The Politics of Finance in Developing Countries

Edited by

STEPHAN HAGGARD,
CHUNG H. LEE, *and*
SYLVIA MAXFIELD

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CHAPTER NINE

Brazilian Politics and Patterns of Financial Regulation, 1945–1991

LESLIE ELLIOTT ARMIJO

This essay investigates the effects of Brazilian politics on the choice and implementation of national financial policies, especially policies for industrial finance, between 1945 and 1991. The pattern of Brazilian financial regulation during this period was broadly interventionist, with central government policymakers playing a role in determining the allocation and often the cost of credit. Government control of credit was one of the three main economic policy instruments of the postwar Brazilian developmental state, along with direct production through state-owned enterprises and guidance of private investment through a complex and frequently changing fiscal code.[1]

The story of the politics of postwar financial policy-making divides

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[1] See Werner Baer, *The Brazilian Economy: Growth and Development*, 3d ed. (New York: Praeger, 1979); J. R. Mendonça de Barros and D. H. Graham, "The Brazilian Economic Miracle Revisited: Private and Public Sector Initiative in a Market Economy," *Latin American Research Review* 13, no. 2 (1978); Pedro Malan and Regis Bonelli, "Brazil, 1950–1980: Three Decades of Growth-oriented Economic Policies," Institute de Planejamente (Rio de Janeiro: IPEA, March 1990); Working Paper and Thomas Trebat, *Brazil's State-Owned Enterprises: A Case Study of the State as Entrepreneur* (Cambridge: Cambridge University Press, 1983).

into two periods: 1945 to approximately 1980 and 1980 to the end of 1991. This periodization is perhaps counter intuitive in that it does not coincide with the three distinct national political regimes: the semi-elite democracy from 1945 to the military coup in 1964, military authoritarianism from 1964 to early 1985, and restored civilian, democratic rule since 1985. From the close of World War II to around 1980, however, underlying patterns of national interest aggregation via the political system, insofar as they affected choices about financial regulation, remained comparatively stable. Sometime during the presidential term of João Figueiredo (1979–1985), they changed.

Throughout the first period, the central government was relatively strong vis-à-vis domestic economic elites in terms of the state's ability to control the agenda of financial reform. Three underlying structural characteristics of the national political economy allowed for reasonably autonomous central government financial policy-making from 1945 through 1980: (1) access to external financing, (2) low integration of banks with industrial firms within the Brazilian private sector, and (3) the institutional inheritance of a comparatively strong, economically interventionist state. As a result, relatively insulated technocrats within the state held the initiative, both in shaping the broad financial policy agenda and in targeting credit to specific sectors.

Central government financial policy choices in the postwar years were influenced by two elite economic ideologies: "liberalism," which in the financial sphere meant promoting decentralized, private financial intermediation and an independent central bank; and "structuralism" or "developmentalism," which advocated an activist role for the state in promoting high levels of industrial investment.[2] The developmentalist position also implied a comparatively greater tolerance for inflation as a necessary evil associated with overcoming structural supply rigidities in the economy. Despite the frequent use of "liberal" rhetoric to describe financial policy choices and the apparently sincere "liberal" intentions of some individual policymakers, especially immediately following the 1964 military coup, developmentalist industrial policy drove financial policy, which displayed a high degree of state intervention in credit allocation through the early 1990s. The importance placed on rapid industrialization as a shortcut to achieving great power status by the military intellectuals reinforced developmentalist policymaking during two decades of authoritarian rule.

Financial policies did not originate primarily in response to lobbying by private groups or as straightforward expedients to purchase wavering political support. Nonetheless, policymakers were cognizant of

[2] I employ "ideology" to mean a set of beliefs that are mutually consistent, plausible, and causally related, but intrinsically nonfalsifiable.

broad limits on government action imposed by the elitist class coalitions supporting both democratic and authoritarian Brazilian political regimes through the early 1980s. For example, despite the desires of successive Brazilian administrations to make loan allocation conform to state development priorities, there was no debate about bank nationalization. Decision makers understood private bankers to be crucial to the regime support coalition; therefore, technocrats designed policies to induce, but never to coerce, private banks' cooperation. Commercial banks operating under high inflation gained from legislation prohibiting interest payments on demand deposits and from guaranteed returns resulting from rediscount operations. Consequently, the private financial sector was noticeably less opposed to an interventionist state than the prevalent image of bankers in most countries would suggest. Similarly, industrial and agricultural producers received generous credit incentives in return for channeling their investments according to priorities defined by state planners. But, although it was true that state planners were relatively free to initiate credit incentives, it did not follow that policymakers possessed the power to cancel subsidies that had outlived their developmental justifications. In this sense interest group pressures mattered, as policymakers often layered new incentives on top of earlier favors, with pernicious cumulative consequences for the state's freedom of action in macroeconomic management.[3]

Around 1980, the political economic equation changed, with important consequences for financial policy-making. Concurrent democratization and economic trauma led to a breakdown of executive branch dominance over financial regulation. Interest groups, the national legislature, and state and municipal politicians asserted their right to participate in national economic policy-making. Some private and public sector elites questioned the priorities of the import substitution model itself. Although both government and opposition politicians and nonpolitical elites agreed that financial reform was necessary, society's willingness to accept technocrats' initiatives passively was no more.

I. The Semi-elite Democracy and Financial Repression, 1945–1964

The political system established during the long domination of national politics by President Getúlio Vargas (1930–1945, 1950–1954)[4]

[3] For a related explanation of the proliferation of bureaucratic agencies within the federal government, see Edson Nunes and Barbara Geddes, "Dilemmas of State-led Modernization in Brazil," in *State and Society in Brazil: Continuity and Change,* ed. John D. Wirth, Thomas Boganshields, and Edson de O. Nunes (Boulder, Colo.: Westview Press, 1987).

[4] Vargas was put in office by force in 1930, indirectly elected in 1932, directly elected

represented a shift from decentralized federal governments operating in the interests of agroexport elites to an increasingly centralized, urban and industrial sector–oriented national government.[5] After the international financial collapse of 1929, the central government had assumed control of all foreign exchange operations through the Banco do Brasil (BB). In 1933, Congress, responding to presidential initiative, passed two financial laws largely directed at British export-import houses and at the U.S. and German banks, which had become more prominent after the turn of the century. A usury law prohibited financial instruments from paying more than 12 percent annual interest. The gold exchange clause law forbade contracts denominated in any currency (such as gold or currencies freely convertible into gold) other than the national money, the cruzeiro. This provision effectively disallowed inflation-indexed financial instruments. The 1934 constitution stated a goal of the gradual nationalization of all banks and insurance companies, a threat that Vargas periodically raised but never acted on.

Monetary policy and banking and foreign exchange regulation were the responsibility of the Banco do Brasil. The BB had a dual existence as the largest commercial bank in Brazil and the official financial agent of the Treasury.[6] The BB was also a development bank, not only making loans to the agricultural and nascent industrial sector, but also in the 1930s and 1940s developing a strong organizational ethos that emphasized the BB's unique role in promoting progress and economic growth throughout the country.[7] The BB remained an alternative power center, allied to coffee and other agricultural interests, despite attempts by Vargas during the authoritarian period of the *Estado Novo* ("New State," 1937–1945) to subordinate the BB to executive control. Meanwhile, the activities of private commercial banks centered on financing imports and agricultural exports, with a comparatively minor role in financing production. Commercial banks owned by individual state governments handled state deposits and payments. Private industry relied primarily on internal (often family) resources for long-term capital.

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in 1934, allowed to assume authoritarian powers in 1937, ousted by the military in 1945, and popularly reelected in 1950. In 1954 he shot himself to avoid being forced out by the military once again.

[5]For more on the political economy of 1930–1964, see Nathaniel H. Leff, *Economic Policy Making and Development in Brazil, 1947–1964* (New York: Wiley, 1968); and Thomas E. Skidmore, *Politics in Brazil, 1930–1964: An Experiment in Democracy* (New York: Oxford University Press, 1967).

[6]On the history of the Banco do Brasil during the First Republic (1889–1930), see Steven Topik, *The Political Economy of the Brazilian State, 1889–1930* (Austin: University of Texas Press, 1987).

[7]Popular Brazilian wisdom suggests that there are three persons of power in every town throughout the country: the priest, the magistrate (sometimes the mayor), and the manager of the Banco do Brasil.

Brazil fought in World War II on the side of the Allies and participated in the Bretton Woods Conference. These experiences, along with several other opportunities to interact with the central banking community of the United States and Great Britian, made a lasting impression on Eugênio Gudin, the prominent Brazilian economist, and Octávio Bulhões, his younger colleague. Before the war's end and Vargas's forced exit from the presidency, Bulhões, a senior economic aide, prevailed upon Vargas to create the Superintendency of Money and Credit (SUMOC), a consultative committee within the government to oversee the formation of monetary policy.

