first years of the military regime is very important for the argument of this thesis. It is important for the understanding of how the government defeated several obstacles which marked previous governments. In addition, in face of the achievements of these policies, it is necessary to emphasise why they were not preserved.

The Castelo government concentrated on stabilising the economy and adopting the measures necessary to stimulate a new cycle of productive investment. In foreign policy, his government re-structured the foreign debt and adopted guarantees to attract foreign capital. His economic policy was marked by the adoption of a positive interest rate and by a realistic exchange rate, aiming at stimulating savings and exports and correcting key distortions of the previous programs of development. In addition, substantial incentives were given to exports.

His program of stabilisation was centred on a mechanism of readjustment and control of wages and on the reduction of public deficit. The reduction in expenditure, the readjustment in public prices and tariffs, the increase in several tax rates and creation of new forms of tax\textsuperscript{230} permitted a reduction in public deficit from 5\% in 1963 to 1.1\% in 1966. Inflation, which had been above 80\% in 1964, fell to less than 22\% in 1967 (see Abreu, 1994: 169-171; Resende, 1990).

The Castelo government also introduced the reforms necessary to solve deficiencies which had marked state intervention in the previous period. Important measures were the re-organisation of the financial system\textsuperscript{231}, the creation of a central bank, improvement in the financial capacity of the state and administrative reform. The central bank was created to increase the capacity of control over monetary policy. Although it was a very important innovation, the influence of Congress constrained the autonomy of the

\textsuperscript{230} The total government revenue increased from 19.1\% of GDP in 1965 to 25.7\% in 1970.

\textsuperscript{231} This included the strict definition of the functions of the financial intermediaries, including commercial banks, investment banks, credit companies and stockbrokers (Abreu, 1994: 175).
reformers, who were not able to eliminate the capacity of the *Banco do Brasil* to create liquidity\(^\text{232}\) (Campos, 1993: 666-667).

Furthermore, the government created the stock market and adopted measures to stimulate the development of the capital market. A fund, extracted from compulsory deposits of employees and aiming at protecting the workers in case of dismissal, was created and channelled to stimulate the housing industry. A key innovation was the introduction of monetary correction, a mechanism which permitted the ex-post correction of inflation in the contracts and, consequently, the signing of contracts on basis of real rates of interest. The monetary correction was very important for the preservation of the value of tax, the correction of the value of assets by the enterprises and the development of a market of public bonds\(^\text{233}\). In brief, the introduction of monetary correction was fundamental to the working of an economy which had high rates of inflation (Abreu, 1994: 171). And last but not least, important achievements were obtained in the administrative area, marked by a substantial process of training of civil servants (See Campos, 1993: 697-709).

The Castelo government had very positive effects in stabilising the economy and producing the pre-conditions for a new cycle of economic growth. As a result of these policies, economic growth increased from 0.6\% in 1963 to 4.2\% in 1967 and 9.8\% in 1968. The reforms addressed critical deficiencies, increased fiscal capacity and prepared the state to expand its role in economic activity. Likewise, they were very important to permit an expansion in the country’s capacity of investment, which increased from 15.3\% of GDP in 1967 to 21\% in 1973.

\(^{232}\) The *Banco do Brasil* preserved a mechanism which gave it almost unlimited capacity to expand its loans, constraining the central bank’s capacity to control the money supply. According to Campos (1993: 667), the resources transacted by the special account of the *Banco do Brasil* (*conta movimento*) achieved, in critical years, a value superior to the monetary basis.

\(^{233}\) In this sense, it permitted the government to finance its deficit through the emission of bonds. Before the introduction of monetary correction, the development of a market of public bonds and long term loans was hindered by a constitutional law which limited interest rates to 12\% a year.
Campos (1993: 633) emphasises the importance of the reforms and of the economic policy practised in that period. He stresses how the positive interest rate and the realistic exchange rate were the right policies to solve the deficiencies which had marked the previous process of development. He concludes that Brazil was on the right path to produce a balanced long term process of economic growth, similar to that achieved by the East Asian countries\textsuperscript{234}.

Nevertheless, the policies adopted after 1967 did not demonstrate concern to produce a stable process of economic development. As Campos (1993: 624) stresses, the emphasis on a balanced process of economic growth was abandoned by the Costa e Silva and Médici governments. The result was the accumulation of imbalances, which impeded the continuity of the process and constrained the capacity of the Brazilian government to respond to the oil crisis in 1973\textsuperscript{235}.

\textsuperscript{234} It is important not to underestimate the problems faced by the policy-makers during Castelo government. The government suffered substantial pressures and, as Abreu (1994: 176) emphasises, the excessive concession of fiscal subsidies in the period 1964-67 “reveals the persistence of clientelism as important criteria of allocation of public resources”. Notwithstanding the pressures and difficulties, the concern to stability and adjustment was an important characteristic of Castelo government, not preserved in the following administration.

\textsuperscript{235} According to Campos, the responses given to this crisis, accepting high rates of inflation and increasing foreign debt, had also very negative consequences over the country’s long term capacity of growth.
6.6. Conclusion

This chapter summarises how the military, after playing a subordinate role before 1930, redefined its insertion in society and decided to play a more active role in politics. In the post-war period, the *Escola Superior de Guerra (ESG)* consolidated and developed the Doctrine of National Security. This doctrine was very important not only to the military intervention in 1964, but also to the direction given to the program of development after that.\footnote{It is difficult to underestimate the influence of ESG. Two of the five presidents and important ministers and assessors were graduates of ESG. ESG offered a solid project of development and its influence is important to explain why the military experience in Brazil produced better results than in other Latin American countries (see Sikkink, 1991).}

The chapter also emphasises the difficulties faced by the military in implementing a coherent program of economic development. The division inside the military, the necessity to legitimise the regime and the pressures from civil society influenced economic policy and prevented the direction adopted by Castelo Branco from being followed by succeeding governments. In the following years, the state increased its role in the economy and from 1974 promoted an ambitious program of import substitution.

The next chapter analyses this program of import substitution undertaken during the Geisel government (1974-1978). The objective is to present the principal policies and to highlight the obstacles faced by the state to transform the pattern of industrialisation. The issues emphasised in the present chapter are very important to an understanding of the economic policy orientation and also of several obstacles faced by that government.
CHAPTER 7. STATE CAPACITY AND POLICY TOWARDS THE CAPITAL GOODS SECTOR DURING THE GEISEL GOVERNMENT

7.1. Introduction

The object of the present chapter is to examine the program of industrial development promoted by the Geisel government (1974-1978). In 1974, the government adopted the Segundo Plano Nacional de Desenvolvimento (PDN II – Second Plan National of Development), which constituted a substantial effort to produce substitutes for imports of oil, basic inputs and capital goods. In this program, the state, whose capacity of action had been strengthened by the financial and administrative reforms of the 1960s, assumed a key role in the effort to promote and upgrade the national industrial structure.

The analysis of the Geisel government occupies a central role in this thesis, since it constitutes an important opportunity to investigate the determinants of and limits to state capacity to promote industrial development. The PND II was a very ambitious program and involved substantial obstacles, requiring direct state participation and a set of instruments and measures to stimulate the development of target sectors. Its objective was to produce a modern industrial structure, typical of a developed country. For these reasons, it constituted a very good opportunity to see the Brazilian developmentalist state in action and to investigate how the institutional characteristics of state and its relationships with social groups constrained its capacity to shape a different industrial structure.

Although the PND II also included investments in basic inputs and infrastructure, I decided to centre the analysis on the policies for the capital goods sector. In addition, the choice of the Geisel government is also justified because it was the last effort to employ the direct action and influence of the state to push a process of industrial development. Its ‘relative failure’ determined also the end of the developmentalist state in Brazil and the advent of deep transformations which altered the role of the state in the economy.

237 In addition, the choice of the Geisel government is also justified because it was the last effort to employ the direct action and influence of the state to push a process of industrial development. Its ‘relative failure’ determined also the end of the developmentalist state in Brazil and the advent of deep transformations which altered the role of the state in the economy.

238 The capital goods sector includes machines and equipment. For simplification, in certain parts of this chapter I use equipment as a synonym for capital goods.
aspects justify this choice. Firstly, capital goods production, in contrast to basic inputs, was concentrated on the private sector and its development required a wide range of instruments of industrial policy. Likewise, the policies for the sector illustrate the importance of contacts between state and business and its effects on state capacity.

Secondly, the capital goods sector was the sector which had faced, in the previous decades, the worst results in terms of import substitution. According to a variant section of the developmentalist ideology, the completion of import substitution in this sector was a crucial and necessary step for a successful process of development. In other words, it represented an opportunity to generate an autonomous and modern industrial structure, able to internalise the inter-sectoral linkages.

Thirdly, the complexities and challenges present in this sector demanded intense and elaborate action of the part of the state, including the creation of huge financial mechanisms, the adoption of a policy of technological development and the confront with foreign capital. For all these reasons, a case study for the capital goods sector in Geisel government represents a special opportunity to analyse the challenges and constraints faced by the state to promote industrial development.

Therefore, it is important to emphasise that the objective is not to undertake a detailed analysis of the capital sector goods in Brazil, which would require a different kind of approach (see, for example, Amann, 1996). The objective is rather to use the policies and the challenges for the development of the sector as a way to highlight the limits in the capacity of the Brazilian state to promote an ambitious program of industrial transformation. The analysis thus concentrates on the new direction adopted by the PND II, on the measures which implemented these directions and on their suitability to face the challenges inherent to the development of the sector.

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239 In this sense, as I have emphasised in other chapters of this thesis, this study is also an investigation of basic characteristics of the state and of its relationships with the social groups.
**Brief summary of the evolution of the Brazilian capital goods sector**

In the 1930s and 1940s, import substitution in the capital goods sector faced many difficulties. The high degree of technological complexity, the scale necessary for a plant to be efficient and the need for a huge amount of financial resources inhibited investments in this sector. For these reasons, the process of import substitution was concentrated particularly on non-durable consumer goods and, to a lesser extent, on intermediate goods. In 1949, the capital goods sector accounted for only 4.3% of national industrial production and, at the end of the 1940s, it was responsible for 35.2% of total imports (Baer, 1966: 36).

At the beginning of the 1950s, the capital goods industry was very simple, centred on light equipment, motors and small generators and machines (Lessa, 1981: 50). After 1956, the development of the sector was stimulated by the substantial program of investments promoted by Kubitschek. Large-scale investment in infrastructure and heavy industry, including energy, transports, steel, cement, chemical and naval industry, substantially increased the demand for capital goods and provided important opportunities for domestic producers, who benefited from the limited capacity to import and from the government’s incentives. In addition, the sector was stimulated by the introduction of the automobile industry into the country. The production of more than 300,000 vehicles in the period 1957-1961 represented a substantial incentive to the development of the national car components industry.

Thus, during the Kubitschek government (1956-1960) the capital goods industry grew by 26.4% a year. Priority was given to the production of machines and equipment which could be used in different industries, such as generators, electrical motors, turbines and ovens (Lessa, 1981: 51). This was a way of circumventing the limits of scale present in the production of specific capital goods. The niches of machine tools, electrical materials and mechanical materials also grew at very high rates. As a result, the capital goods industry, at the beginning of the 1960s, was more developed and
supplied a significant part of the demand of the economy. Nevertheless, the sector was still responsible for 39.8% of the total imports (Baer, 1966: 36).

The capital goods industry suffered substantially from the cyclical reversion and the deceleration of public investment at the beginning of the 1960s. The sector was very dependent on public demand and, given the peculiarities of this industry, was very sensitive to the process of cyclical reversion. The 1960s were thus difficult years for the sector, which was only stimulated again by the recovery of economic growth in the second half of the decade.

From 1967 to 1973, the capital goods industry grew at an average rate of 18.2% a year (Lago et alii, 1979: 143). Nevertheless, the imports of capital goods expanded much faster. They increased from US$ 603.9 million in 1968 to US$ 2.142 billion in 1973 and US$3.2 billion in 1974, thereby becoming an important source of difficulties in the balance of payments (Almeida, 1983: 31). In addition, a large part of the growth of the sector was based on utilisation of idle capacity, which had reached 91% at the end of 1973.

Thus, the production of the capital goods sector, although increasing substantially, was not able to keep pace with the increase in demand. Several obstacles hindered the sector’s development. Firstly, the sector suffered from the lack of national institutions of credit aiming at financing purchase of machines and equipment. This made the investment very dependent on foreign supply credits, which required the realisation of international bids and/or the import of capital goods, thereby substantially reducing the opportunities for the national producers to supply the product.

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240 As Serra (1982) shows, the high concentration of the investments in a short period, the expansion of productive capacity ahead of demand and the exhaustion of the public sector financial capacity were factors which contributed to the intensity of the cyclical reversion.

241 This is very well illustrated by the projects of expansion of the steel sector at the end of the 1960s and beginning of the 1970s. This required substantial investment and purchase of equipment. Nevertheless, the dependence on foreign credit resulted in a very low index of national participation in the supply of equipment, much inferior to the national capacity of production.
Another difficulty resulted from the policy of incentives, which lacked selectivity and was very liberal in the concession of tariff exemptions to the import of equipment. This policy reduced the effective protection to the capital goods sector and had negative consequences for the development of the sector. As explored in the forthcoming sections, the Geisel government altered this structure of incentives and engaged in the creation of a range of instruments to stimulate an ambitious process of import substitution in the sector.

The structure of the chapter is organised in the following way. Section 7.2 explores the diagnostic of the plan and emphasises how the influence of developmentalist ideology was important to understanding certain decisions of economic policy. Section 7.3 introduces the set of instruments adopted to stimulate import substitution in the capital goods sector. Section 7.4 focuses on efforts to stimulate technological development and the substantial obstacles faced in this area. Section 7.7 explores the channels of interaction between the state and industry and its impacts on state capacity. Important attention is also given to the main industrialists’ demands and forms of influence.

Sections 7.5, 7.6 and 7.8 explore important obstacles faced by the program of development. Section 7.5 investigates how the divisions inside the state reduced the coherence of the program of development. Section 7.6 analyses the emergence of business opposition and how this constrained government initiatives. Section 7.8 explores the obstacles to continuity for the program of industrialisation and its effects on the capital goods sector. Finally, Section 7.9 concludes, summarising the main obstacles to the emergence of a developed and modern capital goods industry.

In brief, the sections explore the institutional factors that constrained the capacity of the state to promote successfully a program of industrial transformation. As emphasised, the chapter is an in-depth case study which illustrates the importance of state capacity and other institutional elements introduced in the previous chapters.
7.2. The diagnostics of the Segundo Plano Nacional de Desenvolvimento (PND II)

An important step in this analysis of the Geisel government (1974-1978) is to emphasise certain determinants of the economic program, marked by the adoption of a substantial plan of investments, the PND II, in the middle of the international crisis and despite the explosive effects of the oil shock. In 1973, there was already evidence of the exhaustion of the cycle of economic growth which had characterised the Brazilian economy since 1967. At the end of that year, the oil shock aggravated the problems of an economy which already had difficulties in the foreign accounts.

The PND II was elaborated during the year of 1974 by the *Instituto de Pesquisas Econômicas Aplicadas* (IPEA - Institute of Applied Economic Research), under the direction of the Planning Minister, João Paulo dos Reis Velloso\textsuperscript{242}. It was based on a series of studies, elaborated previously by IPEA and BNDE, which had identified sectoral imbalances and proposed measures to correct the deficiencies of the industrial structure. It is important to emphasise that many of these studies, including a study about ‘basic inputs’ which was critical to the elaboration of the PND II, were elaborated before the oil shock (Velloso, 2000).

The PND II’s main direction was to promote a substantial program of investment in infra-structure and heavy industry, including basic inputs, oil and capital goods\textsuperscript{243}, which would be accomplished through a strong effort of public investment\textsuperscript{244} and a range of incentives to the private sector. Its diagnostic was based on the imbalances of the industrial structure and on the consequent negative effects on the balance of payments. In spite of the favourable performance of exports in the period 1967-73, which

\textsuperscript{242}Velloso was the Head of the Secretary of Planning, created by Geisel. He had the status and the power of a minister and I refer to him as the Planning Minister.

\textsuperscript{243}For the period 1975-79, the PND II estimated investments of CR$ 439.4 billions (US$ 54.2 billions) in economic infrastructure and CR$ 255 billions (US$ 31.4 billions) in basic industry, including private investment (PND II, 1974: 118 – values in CR$ of 1975).

\textsuperscript{244}According to Pereira (1982: 39), public investment increased from 5.7% of GDP in 1973 to 10.7% in 1978. Meanwhile, private investment declined from 19.7% of GDP in 1973 to 13.6% in 1978. This is a good indication of the role of state capital in the program of investment.
responded very well to the huge program of incentives, the year 1973 was marked by a
deficit of US$1.7 billion in the current transaction account. In 1974, as a result of the
oil shock, this deficit increased to US$7.1 billion, 89.6% of total exports.

This unfavourable performance was explained by the increasing imports, not only
of oil, but of raw materials and capital goods. Imports of raw material, excluding oil,
expanded from US$771 million in 1968 to US$2.6 billion in 1973 and US$ 5.6 billion in
1974. Meanwhile, imports of capital goods grew from US$625 million in 1968 to US$2.1
billion in 1973 and 3.1 billion in 1974 (Almeida, 1983: 31). These results were attributed
to deficiencies in the industrial structure: given the fragility of the heavy industry, the
backward linkages provided by the other sectors, stimulated by the high rates of
economic growth, were exported to other countries and provoked an increase in imports.
Consequently, the correction of the imbalances in industrial structure was seen as
necessary to produce sustained economic growth.

This diagnostic fits very well in the developmentalist position embraced by Geisel
and by an important part of his economic team. Geisel, although a member of ESG and a
supporter of the former-president Castelo Branco, espoused a more nationalistic and
developmentalist position than the previous president. Geisel had restrictions against
excessive participation of foreign capital. Similarly, Geisel emphasised the necessity of
obtaining technological control in certain strategic areas, a pre-condition to release the
country from a dependent position. Concerning economic development, he viewed state
action as the main tool to defeat poverty and backwardness. According to Geisel,

"if Brazil wants to become a modern nation, without the problem of starvation and
many other problems, it needs to promote development. The main instrument to it is the
propellant power of the federal government. The nation does not develop spontaneously. An agent is necessary to guide and push the process, and this role
should be filled by the government. This is an old idea that I have solidified during my

245 In addition, from 1968 to 1973, the liquid foreign debt increased from US$ 3.5 billion to US$ 6.1
billion.
246 Only the deficit in trade account was US$4.7 billion. Oil imports accounted for US$ 2.5 billion, or 20%
of total imports.
life and espoused in the courses of ESG. As the country did not have capital and as the private sector was shy, sometimes selfish and did not engage in promoting development, the government had to use its power. The basic challenge of my government, and the one that most concerned me in those five years, was to do whatever was necessary to develop the country” (D’Araujo and Castro, 1997: 287).

A central aspect of economic policy was the refusal to adopt a stringent monetary policy, to decelerate radically the economy and to apply a macro devaluation of the exchange rate in response to the international crisis. As already stated, the PND II rejected an orthodox response and promoted a substantial investment effort in order to address the structural deficiencies of the balance of payments. In the short term, the imbalances had to be addressed through an increase in foreign loans, justified as the international contribution to the national effort of investment.

Several factors influenced the government’s response to the international crisis. Firstly, it is necessary to emphasise the role of developmentalist ideology, which was embraced by the President and had strong appeal in the national political culture. The strong influence of the developmentalist theses helps to explain the option for a strategy that was permissive with regard to inflation. As seen in chapter five, those theses considered that a strong concern with combat of inflation tended to impede the necessary commitment to address the structural problems and promote development. This view was embraced by Geisel, who believed that, although the control of inflation deserved attention, it was not the central objective of his government. Commenting about the suitability of an independent central bank in his government, Geisel emphasised that a strict commitment to contain inflation would have precluded the pursuit of the main objectives. According to him, “the government depends on resources and an independent central bank would be an organ in conflict with the executive” (D’Araujo and Castro, 1997: 296, 297). In brief, this statement makes clear that there were urgent objectives which had to be accomplished, despite provoking certain inflation.

The decision to refuse stabilisation and soften economic deceleration was also influenced by pressures from within the military and by the need to legitimise the
regime. As seen in chapter six, the program of stabilisation adopted after 1964 had provoked a strong military reaction and created the conditions for the seizure of power by military 'hardliners'. In a similar way, if the government had opted for stabilisation in 1974, after seven years of elevated rates of economic growth, such a decision could have intensified the opposition from other sections of the military and put the government at risk. In addition, economic growth was critical for the legitimacy of the regime.

In the face of these constraints and supported by an ideology permissive of inflation, it is not difficult to understand the decision of the government, which had the alternative to use foreign savings in order to finance the deficits in current transaction account. As Geisel later points out, justifying his decision, “How could I justify a recession after the euphoria of the development under the Médici government? And how would I solve the social problems which would result from unemployment? (D’Araujo and Castro, 1997: 288).

There were also several technical arguments to justify the strategy of economic growth implicit in the PND II. Besides the need to address the structural problems in the balance of payments, the government stated that a recession would provoke serious damage in a country which was still consolidating its business class and industrial structure. Given the high rates of previous economic growth, it was alleged that a radical cyclical reversion could provoke a crisis powerful enough to cause irreversible damage to many national enterprises (PND II, 1974: 20).

And last but not least, Velloso (2000) argues that the program of investments in basic input and capital goods was a pre-condition to increase the country’s capacity to export. Given the deceleration in international economy, the difficulties of increasing traditional export goods were indeed substantial247.

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247 Velloso (1986) presents many arguments which supported the economic strategy of the government. A brief analysis of the suitability of the economic policy is realised in the conclusion of this chapter.
The sectoral treatment

A key objective of the PND II was to strengthen heavy industry, including basic inputs and capital goods. The high priority given to the development of these sectors transcended the important effects on the balance of payments. It was also justified in terms of national control over strategic areas and of the reinforcement in inter-sectoral linkages, necessary to produce more vigorous and self-balancing process of economic growth. This is very well illustrated by the statement of Marcos Vianna, President of BNDE, supporting the capital goods industry:

“The capital goods industry plays an important role in terms of the political and economic autonomy of the country; the domain of such a technology confers on the economic national space a larger control over its means of production, permitting the continuity of the process of accumulation with relative independence from the international economic cycles and from foreign political decisions” (in Cruz, 1995: 169).

The PND II also demonstrated a special concern with the process of technological apprenticeship and announced a program of incentives and expenditure without precedent in Brazil’s history. According to the PND II, the objective of the technological effort was not only to acquire the ‘know-how’ necessary to produce goods, but also to create the capacity to adapt and produce technology and to dominate it in strategic sectors. Nevertheless, the PND II (1974: 35), demonstrating prudence and a consciousness of the national limits, also “recognises that the bulk of the innovation effort should imply adaptation of technology”.

In the basic inputs sector, the strategy was centred on the investment of the state enterprises, which had recovered their capacity of investment after the military coup and also undergone a significant process of modernisation. The program contemplated, besides the steel and the petrochemical projects - already in operation -, investments in

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248 The military readjusted the tariffs and public prices and adopted a plan of technical capacitating in several enterprises.
oil exploration and refine, iron-ore extraction, electric power generation, fertilisers, paper and cellulose, non-iron metals and pharmaceutical industry (PND II, 1974: 39). In addition, a subsidiary of BNDE and other instruments were created to support private investment.

The policies for the capital goods industry were based on a deep diagnostics of the problems of the sector. In the beginning of the 1970s, BNDE contracted the consultancy firm Tecnometal to undertake a very detailed study of the sector. The study offered a very elaborate investigation of the industry, analysing carefully the situation of the respective niches and the structure of the firms and collecting demands and suggestions of the businesspeople. As a result, it provided the policy-makers with a very precise diagnosis of the characteristics of the sector.

As seen, the capital goods sector had grown substantially in the period from 1967 to 1973. However, it had been unable to absorb the increasing demand and, as a result, the imports grew much faster. In addition, as seen, a substantial part of the growth in production was based on utilisation of idle capacity and the industrialists demonstrated a certain reluctance to invest. This was the conclusion of the document elaborated by the Conselho de Desenvolvimento Econômico (CDE - Council of Economic Development) in 1974, which identified in the uncertainty concerning the future demand for equipment and in the lack of structures of capitalisation the main factors responsible for the inhibition in investment. (CDE I, 1974: 23).

As additional obstacles to the development of the capital goods sector, the policy-makers identified the structure of incentives and the lack of suitable financial instruments. In the PND II (1974: 38), the policy makers emphasised that “the fundamental objective is to invert the present tendency that leads the purchaser to attempt to import as much as possible, due to the disadvantages implicit in the purchase of national equipment”. In order to reverse this tendency, the government expanded and improved substantially the conditions of the credits of FINAME\textsuperscript{249} for the acquisition of

\textsuperscript{249} FINAME, Agencial Especial de Financiamento Industrial (Financial Agency of Industrial Financing),
capital goods and created other mechanisms to provide long term loans in favourable conditions (see section 7.3). In addition, the policy makers altered the policy of incentives practised by the Conselho de Desenvolvimento Industrial (CDI - Council of Industrial Development), which conceded tariff exemptions to the import of equipment and thus reduced the effective protection to the national industry.

Another important issue concerns the difficulties of capitalisation and the necessity of financial support for national producers. The PND II had the objective of strengthening national private capital, considered necessary to balance an industrial structure marked by the strong presence of both foreign and state enterprises. To this end, the PND II intended the creation of special financial mechanisms, the adoption of a policy of mergers, the support for the constitution of national conglomerates and the provision of financial aid and other incentives to increase competitiveness in key sectors\(^{250}\) (PND II, 1974: 38).

Finally, it is necessary to make some observations about the role attributed to foreign capital and the participation of the industrialists in the policy making process. Geisel was the most nationalist of the five military presidents and believed that foreign capital, although indispensable, should be controlled. Besides the national security areas, reserved for state enterprises, Geisel felt that other productive sectors should be controlled by private national capital. For this reason, his government adopted a clear discriminatory policy, reserving certain instruments of economic policy, including lines of credit, mechanisms of capitalisation and incentives, to national capital. In addition, the government’s objective was to mould the action of foreign capital according to the priorities of the economic policy, pushing it towards the necessary sectors and

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\(^{250}\) It is important to emphasise that several of these measures were adopted in response to the demands of the producers, who complained of the difficulties of constituting solid enterprise structures and of the constant threat of take over by foreign companies. Nevertheless, other directions, such a policy of mergers, were not implemented.
pressuring foreign firms to transfer technology. And last but not least, the government attributed to foreign capital a positive contribution to the export performance.

In the definition of the role of foreign capital, the policy-makers believed that the large programs of investment and the privileged situation of the country, ‘an island of prosperity in the middle of the turbulent international context’, would give the government the bargaining power necessary to shape the action of foreign enterprises according to national objectives. The reality, however, was very different: the multinational corporations (MNCs) controlled key industrial sectors and had no reason to change their behaviour. Most of them had no interest in transferring technology and refused to participate in joint ventures in a minority position. In brief, the bargaining power of the government was not as high as the policy-makers desired. As Suarez (1986) shows for the petrochemical sector, the few cases of success occurred in the niches in which the strong involvement of state enterprises increased government bargaining power.

Finally, it is necessary to emphasise that the diagnostic of the PND II, although technocratic, was elaborated in permanent contact with the private sector (Velloso, 2000; Vianna, 2000). Many of the measures adopted to stimulate the capital goods sector, such as the creation of special lines of credit, the mechanisms of capitalisation and the reduction of monetary correction in the loans of the BNDE (see section 7.3), were adopted in response to the suggestions and demands of the industrialists. As the Minister of Planning and the president of BNDE emphasise, the participation of businessmen in meetings and seminars promoted by the government facilitated the exchange of information and introduction of demands. Velloso (2000) claims he did not adopt any measure concerning the capital goods sector without consulting the Associação Brasileira das Industrias de Base (ABDIB – Brazilian Association of Basic Industry).
7.3. The instruments of the PND II and the capital goods sector

The objective of this section is to present a summary of the instruments created by Geisel government to stimulate the capital goods sector. The paragraphs below describe the different instruments of industrial policy, which included financial mechanisms, a system of incentives, a policy of import controls, a policy of public purchases and mechanisms to stimulate technological development.

Initially, it is important to emphasise that the effort present in the PND II was only possible because of the reforms undertaken in the 1960s, which substantially increased the financial capacity of the state\textsuperscript{251}. Similarly, these reforms increased the rationality of public administration and improved the qualifications of the technicians, who were allocated to strategic agencies and state enterprises. In brief, this increase in financial and technical capacity was crucial to the implementation of a program of industrialisation which required substantial increase in state participation.

The PND II intended a substantial transformation in industrial structure, which required the concentration of the financial funds on the priority sectors. In order to understand the magnitude of the task, it is important to take into consideration that the process of economic development in Brazil had not produced either large private banks of investment or large financial conglomerates articulating banks and enterprises. The role of supplying long term credit was allocated to the national bank of development, BNDE.

The orientation given by the PND II strengthened the role of BNDE. The Bank assumed control of the PIS-PASEP fund\textsuperscript{252}, a form of compulsory saving which controlled a substantial amount of resources\textsuperscript{253} and was previously utilised as a source of short term loans to the enterprises. The control of the PIS-PASEP fund permitted the

\textsuperscript{251} As emphasised in chapter 6, the total government revenue increased from 19.1\% of GDP in 1965 to 25.7\% in 1970.
\textsuperscript{252} PIS – Programa de Integração Social (Program of Social Integration); PASEP – Programa de Formação do Patrimônio do Serviço Público (Program of Formation of the Public Service Patrimony).
\textsuperscript{253} The PND II estimated that the resources administered by these funds would amount CR$ 58 billions (US$ 7.16 billions) in the period 1975-1979.
BNDE to double its resources and to substantially expand its activities. In 1974, the value of its operations increased by 110.7% and in the following four years it grew at an average annual rate of 20.6%\(^\text{254}\) (Tadini, 1986: 55). Due to its high degree of coherence and commitment with the economic policy, a large part of the resources were transferred to the targets of the PND II. In 1975, for example, 18% of the resources of the system BNDE, including the subsidiaries, were destined to finance basic equipment, while 41% were used to finance basic inputs projects\(^\text{255}\). This participation increased considerably in 1977, when investment in basic equipment and basic inputs absorbed respectively 35% and 36% of the resources of the BNDE, shares much superior to their participation in the economy\(^\text{256}\) (Almeida, 1983: 73).

As explored in the section 7.5, BNDE had a very active role in promoting the objectives of PND II. As Martins (1985) and Klein (1985) show, it was engaged, like a political party, in the objectives of domestic heavy industry. Its initiatives included attempts to strengthen private enterprises and convince them to invest in the strategic sectors. Almeida (1983) illustrates very well this kind of initiative. In 1974-75, BNDE, judging necessary the construction of a factory of ‘extra-heavy’ components, searched for a suitable partner in the private sector. The bank offered, as ‘incentives’, participation in 50% of the subscribed capital, credit for the purchase of equipment, guarantee for imports and access to foreign credits. According to Almeida (1983: 79), “the total of these ‘mechanisms’ accounted for about 80% of the investment”.

The objective of strengthening the national private sector and stimulating investments in basic inputs and capital goods led the BNDE to create, in 1974, three subsidiaries. *Investimentos Brasileiros S.A* (IBRASA) was created to stimulate the capitalisation of private enterprises and strengthen the position of national capital (CDE I, 1974: 17). *Financiamento de Insumos Básicos* (FIBASE) was created to offer

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\(^{254}\) In 1976, for example, the total of financial operations approved by the system BNDE amounted to CR$ 70.2 billions (a sum around to US$ 5.6 billions), while the resources effectively lent in that year amounted to CR$ 32.7 billions. The total investments in the economy amounted to CR$ 366.3 billions (BNDE, 1978; IBGE, 1987).

\(^{255}\) The participation of the two sectors in the loans of BNDE was 39% in 1973.

\(^{256}\) In 1978, the participation of the two sectors reached 73.6%.
resources for credit and capital participation in private projects in the basic inputs sector. Finally, *Mecânica Brasileira S.A* (EMBRAMEC) was created to provide resources for capitalisation in projects in the capital goods sector. The objective of EMBRAMEC, by supplying capital and sharing the risk of investment, was to reverse the conservative behaviour of the producers and encourage them to invest\textsuperscript{257}. In the three financial agencies, it is important to emphasise, the core of the resources came from BNDE.

The importance of the creation of BNDE’s subsidiaries is emphasised by the President of the Bank, Marcos Vianna, commenting on the creation of FIBASE. According to Vianna, the studies elaborated by BNDE had indicated the need of investments in many productive sectors. The projects, however, demanded high amount of capital, substantially beyond the capacity of the national enterprises which acted in the respective sectors. The solution, thus, was the creation of FIBASE which, by supplying resources for credit and capitalisation, reduced the risks of takeover by foreign enterprises\textsuperscript{258} (Vianna, 2000).

A central role in the financial structure of the PND II was played by the *Agência Especial de Financiamento Industrial* (FINAME – Special Agency of Industrial Financing), a BNDE subsidiary responsible for financing the purchases of capital goods. Before the PND II, the lack of a consistent long term structure of credit created serious difficulties for the national producers of capital goods. As already stated, the dependence on foreign supply credits, which required the realisation of international bids for the acquisition of capital goods, eliminated the chances that the national producers would supply the project. In this sense, the action of FINAME, which financed the acquisition of capital goods under very good conditions, was crucial to directing the demands of the state enterprises and other investors towards the domestic market\textsuperscript{259}.

\textsuperscript{257} According to Almeida (1983: 73), EMBRAMEC, after 1976, came to play a more active role by identifying deficiencies in the capital goods sector and defining a program of action. In addition, it engaged in the creation of technical groups inside the enterprises.

\textsuperscript{258} As emphasised, the control of national capital in certain niches was also an important target of the government.

\textsuperscript{259} This is very well illustrated by the performance of the state enterprises of the steel industry, which at the beginning of the 1970s obtained most of their capital goods abroad. After 1974, the special conditions
Between 1973 and 1978, the value of the operations approved by FINAME, in real terms, increased 9.4 times (Almeida, 1983: 71). The agency adopted strictly the directions of PND II, working for the strengthening of the national capital goods sector and discriminating against foreign capital. In order to have access to credits of production and commercialisation, the enterprises had to present a minimal index of ‘nacionalização’ in the acquisition of equipment. Accordingly, there was also a clear policy to promote ‘nacionalização’ of engineering: in certain sectors, FINAME required that the engineering project, if not realised by the firm which contracted the project, must be undertaken by a national enterprise or by a consortium led by a national enterprise (Almeida, 1983: 78-79). In this process, the foreign enterprises only benefited from the commercialisation credits when the other part was a national enterprise (Tadini, 1986: 60; Vianna, 2000).

In conclusion, the action of FINAME was crucial for the development of the capital goods sector in the 1970s. This was a point much emphasised in interviews with businessmen, technicians and policy-makers. According to the President of BNDE, the importance of FINAME stems from the fact that “each dollar of FINAME’s credit constituted a dollar extra in the production of capital goods” (Vianna, 2000). Jose Lúcio Pádua Soares, director of the steel state enterprise USIMINAS, emphasises how FINAME’s credit contributed to changing the policy of the enterprise. At the beginning of the 1970s, USIMINAS concentrated most of its purchases in Japan. At the end of the decade, the enterprise was engaged in the achievement of the minimal index of FINAME credit, charging interest rates which decreased according to the index of national participation in the supply of equipment increased to around 70% (Almeida, 1983: 76; Tadini, 1986: 69; 74).

260 Index of ‘nacionalização’ (or simply ‘nacionalização’) means the participation of the national producers in the total purchase of capital goods. As I did not find a synonym in English, I employ several times the word in Portuguese.

261 According to Amann (1996: 115), this index in the operations of FINAME varied between 55% and 88%. In 1978, the average index of the operations of the agency attained 85%.
nacionalização required by FINAME, as a pre-condition to obtaining supply credits in very special conditions (Soares, 2000).

Another important leg of the industrial policy was the set of measures adopted to control imports. During the Geisel government, both tariff and non tariff measures were utilised to protect the capital goods sector. In addition, the increase in the difficulties of the balance of payments also contributed to increasing protection of national production. Before 1974, as emphasised, the effective protection to the capital goods sector had been substantially reduced by the incentives conceded by the Conselho de Desenvolvimento Industrial (CDI), which exempted many projects from the payment of tariffs in the import of equipment. This practice was altered by the PND II, which guaranteed the increase in protection to national production. This direction was reinforced by the Carteira de Comércio Exterior do Banco do Brasil (CACEX – Bureau of Foreign Trade of Banco do Brasil), which was strictly committed to the control of imports of capital goods.\(^{262}\)

A critical instrument of the import policy was the Princípio do Similar Nacional (Principle of National Similarity), which forbade the concession of incentives and tariff exemptions to the import of equipment which had a ‘similar’ product manufactured by national firms. A national product was considered ‘similar’ if it was a good substitute for the product to be imported in three aspects: price, quality and period of delivery. The evaluation, however, was not automatic, involving a process of consultation and negotiation with the national producers (Erber, 2000; Amann, 1996: 114). Therefore, it is easy to see how the process of evaluation gave a high margin of discretion to the organ responsible for enforcing the principle. This discretion was much more critical in the case of non-serial capital goods, which, by definition, were not subject to a standard specification. As a consequence, the effectiveness of the Principle of National Similarity was critically dependent on the engagement of the agency responsible for its application.

\(^{262}\) Amann (1996), offers detailed data about the increase in tariffs. In machinery, for example, the nominal tariff increased from 34.4% in 1972 to 41.6 in 1978, while the effective tariff increased from 7.2% to 13.6%. In electrical equipment, the nominal tariff increased from 48.5% to 68.1% and the effective tariff from 12.2% to 19.5%.
Before 1974, the government had other priorities and the Principle of National Similarity was easily circumvented. This was changed by the economic strategy of the Geisel government: CACEX rigorously applied the principle, which was extended to cover the import of equipment from public enterprises and agencies (Amann, 1996: 115).

Another important instrument was the Acordos de Participação (Accords of Participation), administered by CACEX. These accords, which took place in large-scale investment projects, were marked by an intense process of negotiation between the investors and the national producers of non-serial capital goods. Initially, the investor presented to CACEX a list of the equipment and components which they intended to import and a list of those they expected to acquire in the domestic market. CACEX sent the list to the national producers, who analysed the potentialities of the national industry and elaborated a counter-purpose. Then, the two sides met and tried to establish an agreement, in a process in which CACEX used its power of sanction to increase the participation of the national producers (Erber, 2000; Martins, 1985: 179-180). The commitment of CACEX was very important to increasing national participation in those accords, which grew from 52.6% in 1973 to 82.4% in 1979 (Tadini, 1986: 100).

The adoption of more rigorous control over imports, in response to increasing balance of payments difficulties, also had positive effects for the ‘nacionalização’ of capital goods. In 1975, the Central Bank decreed that the importer must pay a deposit equivalent to 100% of the value of the operation, which was to be retained for 180 days. In the same year, the government increased control over the imports from public organs and enterprises. Besides the target of a 15% reduction in the programmed annual imports, “government departments and public enterprises were required to submit an

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263 It is important to emphasise that such decisions affect the economic groups in very different ways. While the national producers were keen to demonstrate their capacity to produce the item, the importers were interested in purchase the most reliable and cheap equipment, regardless of its origin.

264 The measure had the obvious effect in increasing the disincentive to import. According to Lessa (1988: 208), it was very effective and contributed even to increase the national participation in the purchase policies of the foreign enterprises.
annual foreign exchange and import budget to the Ministry of Finance” (Amann, 1996: 115). In addition, an effort was made to rationalise imports and concentrate them in the items necessary to the continuity of the program of industrialisation, a position pursued during the duration of the government.

An important role was also played by the policy of incentives. The Geisel government promoted a radical reorientation in the action of CDI, adapting its policies to the objectives of the PND II. Enterprises needed to acquire certification from the CDI in order to qualify for the incentives. These included immunity from the compulsory import deposit and exemptions from import tariffs and from the payment of IPI and ICM, two important forms of tax. Before 1974, the action of CDI had been characterised by a very liberal and indiscriminate policy of incentives, approving practically every demand. This was changed from 1974: through Resolution 35/74 of the Conselho de Desenvolvimento Econômico (CDE – Council of Economic Development), the activities of CDI were concentrated on the sectors considered strategic by the PND II (Lessa, 1988: 103). The organ became more committed to the Principle of National Similarity and to the objective of orienting the demand of equipment to the domestic market. Furthermore, it extended the fiscal incentives given to exports to the purchase of equipment in the domestic market and attempted to increase the rate of protection of the capital goods demanded by non-strategic sectors (Almeida, 1983: 59). And finally, CDI came to demand, as an extra requirement to projects applying for incentives, the verification of a minimal index of national participation in the purchase of equipment. According to Amann (1996: 115), the required ‘index of nacionalização’ reached 85% in 1978.

The new orientation of CDI is very well illustrated by the increase in the participation of the capital goods and basic input sectors in the projects approved by the organ. In 1973, the capital goods sector accounted for 5% and the basic inputs sector

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265 IPI (Imposto sobre Produtos Industrializados) was a tax on industrial products; ICM (Imposto sobre Circulação de mercadorias), was levied on the circulation of goods.
266 The CDE, headed by the president Geisel, was responsible for the main economic decisions of the government. See section 7.5.
responded for 43.7% of the value of the projects of fixed investment approved by CDI. In 1977, the two sectors increased their participation to 18% and 73.7% respectively\textsuperscript{267}. (Lessa, 1988: 152). Accordingly, the national producers increased substantially their participation in the supply of equipment to projects approved by CDI. Considering all the industrial projects approved by the organ, the national participation increased from 36% in 1973 to 68% in 1977.

Another important incentive to investment was the limit in the monetary correction in the long term loans provided by official institutions (decrees 1410/75 and 1452/76). Since inflation was 27.7\% in 1975 and reached 41.3\% in 1976\textsuperscript{268}, fixing monetary correction at 20\% constituted a substantial subsidy to investment. According to the government’s evaluation of the economic policy in 1975, the fixation of monetary correction was very important to encourage investment in capital goods and basic inputs sectors (CDE IV, 1976: 06).

