

# **Global Perspectives on Economic Development**

## **GOVERNMENT AND BUSINESS FINANCE**

edited by

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*Business Finance in Brazil,  
the Land of Superinflation*

**INTRODUCTION**

**I**n March 1990, Brazil's then newly inaugurated president, Fernando Collor (1990–92), announced a radical but, by recent Brazilian standards, comparatively orthodox inflation stabilization program. One result was a severe industrial recession. However—and, it might be added, as usual—the program began to unravel within a few months. By early 1991 it was clear that, on the one hand, resourceful private businesses had found ways around government controls that included both price ceilings and a moratorium on withdrawals of up to 75 percent of all the financial assets held in banks. On the other hand, the central government had not kept its promises of deep cuts in public spending. The economy minister was let go. The new economy minister, not an economist but a career diplomat known for his tact and good international contacts, valiantly struggled to put the best face on the situation. Marcílio Marques Moreira announced in early November 1991 that the jump from 15 percent monthly inflation in September to almost 23 percent in October was not the precursor to “hyperinflation” but merely “superinflation,” a vaguely defined but somehow much less worrisome condition.<sup>1</sup> The story's punch line is that many Brazilian elites accepted Marques Moreira's questionable distinction and its implied message of reassurance.

This chapter describes the financial environment confronted by private Brazilian businesses, an environment distorted during the entire post-World War II era by extraordinarily high and variable inflation. The story of the evolution of nearly fifty years of government regulation of the main sources of industrial finance—international investment, domestic capital markets, and domestic credit institutions—has three overarching themes. First, Brazilian presidents and their economic policy teams, from the early 1950s through at least the early 1980s, demonstrated a remarkably single-minded commitment to achieving rapid industrial growth. Second, policymakers consistently subordinated financial regulations to industrial policy goals. Third, already by the late 1960s Brazilian patterns of financial regulation had evolved in such a way as to make increasingly high levels of inflation tolerable to the business community. In other words, as Brazil's macroeconomic situation worsened in the 1980s and early 1990s, the regulatory regime governing financial intermediation had become part of the problem, generating interests and confirming ideas opposed to or ambivalent about necessary economic reforms.

Five sections follow. The first summarizes industrial policies and outcomes from the 1950s through the 1970s, a period when most Brazilians regarded their country's economic policies, except briefly in the early 1960s, as strikingly successful. Section two maps the underlying financial patterns of that "model." Section three shows how the economic policies that appeared to be working so well began to fall apart in the 1980s. The data presented emphasize the drop in financing from all available sources for industrial investment that occurred in the 1980s and 1990s. Section four discusses ways in which the financial sophistication of many large Brazilian and multinational firms enabled these firms to reduce the adverse effect of Brazil's inflationary environment on profits. In other words, the section explains some of the reasons why Brazil's macroeconomic and financial troubles, which loomed so large when considered from the viewpoint of the economy as a whole, seemed not to matter very much from the viewpoint of many large, and politically influential, Brazilian businesses—including both private nationally owned firms and multinational subsidiaries operating in Brazil. The chapter's final section is short—and speculative. In early 1994, Brazil's then finance minister and later president, Fernando Henrique Cardoso, announced a new inflation stabilization plan, the *Plano Real*, to be implemented in gradual, preannounced stages. On July 1, 1996, the new currency, the *real*, completed two years of existence, having maintained rough parity with its foreign exchange anchor, the U.S. dollar, and kept annual inflation at less than 20 percent. Many observers had begun to believe that this might, finally, be the plan that worked. The chapter closes with a brief

consideration of challenges that economic stabilization will have to surmount to be truly successful.

### THREE DECADES OF INDUSTRIAL PROMOTION, 1950–1980

At the close of World War II, President Getúlio Vargas, chief executive since 1930, was forced to resign by his own generals. His replacement made the mistake of following classically “liberal” economic policies—one result of which was to deplete the foreign exchange reserves built up during the war. But the Brazilian public found it did not want a government that passively pursued its comparative advantage as the world’s largest coffee exporter. They admired Vargas, who, along with other “developmentalist” achievements, had gotten the United States to build the first steel mill in Brazil in exchange for allowing the United States to maintain naval and air bases at the closest point in the Western Hemisphere to the European campaign. By the next election, in 1950, Vargas was back in power, easily trouncing his opponent.