Bulhões was a committed economic liberal, favoring free trade and domestic free markets. He believed Brazil—which was historically prone to government deficits, financial booms and busts, and inflation—needed a monetary authority independent of the central government. He and his "coreligionists," to translate the applicable (nonpejorative) Brazilian term, had no faith in the ability of Banco do Brasil to behave as an independent central bank. If anything, the BB already was substantially independent of the central government executive but was heavily compromised with agricultural interests. At the same time, Bulhões recognized that the political power of the BB in the Congress, which was soon to be reopened, would make the effort to create a new institution extremely difficult. They chose the name SUMOC, rather than Banco Central, explicitly to soothe the sensibilities of the BB.[8] Despite this, the procentral bank lobby within the government found it necessary to modify its initial plans for Ministry of Finance dominance within the SUMOC so that three of the five members of the superintendency would instead be the president and two directors from the Banco do Brasil. SUMOC would formulate monetary and credit policies, which then would be executed by the BB.[9]

[8]See Pedro A. C. Lago, "A SUMOC [Superintendency of Money and Credit] com embrião do Banco Central: Sua influência na condução de política econômica, 1945/65," M.A. thesis, Department of Economics, Catholic University of Rio de Janeiro, 1982.

[9]The Banco do Brasil on several occasions between 1945 and 1964 showed itself to be less than fully subordinated to the central government executive. For one thing, the president of the BB, always a policymaker with an independent power base or the personal nominee of a political broker outside the central government, could refuse to comply with the wishes of the finance minister and, presumably, the president. Faced with such a rebellion, Vargas in 1952 ended up firing Finance Minister Horácio Lafer and retaining BB president Ricardo Jafet. Other times it went the other way. In addition, the technical mechanisms for restraining credit growth were also weak. A. C. Sochaczewski suggests that given the large number of branches of the BB throughout the country, it was relatively easy for local managers to ignore inconvenient central instructions. See Sochaczewski, "Financial and Economic Development of Brazil, 1952–1968," M.A. thesis, London School of Economics, 1980, p. 245. Certainly, there never was any question of causing hardship to the regional economy for the sake of satisfying the central government, much less foreign lenders, a populist position of which BB directors were, and continue to be, openly proud.

The next financial innovation represented a more interventionist approach. Vargas, reelected in 1950, warmly welcomed the U.S. offer to send a technical mission to help make an overall assessment of Brazil's industrial infrastructure needs. The results of the joint Brazil-United States Economic Commission included plans for forty-one projects in transportation (railroads, ports), electric power, and steel, which became the core of the Vargas government's economic program.[10] The Vargas administration, wary of using the extensive but politicized network of the BB to channel the expected foreign aid funds, created an entirely new institution, the National Economic Development Bank (BNDE, later BNDES). When expected U.S. assistance did not fully materialize, President Vargas got Congress to vote for a special tax. The BNDES rapidly became the major government instrument for channeling credit to industry. Control of the *distribution* of financing, particularly long-term investment credits, was a consistent aim of the state. The success of this goal is symbolized by the sectoral lending patterns of the BNDES, which were consistent with central government industrial development goals, as well as with the eventual sectoral distribution of actual economic growth. BNDES lending averaged slightly over 0.5 percent of GDP between 1952 and 1964 and accounted for the majority of long-term credit from all in-country sources.[11]

These developments overlapped with a wide-ranging debate on the role of the state in managing the economy. The most articulate proponent of the pro-interventionist position was Roberto Simonsen, a São Paulo industrialist. Gudin championed the liberal position.[12] By the 1930s, however, the institutions of the interventionist state had already progressed far beyond a laissez-faire or even a purely regulatory stance.[13] A joint cooperative and training agreement between the BNDES and the United Nation's Economic Commission for Latin America (CEPAL) was also an important mechanism for the transmission of developmentalist ideas.[14] Meanwhile, SUMOC, despite its eco-

[10]See Eliza Jane Willis, "The Politicized Bureaucracy: Regimes, Presidents, and Economic Policy in Brazil," Unpublished manuscript, 1990.

[11]See BNDES, *25 anos de BNDE: Avaliação,* Revista do BNDE (Rio de Janeiro, 1977), p. 14.

[12]See Eugénio Gudin and Roberto C. Simonsen, *A controvérsia do planejamento na economía brasileira,* 2d ed. (Rio de Janeiro: IPEA/INPES, 1978), for the most telling essays and speeches. Also see Leff, *Economic Policy Making,* and Kathryn A. Sikkink, *Ideas and Institutions: Developmentalism in Brazil and Argentina* (Ithaca: Cornell University Press, 1990). Both explore the assumptions and history of developmentalist ideas in Brazil, emphasizing their wide acceptance among various elite publics.

[13]See Nathaniel H. Leff, *Underdevelopment and Development in Brazil* (Winchester, Mass: Allen and Unwin, 1982), vol. 1, *Economic Stucture and Change, 1822–1947;* or Topik, *Political Economy of the Brazilian State.*

[14]See Albert O. Hirschman, "Ideologies of Development in Latin America," in *Latin American Issues: Essays and Comments,* ed. Albert O. Hirschman (New York: Twentieth

nomically liberal origins, nonetheless strengthened the patterns of interventionist policy-making and executive branch initiative. Two of the most important changes in economic and financial legislation of the entire postwar democratic period were both administrative decrees of the superintendency. Instruction No. 70, dating from the Vargas years, created the multiple exchange rate system by which the government subsidized the import of capital goods and penalized consumer goods imports and agricultural exports. Instruction No. 113 (1955) allowed multinational investors to count imported capital goods as part of their total direct investment in the country, thus raising the limit of funds they later could remit abroad and giving them an advantage over Brazilian firms.[15]

The next president, Juscelino Kubitschek (1956–1961), was one of the most explicitly "developmentalist" of all postwar Brazilian chief executives. Kubitschek strongly supported the BNDES, which became the "steel bank," benefiting from a big U.S. loan through the P.L. 480 program. His visionary plans to move the national capital to the interior made him popular with both the general public and construction contractors. Kubitschek utilized the technical expertise of the BNDES to support his "executive groups," namely, sector-specific, government-organized consultative groups of state technocrats and Brazilian and foreign businesspersons, of which the best known was that for the automotive sector.[16] The executive groups ostensibly designed viable sectoral strategies; they also served to diffuse the always potent issue of denationalization associated with Kubitschek's active support for foreign direct investment. Many Brazilian businesspersons found they could prosper in cooperative or mutually interdependent ventures with foreign firms or with the state itself. Thus, the explicit Brazilian *tripé* (tripod) model of industrialization was born.[17]

While central governments of the 1950s attended to the possibilities for expanding state and foreign financing for industrialization, activity in private financial and capital markets remained listless. Inflation had by 1950 risen to over 20 percent annually, yet banks were legally bound by the 1933 usury law not to charge over 12 percent (nominal) interest

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Century Fund, 1961); and Celso Furtado, *A fantasia organizada* (Rio de Janeiro: Paz e Terra, 1985).

[15] See Leff, *Economic Policy Making.*

[16] See Helen Shapiro, "State Intervention and Industrialization: Origins of the Brazilian Automotive Industry," Ph.D. diss., Department of Economics, Yale University, 1988.

[17] Fernando Henrique Cardoso and Enzo Faletto, *Dependency and Development in Latin America* (Berkeley: University of California Press, 1979), and Peter Evans, *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil* (Princeton: Princeton University Press, 1979), critique the costs of Brazil's "associated, dependent development." The three legs of the tripod were national, state, and transnational capital.

a year. The consequence was financial disintermediation: the ratio of financial assets to GDP steadily fell from a mean of almost 37 percent in the years 1948–1952 to only 21 percent in 1966, just before the financial reforms of the new military regime began to take effect.[18] Time deposits disappeared as large savers took their money out of the financial system and bought land or jewels. Banks, including the BB, evolved techniques that amounted to charging positive interest rates to industrial and commercial borrowers, including requiring large "compensating" deposits (which could be 25 percent of the total value of the loan), adding substantial service charges, or exacting under-the-table payments.[19] Nonetheless, real interest rates on loans sometimes fell below the rate of inflation, and banks had to try either to recoup their losses on the spread between deposit and loan rates or to expand their branch network to capture demand deposits from small savers. Between 1944 and 1964, the total number of commercial banks fell from 509 to 328.[20] Stock markets in Rio de Janeiro, São Paulo, and several other cities, although quite long-established, did not intermediate a significant quantity of funds.[21]

Meanwhile, Bulhões, Gudin, and others in and out of government had been preaching the gospel of sound money and an independent central bank. They found few converts among the nonfinancial business community, which naturally did not favor credit restrictions, but the arguments made sense to many bankers. By the early 1960s, the private financial community, led by Brazilian-owned commercial banks, had began to organize explicitly for the purpose of seeking political action from the legislature to modernize the country's financial regulations.[22] Their principal demands were abolishing interest rate controls, legalizing innovative financial instruments (such as the discounting of trade

[18] See Comissão Nacional de Bolsas de Valores, *Introdução ao mercado de ações* (Rio de Janeiro, 1986), p. 99.