A central instrument of the PND II was the policy of purchase of the state enterprises. Before 1974, the national producers complained that uncertainty in relation to the future demand of capital goods was one of the main factors which inhibited investment in the sector\textsuperscript{269}. The PND II addressed this issue through the firm utilisation of the state enterprises policy of purchases as an instrument of industrial policy. In this sense, the large projects in infra-structure and basic inputs provided a substantial demand which was utilised to stimulate the development of the capital goods industry.

In the \textit{Exposição de Motivos}\textsuperscript{270} 6 (E.M 6), published by CDE in 1974, the government recommended that public enterprises give preference to national producers, when acquiring capital goods (Vilella, 1984: 103-104). The \textit{Exposição de Motivos} 16.B

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\textsuperscript{267} These numbers, it is necessary to emphasise, also reflect the general tendency observed in the economy, characterised by the concentration of investments in the two sectors elected as strategic by PND II.
\textsuperscript{268} For measuring inflation in the 1970s, I used the index IGP-DI calculated by Fundação Getúlio Vargas.
\textsuperscript{269} According to them, this uncertainty was critical in a sector in which the investments took a long time to mature.
\textsuperscript{270} \textit{Exposição de Motivos} (Exposition of Motives) was the report elaborated by the policy makers justifying the measures adopted.
\end{flushright}
(E.M 16.B), of the same year, condemned certain state enterprises for giving excessive emphasis to efficiency criteria and disregarding other important objectives, such as technological autonomy and development of the capital goods industry. As practical measures, the E.M 16.b recommended: a careful study of the list of equipment demanded in the new projects, considering the viability of obtaining them in the domestic market; the elaboration by the enterprises of long term plans of investment, in order to permit the national producers to program their plan of expansion, and the creation of technical centers to develop technology. Finally, the *Exposição de Motivos* went a step further and suggested the elaboration of a detailed catalogue about the national producers and the establishment of close contact between the state enterprises and the national producers (Vilella, 1984: 104-105).

This orientation was institutionalised through the creation of the *Núcleos de Articulação com a Indústria* (NAIs - Centers of Articulation with the Industry), in 1975. The NAIs were installed inside the state enterprises with the objective of co-ordinating the relationship with the producers of capital goods. In 1977, 88 state enterprises had their NAI. The function of co-ordinating the sectoral NAIs was played by the *Comissão Coordenadora dos Núcleos de Articulação com a Indústria* (CCNAI – Commission of Co-ordination of the Centers of Articulation with Industry), a council formed by representatives of CACEX, CDI, EMBRAMEC and FINEP and presided over by this last organ.

The objectives of NAIs were pursued in the following way. Firstly, the state enterprises designed a long term program of investment and equipment acquisition, necessary to keep the producers informed of the future demand of equipment and to permit the elaboration of their plan of expansion (Almeida, 1983: 81). Secondly, the NAIs organised a catalogue systematically describing the present and potential producers of capital goods in each niche of production. This catalogue, by making the engineering department of the enterprises aware of potential producers, was designed to

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271 FINEP, *Financiadora de Estudos e Projetos*, was the agency responsible for conceding credits to projects and studies destined to increase scientific and technological capacity.
encourage such enterprises to take into account the capacity of Brazilian firms when formulating projects. In addition, knowledge of the characteristics of the suppliers allowed the NAIs to choose the producers in accordance to the objectives of the economic policy (Souza, 1997: 55-58). Besides the ‘nacionalização of equipment’, objectives such as technological development, achievement of a solid market structure and of economies of scale and the development of domestic engineering firms could be taken into consideration.

The NAIs had a very active role and achieved very positive results. They elaborated studies about the characteristics of the demand for parts and components, investigated carefully the characteristics of the national producers and checked whether the demands of the state enterprises generated sufficient scale to justify investment in certain niches. In addition, the engineers of the state enterprises were engaged in a careful monitoring program in support of the capital goods producers. They accompanied the process of technological transfer, kept the producers informed about the performance of the equipment, suggested upgrading and helped the producers in the technological process (Souza, 1997: 57). Furthermore, several sectoral NAIs monitored the process of purchase of technology and used their greater bargaining power to obtain better conditions in terms of technology transfer.

In conclusion, the NAIs constituted an ingenious instrument of economic policy which, providing an articulated structure of co-ordination and exchange of information,

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272 The catalogue classified the producers according to different issues, which included: the structure of capital; the origin of the technology utilised; the degree of ‘nacionalização’ of equipment; the degree of diversification/specialisation; the entrepreneurial, administrative and financial capacity of the enterprise; the productive capacity; the suitability of the layout; the qualification of the technical team and the potentiality of the enterprise to engage in an effort of technological development (Souza, 1997: 56).

273 National control of engineering, by influencing the design and specification of the capital goods demanded in the project, was an important step in increasing the national participation in the supply of capital goods.

274 In this sense, the engineers’ knowledge of design, of the technical characteristics of the product and of the conditions of use of material were very useful to permit the enterprises upgrade the product. Their assistance was especially important to the producers unable to pay specialised technicians or to keep their own laboratories.
had very positive effects on the development of the capital goods industry. Besides their role in the nacionalização of the supply of capital goods, the NAIs were important to increase the quality of the equipment and also had positive, although limited, effects on technological development.

The results, nevertheless, varied considerably according to the enterprise. Although the CCNAI was very committed to the objectives of the PND II, it had no legal or financial resources to force a sectoral NAI to follow its orientation. Accordingly, the NAIs had no influence on the policies of purchase and investment of the state enterprises. Their influence was limited to the evaluation and classification of the suppliers, which were chosen from the catalogue organised by the respective NAI. As Souza (1997: 62) points out, they could suggest and orient but they did not have power to take decisions. As a consequence, the performance and the capacity of influence of the NAIs were dependent on the personal orientation given by the director of the enterprise (Souza, 1997: 62).

This explains why, on one hand, the NAIs of Petrobrás and Eletrobrás, enterprises whose directors were committed to the aims of the PND II, obtained very satisfactory results in promoting import substitution and achieved also advances in technological effort, while, on the other hand, the results of the NAIs were much inferior in state enterprises which adopted a strict business rationality and refused to direct their action according to the more general objectives of the program of development.

It is worth emphasising the capacity of certain NAIs to obtain important achievements in technological area. The example of Eletrobrás illustrates very well the point. Henrique Mello, President of the NAI Eletrobrás, emphasises how the state enterprise had substantial bargaining power, which included the capacity to demand technology transfer. According to him, if the process did not follow the desired direction, the enterprise could withdraw the firms manufacturing certificate and,

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275 Petrobrás was the Oil State Enterprise and Eletrobrás a holding of the public enterprises in the electrical sector.
consequently, exclude the respective firm from the list of the suppliers. According to Mello, *Eletrobrás* closely tracked the process of transfer of technology: “the producer had to prove to Eletrobrás that it received and dominated the technology, and Eletrobrás had to show to EMBRAMEC and FINEP that the technology had actually been transferred” (cited in Souza, 1997: 39).

As an example, Mello mentioned the case of one national producer of turbines which obtained foreign technology from Canada. As the Canadian firm resisted the requirement to provide integral transference of technology, the President of NAI, accompanied by the President of the *Instituto Nacional de Propriedade Intelectual* (INPI - Institute National of Intellectual Property)\(^{276}\), contacted the foreign enterprise and demanded the opening of the technological process to the Brazilian technicians, including access to the hydraulic laboratories of the enterprise and participation in tests and in the elaboration of models. In the case of the foreign enterprise's disagreement, the state enterprise threatened to veto the contract of technology transfer and cancel purchases from the respective producer (Souza, 1997: 39).

The example illustrates how the engagement of the state enterprise could produce important results in terms of industrial policy. However, it is necessary not to underestimate the difficulties faced by the process. The existence of other priorities, opposition from sections of the business class, divisions inside the state and resistance from the foreign producers were factors which, as explored in subsequent sections, impeded the achievement of better results. Accordingly, the priority given to the rapid internalisation of the supply of capital goods, a result of the immediate constraints of the balance of payments, forced the enterprises, in many situations, to import technology and downgrade the objective of technological development.

In brief, this section shows how the effort undertaken by the PND II included a set of articulated instruments adopted with the intention of developing the capital goods

\(^{276}\) INPI was the organ responsible for regulating the operations of purchase of technology. A detailed evaluation of its action is presented in section 7.4.
sector. Certain instruments, as seen, presented a high degree of coherence, reflecting the commitment of competent technicians to the objectives of the PND II. In addition, the government demonstrated a large capacity to concentrate resources on the target sectors. As a result, those instruments had a substantial impact over the production of the sector, which increased from US$ 5.89 billion in 1973 to US$16.57 billion in 1978. As the imports grew at a much slower pace, their participation in the national demand for capital goods decreased from 28.7% in 1973 to 19.8% in 1978 (see section 7.9). It is worth emphasising the magnitude of import substitution, achieved in a period in which the rate of investment and, consequently, the demand for capital goods, had increased substantially.

A careful analysis of the results of the process of import substitution in the capital goods sector, as well as of the suitability of the industrial policy, is undertaken in section 7.9. For the moment, it is important to emphasise the instruments created by the government and the favourable impact on the capital goods sector. In addition, it is also important to anticipate that the industrial policy had significant limits. As stressed in the description of the NAIs, the lack of an unified orientation for the state enterprises was a liability which reduced the effectiveness of the industrial program. Accordingly, the industrial policy, concentrated on promoting a very rapid process of import substitution, failed in not taking into consideration the efficiency of certain projects and in not discriminating between niches to be developed. Thirdly, the government’s policy of incentives encouraged a proliferation of producers, hindering the constitution of an industrial structure concentrated enough to allow the producers to obtain economies of scale. Finally, no policy of mergers was adopted to increase the efficiency of the industrial structure (See, Amann, 1996: 121 and Villela, 1984: 109; 152).
7.4 The PND II and technological development

Introduction

The objective of this section is to summarise how the Geisel government addressed the issue of technological development and to emphasise the main obstacles it faced. As indicated, technology was an important component of the program of industrial transformation proposed by Geisel. The development of heavy industry, implying the capacity to produce more sophisticated items, required an improvement in the capacity to adapt and develop technology. However, the challenge was substantial: Brazil was very dependent upon imported technology and the possibility of developing it internally required a huge effort.

A crucial inflection in the treatment given to technology occurred after the military seizure of power in 1964. During the first stages of industrialisation, when the industrial structure was more elementary, the technological necessities were obtained basically through the import of machines and the recruitment of skilled technicians from abroad. Economic development and the growing sophistication of the industrial structure modified the situation, requiring the contract of projects and services of engineering from foreign companies. Overall, during these phases of industrialisation, the objective was to substitute imports using foreign technology and no substantial effort to improve technological capacity was attempted (See Guimarães, Araujo Jr and Erber, 1985: 41).

The military regime, which viewed technological development as important for national sovereignty, paid more attention to the issue. The Castelo Branco government increased investment in education and created the Fundo de Desenvolvimento Científico e Tecnológico (FUNTEC – Fund of Development in Science and Technology), in 1964. Nevertheless, little progress was made and the technological policy consisted basically of facilitating the access of foreign capital and technology to the domestic market.

During the Costa e Silva government, the Programa Estratégico de Desenvolvimento (Strategic Program of Development) selected, as important objectives,
the increase in capacity of adapting foreign technology to the national necessities and of creating and developing new technology (Guimaraes, Araujo Jr and Erber, 1985: 45). An important innovation was the elaboration of the *Plano Básico de Desenvolvimento Científico e Tecnológico* (PBDCT – Basic Plan of Scientific and Technological Development), which was responsible for co-ordinating government efforts in the area. The new direction also included the strengthening of the institutes of research, the establishment of a special fund to finance research and development, the *Fundo Nacional de Desenvolvimento Científico e Tecnológico* (FNDCT – Fund National of Scientific and Technological Development), the re-orientation of the programs of the universities and the strengthening of programs aimed at training and qualifying people (Guimarães, Araujo Jr and Erber, 1985: 45-46). Organs such as the *Conselho Nacional de Pesquisa* (CNPQ – Council National of Research) and *Coordenação de Apoio ao Pessoal de Nível Superior* (CAPES – Co-ordination of Support to People of University Level) increased their resources and activities, which were channelled towards training people and funding research at the universities (Amann, 1996: 342). In addition, planning agencies, such as IPEA, adopted a policy to qualify the staff and encourage technicians to obtain doctorates abroad.\(^{277}\)

In brief, the new orientation was a landmark, characterising the first systematic effort to address the technological issue. It left an important legacy, which included the adoption of the PBDCT I in the Médici government, the strengthening of the FNDCT and the new role assumed by CNPQ and CAPES. However, it is important to emphasise that, during both the Costa e Silva (1967-1969) and the Médici (1969-1973) governments, there was a very significant distance between the intentions declared for the area of science and technology and the practice of the industrial and economic policies. The Planning Ministry was isolated and the plan for science and technology became, in large measure, a mere declaration of intent. In other words, there was no consistent effort to develop domestic technological capacity. The technological services

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\(^{277}\) As Vilella (2000) points out, the beginning of the 1970s was marked by the return of the first generation of economists who got their PhD abroad, which had an important impact in the activities of the planning agencies.
and products necessary to sustain the high rates of growth were obtained abroad and the role of industrial policy was to facilitate the import of technology (Guimarães, Araujo Jr and Erber, 1985: 55, 56).

The orientation of the industrial policy was, as seen, considerably reversed by the program of development adopted by Geisel. The priority given to heavy industry was accompanied by an increase in attention paid to technological development. Thus, both the PND II and the PBDCT II emphasised the objective of intensifying the effort to adapt and develop technology (Guimarães, Araujo Jr and Erber, 1985: 57). The technological budget and the resources destined to finance investments in science and technology increased substantially and the PBDCT II programmed, for the period 1975-79, the expenditure of resources which amounted to 0.7% of GDP\(^{278}\) (CDE II, 1975: 08). This amount allowed FINEP to increase significantly the supply of resources to enterprises engaged in R&D. As a result, a huge amount of resources, subjected to negative interest rates and very favourable conditions, were made available to stimulate investment in technology\(^{279}\).

Another important arm of the technological policy was the action of the Instituto Nacional de Propriedade Intelectual (INPI - Institute National of Intellectual Property). INPI regulated technology imports and was committed to supporting national firms in the negotiation of contracts of purchase of technology. Its objective was to obtain favourable conditions which allowed Brazilian firms to absorb technology.

The technological effort was complemented by the investment in the creation of R&D institutes and research laboratories. An important example was the creation of the Instituto de Pesquisas Tecnológicas (Institute of Technological Research), in São Paulo, which had a laboratory dedicated to the capital goods sector (Amann, 1996: 343).

\(^{278}\) The resources controlled by the FNDCT increased from CR$ 546 million in 1974 to CR$2,162 million in 1975 and a highpoint of 3,645 million in 1976, corresponding to 1.16% of the budget. In ‘Tecnologia. Financiamentos ou incentivos fiscais à pesquisa?’ Negócios em Exame. 12-4-1978.

\(^{279}\) As an example, FUNTEC supplied resources at the annual interest rate of 4%, without monetary correction. Given an annual inflation of 41.3% in 1976, the subsidy was very substantial.
Similarly, the state enterprise USIMEC created a laboratory and engaged substantially in the effort to develop technology in the capital goods sector.

The objective of developing technology was closely connected to the priorities of the PND II. Firstly, the import of technology, implying payment of royalties and services of technology, put pressure on the balance of payments. Secondly, the control of engineering projects by foreign firms tended to lead to the specification of capital goods which did not favour domestic producers. Thirdly, and very important, the lack of technological skills prevented domestic enterprises from producing more sophisticated equipment, thereby limiting the achievements of the import substitution program. As the Director of BNDE, Roberto Lima Netto, points out, the lack of know-how led large and well equipped national enterprises to produce simple and elementary products, missing the opportunity to produce high quality, sophisticated items. And finally, the solidification of the national industry of capital goods and the achievement of economies of scale required the conquest of foreign markets, an objective which would be difficult to achieve in the absence of the mastery of technology.

The achievements and obstacles faced by the technological policy of the Geisel government are explored in the next subsections. In contrast to the Médici government, there was a large attempt to make the industrial policy compatible with the technological policy. However, the technological effort was timid and the objectives of the economic policy conflicted with the technological targets. As the next paragraphs explore, the need for rapid import substitution pushed the enterprises to sign contracts of technological license. In addition, uncertainty about the future of the economic policy discouraged investment in technology.

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280 These payments were substantial and reached US$ 550.8 million in 1975. However, as Ubirajara Cabral, director of INPI, emphasises, this value underestimates the impact of technology on imports, since it does not include the payment of technology implicit in the price of the products. In ‘Tecnologia Industrial - Discussão das Opções Brasileiras’. Visão. 14-11-1977. In certain cases, these prices assumed very elevated levels, because importers did not have any idea about the costs involved in the process. See ‘Tecnologia - a ofensiva da FINEP para abrir ‘caixas pretas’’. Negócios em Exame. 27-10-1976.


Difficulties and obstacles

Technology is a key variable to understanding the obstacles faced by the PND II in its effort to change the pattern of industrialisation. Firstly, it is important to emphasise the magnitude of the challenge, explained by Brazil’s chronic dependence on foreign sources of technology. As already stated, no serious effort of technological development had been undertaken before 1974 and the country was critically dependent on multinational enterprises. In addition, as Lago et al. (1979: 424) point out, expenditure on ‘research and development’ was very small and was in large part dissociated from the productive sector.

Countries which industrialised in the twentieth century faced very substantial obstacles in ‘catching up’. In comparison to the first latecomers of the nineteenth century, the technological gap was much more substantial and the difficulties in overcoming it were much more significant. Production techniques were disseminated basically via foreign direct investment, in a process which substantially increased technological dependence. As a result, the main technological decisions, which critically affected the course of the internal economy, were taken abroad. In such a context, the objective of increasing domestic technological capacity had to face opposition from multinational companies (MNCs), which had no interest in opening the black box and transferring control of technology.

Thus, the rupture with technological dependence required the engaging in a huge effort of investment. Besides the measures adopted by the government, it was crucial to convince private enterprises, responsible for the core of the production of capital goods, to change their established practices and invest in development and the absorption of technology. Nevertheless, there were many factors that inhibited this

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283 The activities of R&D were concentrated on the original countries and the MNCs’ activities in the host nations did not have significant impacts on technological development.

284 Which included, as seen, the creation of institutes of research and laboratories, investment in education and the strengthening of funds to finance investments in technology.
engagement in the technological effort. The costs of investment in R&D were substantial and the risks considerable, since there was no guarantee that investment would produce positive results. In addition, uncertainty over the future of economic policy was a disincentive to complex and expensive investments in technology.\footnote{According to the industrialists, the magnitude of the task and the uncertainty concerning the future were the main factors that inhibited investments in technology. They considered that the guarantee of future orders by the government was a crucial measure to encourage such investments. Thus, they demanded the adoption of a clear and long term industrial policy and, specially, the establishment of a long term plan of investment and purchases by the state enterprises (Erber, 1982: 74; Lessa, 1988: 118). See section 7.7.}

A critical obstacle to the domestic development of technology came from the exigencies of customers. The purchasers of capital goods, especially in the case of non serial capital goods, acquired expensive equipment which represented substantial part of their investment. Consequently, they were very concerned with the reliability of the product and tended to require that the producers used a tested and reliable foreign technology.\footnote{According to Erber (1982: 70), “the price is not the main determinant in sales of complex capital goods: performance, durability and reliability, besides financing, are far more decisive considerations”.} This exigency, adopted also by many state enterprises, pushed the firms to sign licensing contracts with reputable international producers and thus worked as an obstacle to the engagement in expensive investments to develop technology. As Erber (1982: 70) concludes,

> “the conditions imposed by the purchasers of capital goods, coupled with the competition of other producers having access to foreign technology and the time and cost necessary to develop an alternative technology locally, often leave the manufacturers no choice but to conclude a licensing agreement...”

As Erber argues, the licensing of technology favoured the reproduction of the cycle of dependence. Although it allowed domestic firms, in certain cases, to develop the ‘detailing project’ and absorb the technology of manufacturing, it did not give the enterprises the ability to develop the basic project, crucial to the capacity of innovating. According to Erber (1982: 75), there was a critical discontinuity between the two abilities and the domain of the ‘detailing project’ very rarely permitted the enterprise to
achieve the knowledge of the basic project. In consequence, the licensing of technology had very limited effects on the development of the domestic technological capacity. The rupture of the cycle required, thus, that the enterprises invested substantially in technology\textsuperscript{287}.

Another important obstacle was the low level of qualification of the labour force. At the moment when the PND II was adopted, few enterprises had skilled technicians with “enough capacity to absorb the knowledge necessary for the reproduction and improvement of the acquired technology” (Lago, 1979: 424). The correction of this deficiency required substantial expenditure of time and resources in programs of training. In the absence of such effort, the chances that the contracts of licensing would produce effective absorption of technology were very small\textsuperscript{288}.

Therefore, given the incentives to import technology and the dependence on licensed technology, the great challenge of the government was how to reverse the situation and encourage enterprises to invest in technology. As emphasised, the risks of not achieving satisfactory results were significant, as well as the risk that the personal trained by the enterprise would move to other firms\textsuperscript{289}. In conclusion, as events demonstrated, the objective of modifying the producers’ behaviour required much more than the offer of financial resources at highly subsidised rates. Besides public investment in education and R&D, it was critical that the government produced an atmosphere of confidence necessary to persuade industrialists of the long term advantages of mastering technology. Unfortunately, this was very difficult to achieve in the 1970s.

\textsuperscript{287} According to Erber (1982: 69), the firms, once dependent on licensing, tended to perpetuate the ties, even in cases in which they achieved similar technical capacity. Besides the exigencies of the customers, as mentioned above, this behaviour was explained by the possibility of benefiting from future innovations and by the intention to prevent that the rivals had access to the technology.

\textsuperscript{288} According to Jaguaribe, one important effect of the lack of technical capacity was the lack of demand for the resources destined by the government for science and technology. According to him, Brazil destined for science and technology “the highest amount spent in developing countries” at that time, but a significant part of these resources were not utilised. In ‘Um inviável projeto nacional’. Visão, 26-12-1977.

\textsuperscript{289} A classical example of externality, as utilised by the manuals in economics to justify state intervention.
The role of state enterprises

The state enterprises, crucial agents in the strategy of development, also had a key role in the effort of technological development. Besides their direct investment in institutes of research and laboratories, their policy of purchase was seen as an important instrument for the development of the technological capacity of the private enterprises. As section 7.3 emphasises, the NAIs, which provided exchange of information, mutual consultancy and technical assistance, were a central element of this strategy.

The idea of using state enterprises as instruments of economic development was founded on the view that, given their public nature, their large scale and their capacity to assume higher costs and risks, they could accept higher prices, longer delivery times and even inferior quality. Thus, they could provide the stimulus to the domestic producers in their learning phase. As stressed, the new suppliers in the capital goods sector were victims of a vicious circle, in which the purchasers, preferring well established and reliable producers, did not provide opportunities for the development of the new enterprises. The idea was thus that the state enterprises could contribute to breaking this vicious circle.

In reality, however, the situation was more complex. State enterprises had their own pattern of behaviour and rationality and many of them were not inclined to give up their immediate objectives to play a part in the government strategy. As section 7.5 emphasises, the state was divided and the government had difficulties to extend its orientation to other agencies of the state apparatus. The state enterprises and the agencies of indirect administration had substantial autonomy, including financial autonomy, and could follow directions not necessarily congruent with those desired by the government.

Consequently, as the government was not able to impose general direction, the behaviour of enterprises was very dependent on the personal conceptions of the directors, including their view about the objectives of the enterprise and their sympathy
for the policies of the government. During the Geisel government, it is possible to identify two very different patterns of behaviour. On the one hand, enterprises such as Petrobrás, Eletrobrás and CESP\(^\text{290}\) were strong supporters of the PND II strategy. Although these enterprises had also their own interests and concern with profitability, they believed that the development of the local industry was one of their objectives and were thus ready to stimulate the national producers. The NAIs of these enterprises achieved substantial results, a consequence of the disposition of the firms to support the suppliers and participate in partnership programs to improve the product.

Other enterprises, on the other hand, had a more ‘pragmatic’ idea about their objectives, usually connected to micro-economic efficiency. As Erber (2000) argues, enterprises such as CEMIG and FURNAS, state enterprises in the electrical sector, considered that their objective was to produce electricity well and cheaply and were thus less sensitive to the objectives of the industrial policy. Consequently, these enterprises tended to define their purchase policy like private companies. Once they acquired expensive equipment, they tended to pay special attention to the reliability of the equipment and to require that the producers signed a contract of licensing of technology with international suppliers.

Furthermore, as emphasised, the state enterprises played an important role in the technological program through the constitution of centres of R&D. As Villela (1984: 150) points out, the four state enterprises’ systems studied by him - Petrobrás, Siderbrás, Eletrobrás and Telebrás\(^\text{291}\) - engaged in such an effort, employing 1058 people with university level education (Petrobrás alone employed 617 people). According to the author, these R&D centres played an important role in the realisation of applied research, contributing to the development of products and to an increase in exports.

\(^{290}\) CESP, Centrais Elétricas do Estado de São Paulo, was the state enterprise responsible for the generation and transmission of electrical energy in the state of São Paulo.

\(^{291}\) Siderbrás, Eletrobrás and Telebrás were respectively the state holdings responsible for the co-ordination of the state enterprises in the steel, electricity and telecommunication sectors.
USIMEC, a subsidiary of the state steel company USIMINAS which produced capital goods, illustrates very well the state enterprise engagement in the technological effort. As Soares, an USIMINAS director in the period, points out, “USIMEC, taking into consideration the future prospects for the enterprise, created a laboratory and invested a substantial amount of resources in training the staff and in other steps necessary for the absorption of technology” (Soares, 2000).

Soares emphasises several difficulties that marked the negotiation of USIMEC with foreign suppliers of technology. According to him, this process involved a permanent bargain with the foreign company. Initially, USIMEC looked for the best supplier of technology and signed a contract which comprised all the steps of production, including engineering and manufacturing. However, during the process, the engineers of the enterprise had to convince the foreign partner of their capacity to carry out certain steps, while the foreign enterprise tended to propose to sell the whole package and to refuse to open the technological process. As a consequence, the degree of learning depended on the capacity of negotiation (Soares, 2000).

Soares stresses how important results were attained and, in certain niches, USIMEC achieved control of both the basic and the ‘detailing project’. However, he accentuates how the effort was abruptly interrupted with the end of the program of expansion of the steel industry. As the enterprise did not yet have the capacity to conquer foreign markets, the interruption in domestic orders forced it to stop its technological activities. As a result, substantial investment and important achievements were lost.

Another interesting example comes from the petrochemical sector. The key characteristic of this sector was the participation of state capital in a partnership which also included national private and foreign capital. In such an arrangement, the central position occupied by public enterprise gave it strong bargaining power to negotiate with foreign capital. Accordingly, the ‘petrochemical model’ introduced an important innovation, since foreign capital participated through the transfer of technology. As the payment for the services of technology were transformed in shares of the company, the
profits of the multinational enterprise became dependent on the success of the investment (Guimarães, Araujo Jr e Erber, 1985: 55).

In spite of the difficulties in the negotiation of technology, the petrochemical model achieved positive resources, including the guarantee of an important space for national private enterprise and the imposition of certain conditions on the action of foreign capital (Suarez, 1986: 189-190). According to Lessa (1988: 213), the foreign firms avidly disputed the possibility of participating in the joint ventures of the sector292. These favourable achievements led bureaucrats and businesspeople to support the extension of the petrochemical model to other sectors.

In brief, the examples above illustrate important issues related to state enterprises’ participation in the technological effort. The petrochemical experience shows how state enterprises could be used to change the balance of power and shape the action of foreign capital according to the objectives of the industrial policy. Accordingly, USIMEC illustrates how the large size and capacity to take risks led the enterprise to construct laboratories and to engage in a substantial effort to absorb foreign technology. The end of the program of investment in the steel sector, nevertheless, crucially affected the plans of the enterprise and provoked significant losses. As Soares (2000) points out, this would have been the fate of the private enterprises if they had engaged in a similar strategy.

The actions of INPI

One important role in the technological policy of the Geisel government was played by the organ responsible for the control of imports and operations with technology, the INPI. The main objective of this organ, by imposing norms and controlling information,

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292 Suarez emphasises that the development of technology was not an original objective of the petrochemical model. The lack of qualified technicians was an important liability and the intention was to import technology. However, the model permitted a certain degree of technology transfer, a result of learning by doing, achieved through the operation of the plant and dealing with everyday problems (Suarez, 1987: 190).
was to improve the conditions of negotiation in the contracts for transfer of technology and increase the chances of effective technological absorption by the national producers.

For this purpose, INPI would not allow contracts that contained certain restrictive clauses. These included norms connecting the use of technology to the import of equipment; prohibition of exports; clauses implying the appropriation, without compensation, of the improvements introduced in the licensed technology and rules forbidding the firm to continue utilising the technology after the end of the contract (Erber, 1982: 71). In addition, INPI prohibited the existence of norms imposing limits on the absorption of technology and pressured for the opening of the technological packages.293

Thus, the regulations of INPI intended to increase the bargaining power of the national producers in the negotiation of contracts. In addition, INPI, by storing information about the market and about the potential suppliers of technology, assisted producers in the selection of suppliers and, in certain cases, attempted to persuade them to finish a contract and find another supplier (Lessa, 1988: 211). During the renewal of the contracts, INPI pressured for the reduction in the amount payable for the services of technology. This orientation, nevertheless, sometimes clashed with the interests of the enterprises, which were willing to intensify the purchase of technology.

Erber (1982) finds evidence of support for the actions of the INPI. According to interviews realised with producers of the capital goods sector, several objectives of INPI were achieved and the bargaining power of the national firms was increased. According to him,

\[ \text{\textit{the interviews show that the firms are learning how to negotiate licence contracts, that is how to reduce payments, avoid excessively restrictive clauses and receive favourable terms. Several of the enterprises interviewed have come to welcome INPI's}} \]

\[ \text{\textsuperscript{293} Another objective of INPI was to reduce national payment for the use of foreign technology and intellectual property. For this purpose, it established norms limiting the amount of payment of royalties, which generated protests from the multinational firms and also from the national enterprises interested in increasing the services of transference of technology.}} \]
policy with respect to restrictive clauses as an asset on their side when negotiating contracts” (Erber, 1982: X). Notwithstanding the positive impact on negotiation, certain enterprises stressed that the necessity to get agility and to reduce the time of approval led them to omit certain clauses from the contract (Erber, 1982: 71).

Nevertheless, the action of INPI also encountered significant opposition. The main difficulty stems from the fact that domestic enterprises were not convinced of the advantages of investing in technology and viewed the activities of INPI as an obstacle to their immediate interests. They blamed INPI for increasing the time necessary for the approval of contracts, for increasing transaction costs and for making enterprises lose important opportunities.

In the face of these criticisms, Erber emphasises the existence of a conflict between the laws and economic rationality, which is critical to understanding the limits of the INPI’s action. According to Erber the laws and the regulation, even if very well elaborated and executed, were not sufficient “to change the behaviour of enterprises radically if the economic motives which govern such behaviour remain largely unchanged” (Erber, 1982: 73). As rational behaviour led the firms to import technology, they looked for ways of circumventing the regulations, such as the omission of clauses in the contracts for technological transfer.

Amann (1996) believes that the actions of INPI had negative effects on the effort of industrialisation, arguing that the excessive control and the limits imposed on the payment of royalties hindered the rapid transference of technology and the consequent modernisation of the enterprises. According to Amann (1996: 348-349), who bases his conclusions on interviews carried out with businessmen, there are reasons to suspect that the action of INPI increased transaction costs, lengthening the time and increasing the

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294 In addition, the businesspeople complained that the combination of regulation in the acquisition of technology and incentives to the entrance of foreign capital contributed to reducing the competitiveness of Brazilian industry.
costs of technology transfer, and had very negative consequences on the productivity of the enterprises\textsuperscript{295}.

In brief, the difficulties faced by INPI reflected the complexity of the technological issues for developing countries. The issue divided the agents and the policy makers who, although recognising the backwardness of the country, disagreed about the best policy to address it. While the ‘nationalists’ emphasise the importance of increasing the control over foreign capital and of obtaining better conditions of technological transfer, the critics of such policies supported soft regulations and the necessity of not damaging other sectors of the economy. Furthermore, the sources of divergence were aggravated by the immediate constraints and by short term objectives. As a consequence, the lack of unity among the policy-makers hindered the achievement of the cohesion necessary to face such a crucial issue; INPI became isolated and did not have the support necessary for obtaining better conditions of negotiation with the foreign enterprises.

In my view, it is impossible to dissociate the action of INPI from the model of economic development of which it was a part. Given the model centred on the promotion of national heavy industry through import substitution, it is possible to conclude that there was space for the action of an organ which controlled the operations of technology and attempted to improve the conditions of technological transfer. The action of this organ, however, suffered from the general difficulties which marked the strategy of development. These included the lack of unity inside the state and the incapacity to create an atmosphere of confidence necessary to convince the enterprises to undertake investments in technology. If these conditions were present, an interventionist action, as illustrated by the Japanese MITI, could have produced positive results. However, in the context of governmental incapacity to create these requirements, the model and the action of INPI became vulnerable to the liberal criticisms, which supported a reduction in state intervention and the creation of favourable conditions to stimulate the flow of foreign capital and technology.

\textsuperscript{295} For Amann, only the reform of the property rights legislation, in the 1990s, substantially changed the situation and created the incentive for the foreign enterprises to transfer technology.
Conclusion - economic policy and the results of the technological effort

The Geisel government demonstrated a clear commitment to intensifying effort to develop technology. As seen, the resources destined to finance investments in science and technology increased substantially. In addition, investments in education and in R&D and the control on the import of technology were also intensified.

However, in spite of the increasing importance given to the area, the measures were timid and the ‘conflicts’ with the economic policy limited substantially the achievements of the technological policy. As Erber points out, there was a significant divergence between the implicit and the explicit technological policy. While the explicit policy emphasised the priority of investments in R&D and the necessity to develop the basic engineering, the implicit policy, marked by the need that the firms responded quickly to the expansion of demand, made the licensing of technology the only realistic alternative (Erber, 1982: X-XI).

Thus, despite the intentions presented in the PND II and in the PBDCT II, it is possible to conclude that the development of technology was a secondary objective in face of the more urgent requirements of the process of import substitution. Although the objectives in the long term were complementary, since the consistent development of the capital goods sector required technological progress, in the short term they emerged as conflicting. As stressed, the rapid necessity to substitute imports and to increase the ‘nacionalização’ of the capital goods led the government and its supporters, including the BNDE, to put the technological objectives in a second plane and to support the development of the sector through the import of technology (Klein, 1985: 177). This position contributed to increasing the isolation of INPI, playing a key role in frustrating its attempts to improve the conditions implicit in the contracts of technology transfer.

Furthermore, given the magnitude of the task, the measures adopted by the government were clearly insufficient. As Erber (1982: XI) points out, a successful
technology policy able to persuade the firms to invest in technological capacity required
the formulation of a long term industrial policy, marked by the precise establishment of
priorities and by the commitment of the government to keep the directions for a long
time. These requirements, however, were very distant from the Brazilian reality in that
period, marked by economic difficulties and uncertainty.

One important part of the technological effort was undertaken by the state
enterprises. The creation of institutes of research and the investments in R&D had
positive effects over the capital goods enterprises, permitting the upgrading in design
and the achievement of manufacturing skills. According to the interviews undertaken by
Erber, there was an increase in the number of firms utilising the institutes of research.
Furthermore, he found several examples of enterprises engaged in more ambitious
projects in the “development of prototypes and design of equipment” (Erber, 1982: 57,
58). The same conclusion is shared by Amann (1996: 341), according to whom the
enterprises of the capital goods sector, in particular, benefited from the creation of these
institutes and from the establishment of laboratories for the development of product and
control of quality.

In addition, it is important to conclude that, as far as the technological program of
the Geisel government is concerned, important results were achieved in the sectors of
aircraft-industry, petrochemical, computers and telecommunication, sectors in which the
presence and the bargaining power of the state enterprise was an important asset. As
seen, the results achieved by certain NAIs were also substantial (see section 7.3).

In spite of these sectoral achievements, the national industry of capital goods
remained critically dependent on the import of technology, as confirmed by the
interviews undertaken by Erber (1982: ix). As emphasised, the licensing of technology
permitted the development of ‘detailing’ engineering and manufacturing skills but, with
few exceptions, did not give national enterprises the capacity to develop the basic

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296 In ‘Um inviável projeto nacional’. Visão, 26-12-1977. See also Guimarães, Araujo Jr and Erber (1985).
project, which was critical for the capacity of innovation. As a consequence, the reliance on purchase of technology and the resistance to engage in substantial investments to absorb technology contributed to perpetuate the technological dependence.

Finally, it is important to emphasise the difficulties of fitting the multinational corporations into the objectives of the strategy. In spite of the confidence demonstrated at the beginning of the period, the policy makers failed to obtain substantial improvement in the negotiations with foreign capital. Positive results were obtained in isolated cases, in sectors in which the state participated actively in the negotiation or affected the balance of power through direct participation in the investment. In several of these cases, joint ventures were established following the directions of the PND II (Lessa, 1988: 213). However, these examples were the exception, not the rule. As Lessa points out, “in most of the cases the negotiations did not alter basically the relations of power”.

In conclusion, in spite of the increasing commitment by the government and of some positive sectoral results, the industrial policy failed to produce significant improvement in technological capacity. According to Vianna (2000), lack of time was a critical factor. Balance of payments constraints were a permanent challenge and the government urgently needed to obtain results in import substitution. In such a situation, the government had to pressure for immediate results and could not afford the time and the measures necessary for a consistent program of technological development. As Vianna concludes, the few years of the Geisel government, marked by the existence of many constraints, were far from sufficient for the task. The following government, as section 7.8 explores, did not continue with the technological effort\textsuperscript{297}.

\textsuperscript{297} The resources controlled by the FNDCT, for example, fell from 1.16% of the budget in 1976 to 0.24% in 1984, a fall of 50% in real terms (Guimarães, Araujo Jr and Erber, 1985: 69-70). In addition, the economic policy exacerbated the financial conditions of the state enterprises, reducing their capacity to invest in technology.
7.5. Bureaucratic conflict, personal networks and the challenges of the industrial policy

Introduction

The objective of this section is to emphasise the divisions which marked the state during the military period. As stressed in chapter 2, bureaucracy is not an unitary and coherent entity able to detect the challenges and adopt the best policies to promote the national interest. It is marked by the existence of patron-client relations, by the formation of coalitions with private groups, by the constitution of personal networks and by inter-bureaucratic conflict. In other words, the state is marked by conflicts and divisions which tend to affect the coherence of economic policy. The objective of this section is to investigate how these divisions, as present in the military state, affected the capacity of the Geisel government to pursue its industrial objectives.

The process of state expansion after 1964

Martins (1985) emphasises one important characteristic which marked the expansion of the state in the post 1964 period. According to Martins, in spite of the concentration of financial resources and decisions in the hands of the federal government, one crucial aspect of the process was its centrifugal nature, stemming from the growth of agencies and state enterprises which had financial and technical autonomy and were not controlled by the central government. As Martins (1985: 43) points out, “this tendency to growth in the independence of agencies and in the relative autonomy of the actors, based on a logic which is particular and specific to each one, seems to be implicit in the way the state expanded.”

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298 Martins (1985: 51) describes the process as an ‘expansion to outside’, highlighting the expansion of agencies and enterprises which, having financial autonomy and the liberty to allocate their own resources, were not strictly controlled by central government.
In the case of the state enterprises, their independence was justified by the context in which they were created, marked by the need to preserve autonomy from the clientelistic practices present in the political system. As a result, their resources were legally tied to specific funds, independent from and inaccessible to congressional interference. After 1964, the enterprises benefited from the readjustment in public prices and tariffs and increased substantially their operations and number of subsidiaries. In some cases, they consolidated large groups organised in the form of conglomerates. In addition, the enterprises were not significantly constrained by any institutional mechanism and, in contrast to international experience, they were not accountable to the Congress or to tribunals (Martins, 1985: 73-75). In brief, their independence became a limitation on the capacity of the government to control and co-ordinate their action.

A similar process occurred with many agencies of indirect administration. As seen in chapter five, the creation of ‘pockets of efficiency’ was the way found to reconcile an increase in technical capacity with the preservation of the clientelistic practices of the political system. Thus, certain agencies were designed with substantial autonomy, necessary to insulate them from patronage and the clientelist practices which marked the traditional bureaucracy.

Thus, the practice of these agencies and enterprises was marked by the employment of their financial capacity and liberty to allocate resources to strengthen their position inside the state apparatus. Martins makes an interesting analogy, comparing the expansion of the agencies with the logic of enterprise diversification in capitalism. Similarly to the private enterprises, which direct their action towards finding new opportunities for investment to realise their potential of accumulation, Martins describes the expansion of the agencies as a process of employment of technical and financial capacity to occupy adjacent areas. The agencies had their own conception and interests and attempted to strengthen their position as a way to have their objectives addressed by the economic policy. As a consequence, such a movement tends to result in the

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expansion of their action beyond the original functions, facilitating the emergence of conflicts of jurisdiction. In addition, as each agency developed an independent logic and as the process was marked by lack of co-ordination, the result was the development of different and not necessarily compatible conceptions inside the state apparatus (Martins, 1985: 51-56).

The difficulties of control by central government were aggravated by the inferiority of the organs of direct administration in comparison to those of the indirect administration, which had better technical resources and paid much better salaries. The government’s attempt to increase its control through the creation of sectoral holdings for state enterprises did not significantly improve the situation. The enterprises’ directors offered substantial resistance and the new arrangement created additional conflicts between the president of the holding and the ministers responsible for the respective enterprises. As a result, the enterprises maintained considerable autonomy and, during the Geisel government, were subjected to suggestions, pressures and measures intended to shape their action according to the objectives of the industrial policy.

In brief, the process of expansion of the state after 1964 aggravated a characteristic which is, in different degrees, inherent to the organisation of every state. The unconstrained growth of the agencies intensified the fragmentation and the division inside the state, favouring the accumulation of conflicts of jurisdiction and creating obstacles to the pursue of a coherent industrial policy. In addition, it transformed the state into a field of dispute between different conceptions and interests. Martins goes so far as to say that the Brazilian state, at that stage, was not organised (or re-organised) yet as a system⁴⁰⁰ (Martins, 1985: 11).