The other strong president of the 1950s was Juscelino Kubitschek (1956–1961). Brazilians in the early 1990s continued to remember both men fondly. Like Vargas, Kubitschek believed that one of the central government’s most important tasks was to get the economy moving. His government adopted a five-year plan, set national investment priorities among alternative projects, and attempted to specify how to achieve its various goals (see Leff 1968; Lessa n.d. [ca. 1963]; Shapiro 1988; Sikkink 1991). Primary emphasis was placed on infrastructure (energy and transportation) and “basic industry,” which included intermediate industrial inputs (steel, cement, nonferrous metals, and fertilizers), trucks and automobiles, and heavy electrical machinery. In common with most other Brazilian planning exercises that followed, Kubitschek’s *Plano de Metas* (Target Plan) made little pretense of allocative efficiency. Yet, the Target Plan was quite successful in accomplishing its quantitative targets. For example, in 1950 only 6 percent of the nitrogen fertilizer used in Brazil was produced at home. By 1961, although indigenous consumption had almost quadrupled, Brazilian factories produced 28 percent of domestic needs. In 1951, imports filled more than one-quarter of the country’s cement needs; by 1961, Brazil had achieved self-sufficiency, although cement needs were also up by a factor of four. One goal had specified that by 1960 at least 95 percent of passenger cars would be produced domestically; by that date 89 percent of automobiles sold in Brazil were made at home. The goal had been achieved by a combination of external tariffs and sector-specific investment policies (Lessa n.d. [ca. 1963], 24, 26, 27).

**TABLE 13.1**  
**Brazilian Economic Growth and Inflation, 1950–1994**  
 (percent)

<i>Year</i>	<i>Average Annual Growth, Gross Domestic Product</i>	<i>Average Annual Inflation</i>
1950–1959	7.50	17.35
1960–1969	6.12	44.79
1970–1979	8.84	33.57
1980–1989	2.93	427.70
1990–1994	1.04	1,240.93

*Sources:* 1950–1992 from Baer (1995, 382–283); 1993–1994 from “Survey on Brazil,” *Financial Times* (May 17, 1995).

However, the cost of industrial expansion in the late 1950s, together with the president’s visionary, but expensive, project of moving the national capital from coastal Rio de Janeiro to Brasília in the underpopulated interior, pushed government spending beyond government revenues by a substantial margin. Foreign borrowing and monetary emissions financed the shortfall.<sup>2</sup> By the early 1960s, Brazil was plagued by high inflation, labor unrest, and eventually recession (Table 13.1.) In 1963, economic growth slowed to 1.5 percent while year-end inflation reached a then unprecedented level of 75.4 percent. Left-leaning President João Goulart (1961–63), once a Vargas protégé but without his mentor’s firm political instincts, seemed unable to control the economic crisis. When Goulart threatened an end run around the conservative congressional majority by taking his case directly to the voters at mass rallies in Rio de Janeiro, members of Brazil’s political, economic, and military elites implemented a putsch against him.

Skilled technocrats appointed by the new military president, General Humberto Castello Branco (1964–67), brought down inflation through classic austerity measures (Fishlow 1973; Skidmore 1973). For a year or two, it appeared that the new military rulers might have a different, more market-driven, economic model. Their financial reforms attempted to create a decentralized model of financial intermediation, relying on private capital markets, as was common in the United States and Great Britain. Yet, as long as policymakers were unwilling to relinquish their desire to guide industrial development, they could hardly allow financial resources to be allocated by market signals. Instead, financial and fiscal incentives remained the principal levers of an activist industrial policy.