[19] Further details are in Adroaldo Moura da Silva, *Intermediação financeira no Brasil* (São Paulo: FIPE/USP, 1980); and John H. Welch, "Capital Markets in the Development Process: The Case of Brazil," Ph.D. diss., Department of Economics, University of Illinois at Urbana-Champaign, 1988.

[20] Sochaczewski, "Financial and Economic Development of Brazil," p. 134.

[21] Some sources show new stock issues to represent quite a substantial percentage of gross domestic product. Goldsmith, for example, reports that total new stock emissions by private firms averaged 5.4 percent of GDP between 1950 and 1964. This figure, however, is not quite what it first seems. Fully 3.9 percent represents the upward revaluation of permanent assets to reflect inflation; the vast majority of the remainder of the "new stock" was new infusions of capital by existing partners in family-owned firms, not capital raised in financial markets. See Raymond W. Goldsmith, *Brasil, 1950–1984: Desenvolvimento financeiro sob um século de inflação* (São Paulo: Harper & Row do Brasil, 1986), p. 305.

[22] See Ary Cesar Minella, *Banqueiros: Organizado e poder político no Brasil* (Rio de Janeiro: Espaco e Tempo/ ANPOCS, 1988), for full details of the political activities and organizations of bankers between the late 1950s and the early 1980s.

bills), and creating an independent central bank. Rising inflation, which averaged 19 percent annually from 1950 to 1954 but 61 percent from 1960 to 1964, gave credence to the financial community's complaints.[23]

In 1961 both the economic and the political situations worsened. The new president, Jânio Quadros, represented the anti-Vargas UDN (National Democratic Union), a party that had prominent bankers and newspaper owners among its visible leaders and financial backers. Quadros quit after six months, which brought to office his separately elected vice-president, the leftist João Goulart, who was an anathema to the military and Brazil's self-designated "productive classes." Under Goulart, financial legislation became more nationalistic. In 1962 the president urged the Congress to pass Law 4131, the (anti)foreign capital law, which increased restrictions on capital repatriation and dividends payment abroad for multinational direct investors but also permitted Brazilian firms (including the Brazilian subsidiaries of foreign multinationals) to contract foreign loans directly. Other legislation limited foreign banks operating in Brazil to the number that were already in the country as of the early 1960s. In addition, the Goulart administration created the Bank of the Northeast of Brazil (BNB), a new federal development bank to channel monies to Brazil's historically poor, populous, and natural disaster-prone Northeast.[24]

Finally, in the years and months before the March 1964 coup, the old controversy over credit expansion and the need for a central bank heated up again, this time in the national legislature. The Goulart administration proposed a banking reform relatively close to that favored by the economic liberals and the newly politically active banking communities of Rio de Janeiro and São Paulo. Congress's lower house instead passed a version that definitively would declare the Banco do Brasil to be the nation's central bank. Federal deputies associated with both the São Paulo Federation of Industry (FIESP, then and now the most powerful business association in Brazil) and the employees' union of the BB (historically the backbone of civil servant unionism) had lobbied their colleagues for this bill. While the banking community tried to organize in opposition, the military and their allies among the civilian politicians moved against Goulart.[25]

[23] Figures are from Francis A. Lees, J. M. Botts, and R. P. Cysne, *Banking and Financial Deepening in Brazil* (New York: St. Martin's, 1960), pp. 38–39.

[24] On the early years of the BNB, see Albert O. Hirschman, *Journeys toward Progress: Studies of Economic Policy-Making in Latin America* (New York: Twentieth Century Fund, 1965).

[25] On the role of bankers in the 1964 coup, see Minella, *Banqueiros;* and René A. Dreifuss, *1964: A conquista do estado, ação política, poder e golpe de classe* (Rio de Janeiro: Vozes, 1981). For other perspectives on the coup, see Skidmore, *Politics in Brazil;* Thomas E. Skidmore, *The Politics of Military Rule in Brazil, 1964–1985* (New York: Oxford Uni-

II. FINANCIAL DEEPENING AND STATE PROMOTION OF INDUSTRY, 1964–1980

After the coup, the new president, military intellectual and "moderate" Humberto Castello Branco (1964–1967), appointed as ministers two prominent economic liberals:[26] Bulhões, veteran campaigner for an independent central bank, and Roberto Campos, former president of the BNDES.[27] Campos and Bulhões implemented what was perhaps Brazil's only successful government-designed stabilization program. Among the costs were wage repression and a credit squeeze sufficiently severe to cause many small businesses to fail.[28] Multinational businesses and a few large Brazilian companies met their urgent credit needs by using the new Law 4131 facility to borrow abroad. The World Bank, the International Monetary Fund, and the U.S. government supported the new government with cheap credits. Other government reforms increased tax collections and raised prices of the outputs of many state enterprises.

Dearest to the heart of Bulhões, however, was the comprehensive, clearly articulated, extremely wide-ranging series of financial reforms.[29]

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versity Press, 1988); and Phyllis R. Parker, *Brazil and the Quiet Intervention, 1964* (Austin: University of Texas Press, 1979).

[26] Economic liberals are also called "monetarists" in Brazil, which is probably a misnomer. On the wide divergence between the Brazilian military regime and the more economically orthodox Argentine, Uruguayan, and especially Chilean juntas of the 1970s, see Alejandro Foxley, *Latin American Experiments in Neo-conservative Economics* (Berkeley: University of California Press, 1979).

[27] On the political economy of the military era, see David Collier, ed., *The New Authoritarianism in Latin America* (Princeton: Princeton University Press, 1979); Evans, *Dependent Development;* Jeffry A. Frieden, *Debt, Development, and Democracy: Modern Political Economy and Latin America, 1965–1985* (Princeton: Princeton University Press, 1991); Luciano Martins, *Estado capitalista e burocracia no Brasil pos-64* (Rio de Janeiro: Paz e Terra, 1985); Guillermo O'Donnell, *Modernization and Bureaucratic-Authoritarianism: Studies in South American Politics* (Berkeley: Institute of International Studies, University of California, 1973); Ben Ross Schneider, "Politics within the State: Elite Bureaucrats and Industrial Policy in Authoritarian Brazil," Ph.D. diss., Department of Political Science, University of California at Berkeley, 1987; Skidmore, *Politics of Military Rule;* and Alfred Stepan, ed., *Authoritarian Brazil: Origins, Outputs, Future* (New Haven: Yale University Press, 1973).

[28] See Albert Fishlow, "Some Reflections on Post-1964 Brazilian Economic Policy," and Thomas Skidmore, "Politics and Economic Policymaking in Authoritarian Brazil, 1937–71," both in Stepan, *Authoritarian Brazil.*

[29] On financial reforms in 1964–1980, see José Carlos de Assis, *A chave do tesouro: Anatomia dos escândalos financeiros no Brasil, 1974–83* (Rio de Janeiro: Paz e Terra, 1983); Daniel L. Gleizer, "Government, Financial Systems, and Economic Development: Brazil," 1991, mimeo; Lees et al., *Banking and Financial Deepening;* da Silva, *Intermediação;* W. L. Ness, "Financial Market Innovations as a Development Strategy: Initial Results from the Brazilian Experience," *Economic Development and Cultural Change,* no. 3 (April 1974); L. C. Bresser Pereira, "Changing Patterns of Financing Investment in Brazil," *Bulletin of Latin American Research* 6, no. 2 (1990); D. E. Syvrud, *Foundations of Brazilian Economic*

The principal goals of the financial policy package were to increase voluntary private savings and industrial investment. The reforms embodied a curious mixture of liberal and developmentalist aims, whereas their architects, at one and the same time, preached free markets and enforced a stabilization program of unprecedented toughness while busily constructing the next generation of targeted credit lines and special incentives. Although Congress, once purged, was shortly reopened, it was clear where the power lay, and the new regime's reforms passed without extensive debate or contentious amendments. The military regime, in any case, initially was quite popular not only with foreign governments and the "productive classes" but also with the urban middle class, which was frightened by both inflation and the image of Goulart calling on workers to protest in the streets. Most segments of Brazilian opinion were happy to support technocratic innovation by the executive.