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⁴⁰⁰ According to Martins (1985: 11), “in the present stage, it does not constitute (or re-organise) yet as a system, in virtue of the characteristics assumed in the recent phase by its own expansion”.
Co-ordination and the structure of economic policy decision making\textsuperscript{301}.

In the period 1967-1974, the structure of co-ordination of the main decisions of economic policy was marked by high degree of improvisation. The functions of the Ministry of Planning were significantly reduced and it did not play the role of central organ of co-ordination of the economic policy. This function was played by the National Monetary Council (CMN), headed by the powerful Finance Minister, Delfim Netto.

This period was marked by the proliferation of sectoral councils, which had consultative and executive functions. The CMN was responsible for the monetary and banking policies. The CDI was responsible for the policy of industrial incentives. The Inter-Ministry Council of Prices (CIP) implemented the policy of prices control and the CONCEX was the organ responsible for the policy of foreign trade. In this arrangement, the ministries lost autonomy and were subordinated to the respective councils.

Codato (1997: 32-35) described the structure of policy making as composed of four levels of hierarchy. The first level was occupied by the CMN, which controlled, informally, the decision making process. Although originally responsible for monetary and credit policy, CMN became the most important instance of decision and deliberated in diverse areas, including industrial policy, agriculture policy, exchange rate and institutional policies. However, CMN was not originally prepared for these functions and the structure was marked by high degree of improvisation. According to Codato, CMN, besides occupying this key role in co-ordination, was also an important arena of intermediation of interests.

The second level of hierarchy was occupied by the inter-ministry councils, responsible for detailing the policies decided in the first level (Codato, 1997: 34). The ministries occupied the third level and the fourth level was occupied by executive agencies such as the BNDE, the Central Bank and the Bank of Brazil.

\textsuperscript{301} This subsection is strongly based on Codato (1997).
This decision making structure was compatible with the high degree of fragmentation described above. As emphasised, many agencies had financial autonomy and capacity to generate public policies, not being controlled by the central agency. The problems in the organisational structure favored conflict of attributions, while the excess of attributions of certain agencies reduced the quality of the decisions. In brief, there was lack of strategic planning and serious problems of co-ordination, which contributed to the proliferation of ‘different conceptions’ inside the state apparatus.

In 1974, the new government promoted a significant reform in the decision making structure, intending to eliminate the problems of the anterior structure and to increase rationality in the economic policy decisions. The government had ambitious economic and political objectives and their implementation required the tackling of the intense fragmentation inside the state apparatus and the closure of many channels of private influence. In other words, the reform was a response to the high degree of divisions inside the state and a way to reverse the lack of co-ordination which had marked the previous structure. This led to centralisation in the decision making process, concentrating the main decisions on the Council of Economic Development (CDE), headed by the President of Republic.

The new administrative structure was marked by the redefinition of the composition and attributions of the sectoral councils (Codato, 1997: 74). The main economic ministers had a seat in CDE, including the Planning Minister, the Finance Minister, the Industry and Commerce Minister, the Interior Minister and the Agricultural Minister. The Head of the Secretary of Planning (SEPLAN), the Planning Minister, had the important role of preparing the agenda of the Council. The main decisions of the council were taken by the President Geisel.

The high capacity of supervision and coordination of CDE was related to the fact that it aggregated the main ministers and that these ministers had a prominent position in the main sectoral councils, guaranteeing thus the implementation of CDE decisions in
the respective councils. This structure gave CDE high capacity of co-ordination in important areas of economic policy (see flow chart). Through SEPLAN, it had access to the main agency of industrial credit (BNDE), to two key organs of the technological policy (FINEP and CNPQ\textsuperscript{302}), and to the main agencies of information (IBGE\textsuperscript{303}) and technical studies (IPEA). Through the Finance Minister, the CDE controlled decisions of CMN and CIP and had access to the policy of foreign trade, via CACEX and CPA. Finally, through the Minister of Industry and Commerce, CDE controlled the policy of industrial incentives (via CDI) and had access to a strategic industrial sector, via CONSIDER\textsuperscript{304} (Codato, 1997: 123-124).

The creation of CDE increased substantially the rationality of the economic decisions and had key impact in the capacity of the Geisel government to implement its ambitious industrial program. It was a firm response to the fragmentation and penetration of the state by private interests. Despite the important advances, certain difficulties persisted and limited the coherence of the industrial policy. Firstly, the state enterprises continued very autonomous and did not necessarily follow the government’s directions. Secondly, CDI, although improving significantly its degree of coherence, continued a problematic organ. Thirdly, the bureaucracy was marked by high degree of political appointments, which reduced its internal coherence. Fourthly, the interests of the governors of the states and the macro-economic difficulties increased the divisions inside the state and reduced the coherence of industrial policy. And finally, as explored in section 7.6, the opposition of the business class to the centralisation of the decision making process represented a significant blow to the government’s basis of support.

These topics and their impact on industrial policy are explored in the next subsections. The next one introduces the characteristics of three organs that played important roles in the industrial policy of the Geisel government. Despite centralisation, the results of industrial policy were very dependent on the political action and commitment of these agencies.

\textsuperscript{302} Council National of Research.
\textsuperscript{303} Brazilian Institute of Geography and Statistics.
\textsuperscript{304} Council of Steel and Non-Iron Metals.
The economic bureaucracy and the industrial policy.

During the Geisel government, an important role in the industrial policy was played by the Bank of Development, BNDE. In order to increase its influence and have its objectives implemented, BNDE engaged in a series of practices, which included the promotion of meetings and seminars, the creation of financial facilities to persuade industrialists to invest and the building of alliances inside and outside the state apparatus (Klein, 1985).

The commitment of BNDE to the causes of heavy industry is explained by its trajectory and by the identity assumed by the organ in the 1950s. As seen, BNDE, created in 1952, adopted meritocratic criteria of selection and promotion and had an institutional design that favoured insulation and efficiency\(^{305}\). In the 1950s, BNDE strengthened its position through improving its techniques of project analysis and increasing its control over information. In that decade, a critical influence for the future identity of the organ was its contact with CEPAL through the realisation of a partnership project. The participation of the cadres of the organ in the mixed CEPAL-BNDE group was crucial to shaping the ideology of the institution and to push it towards a developmentalist position\(^{306}\).

In sum, BNDE had embraced, from the 1950s onwards, a well defined position about the direction to be given to industrial policy. According to Martins (1985), the organ played the role of a ‘think tank’, contributing to shaping, inside the state apparatus, a behaviour favourable to import substitution industrialisation. In addition, as Martins (1985: 107) emphasises, the Bank demonstrated its intention to assume a larger

\(^{305}\) As emphasised in the chapter five, the statute of the organ determined that of the five directors which, together with the president, composed the direction of the bank, three should be members of the organ’s staff.

\(^{306}\) It is interesting to emphasise that the technicians responsible for the creation of the Bank, Roberto Campos and Lucas Lopes, embraced a more liberal position and composed the Cosmopolitan Developmentalist group, as presented in the chapter five. However, they lost contact with the Bank for some years and, later, when they tried to regain control, it was too late (Martins, 1985: 88).
role in the co-ordination of the program of development, intending, for example, to become the holding of the state production system.

Martins (1985) and Klein (1985) emphasise how BNDE adopted certain practices that made it very similar to a political party. The formation of an ‘esprit de corps’ inside the organ, the perception of the importance of political contacts to the success of its action and the engagement in a tactical behaviour were important characteristics of the practice of the Bank, which used the control over information as an important asset in achieving its objectives (Martins, 1985: 93-94). Likewise, BNDE opposed the government when felt that its position and ideas were threatened and was ready to engage in alliances with segments of state and civil society to strengthen its position. In conclusion, as Martins points out, the action of BNDE “makes very distant the classical image of a merely instrumental bureaucracy, routinely following lines of action, as painted by the sociological tradition of the bureaucratic organisation” (Martins, 1985: 94). Conversely, the action of the Bank illustrates very well the dynamic of ‘independent’ agencies aimed at increasing influence inside the state apparatus.

BNDE benefited from a substantial increase in its resources and had a very active role during Geisel government. As the president of the organ in the period, Marcos Vianna, points out, the Department of Sectoral Studies of the Bank liaised very closely with the private sector, promoting seminars in which technicians of the government and businesspeople were invited. Likewise, BNDE produced sectoral studies and position papers which were channelled to other organs of the government. In this sense, Vianna believes that BNDE had an important role in the formulation of the economic policy. Furthermore, Vianna emphasises the direct role of the organ in co-opting the business groups to invest. According to him, BNDE identified, before 1974, 60 projects which could produce rapid results, determined the scale and the number of plants necessary and then invited the enterprises to invest. In order to encourage investment, favourable incentives were offered, including limiting monetary correction to 20% (Vianna, 2000).
Klein (1985) finds in interviews with directors of BNDE many references to the importance of negotiation and conciliation as necessary steps to the objectives of the Bank. According to Klein, the Bank found in the industrialists of the capital goods sector important and reliable allies. According to Klein, BNDE acted as a broker of the capital goods industry inside the bureaucracy, negotiating and finding allies to the cause of the heavy industry. According to Klein, the alliance between BNDE and the Associação Brasileira para o Desenvolvimento da Indústria de Base (ABDIB – Brazilian Association for the Development of the Basic Industry) was very important in overcoming obstacles and obtaining further measures necessary to the development of the sector.

An important role in the 1970s was played by the President of the Bank, Marcos Vianna, whose engagement and personal ties inside the government were crucial to the strong influence of the Bank in that period. It is important to emphasise that there is no contradiction between the high degree of ‘institutionalisation’ of the organ and the crucial personal role played by its president. If Vianna had conceptions different from the Bank, he probably would have found resistance from the cadres. However, this was not the case and his energy and good relationship with President Geisel were very favourable to increasing the influence of BNDE. In this sense, the role of Vianna only confirms how in a context marked by low institutionalisation, high fragmentation inside the state and a divergence of conceptions between the agencies that played complementary roles, the construction of personal networks and coalitions became an essential precondition for the success of a particular agency (Schneider, 1991; see below).

The divisions inside the state and the difficulties of getting co-ordination are well illustrated by the actions of CDI (Council of Industrial Development). Martins (1985), although centring his analysis on the period 1964-1974, highlights certain characteristics of this organ which are also important to understanding the difficulties faced by

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307 As an example, Klein (1985: 176) argues that BNDE, attempting to produce mobilisation to the aims of the industrial policy, promoted leakage of information to the press and to the entrepreneurs.
industrial policy during the Geisel government. As Martins (1985: 124) emphasises, CDI “concentrates and expresses, without creating the means to solve, the main problems and contradictions inherent to the organisation of state apparatus”.

As section 7.3 shows, CDI played an important role in industrial policy, being responsible for the concession of a range of incentives. Its importance for the capital goods sector is emphasised by Klein (1985: 165), who stresses that without CDI’s incentives and FINAME’s credits a project in the sector was rarely possible. From 1970 to 1975, the organ was divided into eight sectoral groups (GSs), responsible for functions such as the analysis of projects - including analysis of viability, accuracy of information and the evaluation of their fitness in relation to the objectives of the government -, monitoring of the execution and definition of incentives and the setting of targets in the respective sectors. The GSs were co-ordinated by the Grupo de Estudos e Projetos (GEP - Studies and Projects Group), responsible for the further evaluation of the projects, proposal of incentives and elaboration of a conclusive report. Finally, the superior collegiate of the council was composed of the Ministers of the economic area, the Minister of the Interior, the presidents of the official banks (Central Bank, Banco do Brasil and BNDE), the Head of the Joint Chiefs of Staff and the presidents of the Confederations of Industry and Commerce. The Minister of Industry and Commerce was the chairman. This collegiate was, in theory, responsible for the execution of the industrial policy and for guaranteeing its compatibility with the general aims of the government (Martins, 1985: 129-132).

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308 The centralisation promoted by Geisel increased substantially the coherence of industrial policy. The objective of this description of CDI is to highlight previous problems of the organ that persisted and impeded a further improvement in its performance.

309 The CDI underwent many changes after its foundation in 1969 in substitution to a consultative commission. Thus, this makes very difficult to undertake a very condensed description of the functioning of the organ, as I intend in this section. I would like to emphasise that my intention is just to give a brief idea of the structure of the organ, emphasising the difficulties that it puts to the practice of the industrial policy. For a detailed analysis of the structure of the council and its changes in the military period, see Abranches (1978); Martins (1985: chapter 3) and Klein (1985: chapter 4).

310 Nevertheless, as Martins points out, it met very rarely and the main decisions were taken in other forums.
The action of CDI, however, faced many obstacles and difficulties. Firstly, there was a problem of conflict of attributions between the ministers. While the key decisions of economic policy were taken in organs controlled by the Finance and Planning Ministers, CDI, considered responsible for the execution of the industrial policy, was located under the Minister of Industry and Commerce. Secondly, CDI’s decisions were not necessarily followed by the organs which had representatives in the Council. In other words, they were not committed to the decisions taken in CDI and the Council had no mechanisms to force them to follow the decisions. Thus, the agencies could, for example, refuse to concede credit or tariff incentives to the projects approved by CDI. This substantially hampered the functioning of the sectoral groups, which proposed incentives but did not have any guarantee that the organs responsible would concede them (Martins, 1985: 137).

Therefore, the organ lacked the mechanisms and authority to co-ordinate industrial policy. These difficulties were aggravated by the lower technical capacity of the organ when compared to other agencies of the indirect administration. CDI paid salaries much lower than those paid in agencies such as BNDE and in the state enterprises and did not have a technical staff able to carry out its functions competently. As Martins (1985: 132-133) emphasises, CDI staff were insufficient in number to analyse the large number of projects which were submitted to the organ. In 1973, for example, the sectoral groups, unable to provide a detailed evaluation of the projects, undertook only a brief summary and directed them to further evaluation by the Studies and Projects Group. GEP, composed of ten members, did not have the wherewithal to realise a careful evaluation of the projects, which amounted to about 80 per week, and had to approve them “in a cluster”. As the projects involved a substantial amount of resources, it is easy to perceive the negative impact on the coherence of the industrial policy.\footnote{As emphasised in section 7.3, CDI conceded incentives in a very liberal way and lacked sectoral criteria to allocate the resources. This was partly changed after 1974 (see Abranches, 1978: 266; 290).}

Therefore, given the lack of co-ordination, industrial policy became dependent on the decisions taken by the individual agencies, which, possessing their own conception
and influenced by distinct interests, were not necessarily compatible with those adopted by the other agencies. The result was the lack of an unified direction, as reflected, for example, in the absence of any uniform criteria for the evaluation of projects and priorities of investment. Furthermore, the difficulties were aggravated by the dispute between the agencies, in a dynamic which intensified the conflict of jurisdiction and the accumulation of overlapping functions (Abranches, 1978: 201; 221).

As an illustration, Martins shows how the autonomy of the sectoral groups (GSs) was frequently challenged by the action of other councils and by the state enterprises, whose interests and areas of activity coincided with those of CDI. As a result, the autonomy of the GSs varied substantially according to sector. While the GS of ‘non metallic intermediary products’, for example, had a large degree of autonomy, the GS responsible for metallurgy had its action constrained by CONSIDER\textsuperscript{312}, which had the power to authorise the import of products, and by SIDERBRÁS\textsuperscript{313}. Accordingly, in the area of naval construction, the action of GS was submitted to the decisions of SUNAMAN\textsuperscript{314}, while in the ‘sectoral group of capital goods-electrical electronic products’, the state enterprise TELEBRÁS\textsuperscript{315} was very influential and the co-ordinator of the GS was a functionary of the enterprise. As Martins (1985: 140) concludes, “it is not difficult to imagine the intense negotiation which this complex network brought about”.

In brief, the decisions of CDI were unpredictable, involving a high degree of personal arbitrariness\textsuperscript{316}. Vianna (2000), when asked about the capacity of the organ, emphasised its fragmentation and described it as a “patchwork quilt”. Similarly, Klein

\begin{itemize}
  \item CONSIDER - Conselho de Siderurgia e Metais não Ferrosos (Council of Steel and Non-Iron Metals).
  \item SIDERBRÁS was the holding of the state enterprises of the steel sector.
  \item SUNAMAN - Superintendencia Nacional da Marinha Mercante (National Superintendence of Merchant Navy).
  \item TELEBRÁS was the holding of the state enterprises of the telecommunication sector.
  \item As emphasised, the centralisation promoted by Geisel, concentrating the main decisions of economic policy in the Council of Economic Development (CDE), substantially increased the degree of selectivity of CDI. However, the problems resulting from the structure described above persisted. The organ remained a field of conflict negotiation, without the resources and capacity to provide co-ordination. As Klein (1985) shows, this is very well illustrated by its vacillating position with regard to the concession of incentives to the multinational projects in the capital goods sector, as explored below.
\end{itemize}
(1985: 219) describes it as a forum towards which the conflicts inherent to the Brazilian state converged. In sum, CDI, far from being an organ to provide co-ordination in the industrial policy, was an arena of political-bureaucratic discussion and conflict negotiation (Klein, 1985: 235).

In conclusion, the difficulties faced by CDI illustrate a more general aspect of the organisation of the Brazilian state that is related, according to Martins, to its process of expansion. Accordingly, it also illustrates the difficulties of following a coherent industrial policy in a state apparatus marked by a high degree of segmentation and the existence of overlapping functions. The difficulties were amplified by the inevitable penetration of private interests, favoured by the lack of institutionalised criteria to solve conflicts. In relation to this last aspect, it is important to emphasise that the incapacity of CDI to follow and enforce strict criteria made its decisions very dependent on the discretion of its directors and other functionaries, including the ‘second echelon’ (lower level officials) (Abranches, 1978: 217). This generated an environment very permeable to penetration of private interests, especially in the case of the sectoral groups, which dealt directly with the industrialists and were thus more vulnerable to the influence of interest groups.

Another important organ of the economic policy in the period was CACEX, the body responsible for the control of imports and for the promotion of exports. CACEX managed the “accords of participation” and was very supportive of the causes of the national producers of capital goods (see section 7.3). According to Klein (1985: 173), CACEX was an important ally of the BNDE-ABDIB coalition in the disputes inside the state apparatus; for the author, it worked as a channel which provided BNDE with access to information monopolised by the Finance Ministry.

Although formally subordinated to Banco do Brasil, CACEX had a large degree of autonomy. The control of an important ‘area of uncertainty’, the incentives to export and
import, gave it an important role in the policy-making process. According to Martins, the action of CACEX illustrates very well the tendency of certain agencies to expand their area of influence and invade the jurisdiction of other agencies. He shows, for example, how the concern to promote exports of certain products, such as soy, citric juices and leather, led CACEX to interfere in the policies of minimal prices and domestic supply of these products. The same motivation led it to create organs the functions of which overlapped with those of CDI sectoral groups (Martins, 1985: 163-164).

*Personalismo* and coordination via personal networks

Another important factor in understanding the vicissitudes of the industrial policy-making process is the key role played by personal ties and networks. In a state apparatus marked by intense conflict of attributions and by a lack of strict institutional mechanisms to solve conflicts, the nomination of personal allies and the constitution of personal networks played a central role in the co-ordination of state action.

This characteristic is very well explored by Schneider (1991), who argues that in the Brazilian military state people were more important than organisations. According to him, a critical peculiarity of the military governments was the large number of personal appointments made at the beginning of each government, which, on average, amounted to about fifty thousand posts (Schneider, 1991: 06). This practice, according to Schneider, had a critical impact on the calculations of the bureaucrats, who shaped their strategies with the intention of maximising their personal careers. In an environment in which promotion depends less on universal practices inherent to the organisation than on personal discretion, loyalty becomes the rational behaviour. This calculation was

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317 According to Martins (1985: 192), the capacity of CACEX to increase influence illustrates a tendency that is valid for the Brazilian bureaucracy in general. According to him, “it is not the delegation of attribution by the political power which confers distinct degrees of importance to each agency, but the resources of power which they are able to aggregate and maximise through its own action and through the faculties conferred by the nature of their respective insertions in the state apparatus”.

318 It is not difficult to understand the rationality of CACEX. Given the lack of strict co-ordination between the organs, the interdependency between the areas encouraged such a process of expansion and intervention.
reinforced by the high mobility between the top officials; according to Schneider (1991: 30), “about one half of the appointees serve in two successive governments, although in different agencies”.

As a consequence, in spite of the existence of organisations with high ‘esprit de corps’, such as BNDE, Schneider believes that the constitution of personal ties is the key element to understanding inter-bureaucratic relations. Consequently, the author emphasises that analyses centred on the fragmentation of the agencies and on its implication on policy making are insufficient. For Schneider, it is necessary to go further and investigate the relationships between key individuals and the constitution of personal networks, critical elements to explain the adoption of certain policies and also their chances of success. In such a context, according to the author, organisations are little more than the locus where the individuals organise their strategies of career maximisation.  

According to Schneider, the insignificant role played by Congress and by the political parties does not mean that politics did not have importance in the dynamics of the military government, but that it was transferred into the bureaucracy. In such an environment, the role of the ‘political technicians’ was substantially increased. So-called political technicians are individuals with solid technical formation, whose competence is an important ingredient for their appointment. In addition, they possess political abilities which make them more apt to survive. They know that the success of the policies depends not only on technical capacity, but also on the support of key actors inside the state apparatus.

In this sense, Schneider stresses how the regime brought about a practice of political nomination that is different from the traditional forms of patronage. As emphasised, in a context of low institutionalisation and a high degree of fragmentation,

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319 Schneider stresses the contrast of the Brazilian bureaucracy with the high degree of institutionalisation characteristic of the military organisation. According to him, the high concern to produce results, which marked the military government from 1967, explains why the military refused to shape the bureaucracy in the image of the corporation (Schneider, 1991: 26).
the nomination of loyal individuals to key posts of the bureaucracy works as a pre-
condition to obtaining co-ordination and reducing uncertainty. Therefore, nominations
mean the exchange of prestigious posts for “‘efficiency, loyalty and results’” (Schneider,
1991: 76, 77)\textsuperscript{320}.

An environment marked by low institutionalisation and importance of the personal
networks tends to give large discretionary power to individuals. Martins (1985: 209)
stresses how co-ordination via personal nominations, without the constitution of a solid
institutional arrangement, is a very fragile basis upon which to found a program of
development, because the “personal characteristics of one president (or of one ‘strong’
minister) are able to re-organise (or disorganise) all the internal relations of an
administration which intends to be efficient and modern: technocratic”.

This is very well illustrated by the two ministerial terms of the Delfim Netto, which
brought about a radical transformation in the direction of the economic policy. In his
first participation, from 1967 to 1973, the effort of planning and control undertaken
under the Castelo Branco government was abandoned\textsuperscript{321}. When he came back to power,
in 1979, Delfim also rejected the directions which had been given by the previous
finance minister. He adopted a heterodox program to combat inflation and accelerated
the growth of the economy (see section 7.8)\textsuperscript{322}.

\textsuperscript{320} In addition, Schneider (1991: 73) shows how the politicians had also an important role in these
personal networks. According to him, 20\% of the 450 top appointments to economic bureaucracy in the
five military government were composed of politicians, probably nominated to open channels, provide
support and reduce opposition to the working of the respective agencies. Emphasising the large number of nominations, Schneider challenges the notion that authoritarian states are
more insulated than democratic ones: in democratic states, at least the individuals are accountable to the
parties and groups of interest which they represent. For Schneider, an important indicator of insulation is
the quantity of outsiders appointed to determinate agency, which was very high in large part of the
Brazilian agencies, although not in all.

\textsuperscript{321} On that occasion, as seen, Delfim promoted a very accelerated process of economic growth (see section
6.3)

\textsuperscript{322} Delfim Netto had a very close relationship with the entrepreneurs, which explains in part his support
for the expansionist policies. In addition, as the interviews reveal, the minister preferred a short-term
approach and tended to be very sceptical in relation to planning.
Consequently, as the example above illustrates, this critical dependence on individuals made the long term maintenance of a program of development very difficult. The conclusion of Schneider (1991: 93) is striking: “paradoxically, the same dictatorial powers that in 1964 were considered necessary to create rational planning structures allowed subsequent presidents to undermine the same structures”.

Another problem characteristic of a state structure marked by high degree of personal discretion is that it may favour the adoption of very inefficient projects. The example of Açominas, a large steel project approved in the Geisel administration, illustrates the point very well. The project was inefficient and irrational, not justified by any technical criteria. However, the close ties between the Governor of Minas Gerais, Aureliano Chaves, and President Geisel made it possible. Aureliano had easy access to the government and used his influence to approve a project of interest of his regional clientele. Given the technical fragility of the project and the moral integrity of President, the approval was a puzzle. However, information collected in the interviews permits conjecture. Geisel, who had the power to approve almost everything, was persuaded that the Açominas project was important for the electoral results in the important state of Minas Gerais. This state was considered critical to the process of redemocratisation which his government was promoting. In this sense, concern with the future of the political process seems to have influenced the decision of the President, in spite of the opposition of many of his advisers, who drew attention to the technical problems of the project.

Policy making as a process of coalition building

In a state apparatus marked by internal divisions and low institutionalisation, the process of policy making becomes critically dependent on coalition building and political negotiation. This is shown in detail by Lucia Klein (1985), who investigates ‘the corridors of power’ in important policies and decisions concerning the capital goods

323 According to Schneider (1991: 128), despite the opposition, the coalition against the Açominas project was weak: “officials at all levels opposed the project, but they lacked the power or will to put up a fight”.

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323 According to Schneider (1991: 128), despite the opposition, the coalition against the Açominas project was weak: “officials at all levels opposed the project, but they lacked the power or will to put up a fight”.
sector during the Geisel government. According to Klein, the measures adopted to promote the development of the capital goods sector after 1974 were strongly supported by a coalition which included BNDE and CACEX. Likewise, she explores how the weakening of this coalition at the last year of the Geisel government had negative consequences for the interests of the capital goods producers.

Klein identifies important obstacles to the running of industrial policy along the lines laid down by the PND II. As seen, one important obstacle was the refusal of several state enterprises, especially those of the steel and hydroelectric sectors, to comply with the directions of the government and to concentrate the purchase of equipment on the domestic market. As seen, these enterprises, not convinced of the reliability of the national producers and having financial autonomy, continued to import a substantial proportion of the capital goods utilised.

The attempt to change the behaviour of these state enterprises led to a substantial mobilisation which involved the Planning Ministry, BNDE and ABDIB. CDE decreed successive measures suggesting, encouraging and pressuring the state enterprises to direct their purchases to the domestic market. Accordingly, as seen, BNDE, via its subsidiary FINAME, created very special mechanisms of credit to finance the purchase of national equipment, offering interest rates and time conditions more favourable than the international supply credits (see section 7.3).

The conflicts inherent to the industrial policy, resulting from divisions inside the state apparatus, are very well illustrated by Klein in her reconstruction of the disputes around two foreign projects of investment in the capital goods sector. The projects of the German firms Krupp and Demag, which constituted investments in niches already occupied by the national producers, were strongly opposed by the capital goods producers and by those organs committed to the targets of the PND II. According to the industrialists, control of the domestic market was a key instrument to the development of the enterprises which, after 1974, had invested substantially in response to the government’s claims. Accordingly, they argued that the entrance of new producers
would negatively affect the goal of specialisation, forcing the national producers to diversify their lines of production.

On the other side, the government of Minas Gerais, the state that received the projects, viewed foreign investment as an important means of expanding employment, production and tax revenue. The representatives of this state backed their demands with the objective of reducing regional differences, also present in the PND II. For them, the interests of the capital goods producers occupied a very secondary role.

In the Krupp project, the disputes were intense and ABDIB insisted that the German company submit a detailed list of the goods to be imported and that it concentrated on production in specific niches. CDI, however, disregarded the demands of the association and of BNDE and approved the incentives to Krupp without any constraint related to niches or goods to be produced, a good demonstration of its lack of commitment to the objectives of the industrial policy. The decision provoked an immediate reaction from BNDE and ABDIB: through pressures and articulation in the high echelon, they persuaded President Geisel to veto the project (Klein, 1985: chapter 5).

The same kind of debate and mobilisation marked Demag’s project of investment. The governor of Minas Gerais, Aureliano Chaves, attacked regional inequalities and the concentration of economic power in the state of Sao Paulo, attempting to transform the issue into a regional dispute. The BNDE and its allies strongly opposed the project, emphasising that it was in disagreement with the main lines of industrial policy. According to Klein, the Finance Minister, sensitive to the difficulties of the balance of payments, supported Minas Gerais’ cause.

After lively debate and disputes, the ‘BNDE - CACEX – ABDIB’ alliance was not able to block the project and a decree of President Geisel approved 100% of incentives

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324 Klein (1985: 254) emphasises how, in this episode, the Minister of Industry and Commerce, well known for his nationalist positions, surrendered and supported the approval of the incentives. Klein interprets this behaviour as a demonstration of the forces which penetrated CDI and of the large pressures suffered by the minister.
to Demag’s project, which submitted only to the requirement of exporting 30% of its production (Klein, 1985: 270). CDI was completely circumvented in this affair. In contrast to the Krupp case, this event demonstrated that the ‘developmentalist alliance’ had lost influence, which is explained, in part, by the aggravation of short term difficulties and of balance of payment constraints. In that context, the Minister of Finance extended his power and increased his control over CACEX; meanwhile, from 1977, BNDE suffered a substantial reduction in its budget (Klein, 1985: 285).

Another example of the loss of influence of the developmentalist coalition was the afore mentioned Açominas project. In this event, CACEX was circumvented in the approval of special licenses to import capital goods, BNDE had no voice and the approval of the project followed completely different bureaucratic procedures. As already stated, the personal approval of President Geisel was critical to the circumvention of the normal circuit, determining a regime of exception which damaged considerably the interests of the capital goods industry.  

In conclusion, those events highlight how the existence of other interests constrained the objectives of the industrial policy. Lessa (1988: 150) shows how the governors of Minas Gerais and Rio Grande do Sul, intending to stimulate regional development, pressured the national capital goods firms to open factories in the respective states, under threat of attracting foreign investment instead. The enterprises, however, had already increased their production capacity substantially and had no interest in expanding investment. Not surprisingly, they opposed the entrance of foreign investment.

As this section has emphasised, the state was not a unified whole and its agencies shared different conceptions and interests. This is, in different degrees, a characteristic of every state, but was aggravated in Brazil by the decentralised expansion of the state

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325 The Açominas project was marked by the government’s attempt to advance it until an irreversible point, which contributed to increase inefficiency. The government, for example, did not wait for the World Bank credit and contracted very bad loans at flexible interest rates. In addition, the project was undertaken with a high rate of import of capital goods, disregarding an important objective of industrial policy.
and by the way in which private interests exerted pressure on the bureaucratic agencies. This division, exemplified by the erratic action of CDI, was an important factor that limited the coherence of industrial policy. Although this coherence was substantially increased under Geisel, several difficulties persisted, preventing his ambitious program of industrialisation from achieving more substantial results.\[326\]

In brief, the existence of divergent conceptions and interests inside the state was an additional source of difficulties faced by the Geisel government to promote a substantial transformation of the industrial structure. The difficulties were also aggravated by the military’s internal conflicts, as emphasised in chapter six, and by a high dependence on personal networks, which reduced the cohesion of the bureaucratic agencies and hindered the preservation of a long term economic program. Furthermore, the Brazilian bureaucracy was not as insulated or coherent as that of, for example, Japan and Korea and the excessive use of personal appointments made it more sensitive to external pressures. In this sense, the action of the *developmentalist state* was also constrained by the intense penetration of private interests and by the government’s vulnerability to pressures from ‘the business community’. This important topic is explored in the next section.

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326 As emphasised in other sections, Geisel’s industrial policy achieved a significant degree of coherence. Nevertheless, given the magnitude of the industrial effort that it attempted, in a very difficult international context, the frictions and divisions inside the state proved to be very significant obstacles for the industrial program.
7.6. Interest representation, business pressures and state capacity

Introduction

As emphasised, the central objective of this thesis is to investigate the limits of the developmentalist state in Brazil. Given the substantial role occupied by the state in Brazilian economic development, a key question is to understand why it was not able to adopt the ‘right policies’ and promote the necessary changes to overcome basic problems and establish an advanced economy. In the present chapter, the capacity of the state to promote industrial transformation is tested in a very special moment of recent Brazilian economic history. As seen, the Geisel government engaged in a substantial effort to upgrade the industrial structure.

The objective of this section is to highlight an important source of constraints on the actions of the developmentalist state during the Geisel government. It explores how the way interests were represented and the consequent pressures from business groups constrained the government’s capacity to pursue the targets of the program of development.

Resistance from business interests was one important obstacle faced by the policy of the Geisel government. The long process of import substitution that had been promoted from the 1930s produced a wide range of interests connected to the process of industrialisation. These groups had channels of penetration into the state and, in the following decades, exerted significant pressure on the government. Thus, it is important to emphasise that the effort of industrial transformation promoted by Geisel did not happen in a vacuum and that well established groups were ready to oppose initiatives which were against their interests.

The difficulties faced by the Geisel government are also related to the very fragmented pattern of interest representation established in the 1930s. As already stated, the creation of corporatist councils and technical organs gave the businesspeople
privileged channels of access to the state apparatus (Diniz, 1978). Given the lack of political parties or encompassing associations able to aggregate interests and intermediate the process of negotiation, the pattern of state–business relationships was marked by decentralised and individualistic ways of access to state apparatus (see chapter 4).

This pattern of interest representation was not altered after the military coup in 1964. On the contrary, it was, according to Codato (1997: 247), intensified. While, from 1946 to 1964, 16 corporatist agencies with private sector representatives had been created, the military government, after 1964, created (or reformed) 24 new organs of this type. Given the emasculation of the Congress and of the political parties, the role of these agencies as instruments of interest representation was increased. Similarly, the substantial expansion of the state, in a very decentralised way, created an environment favourable for the private groups to put pressure on bureaucratic agencies. As a result, in spite of the military emphasis on technocratic solutions, the state apparatus which they inherited and re-constructed gave the private groups privileged channels of access.

It is important to emphasise that the creation of channels of contact between the state and social groups is inevitable. Firstly, as emphasised in chapter two, there are many personal networks which put state representatives in contact with social groups. Secondly, a government needs legitimacy and social support, considerations which force it to create channels to listen to the demands of certain social groups. This is specially true in relation to the business interests, since the government’s success is very dependent on their disposition to invest. Thirdly, the bureaucratic agencies and the government need channels to promote exchange of information, achieve co-ordination and implement policies.

In brief, this permeability to private interests, common to every state, was intensified in Brazil by the pattern of interest representation and by the way the state expanded after 1964: i.e. expansion was characterised by decentralised agencies with
substantial autonomy, by difficulties in achieving co-ordination and by the lack of social control over the process (see section 7.5).

**Interest representation and centralisation in the policy-making process**

After the years of austerity and reforms which followed the coup of 1964, the period from 1967 to 1973 illustrates very well the dynamics of a state marked by the expansion of autonomous agencies not strictly controlled by central government and very permeable to private demands (Abranches, 1978; Brasil and Abranches, 1987). During both the Costa e Silva and the Médici governments, the capitalists participated in important economic councils, including the powerful *Conselho Monetário Nacional* (CMN - National Monetary Council). Likewise, the businessmen had very good relationship with the powerful Minister of Finance\(^{327}\) and easy access to policy-makers. The period was marked by the intense and indiscriminate expansion of credit and incentives, an indication of the government’s disposition to comply with business requests.

The Geisel government was marked by its effort to increase co-ordination of economic policy. The ambitious program of industrialisation adopted by this government, in a context of cyclical deceleration and international crisis, required the concentration of public resources on the priority sectors. Therefore, the government promoted a significant centralisation in the process of decision making, reducing the autonomy of many agencies and concentrating the main decisions on the *Conselho de Desenvolvimento Econômico* (CDE - Council of Economic Development), a council composed by the economic ministers, chaired by the President and which excluded private representation\(^{328}\).

\(^{327}\) One interviewer cited by Guimarães and Vianna (1987: 54) states that the agenda of the Minister Delfim Netto included about 6 daily hours of interviews with entrepreneurs.

\(^{328}\) The composition of CDE included the Minister of Planning, the Minister of Finance, the Minister of Agriculture, the Minister of Industry and Commerce and the Minister of the Interior. The council was headed by President Geisel and the Minister of Planning, appointed general secretary of the council, was responsible for preparing the agenda of the meetings. This gave him a closer contact with President Geisel and increased his influence over the process of policy-making.
Codato (1997: 248) emphasises the importance of this process of centralisation, interpreted by him as a “bureaucratic reaction to the colonisation of the agencies of the dictatorial state by all kinds of interests and to the fragmentation and division of the state apparatus in multiple councils without any co-ordination”. As Guimarães and Vianna (1987: 25) point out, “the creation of CDE transferred to the Presidency of the Republic the core of the fundamental decisions, weakening ‘technocratic representation’ and reducing the private groups’ possibility of influence”. In brief, a substantial effort of investment, requiring a selective allocation of resources, was accompanied by the closing of many channels of private influence.

The centralisation promoted by Geisel was followed by a significant reaction from the business groups. From 1974, the businesspeople mobilised in a fierce ‘campaign against statisation’329. The campaign, which had its origin in a liberal segment of the press, focused on the increasing state participation in the economy and on the consequent negative effects on ‘free enterprise’. The mobilisation, by uniting a substantial segment of the business class against the economic policy, very negatively affected the government’s legitimacy. This is explored below.

The interpretation of the causes and nature of this movement has significant importance for the argument developed in this chapter. Given that the increase in state participation in the economy was not an innovation of the Geisel government and had been occurring since the 1930s, why was the campaign organised in precisely this period? The mystery deepens when one takes into consideration that the measures promoted by the government contributed to soften the cyclical decline and that the investments of the PND II had favourable effects upon many sectors of the economy.

329 Cruz (1995: 53) associates the beginning of the campaign with the discourse of the economist Engenio Gudin at the event promoted by the liberal magazine Visão, in December 1974. On that occasion, Gudin emphasised that “Brazilian capitalism was more controlled by the state than in any other country, except the Communist ones” (In Codato, 1997: 284).

The campaign continued during the year of 1975 and the first semester of 1976, finishing at the following months, after the government edited the document “Action to the National Private Enterprise”, in which the criticisms were responded and measures of support to the national enterprises were proposed.
Cruz (1995) undertakes a detailed analysis of the anatomy of the movement. One important point emphasised by him is the strong engagement of the commercial and financial bourgeoisie in the campaign. According to the author, this is explained by the effects of the economic measures on these groups, especially the transference of the PIS/PASEP funds to BNDE control\textsuperscript{330}, which considerably reduced their influence. Accordingly, the new role attributed to BNDE frustrated the project of forming large financial conglomerates articulating industrial and financial capital, an arrangement in the interest of the private banks. In conclusion, as Cruz emphasises, one important cause of the campaign is related to the fact that PND II, in the effort of concentrating the resources on the target sectors, promoted a redistribution of resources between fractions of private capital, provoking the reaction from the sections whose interests were not considered (Cruz, 1995: 125). This explains the protests of segments of the financial and commercial capital and also from producers of non-durable groups against a program which discriminated in favour of heavy industry\textsuperscript{331}.

Cruz (1995), Diniz (1994) and Codato (1997), observing the main complaints made by the business class, emphasise that the core of the reaction against “statisation” is related to the closing of the channels of private participation and, consequently, to their exclusion from the main decisions of economic policy. The businesspeople position is very well summarised in the declaration of Claudio Bardella, President of ABDIB in the period, one of the associations which had more channels of influence during the Geisel government (see section 7.7). According to him,

\textit{“there is almost no business participation in the organs which have power of decision. Our participation is ‘behind the scenes’, without direct influence on decisions which affect us directly”. (...) “The government should review its position, permitting business participation in the organs of decision. (...) Dialogue is powerless if, at the...”}

\textsuperscript{330} PIS-PASEP funds accounted for a wide range of resources and had previously been used as a source of short term credit.

\textsuperscript{331} Nevertheless, it is important to emphasise, PND II did not hurt significantly any of these groups, nor did it adopt any measure that threatened their comfortable position. In addition, as Lessa (1988) emphasises, the financial circuit offered very lucrative investment opportunities.
Therefore, one important motivation of the ‘campaign against statisation’ was the reaction against the centralisation promoted by the Geisel government, which closed the usual channels of business participation. It is important to emphasise that, since the 1950s, almost all ‘inter-ministerial’ collegiates had some kind of corporatist representation. In this sense, the reform promoted by Geisel, limiting business participation to specific organs and reducing the autonomy of the agencies to deal with their respective clienteles, constituted a significant rupture with established practices (Codato, 1997: 250, 254). This of course clashed directly with the interests of the businesspeople, who, in an authoritarian regime, depended on direct access to the state apparatus to influence decisions which were important to their activities.

Consequently, a very important aspect of the campaign against statisation is that it reveals a dimension which is critical to understanding the limits in the capacity of the Geisel government to transform the pattern of industrialisation. As emphasised, the reaction against centralisation (or statisation) uncovered the role of the bureaucratic apparatus as a field of interest accommodation, essential in an authoritarian regime which had emasculated the traditional mechanisms of political representation. In this sense, the increase in state capacity to promote and regulate the process of accumulation, achieved by the Geisel government, was accompanied by a reduction in its capacity to accommodate, inside the state apparatus, multiple and heterogeneous interests. In other words, the Geisel government disturbed a function which had been important characteristic of the Brazilian state since the 1930s: its capacity to “re-equilibrate, inside its structures, potentially unbalanced social interests” (Draibe, 1985: 43; Codato, 1997: 240).

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332 As the literature emphasises, the economic difficulties had also a role in the emergence of the movement. While in a context of abundance and rapid economic growth the adjustments would be easier, in a moment of cyclical reversion and economic deceleration the uncertainty and the difficulties reinforced the demands to institutionalise the dialogue.

333 Draibe (1985) emphasises how this function of accommodation of interests was an important
In brief, an important effect of the concentration of ‘decision power’ in CDE was the debilitation of the bureaucracy’s function as representative of interests and mediator of conflicts. In this sense, the ‘campaign against statisation’ highlights this important aspect which, though common to every state, was especially important given the pattern of interest representation that emerged in Brazil in the 1930s and was maintained and deepened after 1964. As emphasised, the fragility of the party system and the lack of encompassing associations made the bureaucracy a very important locus of interest representation and intra-elite conflict negotiation.

Furthermore, a fact which is very significant for this argument is that the next government, with the intention of increasing support from the business class, substantially modified the organisational structure of the state and re-opened the channels to business participation in the process of decision making. The government re-established the mechanisms of corporative representation and the business class gained a seat on many councils, including the CONSIDER, the CONCEX\textsuperscript{334} and the collegiate responsible for the administration of the important PIS/PASEP fund. In addition, business participation in the CMN, whose power had been substantially expanded in the new government, increased from three to eight representatives (Codato, 1997: 316). As Codato (1997: 308) concludes,

\textit{“General Figueiredo, with the intention of responding to the social pressures accumulated in the last period, built a different bureaucratic structure, more open and receptive, re-constructing the old channels of the big business participation in the state affairs and paving new ways of access to the state apparatus. There was, indeed, a restoration of the corporatist patterns suppressed after 1974 and a re-definition of the centres of power”}.

\textsuperscript{334} CONSIDER - Conselho de Não Ferrosos e de Siderurgia (Council of Steel and Non-Iron Metals).\linebreak CONCEX - Conselho Nacional de Comércio Exterior (National Council of Foreign Trade).
The ‘campaign against statisation’ and the autonomy of the government

The government suffered the effects of the ‘campaign against statisation’. In an authoritarian regime, characterised by the employment of repressive mechanisms and by strict control over labour and other popular movements, support from the business class assumed critical importance. In addition, as seen, PND II was designed to solve imbalances of the industrial structure, to improve the foundations of national capitalism and to strengthen the national bourgeoisie. In the face of these objectives, protests from the business groups were very disturbing, constituting a strong blow against the government’s claim to represent the national interest. It is difficult to underestimate the effects of the business protests when one takes into consideration that in 1977 manufacturers of capital goods, who had greatly benefited from PND II, signed a petition against the economic policy of the Geisel government\(^{335}\) (Lessa, 1988: 116).

Despite the blow suffered with the campaign, the government did not alter substantially the directives of the program of investment. According to Marcos Vianna, President of BNDE, the “government felt the protests but did not change the main lines of action. It made small concessions, adopting programs of support to small and medium enterprises and inviting the businessmen to participate in certain debates. However, the core of the economic policy was maintained” (Vianna, 2000). The same position is confirmed by the Minister of Planning, Reis Velloso (2000), who emphasises that the key programs of the PND II “were not negotiable” by the government and that they were kept.

Nevertheless, the business protests, by undermining government’s legitimacy and basis of support, limited its degree of freedom and constrained its capacity to adopt hard and unpopular decisions. This is very well illustrated by the following statement of Reis Velloso. When asked why the government did not adopt a policy of mergers in the capital goods sector, he answered: “such measures would imply compelling the

\(^{335}\) Manufacturers in this sector were not against statisation and their criticisms were of a different nature. For a detailed evaluation of the position of the industrialists of capital goods sector, see section 7.7.
enterprises to follow certain direction; since they already complained of ‘statisation’ without it existing, such a direction could have provoked a strong reaction” (Velloso, 2000).

In 1976, in response to the business groups’ mobilisation, the government published the document Ação para a Empresa Privada Nacional (Action to the National Private Enterprise). In this document, the government rejected accusations of statisation and emphasised that the promotion of free enterprise was the main objective of the economic policy. Public investment was justified as a result of a division of labour whose objective was the development of the economy and the strengthening of national capital (CDE IV, 1976: 27).

In addition, the document argued that most of the financial resources administered by public banks were destined for the private sector, including 90% of the resources of the BNDE. Likewise, it accentuated the magnitude of the program of incentives, the creation of mechanisms of capitalisation and the supply of long term loans under favourable conditions, measures deliberately conceived to strengthen national capital. In brief, according to the document, “it is very rare to find, even in developed economies, such a determined effort to push the development of a market economy (CDE IV, 1976: 40)”\(^{336}\).

In brief, the document attempted to demonstrate that the businesspeople had no reason for protesting against statisation, since state intervention was centred on the promotion of economy and on strengthening the private sector. As concrete measures, the government created funds of capitalisation and reinforced the prohibitions to state enterprises\(^ {337}\). They had access to official loans restricted and were recommended to

\(^{336}\) Furthermore, the document stressed that the effort of public investments and increases in incentives was implemented without the creation of additional duties, increases in the rate of taxation or an expansion in the deficits of the government (CDE IV, 1976: 30).

\(^{337}\) The government had already forbidden the state enterprises from having access to programs of incentives and exerted a strict control over the creation of new subsidiaries and the expansion of their activities to other areas.
avoid obtaining savings in the private capital markets. Later, measures from the Central Bank reinforced the restriction of access to the private financial market and pushed state enterprises to obtain resources in foreign markets (Rodrigues, 1989: 69).

**Conclusion to section 7.6**

In conclusion, the business class mobilisation against the Geisel government revealed the limits on the autonomy of the state, which faced opposition from the sectors which felt their interests had been disregarded. The Brazilian industrial structure, as a result of decades of import substitution, was very diversified and complex. It had produced strong and well established interests, many of which were dependent on foreign capital and which were ready to oppose any state initiative that attempted to affect significantly the *modus operandi* of the economy.

During the Geisel government, business class mobilisation was triggered by the government’s efforts to concentrate resources and incentives on heavy industry. As stated above, this led to the centralisation of the process of decision making, which provoked the big business reaction. This mobilisation reduced the government’s legitimacy and capacity to adopt unpopular and hard measures, as required by the wide effort of investment in such a difficult economic context. Although the government did not modify its main industrial objectives, a more solid political position would give it more degrees of liberty, permitting, for example, stronger anti-inflationary measures or the imposition of the costs of the adjustment on other social groups or on non-priority industrial sectors³³⁸.

In conclusion, one important source of difficulties faced by the Geisel program originated from the business class opposition and from the lack of a solid social coalition in favour of the strategy. Although the President and several government agencies were

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³³⁸ Lessa (1988: 152-173) argues that the PND II was unable to impose any substantial loss on the non-strategic sectors. According to him, the existence of powerful interest groups, including those in the automobile industry, the civil construction sector and the financial sector, constrained substantially the action of the government, impeding the adoption of further measures required by the PND II.
committed to the program of industrialisation, this commitment was not shared by
certain segments inside the state nor by a large part of the business class. As a
consequence, the government had problems sustaining its strategy and the business
opposition was a key constraint on the government’s capacity of action. Bielshovski
(1978), making comparisons with the Japanese experience, suggests how, in Brazil, the
interests produced by the previous process of import substitution were strong obstacles
to the success of a strategy committed to increase national autonomy and achieving
technological development. According to Bielshovski,

“if a strong national bourgeoisie and the need of affirmation of the national capital in
the face of foreign capital existed in Brazil, as it did in Japan, the essential political
conditions for the adoption, by the organs of economic policy, of a behaviour suitable
to the protection of the technological absorption [and to the solidification of an
autonomous and powerful heavy industry] would be guaranteed” (Bielshovski, 1978: 134).339 In addition, it is important to add, the Japanese bureaucracy was more coherent
and strong, in relation to private sector, than that of Brazil (see chapter two).

In brief, Geisel’s attempts at reform revealed an important characteristic of the
Brazilian state. Given the high degree of politicisation inside the state apparatus, its
capacity of action demanded much more than the will for transformation by a group of
competent technocrats. It also demanded the generation of political mechanisms able to
produce support for measures aimed at modifying the pattern of industrialisation.

339 Bielshovski is discussing the possibilities of technological development. However, the argument is
suitable to understanding the more general difficulties faced by the program of development of the Geisel
government.
7.7 State-business relationships and the policy for the capital goods sector.

Introduction

One important issue in evaluating state capacity is the relationship between state and business. As the essays of the book organised by Maxfield and Schneider (1997) show, co-ordinated actions between government and business, permitting exchange of information, policy enforcement and mutual commitment to the same cause, play a crucial role in the success of state–led strategies of industrialisation. This section focuses on the action of the industrialists of the capital goods sector, highlighting the pattern of action and the channels of contact, interest representation and exchange of information between them and the government. One important objective is to judge whether the policy for the capital goods sector was adopted in accordance to the requirements of the sector. In addition, the main criticisms and requests of the capital goods producers are summarised, as an important way to view the challenges of the industrial policy from a different angle.

The pattern of action and the business influence in the process of policy making

The activities of capital goods industrialists in the 1970s provide a good illustration of the capacity of the business class to influence the policy making process. Although they had benefited very much from the new direction given to economic policy, the action of the business associations, especially the ABDIB, was very important to a consolidation of the position and to obtaining approval for the supplementary policies necessary for the development of the sector.

As section 7.2 shows, the adoption of measures to strengthen heavy industry was a result of the diagnostic of the Brazilian problems made by Geisel and his economic team. As Einar Kok, president of another association of the heavy industry in the 1970s, - the Associacao Brasileira para o Desenvolvimento das Industrias de Máquinas
(ABIMAQ - Brazilian Association for the Development of the Machine Industry)- points out, the producers of the capital goods sector were co-opted by the government to invest. According to him, the government, alarmed with the balance of payments situation, invited the industrialists to participate in the development effort. In order to encourage investment, the government combined incentives and threats. If the producers agreed to follow the government’s direction, they would receive a range of incentives, including protection, credit facilities and subsidies. However, if they refused, the government threatened to ‘open the doors’ and stimulate the entrance of foreign capital

Therefore, the strengthening of the capital goods sector and of its associations was very favoured by the new direction given to the industrial policy. The priority given to the development of heavy industry created a significant identity of interests between the government and the capital goods producers. Nevertheless, to attribute the association’s fortune merely to the will of the government misses important part of the process. It is important to take into consideration that ABDIB, realising the favourable conditions, reformulated its pattern of action and mobilised to obtain further measures necessary for the development of the sector.

After 1974, ABDIB, which had had its membership significantly increased, became more combative and came to direct its demands to more specific targets. Following PND II, the association mobilised to support the targets of the program of industrialisation and to guarantee the approval of supplementary measures. Despite the government’s objective of developing the capital goods sector, realisation of this objective required permanent action and vigilance from the industrialists.

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340 In the following years, certain government organs, such as BNDE, engaged substantially in the effort to promote the capital goods sector. The subsidiaries of the Bank, EMBRAMEC, FIBASE and IBRASA, increased substantially the supply of financial resources and, from 1974 to 1976, came to participate in the capital of 95 private enterprises, with shares which varied from 10% to 91% (Martins, 1985:113).

341 This was very important to explain the privileged position attained by the entrepreneurs of the sector during the Geisel government. According to Boschi and Diniz (1978: 205), ABDIB was one of the business associations which had better access to the corridors of power.
This is very well illustrated by the ‘Accords of Participation’ and by the enforcement of the ‘Principle of the National Similarity’ (see section 7.3). In the Accords of Participation, the producers had to bargain with the investors the share of the equipments to be supplied by the national industry. Likewise, the definition of ‘similarity’ was not straightforward and depended on the industrialists’ claims, supported by political negotiations, that the national producers were able to supply the product (Kok, 2000).

ABDIB’s action included a diversified set of lines. An important form of pressure was exerted through personal contacts with the policy-makers, a practice which was intensified during the Geisel government. The meetings with the Planning Minister were frequent and the association, according to Boschi (1979: 204), had contact with twenty-four bureaucratic agencies. Likewise, the activities of the association included the promotion and participation in a range of lectures and seminars, viewed as an opportunity to present its main requests and to obtain allies for its causes\(^3\)\(^4\)\(^2\).

The building of alliances with bureaucrats and organs of the government was also an important practice of the association\(^3\)\(^4\)\(^3\). In addition, the association exercised direct pressure in the organs of industrial policy, such as CDI and FINAME. The lobby in CDI had the objective of holding up the concession of incentives to foreign projects which could compete with the established national producers. When the action in CDI failed, the association turned to FINAME and attempted to block the concession of credits to the respective projects\(^3\)\(^4\)\(^4\).

\(^{342}\) In the report of the activities of ABDIB, there are many references to lectures to sectoral associations in other states, which had the objective of convincing the local industrialists to increase investments and participate in the process of import substitution. In certain occasions, ABDIB identified the market niches which, supplied by foreign producers, could be replaced by national producers. See, for example, *ABDIB Informa.* 132/1975 and *ABDIB Informa.* 133/1976.

\(^3\)\(^4\)\(^3\) As seen, BNDE was an important ally.

\(^3\)\(^4\)\(^4\) Furthermore, Boschi (1979: 210-213) emphasises how ABDIB attempted to take advantage of the conflict between the two agencies to improve its position. Accusing government agencies of a lack of co-ordination, it organised an offensive, using the press, to put the government in a defensive position and to press for the approval of its demands.
In conclusion, the influence of ABDIB, although critically favoured by the priorities of the economic policy, was also founded in the intense action of the association. As Boschi (1979: 219) points out, the association combined a wide range of measures, including informal contacts, aggressive action towards specific agencies, penetration in decision areas, the ability to explore the inter-bureaucratic conflicts and pressure through articles in the press\textsuperscript{345}.

**Consultation, exchange of information and state capacity**

The objective of the following paragraphs is to evaluate whether the policies of the Geisel government were adopted in tune with the needs of the business community. As emphasised, the contacts between business groups and government during the elaboration of PND II and in the other years of the Geisel government were intense and permanent. Vianna (2000) mentions the seminars promoted by BNDE which, joining businesspeople and policy makers, acted as a forum for debate in which the producers presented their main requests. Similarly, Reis Velloso (2000) confirms the proximity of the industrialists and emphasised that no relevant decision concerning the capital goods sector was taken without consulting ABDIB.

Thus, the demands of the industrialists played importante role in the design of the policies for the sector. The BNDE’s subsidiaries, for example, were created in response to the industrialists’ complaints about the lack of mechanisms of capitalisation and instruments of credit. In addition, Velloso (2000) emphasises how several measures adopted by the government, including the direction to reduce the number of producers in certain niches, were responses to the demands of the producers.

The frequency of the contacts was also emphasised by the businesspeople. Carlos Chiti, Director of the Romi Group, points out that “the demands related to the

\textsuperscript{345} Boschi emphasises how the press was an important ally in the causes of ABDIB, claiming in particular that the capital goods sector achieved more publicity in the important paper *Jornal do Brasil* than other sectors of industry.
development of the capital goods sector were considered the subject of collective interest and were thus promptly accepted by the government” (Chiti, 2000). Einar Kok, President of ABIMaq, also states that the businesspeople were very well received by the government, claiming that there was the feeling that “we were collaborating with the government and that our action was crucial for the development of the country” (Kok, 2000).

Thus, the declarations of policy-makers and businessmen indicate that the policies for the capital goods sector were adopted in permanent contact and interaction with the private sector, permitting the identification of the main deficiencies and the proposal of corrective measures. EMBRAMEC was an important forum of exchange of information, consultation and debate about the problems of the sector (Almeida, 1983). Similarly, the NAIs, as indicated in section 7.3, were very ingenious instruments to identify the reality and the problems of the industry, to adjust the enterprises’ strategies according to the demand of the state enterprises, to shape the action of the private enterprises according to the objectives of the industrial policy and to promote a program of technical upgrading and adjustment.

Although the capitalists had been excluded from important councils of economic policy, including the powerful CDE, representatives of the capital goods sector did participate in two key organs of economic policy. They participated in CACEX’s ‘Accords of Participation’ and in the sectoral group 1 of CDI, which brought together representatives of the pertinent ministries and economic organs. In addition, Diniz and Boschi (1978: 172) emphasise the existence of many forums permitting contact and articulation between public and private agents, which included the connection between the business associations and trade unions of heavy industry, such as ABDIB, SIMESP and ABINEE\(^\text{346}\) and economic organs such as CACEX and BNDE.

\(^{346}\) SIMESP, Sindicato da Indústria de Máquinas do Estado de São Paulo, was the official corporatist association responsible for the capital goods sector. ABINEE, Associação Brasileira das Indústrias Elétricas e Eletrônicas, represented the producers of electrical and electronic products.
Furthermore, it is important to highlight the high degree of personal mobility and interchange between the public and private sectors, a characteristic of the Brazilian state that facilitated co-ordination and the access of private groups to the state apparatus. Suarez (1986: 101-113) gives interesting examples of the petrochemical sector, in which the contract with ex-ministers and influential men of the government gave business groups easy access to the corridors of power. His examples convincingly illustrate how this personal interchange between public and private sector assumed very high levels.

In sum, it is possible to conclude that the contacts between the government and the industrialists were very frequent, as was the use of channels and mechanisms, such as the NAIs, which strengthened the interaction and illustrated very well the positive effects of a co-ordinated action. In addition, the frequent practice of personal contacts and the constitution of informal networks facilitated business access to the government, compensating in part for their lack of participation in the main forum of economic decisions. However, the impact of these personal networks over the rationality of the economic policy was dubious. If, in one hand, it facilitated the exchange of information and co-ordination, on the other hand it increased private influence and reduced the capacity of the state agencies to adopt autonomous policies. In this sense, given the low degree of institutionalisation and the importance of personal networks, the forms of interaction between private and public agents also marked the limits of “embedded autonomy” in Brazil (see chapter two).

Finally, it is important to emphasise the difficulties caused by the lack of an encompassing business organisation. The positive effects of such an association in promoting collective action and leading the business groups to support the government’s strategy are very well illustrated by the Chilean experience in the 1990s (see Silva, 1997 and chapter two). In Brazil, by contrast, the pattern of interest representation was marked by the multiplication of sectoral associations exerting local pressure over the

347 As Silva shows, the existence of an encompassing business organisation, the Cooperation for Production and Commerce (CPC), was very important for leading the entrepreneurs to agree to an increase in tax and with the creation of a new labour code. The encompassing nature of the association facilitated negotiation and inhibited pressures for rent-seeking (see chapter 2).
bureaucratic agencies (Diniz, 1978; Diniz and Boschi, 1978). This pattern hindered the achievement of a general agreement with the capitalists, which could have increased support for the strategy of industrialisation. In addition, the sectoral pressures over the agencies constituted a significant obstacle to Geisel’s attempts to increase the coherence of the industrial policy.

In conclusion, despite the existence of many ties and networks, the lack of general business support was an important obstacle to Geisel’s policy of industrialisation. In contrast to Korea in the 1960s (see chapter eight), the Brazilian government did not have sufficient control over business to impose a strategy and to use the associations as transmission belts to provide information and enforce the government’s decisions. Also, in contrast to Chile, the absence of an encompassing association hindered the achievement of collective action necessary to lead the parties to restrain their immediate demands and support more general economic objectives. As a consequence, low support from business was a blow to the government, while sectoral pressures negatively affected the coherence of the strategy and reduced its chances of success.

Criticisms and demands

ABDIB, on many occasions, emphasised the importance of the program of the Geisel government to the development of the capital goods sector. The industrialists stressed the importance of many measures, which included: FINAME’s special lines of credit; BNDE’s practice of making the concession of credit conditional upon the index of nacionalização of equipment; the action of the NAIs of certain enterprises and

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348 The achievement of strong business support for a strategy such as the PND II would not be easy. The existence of a very complex and diversified industrial structure, very dependent on foreign capital, raised difficulties in gaining support for a strategy that intended to promote deep transformations. Nevertheless, there is no doubt that an encompassing association could facilitate negotiation and the achievement of compromise with the government.

349 In this sense, the existence of an encompassing association, able to develop independent studies and have a clear diagnostic of the national problem, would have facilitated the achievement of a co-ordinated plan of action to adjust the economy and address the immediate challenges.
Resolution 77 of CDE which, by reinforcing the ‘Principle of National Similarity’, exerting strict control over foreign investment, supporting specialisation and stimulating the leadership of domestic enterprises, was considered “the most significant step to the constitution of a true industrial policy in the country”\(^{350}\).

Despite these important measures, the industrialists considered that there were still many gaps and that supplementary measures were essential for the development of the sector. According to the producers, PND II was an immediate response to difficulties in the balance of payments and was not the fruit of a coherent effort of planning. Thus, they blamed the government’s strategy for lacking both co-ordination and a precise specification of the instruments, objectives and role of each agent.

According to Thompson Motta, an active executive in the sector at the time, there were 22 organs legislating about industrial policy, without an adequate co-ordination existing between them. Similarly, Carlos Villares, Vice-President of ABDIB, emphasised the fragility and incapacity of CDI, the organ which, according to him, should have been responsible for the conduct of the industrial policy. Correspondingly, Einar Kok believes that the conflict of functions inside this organ and, consequently, a lack of a coherent direction was responsible for the approval of measures which diverged from the objectives of the PND II, such as the concession of incentives to foreign projects in areas already occupied by the national producers\(^{351}\).

A similar criticism concerns the lack of sectoral planning for the development of the capital goods industry. In 1975, when the business groups still embraced the optimism which marked the new orientation given by the PND II, Carlos Villares stated: “believable objectives are essential if private capital is to plan and invest wisely for the future”\(^{352}\). Henrique Sanson, Vice President of ABDIB, similarly emphasised, in 1976,

\(^{350}\) *ABDIB Informa*. 143/1977.
\(^{351}\) All the references made in this paragraph were quoted from the article ‘O que a Indústria de Base Espera do Governo’. In *Negócios em Exame*. 13-07-1977.

\(^{352}\) *ABDIB Informa*. 131/1975.
that planning and co-ordination could have very positive effects for the specialisation and efficiency of the sector. According to him,

“There is no doubt that there is a large market, but if there were also a global plan and a government policy to achieve specialisation of each producer, instead of ‘everybody producing everything’ - a result of uncertainty concerning the future – the results would be much better.”

Thus, the industrialists demanded rigid control in order to avoid investments in sectors that already had enough production capacity. This argument was constantly employed to prevent the penetration of foreign capital into sectors already occupied by national enterprises. They suggested the concession of ‘patent letters’ to each line of production, intending to encourage firms to concentrate production on areas in which they had “tested speciality, capacity of production, tradition and technology”.

Another important concern of the producers was to combat exceptional measures, which circumvented the principles implicit in the PND II. An important criticism was against the circumvention of the ‘Principle of the National Similarity’, authorised by the government in special cases. Similarly, the association condemned the approval of bilateral agreements containing clauses implying import of equipment.

The industrialists also criticised strongly the refusal of several state enterprises to follow the directions of the PND II. Recognising the critical importance of the NAIs,
they insisted that they would only fulfil the objectives if the government demonstrated its capacity to extend the practice of the Petrobrás and Eletrobrás NAIs to the other state enterprises. The industrialists blamed certain state enterprises for discrimination against national engineering firms, for giving preference to well established international producers and for importing a larger proportion of their components. According to Henrique Sanson,

“we reached a stage at which we can produce almost everything in the capital goods sector. The realisation of this potential, however, depends on the collaboration of the state enterprises which, with few and honourable exceptions, import (...) a large part of their components.”

The producers’ requests also included the guarantee of orders and the offer of subsidies. According to Bardella, the PND II created a very optimistic expectation for the sector and this expectation was frustrated by the subsequent events. Thus, in face of the economic deceleration promoted in 1976, Bardella insisted on the necessity of keeping part of the PND II working, in order to secure the viability of sector. In addition, he suggested that the costs of re-programming the state enterprises’ purchases were imposed on foreign suppliers, thereby not penalising the national producers.

A key claim was the insistence that the government establish a long term direction for the economic policy, defining and institutionalising a program of priorities for investment over the coming years. In an interview, at the beginning of 1978, Bardella stressed that the concern of the producers was not with the perspectives for 1978, which seemed well defined, but with those perspectives for 1979, 1980 and 1981. As the leader of the ABDIB accentuated, no enterprise invests in the sector without at least a forecast for the next three years and the industrialists had no idea about the government’s


programs for those years\textsuperscript{360}. The same point is emphasised by Einar Kok, who states that “the government only offers to the producers a program for the next two years” which, according to him, is “very little when one thinks about industrial planning”. According to Kok,

\begin{quote}
“a government that is right about making its successor should have, at least, a project of economic program already elaborated. These things, however, happened backwards: firstly a person was chosen and afterwards some technicians were nominated to produce a plan in three months”\textsuperscript{361}.
\end{quote}

In a seminar in 1978, Bardella asked the Finance Minister, Mário Henrique Simonsen, to offer a definition of the economic policy for the next government. Simonsen, in his answer, “observed that the priorities of 1979 and of the other years could be inferred by logic, arguing that independently of the desire of the future government, priorities such as the continuity of the projects of import substitution, the increase in the exports and continuity of agriculture modernisation would necessarily be maintained\textsuperscript{362}”. As the article points out, this was not the answer expected by Bardella who, like the other businessmen, was not very confident of increasing their production capacity to meet the demands of projects which, although announced as priority by the government, were still uncertain\textsuperscript{363}.

In a document submitted in March 1976 to President Geisel, ABDIB presented a summary of its main requests. The central demand was the definition of a precise industrial policy, able to determine, in details, the objectives, the target areas, the participation of the national capital, the form and magnitude of foreign capital

\textsuperscript{360} ‘Governo garante que nao haverá reaquecimento’. \textit{Negócios em Exame}. 08-02-1978.

\textsuperscript{361} ‘Indústria de Base - Similar: o temor de uma excessão se tornar regra’. In \textit{Negócios em Exame}. 24-08-1977.

\textsuperscript{362} ‘Governo garante que nao haverá reaquecimento’. \textit{Negócios em Exame}. 08-02-1978.

\textsuperscript{363} These criticisms touched upon a critical point. The instability concerning the future and the lack of continuity in the industrial policy were central factors that explain the difficulties faced by the capital goods sector at the end of 1970s and beginning of 1980s. This is explored in detail in section 7.8.
participation and the degree and form of state involvement\textsuperscript{364}. The industrialists wanted industrial policy to be translated into a set of laws, as a way to guarantee its continuity in years to come.

An interesting request was the demand for the creation of an inter-ministerial organ to deal with the specific problems of the capital goods sector. The organ, having representatives of the private sector, would be responsible for the definition and running of the above-mentioned sectoral policy. It thus constituted a way for ABDIB to increase participation in determining the fate of the sector. Furthermore, the organ, by incorporating representatives of the industrial policy agencies, could facilitate the relevant negotiations and provide co-ordination in the sectoral policy. In conclusion, the businesspeople believed that the organ would be able to remove any obstacles to the consolidation of the capital goods industry (Boschi and Diniz, 1978: 197).

It is interesting to notice that this organ, as proposed by the industrialists, had many similarities with the Executive Groups created by Kubitschek in the 1950s (see chapter five). As that experience demonstrates, the sectoral policies for the elected groups worked very well when the government gave a high degree of priority to these targets, guaranteeing the approval of the necessary measures in the organs of the economic bureaucracy. The difficulties, however, emerged with the accumulation of other demands and constrains, which seriously hindered the smooth working of the executive groups in the years that followed the Kubitschek government (see Abranches, 1978).

In this sense, it is important to emphasise that the creation of such an organ, in the form proposed by the industrialists, required the solution of difficulties which were at the root of problems faced by the capital goods sector. On the one hand, it would have a very positive effect by addressing the conflict of competencies and guaranteeing the commitment of the public organs to the causes of the PND II. On the other hand, its smooth working would require a degree of commitment from the government that was

\textsuperscript{364} ABDIB Informa. 134/1976.
not possible in such a complicated economic context\textsuperscript{365}. In other words, the organ, although important in addressing several issues, was not able to satisfy many of the demands of the producers. Conversely, its success required the solution of important difficulties that were at the root of the industrialists’ demands.

In the face of the criticisms presented above, the position embraced by the government was that import substitution and the development of the capital goods sector had to be followed in a pragmatic way. According to the Planning Minister, Reis Velloso, it was necessary that the costs of the process of import substitution did not become too high. Consequently, the minister insisted upon the necessity of encouraging competition, a requirement to avoid the constitution of monopolies and the fixing of prices at very high levels. In an answer to a journalist’s comment that ‘the national producers wanted to deny the access of foreign capital to the country’, the minister declared:

“firstly, the government will not forbid [the entrance of foreign capital], because even the Brazilian legislation does not permit it. The instruments of the government are incentives and we can give them to one project and deny them to others. And nowadays, incentives are powerful. In addition, a position of avoiding competition does not fit well for the industrialists. (…) The issue has to be put in terms of support to the national enterprise to occupy ‘empty spaces’, and it was already contemplated in Resolution Nine of CDE”\textsuperscript{366}.

A similar position is taken by the Minister of Industry and Trade, Calmon de Sá, according to whom the desire of the producers was that the government forbid any import of capital goods or entrance of foreign investment in sectors occupied by national producers. As Calmon de Sá points out, this direction was incompatible with the objectives of the government, committed to the interests of many social groups and not only to those of the capital goods’ producers (Boschi and Diniz, 1978: 193-94).

\textsuperscript{365} As explored in the sections 7.5, 7.6 and 7.8, the Geisel government suffered many pressures and constraints, including regional interests, divisions inside the state, social pressures that emerged with democratisation and short term macroeconomic difficulties.

\textsuperscript{366} ‘Política Industrial. Um novo diálogo entre empresários e governo’. \textit{Negócios em Exame}. 12-10-1977.
Regarding specialisation, Velloso emphasised that EMBRAMEC had produced many studies showing the number of producers in each niche, which permitted the government to examine the desirability of a new project when it applied for credit in FINAME. Thus, if studies demonstrate the existence of many producers in certain niche, CDI should not concede incentives and FINAME should not approve credit. The Minister emphasised that specialisation should be one of the criteria adopted by the state enterprises in the choice of their suppliers.

In the declarations of the economic team, it is possible to observe the adoption of a cautious position, supporting the objectives of the PND II but stressing that it had to be pursued in a pragmatic way and to be reconciled with the constraints of the balance of payments situation and of the control of inflation. Questioned about the risks of provoking severe economic deceleration and serious damage to the capital goods sector, Velloso emphasised that the government was very closely supervising the orders. Furthermore, the Minister insisted that the situation demanded caution and ‘fine tuning’, requirements to avoid a recession and to preserve the results achieved. In an interview in 1977, he emphasised that the ‘strategy’ was working and having good results “and the basic industry which has been consolidated is maybe the most substantial structural change yet verified in the Brazilian economy”. According to the Minister,

“from now on, the main effort is to continue executing the programs already underway and to avoid disturbances which could affect the balance achieved between a medium rate of growth, control of inflation, control of the balance of payments and the execution of this strategy in the medium term”.

In this sense, given the prudence demonstrated by the economic team in 1977 and 1978, it is interesting to speculate about the degree to which the change of government was critical for the future abandonment of the strategy. This is explored in the next section.

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7.8. The change of government and the discontinuity in the industrial policy

Introduction

The objective of this section is to explore the turn in the economic and industrial policies under the Figueiredo government (1979-1984), which had an important impact on the capital goods sector. The purpose is to investigate which factors influenced the change and the degree to which they were important for the rupture with the industrial program. With this end, the analysis pays also special attention to the constraints faced by the government, which are critical to the comprehension of the decisions adopted.

In order to evaluate the rupture, it is necessary to highlight some difficulties already present under Geisel, both in industrial and in monetary policies. It is also important to understand the factors which influenced Geisel in his choice of successor. Then, the policies undertaken by the new government are evaluated taking into consideration two main aspects. Initially, the direction given to the monetary policy is investigated, highlighting how the adoption of an expansionist policy aggravated the difficulties. Secondly, the discontinuity in industrial policy, the mechanisms of control imposed on the state enterprises and the impacts on the capital goods sector are examined.

The Figueiredo government faced substantial constraints. Initially, it is important to take into consideration that it was a government of transition, committed to the democratisation of the country. This made it more open to social pressures, including the demands of the businesspeople and of the re-emerging labour movement which, after many years under strong repression, was becoming very successful in mobilising the workers in broad based strikes. Therefore, “Figueiredo found a business class stronger and less docile (…) and a labour movement more free, more organised (…) and less afraid of contesting the government”.

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368 Difficulties which indicated important obstacles to the objectives of the PND II.
the period was marked by the end of censorship\textsuperscript{370}, facilitating criticisms of and protests against the government.

In addition, the difficulties of the Figueiredo government were aggravated by the deficit of legitimacy of the military regime. In spite of the substantial economic growth which marked the 1970s, the regime suffered substantial defeats in the legislative elections of 1974 and 1978. Figueiredo inherited this dissatisfaction with the regime, inflated by the end of the censorship and by the loosening of the mechanisms of control. The fragility of the government, in a context of increasing contestation, made it particularly susceptible to offering concessions in the attempt to increase the support from social groups. This is very well illustrated by the institutional changes which reversed the centralisation and the insulation in decision making. Figueiredo, as the section 7.6 emphasises, re-opened the channels of business participation.

A second important set of constraints stemmed from the economic difficulties, which were seriously intensified by the second oil shock and by international events at the beginning of the 1980s\textsuperscript{371}. The international crisis reached an economy whose foreign debt had increased significantly in previous years. In addition, the difficulties were extremely aggravated by the policy of high interest rates adopted by the Reagan government, which had a substantial impact on a foreign debt contracted, in large part, at flexible interest rates\textsuperscript{372}. Thus, international economic turbulence was extremely serious and it is necessary not to underestimate its impact. The urgent need to combat short term imbalances reduced the degrees of freedom of the government and its capacity to promote other objectives.

\textsuperscript{370} The AI5 (Institutional Act 5), an important arm of the dictatorship, was cancelled by Geisel in a Constitutional Act of October, 1978, valid from the first day of 1979 (Couto, 1999: 250). Freedom of the press had been recovered gradually in the last years, but the posture of Geisel was very important to determine the end of censorship. At the beginning of the Figueiredo government, the sections of the media which criticised the government had substantial freedom (Couto, 1999: 170).

\textsuperscript{371} As a result of the increase in the average international price of oil from US$ 12.4 in 1978 to US$ 34.4 in 1981, imports of oil and oil derivatives increased from US$4.8 billion in 1978 to US$11 billion in 1981.

\textsuperscript{372} The average interest rates of the foreign debt increased from 9.1% in 1978 to 16.5% in 1981. The payment of interest rates increased, as a result of both the growth in interest rates and foreign debt, from US$2.7 billion in 1978 to US$9.2 billion in 1981 (Velloso, 1986: 357).
**Geisel and the choice of his successor**

Given the discontinuity which marked the industrial policy, leading to the abandonment of certain principles present in the PND II, a very important issue is to understand why Geisel, who was very concerned with the national interest, did not choose a successor more suitable to following the main lines of his economic program. Geisel wanted to choose the man he considered the most suitable to pursue his program of economic development and political democratisation. However, he had to take into consideration the rules of the military corporation. In the search for his successor, an important constraint faced by the president stemmed from the division inside the army and from the pressures of the sections who supported a more radical role for the revolution and opposed the return of power to civilians.

The main name of the ‘hard line’, candidate to the succession of Geisel, was General Frota, dismissed by Geisel in 1977 as a result of his presidential ambitions. A letter written after his dismissal illustrates how the position of this group was much more radical and differed substantially from the orientation given by the government. Frota criticised the incumbent government for abandoning the original objectives of the revolution, as demonstrated, according to him, by the re-establishment of relations with China, by the refusal to vote against Cuba in the Organisation of the American States and by the recognition of Angola by the Brazilian government (Couto, 1999: 229).

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373 Geisel had a strong sense of duty in relation to the function of the president, considered by him as a “soldier’s obligation”. Geisel described the function as a burden and considered the days immediately before he left the government as some of the happiest of his life. The same posture is valid for Figueiredo, who did not have any vocation to be a president of the republic. According to his declarations and his posture when president, he also accepted the post as an order (Couto, 1999: 241).

374 Couto (1999) illustrates very well the radicalism which marked this wing of the military. This group had an excessive concern to the combat of communism, despite the fact that the fierce repression during Médici government had eliminated any significant focus of opposition to the regime.

375 This was a landmark in the Geisel government, when he consolidated the power inside the military corporation and eliminated opposition from the ‘hard liners’. The candidacy of Frota had already been thrown and there was a strong articulation to support it. Geisel was very careful, waited for the best moment and took precautions to avoid a possible reaction from sections of the military. See Couto (1999: 217-232)
Geisel and Golbery do Couto e Silva\textsuperscript{376} were strategists and had not forgotten the defeat suffered to ‘hard liners’ in the succession of Castelo Branco (Couto, 1999: 206 – see chapter six). They were also aware of the necessity to keep the unity of the military and knew that the successor had to be someone able to achieve the approval of the corporation. Geisel believed that Petrônio Portela, the government representative in the Congress, could be a good president. However, he knew that he would never be accepted by the military, which considered him as ‘very smart’ and ‘opportunist’, a typical military evaluation of politicians (Couto, 1999: 207). Thus, the successor had to be a member of the armed forces able to fulfil adequately the criteria of the corporation and Geisel believed that Figueiredo was the man who had most of the required characteristics. According to Geisel,

\begin{quote}
“There were many reasons to choose Figueiredo. He was an official who had large projection inside the Army. He had been excellent student in the Military School, in the Escola de Aperfeiçoamento (Upgrading School), and in the School of ‘Estado Maior’. In brief, he had completed all those courses brilliantly. In addition, he had leadership inside the Army. Furthermore, and this was very important, he had accompanied very closely the government, day to day and since the beginning” (In Couto, 1999: 207).
\end{quote}

And finally, Geisel believed that by choosing Figueiredo he could guarantee a key post for Golbery do Couto e Silva, considered very important to give continuity to the process of democratisation.

It is important to emphasise that the characteristics cited by Geisel did not include political or administrative skills. It is easy to conclude that the military paid attention to attributes dissociated from several elementary characteristics necessary for a man to be a good president of republic. As Iglesias points out, the fact that from the five military presidents, two, Castelo Branco and Geisel, were very well prepared, was an extraordinary achievement\textsuperscript{377} (Couto, 1999: 260-61). By contrast, officials such as

\textsuperscript{376} Golbery was the head of civil cabinet under Geisel government and played a very important role in the process of redemocratisation.

\textsuperscript{377} This is explained, as the section 6.1 explored, by the role of the Escola Superior de Guerra (ESG), which gave to the officials a formation which transcended widely the military and war affairs. Both Castelo and Geisel had been members of ESG (see section 6.1).
Médici and Figueiredo had neither an interest in nor the abilities for the daily affairs of their government.

As a result, Geisel, although making his successor, was not able to choose a man suitable to give continuity to his projects. The succession determined a radical change in the style of the presidency: while Geisel liked to centralise everything, “was extremely interested and participated in the small and large administrative issues, Figueiredo delegated without limits. He had neither the patience nor the taste for politics or administration” (Couto, 1999: 257). Therefore, in vital issues, such as in the economic policy, Figueiredo did not give a strict direction to his government.

**Discontinuity in macro economic policy**

The three first years of the Geisel government were marked by a very loose monetary policy, despite the claims of the Finance Minister, Mário Henrique Simonsen, to keep the pace of growth and inflation under control. In spite of the prestige of the Minister and of his good relationship with the President, the economic policy gave priority to promote the program of industrialisation and the control of inflation was relegated to second place\(^{378}\).

From 1974 to 1976, credit to private sector and the means of payment increased substantially. In 1976, credit to the private sector grew by 55% and the means of payment expanded by 36%. The economic growth reached 9.8%, very much higher than the 5.2% achieved in 1975. The expansive monetary policy provoked an increase in inflation and in foreign debt, indicating to the government that a more restrictive economic policy was necessary.

\(^{378}\) According to Carneiro (1994), the government faced significant obstacles to undertake a consistent program of stabilisation. Geisel suffered pressures from the ‘hard liners’ and from other segments of the military and had difficulties to legitimise the regime, particularly after the defeat in the elections of 1974. In addition, the bureaucracy opposed the reduction in expenditure, while the capitalists, unsatisfied with the previous policies of control of prices, were strong opponents of a program of stabilisation.
As Carneiro (1994: 209-210) points out, only in the last two years of the government did the economic policy demonstrate firm concern to control the expansion of demand and the rate of inflation. In 1977, monetary policy became more restrictive and for the first time the interest rates achieved a positive value. In 1978, the cautious position was maintained, demonstrating the intention to keep inflation and the deficit in current account under control. In this last year, inflation fell to 38%, after having achieved 41.3% in 1976 and 42.7% in 1977.

In a document elaborated in 1978 and delivered to Figueiredo, Geisel’s economic team discussed the macro-economic situation and the possibilities of economic growth in the next year. According to the document, as Velloso (1998: 141) points out, the future rate of economic growth should “depend essentially on the possibility of preserving a growing surplus in the balance of trade and of achieving declining rates of inflation” According to the ex-Minister of Planning, only by fulfilling these conditions would Brazil be able to re-establish a process of high rates of economic growth.

At the beginning of the Figueiredo government, Simonsen, appointed as the powerful Secretary of Planning and controlling the main instruments of economic policy, decided to undertake the adjustment. In face of the economic difficulties at the beginning of 1979, amplified by the second oil shock, Simonsen proposed an adjustment to improve both the balance of payments and the fiscal accounts, intending the reduction of economic growth to something between 3% and 4%. In an interview at the beginning of 1979, Velloso emphasised the suitability of the government’s program and argued that it did not mean a recession, since a medium level of growth was compatible with the control of inflation.

Simonsen, when invited by Figueiredo, imposed a variety of conditions and demanded total autonomy to adopt a program of stabilisation and adjustment in the balance of payments. Figueiredo, to the surprise of the minister, accepted. Thus,

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379 The index used was the IGP-DI calculated by Fundação Getúlio Vargas.
Simonsen, in the first months of the new government, engaged in the effort to put brakes upon the expansion of the economy. In a context of considerable uncertainty, the government adopted a very cautious position, committing only to crucial programs and to the maintenance of the projects of investment already in operation.

Nevertheless, Simonsen faced substantial opposition and pressures from the other ministers and segments of civil society. The ministers demanded increased resources to finance huge programs in their respective areas. In addition, the difficulties of adjustment were also increased by the process of democratisation, which intensified the private sector pressures and put additional targets for the respective ministers. In brief, Simonsen suffered pressures from business, politicians, bureaucrats and the press, which condemned a strategy which proposed modest rates of growth. Even a rate of economic growth of 4% was seen as insufficient.