In July 1964, just four months after the military coup, the new economic team moved to recover the central government's capacity to borrow by creating the ORTN (Readjustable Obligation of the National Treasury), a new inflation-indexed government debt instrument, the first such one to be used in Brazilian financial markets since the passage of the gold exchange clause law of 1933. ORTNs were an immediate hit in the markets, particularly with such a credible new government in charge. In August, Congress approved the legislation for the housing finance system, which provided loans to builders for residential construction as well as mortgage loans to individuals. The new housing finance system simultaneously was a large stimulus to the construction industry, a benefit for the politically important urban middle class (ostensibly also for urban workers), and a new lease on life for a moribund national system of public savings banks (*caixas econômicas*). Funds came from inflation-indexed mortgage bonds and indexed savings accounts that were guaranteed by the central government through a new specialized "central bank" (the National Housing Bank) for the national network of mortgage and residential construction lenders. In addition, compulsory deposits came from a new workers' unemployment and special-purpose fund (the FGTS), which was created by the central

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Growth (Stanford: Hoover Institution Press, 1974); M. Conceição Tavares, "O sistema financeiro brasileiro e o ciclo de expansão recente," in *Desenvolvimento capitalista no Brasil,* vol. 2, ed. L. G. M. Belluzzo and Renata Coutinho (São Paulo: Brasiliense, 1983); N. G. Teixeira, *Os bancos de desenvolvimento no Brasil* (Rio de Janeiro: ABDE/CEBRAE/BNDE, 1979); D. M. Trubeck, "Law, Planning, and the Development of the Brazilian Capital Market," *Bulletin,* School of Business Administration, Institute of Finance, New York University, nos. 72–73 (April 1971); Welch, "Capital Markets"; and M. L. T. Werneke Vianna, *A administração do milagre: O Conselho Monetário Nacional, 1964–1974* (Petropolis: Vozes, 1987).

government to compensate (or placate) workers for the loss of job security and had been constitutionally mandated under the *Estado Novo* legislation of the late 1930s but overturned by the economic policymakers of the new military regime. The housing finance system had so much money through the late 1970s that its "agents" were soon allowed to lend to municipal governments for urban infrastructure projects as well.

In December 1964, the banking reform law simultaneously deregulated—by lifting the 12 percent limit on nominal interest rates—and reregulated—by functionally segmenting an array of special-purpose financial institutions—private financial markets. The law forbade financial institutions to own industrial companies and vice versa, annoying some São Paulo bankers with incipient industrial holdings but in fact simply codifying the status quo.[30] Most important, the banking reform law transformed the SUMOC into a National Monetary Council (CMN) and established a partially independent central bank, the Banco Central do Brasil (BACEN). The BACEN's president and directors would be nominated by the nation's president and confirmed by the senate. Although the finance minister would preside over the CMN, he or she could neither dismiss the BACEN president nor force the BACEN to implement specific credit policies. Bulhões and Campos chose the new institution's president and directors and saw them confirmed and installed. However, and significantly, Bulhões and Campos could not get even the cowed legislature to pass a bill entirely removing the independent credit creation attributes of the Banco do Brasil, which the BB argued was absolutely necessary to its mission of supporting the agricultural sector. There were limits to authoritarian control.

Policymakers expected the law on capital markets (July 1965), designed with the decentralized U.K. and U.S. financial markets as implicit models, to stimulate long-term, voluntary financial intermediation from household savers to private business. When, two years later, the markets remained sluggish, Bulhões and Campos offered inducements. The first and longest-lasting inducement was the so-called 157 funds (named after their enabling legislation), which is a scheme allowing partial income tax forgiveness for individuals (initially also for corporations) in exchange for "investment" in private commercial and investment bank-managed mutual funds. Over the next twenty years, Brazil spent in excess of US $13 billion on direct tax incentives alone to try to "educate" the general public about the virtues of investing in the stock market.[31]

[30] The new rules did envision that investment banks would hold minority positions in traded firms pursuant to their roles as underwriters of equity issues. Commercial banks, furthermore, could manage stock mutual funds.

[31] The figure of US $13 billion comes from a public lecture to potential foreign investors

Given this rich source of public funds, the capital markets institutions by the late 1960s had organized to lobby for the continuation of these extraordinary incentives. The 157 funds continued into the early 1980s, although the original plan had envisioned a duration of about three years. Their long life provides a classic example of how state elites created a private interest group that later blocked removal of its privileges.

The new government also took steps to meet the immediate credit needs of industry, which was hurting because of the government-induced recession. Campos and Bulhões informed the staff of the BNDES that the days of big steel were over; henceforth, the BNDES was to support private industry. The Treasury received orders not to release legally earmarked funds to the BNDES until its senior staff fell into line.[32] Castello Branco's economic team also responded to demands of specific industrial sectors, as long as these demands fell within the framework of the overall development goals. For example, capital goods producers had complained that the special incentives to import capital goods in the mid- and late 1950s discriminated against them. The now-unified exchange rate removed some of the implicit subsidy for machinery imports. In addition, the economic ministers created a special credit line, known as FINAME, within the BNDES especially to support the capital goods industry.[33]

In 1967, BACEN Resolution 63 responded to small business complaints that big firms, usually multinationals, could now borrow abroad, whereas small firms lacked that option. Through Resolution 63, Brazilian banks could borrow in international markets, on-loaning the funds to creditworthy firms that were too small or too new to be able to contract foreign loans directly. Resolution 63 on-lending was a sweet deal for private commercial banks, which earned a secure commission and passed on the exchange risk to the ultimate borrower. The bulk of the foreign borrowing in the 1970s came in under the auspices of either Law 4131 or Resolution 63.[34]

The next two generals that became president were both political hardliners who identified national security with strong industrial growth. Antônio Delfim Netto, the first agriculture but soon finance

by Securities and Exchange Commission (CVM) President Ary Oswaldo Mattos Filho, Boston, October 1991.

[32] See R. F. S. Pinto, *The Political Ecology of the Brazilian National Bank for Development* (Washington, D.C.: Organization of American States, 1969).

[33] On the BNDES, see Willis, "Politicized Bureaucracy."

[34] On the political economy of Brazilian borrowing, see Mônica Baer, *A internacionalização financeira no Brasil* (Petropolis: Vozes, 1986); P. Davidoff Cruz, "Notas sobre o endividamento externo brasileiro no anos setenta," in Belluzzo and Coutinho, *Desenvolvimento capitalista no Brasil;* and Frieden, *Debt, Development, and Democracy.*

minister under Presidents Arthúr da Costa e Silva (1967) and Emílio Garrastazá Médici (1968–1974), who had strong ties to São Paulo industrialists, never pretended to be a liberal.[35] Delfim saw his brief as delivery of prosperity to urban Brazil and gambled that his constituencies would resent neither politically authoritarian nor economically interventionist methods so long as the economy grew. One of his first acts as new economic superminister was to do away with the independence of the newly born central bank by forcing its president and directors to resign.[36] He expanded credit and recontrolled interest rates, as well as some prices. On the whole, the São Paulo industrial and commercial bourgeoisie loved him. He made the ministers of agriculture, industry, and commerce full members of the CMN and turned the meetings into broad economic summits. The CMN performed the dual functions of setting the extensive permutations of monetary and credit policy, on the one hand, and of interest aggregation for the business community, on the other. It became known that complaints and suggestions about the terms and availability of credit, price controls, or other sector-specific economic parameters were to be brought to the attention of the appropriate minister or subminister, who would then represent the interests of that sector before Delfim and the CMN. Nonetheless, as was traditional in Brazil, policy initiative remained firmly with the federal executive.

During Brazil's "economic miracle" (1968–1973), policymakers gave particular stimulus to the consumer durables sector, namely, the producers of air conditioners, washing machines, and, of course, automobiles. Credit expansion to the urban middle class through CMN directives to consumer finance companies played a key role.[37] Through the manipulation of financial regulations, the regime extended benefits to industrialists and the politically crucial middle class while achieving the developmentalist imperative of rapid industrial growth, which was concentrated in sectors selected by government experts. Other financial policies partly mollified agricultural export interests and less-developed regions of the country, which correctly perceived themselves to be net losers from government economic policies that favored the already industrialized southeastern states. For example, the "crawling peg" form of frequent mini-devaluations instituted in 1968 pleased the agricultural export sector by implying a central government commitment to avoid the chronically overvalued exchange rates of the 1950s. The BB continued to extend agricultural credit at well below market rates.

[35] This statement is strictly true only with respect to his views on the necessity for a national industrial policy. His earlier academic work had criticized excessive state interference in the growing and marketing of coffee.

[36] See Assis, *A chave do tesouro;* and Vianna, *A administração do milagre.*

[37] See Tavares, "O sistema financeiro."

Delfim apparently tried for the first year or two in office to go along with those aspects of Bulhões and Campos's mostly liberal financial reforms that did not particularly inconvenience him. But by the late 1960s, Delfim lost patience with the model based on the decentralized, and functionally segmented, private credit and capital markets of the United States, as the hoped-for surge in long-term credit and equity investments from private banks had not materialized. Investment banks proved unwilling to loan for more than six months; in 1971 a speculative boom and crash in the stock market justifiably scared off most individual investors. The new model championed by Delfim was that of integrated, multipurpose private banks. The CMN modified tax and other incentives to encourage formation of de facto financial conglomerates, usually but not always headed by commercial banks and uniting under one roof all the financial services a commercial or industrial firm might need.[38] Brazil's biggest banks delighted in being free of restrictive legislation. Delfim also altered tax incentives to encourage direct foreign borrowing by firms (Law 4131) and banks (Resolution 63). The BNDES expanded its operations into equity as well as long-term loan finance, thus completing its move into the functions private banks had declined to fill.

The 1973–1974 rise in international petroleum prices coincided with the installation of the next military president, Ernesto Geisel (1974–1979). The two ideological currents each had representation within his government. Finance Minister Mario Henrique Simonsen was closer to the liberals, whereas Planning Minister J.P. dos Reis Velloso (who had worked for three years with Delfim Netto) and President Geisel himself clearly were developmentalists. Whatever their individual preferences, the political pressures on policymakers pushed them toward greater state intervention. Inflation and external disequilibria were up, but Geisel was determined to avoid painful domestic economic adjustment.[39] Societal support for continued authoritarian rule had begun to soften. Superior economic performance was the military's only marketable justification for the prolongation of its "temporary" stewardship. Geisel continued the pattern of manipulating financial regulation to maintain high industrial investment. In 1974, policymakers transferred to

[38] See Wendy Joan Barker, "Banks and Industry in Contemporary Brazil: Their Organization, Relationship, and Leader," Ph.D. diss., Yale University, 1990; H. M. Makler, "Financial Conglomerates in Brazil: The Case of the Sorcerer's Apprentice?" Paper presented at a workshop on The Impact of the Current Economic Crisis on the Social and Political Structure of NICs, Sao Paulo, February 1985; and Minella, *Banqueiros*. A typical conglomerate united a commercial bank, an investment bank, a stock dealership or brokerage firm, and a consumer finance company, and, toward the latter 1970s, innovations such as leasing or cash management firms.

[39] See Albert Fishlow, "A Tale of Two Presidents: The Political Economy of Crisis Management," in *Democratizing Brazil: Problems of Transition and Consolidation*, ed. Alfred Stepan (New York: Oxford University Press, 1989).

BNDES management two social security/pension funds (PIS and PA SEP) created by Congress in the early 1970s, thus approximately doubling the bank's loanable resources from in-country sources. After the mid-1970s, as Brazilian inflation made many private firms wary of contracting liabilities denominated in foreign exchange, economic planners altered detailed financial and accounting rules to push SOEs, including the BNDES, to increase their foreign borrowing, often in excess of the SOEs' own import needs.[40]

As a whole, the years between 1964 and 1980 were boom years for private industry, especially heavy industry. Between 1975 and 1977, BNDES loan approvals briefly reached the astonishing level of 4 percent of GDP.[41] Besides facilitating easy access to inexpensive BNDES credit and foreign loans, the state helped private business via extensive fiscal incentives and by promoting huge public sector infrastructure projects such as the Itaipú Dam, the world's largest hydroelectric plant. Infrastructure projects procured their inputs from, and often supplied below-cost outputs to, private industry. The construction and heavy engineering industries were especially blessed. The efforts of economic policymakers contributed to GDP growth of 7 percent from 1965 to 1969, 13 percent from 1970 to 1974, and over 6 percent in the more difficult post-oil crisis years from 1975 to 1979. Industry's share in GDP was 32 percent in 1960 and 38 percent in 1980.[42]

One might have assumed that private bankers would resent an industrial policy that, along with high growth, brought escalating inflation (up from 19 percent in 1970 to 77 percent in 1979), international debt (increasing from \$5 to \$56 billion), and domestic public debt (rising from 1 percent to almost 7 percent of GDP in these years).[43] In addition, virtually every month saw new BACEN regulations that altered taxation on banks' earnings from different assets, modifying maximum and minimum allowable time periods and interest rates for credit to specific uses and mandating direct quantitative targets for credit to be extended to different types of borrowers. The World Bank estimated that, as of December 1978, 34 percent of existing loans to the private sector were

[40] During Geisel's presidency, the foreign debt went from around US \$18 billion, mostly owed by the private sector, in 1974 to around \$ 56 billion, overwhelmingly the responsibility of the state, in 1979.

[41] See BNDES, *25 anos*, p. 14; and Lees et al., *Banking and Financial Deepening*, pp. 38-39.

[42] Figures are from CNBV, *Introdução;* and Fundação Instituto Brasileiro de Geografia e Estatística (IBGE), *Estatísticas históricas do Brasil: Series economicas, demograficas, e sociais de 1550 a 1985* (Rio de Janeiro: IBGE, 1987).

[43] For economic growth, see CNBV, *Introdução;* for inflation, see Lees et al., *Banking and Financial Deepening*, pp. 38–39; for foreign debt, see Baer, *Internacionalização financeiro*, pp. 67–71; and for public debt, see D. D. Carneiro Netto, "Passivo do governo e déficit público no período 1970/84," in *Déficit público brasileiro: Política econômica e ajuste estrutural*, ed. Ernesto Lozardo (Rio de Janeiro: Paz e Terra, 1986).

"highly subsidized," and only 21 percent of total loans to the private sector had been extended at free-market rates.[44] In the 1970s, 15–20 percent of the liabilities of private banks represented credits from federal public banks that were targeted for on-lending to purchasers of capital goods, small and medium-sized enterprises, farmers, residential construction, and so on. An additional 15–20 percent of liabilities of both commercial and investment banks were Resolution 63 monies borrowed abroad, the rules for which the BACEN actively manipulated.[45]

Yet Brazil's pro-industrialization policies did not imply marginalization of bankers. Although bankers professed chagrin at the failure of the project to create an independent central bank, many financial sector players soon accommodated themselves to the new order. As liberal views of financial regulation in practice lost out to interventionist ones, bankers also received concrete benefits. Policymakers constructed national financial regulations so that, in return for banks' compliance with the state's extensive programs of targeted credit, private banks received ample benefits. Several unquestioned fundamental principles of the regulatory environment protected profits. The de facto permission to form financial conglomerates meant that integrated financial businesses could protect themselves from the sudden shifts in operating costs of component units provoked by rapidly changing regulation. Rules limited bank competion by forbidding interest-bearing demand deposit accounts. Francis A. Lees, J.M. Botts, and R.P Cysne estimate the resultant inflationary transfers to commercial banks as 1.3 percent of GDP in 1970 and 2.3 percent in 1979.[46]

Retail banking was closed to most new foreign entrants, and existing foreign banks could not open additional branches. Domestic entry to the sector was also restricted; yet existing holders of licenses to operate financial institutions were free to sell their rights to the highest bidder, whose fitness to open a bank BACEN vetted only superficially. The BACEN also continued to facilitate financial concentration and conglomeration, ostensibly for prudential reasons. In 1955, the top ten banks had almost 34 percent of deposits; by 1980, this figure had almost doubled to 64 percent. Not surprisingly, the overwhelming majority of deposits (by 1980 fully 83 percent) were with banks headquartered in the already-developed southeastern states of São Paulo, Rio de Janeiro, and Minas Gerais.[47]

[44] World Bank, *Brazil: Financial Systems Review* (Washington, D.C., 1984), p. 13.

[45] See World Bank, *Brasil: Análise dos sistemas financeiros* (Rio de Janeiro: Instituto Brasileiro de Mercado de Capitais, 1985), pp. 57, 162.

[46] Lees et al., *Banking and Financial Deepening,* pp. 38–39.

[47] Figures are from Minella, *Banqueiros,* pp. 138, 158; and M. J. F. Gonzalez et al., *O Brasil e o Banco Mundial: Um diagnóstico das relações econômicas, 1949–1989* (Rio de Janeiro: IPEA, 1990), p. 147.

Another potentially sensitive issue was the market share reserved for private versus public financial institutions. Although no private banks were nationalized, the relative size of most public banks, except the Banco do Brasil, expanded. Deposits at private banks were 116 percent of resources captured by public banks in 1968, but only 55 percent in 1978.[48] Consequently, policymakers designed financial regulations to ameliorate the pressure felt by private banks, effectively reserving for them the most lucrative and visible sectors of loan markets. As a result, the share of private financial institutions as final lenders in total loans to the nonfinancial private sector almost doubled, rising from 21 percent in 1964 to 37.5 percent in 1980.[49] Public sector banks, except the BNDES, absorbed most of the pressure to loan to increasingly hard-pressed SOEs and government agencies.