Simonsen, although a brilliant economist, was not the man to deal with such pressures and to engage in the range of negotiations necessary to guarantee the maintenance of the program of stabilisation. He was not a politician and, as Couto (1999: 259) emphasises, lacked the style of a “determined executive with the capacity of leadership to impose his policy”. In other words, Simonsen had a profile of a technician and, having demanded carte blanche, had the support of the President to implement his program. The position of the President, however, was not very comfortable: he was strongly pressured by the ministers and by the sections of society which opposed the recessionary measures adopted by Simonsen. In addition, in contrast to Geisel, he was not very interested in economic policy and lacked the energy and active style necessary to support a minister which promoted such unpopular measures.

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381 Andreazza, the Minister of the Interior and a potential successor to Figueiredo, demanded resources to combat the drought in the northeast states and to promote a housing program. Delfim Netto, minister of agriculture, used all his prestige and popularity with the businesspeople to pursue a very ambitious plan for agriculture and pressured Simonsen for the resources to implement a program of minimum prices. In ‘A volta do Superministro’. Negócios em Exame, 29-08-1979.

382 The resistance to a program of stabilisation was favoured by the influence of the developmentalist ideology which, as seen, justified a permissive treatment of inflation.
Thus, Simonsen was alone, supported only by the President and by Golbery do Couto e Silva. Very different was the situation of Delfim Netto, who had massive business support, a qualified team of collaborators and an incredible capacity for political communication. As the former minister Roberto Campos points out, the dismissal of Simonsen and appointment of Delfim implied a substantial increase in the popularity of the Figueiredo government, expanding the support necessary to face the crisis. The direction of the economic policy, however, was substantially modified (Couto, 1999: 261).

Delfim Netto, nominated as Secretary of Planning in August 1979, preserved some directives pursued by Simonsen, such as the reduction in the subsidies and the imposition of financial discipline over the state enterprises[^383]. However, Delfim refused to continue the deceleration of the economy. According to Couto, his economic team preserved a document elaborated by Simonsen but introduced a critical change: instead of the original purpose of reducing the rate of growth, it decided to pursue the ‘historical rate of economic growth’. In other words, Delfim decided to release the brakes and start to accelerate the economy: “the words of priority were accelerated growth and expansionist policies” (Couto, 1999: 265-66).

The rupture with the orthodoxy was shown since the first declarations and measures adopted by Delfim. In September, 1979, he declared, “we decided to start reducing the rate of interest and, then, to introduce some restrictions in the market, in a way to give no other alternative to people than to invest in the enterprises[^384]”. In addition, he asked the banks for not increasing interest rates, considered a necessary measure to keep low the expectations regarding future inflation. Therefore, Delfim’s conception was very peculiar. As Simonsen points out,

[^383]: Although, as it will be seen, he intensified the control and gave new directions to it.
“his ideas were completely different. Delfim’s theses, in that moment, were as follow: fixation of interest rates, no concern either with monetary expansion or with increase of credit to agriculture, since he believed it would produce a super-harvest able to make the prices fall”. According to Simonsen, “nowadays, everybody knows that an increase in interest rates is used to combat inflation. (…). However, in that time, many people believed in the opposite, that the government should reduce interest rates to reduce costs and, consequently, reduce inflation. And Delfim believed indeed in that” (In Couto, 1999: 264-265).

Consequently, the interest rates were reduced and the monetary basis expanded substantially. Accordingly, there was a substantial expansion of credit to agriculture. In 1979 and 1980, economic growth achieved rates of 7.2% and 9.1%, contributing critically to increasing the impacts of the international shock on the economy.

The strategy of macro-economic stabilisation also included a maxi-devaluation of the national currency of 30% in December of 1979. In addition, at the beginning of 1980, monetary correction for the whole year was pre-fixed at 45% and the government guaranteed that the maximum devaluation in exchange rate would not exceed 40%. Accordingly, the government announced its intention to limit the increase of the means of payment at 50%385. Meanwhile, it reduced the compulsory deposits of the banks in order to stimulate the expansion of loans and discourage increase in interest rates. In brief, Delfim tried to use his prestige as a key element to convince the economic agents of a new level of inflation, of no more than 45%. The influence on expectations was considered the key aspect of the strategy.

The results of the economic policy were catastrophic. The decision to accelerate the economy made it much more vulnerable to the effects of the international crisis. As a result, inflation increased from a level of 38.7% in 1978 to 54% in 1979 and 100% in 1980. Accordingly, the deficit in the balance of payments current account grew from US$ 5.5 billion in 1977-78 to US$ 11.9 billion in the period 1979-80 and the liquid foreign debt expanded from US$ 31.6 billion in 1978 to US$ 46.9 in 1980 (Velloso, 1998: 142). Furthermore, the public deficit and the domestic debt also increased substantially.

The ‘heterodox’ measures attempted by Delfim Netto also had very negative results. The economic agents perceived that the government would not be able to fulfil the target for the expansion in monetary basis and speculated against the currency and the economic policy, therefore aggravating economic difficulties.

The macro-economic imbalances, intensified by the deepening of international crisis, gave government no alternative but to adopt, from 1981, an orthodox program of stabilisation with the support and advice of the IMF. From 1981 to 1983, the recession was severe, provoking a reduction in GNP and a substantial increase in unemployment. In such a context, government’s capacity to practice industrial policy became very restricted.

In the face of these results, one important point to address is whether a more balanced economic policy could have saved Brazil from the huge economic crisis which engulfed the country in the 1980s. In other words, could a policy of fine tuning, as practised under Geisel in 1977 and 1978, have saved Brazil from the international turbulence? The issue assumes special importance when one addresses the strategy adopted by Korea in the 1970s. The response given by the Korean government to the first oil shock was very similar to that given by Brazil and an ambitious program of heavy industrialisation was adopted (see chapter eight). One important difference, however, was the capacity of the Korean Economic Planning Board (EPB) to assume the leadership and to convince the government of the necessity of a substantial control of inflation (Jong-Chan Rhee, 1994: 134). In this sense, the decision and the capacity to stabilise the economy was critical to the ability of the country to escape from the crisis of the 1980s.

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386 Inflation, however, refused to fall and, after another maxi-devaluation in 1983, reached a rate of 154% in that year.
387 In addition, it is important not disregard other important differences, such as Korea’s much higher capacity to export and the far better conditions obtained by that country to finance foreign debt at the beginning of the 1980s.
As emphasised, it is important not to underestimate the impact of the international crisis, which reached most of the Latin American countries. According to Couto, the crisis was inevitable and the refusal of adjustment in 1979 only amplified its impact:

“If the adjustment had occurred in 1979, it would have been traumatic and would not have eliminated the enormous difficulties which followed, all of them externally induced. The difference was that it would be an a slightly smaller enormous problem. But the aggravation of the international crisis would not save Brazil, as it had not saved other countries in Latin America” (Couto, 1999: 266).

Velloso is not so sure about the inevitability of the crisis. He condemned the policies adopted by Delfim and, although recognising that the international shock was not predictable and that its consequences were very bad indeed, he believed that an adequate economic policy could have increased the chances that Brazil would escape from the crisis. According to Velloso (1998: 141-142),

“What defined the destiny of each country was the strategy of reaction to the shocks. (…). The new government opted for not decelerating the economy and not making the necessary macroeconomic adjustment. If it had realised it (as Korea did, for example), maybe it could have escaped from the international collapse. Or maybe not”.

It is impossible to evaluate precisely what would have happened if the economic policy had been different. As already stated, the difficulties of stabilisation were substantial and had been very present during the Geisel government. Geisel, despite all his authority, refused to make an adjustment. Nevertheless, the government had demonstrated, from 1977, more sensitivity to the macro-economic difficulties and a disposition to keep inflation under control. In this sense, there is no doubt that the change in the economic team and in the economic policy had very negative effects. The

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388 And a complicated legacy of annual rates of inflation of 40% was transmitted to the following government.
Figueiredo government suffered substantial pressures and the wrong decisions adopted by Delfim contributed substantially to the aggravation of the crisis.\(^{389}\)

In brief, the new style of administration adopted by Figueiredo and the power assumed by Delfim Netto had an important influence in the routes of economic policy adopted from 1979. The discontinuity illustrates an important characteristic of the Brazilian state. As emphasised, the low degree of institutionalisation and the high dependence on personal ties and networks were obstacles to the pursuit of long term strategies of development (see Schneider, 1991).

**Industrial policy – the difficulties in the last years of Geisel government**

The events which marked the last years of the Geisel government illustrate the existence of constraints and difficulties which limited the achievements of the industrial objectives present in the PND II. Those years were marked by the deceleration in the programs of investment and by difficulties in the balance of payments, which led the government to adopt measures which hurt the interests of the capital goods industry.

The difficulties of the capital goods sector at the end of the government are very well illustrated by the negotiations which marked the steel project Açominas and the construction of the railway “Ferrovia do Aço”, in which the dependence on foreign credit brought about a level of ‘nacionalização’ of equipment much below the national

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\(^{389}\) One careful work has yet to be written about the style of administration of the minister Delfim Netto, exploring its impacts on economic policy. His capacity of dialogue and co-ordination with the businesspeople was outstanding, which may help to understand the form and the timing given to the process of adjustment. His capacity to obtain allies and to expand power in a very imperialist way was similarly impressive. After assuming the Secretary of Planning, Delfim created the Secretaria de Controle de Empresas Estatais (SEST - Secretary of Control of the State Enterprises) and an organ of supervision of food supplies. At the same time, he seized the organ responsible for the control of prices from the Ministry of Finance and, some months later, he captured CONCEX. After the dismissal of the Minister of Finance, Karlos Rischbieter, Delfim put men of his confidence on the respective ministry and on the Central Bank. ‘O ministro atípico’. *Isto É*. 23-01-1980.
capacity. In these two examples, the normal bureaucratic channels were circumvented and BNDE and CACEX had little influence and capacity to support the cause of the national producers.

In sum, the government found difficulties to maintain certain measures which had previously been chosen as necessary for the development of national industry. As already stated, besides the short term macro-economic difficulties, the influence of regional interests constrained the government’s capacity to give priority to the capital goods sector (see section 7.5). Besides the deceleration of the investments, the producers suffered also from the import of equipment in niches in which they had capacity to produce.

The capital goods sector: planning the subsequent development

In spite of the aggravation of the constraints, the Geisel government maintained the programs of basic inputs and conserved their disposition to stimulate the capital goods sector. The concern to plan the subsequent process of industrial development was attributed to BNDE, which from 1977 was dedicated to the task of elaborating a careful study of the Brazilian industry that included one hundred sectoral diagnostics. One important objective was to identify the supplementary measures necessary to strengthen the position of the national capital in many sectors. A very detailed study was elaborated for the non-serial capital goods, which divided the sector into 16 niches, evaluated the chances of survival of national producers in face of foreign competition and proposed measures to consolidate their position.

The diagnostic of the capital goods sector gave special attention to the promotion of specialisation, considered crucial to the achievement of economies of scale and, consequently, to the increase in productivity. Thus, it prescribed measures to avoid

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390 In the Açominas project, for example, the national participation in the supply of capital goods was 50%, while the producers declared capacity to supply 80% (Tadini, 1986: 73; Klein, 1985).

391 ‘Diagnóstico do BNDE: alternativas para indústria nacional’. Isto É. 29-03-1978. The following paragraphs are also based in this article.
dissemination of producers in certain niches and to veto the entrance of foreign firms in sectors already occupied by national enterprises. In addition, the report emphasised the importance of not loosing the ‘Principle of National Similarity’ and of avoiding the import of items which could be produced domestically. Furthermore, ‘nacionalização’ of engineering services was supported as an important step to increase the participation of national producers in the supply of capital goods.

In certain niches, such as hydraulic turbines, large size boilers, equipment for production of paper and electrical ovens for the steel industry, for example, the report concludes that little could be done to reverse the control of foreign producers. Nevertheless, it emphasised that certain measures could be adopted to make this control more favourable to domestic industry. According to the document, the government could impose conditions requesting integral transference of technology and the direction of the demand of components to the national producers. In addition, it suggested the adoption of measures to impede verticalisation and to preserve the small and medium producers of components.

In other sectors, such as rolling bridges, hoists, transport equipment of ‘material in bulk’ and non electrical ovens, the sectoral study emphasised that the position of the national enterprises could be consolidated if the right policies were implemented, including the prohibition of entrance of other producers and the commitment of the state enterprises to make the bulk of their purchases from national firms.

In sum, the document elaborated by BNDE demonstrates the existence of a very firm and well-defined program of sectoral development. It emphasised the necessity of measures to solidify the position achieved by national capital, which included control over multinational companies, pressure for technology transfer, participation of state enterprises in the effort to upgrade national producers and protection to small and medium enterprises. In addition, the study stressed that the control of national capital in certain sectors was vital for the effort of industrial development. As an example, BNDE, alleging the high propensity of MNCs to import components, supported national control
in the segment of ‘radio-transmission’ as very important for the development of the national industry of electronic equipment\textsuperscript{392}.

In conclusion, it is important to emphasise that, as far as the capital goods sector was concerned, there was a disposition to give continuity and to deepen the impulse of development introduced by the PND II. Nevertheless, the industrial policy in subsequent years took a very different direction. BNDE lost force and the aggravation of short term constraints reduced significantly the government’s degrees of liberty. In addition, the Figueiredo government did not share the priority given by Geisel to the development of the capital goods industry. As Vianna (2000) emphasises, the huge effort of industrial planning undertaken by BNDE was completely disregarded\textsuperscript{393}.

**The control over the state enterprises**

During the Figueiredo government, the state enterprises ceased to be instruments to promote industrial development and were used to help the government address short term difficulties. They were subjected to a strong control, including the artificial limit on their prices, which reduced substantially their capacity of investment and aggravated their financial situation. In addition, they were employed to obtain foreign resources necessary to release the difficulties in the balance of payments.

The reduction of the autonomy of the state enterprises had already been an objective of the Geisel government. The government had controlled their access to financial markets, had attempted to regulate their acquisition of foreign resources and prohibited them from undertaking investments without specifying precisely the source of resources\textsuperscript{394}. However, the control was timid and unable to have significant impact on their activity. According to Nelson Mortada, appointed in 1979 to the directorship of


\textsuperscript{393} According to Vianna, the abandonment of planning was favoured by the preferences of Delfim Netto, who was not very concerned with strategies of planning. The same point is emphasised by Penna (2000), according to whom Delfim was a tactical man, not very interested in planning.

SEST (Secretary of Control of State Enterprises), the controls were basically limited to the accompaniment of investments and had very restricted success\textsuperscript{395}.

In the first months of the Figueiredo government, Simonsen demonstrated his intention to exercise firmer control over state enterprises, a direction which was implemented afterwards by Delfim Netto. An important step for this objective was the creation of SEST, in 29-10-1979. SEST gave the government the authority to control the ‘efficiency of the enterprises’, the administrative expenditures, including the wages of the directors, the expansion and diversification of the enterprises and the sale of subsidiaries\textsuperscript{396}. In brief, SEST gave Delfim Netto the control over the expenditure and investments of the enterprises, which became, in the following years, the key instrument of adjustment in public expenditure\textsuperscript{397}.

The state enterprises, as expected, reacted against the power of SEST, alleging that the new controls, particularly over investment and administrative expenditure, critically affected their capacity to act efficiently. They insisted that such cuts were not the unique alternative and that the government could, otherwise, opt for an increase in tax of three or four per cent. However, they soon realised that, in contrast to the Geisel government, they had very little voice in the new government\textsuperscript{398}.

In his fight against state enterprises, Delfim mentioned the risk of "statisation" and blamed state enterprises for contracting irresponsible loans abroad\textsuperscript{399}. The accusation, however, was unjust. In the Geisel period, the government had closed the access of the public enterprises to the private financial system and to some official institutions,

\textsuperscript{396} ‘A terceira perna do tripé’ \textit{Visão}. 10-12-1979.
\textsuperscript{397} Delfim Netto justified the control over the state enterprises in the following terms: the increase in the oil prices meant the imposition of an international tax over the country which had to be paid through reduction in consumption and (or) cut in investment. The Minister argued that “as Brazil could not afford a recession, a ‘luxury’ of developed countries, we had to do a little of both” (In ‘A terceira perna do tripé’ \textit{Visão}. 10-12-1979). In practice, however, state enterprises paid a very substantial part of the costs of the adjustment, a result of the incapacity or unwillingness to extend the costs to certain sections of the private sector.

\textsuperscript{398} ‘A terceira perna do tripé’ Visão. 10-12-1979.
\textsuperscript{399} ‘A terceira perna do tripé’ Visão. 10-12-1979.
pushing them to obtain resources abroad. Under Figueiredo, the practice of using the enterprises as instruments to obtain foreign resources was intensified. Rodrigues (1990: 70-71) argues that they were led to use their patrimony as a guarantee to obtain foreign loans, even when they did not need the resources. Trebat goes so far as to say they were used by SEST to “organise the national program of absorption of foreign resources”. In conclusion, Delfim inverted the argument: instead of being the cause which justified the control, the irresponsible capture of foreign loans was in large part a consequence of the forms of control adopted by the government.

Correspondingly, state enterprises were also used as instruments to contain inflation and to provide subsides to the private sector. Their prices and tariffs were readjusted very far below inflation, aggravating their financial situation and making the self-financing of their investments impossible. Werneck (1987) highlights the magnitude of the reduction in prices. According to his calculations, the prices of iron and steel, corrected by the national index of prices (igp-di), declined from 100 in January 1979 to 80.9 in January of 1980, 74.8 in the same month of 1982 and 56.5 in 1984. In electricity, the reduction was from 100 in January 1979 to 89.1 in the same month in 1980, 81.6 in 1982 and 62.6 in 1984. Similarly, telephone tariffs declined from 100 in January 1979 to 81.2 in 1980 and 74.2 in 1982 (Werneck, 1987: 66-67). The reduction in prices is also emphasised by Sallum (1996: 74), who states that, between 1980 and 1985, the prices of electricity tariffs fell 52%, the price of plain steel by 18.6% and the price of oil derived products by 27.8%.

The deterioration of prices was lethal for the financial situation of the enterprises. According to Werneck (1987: 72), from 1980 to 1983, the financial expenses of the state enterprises increased by 133% in real terms. In the Petrobrás and Siderbrás groups, those values increased four times. In addition, the result of the policy was also an increase in their foreign debts. According to Rodrigues (1990: 69), from 1978 to 1983 the foreign

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400 Consequently, they suffered with the maxi devaluations of the currency in 1979 and 1983 and with the increase in international interest rates.

debt of Petrobrás increased 677% and, “in 1983, Siderbrás, CVRD, Petrobras and Eletrobrás were responsible for 27.9% of the Brazilian foreign debt⁴⁰².” And last but not least, the control of prices also affected the capacity of the enterprises to give continuity to their investments, leading some firms to postpone (or cancel) the projects and others to slow the pace of execution.

Although there is a certain consensus that some form of control was necessary, the government could have opted for a kind of regulation which did not hit the enterprises too hard. According to Villela (1984: 157), the cuts in expenditure were undertaken in an indiscriminate way, in spite of the existence of an articulated planning apparatus which had been built during the last few governments⁴⁰³.

As Rodrigues (1990: 62) emphasises, investments of state enterprises and expenditure of ‘unproductive’ public agencies were cut indiscriminately. According to him, the government adopted a classification which established no distinction between enterprises and “unproductive” public organs. Thus, organs such as hospitals and public foundations were also classified as state enterprises. Furthermore, this classification did not distinguish the enterprises’ self-financed investments from other kinds of expenditure, considering them indistinctly as sources of public deficit. Such a procedure, as Werneck (1987: 22) emphasises, was completely unsuitable, since these investments, besides their contribution to productive capacity, did not pressure for further resources and, consequently, did not have an impact on the public deficit and on inflation. In other words, “from a fiscal point of view, what matters, concerning the state enterprises, is the volume of resources of the Treasure which is, directly or indirectly, transferred to them, and not the total expenditure”. In sum, expenditure of different kind of public entities

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⁴⁰² Siderbrás and Eletrobrás were respectively, as seen, the holdings of the state enterprises of Steel and Electrical sectors. CVRD (Companhia Vale do Rio Doce) was a state enterprise in mining sector.

⁴⁰³ The government gave continuity to certain programs already initiated and the expenditure in non-priority sectors fell much faster (Velloso, 1986: 364-365). However, a planned and integrated program of cuts could have produced much better results and softened the effects of the crisis on the industrial structure.
was treated as the same thing and cut indiscriminately, a kind of control which substantially hurt the state enterprises.

There is no doubt that the indiscriminate classification of many organs as public enterprises contributed to the deterioration of their image and to preparing public opinion for the measures which followed. In that classification, the deficit associated with the state enterprises got very high values, favouring their association as mainly responsible for the economic difficulties (Werneck, 1987: 22). As Rodrigues (1990) points out, the adoption of such measures was associated with the existence, inside the state, of a cluster of interests opposed to state enterprises, already present during the ‘campaign against statisation’ and which was strengthened during the Figueiredo government.

**The impact on the capital goods sector**

The crisis of the state enterprises had very negative effects on the capital goods sector, a result of the fact that the national producers directed a large part of their production to those enterprises. As Amann (1996: 167) points out, the public sector, in 1980, absorbed 60% of the sales of the sector. The reduction in the level of investments and the interruption in the projects provoked the postponement and the cancellation of orders, increasing the idle capacity of the sector. In addition, the financial crisis of the enterprises led them to delay the payments or to pay without monetary correction (Thompson Motta, 2000). According to Lessa (1988: 138), the crisis left few options to the enterprises but to use their power of monopsony over the suppliers. This directly clashed with the strategy of the PND II which, as seen, used the enterprises as instruments to stimulate the development of national industry.

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404 According to Werneck (1987: 83), the direct investment of the 20 larger groups reduced 27% between 1980 and 1983. Velloso (1986: 363) shows how although the investments in certain priority sectors were conserved, the total investments of the enterprises controlled by SEST declined by 36% between 1980 and 1983.
Consequently, the capital goods sector suffered substantially from the crisis of the state enterprises and from the consequent deceleration in the investments. It is important to emphasise that the producers had invested substantially in 1974 and 1975, a result of the atmosphere of optimism and of the favourable credit conditions offered by BNDE. Thus, they were surprised by the deceleration in the programs of the PND II and, after 1979, by the new policy adopted for the state enterprises. Although the impacts on the niches were differentiated and certain niches maintained good performance at the beginning of the 1980s, the demand for capital goods demonstrated a clear tendency of reduction.

Einar Kok stressed how in 1979 the increase in the demand of capital goods had been very modest, leading some enterprises to diversify the lines of production in the attempt to obtain more orders\textsuperscript{405}. In April 1980, the sector was still demonstrating a reasonable performance, but the future orders showed substantial reduction, indicating the tendency towards deceleration\textsuperscript{406}. The data for the production of the sector in those years confirmed the deceleration. In 1980, the production of the sector increased 6.5\%, but in 1981 it fell by 18.5\% and in 1982 fell again by 11.9\%. The same trajectory of decline was verified in the non serial capital goods, whose production declined 5\% in 1980, 8.1\% in 1981, 4.5\% in 1982 and 23\% in 1983 (Villela, 1984: 152).

The difficulties of the sector were aggravated, as stated above, by the problems in the balance of payments and by the increasing dependence on foreign resources. The urgent need for resources led to a substantial increase in the contract of foreign supply credits which, as emphasised, made the loan conditional upon the acquisition of foreign equipment. The amount of supply credit increased substantially after 1979, achieving US$7.5 billion in that year and US$8 billion in 1982\textsuperscript{407} (Tadini, 1986: 111). Consequently, the national producers, who were already facing deceleration and the


\textsuperscript{407} In 1973, for example, the supply credits amounted to only US$ 1.9 billion.
decline in the national demand, suffered also from the import of equipment which could be produced domestically.

**Conclusion: understanding the discontinuity**

The development of the capital goods sector, after the substantial stimulus offered by the PND II, required a continuity of industrial policy and the adoption of supplementary measures. Nevertheless, the aggravation of the macro-economic constraints and the change of priorities during the Figueiredo government affected the industry very negatively and hampered the consolidation of the advances made by the previous government.

As the paragraphs above emphasise, the economic crisis played an important role, imposing serious constraints and considerably restricting the capacity of the state to engage in a program of industrial development. However, it is not correct to believe that there was no alternative and that the government simply responded rationally to the macro-economic constraints. Firstly, as emphasised, the policies adopted from 1979 were extremely inadequate and aggravated the magnitude of the crisis, amplifying the impacts of the international crisis on the economy. Secondly, it is important to take into consideration that the responses were extremely constrained and influenced by the social groups which supported and pressured the Figueiredo government. Thirdly, it is necessary to consider the personal influence of the man responsible for the economic policy from 1979 to 1984. Delfim Netto, with his political abilities and proximity with the businesspeople, played an important role in the adoption of a program of adjustment which imposed the bulk of the costs on the state enterprises.

As emphasised, the change of direction promoted by Delfim Netto illustrates a very important obstacle to the pursuit of a long term industrial policy. The low degree of institutionalisation makes economic policy very dependent upon individuals and on personal networks. Despite his intentions, Geisel was not able to elect a successor suitable to give continuity to his industrial priorities and the direction given by Delfim
Netto, including the disregard of planning, amplified the rupture with the previous government.

Sallum (1996) offers an interesting interpretation of the events in the first years of the 1980s. According to him, the response of Geisel to the first oil shock, in 1974, rejecting stabilisation and the reduction in consumption, was an attempt to use international credit to keep the process of development without penalising the classes which composed the developmentalist alliance. This possibility, however, was exhausted at the end of the 1970s and beginning of 1980s, when

"the developmentalist state suffered (...) the effects of the changes in the international and in the social conditions which had served as a shell to direct, successfully, the construction of a nationally oriented, but socially exclusive industrial capitalism” (Sallum, 1996: 88).

As a result, the impasse claimed an adjustment, undertaken by Delfim Netto through the imposition of unequal burden on the members of the alliance. The bulk of the costs, as seen, were concentrated on the bureaucracy and on the state enterprises.

As Sallum (1988: 88) points out, one important achievement of The Figueiredo government was the modification of the developmentalist alliance, reducing its aspiration to national autonomy. While the macro-economic constraints, intensified by the international events, put the developmentalist state in check, the different interests which supported the government are important to explain the kind of adjustment adopted. In this sense, this adjustment represented a strong blow to the developmentalist state, striking at the core of the model of development which had been pursued, in different degrees, since the 1950s. Thus, the Figueiredo government represented an

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408 It was, however, only the first step of a longer process. In the 1980s, the developmentalist faction was still alive and engaged in the promotion of policies aimed at strengthening national capital and capacity to control technology, as illustrated by the policy in the area of computers (Tapia, 1995). The defeat of the alliance was only consolidated at the end of the decade, as a result of the international transformations and of the international pressures against nationalist initiatives.
important step of a process which modified substantially the role of the state in the economy. The capital goods sector, whose rapid development had been built under the protection of the state, suffered particularly from this transformation.\footnote{As Amann (1996: 167) shows, the public sector met 60\% of the demand of the sector in 1980, a participation which declined to 40\% in 1992. For a detailed analysis of the transformations of the capital goods sector in the 1980s, see Amann, 1996.}

In conclusion, although the Figueiredo government gave continuity to several projects initiated by the previous government, the new direction given to industrial and economic policy had a very negative effect on the industrial effort initiated by Geisel. The discontinuity in industrial policy hurt significantly the capital goods sector, provoking accumulation of idle capacity and technological backwardness. In addition, the technological apparatus, set in the 1970s, suffered substantially from the lack of continuity; the area of science and technology endured a decade of lethargy and demonstrated signs of recovery only in the 1990s, and then on a very different basis (Guimarães, Araujo Jr and Erber, 1985; Amann, 1996). In conclusion, a substantial part of the effort undertaken in the capital goods sector and also in technological development was lost.
7.9. Conclusion: state capacity and the achievements of Geisel industrial program

The objective of this section is to summarise the main points presented in the preceding sections. Although most of the sections had a conclusion, it is very important to provide a general evaluation of the effort undertaken by the Geisel government, highlighting how the results and failures achieved in the capital goods sector are connected to the capacity of the state to undertake the necessary measures. The section is organised in the following way. Initially, it presents a general outlook of the economic results of the period and comments on the decision to adopt the PND II in response to the oil shock. Secondly, the results achieved in the capital goods sector are presented. The third sub-section evaluates the industrial policy, emphasising the coherence achieved in certain instruments but also the problems and limits of the respective policy. Finally, the last sub-section proposes a general conclusion, evaluating the main obstacles faced by the Geisel government to transform the pattern of industrialisation.

The macro economic results and the response to the oil shock

The strategy of development promoted by Geisel had very positive effects on the industrial structure. The GDP grew 38% and industrial production grew 36% in the five years of the government. Although this was a deceleration in comparison with the previous period, the public program of investments was crucial to softening cyclical deceleration and to guarantee a favourable industrial performance in that difficult international context. The effort of investment, supported mainly by public and state enterprises investment, was also substantial. The participation of investment in GDP increased in relation to the previous periods and achieved the average level of 22.6% of the GDP.\footnote{This is the data used by Resende (1990: 408), adopting methodology of IBGE. Velloso (1986: 244), using different methodology, finds, for the period 1974-1978, an average level of investment of 28.6% of GDP. Despite the differences in methodology, the level of investment in Geisel government was very high for Brazilian standards. It was superior to the investment verified in the \textit{Brazilian miracle} (1968-73) and}
Industrial capacity in oil, basic inputs and capital goods, the priority sectors, grew substantially. The effort of import substitution had very positive results and the total imports reduced from 11.9% of the GDP in 1974 to 9.5% in 1980, in spite of the second oil shock, which had an impact on imports of approximately 3% of the GDP. Carneiro (1994: 215-216) emphasises the important results in basic inputs. According to him, the amount spent on imports of paper and cellulose, non iron metals, fertilisers, petrochemical and steel declined from US$ 3.5 billion in 1974 to US$ 1.2 billion in 1979.

In addition, exports responded very favourably, increasing at the average annual rate of 15% and expanding from 7.5% of the GDP in 1974 to 8.4% of the GDP in 1980, despite the deceleration in international trade (Carneiro, 1994: 216). Industrial exports performed outstandingly, increasing at an annual rate of 25%\textsuperscript{411}. In this sense, the PND II constituted a program of import substitution also marked by a very favourable export performance, permitting a substantial economy of foreign currency already in 1979. As Reis Velloso emphasises, without the achievements of the program of import substitution, the difficulties faced in 1979 would have been much more considerable\textsuperscript{412}. The success in the trade balance, nevertheless, was not able to reverse the current account deficit, which was aggravated by the policies adopted after 1979\textsuperscript{413} (Carneiro, 1994: 213).

Although the favourable impacts on the balance of payments were already present in 1979, the positive effects of the PND II on the trade account only emerged plentifully at the end of 1983, a result explained by the long maturation period of certain projects. From that year, Brazil had a substantial surplus in the trade account, led by the excellent

\textsuperscript{411} This was in part due to the improvement in the international prices of the exports, although there was also increase in quantity exported.

\textsuperscript{412} 'Balanço: A herança otimista de Reis Velloso'. Isto É. 14-03-1979.

\textsuperscript{413} According to Carneiro (1994: 211), this deficit was responsible for an increase of US$ 20 billion in the foreign debt from 1974 to 1979. In the period 1977-78, the yearly deficit in current account achieved, in average, US$ 5.5 billion, increasing to US$ 11.8 billion in the period 1979-80 (Velloso, 1998: 142).
performance in the sectors considered by the PND II. As Velloso (1986: 250) shows, the balance of trade, in 1984, presented a surplus of US$ 6 billion in raw materials (excluding oil), of US$ 2.1 billion in basic inputs and of US$ 917 million in capital goods\textsuperscript{414}. The same opinion is shared by Carneiro (1994: 215-216), according to whom the PND II was very successful in modifying the structure of industrial supply, although it took more time than had been planned.

This process, undertaken in a difficult international context, also had negative effects. Inflation, although artificially controlled in 1973, grew from 1974 and achieved a new level around 40% in the period 1976-1978. The liquid foreign debt increased from US$ 6.1 billion in 1973 to US$ 31.6 billion at the end of 1978, provoking an increase in the payment of interest rates from US$ 500 million in 1973 to US$ 2.7 billion in 1978 and, as a result of the increase in the international interest rates, to US$ 4.2 billion in 1979\textsuperscript{415} (Carneiro, 1994: 211). In the 1980s, the payment of interest rates, expanded by the effects of the economic policy and by the further increase in international interest rates, became the main element responsible for the increase in foreign debt.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|c|c|c|}
\hline
\textbf{Years} & \textbf{GDP (growth \%)} & \textbf{Investment/ GDP (\%)} & \textbf{Imports} & \textbf{Exports} & \textbf{Liquid Foreign Debt} & \textbf{Payment of interest rates} & \textbf{Inflation (IGP-DI) (\%)} \\
\hline
1973 & 14.0 & 21.4 & 6.1 & 6.2 & 6.2 & 0.5 & 15.1 \\
1974 & 9.0 & 22.8 & 12.6 & 7.9 & 11.9 & 0.6 & 28.7 \\
1975 & 5.2 & 24.4 & 12.2 & 8.6 & 17.2 & 1.5 & 27.7 \\
1976 & 9.8 & 22.5 & 12.3 & 10.1 & 19.5 & 1.8 & 41.3 \\
1977 & 4.6 & 21.4 & 12.0 & 12.1 & 24.7 & 2.1 & 42.7 \\
1978 & 4.8 & 22.2 & 13.6 & 12.7 & 31.6 & 2.7 & 38.0 \\
1979 & 7.2 & 23.0 & 18.0 & 15.2 & 40.2 & 4.1 & 54.7 \\
1980 & 9.1 & 22.5 & 22.9 & 20.1 & 46.9 & 6.3 & 100.0 \\
\hline
\end{tabular}
\caption{Macroeconomic Variables Brazil - (1973-1980) (US$ billions)}
\end{table}

Source:: Abreu (1990); Velloso (1986); Conjuntura Econômica e Banco Central do Brasil.

The economic policy of the Geisel government had also important consequences for

\textsuperscript{414} For a detailed treatment of the import substitution results of the PND II, see Castro and Souza (1985).
\textsuperscript{415} An amount equivalent to 27.6\% of the total exports.
public finances. Public saving fell as a result of the significant increase in subsidies and incentives to the private sector. The ‘liquid tax’ fell from 16.6% of the GDP in 1973 to 13.1% in 1978, a result of the reduction in gross tax from 26.4% to 24.7% of GDP and of the expansion in transferences from 7.5% to 9.8% (Oliveira, 1995: 60). From 1974 to 1978, public federal debt increased from 4.6% to 9.9% of the GDP, provoking an expansion of the expenditure with payments of interest rates\textsuperscript{416}. The financial difficulties of the government were aggravated by the adoption of mechanisms which, from the end of the 1970s, produced the statisation of foreign debt\textsuperscript{417}. As a result, the maxi devaluation of currency in 1979 and the increase in international interest rates was a strong blow to public finances. In the 1980s, the difficulties in public accounts became a key component of the serious economic crisis which marked the country during the decade.

In this sense, it is possible to conclude that the strategy adopted by Geisel, refusing to stabilise the economy and increasing public investment, had significant consequences on the macro-economic difficulties. Although it had positive effects on exports and imports, inflation, foreign debt and public debt increased during his government. Although the situation was under control during the Geisel government, a complicated legacy was transmitted to the next government which, weaker and more exposed to pressures, suffered also the explosive effects of the international crisis. This, nevertheless, does not reduce the importance of the mistakes made in 1979 and 1980 (see section 7.8).

\textsuperscript{416} As Carneiro (1994: 218-219) points out, “the lack of an official homogeneous series which measures the evolution of ‘the necessity of finance of the public sector’ hinders an accurate analysis of the fiscal policy of the Geisel government and of the legacy transmitted to the Figueiredo Government”. Velloso (1998: 141) has a much more favorable evaluation of the public accounts in the period. According to him, the financial accounts of the public sector were balanced and the public deficit, including the federal, state and municipal governments, but excluding public enterprises, was very small. According to him, the domestic public debt was also very small, achieving 6.4% of the GDP in June of 1979. In addition, Velloso stresses that the government’s expenses with interest rates were very low: the expenses with the domestic debt represented 0.47% of the GDP in 1978, while the payment of interests of the foreign debt amounted to 0.18% of the GDP.

\textsuperscript{417} These mechanisms were adopted to stimulate the private sector to contract foreign debt in a context of increasing uncertainty. They included Resolution 432 and the Instruction 132, “which permitted the private firms and banks, respectively, to deposit foreign currency in the Central Bank as a hedge against their debts in foreign currency” (Carneiro, 1994: 222)
There is an intense debate evaluating the response given by The Geisel government to the second oil shock (see, for example, Castro and Souza, 1985). Carneiro (1994: 187, 196), although recognising the important achievements of the Geisel government, criticises its refusal to stabilise the economy. According to him, the substantial growth achieved from 1968 to 1973 was a demonstration of the potentialities of the Brazilian economy when important elements of uncertainty, particularly inflation, were kept under control.

Velloso, the Planning Minister in the period, argues that government’s response to the oil shock consisted basically of two arms: the promotion of gradual deceleration and structural change in supply, a combination which required a fine tuning adjustment. Velloso emphasises that the adjustment of supply, the main target of PND II, was the right strategy, since it represented the best alternative to face the serious imbalances inherited from the process of economic growth of the previous government. Accordingly, Velloso stresses the disposition demonstrated by the government to contain economic growth, considered compatible with the programs of the PND II. According to him, the situation was under control and only became critical because of the second oil shock and of the terrible response given by the Figueiredo government (Velloso, 1998).

I believe that the analysis embraced by the Minister Reis Velloso is largely true. However, the government committed certain mistakes which, if avoided, could have made the country less vulnerable to the international crisis and increased the chances of escaping from the international turmoil. Carneiro (1994: 220-221), evaluating the response to the first oil shock, emphasises that the instruments adopted by the

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418 The essence of that response was already commented in the section 7.2 and the objective here is only to make some conclusive remarks.
419 The main challenge, as emphasised, was to avoid radical deceleration that would depress expectations and discourage investments. See Velloso (1998).
420 In addition, Velloso emphasises how PND II was important to increase the national capacity to export.
421 However, as Carneiro (1994) shows, the monetary policy was very loose in the first three years of the government and a serious disposition to contain economic growth was only demonstrated in 1977 and 1978.
government were timid and insufficient. According to him, there was a double mistake of evaluation, including the misperception of the gravity of the crisis and the refusal to adopt certain instruments more actively. According to Carneiro, “with more emphasis on pricing policy, more rigour in the conduct of the demand policy and in the administration of the conflicts which provoked inflation and less emphases on ambitious and disastrous programs such as the Nuclear Program, the Geisel government would certainly have transmitted a less indigestible inheritance to its successor”. Nevertheless, Carneiro also believes that, in face of the disaster which marked the economic policy in 1979 and in 1980, “those mistakes lost substantially their significance” (Carneiro, 1994: 221).

As a general evaluation, I believe that the program adopted by Geisel had very positive results. The high rates of investment and economic growth made the country richer and important advances were obtained in the heavy industry. It, however, was achieved, as argued above, at the cost of an increasing inflation, foreign debt\(^\text{422}\) and reduction in public savings. Particularly, government could have been more careful with inflation and adopted a less expansionist policy between 1974 and 1976.

In addition, if the process had not been paralysed in the 1980s and if supplementary measures had been adopted, including a solid program of technological development, a modern heavy industry could have been consolidated, including a solid capital goods sector. Unfortunately, the country did not escape from the crisis and the dream to set up a modern industrial structure, led by the state investments, was buried by the events of the 1980s.

\(^{422}\) According to the Minister Simonsen, the increase in foreign debt has to be evaluated in face of the increase in the national wealth that it permitted. In 1979, Brazil was much richer than 5 years before, a result of the program of investments adopted from 1974. He also concluded that, as the level of domestic savings remained constant, the indebtedness was used to finance investment (declaration extracted from the Video. *O Último Trem para Paris – o Governo Geisel*. Rio de Janeiro: Manchete – Funtevê).
The results in the capital goods sector

The results achieved in the capital goods sector were very impressive. Production was increased from US$ 5.8 billion in 1973 to US$ 16.9 billion in 1979 and US$ 19.9 billion in 1981. As a result, the participation of the capital goods sector in the value of industrial production expanded considerably, from about 10% at the beginning of the decade to 15% in 1980 (Tadini, 1986: 30). Meanwhile, imports increased at a much slower pace, from US$ 2.28 billion in 1973 to US$ 4.04 billion in 1979, thus constituting a substantial process of import substitution. From 1973 to 1979, the participation of the imports in the national demand declined from 28.7% to 20.8%, in spite of the substantial rates of investment.

Table 2. Figures - Capital Goods Sector

<table>
<thead>
<tr>
<th>Years</th>
<th>Production</th>
<th>Exports</th>
<th>Imports</th>
<th>Import Coefficient (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>5,890</td>
<td>232</td>
<td>2,282</td>
<td>28.7</td>
</tr>
<tr>
<td>1974</td>
<td>8,833</td>
<td>465</td>
<td>3,355</td>
<td>28.6</td>
</tr>
<tr>
<td>1975</td>
<td>11,251</td>
<td>591</td>
<td>4,217</td>
<td>28.3</td>
</tr>
<tr>
<td>1976</td>
<td>12,872</td>
<td>631</td>
<td>3,874</td>
<td>24.0</td>
</tr>
<tr>
<td>1977</td>
<td>14,435</td>
<td>948</td>
<td>3,314</td>
<td>19.7</td>
</tr>
<tr>
<td>1978</td>
<td>16,571</td>
<td>1,267</td>
<td>3,775</td>
<td>19.8</td>
</tr>
<tr>
<td>1979</td>
<td>16,983</td>
<td>1,577</td>
<td>4,041</td>
<td>20.8</td>
</tr>
<tr>
<td>1980</td>
<td>17,926</td>
<td>2,103</td>
<td>4,686</td>
<td>22.8</td>
</tr>
<tr>
<td>1981</td>
<td>19,933</td>
<td>2,427</td>
<td>4,304</td>
<td>19.7</td>
</tr>
<tr>
<td>1982</td>
<td>19,179</td>
<td>2,086</td>
<td>3,503</td>
<td>17.0</td>
</tr>
<tr>
<td>1983</td>
<td>10,749</td>
<td>2,534</td>
<td>2,682</td>
<td>26.6</td>
</tr>
</tbody>
</table>


Import substitution was also outstanding in the non serial capital goods. From 1973 to 1979, national production increased from US$ 983 million to US$ 4.19 billion and imports expanded from US$ 590 million to US$ 1.32 billion in 1979. As a result, the participation of the national production in the national demand increased from 60% in 1973 to 71% in 1979 (Tadini, 1986: 98-99)\(^{423}\).