Finally, the state assumed many of the risks of rapid innovation in financial markets. At first, Geisel's liberal new finance minister, Simonsen, had felt that what the private financial sector needed was a dose of healthy competition; he opposed too cosy a relationship between private banks and the state. Accordingly, in early 1974, Simonsen announced that banks that found themselves in financial difficulties could not expect the state to bail them out. In late 1974, however, the failure of one big private bank, the Banco Halles, produced such a shudder in financial markets that the BACEN rushed in to prevent a widespread panic. After the Halles episode, the central authorities treated private financial institutions, particularly large banks based in São Paulo and Rio de Janeiro, generously.[50] Once again, essentially liberal impulses in financial regulation had been undermined. Moreover, there were significant lacunae in the corpus of financial law, such that many notorious cases of gross managerial irresponsibility or outright fraud by high-flying financiers went virtually unpunished. One of the more famous of such legislative "oversights" was the rule directing that, when a financial institution went into receivership and had its operations taken over by the BACEN, the private banks' assets would receive full inflation indexing while its liabilities continued to be recorded in nominal terms. If expensive lawyers succeeded in prolonging final settlement of the case over several years during which there occurred 30–40 percent inflation, the ultimate result would be that the BACEN owed the

[48] If obligatory savings schemes for certain classes of wage earners are excluded from the definition of "deposits," then private bank deposits were 120 percent of public bank deposits in 1968, dipping to 106 percent a decade later. Figures computed from World Bank, *Brasil: Análise dos sistemas financeiros,* p. 56.

[49] See Welch, "Capital Markets," pp. 194–96.

[50] Assis, *A chave do Tesouro,* includes a chapter on the Banco Halles episode. See also the testimony of expert witnesses before the various congressional inquiry committees set up after 1986 to investigate possible financial reforms.

erstwhile bankrupt owners money! This (economically, if not politically) perverse law remained in force until 1986.

In sum, large private industry and big banks both gained from the style of financial management of Brazil's military rulers, implicitly exchanging political support for broadly favorable policies, although private actors controlled neither the inter- nor intrasectoral decisions about who received financing. Agricultural interests, still the country's primary earners of foreign exchange, were also part of the regime support coalition, although located on its outer fringes. Credit for agriculture was massive in quantity and very highly subsidized, being offered, for example, at a nominal annual rate of less than 10 percent in the mid-1970s, when inflation was above 30 percent. The almost "free" credit expansion facilities still retained by the BB in its capacity as rump monetary authority underwrote agricultural lending.

And what of Brazil's capital markets, the object of so much hopeful attention in the mid-1960s? The annual value of stocks traded was a respectable 2.48 percent of gross domestic product in the bullish year of 1975 and 1.26 percent in the bear market of 1979. On the other hand, stock market activity concentrated in only a few issues. For example, in 1978, 68 percent of all stock trades involved only the top ten shares.[51] By the early 1970s, the elaborate edifice of capital markets institutions and incentives created under President Castello Branco had evolved into performing four main functions. Brazilian capital markets funded and traded federal government securities; preferential (nonvoting) shares of large state-owned enterprises such as Pétrobras, the mining conglomerate Rio Doce Valley Company CVRD, and the BB itself; shares of multinational affiliates such as Sharp; and only lastly the mostly preferential shares of profitable, but usually closely held, Brazilian-owned private firms. The liberal goals of stimulating large increases in voluntary private savings, intermediated through a decentralized market in private company equities and debt securities, clearly had not been realized.

Overall, there were more similarities than differences between the political context of financial regulation under the postwar limited democratic regime of 1945–1964 and the military authoritarian period that followed it, despite quite real differences in the political support bases of the two regimes and significant variations in both economic ideology and personal style among the nation's senior financial policymakers. Similarities extended to policymakers' goals (finance of rapid import-substituting industrialization), instruments (if the private sector has not

[51] Figures from Goldsmith, *Brazil, 1950–1984;* and Lees et al., *Banking and Financial Deepening,* pp. 295, 300.

voluntarily fulfilled a desired function, then create a state incentive or state agency), and decision-making style (centralized and technocratic). Large-scale private industry, large banks, the urban middle class, and, slightly removed, large and medium-sized commercial agriculture figured among the political supporters and economic beneficiaries of both regimes. The organized industrial working class, a junior coalition partner in the semi-elite democratic period but excluded during the years of military rule, was not even a peripheral player in national financial policy-making in either period, partly because of the specialized knowledge required for making demands in this policy arena. Subnational politicians based in the state capitals and important regional cities, with the exception of agricultural export elites, also had little interest in or influence over the design of national banking and credit regulations before the 1964 coup, mainly because Brazilian credit markets were both repressed and regionally segmented. Consequently, suppression of political competition and interregional distributional conflicts during the military period did not greatly alter the center-state dimension of financial policy-making, despite the fact that financial policies clearly widened interregional inequalities. Around 1980, however, the political and economic conditions that had supported centralized, technocratic financial policy-making began to unravel.

III. REDEMOCRATIZATION AND FINANCIAL DECAY, 1979–1991

Redemocratization and macroeconomic disarray combined to undermine the model of financial policy-making that had been in place since the close of World War II.[52] The developmentalist and comparatively insulated model of financial regulation had depended on (1) a large degree of ideological concensus among policymakers and economic elites about the legitimate purposes of central government economic policy-making and (2) the rest of society's willingness to accept the decisions of "experts" in arcane policy arenas such as finance. Although faith in the activist state remained, the second of these preconditions for technocratic policy-making had come under severe strain. The political support coalition backing what Guillermo O'Donnell aptly labeled a "bureaucratic-authoritarian" regime (business elites, multinational investors, most of the urban middle class, and the military officer corps) became disenchanted with the regime's economic per-

[52] On the political economy of the early 1980s, see L. C. Bresser Pereira, "Six Interpretations of the Brazilian Social Formation," *Latin American Perspectives* 11 (Winter 1984); and Stepan, *Democratizing Brazil.*

ricultural sectors suffered (although not in silence), the financial sector did well through the 1980s, earning a large inflation bonus from demand deposits and investing funds in high-yielding treasury bonds.

Figueiredo himself was preoccupied with the coming transition to democracy, which he hoped to control and shepherd at the appropriate majestic pace. Figueiredo did not at first expect to be the regime's final military president. Nor did he anticipate that the authoritarian regime's carefully nurtured political party, given every political advantage (from campaign funds to gerrymandered rules) would lose embarrassingly in urban centers around the country in the November 1982 elections for state governors, mayors and city council members, and federal and state legislatures, the first free elections for many of these offices in over a decade. Financial policy-making was not his priority.

Under Figueiredo, government management of public banks became politicized in more visible ways. The president tried to use the intensely, even self-righteously, technocratic BNDES as a source of patronage and consequently demoralized many of the staff.[57] As the 1982 gubernatorial and mayoral campaigns opened up state and municipal politics, center-state financial and fiscal relations became more contentious. Almost every state had a state-level commercial bank and sometimes a development bank. Through most of the 1970s, these banks had been comparatively insulated from local political pressures. With the resumption of regional political competition, however, few politicians in control of governorships had been able to resist leaning on state banks for loans to pet "development projects": these resources often ended up funding campaigns. Concomitantly, the Figueiredo administration made no attempt to disguise its policy of slowing down legally mandated fiscal transfers from the center to the states in which opposition politicians had won the elections.

José Sarney (1985–1990), the first civilian president since João Goulart, came to office through the unexpected death of president elect Tancredo Neves, the skillful consensus builder who had led the victorious opposition coalition during the transition to democratic rule. Sarney lacked legitimacy both with the conservative supporters of military rule, whom he had recently deserted, and with the prodemocracy agitators, for whom he was an uncommitted Johnny-come-lately. A major feature of his political and economic agenda included redistributing government largesse to the poor northeastern region of the country and, coincidentally, the president's own political base. His first economic team included as finance minister economic liberal, Francisco Dornelles, who had links to the Rio de Janeiro financial community,

[57] See Willis, "Politicized Bureaucracy."

and a moderate structuralist, João Sayad, who was close to the São Paulo academic and industrialist communities. Dornelles wanted to stabilize the economy via tight monetary and fiscal policies; Sayad worried over maintaining industrial growth and employment. They proceeded to fight very publicly over macroeconomic policy, until first Dornelles, then Sayad, resigned. The next three finance ministers each introduced at least one drastic economic stabilization plan (involving external devaluation, a wage-price freeze, and promises to cut the public sector deficit). None of the plans held.

Sarney's government, like Figueiredo's, raised the price of agricultural loans, which had been heavily subsidized in the early 1980s. This policy raised howls from the rural areas and the Banco do Brasil. The successful efforts to increase the price of credit to agricultural borrowers contributed to loan defaults. By October 1991, the BB had a nonperforming loan portfolio of US $636 million.[58] Banco do Brasil executives and the BB "bloc" in Congress began to publicize the interpretation that the cutbacks in agricultural credit, along with the attacks on the BB's continued special privilege of expanding credit through the "movement account" (in essense, unlimited overdraft privileges with the Banco Central do Brasil, billed at negative real interest), represented a conscious plot to destroy the BB, the champion of nationalist (as opposed to foreign) financial interests. Plotters sometimes included the World Bank (which had heavily criticized the monetary role of the BB in a study published in 1985), the BACEN, U.S. bankers who wanted increased access to Brazilian markets, and the São Paulo financial community. In fact, although the BB's language was not modulated, there was some truth to each of these allegations. In February 1986, the BB lost the movement account, although its president, Camílio Calazens, was able to negotiate for the BB the right to become a financial conglomerate, thus enabling it to continue competing with private sector banking giants such as Bradesco, Itaú, or Citibank do Brasil.

Congress, moreover, had become a new locus for policy-making, including financial regulation. Legislators passed a "white-collar crime" law aimed particularly at those who profited from various sophisticated financial frauds. A specially elected legislature produced a new national constitution in late 1988. When lawmakers reinstated a clause prohibiting interest charges of more than 12 percent (real) interest a year, the new constitution appeared to signal a return to the early 1930s' model of financial regulation, which had repressed financial markets before the reforms of the mid-1960s. As with many of the other clauses in the constitution, however, this change would not go into effect until

[58] *Brazil Watch,* October 21–November 4, 1991, pp. 10–11.

many sour assets owing to borrowers who had fallen on hard times. The National Housing Bank (BNH) went bankrupt and in 1986 was merged with the only slightly healthier Federal Savings Bank (CEF). The heavy dependence of both private and public commercial banks on their earnings from inflation raised a policy dilemma: all commercial banks had a vested interest, at least in the short to medium term, in perpetuating inflation, despite its ravages on the rest of the economy.

In November 1989, Fernando Collor de Mello became Brazil's first elected president since 1961. As Figueiredo and Sarney had been, Collor was besieged by economic crises and political demands. His government's ability to formulate and carry through necessary short-term stabilization (which required the sharing out of costs among groups in society), not to mention longer-term reform of the financial system, was seriously in doubt. In early 1991, Collor's economic team, headed by Economy Minister Zélia Cardoso, instituted the most stringent stabilization program since the Campos-Bulhões policies of the mid-1960s. The heterodox Collor Plan came complete with the populist rhetoric of stabilizing the economy on the backs of the wealthy rather than on those of the traditional losers from Brazilian recessions, the poor. It froze three-quarters of all financial assets in the banking system for eighteen months, simultaneously angering both banks and depositors, including businesses and most of the middle class. A draconian monetary policy announced later in the year slashed credit, completing the alienation of the business community.

In 1989, the World Bank offered to make Brazil a $500 million loan, to be funneled through the BNDES, for the purpose of financial restructuring, including, it was rumored, compensating the BB to some degree for the loss of the "movement account" and perhaps assisting the central government in salvaging the commercial and development banks of the individual state governments. For political as well as prudential reasons, the BACEN had had to rescue these banks. The total debt of the state and municipal governments to the central government was estimated as of August 1991 to be $57 billion.[61] As of late 1991, the World Bank was holding its promised loan in abeyance until Brazil complied with certain conditions, presumably including guarantees about monetary restraint, limits to Banco Central bailouts, and perhaps also domestic market access for multinational banks.[62] What World

[61] "Estados que mais devem são os do Sudeste," *Jornal do Brasil,* September 3, 1991, p. 1. The three wealthy southeast states owed 53 percent of the total.

[62] The latter point has been a demand of the United States, in particular vis-à-vis semi-industrial developing countries such as South Korea, Brazil, and India, in the General Agreement on Trade in Services being negotiated within the Uruguay Round of the General Agreement on Tariffs and Trade in the late 1980s and early 1990s.

Bank negotiators might not have recognized was that the power to make national economic policy almost exclusively in the presidential palace was now gone: both the Congress and governors and state-level legislators of powerful states such as São Paulo could veto policies if they were excluded from participation in the decision-making process.

As of late 1991, some twenty-three proposals to regulate the financial reform provisions of the constitution were working their way through the national legislature, ranging from those that would immediately implement the 12 percent interest rate cap mandated by the 1988 constitution to others, backed by much of the professional economics community and virtually all bankers, that would honor the 12 percent limit by defining it so broadly that it would have no teeth.[63] There also were several proposals favoring establishment of a "truly independent" Central, Bank which variously was defined to mean an institution like the U.S. Federal Reserve, or one "independent" of the executive branch but under the supervision of Congress, a proposal that was put forward by the Banco do Brasil bloc.[64] Meanwhile, the business community as well as many professional economists worried over the fall in industrial investment and the lack of strategies within the government to cope with this.

Interestingly, despite the pressures of trying to manage the foreign debt, negotiate a pact with Congress to restore to the federal government some portion of the tax receipts distributed to the states and municipalities in the 1988 constitution, liberalize trade, and impose stabilization, the Collor government by the end of 1991 had instituted at least two potentially significant financial reforms. The more publicized was the program to end some of the state's direct responsibility for industrial investment through the sale of some big state-owned enterprises. Since early 1990, the major push within the BNDES had been the privatization program: fully three-hundred of fifteen-hundred employees were assigned full-time to this project. The other initiative was a new attempt to stimulate capital markets, this time focused on legislative and procedural changes needed to increase foreign portfolio investments. But in a move that was seen by supporters as an essential reform but by resolute economic liberalizers as caving into political pressures, Collor reversed in mid-1991 the policies of squeezing agricultural credit, which had been progressively introduced after 1980 under external pressure to cut budget deficits. Despite these initiatives, by the early 1990s virtually all Brazilians were highly dissat-

[63] As an example of the latter, see the proposal by Francisco Dornelles, the economically liberal federal deputy and former finance minister.

[64] See the proposal of Federal Deputy Odacir Klein, who represented the important agricultural state of Rio Grande do Sul.

isfied with both the form and the content of national financial regulation.

In the forty years following 1950, Brazil developed a modern, diversified national financial system. Loans to the private nonfinancial sector as a share of GDP rose from only 13 percent in 1964 to 51 percent a decade later, remaining near that level through the 1980s.[65] State-owned banks steadily expanded until 1980. At the same time, private Brazilian banks played an important role in financial intermediation, prospering despite the fact that substantial portions of their credit allocation were ruled by government directives. The regulatory regime limited the access of foreign private banks to a few long-established (and highly profitable) branches for commercial banks and minority positions in joint ventures in market segments other than commercial banking. In contrast to the experience of countries such as the Philippines, widespread accusations of blatant clientelism, corruption, or explicit political bias in the granting of specific loans had not been made against most Brazilian regulators or banks.[66]

The broad pattern of Brazilian financial regulation was of state, rather than free-market, direction of national and international financial resources. Sylvia Maxfield has argued that Brazil's historically loose monetary management and web of targeted credits reflects the power of an "industrialists' alliance" in Brazil, which she contrasts to the tighter money and limited credit and capital controls in a country such as Mexico, where a "bankers' alliance" captured policy-making.[67] This essay offers an alternative explanation, containing both a structural and an ideological component.

At the objective level of control over power resources, it was not so much industrialists, as individuals or as a group, that were strong in Brazil in relationship to bankers as it was the state itself that enjoyed considerable freedom of economic policy initiative vis-à-vis all private

[65] See Welch, "Capital Markets"; and *Conjuntura Econômica,* various issues.

[66] This statement, of course, is comparative. Assis, *A chave do tesouro,* describes numerous famous financial scandals. The lessons of over half of the cases, however, turn on techniques employed by sharp operators to exploit legal loopholes. That is, much of the volume is a plea for better prudential regulation rather than an exposé of corruption per se. A good comparative test case might be the lending practices of the Banco do Brasil. For many decades, it has been a heavily politically involved institution. But the BB is also renowned for its technocratic institutional culture. Entry to its ranks is by competitive examination. Its loan procedures are generally considered fair. At the operational level, it not only is seldom accused of corruption but also is often judged (particularly by individual, as opposed to corporate, clients) to compare favorably in efficient customer service with the large private banks.

[67] See Sylvia Maxfield, "Bankers' Alliances and Economic Policy Patterns: Evidence from Mexico and Brazil," *Comparative Political Studies* 23 (January 1991): 419–58.

interests—so long as the economy as a whole grew rapidly enough to ensure substantial benefits for all elite groups. Executive branch domination of financial regulation and credit allocation continued unbroken despite the shift from semi-elite democracy to military authoritarianism following the 1964 coup. Most of the major financial policy innovations came from economists and other technical specialists within the central government bureaucracy. New initiatives usually were not a result of close consultation with leading industrial or financial elites (as often was the case in Japan or South Korea). Technocratically designed initiatives, of course, could only be adopted because Brazil's institutionally powerful chief executives—at least until about 1980–on the whole were both willing and able to provide their chosen experts with the necessary resources and political support.