\(^{423}\) In order to evaluate better the results of the import substitution, it is very useful to utilise the triennial media, which permits the elimination of seasonality. For the sector as a whole, the triennial average
Table 3. Figures – Non Serial Capital Goods

<table>
<thead>
<tr>
<th>Years</th>
<th>Production</th>
<th>Exports</th>
<th>Imports</th>
<th>Import Coefficient (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973</td>
<td>983</td>
<td>20</td>
<td>570</td>
<td>37.2</td>
</tr>
<tr>
<td>1974</td>
<td>1,528</td>
<td>34</td>
<td>721</td>
<td>32.6</td>
</tr>
<tr>
<td>1975</td>
<td>2,294</td>
<td>53</td>
<td>1,074</td>
<td>32.4</td>
</tr>
<tr>
<td>1976</td>
<td>2,567</td>
<td>91</td>
<td>1,151</td>
<td>31.7</td>
</tr>
<tr>
<td>1977</td>
<td>2,964</td>
<td>112</td>
<td>1,106</td>
<td>27.9</td>
</tr>
<tr>
<td>1978</td>
<td>3,636</td>
<td>244</td>
<td>1,514</td>
<td>30.9</td>
</tr>
<tr>
<td>1979</td>
<td>4,192</td>
<td>384</td>
<td>1,321</td>
<td>25.6</td>
</tr>
<tr>
<td>1980</td>
<td>3,992</td>
<td>529</td>
<td>1,624</td>
<td>31.9</td>
</tr>
<tr>
<td>1981</td>
<td>5,090</td>
<td>742</td>
<td>1,637</td>
<td>27.4</td>
</tr>
<tr>
<td>1982</td>
<td>4,854</td>
<td>696</td>
<td>9,72</td>
<td>18.9</td>
</tr>
<tr>
<td>1983</td>
<td>2,770</td>
<td>681</td>
<td>712</td>
<td>25.4</td>
</tr>
</tbody>
</table>


The positive performance is also seen by the increase in the exports of capital goods, which expanded from US$ 232 million in 1973 to US$ 2.42 billion in 1981. The participation of exports in the production doubled from 1974 to 1982, achieving 10.9% in this last year. However, it is important to emphasise that this participation was much inferior to that verified in the industrialised countries, indicating the large dependence of the national producers on the domestic and public demand (Tadini, 1986: 103). Thus, despite the growth, the performance of the exports had important limits. As Tadini (1986: 103) points out, there was low diversification in the exports, which consisted mainly of unsophisticated items. In the non-serial capital goods, for example, twenty items accounted for 90% of the total exports, while five items were responsible for 60%.

Participation of the imports in the national demand declined from 31.3% in 1973 to 21.2% in 1979 and 22.5% in 1983. In addition, the achievements in import substitution are also seen by the increase in national participation in CACEX accords of participation, which grew from 52.7% in 1973 to 82.4% in 1978 (Tadini, 1986: 98-100).

Besides the low productivity, other aspects were identified as obstacles to insertion in the international markets. According to Erber (1982: 54), the obstacles to export in two of the niches researched by him, equipment for chemical and related industries and equipment for electric power generation, were due to a combination of causes which included the high costs of the components acquired in the domestic market, the lack of tradition and reputation of the firms and the “the lack of agents who organise the ‘package’ of items for export.”
In conclusion, in spite of the dependence on the national demand, particularly on the investments of the state enterprises, the results achieved were substantial. The reduction in the participation of imports, in a moment in which the demand of capital goods was increasing substantially, is a very good indicator of the substantial achievement of the government’s program. As Amann (1996: 197) concludes for the non-serial capital goods, the industry, in 1980, had achieved certain maturity, being modern and diversified enough to supply a range of products to the domestic demand. The same conclusion is embraced by Erber (1982: 52), according to whom “the relatively low share of imports in the total supply of capital goods (...) suggests that the industry established in Brazil is capable of producing goods of international quality”.

The performance, as expected, varied widely according to the niche. The best results were achieved in less elaborate capital goods, niches in which the barriers of technology were lower and did not block the advance of national firms. Accordingly, the process was more successful in the sectors of mechanical equipment and machinery, material of transport and metallurgy, and faced more obstacles in electrical, electronic and telecommunication equipment. In these last niches, the technological sophistication and the control of the national production by foreign companies constrained the achievements of the industrial policy. The tendency is confirmed by Tadini (1986: 94) in his analysis of the non-serial capital goods. Tadini writes that the electrical equipment increased their share in total imports of non-serial capital goods technical, economic and financial constituents which are typical of exports in those markets”. Similarly, Einar Kok (2000) believes that the lack of control over technology and the difficulties to introduce the national mark in the international markets were the main factors which explain the limited capacity to export (Kok, 2000).

425 According to several large producers interviewed by him, in certain niches the national production did not have technical disadvantages when compared to that of international enterprises (Erber, 1982: 52).

426 In a sample contained 240 enterprises, organised by Lago et al (1979: 185), the following niches were those which presented the higher rates of growth in the period 1974-1977. In mechanical capital goods, the average annual rate was 14%, in material of transport, 15.9%, in railway material, 15.4%, in shipbuilding, 17.8%, in the aeronautic industry, 18.4% and in metallic structures, 14.7%. For a detailed numeric analysis of the performance of the capital goods industry in the period, see Lago et al. (1979).
from 16.9% in 1971 to 32.4% in 1983, while the share of mechanical goods and boilers fell from 61.3% in 1971 to 54.3% in 1983.  

**Evaluating the industrial policy**

It is important to emphasise the role of the instruments of industrial policy to the achievement of the results presented above. Certain agencies were heavily involved in the process and certain instruments demonstrated a high degree of coherence. As seen, lines of credit, resources for capitalisation, incentives and protection were offered to stimulate national industry. Likewise, the policy of purchases of the state enterprises and the technical assistance provided by the NAIs also played a very important role.

The role of FINAME was crucial, confirming the critical importance of the supply of long term lines of credit to the development of national capital goods sector. As seen, this is illustrated by the events in the steel sector, in which the national participation in the supply of equipment increased from 25% in the “Second Steel Stage” to 75% in the “Third Steel Stage” (Tadini, 1986: 69; 74; Almeida, 1983: 76). Similarly, FINAME’s participation was also critical to increase the participation of national equipment in the hydro-electrical projects, permitting, for example, the growth in the ‘nacionalização’ in the supply of turbines and generators from 60% in 1975 to 90% at the end of the decade (Amann, 1996: 117).

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427 The larger difficulty of substitute electrical and electronic capital goods is also emphasised by Soares (2000), director of the steel state enterprise Usininas in the period. According to Soares, the enterprise, in the effort to qualify for the incentives offered by FINAME, was able to ‘internalise’ successfully the demand for mechanical capital goods, but not for electrical and electronic equipment.

428 The Second Steel Stage took place between the end of the 1960s and beginning of 1970s. The Third Steel Stage was programmed to be completed in 1978, but was only concluded many years later. The index of national participation, quoted from Tadini (1986), includes the acquisition of equipment up to 1984. In the third stage, it is important to stress, the basic engineering was also carried out in Brazil.

429 In projects in which the participation of FINAME was intense, such as in the large hydro-electric ITAIPU, the participation of the national industry in the supply of capital goods was very high. By contrast, in other projects which depended on foreign credit, such as Tucuruí and Itaparica, the index of national participation was much inferior. In Itaipu, the index of national participation reached 85%, while this index was 60% in Tucuruí and 45.8% in Itaparica (Tadini, 1986: 79-81).
The coherence in the economic policy is also demonstrated by the action of BNDE and by the improvement in the performance of CDI. As section 7.3 stresses, CDI became more selective in its policies of incentives, incorporating certain objectives of the PND II. This is illustrated by the concentration of the incentives on projects in basic inputs and capital goods and also by the substantial growth in the index of “nacionalização” of equipment in the projects approved by the organ (Lago et al, 1979: 379).

It is also worth indicating the advances achieved in the technological field, although the policy in this area also illustrates the difficulties and problems which marked the industrial policy. As seen in section 7.4, the efforts of the industrial policy had positive effects on technological development, leading to the increase of investments in laboratories and in R&D and to the growth in the number of firms engaged in the task of technological upgrading. Important progress was also obtained in the negotiation of the contracts of technology licensing. As Tadini (1986: 69) points out,

“besides the financial and fiscal incentives, the fragmentation of the orders in a large number of packages made possible the national leadership in those packages and gave the national producers a larger bargaining power in the negotiation with foreign licensors”. Thus, the national industry came to fabricate more sophisticated equipment, utilising a high share of components produced domestically.

However, the obstacles to the development of technology were considerable, aggravated by the urgent necessity to substitute imports. As Klein (1985) shows, the ‘technological issue’, although assuming an important role in the discourse of the government, was, in reality, of only secondary concern. According to her,

“the extremely short time set for the expansion and diversification of the domestic equipment sector did not allow large national enterprises to build up their own research and development departments. Large state-sponsored projects demanded an almost immediate and highly specialised supply of equipment. Lacking adequate technology to manufacture the more sophisticated capital goods required, the only

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430 In 1977, these sectors accounted for 92% of the investment projects approved by the organ (Lessa, 1988: 152).

431 For the total projects of the industry of transformation, the national participation in the supply of capital goods increased from 36% in 1973 to 72% in 1978. Although this reflects the general trend of the process of import substitution, it is also an indication of the new direction given by the organ.
chance of competing with foreign imported technology, in the domestic producers’ view, was to resort heavily to technology imports” (Klein, 1985: 177).

Thus, there was a conflict of objectives, leading even developmentalist organs such as BNDE to abandon the objective of technological development and engage in the creation of the conditions to allow the national firms easy access to foreign technology. As a result, the advance in technology was timid and limited, annulled in the 1980s by the adoption of an economic policy which provoked the destruction of the technological apparatus built in the 1970s.

Although the instruments of PND II achieved substantial results in terms of import substitution, it is necessary to be cautious in the evaluation of the industrial policy, taking into consideration that the resources could have been utilised in other ways. One important criticism emphasises that the industrial policy, aimed at increasing the national production of capital goods at all costs, failed in not selecting carefully several potential sectors and in not concentrating the instruments of economic policy on their development. According to the critics, such a policy could have produced a more consistent sectoral structure, permitting also a selective program of cuts in response to the economic difficulties which emerged from the end of the Geisel government.

According to Fishlow, the emphasis on the ‘nacionalização’ of the production and on the generation of an autonomous heavy industry failed in not taking market criteria into consideration, thus producing an inefficient capital goods sector with little capacity of survival. A more selective process of import substitution, taking also into consideration the effects of the purchase of components on productivity, could have produced a more efficient industry. Similarly, Vilella (1984: 152) emphasises how the supply of a wide range of incentives, aimed at stimulating import substitution ‘at all costs’, distorted the composition of the product and reduced productivity and the chances of insertion in foreign markets.

It is important to stress that these criticisms were also shared by Einar Kok, president of the business association ABIMAQ in the period. Kok (2000) believes that the government over-emphasised the necessity to substitute imports in a process which did not pay adequate attention to the quality of the product. According to Kok (2000), the objective of producing domestically, “at no matter what cost”, provoked a lack of selectivity in the concession of incentives and an excessive dissemination of enterprises, which hindered the achievement of specialisation.

In this sense, it is important to emphasise that the policy of incentives, bringing about a diffusion of producers, was unable to generate an industrial structure characterised by the existence of strong and specialised producers in the respective niches. As Amann (1996: 121) points out,

“one significant criticism that could be levelled at procurement policy (…) was that, in an effort to spread orders as widely as possible, the state encouraged an industrial structure that was insufficiently concentrated and firms that were excessively diversified”.

As a consequence, the industrial structure was marked by a very low degree of concentration, impeding the firms to obtain economies of scale. Villela (1984: 109) shows how in certain niches the number of producers in Brazil exceeded substantially those verified in countries which had already a consolidated capital goods sector. In turbines, for example, Brazil had four producers, while German had two, United States one, Japan three and France one. In Laminators, Brazil had seven producers, against three in Germany, three in United States, three in Japan and one in France. The list used by Villela (1984) included a further six important items in which the number of producers in Brazil was superior than in the developed countries. In brief, the large dissemination of firms and the lack of specialisation was a serious liability, discouraging investments in technology and hindering the increase in productivity necessary to the conquest of foreign markets.

433 In addition, Kok (2000) believes that the government could have adopted a policy to enforce productivity, such as a program of gradual reduction in tariffs.
In the face of this situation, it is important to stress that, in contrast to France or Korea, there was not a policy of producing national winners. Although the PND II (1974: 54) emphasised the necessity of promoting mergers, nothing was done in this direction. According to Velloso (2000), the opposition of the private capital, already mobilised in the ‘campaign against statisation’, was a potential obstacle to the adoption of such a kind of policy. In this sense, the business resistance was an important constraint to the government’s initiatives of shaping a more vigorous industrial structure.

Another criticism emphasises the fact that the government underestimated the cyclical nature of the demand of capital goods (See Carneiro, 1994: 215). In this sense, the incentives offered in 1974 led to a substantial expansion of investments and of productive capacity which, when in operation, faced the cyclical reduction in investment and, consequently, in demand\(^\text{434}\).

In addition, the effectiveness of the industrial policy was also affected by the incapacity to promote a co-ordinated policy shared by all the state enterprises. As emphasised, the state enterprises had a large degree of autonomy and the government did not have an effective mechanism to make them comply with the objectives of the PND II\(^\text{435}\). As a result, the lack of such an integrated policy limited the capacity of the government to stimulate the development of a more specialised and efficient capital goods sector, able to achieve economies of scale and technological expertise (Villela, 1984: 156).

In sum, in spite of the coherence achieved in certain instruments, which permitted a rapid process of import substitution, \textit{the lack of a careful process of industrial planning, capable of selecting certain niches to be developed and promoting specialisation, hindered the emergence of a more productive capital goods sector.} Furthermore, it is important to accentuate the lack of a policy of mergers and of a co-

\(^{434}\) As seen, the conclusion of several projects and the financial problems of the state enterprises had negative effects on the demand of capital goods, contributing to increase idle capacity in the sector.

\(^{435}\) Thus, as illustrated by the performance of the NAIs, the use of the purchasing policy as an instrument to develop the capital goods industry varied widely depending on the enterprise (see section 7.3).
ordinated policy for state enterprises. While the former indicates the limits of the state in face of business opposition, the latter illustrates the divisions inside the state and the difficulties to achieve co-ordinated action. These two aspects, as emphasised, are very important in understanding the limits in the capacity of the state to transform the industrial structure.

Finally, it is important to emphasise that the timing of the PND II did not help. Besides the many constraints produced by the international crisis, which reduced the government’s ‘degrees of liberty’, the fate of the capital goods sector was also strongly influenced by the substantial technological revolution in microelectronics and information science, which made the advances achieved by the national industry insignificant. As Sallum (1996: 169) points out, while Brazil, via indebtedness,

“completed a process of industrialisation centred on the technological pattern of the second industrial revolution, the large corporations of the developed countries advanced inside the pattern of the third industrial revolution, in which the electronics and the information science had a fundamental role”.

From then, the differences in productivity became very high, particularly because Brazil was involved in a serious economic crisis which critically affected the state enterprises and the whole pattern of development which had been centred on their investments and demand policy. The situation was aggravated by the American pressures in the second half of the 1980s, which pushing for deregulation and reduction in the tariffs, made unsustainable a strategy based on protection and on reserving markets, as illustrated by the policy of “Information Science” (Sallum, 1996: 169; Tapia, 1995).

In such a context, many capital goods firms were bankrupted and the sector had to adapt to the new reality, in which the public investments lost their previous prominent role. During this process, the production declined substantially: in 1994, it was 53.5% of that achieved in 1980 and the employment in the sector fell 60%. In brief, a significant
part of the industry built in the 1970s did not survive. As Soares (2000) concludes for the steel sector, the end of the large programs of investment and the incapacity to export were lethal for the survival of those enterprises whose capacity had been constructed mainly in response to the demand of the state enterprises.

**The obstacles to change the pattern of industrialisation**

The PND II, in spite of very positive results, failed to generate a solid and technologically advanced capital goods industry. While the achievements in basic inputs and oil were indeed substantial, a significant part of the advances in the capital goods sector and technology were lost because of the lack of continuity of the industrial program in the 1980s. In addition, the increases in inflation, public debt and foreign debt indicate the difficulties faced by the government in promoting industrial development in that very complicated international context. As seen, this growth in macro-economic difficulties increased the vulnerability of the economy to the international crisis of the 1980s.

Given the central role played by the state in this program of industrialisation, the limits in the achievements of the PND II can also be interpreted as the difficulties of the state adopting the measures necessary to promote a successful and stable transformation in the industrial structure. Given the complicated international context, the success of the PND II required a very substantial effort and capacity to concentrate the allocation of resources on the priority sectors. Similarly, given the macro-economic difficulties, the intensification of the program of investment required cuts in other sectors of the economy. This objective, despite all the authority of the Geisel government, was beyond the capacity of the Brazilian state.

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436 The objective of this conclusion is less to emphasise mistakes of the Geisel program than to accentuate limits which even serious and efficient governments faced to promote changes in the economy. I believe that, despite mistakes, Geisel government was a good government and had a positive impact in economic development. Nevertheless, the objectives that it proposed, given that very difficult international context, required a power and a capacity that Brazilian state did not have.
Before summarising the limits faced by Geisel’s program of industrialisation, it is necessary to emphasise the high degree of rationality and coherence which marked the design and implementation of the PND II. Geisel benefited from previous reforms which produced public organs and state enterprises staffed with well prepared technicians and insulated from direct private influence. In addition, the Geisel government centralised the main economic decisions and reduced the capacity of influence of the interest groups. In this sense, his government made a very substantial effort to achieve rationality in the decisions and to concentrate the resources on the priority sectors.

Despite this increase in coherence, Geisel’s program of development suffered important difficulties, which limited the achievements of the program. As emphasised in chapter two, the state is not a unity and the bureaucratic agencies and state enterprises have different orientations and are influenced by different interests. As seen, inter-bureaucratic conflict has been an important characteristic of every developmental state, including the Japanese, the Korean and the French state in the post-war period. During the PND II, an important difficulty was that certain state enterprises did not share the priority given by the government to the development of the capital goods industry. Similarly, the pressure of regional interests led the government to adopt measures which disregarded the objectives of the industrial policy. In addition, the divisions inside the state are illustrated by the action of CDI which, despite the positive changes under Geisel, was not committed enough to the causes of the industrial policy. In brief, despite the centralisation and the high degree of coherence in industrial policy, the divisions inside the state limited the cohesiveness of state action and its capacity to concentrate resources and energy on the pursuit of industrial objectives. Given the magnitude of the task and the difficulties in international context, they were important limits to the objectives of the industrial policy.

An additional difficulty stemmed from the fact that only part of the bureaucracy was ‘Weberian’ or ‘rational’ and that each new government made a large number of

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437 As seen, it was described as a patchwork quilt and as an arena of conflict negotiation.
438 As seen, the process of modernisation of the bureaucracy was promoted through the creation of ‘pockets of efficiency’, dissociated and independent from the traditional bureaucracy.
appointments to posts in the bureaucracy (Schneider, 1991). This high incidence of political appointments reduced the insulation of the bureaucracy and made economic policy very dependent on personal networks (Schneider, 1991). This was a very important difference with the classical model of developmental state, marked by coherent and strong bureaucracies with high ‘esprit de corps’ and channels of penetration into civil society. As Schneider emphasises, this dependence on personal networks tended to have very negative effects for the pursuit of long term projects of development.

This lack of continuity was also an important factor in explaining the difficulties faced by the military state in promoting economic development. The lack of continuity marked the transition of Castelo Branco to Costa e Silva and Médici governments, which did not maintain the concern with stabilisation and adopted a very expansionist monetary policy. This transition illustrates very well how a change in economic ministers hindered the pursuit of long term and stable programs of development (see section 6.3). In addition, discontinuity also marked the end of Geisel government, which was unable to elect a successor who maintained his style of administration and the priority which had been given to the program of industrialisation. As seen, the change in economic policy and the refusal to stabilise had very negative effects and increased the impact of international crisis over the national economy. In addition, the kind of adjustment adopted by the Figueiredo government, which imposed the bulk of the costs on the state enterprises, reached frontally the core of the model of development and provoked the loss of important gains achieved by the industrial policy in the previous years.

Another important difficulty stemmed from the opposition of the capitalists to a project which aimed at producing important changes in economic structure and thus affected the distribution of resources within the business class. As emphasised, the Geisel government, attempting to rationalise economic policy and concentrate the resources on the priority sectors, centralised economic decisions and closed channels of business influence. This reduction in business participation, debilitating the function of
bureaucracy as an arena of interest representation, provoked strong business mobilisation against the government. The hostility of the businesspeople was a significant blow to the government’s initiatives and legitimacy (see section 7.6).

The business reaction was followed, in the Figueiredo government, by measures which re-opened the channels of business participation, a good indication of the power and influence of the business class. In this sense, the power of the capitalists, illustrated by these events, is very important to understand the limits in the capacity of the state to promote substantial programs of industrial restructuring. In the case of the PND II, the success of the program depended on government’s capacity to impose cuts and sacrifices on other social sections or sectors of the economy. Given the incapacity to reduce consumption or investments in non-priority sectors, the adoption of such a program provoked an increase in inflation and in the deficits in trade account. The aggravation of macro-economic problems, as already argued, constrained the initiatives of the government and limited the achievements of the program of industrialisation.

This capacity of social groups to resist state initiatives is very well emphasised by Fiori (1990; 1994). According to him, the fragility of the Brazilian state is related to the pact manufactured in 1930 which, although very important to permit industrialisation, constrained the involvement of the state and was responsible for the frequent emergence of economic crises. According to him, the autonomy of the state was limited by the heterogeneity of the interests which composed the political compact. As a consequence, in critical moments of the process of industrialisation, the state was not strong and insulated enough to adopt the reforms necessary to produce a smooth and sustainable process of development (Fiori, 1994: 130).

According to the author, this is very well illustrated by the difficulties to undertake a fiscal reform or to stabilise the economy. As seen in chapter five, the obstacles to

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439 It is important to see this fragility in relative terms, since the Brazilian state went much further than other Latin American states in the task of promoting industrialisation. However, it suffered many pressures and was not able to adopt measures to produce a sustainable process of economic development.
undertaking tax reform was a serious difficulty faced by the democratic governments from 1945 to 1964, provoking emission of money as the “line of less resistance” to finance the increasing role of the state in the economy. Similarly, public savings decreased during the 1970s and the reduction in liquid tax was an important component of the fiscal difficulties of the state in the 1980s.

Correspondingly, the incapacity to stabilise the economy was also a permanent characteristic of the history of the developmentalist state in Brazil. During the Kubitschek government, the resistance of Congress and the opposition of social groups hindered a program of stabilisation in 1958 (see chapter five). Similarly, business pressures and other social demands made stabilisation a very hard decision during the Figueiredo government. According to Fiori (1994: 138), the alternative found by the governments was to “escape forward” and find new ways to stimulate the economy, postponing any substantial program of stabilisation and fiscal control. The adjustment was only undertaken when inflation became too high and constituted an insurmountable obstacle to the program of capital accumulation.

In addition, Fiori emphasises the financial fragility of the state. According to Fiori, the heterogeneity of the business groups and the existence of groups which opposed an increasing participation of state blocked the alternative of financial centralisation. Thus, in contrast to Korea and France, the public financial system did not actively participate in the process of monopolisation of capital (Fiori, 1994: 128). As a result, the state financial basis, dependent on inflation and indebtedness, was extremely fragile, as demonstrated in moments of international crisis and when inflation became too high.

This fragility of the Brazilian state is related, as chapter four shows, to the international insertion and timing of industrialisation, important to explain the emergence of a state supported by a very broad coalition. The importance of the international context to the path of industrialisation of developing countries is very well emphasised by Cox (1987: 236), who described how the crisis of the 1930s brought about the emergence of ‘neo-mercantilist states’, marked by the lack of an hegemonic
social group or vanguard party. This made the state “the only basis for the project of an indigenously inspired, populist-flavoured, autonomous direction to national development”. The public sector assumed the control of many instruments, invested directly in production and used foreign and public resources to keep the coalition working. However, the state was not able to reshape society and the process was marked by friction between several state initiatives and the social groups. In many countries, the incapacity to remove the sources of conflicts, which at certain moments threatened the process of capital accumulation, brought about military regimes which, by repressing the labour movement and promoting reforms, continued to develop the process of industrialisation.

The similarities in the experience of many countries, as Cox’s analysis emphasises, is a very good evidence of the relevance of the form of international insertion on the configuration of the social forces and on the paths of national development (see Cardoso and Faletto, 1970). In Brazil, import substitution produced a very complex industrial structure, dependent on foreign capital and on public resources. This constrained the capacity of the state, even of bureaucratic authoritarian regimes, to promote substantial changes on the economy.

Another important factor to understand the limits of the state-led process of industrialisation in Brazil is the pattern of representation of private interests in the state apparatus. In this sense, the characteristics of the corporatist solution adopted in the 1930s - marked by the control of the labour movement, by the fragility of the political parties, by the non-existence of an active encompassing business organisation and by individualistic form of business penetration into the state apparatus - had important consequences (Diniz, 1978, 1997; see chapter 4 and section 7.6 of this thesis). The individualist and decentralised access of private interests constrained the autonomy of the state and blocked the adoption of measures and reforms necessary to a balanced process of economic development. Meanwhile, the lack of an encompassing business organisation and of representative political parties hindered the achievement of negotiated solutions and collective action.
These difficulties were very present under the Geisel government, when a substantial program of state investments attempted to complete an important stage of the process of import substitution. As seen, the government’s attempts to give coherence to the process of decision making provoked a reaction from the business class, unhappy with the closing of their channels of access to the state apparatus. In this sense, it is important to emphasise that the existence of an encompassing business association, able to produce consensus in the business class in relation to the priorities of the process of development, could have produced the support required by the government to give sequence to the process of development. Nevertheless, the industrial class was very heterogeneous and not convinced of the suitability of the government’s priorities. The concern to their immediate interests, threatened by centralisation in decision making and by important changes promoted by the government, brought about the campaign against statisation.

In conclusion, it is important to emphasise that the government could have obtained much better results if it had had mechanisms to obtain a national consensus and support for the measures of the PND II. In this sense, the characteristics of the military government, marked by the emphasis on ‘technical solutions’ and by the fragility of the political institutions was a clear liability. Since the conflicts of interest were very present and the government was not strong enough to ignore them, the chances of successfully implementing such an ambitious industrial program would have been substantially increased if the government had been elected and authorised to execute it and had thus obtained the legitimacy necessary to defeat opposition and adopt the necessary measures.\footnote{This aspect, emphasised by Atul Kohli (1994) as a pre-condition to the adoption of a successful program of combat of poverty in India, is valid for any program which intend a substantial transformation of the economy and is thus subject to considerable social opposition.} However, in the absence of such legitimacy, the Brazilian military government did not demonstrate sufficient strength to carry out the substantial task that it had set itself.
CHAPTER 8. INSTITUTIONS, STATE CAPACITY AND INDUSTRIALISATION IN KOREA, MEXICO AND ARGENTINA

8.1. Introduction

The objective of this chapter is to use the experiences of Korea, Mexico and Argentina to highlight the importance of the institutional factors introduced in chapter two. Important emphasis is also given to explaining the relevance of state capacity to the results of industrial development. After the exposition of important aspects of the trajectories of development adopted in each country, I believe that the relevance of the institutional factors to the Brazilian path of industrialisation will become more clear. In other words, the objective is to take Peter Hall’s categories and ask how Brazil’s experience can be compared with the experience of South Korea, Mexico and Argentina (see chapter two). The chapter is divided into three main sections, with each exploring determinate national experience. The three sections deal with the involvement of the state at important moments and decisions of the process of industrialisation in the respective countries.
8.2. Institutions, state capacity and industrialisation in Korea

The legacy of Japanese colonisation

Kohli (1999) explores the important influence that Japanese colonisation had in Korean development. According to the author, Japanese colonisation, although very brutal, promoted crucial transformations in the organisation of the Korean state and in its relationships with social groups. In this sense, it sowed the seeds of a modern state with the capacity and willingness to promote economic development. Accordingly, it promoted substantial economic development, which included a considerable impulse towards industrialisation. The objective of this subsection is to describe this process of transformation which, according to Kohli, is an indispensable task to understanding the roots of the Korean state capacity to transform economic activity and promote development.

Kohli shows how the pre-colonial Korean state shared many characteristics inherent to the first phases of state consolidation in developing countries. The Korean monarchy was very weak, unable to increase its financial resources and very dependent on the local landowners. The inability to increase tax had very negative consequences, putting excessive pressure on the peasants and leading to the emergence of constant conflicts among the members of the political elite (Kohli, 1999: 88). In addition, financial fragility blocked the military mobilisation necessary to face foreign threats and to control the local landowners.

Similarly, Korean monarchy shared many attributes characteristic of patrimonial states. The central authority was unable to exercise effective power and the localities were controlled by the local propertied classes. Although the central government appointed public officials for the local administration, the number was clearly insufficient and each administrator was responsible for a very large area and population. According to Kohli (1999: 99), each official was responsible for about 40,000 people.
and became dependent on the powerful local men. Furthermore, the weakness of the central state is illustrated by the fact that a substantial part of the employees did not receive wages; instead, they had acquired, as a compensation for their tasks, the right to keep part of the tax collected. In such a state, the notions of public and private were not properly separated and the holder of a public post tended to consider it a private property (Kohli, 1999: 99).

This reality was substantially altered by Japanese colonisation, which undertook a radical process of state building and transformed substantially the relationships between the state and the local groups. The first step, the demolition of the old Choson state, was accomplished through the abdication of the monarchy, the dismantling of the Korean army and repression of the opponents. Then, the Japanese endeavoured to construct a modern state composed of a depersonalised bureaucracy, which was considered a precondition for increasing political control, expanding the capacity to extract tax and improving the ability to promote economic transformation. Therefore, the model of organisation of the Japanese Meiji state was transferred to the colony, which included the establishment of a cabinet style government and the imposition of strict rules and regulations on the bureaucracy, including meritocratic rules of selection. (Kohli, 1999: 102).

The effort of constructing a powerful state is very well illustrated by the substantial growth in the number of civil servants which, as Kohli shows, increased from 10,000 in 1910 to 87,552 in 1937. This growth was in large part accomplished through the importation of Japanese officials, who in 1937 accounted for 52,270 of the civil servants. However, the number of Korean bureaucrats trained by the Japanese was also substantial, amounting to about 40,000 officials on the eve of the Second World War. These Korean bureaucrats were promoted during the war and came to occupy key posts under the American occupation and later (Kohli, 1999: 103).

Another important concern of the Japanese was the creation of linkages between the central administration and the regions, a crucial step to make the local officials follow
the government’s directions. Besides the depersonalisation of the bureaucracy and the reduction in the influence of the landowners, the task was undertaken through the creation of a centralised and well disciplined police force. Kohli emphasises the nature and intensity of this supervision, a distinctive factor of the Japanese colonisation. Besides the natural function of enforcing order, the police were used as a channel to influence the villagers in a range of subjects, which included the selection of crops to be cultivated and the techniques to be utilised in production. Furthermore, the policemen were used to play functions such as the counting of people, the mobilisation of compulsory labour, advocating the use of birth control, the prevention of spread of diseases and the elimination of political dissidence (Kohli, 1999: 105).

As a result, the reforms, which included the introduction of a well trained and disciplined bureaucracy, the co-optation of the Korean elite and the strict supervision by the police, substantially increased the capacity of the colonial state to enforce directions and implement policies. This is very well illustrated by the increase in the capacity to extract tax. The land revenue increased by 30% in the first three years of Japanese influence, a good indicator of the capacity of the new colonial state to impose this burden on the landowners. Similarly, other forms of tax were created, including those extracted from the post office, railway, customs, salt manufacturing, coal mines, the timber industry and printing bureaus. They permitted the substantial increase in the total revenue from 7.3 million yen in 1905, the year in which the Japanese influence started, to 24 million in 1911, one year after formal annexation (Kohli, 1999: 109). This result, as emphasised, reflected the modernisation of the state, in which trained bureaucrats replaced the local groups in the functions of administration and the police and bureaucrats were used to collect tax.

In addition, the new state increased the involvement in economic activities and promoted a range of measures, which stimulated Korean economic development. As an example, investments in education were substantial, as seen by the increase in the number of students attending some sort of school from just under 10,000 in 1910 to up
to 1.7 million in 1941. This education had a very pragmatic nature, aimed at training practical men to occupy the posts required by the state (Kohli, 1999: 107).

In order to increase the knowledge of the territory, the Japanese organised, from 1910 to 1918, an exhaustive land survey which permitted the classification of the plots of land by type, productivity and ownership (Kohli, 1999: 110). Correspondingly, the investments in infrastructure were substantial, producing a considerable improvement in roads and railways. And finally, currency and bank reforms were undertaken, producing a considerable increase in the deposits in the Bank of Korea and in the postal savings bank.\footnote{Deposits in the Bank of Korea, for example, increased from 18 million yen in 1911 to 37 million in 1913.}

The colonisation had also a very substantial impact on agriculture, promoting an agrarian revolution in Korea in the first half of the century.\footnote{Considerably earlier than most other developing countries.} Kohli emphasises how the agricultural productivity achieved very high levels in certain sectors. In rice production, for example, Korea had, just before the war, one of the highest productivity levels in the world. This development in agriculture played an important role in supporting industrial development in the post-war period.

Furthermore, Japanese colonisation produced a process of industrialisation that was unique in the history of colonisation. In spite of the destruction wrought by the war, the colonial period gave Korea a tradition of industrialisation and a significant business stratum.\footnote{According to Kohli (1999: 122), in 1937 there were 2,300 Korean-run factories, 160 of them employing more than 50 workers.} Export performance, which included the export of manufacturing goods, was also outstanding.\footnote{In 1938-39, manufactured goods accounted for 43% of exports. According to Kohli (1999: 123),} Kohli believes that this export tradition had very important
consequences for the future path of economic development. Besides the positive impact on competitiveness, the colonial period showed the Korean leaders the virtues of an export-oriented economy. Thus, in the post-war period, while other developing countries were very resistant to opening up their economies and espoused autarchic strategies of development, the Korean authorities had already had the experience of an exporting economy as well as the knowledge of its advantages (Kohli, 1999: 123).

The colonial period was also very important in shaping the patterns of interaction between the state and the private groups. Besides the emasculation of the local groups, the inauguration of a practice of collaboration between the state and the business groups was also a very important legacy. In this relationship, the state occupied the central position. It intervened directly in production and utilised many instruments, including credit allocation, subsidies and non-economic exhortation, to achieve business cooperation (Kohli, 1999: 123). The capitalists accepted a subordinate position and learned the advantages of collaboration, which was translated into high rates of profits.

Likewise, the colonial period had an important influence in the relationship between manufacturers and workers. Besides the strong control over the labour movement, typical of the Japanese model, the authorities encouraged the consolidation of patriotism clubs, which brought together both employees and businessmen. These clubs, which embraced and disseminated the idea of harmony of interests, designed programs of training and measures to increase the efficiency of the production process (Kohli, 1999: 127).

As a consequence of all these policies, Korea, on the eve of the Second World War, already possessed many institutions favourable to a very interventionist and efficient model of economic development. As seen, the Japanese had installed a very strong state,

estimations show that in this period “Korea was exporting twice as much as any comparable economy”.

446 As Kohli (1999: 131) points out, “The Korean economy, especially the Southern Korean economy, had already been export oriented, its business groups had considerable experience in selling abroad, and the state within this economy had learned from its own history that strong support for business and exports, along with tight control over labour, was a route to high economic growth”.
a pattern of state-business relationship and a form of labour control which later proved very favourable to the promotion of a rapid process of economic growth. However, there was no guarantee that these institutions would be transmitted to the organisation of the Korean state in the post-war period. The lack of continuity is very well illustrated by the experience of North Korea and by the disorder and corruption which marked the post war Syngman Rhee’s government.

Thus, it is necessary to see how the institutions inaugurated in the colonial period were preserved. Firstly, it is important to emphasise that the American occupation did not produce substantial modifications and that institutions such as the bureaucracy, the military and the police were kept intact from the colonial period (Kohli, 1999: 129). Similarly, the state’s economic instruments and the patterns of labour control were also maintained. As Kohli (1999: 130) points out,

“the corporatist patterns of worker control were also colonial in origin: the employer-employee ‘clubs’ for promoting ‘patriotism’ and production, in the words of a labour analyst, became ‘one of Japan’s permanent contributions to Korea’s industrial relations system’”.

In addition, a decisive element to provide continuity was the direction given by President Park Chung - Hee. Park, who had been trained in the Japanese military academy, was a Japanophile and a strong supporter of the Meiji model of economic development (Kohli, 1999: 130). Thus, he was very conscious of the positive legacy of the Japanese colonisation and of the potentialities of an economic structure characterised by large enterprises co-ordinated and supervised by a strong state (Fields, 1997: 128).

In sum, Kohli concludes that, although in the 1950s the per capita income of Korea was similar to that of Brazil, India and Nigeria, the departure point was very different. Korea, as shown, already had many factors favourable to economic modernisation, such as a modern bureaucracy embedded in society, investments in infrastructure, a productive agriculture, a substantial degree of industrialisation and a paternalist pattern

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447 The vicissitudes of the Shygman Rhee’s government are explored in the next sub-section.
of co-operation between state and business. In this sense, Kohli believes that the colonial past was key to understanding the kind of state intervention established from the 1960s and to explaining why this intervention was constructive instead of predatory.

It is important to emphasise that the Japanese colonisation, as described by Kohli, eliminated many of the obstacles to modernisation faced by other developing countries\textsuperscript{449}. The following statement of Kohli (1999: 135-136) explains this very well:

\begin{quote}
\textit{\textbf{“the roots of economic dynamism in the critical case of South Korea are located, at least in part, in the state-society relations created under the auspices of Japanese colonialism. This find, in turn, directs attention to unique aspects of Japanese colonialism: as a late developer, who had perfected a state-led model for catching up in the world economy, Japan in its colonies constructed a political economy that also turned out to be well suited at catching up”}.}
\end{quote}

These peculiarities of the Japanese colonisation are specially important when one consider the legacies of other colonisation, such as the production of incomplete and predatory states in Africa or weak states controlled by agrarian oligarchies in Latin America. Those countries did not have such an ‘external shock’ to eliminate the obstacles which constrained the development of their political and economic structures. These difficulties, in part illustrated by the Brazilian experience but much more serious in other countries of Latin America and Africa, authorises Kohli’s question of “how can power to develop be generated without outside forces remoulding state structures …” (Kohli, 1999: 134).

\textsuperscript{449}This interpretation, centred on the effects of the Japanese colonisation, does not disregard the importance of the cultural values and other aspects of Korean society before the colonisation (see the importance of the concept of regime in chapter 2).
The post-war period and the transition to export-led industrialisation

The immediate post-war period was marked by substantial economic crisis. Manufacturing was critically affected by the Japanese defeat and, in 1948, the industrial product was only one fifth of that achieved in 1940. Accordingly, foreign trade collapsed and the increase in the level of prices was substantial.

The measures adopted by the American occupation had important consequences. The military, the bureaucracy and the policy were preserved and had important role in the process of reconstruction. Meanwhile, the left and the labour movement was strongly repressed: strikes were broken and the labour leaders were arrested. In addition, the more resistant trade union was dismantled and replaced by a more ‘collaborative’ association (Haggard, 1990: 53-54). As a result, Korea entered in post war industrialisation with a weak labour movement and with no significant left-wing opposition.

After occupation, the Korean president, Syngman Rhee, faced strong turmoil and social pressures. Despite the pressures of the main political party, Rhee was able to guarantee an institutional structure marked by a very strong executive and a relatively weak legislature. (Haggard, 1990: 54, 55). In this period, Korea was critically dependent on the American aid, which, from 1953 to 1962, accounted for 70% of the imports and for 75% of the total investment (Haggard, 1990: 55). Nevertheless, the Americans were not able to transform this dependency into a more active influence in policy-making. They pressed for tax increases, stabilisation and exchange rate devaluation, but Syngman Rhee, benefiting from Korea’s strategic geopolitical position, managed to guarantee the resources without undertaking the required reforms.

In order to understand Rhee’s position, it is necessary to take into consideration that in a democratic regime, as imposed by the Americans, he could not disregard the interests and pressures which emerged from the political system. Policies suggested by
the Americans, such as an increase in tax and stabilisation, faced strong social opposition. Accordingly, Rhee, aware of the advantages of an overvalued exchange rate to the construction of his basis of support, opposed devaluation and simplification in the exchange rate regime. The control over the allocation of foreign exchange and aid goods, at a price far below the market value, gave him very good opportunities to please his supporters and strengthen his nets of patronage.

In spite of the problems which marked the economic policy, the period was characterised by substantial industrial growth. Agriculture and the service sector suffered a decline, but manufacturing, favoured by the high rate of protection, grew at a rate of 11.2% a year from 1953-55 to 1960. The sectors which most developed were construction, textiles, milling and lighter consumer goods (Haggard, 1990: 59). However, by the late 1950s, Korea already faced many problems associated with import substitution industrialisation, including “an overemphasis on consumer goods, production geared to a limited domestic market, a high dependence on imported intermediates and foreign capital, weak exports, and continuing balance-of-payments problems” (Haggard, 1990: 59).

In April 1960, in the context of strong opposition and protests, Rhee resigned. The new government came to office defending the need to curb corruption and promote economic development. Technocrats gained access to important posts and proposed measures to correct the imbalances of the process of industrialisation. However, such measures, which included devaluation of the exchange rate, stabilisation of the economy and increase in the prices of public services, provoked strong opposition. The government lacked institutional capacity and was not able to manage the conflicting demands. Unable to maintain order, it was replaced by the military in May 1961.