Three structural factors facilitated the relative maneuverability of the central government vis-à-vis both private lenders and borrowers. First, for reasons of both geography and international alliances, Brazil had more or less continuous access to external financing from the end of World War II through the early 1980s, except immediately prior to the 1964 coup. Successive presidential administrations tried to retain discretionary control over flows of direct investment and loan financing, both in order to achieve their visions of economic prosperity and as a political resource with which to reward or punish domestic elites.[68]

Second, integrated financial-industrial-commercial groups were much less prevalent in Brazil than elsewhere in Latin America.[69] Thus, both financial and industrial capital depended on the state more than would have been the case otherwise. Banks needed government support for the kinds of financial regulation they wanted (i.e., for provision of a lender of last resort, enforcement of financial contracts, and protection against "ruinous competition" from multinational banks), whereas

[68] See Frieden, *Debt, Development, and Democracy*.

[69] For more on economic groups in Latin America, see Nathaniel H. Leff, "Industrial Organization and Entrepreneurship in the Developing Countries: The Economic Group," *Economic Development and Cultural Change* 26 (July 1978); Nathaniel H. Leff, "Entrepreneurship and Economic Development: The Problem Revisited," *Journal of Economic Literature* 17 (March 1979); and Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics* (Ithaca: Cornell University Press, 1990).

On Brazil's historically comparatively low financial-industrial integration, see Barker, "Banks and Industry"; Carlos Halsenbalg and Clovis Brigagão, "Formação do Empresario Financeiro no Brasil," *Dados*, no. 8 (1971); and M. V. de Queiroz, "Os grupos econômicos no Brasil," *Revista do Instituto de Ciências Sociais* 1, no. 2 (1962). Reasons may include the origins of many private banks in financing agricultural exports and the historic importance of public sector commercial banks, especially the BB, Banespa (the bank of São Paulo state) and the several banks of the Minas Gerais government. Recently, this historic division has been fading. In the 1980s, financial conglomerates such as Itaú, the country's second-largest private banking group, began to diversify into related industrial ventures; a few industrial firms have fielded financial affiliates.

industrialists sought reliable access to affordable credit. Each group was sometimes satisfied, sometimes not. Under Vargas, Kubitschek, Médici, and Geisel, financial policies probably pleased industrialists more than bankers: the reverse was true under Castello Branco, Figueiredo, and Sarney.

Third, bureaucratic institutions and traditions continued from previous regimes and administrations. Brazil's state apparatus as early as the nineteenth century was, in comparative terms, economically interventionist; successive presidents and their ministers inherited both legislative respect for their freedom of action and a minimally competent bureaucracy to command. Vargas had promoted civil service reform in the late 1930s, seeking responsive bureaucracies, even while acknowledging the political value to himself and his political machine of the time-honored practice of packing the post office or the public works ministry with friends and supporters. By the mid-1950s, both the BB and the BNDES had entry by competitive examination and were relative paragons of efficiency.

There were, of course, limits to financial policymakers' comparative insulation from big business. Successive central governments proved sufficiently independent to choose their preferred new priorities for targeted credit. Yet each administration also needed cooperation from private business. Therefore, presidents lacked the power to move simultaneously against the short-term interests of all the business community—except at very high levels of macroeconomic crisis, such as in early 1991, when President Collor declared a stabilization plan that initially hit banks and large depositors very hard. In addition, various presidents, but especially Kubitschek and Médici (under the influence of Minister Delfim Netto), created ongoing formal and informal arrangements to extend to the business community symbolic participation in the big decisions of economic and financial policy-making and to receive their suggestions for incremental modifications. Another measure of the circumscribed arena for state initiative was the fact that the federal executive often lacked the strength to wind up previous administrations' financial incentives, which led over time to the proliferation of costly subsidies.[70] The financial regime thus contributed to recurrent problems of macroeconomic management.

[70] For example, in the 1970s the total value of agricultural credit averaged over 61 percent of agriculture's contribution to GDP. This level of assistance is clearly unsustainable, particularly given the extremely high subsidy component of most farm loans. The mean for 1980–1987 dropped only to 44 percent, despite the political flak both Figueiredo and Sarney took for their "attacks" on rural credits. See Gonzalez et al., *Brasil e o Banco Mundial,* pp. 125–26. Similar stories can be told about credit and other incentives to the construction industry, producers of manufactured exports, and heavy machinery, not to speak of the advantages offered to private banks by the financial regulatory regime.

If policymakers were not usually implementing long-term plans generated in consultation with private entrepreneurs, then where did the impetus for rapid innovation in financial regulation originate? Elite economic ideologies, often from abroad, were crucial in suggesting both broad goals and specific reforms to policymakers. One strand of influence was economically liberal, decentralized credit and capital market designs promoted by missions of financial experts representing institutions such as the Bank of England (particularly before World War II), the U.S. Federal Reserve Bank, the Organization of American States, the International Monetary Fund, and the World Bank. The package of financial reforms in 1964–1965 clearly reflected Anglo-American regulatory frameworks. Furthermore, whenever possible, aspiring young Brazilian economists trained at U.S. universities, which increased their job prospects at home as well as the international transmission of neoclassical economic ideology. The other ideological current was Latin American structuralism. From the 1950s through the Chilean military coup in 1973, Brazilian economists swarmed to Santiago to participate in the great debates on the future of the hemisphere sponsored by CEPAL. Brazilian industrialists, together with academia and most politicians, enthusiastically endorsed the structuralist recommendations for industrial and agricultural development banks, external trade and capital controls, and targeted finance to promote growth and national self-sufficiency. By the 1980s, Brazil's BNDES had been a center for both theoretical and empirical research in structuralist economics for decades.

Virtually all urban Brazilian elites embraced some form of structuralism and favored an activist state supportive of rapid industrial growth. Most were relatively unconcerned over the rate of money supply growth or government debt, were willing to accept efficiency losses associated with a proliferation of credit and tax incentives, and considered an annual inflation rate of 20 percent to be benign. In Brazil, as elsewhere, private bankers embraced liberal financial designs more warmly than did industrialists, who were more likely to see a need for state economic intervention on their behalf. Nonetheless, Brazilian bankers were significantly more "developmentalist" than their counterparts abroad, partly because they were not immune to dominant national economic ideologies and partly because technocrats designed the overall financial regulatory regime in such a way that both private industry and private banks flourished. Perhaps because of the conservative political cast of most postwar administrations, however, promarket rhetoric abounded, both within the government and among economic elites, except on the issue of free entry for foreign goods or foreign banks.

A qualitative change occurred around 1980. In the 1980s, although the regulatory framework of a state-led financial model remained in position, successive finance ministers under Presidents Figueiredo, Sarney, and Collor discovered that their centralized authority to allocate financial resources had seriously eroded. A majority of nationally relevant political actors were no longer prepared to accept insulated, technocratic financial policy-making by senior appointees of Brazil's president. Quite apart from the merits or demerits of the particular economic policy packages chosen, an underlying political determinant to the failures of financial regulation existed during these years. For three decades, central government decision-makers had agreed on the overriding importance of industrial growth; private business elites, foreign business interests, and sometimes military officers offered policy modifications at the margin. The transition to democracy through the 1980s undermined the legitimacy of governments performing as the "executive committee" of business interests largely based in southeastern Brazil. From the viewpoint of many business leaders, government ministers suddenly seemed to have become "unreasonable," unwilling or unable to continue to ensure the benefits to major economic interests that had encouraged the latter to acquiesce in central government economic leadership. As of the end of 1991, no new, moderately stable pattern of national interest aggregation had evolved; therefore, the political concensus necessary to once again take national financial policy-making in hand did not exist. The latter 1980s and early 1990s saw a number of awkward attempts to replace the old pattern of informal access for business leaders to senior policymakers with centrally convened "social pacts" among businesspersons, labor unions, and the central government, after the West European-Scandinavian pattern of democratic corporatism. This process probably cannot succeed in Brazil, because it still excludes too many of the newly obstreperous interests that need to be aggregated through the political system.

What does the new political reality of national financial policy-making imply for the future? One option is for policymakers to give up on state-led development, privatize or scale down most public sector banks, end BACEN balance sheet regulation of financial institutions for any but prudential purposes, and let the market allocate financial resources as it will. As of mid-1991, this option continued to be relatively unpopular, at least in an extreme form. Most Brazilian opinion-makers, despite desiring to end waste and inefficiency within the state, remained broadly developmentalist, certainly by comparison with their contemporaries in Chile or Argentina. Notwithstanding the severe problems of the preceding decade, most elites (including leftist intellectuals, who are untypically in agreement with the business community on this issue) looked back with some fondness on the achievements of the economic model between the end of World War II and the onset of the 1980s. The pattern of national financial regulation, of course, had been a significant component in that model. Construction of a stable new pattern of national financial regulation in Brazil in the 1990s may not precede establishment of a new political concensus over the future division of economic decision-making authority between the national executive and legislature, on the one hand, and the central and state governments, on the other.[71]

[71] The planned 1993 plebiscite on the future form of Brazilian democracy–presidential, parliamentary, or constitutional monarchy–epitomizes the current uncertainty.