In brief, the Korean experience under Rhee presented many similarities with other developing countries, including Brazil and Mexico. As shown above, Korea presented, at the late 1950s, many problems characteristic of import substitution industrialisation and the measures necessary to transform this situation faced substantial opposition. In
the face of these difficulties, a very important issue is to understand how Korea changed the pattern of economic policy and adopted the measures necessary to correct the distortions in the process of industrialisation.

In May 1961, the military seized power and, in 1962, rectified the constitution guaranteeing a strong role for the executive. In those first years, President Park Chung-Hee faced strong opposition, which included divergences inside the military. However, after a narrow victory in a referendum to postpone elections, Park employed the excessive power of the executive to implement his program of government. The government increased its control over the rural cooperatives and the labour movement was kept under strict control. As Haggard (1990: 63), quoting an American adviser, points out, the government, seeing a trade-off between the increase in wages and in employment, opted for the growth in employment.

An important part of the process was the reform of the instruments of decision making. In 1961, the government created the Economic Planning Board (EPB), an organ unconstrained by the legislature which concentrated planning and budget functions. The control over the operations of foreign loans and direct investment gave the EPB a large capacity to influence the allocation of investments. Accordingly, the control over the budget gave it leverage in the operations of the other ministers. And finally, the organ incorporated the Bureau of Statistics, which increased its basis of information and capacity of action. In conclusion, EPB accumulated a wide range of instruments and assumed an important role in inter-ministry co-ordination, becoming the key organ in Korean industrial policy (Haggard, 1990: 64-65).

In addition, state capacity was increased by the creation and seizure of other instruments, which included important reforms in the financial sector. After the coup, the government recovered shares of the commercial banks and created two state-owned financial institutions. In addition, the Bank of Korea, under the control of the finance

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449 The control of wages was severe and the real wages in manufacturing, after a peak achieved in 1959, only recovered that level in 1967 (Haggard, 1990: 63).
minister, acquired the power to designate sectors to receive commercial bank loans at favourable rates. As a consequence, the government increased substantially the control over the allocation of financial resources.

In brief, the reforms undertaken by Park increased insulation and rationality in the process of decision making and the capacity of the government to interfere in the business groups’ activities and to monitor, regulate and redirect the economy (Schafer, 1999: 98).

As emphasised, a crucial point is to understand why the government converted to export-led industrialisation. This was not a natural tendency of the new military government which, immediately after the coup, adopted measures which preserved the populist tradition that had characterised Sygman Rhee’s period. The Park government increased public investment, civil servant payments and the price of agricultural products in order to improve its basis of support. The result was an increase in inflation.

The American government, although supportive of several reforms introduced by the military, was especially critical in regard to inflation. The Kennedy administration inaugurated a more strict policy and threatened to suspend American aid if the Korean government did not control the expenditure. In other words, US government became more aggressive in exploiting Korean dependence on American aid in order to pressure for the reforms and policies judged necessary.

The Korean government tried to resist, attempting to obtain the necessary resources via foreign borrowing. However, the experience was fraught with difficulties and, in November 1962 balance of payments difficulties forced the government to cut imports of machinery and equipment (Haggard, 1990: 69). Finally, in April, 1963, the government surrendered and negotiated a plan of stabilisation with the United States, which included the establishment of strict limits for monetary expansion, budget deficit and commercial banks’ credit expansion. The Americans also pressured for devaluation, but this was initially opposed by the Korean government.
In brief, the period 1962-64 was marked by tension between the two governments. The Americans pressured for reforms but Park suffered pressures inside the military junta and could not disregard the social support which was necessary in a context of transition to democracy. However, in the face of the economic difficulties, the government could not resist the American pressures and agreed to stabilise the economy. The currency was devalued in 1964 and a floating unitary exchange rate regime was installed in 1965\(^{450}\).

In addition, the government, in return for an IMF loan, undertook a series of policies, which included “a tight monetary policy, increases in taxation, higher import duties on nonessential items, limits on international borrowing, and greater export efforts” (Haggard, 1990: 70). American advisers and Korean technicians started to work together and a ‘Joint – US Cooperation Committee’ was formed in July 1963. It became an important source of influence in economic policy making.

It is important to emphasise the set of measures adopted to stimulate exports. These included short term loans “without limits to firms that had confirmed orders” and a domestic letter of credit system which was extended to the exporter’s suppliers (Haggard, 1990: 55-56). Tariff exemption on equipment and raw materials was also provided to exporters. (Schafer, 1997: 101). In addition, the government established the Joint Export Development Committee, which had the objectives of co-ordinating the policy of export incentives among different bureaucratic agencies and investigating the export potential of certain sectors of the economy. And finally, measures were adopted to promote Korean exports abroad (Haggard, 1990: 71) \(^{451}\).

\(^{450}\) As Schafer (1997: 101) emphasises, this change in the exchange rate regime was critical to increasing Korea’s capacity to export. According to him, “raw materials account for 35 to 60 percent of production costs” and it was thus very important that those imports were available at competitive prices.

\(^{451}\) The priority given to export policy is illustrated by the meetings organised, from 1965, involving bureaucrats, businesspeople, economists and representatives of trade associations. Those meeting were attended by Park Chung-Hee, “who had the power to solve problems by fiat” (Haggard, 1990: 71).
According to Haggard, the Korean decision to follow an export-led industrialisation was critically affected by the desire of the Korean authorities to rid Korea of American influence. According to him, inflation, balance of payments problems and the dependence on American aid showed President Park the disadvantages of an import substitution model and the necessity of a more successful export performance. In this sense, Haggard believes that the transition to export-led industrialisation was a means to recover government autonomy (Haggard, 1990: 69).

As Haggard points out, a very important part of the process was the capacity of the Korean government to resist the pressures of the sections of society which opposed the reforms. These groups included traders and industrialists in import substitution industries, such as sugar and flour milling, farmers, who were harmed by the end of subsidies in fertilisers, and sections of the military, unsatisfied with the reduction of resources to the Military Assistance Program (Haggard, 1990: 71). For the author, the legitimacy of the government, acquired by electoral means, and also its institutional organisation, which included the autonomy of the executive and its ability to introduce coercive measures, were crucial for government’s capacity to face the protests and keep the reforms. Also important, as Schafer (1997: 105-106) points out, was the timing of the reforms, undertaken when import substitution was still in its initial stages. As the Latin American experience illustrates, the development of a solid block of interests around import substitution could have presented substantial difficulties for the adoption of the reforms.

Finally, it is important to emphasise the ideological influence played by the American advisers who came to work in partnership with Korean technicians. As seen, their prescriptions included stabilisation, exchange rate reform and adoption of incentives to increase exports. This is in stark contrast to the ideas supported by CEPAL in Latin America, which had a strong influence in the 1950s and, to a lesser extent, over Brazilian and Mexican responses to the challenges of the 1970s.
Korea’s Heavy and Chemical Industrial Program in the 1970s

Korea, like Brazil, adopted a very ambitious program of import substitution in the 1970s. Through expansionist policies and intense foreign borrowing, a substantial program of investment in heavy and chemical industries was undertaken. Although achieving considerable results, the process was also marked by significant imbalances, which caused serious economic problems at the end of the decade. However, in contrast to Brazil, the Korean government was very successful in adopting a strict process of stabilisation at the beginning of the 1980s.

The objective of this sub-section is to investigate several aspects of the Korean response, emphasising the basic characteristics of the program and also the limits and difficulties to the achievement of the objectives. At the centre of the analysis is the concept of state capacity and the obstacles faced by the developmental states in promoting industrial transformation.

At the beginning of the 1970s, the Korean economy faced serious problems, resulting from the previous process of economic growth. These included high dependence on foreign borrowing, weak business financial structure, balance of payments difficulties, disregard for agriculture, regional inequalities and inflationary pressures. In addition, Korean economy faced also many challenges related to its insertion into the international economy. At the end of the 1960s, quotas had been imposed on Korean exports, threatening a model of development centred on the exports of labour intensive goods. At the beginning of the 1970s, international trade decelerated and protectionism was intensified, while technological innovations reduced Korean advantages in labour intensive manufacturing.

In 1972, Park, alleging reasons of national security, undertook another coup and inaugurated a new period of authoritarianism. Political parties were closed down, the

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452 These problems contributed to an increasing opposition to the Park government and almost led to Park’s defeat in the elections in 1971.
National Assembly was dissolved and the Opposition was kept under control. Similarly, Park reinforced the controls over the labour movement, utilised emergency instruments such as price controls and adopted further reforms in the financial system (Haggard, 1990: 130-131).

In response to the economic challenges, the government opted for deepening industrialisation through a program of import substitution in the intermediary and capital good sectors. The decision, however, presented significant challenges. The new sectors were more capital and technologically intensive and represented, consequently, more risks to investors. In addition, the intensification of import substitution represented a change in the balance between national and foreign capital and demanded a different type of state intervention in the economy (Haggard, 1990: 127).

In 1973, the government adopted the Heavy and Chemical Industry Plan (HCIP), conceived to eliminate foreign dependence in sectors such as machinery, chemicals and transport equipment. The plan, elaborated by a group surrounding Park and the Minister of Commerce and Industry (MCI), bypassed the more liberal Economic Planning Board (EPB) and became a central element of Korean economic policy in the period (Haggard, 1990: 130). Its ambitious objectives included a favourable export performance in the new sectors.

The Korean government created a wide range of mechanisms to stimulate the development of strategic sectors. In sectors such as steel and petrochemicals, the task was allocated to the investments of the state enterprises. In other sectors, incentives and guarantees were conceded to encourage private groups to undertake the investments. They included tariff and quantitative protection, fiscal and credit incentives, guarantees of public purchase and credit facilities. In order to channel resources to the target investments, the government created the National Investment Fund, which mobilised resources from pension funds and from compulsory deposits of financial institutions, saving associations and insurance companies (Jong-Chan Rhee, 1994: 73). And finally, a substantial amount of resources was made available for investment in infrastructure.
Control over the allocation of credit was the most important tool of the HCIP. The government used its discretionary capacity of allocation of financial resources to persuade the firms to undertake the investments. In this sense, the offer of resources under very favourable conditions was intended, by reducing both the costs and the risks of the investment, to break down the business resistance to investing in the new sectors. In addition, the government used financial control as an instrument of pressure, threatening to suspend the concession of credits to the firms which refused to follow the directives (Jong-Chan Rhee, 1994: 66-69).

The adoption of the HCIP produced a substantial boom in investments, which increased from 26% of the GNP in 1976 to 37% in 1978 (Jong-Chan Rhee, 1994: 01). In this process, the capacity of the government to concentrate incentives and facilities on the target sectors was outstanding. As Rhee (1994: 02) points out, during 1976-78, “more than 77 percent of all manufacturing facilities investment was put into the HCIs” (heavy and chemical industries). Furthermore, these sectors received an increasing share of the total bank credit, superior to their participation in the national output (Jong-Chan Rhee, 1994: 73).

It is important to emphasise how the adoption of the HCIP was marked by an intense inter-bureaucratic dispute and by a change in the relative power between the bureaucratic agencies. Park’s determination to centralise the decision-making process and the implementation of the plan led to a rupture with the hierarchy that had previously existed in the industrial policy making process. This eliminated the leadership of the EPB and gave substantial power to the first presidential secretary. The EPB, although still responsible for the short term policies, did not have control over the program of investment, which came to occupy a central role in economic policy.

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453 This resistance was explained by the high risk, by the large amount of capital required and by the lack of technological capacity. The government, by offering funds at very favourable conditions, intended to modify the firms’ payoff and to make the investment attractive.
A new organ, the Planning Office of the Heavy and Chemical Industry Promotion Committee, headed by the first presidential secretariat, became the organ responsible for the operations of the heavy and chemical industrial policy. Close contact between the first presidential secretary and President Park gave the Planning Office strong power, which included the attributions of co-ordination and obtaining support from the economic ministries to the objectives of the HCIP (Jong-Chan Rhee, 1994: 61-64).

This bureaucratic reconfiguration had important consequences. EPB supported a more balanced process of industrialisation and was very sensitive to short term imbalances. The Planning Office, by contrast, supported by MCI and by the President, favoured a very ambitious and accelerated program of industrialisation. As a result of the prominent role occupied by the Planning Office, the economic policy was very expansionist.

The government adopted a deliberate strategy of promoting national champions. Policy-makers, bypassing the business associations and relying strongly on informal contacts with the large groups, concentrated on producing the best conditions for a rapid process of capital accumulation. President Park was aware of the importance of a favourable economic performance for the legitimacy of the regime and big business became an essential ally. Thus, the policy-makers concentrated on stimulating investment and imposed the costs of the process on the workers and on small and medium-sized enterprises.

Despite the rapid process of industrialisation, the program of investment was marked by serious imbalances. The very expansionist policies nurtured inflation which, in 1979, reached 14%. In addition, the strong reliance on debt worsened the financial situation of the enterprises. Furthermore, overinvestment in heavy and chemical

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454 The Heavy and Chemical Industry Promotion Committee (HCIPC) was chaired by the Prime Minister and joined the first presidential secretariat and the economic ministers. However, the proximity with the president gave a critical role to the first presidential secretary, responsible, as seen, for the planning office of the committee.
industries distorted the relative prices, increased the wage of qualified workers and, consequently, reduced the competitiveness of the labour intensive industries. This had negative effects on the balance of payments (Haggard, 1990: 132-133).

The most serious difficulty was the inability of the government to co-ordinate the expansion of investment. The excessive offer of incentives, unaccompanied by strict controls, provoked overinvestment and overcapacity in many sectors. The process was thus marked by the government’s failure to achieve important objectives in the industrial policy. The government’s target for certain sectors was to have one or few producers. This was considered necessary for the achievement of economies of scale. However, the rationality of the business groups was different and, under certain circumstances, investments in a particular sector was judged necessary to strengthen the general position or to consolidate the leadership of the group. Thus, the objectives of the policymakers and those of the business groups were not necessarily the same. Consequently, the capacity of the government to enforce a specific direction depended on the control and employment of strategic instruments.

Nevertheless, as Rhee shows, the Korean government failed to use control over the investment licenses and over the allocation of credit to pursue its objectives. Facing fierce business pressure, in a context marked by increasing ties between the state and the enterprises, the government failed to restrict business groups’ entry into certain sectors. In addition, the process of investment was marked by a very indiscriminate expansion of credit and had very negative consequences on the health of the financial system. As the control of credit was the government’s main tool, the deterioration in the financial system represented a substantial blow to the government’s capacity to enforce the intended direction. And finally, the process of industrialisation strengthened the business groups, increasing their capacity of collective action and their resistance to the government’s attempts of control. These difficulties emerged very clearly at the end of

455 This is very well illustrated by the power-generating equipment industry, in which firms had the capacity, in 1978, to produce equipment to supply 8 million kilowatts per anuum, while the expected demand for power plants was only 2 million kilowatts (Jong-Chan Rhee, 1994: 83).
the decade, when the government’s corrective measures, which included a policy of mergers, faced strong opposition from the entrepreneurs (Jong-Chan Rhee, 1994: 81-85).

At the end of the 1970s, the problems, including inflation and difficulties in the balance of payments, became very serious, contributing to an increase in social opposition to the regime and to the pressures, inside the government, in favour of stabilisation and adjustment. EPB was especially critical of the situation and supported, besides stabilisation, the immediate cancellation and delay of projects in the troubled industries. According to the organ, overinvestment and excess capacity produced very serious problems for the health of the whole economy.

In 1978, a small group of EPB members elaborated a study about the problems of the economic policy, which was followed by an investigation into the structural problems of the economy. Both studies had the intention of convincing the economic authorities of the need of stabilisation (Jong-Chan Rhee, 1994: 95-96). Despite his initial resistance, President Park agreed to order EPB to undertake a specific study of overinvestment in the heavy and chemical industries. Three other agencies were also asked to undertake similar investigations. As these studies confirmed the diagnostics of EPB, Park agreed to adopt a program of stabilisation elaborated by the organ. Nevertheless, he required that this program did not disregard the objectives of export promotion and development of the heavy and chemical industries (Jong-Chan Rhee, 1994: 98).

Notwithstanding the decision to stabilise the economy, the government did not show the determination necessary to implement a successful program. EPB suffered substantial opposition from inside and from outside the state apparatus. The business groups opposed stabilisation, demanded continuous support for investment in the HCIs and complained of their lack of participation in the decision-making process. Likewise, the Planning Office protested against the adjustment and the delay in the investments and MCI argued that the cancellation of the projects could have a very negative impact on the financial health of the enterprises (Jong-Chan Rhee, 1994: 107). In brief, this
opposition and the lack of determination of the President inhibited the successful implementation of the program of stabilisation.

Park was assassinated in October 1979, but the military influence continued in the following government. The economic orientation, however, was modified and EPB finally recovered control over economic policy. A former EPB head became prime minister and the new Minister of MCI was also a former EPB deputy minister. In addition, EPB obtained forms of control over the activities of the MCI and of the Finance Minister. As a consequence, EPB consolidated its leadership and created mechanisms to enforce inter-ministry co-ordination in support of the government’s program (Jong-Chan Rhee, 1994: 134).

A strict program of stabilisation was adopted, permitting the reduction of inflation from 14.1% in 1979 to 2.9% in 1983-84. According to Haggard (1990: 134), this capacity of stabilisation rested on the strong power possessed by the military government and by its successor. It allowed the government to adopt very unpopular measures, such as the freeze in civil servants’ wages, the delay in promotions, the halt in hiring and the purge of government employees. The government also tried to restrict the expansion of credits, but the fragile financial situation of the enterprises made this option unfeasible.

In addition, the orientation given by EPB included the restructuring of the heavy and chemical industries and commitment to a long term program of liberalisation. EPB believed that import liberalisation and the attraction of foreign capital were necessary measures to eliminate distortions, to encourage competition and to enforce discipline over big business (Jong-Chan Rhee, 1994:190)\textsuperscript{456}.

However, this liberal direction did not last. The reforms proposed by the organ

\textsuperscript{456} The organ criticised strongly the chaotic system of incentives adopted by the previous government, which it considered responsible for much economic distortion and for the reduction in competitiveness of labour intensive industries (Jong-Chan Rhee, 1994: 189).
implied substantial costs, which were very difficult to support in the complicated political context which marked the beginning of the 1980s. Given the political difficulties, support from big business became very important for the government. As a result, the market oriented reforms did not have continuity. MCI and the Finance Ministry recovered their power and blocked EPB attempts to promote a more apolitical pattern of policy making. The politicians, who were very dependent on business for electoral donations, offered, in exchange, financial incentives and other forms of advantages (Jong-Chan Rhee, 1994: 233).

In addition, the capacity of the government to impose directions on the private sector was substantially reduced. The privatisation of the financial system reduced the instruments available to the policy makers, at the same time that it strengthened the financial position of the business groups. As a consequence, the government’s capacity to shape big business behaviour was substantially reduced. The government lost its capacity to pursue important targets, such as the achievement of international competitiveness and technological development.

The Korean experience in the 1970s and beginning of the 1980s illustrates important dimensions of state capacity. It highlights how state capacity is dependent on the specific task and also how it changes in time. Initially, it is important to emphasise that the government was very successful in promoting the program of investment in the 1970s, concentrating a large amount of the resources in the strategic sectors. It was very strong in ‘persuading’ the business groups to undertake the investments, while the costs of the adjustment were imposed on the weakest groups. However, the government was less successful in controlling investment expansion and the number of producers in certain economic sectors. As already stated, overinvestment was a serious problem in the process.

According to Fields (1997: 128), the fact that the Korean model did not have a strong party system made it very dependent on business for support and electoral funds. This reduced its capacity to impose certain directions on the large chaebols.
In the 1980s, the government demonstrated substantial capacity to stabilise the economy. This decision and the capacity to carry it out were critical in Korea’s avoidance of the Brazilian fate, in which, as already argued, the incapacity to stabilise aggravated the economic crisis. Nevertheless, the Korean government demonstrated much less capacity to shape business action and to influence certain directions in the economy. The strengthening of the business groups and the effects of financial liberalisation contributed to reducing its power.

Another very interesting point, central to explaining the decision of adopting a program of stabilisation, was the role of EPB. As shown above, the action of this organ was critical in convincing the policy-makers of the necessity of stabilisation. In this sense, the Korean case illustrates the importance of a competent economic bureaucracy in carrying out the necessary studies and indicating the need to adopt the appropriate policy. As already stated, the history of the organ, marked by the contacts with the Americans in the 1960s, was very important to its future economic orientation. The contrast with Brazil, in which a substantial part of the economic bureaucracy supported the developmentalist theses, is striking.

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458 This influence was very important, since it permitted the adjustment of Korean economy before the aggravation in the international financial instability occurred during the first years of the 1980s.
8.3. Domestic institutions and import substitution in Mexico

Import substitution from the 1930s to the 1960s

Mexico’s industrialisation in the twentieth century presents interesting similarities, although also important differences, with the path followed in Brazil. Given the similar aspects shared by the two countries – both developing countries which had large domestic markets and similar insertion in the world economy - the comparison between them constituted an interesting opportunity to illustrate the role of the institutionalist approach, in the terms defined by Peter Hall (1986) and summarised in chapter two, to understand different paths of policy-making.

Mexico reacted very similarly to Brazil to the events of the world Depression in the 1930s. In that context, marked by the crash of world trade and by the crisis of the domestic primary sectors, the political elite reacted by promoting many institutional changes aiming at increasing the role of the state in the economy. Accordingly, they created the means for the promotion of inward oriented strategies of industrialisation. As Haggard (1990: 171) points out, “centralisation of political authority, the creation of new economic instruments, and a strengthening of economic bureaucracies were crucial prerequisites for an expanded state role in guiding the next phase of industrialisation”.

Brazil and Mexico had, nevertheless, important differences. In the 1920s, Mexico had undertaken significant institutional transformations, which influenced the policies adopted in the following years. In that decade, the central government, which had just consolidated its power in face of the local groups, adopted reforms to increase its capacity of intervention in the economy (Haggard, 1990: 168). These included the reconstruction of the financial system and the creation of a central bank, under control of the Finance Ministry. This ministry, aiming at increasing co-ordination between public and private agents, encouraged the private banks to organise themselves.
As Maxfield points out, this initiative created close ties between the finance ministry and the private financial sectors, which favoured the consolidation of common objectives between the two parts. According to the author, this was the origin of the ‘bankers’ alliance’, which had an important influence in the following course of economic policy-making.

The power of the financial interests is reflected in the policies adopted in the late 1920s and also in the immediate response to the great Depression. According to Haggard (1990: 168), although the signs of economic contraction were already present in the 1920s, the government decided to maintain the gold parity. In addition, as Graham (1984: 17) shows, the immediate reaction to the crisis was very cautious, marked by restrictive monetary and fiscal policies. Nevertheless, the very harsh effects of the Depression produced substantial changes in the economic policy, which included the refusal to defend the exchange rate and the adoption of expansionist policies. A more incisive rupture with financial conservatism, nevertheless, only happened in the second half of the decade, during the government of President Lazaro Cardenas (1934 – 1940) (Graham, 1984: 17).

Cardenas was a strong opponent of economic orthodoxy and argued that stability should be subordinated to the objectives of industrial and agriculture development (Maxfield, 1990: 34). Similarly, he supported the adoption of deliberate measures in favour of industrialisation. His government engaged in investments in infrastructure and in agricultural reform. In 1936-37, tariffs were fixed and, in 1938, the oil industry was nationalised. Furthermore, the ‘Nacional Financiera’, a credit institution created in 1933, had its operations increased and concentrated on the financing of manufacturing.

In addition, Lazaro Cardenas’ program was marked by many social reforms, which included land distribution and expansion of labour rights. As he depended on the support
of the popular groups to face the conservative forces, he stimulated the organisation of the labour movement and the formation of peasant associations\textsuperscript{459}.

Therefore, the Cardenas regime was a turning point in Mexican economic policy. In response to the events of the international crisis, he forged a new alliance, composed of industrialists and members of state bureaucracy and supported by workers and peasants, who backed policies favourable to industrialisation. The instruments of economic policy included expansionary monetary and fiscal policies, devaluation of the exchange rate, tariff protection, credit facilities for industry and public investment in transport, electricity and communication. In the 1940s, the government increased its control on foreign trade and intensified the use of credit incentives and subsidies.

Cardenas’ successor, Avila Camacho (1940-46), employed corporatist mechanisms to increase control over labour and shape a more collaborative movement\textsuperscript{460}. In 1942, he created Canacintra (\textit{Camera Nacional de la Industria de Transformacion}), a state controlled business organisation which brought together a new group of industrialists from small and medium sized firms, not connected to the interests of the financial groups. The alliance of this group with the labour movement provided important support for the import substitution policies. In the effort to address the shortages of war time, the government adopted an import-licensing system, which was preserved after the end of the war and became an important instrument of protection to industry. At the end of this government, public investment accounted for 50\% of the total investment (Haggard, 1990: 170).

The Aleman government (1946-52) maintained the policies of protection to industry. Despite the role of the central bank, monetary policy was very loose and

\textsuperscript{459} However, Cardenas was very careful and used corporatist mechanisms to keep them under control. He knew the importance of preventing these social movements from becoming independent in nature, as this could have threatened the other members of the coalition.

\textsuperscript{460} As Haggard (1990: 170) points out, this ability to maintain the workers under control was critical for allowing the government, in the following years, to deepen the process of industrialisation without losing control of inflation.
inflation reached very high rates. In addition, the liberation of imports, restricted during the war, soon exhausted the national reserves (Haggard, 1990: 176). However, in contrast to many other Latin American countries (see chapter five), Mexico devalued in 1948. According to Haggard, the threat of capital flight, given the wide border with the United States, was probably an important factor in explaining this decision.

After devaluation, inflation became an important concern and the next president, Ruiz Cardenes (1952-58), gave priority to its defeat. The power of the Finance Ministry was increased and orthodox monetary policies were adopted. As a result, inflation in the 1950s was kept to a yearly average level of 6% (Graham, 1984: 33). According to Maxfield (1990: 75), this period was marked by an increase in Mexico’s dependence on foreign financial resources, which contributed to the strengthening of the influence of the ‘bankers’ alliance’.

Industrial policy, nevertheless, continued to be very active. The government increased import controls, created mechanisms to stimulate the import of capital goods, expanded tax exemptions and created new fiscal incentives to encourage industrialisation (Haggard, 1990: 177). This direction was maintained under Lopez Mateos (1958-64), who expanded the list of imported goods which should be produced domestically. The control over import licences was used to press for a minimal index of domestic content in the production programs. Furthermore, the ‘Nacional Financiera’ concentrated its operations on funding public investments and on stimulating the heavy industry (Haggard, 1990: 177). Despite the incentives to the industrial sector, monetary policy remained very strict and inflation, in the first years of the 1960s, was kept to an average annual rate of 2%.

In brief, the policies adopted by the Mexican governments from Cardenas to Mateos (1936-1964) reflected the existence of forces and interests in favour of import

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461 This is one important thesis defended by Maxfield (1990), according to whom the influence of the bankers’ alliance tended to increase in the periods in which dependence on foreign credit became more critical. However, when the international liquidity became very abundant and the government have facility to obtain resources, such as in the 1970s, this influence declined.
substitution industrialisation. As Mexico, at the beginning of the 1950s, had already substituted a large part of imports in the lighter and simpler industries, the authorities decided to extend the process towards more sophisticated consumer goods and production goods. However, it is important to emphasise the influence of the ‘bankers’ alliance’ in the policy making process. They agitated for monetary stability and were very successful in vetoing the utilisation of further mechanisms to promote industrialisation. Thus, while in other countries the objective of rapid industrialisation led to inflationary policies and to control over exchange rate and capital flow, the power of the bankers’ alliance blocked these possibilities in Mexico. In this sense, it had a critical impact on the characteristics of the process of import substitution.

According to Maxfield, three important factors explain the influence possessed by the ‘bankers’ alliance’ in the policy making process. The first one was the position occupied by the monetary authorities inside the state apparatus. The finance ministry had control over the budget, which gave him a high degree of influence over the other ministers.\(^{462}\) (Maxfield, 1990: 45-47).

A second important factor was the development of strong ties between the private banks and the monetary authorities. According to a survey cited by Maxfield (1990: 43), the ties of the bankers with public officials were not equalled by any other economic sector. The bankers participated in the nomination of officials to financial regulatory agencies and the interchange of people between the private sector and the public financial agencies was also substantial. Thus, this interconnection favoured the interchange of information and the achievement of a co-ordinated and collaborative action.

The third element was the organisation of the Mexican capital, characterised by the consolidation of large financial conglomerates including both banks and industry. The conglomerates produced a congruence of interests between the industrialists and the

\(^{462}\) In addition, the finance ministry was responsible for mediating the relationships with international financiers and therefore also controlled access to this alternative source of resources.
bankers and made an important segment of the industrial class support policies centred on monetary stability, high interest rates and low state intervention. The importance of this characteristic is highlighted when one observes the experience of countries such as Brazil, in which the industrialists played a key role in pressuring for expansionist and interventionist measures. In Mexico, by contrast, the organisation of capital produced fragmentation of the industrial class, reducing the basis of support for import substitution.  

In conclusion, these three aspects strengthened the power of the bankers’ alliance and its influence in economic policy. As Maxfield (1990: 50) summarises,  

> “the historical strength of the Mexican bankers’ alliance is based on institutional structures that provided for close collaboration between private financiers and state monetary authorities, for the latter’s predominance over state planning authorities, and for the close integration of financial and industrial capital”.

As a result, the power of the bankers’ alliance explains a characteristic which distinguishes Mexico from other Latin American countries and also from other countries which adopted developmentalist strategies, such as France: the adoption of an activist industrial policy combined with an orthodox monetary policy. This had important consequences. On the one hand, it gave Mexico a pattern of industrialisation marked by fewer distortions than have been verified in other cases of import substitution. On the other hand, it reduced the capacity of the state to involve itself further in the process of industrialisation and explained, for example, why Mexico was less successful in substituting producer goods than Brazil.  

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463 It is curious to notice that while in other countries, such as Germany and Japan, the integration between banks and enterprises was a very positive element in favour of rapid industrialisation, in Mexico it favoured stabilisation and a slower pace of growth. However, it is important to be cautious in this comparison. In Germany, for example, there was also a high concern with monetary stability.
Graham (1984) shows how low inflation and the positive interest rates allowed the development of private capital markets in Mexico. In Brazil, by contrast, this path was blocked by the instability caused by inflation and by the negative interest rates. The solution was the increase in state participation in the financial sector. Similarly, Graham emphasises how the Mexican experience up to the 1970s was marked by a lower degree of protectionism. In addition, Mexico presented a pattern of economic growth which was much more balanced and less subject to cycles and discontinuities than Brazil. And finally, industrialisation was also less capital intensive, and so was more successful in incorporating workers (Graham, 1984: 19-25).

The other face of this process was the more timid involvement of the state in industrialisation. As seen, the government could not use instruments such as direct control of exchange rates and of the financial operations. In addition, the process was marked by a substantial reduction in the public participation in the total investment. This participation was reduced from 52% in the period 1940-46 to 26% in the period 1954-60 and reached 30% in the period 1963-67. The contrast with Brazil is striking, since state participation in investment increased from 16% in 1947 to 46% in 1960 (Graham, 1984: 42; Baer, 1966: 84). Similarly, the ratio of taxes to GDP was much lower in Mexico than in Brazil. In Mexico, taxes represented 10.6% of GDP in 1959-61 and increased to 13.6% in the 1969-71 period. In Brazil, they corresponded to 23% of GDP from 1969 to 1971, a figure which increased to 26% in the period from 1970 to 1973 (Graham, 1984: 43).

Although the last paragraph indicates the relatively lower capacity of the Mexican state to promote industrialisation, it is necessary to emphasise that Mexico had achieved, by the beginning of the 1940s, a more efficiently institutionalised and, according to Graham (1984) highlights how the Mexican authorities, although more nationalist in dealing with foreign capital, were less nationalist and activist with regard to extending import substitution to the heavy industry. The attempts of Mexican government to increase tax faced strong opposition from the private sector. As Maxfield shows, the bankers’ coalition and the powerful groups were very successful in opposing tax on financial assets, on profits and on sophisticated consumer goods. As a consequence, besides the limited tax capacity, the Mexican tax system continued very regressive; the capital and the richest groups paid very little tax and blocked attempts of reform (Maxfield, 1990: 87).
Graham (1984), a more legitimate regime. This gave Mexican authorities the capacity to achieve results not available to Brazil, such as the control of inflation. Firstly, the Mexican institutional structure was more successful in insulating the government from private pressures, thus favouring the control of expenditure. Secondly, the greater legitimacy of the regime, which also had incorporated the workers, released the government from the need to increase expenditure as a prerequisite to obtaining the necessary support. This was, as shown above, the case of Brazil in the period from 1946 to 1964, in which the government was subject to many pressures and had to make many concessions to the wide range of groups which made up the coalition466.

**Economic policy making and import substitution in the 1970s**

The 1960s were marked by a strong debate about the trajectories of development available to the country. Critics of the previous strategy, named by them ‘desenvolvimentismo estabilisador’ (developmentalism with stabilisation), demanded a more deliberate strategy centred on the expansion of the domestic market and on the reduction of social inequalities (Haggard, 1990: 184; Graham, 1984: 35). The president Echeverria (1970-76), arguing the need to address urgent national problems, supported a strategy of development which adopted a more permissive treatment of inflation. The government’s rhetoric thus assumed a ‘developmentalist’ flavour, supporting an increase in investment as the solution for most economic problems, including inflation. In other words, the new orientation was to accelerate development, despite the aggravation of short term difficulties467.

This new direction provoked reaction from the ‘bankers’ coalition’. In 1973, dissatisfaction with the expansionist measures of the Echeverria government brought

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466 In brief, this paragraph illustrates how state capacity is very dependent on the subject. Brazil had more instruments of planning and intervention, but the governments were unable to control inflation.

467 According to Maxfield, there is an important variable that explains this modification in the pattern of policy making. As emphasised, excessive liquidity in the international financial market and the consequent easy access to foreign credit reduced the power of the bankers’ coalition, permitting the ascendance of the developmentalist group inside the state apparatus.
about business mobilisation against increasing public investment and ‘growing hostility towards private enterprise’ (Maxfield, 1990: 121). Likewise, the 1970s also illustrate very well the polarisation between two different coalitions inside the state apparatus. During this decade, the influence of the Finance Ministry was reduced, while the Ministry of Budget and Industrial Development increased its role. Haggard (1990: 186) emphasises the magnitude of the inter-ministry conflict during Lopes Portillo’s government (1976-1982). As he points out,

“the Ministry of Patrimony and Industrial Development favoured increased state action to promote investment in capital goods, expanded support to industry, controls on banking and foreign exchange, and increased outlays for social expenditures and rural reforms. The Treasury and the Bank of Mexico, backed by the multilateral organisations and supported on some issues by the more liberal northern financial-industrial groups, called for a continuation of the stabilising policies of the first two years of the Lopez Portillo administration, a further rationalisation of industry through phased import liberalisation, a reduction of the state’s role in production, an opening to foreign direct investment, and a realistic exchange-rate policy.”

The economic program of the 1970s was marked by an increase in nationalist measures, which included the strengthening of control over both foreign investment and import of technology. Pressures for joint ventures were intensified and, after 1973, the government required that Mexican enterprises controlled at least 50% of the capital in the partnership. In addition, the government increased the forms of non tariff control, which came to include 70% of the imports (Graham, 1984: 25).

468 It is interesting to notice the similarities with the ‘campaign against statisation’ initiated in Brazil in 1974 (see section 7.6). Comparing the two countries, Graham (1984: 36) emphasises that the capacity of resistance of the private sector in Mexico was much superior to that in Brazil. According to this author, the business opposition was a key factor in the failure of Echeverria’s program.

469 The President suffered the impacts of these divisions, which had clear negative effects on the coherence of his administration. After complaining of their total incapacity to agree about the responsibility conferred to them, Portillo fired both the Finance and the Budget and Industrial Development Ministers (Maxfield, 1990: 126-127). However, as might have been expected, their replacements proved equally unable to solve the problem.

470 Instead of presenting in details the programs of each government, I decided to emphasise general aspects of the economic policies in the 1970s which are important for the argument developed in this section. For a detailed analysis of the policies of Echeverria and Lopes Portillo governments, see Haggard (1990) and Maxfield (1990).

471 In the 1950s, it is important to emphasise, only 25% of the imports were subject to similar control.
In addition, the government adopted many policies to stimulate the development of heavy industry. Public investment in sectors such as oil, petrochemicals, steel, the railways, machine tools and electrical machinery were increased and other instruments were employed to stimulate private investment (Haggard, 1990: 185). The policy of public purchases was used to stimulate private enterprises and the subsidies and transfer payments to the private sector grew from 7% of the GDP in 1977 to 15% in 1981 (Maxfield, 1990: 139).

In spite of this effort, the results were very limited, reflecting the incapacity of the government to promote a consistent program of import substitution. Despite its developmentalist rhetoric, the government failed to use foreign and oil resources to promote substantial reforms and to intensify the development of the country. Significant progress was achieved in certain sectors, such as oil, in which state control and public investments permitted rapid import substitution. In other sectors with high state participation, such as electricity, transport and steel, the performance was favourable and the investments grew almost as fast as imports. However, the participation of the private sector in the effort of industrialisation declined, import substitution in many sectors was negative and the country failed to improve significantly the producer goods industry. As a result, the producer goods were responsible, between 1979 and 1981, for 85% of the increase in the nominal value of imports. (Maxfield, 1990: 115).

As Maxfield shows, the industrial effort in Mexico was negatively affected by the process of internationalisation of capital, which stimulated speculative investments and diverted resources from industry. Although the increase in public investment was substantial, the response of the private sector was far from adequate to the objectives of the industrial program. According to Maxfield (1990: 116), the participation of private capital in total investment declined from 62-65% in 1971-6 to 56-58% in 1977-81.
It is worth taking a glance in the response given by other countries to the international challenges of the 1970s. Chile and Argentina responded to the international financial integration by adopting liberal policies. The process was marked by a substantial transference of resources from the industry to short term financial speculation, while the substantial reduction in tariffs provoked deindustrialisation (Maxfield, 1990: 169-171). Accordingly, the small and medium enterprises, without access to international markets, were easily incorporated by large financial conglomerates, which used the high profits in the financial market to finance the acquisition of those enterprises.

In Brazil, financial speculation was also very present, but the government, as already argued, was very successful in channelling the foreign resources to an intensive program of import substitution which achieved important results in basic inputs and in the capital goods sector. In spite of many obstacles, the existence of an articulated planning apparatus and the capacity of the Geisel government to achieve high degree of coherence were critical to the concentration of the resources on the priority sectors.

Mexico was an intermediary case. Capital was diverted from industry to financial speculation and there was also an increase in the concentration of the economy, but the growth in public investments held back deindustrialisation. However, if Mexico escaped from the Argentinian and Chilean fate, it was not able to replicate the Brazilian process of industrial growth in the 1970s. According to Maxfield (1990: 174), the crucial point is to understand why Mexico, the Latin American country most similar to Brazil, was not able more efficiently to use international liquidity to accelerate industrialisation.

The answer, according to this author, is related to the power of the bankers’ alliance and to its impact on economic policy. As seen, this alliance, forged in the 1920s, became a very influential actor in Mexican politics and was very successful in blocking certain initiatives to the increase in state intervention in the economy. As a consequence, Mexico, in contrast to Brazil, developed neither a substantial planning apparatus nor a
tradition of intervention in the financial markets. According to Maxfield, this was very important to explain the inability of the Mexican state to adopt and enforce the necessary measures in response to the internationalisation of the capital.

In sum, this section shows how national institutions, including the characteristics of business organisation, the structure of the state apparatus and the relationship between state and business explain important differences between the development path followed by Mexico and Brazil. Accordingly, they were also very important to explain the differences in the responses to the financial internationalisation in the 1970s and to understand why the Brazilian developmental state obtained better results in terms of import substitution.

\footnote{Maxfield emphasises how, in Brazil, the private financial sector was weaker and not able to block interventionist measures. Similarly, the interests of the industrialists were not connected to the financial sector and exerted an intense pressure to increase state intervention in favour of industrialisation. In addition, the constitution of the Central Bank in Brazil was a very late phenomenon and the monetary policy was usually collaborative and subservient to the objectives defined by the planning and industrial agencies. In conclusion, the weakness of the financial sector in Brazil permitted the development of a tradition of more active intervention in the economy, providing the government with certain instruments not available in Mexico.}
8.4. Social groups, state capacity and economic decline in Argentina.

Introduction

Argentina’s economic decline constitutes a very interesting puzzle. A developed society at the beginning of the century, marked by rapid rates of economic growth and by a per capita income and social indicators typical of developed countries, Argentina suffered a strong process of decline in the period after the Second World War\textsuperscript{473}. The objective of this section is to investigate the political economy of the Argentinian decline, emphasising how it is related to the national institutions and to the weak state capacity in that country.

Prosperity before 1930

In the second half of the nineteenth century and in the first decades of the twentieth century, Argentina had undergone a considerable process of development as a supplier of temperate agrarian goods, including grains, beef and wool, to European markets. Between 1870 and 1913, exports grew at a rate of 6\% a year, one of the best performances in the world. The vigour of the Argentinian export economy is very well illustrated by data cited by Waisman (1987: 50). According to Di Tella and Zymelman (1973), in 1925, “‘a good but not exceptional year for agriculture, Argentina provided 66\% percent of world exports of corn, 72 percent of linseed, 32 percent of oats, 20 percent of wheat and wheat flour, and more than 50 percent of meat’”\textsuperscript{474}.

In the three first decades of the twentieth century, the GDP grew at 4.6\% a year. The robust performance of the export sector produced significant linkages in the domestic economy, stimulating the development of the industry. The elevated wages which came about as a result of the high land to labour ratio, contributed to the

\textsuperscript{473} In the three first decades of the twentieth century, Argentinian GDP grew at a rate of 4.6\% a year. In the period after the war, by contrast, economic growth was much lower. From 1950 to 1983, for example, the average annual growth of the per capital GDP was around 1\% (Waisman, 1987: 9).

development of a prosperous consumer market, which, in turn, encouraged the development of industry. Thus, although agriculture was the principal activity, employing, in 1914, 36% of the active population and generating 30% of GNP, a significant manufacturing sector had also developed. In the 1910–1914 period, manufacturing employed 20% of the population and had achieved certain diversification. And, finally, development was marked by a high process of urbanisation: “by 1914, more than half of the population was urban” (Waisman, 1987: 60).

As a consequence of the rapid process of economic development, Argentina, on the eve of the First World War, shared many characteristics of developed countries. Its per capita income was superior to France and Sweden and twice that of Italy (Waisman, 1987: 05-06). Indicators of health, education, nutrition, standard of living and social mobility were also superior to many European countries. In brief, these indicators put Argentina very close to the developed countries and very far from the other Latin American countries, with the exception of Uruguay.

Argentina also developed a liberal democratic system which presented, before 1930, substantial stability. Although the political system was controlled by the agrarian elite, the dynamism of the economy and the hegemony of this class permitted the incorporation of other groups. It permitted the enfranchisement of the middle class and the toleration of a peaceful labour movement. In brief, economic prosperity intertwined with political stability; conflicts were solved inside the rules of the political system and the hegemony of the agrarian class was not threatened.

As Waisman (1987) emphasises, Argentina shared certain characteristics with other countries of late settlement, such as Australia and New Zealand, which are critical to understanding certain aspects of the Argentinian development in that early period. One

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475 In 1914, it was mainly concentrated on foodstuffs, which responded for 50% of the industrial production. However, niches such as vehicle, machine and metal, responsible for less than one tenth of the industrial production in 1914, developed rapidly and, at the beginning of the 1930s, were already responsible for almost a quarter of overall industrial production (Waisman, 1987: 61).
crucial aspect was the existence of a high ‘land-labour’ ratio which, added to the non-existence of a subsistence agriculture, tended to increase wages and to prevent economic development from bypassing a substantial part of the population. Waisman stresses the importance of this factor in differentiating Argentina from other Latin American countries, where the existence of plantation economies contributed to the production of a substantial reserve of unskilled workers.476

However, the high ‘land-labour ratio’ did not produce in Argentina the same tendency towards equality that it produced in other lands of late settlement. A crucial difference was the existence, in Argentina, of a high concentration of land in the hands of a powerful landowner class, which considerably reduced the chances of the immigrants acquiring property. Furthermore, it had a substantial influence in the organisation of the political system, producing a powerful class which had a critical impact in the course of Argentinian politics.

The depression and the break in the agrarian hegemony.

As seen, Argentinian politics before 1930 was marked by the hegemony of the agrarian groups. The social conflicts which did emerge, usually conflicts for the division of the surplus, were easily accommodated by the system, without threatening either the existing institutions or the leadership of the agrarian class. As Waisman (1987: 83) points out, “as long as it had no intense conflicts with these new forces, the oligarchy was willing to enfranchise the middle classes and even to transfer power to the party representing them”.

However, the world Depression had a deep impact upon this situation. The Depression, by provoking a fall in international trade and an increase in protectionism, affected Argentinian exports very negatively and led to a deterioration in the terms of exchange. In addition, international events threatened Argentinian traditional markets

476 According to Waisman, the land-labour ratio was a very important variable, usually disregarded by analyses centred on the centre – periphery relationship.
and demanded a re-negotiation of the international insertion of the country. In 1933, a pact was signed with Britain to guarantee the access of Argentinian goods to the British market. In exchange, Argentina had to open its market to certain British industrial products, a measure which damaged the interests of the Argentinian industrialists.

In this sense, the signing of the Roca-Ruciman Treaty illustrates very well one important effect of the Depression. It broke the hegemonic position of the agrarian groups: their interests ceased to be the same interests as those of other groups in society. In such a situation, the political system also lost its capacity to solve conflicts. The oligarchy perceived that, in such a context, the democratic system represented real risks to its interests and decided to maintain their power by supporting a military coup\footnote{According to Waisman (1987: 85), the rupture with democracy was not caused by the Depression, but by its timing. It happened when the democratic institutions were not yet institutionalised and the political forces were still developing forms of interaction.}

The new government, although controlled by the agrarian aristocracy, adopted measures favourable to industrialisation and a new wave of import substitution took place, stimulated by the natural protection provided by the reduction in the country’s capacity to import. Although the government supported manufacturing, support was not given indiscriminately. A distinction was made between ‘natural’ and ‘artificial’ industries and priority was given to the former, which processed national inputs and, thus, had a comparative advantage (Waisman, 1987: 131).

According to Waisman, the Depression, in spite of its important consequences, was not the watershed in Argentinian trajectory of economic development. The Depression marked the end of the agrarian hegemony, but the agrarian elite was still in power and the changes that it promoted were not the cause of the Argentinian decline. Conversely, Waisman believes that the turning point was the coup of 1943, when the military government, followed by Peron (1946-1955)\footnote{In 1943, Peron was the Minister of Labour of the military government. In 1946, he was elected president with a narrow margin over his opponent.}, promoted a new economic model marked by high rates of protectionism and by a corporatist model of labour organisation.
Peronism and the turning point in Argentinian development

After the military coup of 1943, it is possible to identify a certain dissociation between the policies adopted by the government and the interests of the economic elite. According to Waisman (1987: 143-157), two different sources favoured the increase in state autonomy at that time. Firstly, the international events in the 1930s and 1940s, marked by the disruption caused by the Great Depression and by the war, gave more flexibility to the national strategies of adjustment. Secondly, the end of the hegemony of the agrarian aristocracy and the fragmentation of the interests of the dominant groups, as illustrated by the *Roca-Ruciman Treaty*, increased the government’s degrees of freedom and facilitated the rupture with the dominant groups. Thus, these factors explain the increasing autonomy of the political elite, permitting the construction of a coalition in support of an alternative program of development.

Waisman attributes the causes of the Argentinian economic decline to the policies initiated after 1943 and consolidated by Peron after 1946. He argues that Peronism introduced two crucial innovations in the organisation of the Argentinian economy: strong protectionism and a corporatist model of labour organisation. These innovations were critical in modifying the international insertion of the country and also the relationship between state and society. While excessive protectionism provoked inefficiency, reducing the material basis necessary to accommodate the political interests, corporatism produced a strong labour movement which became, in the following years, a considerable obstacle to the government’s attempts at reform. According to Waisman, these innovations sowed the seeds of Argentinian economic decline in the post-war period.

Peron found a crucial ally in the labour movement. After 1943, when he occupied the post of Minister of Labour, he organised the movement on a corporatist basis. In order to get the workers’ support, he increased wages, extended social protection legislation, created courts to enforce the new legislation, institutionalised industry-wide
bargaining and established minimum wages for rural workers (Mallon and Sourrouille, 1975: 7). In exchange, the workers had to renounce left-revolutionary theses and accept the tutelage of the state. As a result, union membership tripled or quadrupled and a mass labour movement became an important basis of support for the government (Mallon and Sourrouille, 1975: 8).

Peron’s economic model adopted a clear pro-industry orientation, to be implemented through a high degree of protectionism. This orientation was crucial for the weak section of the industrial bourgeoisie, unable to survive without protection. In addition, protectionist industrialisation had the aim of achieving full employment, considered a crucial objective of Peron’s program of government.

In this sense, Peron believed that the adoption of an inward model of development was the way to escape from international instability and to guarantee the achievement of full employment. It was also, according to Peron, the way to please both industrialists and workers, achieving the harmony which, according to him, should be inherent to the capital-labour relations under the tutelage of the state. It is very interesting to notice the populist characteristics of his rhetoric, which was not uncommon in Latin America in the period. The disregard for economic considerations, such as productivity and competitiveness, is notable. In the following speech, made in 1953, Peron emphasises the importance of producing domestically, even at the costs of reducing efficiency:

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479 In addition, he extended unionisation to the ‘cabecitas negras’, the migrants from the interior of the country, and to the ‘descamisados’ (shirtless ones - a reference to the marginalised workers). Not surprisingly, these groups showed devoted loyalty to Peron.

480 In the Peronist rhetoric, the development of manufacturing was considered the only way to avoid the unemployment supposed to be caused by the resume of industrial imports after the war. According to Waisman (1987: 171), Peron exaggerated this threat of unemployment in order to obtain support for his program of government. Increasing in employment in services and in agriculture was unjustifiably disregarded as an alternative strategy to combat unemployment.

481 It is necessary to take into consideration that there were many elements favourable to the adoption of a protectionist policy. After the war, Argentina suffered from American retaliation in response to the neutrality adopted during the war. The sanctions included a fuel embargo and the prohibition of acquisition of Argentinian products with resources from the Marshall Plan. In addition, Europe was suffering a severe crisis and did not have sufficient foreign exchange to buy Argentinian products. Thus, this international context made autarchy an attractive option, although it did not determine it. Argentina could have adopted a selective protectionist model, aimed at developing certain strategic sectors. See Waisman (1987: 142).
‘‘if something is left over, we will sell it somewhere, but the Argentine people come first’’. (...) ‘‘anti-economical, everybody said [with reference to the domestic production], but I prefer the anti-economical that we produce to the economical coming form outside. I have always thought that way’’. (cited in Waisman, 1987: 134).

The pro-industry orientation reflected in a series of measures adopted to transfer the surplus from agriculture to industry. The government created the ‘Argentine Trade Promotion Institution’, which controlled the commercialisation of agrarian products, including exports. A system of inventories was used to maintain export prices, while the prices in the domestic market were fixed at a much lower level. Thus, the government used its capacity of control in order to fix prices in favour of industry. It is easy to see how these measures, which included also a freeze in tenancy contracts and the establishment of minimum wages to rural workers, outraged the agrarian groups.

These policies had very negative consequences for Argentina’s export capacity. The increase in wages led to a substantial growth in consumption, while the pricing policy, besides stimulating consumption, reduced the stimulus to invest in agriculture. As a result, domestic demand, which in the time of the Depression was responsible for about half of all agricultural production, increased to around 75% after Peronism (Waisman, 1987: 63). In addition, production of beef and grain fell by 10% during Peron government. As a result, Argentina lost its leadership in the export of primary products. As an example, the share world exports of corn declined from 67% in the period from 1934 to 1938 to 21% in the period from 1950 to-54.

Thus, the result of the economic orientation given by Peron was the concentration of national resources in a very unproductive industrial sector. This was the consequence of a very indiscriminate process of import substitution, extended to many sectors independently of the respective productivity. In addition, the high tariffs and uncertainty in monetary and exchange policy reduced incentives to innovate and adopt the most modern techniques. As Waisman (1987: 120) concludes, the problem was not protectionism, but its excess. According to the author, the average rate of protectionism
at the end of the 1950s was 151%, which was very elevated even for Latin American standards and eight times greater than that of France.

Therefore, Argentina developed an industry unable to compete in the international markets. As this industry was very dependent on the imports of inputs and capital goods, Argentinian economy became critically dependent on the export performance of agriculture which, as seen, was discouraged by government policies. Consequently, it is easy to see the lack of sustainability of Peronist policies, in which periods of industrial expansion tended to produce balance of payments problems, leading thus to ‘stop and go cycles’.

The ejection of Peron from power, by a military coup in 1955, brought the conservative alliance, composed of the agrarian aristocracy and of the high bourgeoisie, back into power. However, protectionism and corporatism were already institutionalised and this hindered the return to the same policies of the 1930s. Corporatism and industrialisation had produced an expanded bourgeoisie, dependent on protectionism, and a strong labour movement. They blocked tariff reduction and the other reforms necessary to re-establish Argentina’s previous insertion in the international economy.

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482 An interesting peculiarity of Argentinian industrialisation, which distinguishes it from other countries of late settlement, was the concentration of the industrial production, since the period before the Depression, in consumer goods. This was in contrast with Canada and Australia, for example, countries in which the industrialisation was more balanced and the proportion of production goods was higher (Waisman, 1987: 64).

483 In the face of the difficulties which emerged in the first years of the government, Peron decided to change his policies and adopt incentives to increase agriculture production, a critical step in improving the balance of payments situation. However, the response was not automatic and Argentina suffered from the fact that the export goods were also consumed in the domestic market. As seen, domestic demand had increased and was not easy to reverse it.

484 As Waisman shows, the institutionalisation of protectionism and corporatism had critical consequences for Argentinian politics, making the task of the subsequent governments very difficult. As seen, it reduced economic efficiency and produced a strong labour movement which became a critical obstacle to the adoption of certain policies. In other words, Peronism contributed to both the stagnation of production and to an increasing dispute over its distribution.
According to Waisman (1987: 123), two peculiarities of Argentinian society played a very important role in amplifying the effects of the Peronist measures. Firstly, the concentration of land in the hands of the agrarian aristocracy produced, as seen, a very powerful agent in Argentinian politics. Although dislodged from the leadership position by Peron, it did not cease to be an influential political actor\(^{485}\). A second important factor was the absence of a labour army (reserve of labour), which could have weakened the labour movement and made corporatism more stable, facilitating the administration of Argentinian politics.

Therefore, Argentinian politics in the post-Peronist period was marked by competition between strong social groups for a stagnant surplus. As no group was strong enough to defeat the others and as there were no institutions able to solve the conflict, the result was instability. Manzetti (1994) describes this situation as a zero sum game. According to him, the social groups acted like interest coalitions, ready to pressure for immediate interests and unable to consider the perspective of long term development. According to this author, the characteristics of the model of development initiated by Peron, marked by excessive use of subsidies and regulation, produced a very favourable environment for the pressures of the interest groups (see Olson, 1982). The situation was aggravated because every group possessed a veto power: exports, in the case of the agrarian groups; employment and investment, in the case of the bourgeoisie, and protests and strikes, in the case of the workers. In conclusion, the result was extreme

\(^{485}\) According to Waisman, in the absence of such a class, Argentina would not have had the polarisation which marked the post-peronist period. Protectionist would have remained the dominant strategy and the alliance weak bourgeoisie–labour movement would not have been consolidated. According to Waisman (1987: 123), “such a situation could lead to high levels of social and political polarisation”.

polarisation, in a context marked by the lack of efficient political parties\textsuperscript{486} and other institutions able to provide way out of this stalemate\textsuperscript{487}.

According to Waisman (1987: 118-119), social groups tended to organise into two main alliances. The first one was composed of the agrarian bourgeoisie and of the internationalist and more developed faction of the industrial bourgeoisie. The second alliance was composed of the workers and of the weaker sections of the bourgeoisie, who were more dependent on protectionism. The difficulties stemmed from the fact that the success of each alliance could only be temporary, since it was followed by the reaction of the opposition that impeded the continuation of the policies.

The victory of the conservative alliance, for example, tended to produce stabilisation, incentives to agriculture and reductions in tariffs. However, these policies tended to trigger the mobilisation of the populist alliance which, through strikes and popular unrest, blocked the implementation of the policies. Similarly, the measures supported by the populist alliance, including increases in wages and tariffs and reduction in the prices of the agrarian products, tended to provoke inflation and problems in the balance of payments. The impasse strengthened the conservative alliance and favoured the adoption of stabilisation and measures to stimulate exports. Waisman uses the image of a pendulum to describe this alternation between liberal and populist policies\textsuperscript{488}.

One critical component of this stalemate was the dependence of industrialists on the export capacity of the agriculture sector. If industry was able to export and obtain

\textsuperscript{486} According to Mallon and Sourrouille (1975: 24), the political parties included very heterogeneous groups and tendencies, incorporating, inside their structure, the conflicts inherent to society. From 1963 to 1966, for example, the Popular Radical Party included different political groups and ideas, from workers to businessmen and from liberals to nationalists. Consequently, this heterogeneity reduced its capacity to offer a coherent program of government, as necessary to solve the stalemate.

\textsuperscript{487} As a consequence, the period 1958 to 1966 was marked by the existence of weak democratic regimes, removed by military coups. The prohibition of the Peronist party reduced the legitimacy of the regime and, in contrast to the military’s belief, hindered its capacity to govern (Waisman, 1987: 91).

\textsuperscript{488} For more details about those cycles, see Waisman (1987: 118-119) and O’Donnell (1988). There are certain differences between the two authors, but they do not affect the main point of the argument.
foreign exchange, the alliance between labour and the industrialists could adopt more independent policies and disregard the influence of the other alliance. Correspondingly, as O’Donnell (1988) points out, the victory of the alliance between the aristocracy and the ‘haute bourgeoisie’, if translated into a stable government, would permit the adoption of a long term program to increase agricultural productivity and solve the economic impasse. However, as emphasised, this alliance did not have enough time to implement such a program. Its policies tended to trigger the mobilisation of the ‘labour-weak bourgeoisie’ alliance, which blocked stabilisation and the reforms required by the agriculture sector.

In conclusion, the response to the Argentinian puzzle is found in the interaction between economic and politics. While this interaction produced, before the Depression, high economic growth and a liberal democracy, in the post war period it produced a vicious cycle marked by economic inefficiency and political instability. The large shift to industrialisation promoted by Peron, implying the concentration of a substantial part of the resources on unproductive sectors, reduced productive capacity and provoked constant crisis in the balance of payments. In addition, the protectionist-corporatist model strengthened the industrial bourgeoisie and produced a very strong labour movement. The development of these forces, in opposition to the traditional elite, increased the polarisation in Argentinian politics and generated a vicious cycle in which none of the groups was able to defeat the others and to break the stalemate.

**The fragility of the state in Argentina**

In face of this very negative polarisation between the groups, responsible for the stagnation in economic development and for the instability in the political process, a very important point to emphasise is the incapacity of the state bureaucracy to play an autonomous role and break the deadlock. As will be seen, this possibility was hindered by the weakness of the Argentinian state, without legitimacy, insulation and institutional capacity to pursue a consistent process of reform and development.
Sikkink (1991; 1993), through a comparison between Argentina and Brazil, explores this fragility of the Argentinian state. She claims that the first important difference between the two countries comes from the political culture, an element which hindered the expansion of the attributions of the Argentinian state. As she points out, it is much easier to adopt measures to increase the role of the state when it is viewed as an agent which promotes the general interest (Sikkink, 1991: 185). As argued above, this was the case of Brazil, where the political culture, influenced by positivism, put the state above the conflicts between the individual interests (see chapter four). Nevertheless, it was not the case in Argentina, in which social groups tended to view the initiatives of the state with suspicion, interpreting them not as steps to promote the general good, but as a result of the influence of rival groups.

According to Sikkink, the characteristics of the political culture were critical to understanding the refusal of the Argentinian governments to adopt developmentalist programs in the post-Peron period. In her opinion, political culture is very important in explaining the refusal of the industrial class, who benefited from the industrialist measures adopted by Frondizi (1958-1962), to give political support to his government. As Sikkink concludes, developmentalism did not have the same social support that it had in Brazil, which is in large part explained by the different traditions of state intervention in the economy.

A central point emphasised by Sikkink is the lack of institutional capacity of the Argentinian state. In contrast to Brazil, Argentina undertook neither a process of

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489 The differences in the insertion of state in society were related to the different paths of development in the nineteenth century. In Argentina, the economic groups organised earlier, occupied the state and were much more effective in making it an instrument of their interests. In Brazil, by contrast, economic development was slower, differentiation between the regional elites was more intense and there was not such a degree of organisation in civil society. As a result, the political elite had more autonomy and the state had a larger role in the economy. In the Argentinian case, it is also important to take into consideration the effects of Peronism, which played an important role in increasing the resistance of the social groups to state initiatives.

490 In my view, Sikkink, although correct, overemphasises the importance of ideas and of political culture to understand the opposition to the developmentalist program adopted under Frondizi. I believe that she underestimates the effects of the high polarisation which marked Argentinian politics, as well as the inability of Frondizi to construct an effective political coalition (see Mallon and Sourrouille, 1975: 19-25).
administrative reform in the 1930s nor the creation of pockets of efficiency in the following decades. As Sikkink (1993: 550) shows, before Peron, there was no uniform or centralised control over selection, promotion, discipline or dismissal of civil servants. As the author points out, in 1942, 99% of the civil servants were appointed by patronage criteria.

As a result, the Argentinian state lacked organisational, instrumental and personnel capacity. It lacked qualified technicians, statistical organs and planning capacity to play a more active role in economic development. Although Peron nationalised infrastructure services and increased the role of the state in the economy, he did not adopt the administrative reforms necessary to increase the capacity to fulfil these functions efficiently. As a result, it was very difficult for subsequent governments, even when successful in breaking the resistance of the social groups, effectively to promote a program of development.

The institutional incapacity was aggravated by the lack of continuity, since the new governments tended to abandon the reforms and dismiss the technicians employed by the previous administration. After Peron, for example, Peronist innovations were abandoned and new institutions were created. In addition, as Sikkink (1993: 562) points out, none of the Frondizi government’s executors of economic policy interviewed by her “had been civil servants, and most of them had had no previous experience in the government”491. This lack of continuity and the substantial ‘turn over’ of bureaucrats impeded the development of a group of technicians associated with the state and independent from the different political groups and governments492.

In this sense, the lack of autonomy was another important limit of the Argentinian state. As Sikkink emphasises, a central component of state capacity is the existence of a

491 Similarly, President Ongania, in 1966, tried to follow Frondizi’s program of industrialisation by stimulating foreign investment, but he did not use any of the top civil servants employed by Frondizi.

492 As seen, this was a substantial difference with Brazil, which developed a group of stable technicians who stayed in office for subsequent administrations. These technicians were very important for increasing the capacity of the state and its autonomy in face of the social groups.
group of functionaries whose interests are dissociated from the dominant groups. This result, which requires a long process of institutional building, was not achieved in Argentina. The state was formed with representatives of the dominant classes and, as a consequence, the civil servants did not develop as an independent caste which owed loyalty to the state (Sikkink, 1993: 549). As Sikkink (1991: 178) put it, “state administrators were part of a gentleman’s club with strong links to the propertied classes”.

Another important factor, which affected the autonomy of the state and also the acceptance of developmentalism, was the characteristics of the military. In Argentina, the military did not support ‘developmentalism’ and they did not show high interest in transforming the economy. Sikkink (1991: 110-111) shows how the economic issues did not have significant importance in the military schools and how industrialisation was not an important goal of the armed forces. As seen in chapter six, the difference from Brazil is striking.

In conclusion, the paragraphs above summarise the fragility of the Argentinian state, which lacked insulation and the technical and personnel capacity to play an autonomous role in development. In contrast to Brazil or Korea, the bureaucracy did not develop its own identity and autonomy and was unable to promote a program of reform and to break the deadlock characteristic of Argentinian politics. As O’Donnell (1988: 202) concludes,

“one possible way out of the cycles, a shift toward some sort of state capitalism, was blocked; a fairly stable and consolidated bureaucratic apparatus with non negligible degrees of freedom vis-à-vis civil society, which would have been a necessary condition for such a solution, was not available”.

493 This lack of autonomy is very well illustrated by the experience of the Banco Industrial de la Republica Argentina (Industrial Bank of Argentinian Republic). Its directors were not autonomous, but representatives of the economic groups. As a result, the Bank lacked the autonomy necessary to work as an efficient instrument to promote economic development. A large part of its resources, in the period from 1953 to 1960, were directed to financing light and simple sections of the industry, sectors which could have obtained resources from the commercial banks (Sikkink, 1993: 566-567).
8.5 Conclusion to chapter 8

The objective of this section is to summarise the main conclusions reached in this chapter, highlighting the importance of institutional factors and of state capacity for the experience of industrialisation in Korea, Mexico and Argentina. Besides the emphasis on state capacity, the objective is to highlight how the characteristics of the social groups, the organisation of state apparatus and the relationships state-business affected the respective paths of economic development (Hall, 1986). Where appropriate, comparisons are made with the Brazilian experience.

The Mexican experience highlights how the characteristics of the business organisation, the forms of relationship between the financial groups and the monetary authorities and the role occupied by the Ministry of Finance had an important impact in the process of policy making. These factors, which strengthened the bankers’ alliance, are very important to understand the more balanced process of import substitution instituted in this country, which presented fewer distortions than in Brazil. The counterpart, nevertheless, was the lower capacity of the state to promote import substitution industrialisation.

In Brazil, the financial sector was much weaker than in Mexico and the industrialists were an important basis of support for import substitution industrialisation. As seen, developmentalism became dominant among technicians and presidents and favoured an increase in state participation and the adoption of a permissive treatment of inflation\(^\text{494}\). An important point was the development of an articulated planning apparatus and the creation of the Bank of Investment, of efficient state enterprises and of further instruments which permitted much better results in terms of production goods import substitution than in Mexico.

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\(^{494}\) As emphasised, the monetary authorities were weaker and, until 1964, unable to pursue a strict monetary policy.
The Korean experience illustrates the importance of external shocks for the development of a country which was very backward at the beginning of the twentieth century. Japanese colonisation promoted important transformations which eliminated many political obstacles to the development of the country. As seen, the power of the local groups was drastically reduced, the state apparatus was modernised by the introduction of a professional bureaucracy, tax capacity was increased and the capacity of state penetration in the regions was strengthened. Moreover, the colonial state promoted a revolution in agriculture, invested heavily in infrastructure, developed the financial system, invested in education and gave an important push to industrial development. As a result, at the end of the Second World War, in spite of the destruction and of the economic crisis, Korea had already the potential to promote a solid process of economic development.

The external influence in Korea was also felt through the American occupation, which eliminated the left wing of the trade unions and controlled the labour movement. Accordingly, American influence was also key for the abandonment of the model of import substitution and for the adoption of the reforms necessary to improve export performance. In this process, the capacity of the Korean state to break with the interests connected to import substitution was also very important.

At the beginning of the 1960s, the government undertook reforms which increased the control over financial resources and concentrated the instruments of economic policy on the Economic Planning Board (EPB). The organ, unconstrained by the legislature, also acquired control over the budget, increasing its capacity to co-ordinate economic policy and to influence the allocation of investment. The Korean government adopted a strategy of promoting national champions and the control over the allocation of financial resources was a key instrument in achieving policy makers’ objectives. The state–business relationship was marked by the dominance of the state which, through a combination of incentives and threats, shaped the action of the private sector.
In Brazil, the process of import substitution, especially before 1964, was marked by the strong pressure and influence of the social groups, which blocked the adoption of the necessary reforms. The attempts of stabilisation also faced strong opposition. Furthermore, in spite of the reforms undertaken in certain sections of the bureaucracy, ‘embedded autonomy’ was a partial phenomenon in Brazil and a substantial part of the bureaucracy was still ruled by patronage and clientelism. In addition, despite the role of BNDE and the increase in the instrumental capacity of the state after 1964, Brazil did not have an organ which concentrated power and institutional capacity in the same way as the EPB.

In brief, the Korean state was stronger than the Brazilian one. It had a better prepared and insulated bureaucracy embedded in society and with the capacity to adopt and implement coherent policies. The Korean state was also more autonomous and able to impose its directions, using the business associations as transmission belts to obtain information and implement its policies. In Brazil, the capacity of the state to promote industrialisation, although it increased substantially in the military government, was inferior. The state was more constrained by the business groups and did not have the same control over the instruments, especially over the financial tools, necessary to shape business behaviour. This lower state capacity is very well illustrated by the incapacity to stabilise and to promote a policy of mergers (see section 7.9).

The experiences of the two countries in the 1970s illustrate the advancements and the difficulties of state programs aimed at improving heavy industry. Although both countries were very successful in concentrating financial resources and investments on the development of heavy industry, the programs of industrialisation were also marked by distortions and obstacles. The Korean experience illustrates very well the inter-bureaucratic conflicts which marked such programs of state intervention and reduced the coherence of state action. It also illustrates the difficulties faced by even authoritarian and strong states in imposing certain directions to the private sector. As already argued,

As seen, this relationship changed in the 1970s in result of the strengthening of the Chaebols.
the Korean state failed to inhibit investments in certain sectors and overinvestment became a very serious problem.

The two programs of industrialisation were marked by high inflation and an increase in foreign debt. In Brazil, inflation reached the level of 40% a year and in Korea it reached 14% in 1979. Nevertheless, a critical difference was the capacity of the Korean government to stabilise, reducing inflation to 2.9% in 1983-84. As a consequence, Korea was much less affected by the international crisis of the 1980s.

Argentina illustrates a very different situation, marked by the strong polarisation between powerful social groups and by the existence of a weak state, unable to promote an autonomous process of development. As already shown, the process of import substitution industrialisation strengthened the labour movement and a faction of the bourgeoisie, groups which came to exert substantial opposition to the powerful agrarian aristocracy and to the internationalist segment of the bourgeoisie. The situation was aggravated by economic stagnation, by the veto power possessed by each group and by the lack of institutions able to solve the conflicts and break the deadlock.

Thus, the Argentinian experience illustrates the difficulties caused by the high polarisation between powerful social groups in a context marked by slow economic growth, low social capital and lack of efficient political parties. In this process, it is important to emphasise the implications of a strong labour movement. While in Brazil and Mexico the control of the labour movement was very important for the success of import substitution, in Argentina the constitution of a strong labour movement became an obstacle to reforms and an important source of instability.

In addition, the task of administrating Argentinian politics was hindered by the political culture and by the social groups’ opposition to an increasing state participation in the economy. Furthermore, the Argentinian state was neither strong nor insulated from social groups. It lacked administrative and instrumental capacity, a result of the lack of reforms and of the discontinuity which marked the respective administrations. As
a consequence, the Argentinian state was a weak agent, unable to undertake the reforms necessary to break the stalemate. In other words, Argentina lacked the agent which was crucial for the process of development in Brazil and Korea: the developmental state.

In brief, the three experiences illustrate how the characteristics of social groups, the organisation of the state apparatus and the relationships between the state and the social groups determine different paths of economic development, being important to understand the results of industrialisation in each country. I believe that the delineation of these experiences highlights the institutional characteristics which marked the Brazilian process and contributes to understanding the vicissitudes of the process of development in Brazil.
CHAPTER 9. CONCLUSION

The historical investigation undertaken in this thesis was an application of the historical institutionalist approach to the understanding of the vicissitudes of the model of economic development adopted in Brazil from the 1930s to the 1980s. As emphasised in chapter 2, historical institutionalism interprets the path of economic policy making as a result of the interaction between institutional variables - such as the characteristics of the state, the power and organisation of the social groups, the forms of relationship between the state and the social groups – and other variables, such as the manner of the state’s insertion in the world order. Although the approach recognises that economic policies are influenced by the power of the social groups, it emphasises that the power of these groups are mediated by the institutional factors emphasised above\(^\text{496}\).

The main strength of the approach is its flexibility and capacity to incorporate the variables relevant to understand why determinate pattern of economic development was adopted. In this sense, historical institutionalism provides a very broad and useful framework to understand how the social forces interact and bring about a specific pattern of development. Nevertheless, it is important to emphasise that historical institutionalism is not a parsimonious theory. In this sense, its main weakness derives from its very broad nature, which does not make it suitable to determine, a priori, which variable is the most important. In this sense, other concepts such as state capacity and developmental state complements very well the approach employed in this thesis.

The changes in the economic model undertook in the 1930s illustrate very well the suitability of the historical institutionalist approach. The international crisis was critical for the stagnation of the agriculture-export model, but the way in which Brazil responded and shaped a new model of development was very influenced by the domestic institutional factors. Firstly, the divisions inside the rural oligarchy, the strengthening of

\(^{496}\) As an example, a peak association may increase business power, while a decentralised trade union movement may reduce the workers’ capacity to influence determinate policies. Similarly, the power of the planning and industrial agencies in the state apparatus may facilitate the adoption of certain measures and increase the chances of success.
the industrialists and the power of the military produced a balance of power that increased the autonomy of the political elite to build a different model of development.

Secondly, the characteristics of the political system at that time, marked by strong practices of clientelism and fraud and by the lack of an independent juridical system, were also relevant to understand the characteristics of the movement and the reforms implemented in the 1930s. In this sense, the institutional factors, as emphasised by the historical institutionalist approach, are key to understand why the response to the international crisis brought about the emergence of a strong state that elected industrialisation as the best strategy for national development. They are important to understand, for example, why Brazil was different from Argentina, where the rural aristocracy kept power and undertook a process of reforms which guaranteed the preservation of its main interests.

The importance of path dependence is very well illustrated by the previous role assumed by the state and by the influence of political culture. Brazilian state in the nineteenth century was more interventionist than any other Latin American state. The participation of the state in the economy was further increased by the demands of the coffee bourgeoisie to regulate the supply of the product. This role of the state was supported by a political culture which, inheritance of the mercantilist Portuguese tradition, viewed state intervention as the best way to address the national interests. Thus, in response to the problems and contradictions of the First Republic (1889-1930), the opposition defended the return of a strong state as the only way to pursue the necessities of national development. In this sense, the existence of an interventionist state and the characteristics of the political culture - as present in the conservative political thought of the 1920s, in positivism and in the military doctrine – are key to understand the directions that marked the re-organisation of the state and the shaping of the new economic model after 1930.

In brief, path dependence is very important to understand the Brazilian model of economic development. Although many changes were undertaken, they took place in a
context marked by the old institutions, which constrained and influenced the new model of development. While the Korean experience illustrates very well the importance of external shocks to eliminate the power of certain groups and undertake a radical transformation in state organisation, the Brazilian experience was marked by certain continuity and by the preservation of power and influence of several social groups. Clientelism was important characteristic of the Brazilian state and, despite the reforms undertook in the 1930s, persisted for a long time. The politicians and the economic groups constrained the path of administrative reform and the creation of pockets of efficiency was the way to conciliate the old practices with the aims of modernising the state and the economy.\footnote{In this sense, the way in which the modernisation of the state took place is a very good illustration of how the old institutions constrained the path of administrative reforms.}

Similarly, the interests of the conservative groups are key components to understand the pattern of economic policy. As seen, they opposed the expansion of the state to certain areas and the creation of a central organ of planning. Likewise, they pressured for resources and vetoed increase in tax and the adoption of a strict policy of economic stabilisation. In this sense, their interests were very important to understand the emergence of a pattern of economic policy marked by over-valued exchange rate, high protectionism and a permissive treatment of inflation. In brief, the vicissitudes of the model of development in the period 1930-1964 were marked by the need to conciliate a wide range of interests, fruit of the structure of social forces created in previous historical phases and that was not dismantled by the events of 1930. This constrained significantly the pattern of development and was crucial to understand certain limits to the pursuit of a more consistent and balanced model of development.

A very important role was also played by the international insertion of the country and by the timing of industrialisation. This determined many regularities in the Latin American pattern of economic development, including the emergence of tensions in the process of industrialisation that led to the uprising of authoritarian regimes in the 1960s and 1970s. Although domestic institutions, specially the capacity to control labour
movement, explained important differences among the countries, the geopolitical position and the insertion in the international order played also relevant role in the configuration of the respective models of development.

As Cardoso and Faletto (1970) emphasises, the interests shaped in the previous phases of import substitution put subsequent difficulties for the adoption of certain changes in the model of development. These groups benefited from a particular (and dependent) relationship with foreign capital and tended to oppose significant changes in the economic model. They were, for example, dependent on import of technology and were not very keen to support a program aiming at achieving national technological autonomy. Thus, this is an important aspect that must be taken into consideration when addressing the difficulties faced by the Brazilian state to promote economic development.

A central objective of this thesis was to use the Brazilian experience as a case study about developmental states, investigating the determinants of state capacity and the limits faced by interventionist states to achieve more positive results. A very important point was to investigate the factors that led to the emergence of the developmentalist state in Brazil. As seen, the existence of a political culture favourable to state intervention played key role, as also happened in the emergence of developmental states in Japan, France and Korea. As argued in chapter 2, state capacity is substantially increased when the action of bureaucracy is considered legitimate and viewed as the best way to address the national interests. By contrast, in countries in which state intervention is viewed with suspicion by the powerful economic groups, as in Britain or Argentina, the chances of emergence of a very interventionist state, able to occupy the central role in the strategy of industrial development, are substantially reduced.

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498 The expression developmentalist state was employed to designate a state that, although playing a very central role in the model of development, was not as strong or cohesive as in other classical experiences of developmental states.
The emergence of the developmental state is also favoured by the power of the state agents vis-à-vis the social groups. In countries in which these groups are very strong, the state tends to lack the autonomy to adopt certain reforms and to shape the strategy of development, specially if these measures collide with the interests of those groups. In this sense, the strengthening of the Brazilian state in the 1930s, a result of the balance between social groups and also of the previous characteristics of the state and of the political culture, was central to understand the pattern of development which emerged in that decade and was consolidated in the 1950s.

The emergence of a very interventionist state in Brazil was also favoured by the international events, including the crisis of the 1930s, the Second World War and the characteristics of the Pax Americana. The world depression in the 1930s and the war increased substantially the autonomy of the states to shape a different economic model. After the Second World War, the United States’ policies frustrated and weakened the liberal forces in Latin America. This led to the abandonment of liberal and orthodox policies and paved the way for the consolidation of a state-centred model of development. In addition, the new international order gave high autonomy to the national states, allowing them to employ many instruments in order to promote a process of industrialisation centred on the domestic market⁴⁹⁹.

In brief, these external factors added to the domestic elements emphasised above and produced a context favourable to the emergence of the developmentalist state. These factors are very relevant to understand how the state increased the involvement in the economic process, adopted reforms in the bureaucracy and implemented a range of measures to promote industrialisation. The events in Argentina highlight how the resistance of social groups and the role of political culture are critical for the success (or not) of developmentalism in a specific country.

⁴⁹⁹ As seen, high tariffs and a permissive treatment of inflation were allowed by the international financial institutions and by the organs that regulated international trade.
A key objective in this political economy of the Brazilian import substitution industrialisation was to investigate the obstacles and limits that impeded the developmentalist state in Brazil to achieve more consistent results in terms of industrial development. As the comparisons with East Asia highlight, the Brazilian developmentalist state was not as strong in relation to private groups as in Japan and Korea and, thus, was not able to define an economic strategy and compel the business groups to follow it. In addition, the bureaucracy was never as strong or coherent as in the two East-Asian countries. As seen, modernisation of bureaucracy in Brazil was a partial phenomenon and the large number of political appointments reduced its internal coherence. Thirdly, the comparison with the Japanese developmental state highlights the political fragility of the Brazilian developmentalist state, unable to obtain the political support necessary for promoting substantial changes in economic structure. In contrast to Japan, Brazil lacked an effective political party able to insulate the decision makers and increase political support for the government’s initiatives.

Special attention was given to the divisions inside the state and to the penetration of private interests into the state apparatus. Although inter-bureaucratic conflict was a problem faced by every state, it emerges in different degrees and their negative effects may be countervailed by other elements, such as the esprit de corps of bureaucracy. In the Brazilian military regime, the uncontrolled form of expansion of the bureaucratic agencies increased conflict of jurisdiction and reduced the coherence of industrial policy. In this sense, the problems to achieve co-ordination was an important deficiency in the capacity of the Brazilian developmentalist state to obtain better results in terms of industrial development. During Geisel government, an effort was attempted to centralise the main decisions and reduce the influence of private interests in the policy-making process. Nevertheless, such attempts provoked strong reaction from the business class, affecting negatively the basis of support and the legitimacy of the government.

In addition, the objectives of the industrial policy were also constrained by the interests of the governors of the states, immediately concerned with the increase in investment and employment in their respective states. As illustrated by the events of
Geisel government, these interests entered in conflict with the objectives of the industrial policy, affecting negatively the policies for the capital goods industry. In this sense, the existence of a federal structure, by introducing other influential actors in the political process, adds another source of division inside the state apparatus. This makes more complex the task of the developmentalist state of employing resources and instruments to promote certain objectives.\(^{500}\)

In brief, this thesis provides a study about the determinants of state capacity to promote economic development. In the Brazilian experience, state capacity was favoured by the political culture and by a continuous process of reform in the bureaucracy. Nevertheless, it was constrained by the veto power of social groups, by the forms of private interests penetration into the state apparatus and by the lack of effective political parties and of a peak business association able to aggregate interests, obtain negotiated solutions, insulate segments of the bureaucracy and increase political support for the implementation of the necessary policies.

In regarding to the role of the state as promoter of development, it is possible to put Brazil in a half-way between Korea and Argentina. As emphasised, the Brazilian state was more constrained by social groups and did not have a bureaucracy as strong, coherent and insulated as in Korea. As a consequence, the state did not have the same control over financial instruments and was not able to use the business associations as transmission belts to impose the economic directions. On the other hand, the Brazilian state was more autonomous and much less constrained by social groups than in Argentina. Administrative reforms, bureaucratic continuity and the existence of a political culture favourable to state intervention were key factors in explaining the role of the Brazilian state as promoter of development. In Argentina, the veto power of social groups provoked deadlock and there was no autonomous political elite able to break this stalemate and promote a process of development.

\(^{500}\) The difficulties put by the federal structure were increased after 1979, when democratic elections in the states strengthened the power of the governors and reduced the capacity of the federal government to keep the economic process under control.
It is important to focus the issue in terms of the dichotomy political-institutional X policy-based explanation, as proposed by Easterly and Levine (2002). I do not think that this dichotomy fits in my work. Many institutions, as inherited from colonisation and from the nineteenth century - including slavery, clientelism, patronage, lack of an insulated and well trained bureaucracy - were factors that affected negatively economic development in Brazil. However, when I am talking about institutions, according to the historical institutionalist approach, I am intending to grasp the influence of a set of institutional factors over the pattern of policy making.

In this sense, institutional factors are mixed with the economic policy choices. As emphasised, institutions are very important to understand the emergence of the developmentalist state and the adoption of a pattern of economic policy marked by high protectionism and a permissive treatment of inflation. A key point in my argument was to understand why certain measures necessary to produce a more sustainable model of development were not adopted. According to my argument, this is related to institutions and to limits in state capacity.

This thesis shows how state capacity is key to understand the vicissitudes of the model of industrialisation. Brazil faced many economic difficulties, including a lack of entrepreneurial capacity, non-development of a consistent and solid financial system and mistakes in economic policy, which had important implications for the model of development. Nevertheless, given the role assumed by the state in this process, state capacity is the most relevant concept to understand why certain measures were not adopted to produce, for example, a solid financial system or strong business groups.

In brief, this study has sought to increase our understanding of the program of import substitution industrialisation in Brazil. The political economy of the process of industrialisation highlighted the determinants of the pattern of economic policy and several obstacles that limited the achievements of the program of development. In addition, the historical study showed in details how the institutional factors worked and
constrained the capacity of the Brazilian state to replicate the results of certain state-led strategies of industrialisation.


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