Castello Branco’s successors, after 1967, stimulated the economy. Policymakers took advantage of substantial excess capacity to generate Brazil’s “economic miracle” of the years 1968 to 1973, during which time

**TABLE 13.2**  
**Sectoral Real Output Growth, 1950–1990**  
 (Year 1949 = 100)

Year	Real Output Growth	Industrial Growth	Agricultural Growth	Transportation and Communications Growth
1950	106	111	101	109
1960	206	261	156	249
1970	369	509	230	463
1980	838	1,245	392	1,609
1990	978	1,293	502	2,861

Sources: Fishlow and Cardoso (1987) and *Conjuntura Econômica*, various issues

gross domestic product (GDP) grew at an average rate of 10.6 percent annually, and industrial product expanded even faster. The economic policies during the long period of military rule, which ended only in 1985, bore a striking resemblance to the expansionary economic and industrial promotion policies of the semi-elite democracy of the 1950s. As in the 1950s, planners' goals were to substitute domestic for imported production across the full range of industrial products. By the 1970s, Brazilian and joint Brazilian–multinational firms, benefiting from substantial credit and fiscal incentives to manufacture capital goods, were able to produce equipment as sophisticated as custom-made turbines for the Itaipú Dam on the Brazil–Paraguay border—planned as the world's largest hydroelectric project (on incentives to capital goods production see Corrêa do Lago et al. 1979; Tyler 1983). Between 1950 and 1980, industry's contribution to GDP increased from 24 to 38 percent (IBGE 1987, 117–120). Changes in the structure of manufacturing output provide a more subtle measure of Brazilian achievements in import substitution. In the same thirty-year period, the share of raw materials and intermediate industrial inputs rose from 21 to 34 percent while that of capital goods went from 5 to 29 percent. Brazilian governments, whether civilian (1945–1964) or military (1964–1985), followed conscious policies of moving from lighter to heavier industry. From 1950 to 1980, Brazil's annual average compound growth rate of 6.8 percent exceeded, in fact, that of any other country in the hemisphere and was close to East Asian growth rates of 8.0 percent (Japan), 7.4 percent (South Korea), and 9.1 percent (Taiwan) (Maddison et al. 1992, 6). Table 13.2 shows that industrial growth far outpaced growth in the agricultural sector. This table also shows that the highly capital-intensive transport and communications sectors grew especially rapidly after 1970.

**TABLE 13.3**  
**Brazil: Balance of Payments Trends**  
 (Negative signs represent debits; % GDP)

<i>Annual Averages</i>	<i>Merchandise Trade Balance</i>	<i>Factor Service Payments (Mainly Interest) (Net)</i>	<i>Current Account Balance</i>	<i>Foreign Direct Investment (Net)</i>	<i>Other Capital Flows (Net)</i>
<b>SERIES #1</b>					
1950-54	0.9	-0.4	-0.9	0.0	-0.1
1955-59	0.9	-0.4	-0.6	0.4	0.2
1960-64	0.3	-0.5	-0.9	0.3	0.2
1965-69	1.1	-0.7	-0.3	0.3	0.6
1970-74	-1.0	-0.8	-3.0	0.6	3.8
<b>SERIES #2</b>					
1965-69	1.3	-1.0	-1.0	0.5	0.6
1970-74	-1.1	-1.3	-3.6	1.2	3.8
1975-79	-1.3	-2.0	-4.2	1.0	3.6
1980-84	1.7	-4.5	-3.8	0.8	0.7
1985-89	4.4	-3.8	-0.2	0.2	-3.6

*Sources:*

- SERIES #1:** Balance of payments data from Fishlow and Cardoso (1987). Gross Domestic Product from Fundação Instituto Brasileiro de Geografia e Estatística, hereafter IBGE (1987).
- SERIES #2:** Balance of payments data from International Monetary Fund, *International Financial Statistics Yearbook 1992* and *Balance of Payments Yearbook 1992*. Gross Domestic Product from World Bank, *World Tables 1980, 1993*.

Planners considered not only local production but also Brazilian ownership of companies an important aim of industrial policy. Although they preferred private firms, successive governments created numerous state firms in areas where Brazilian private capital could or would not go. Heavy public investment in infrastructure, expansion of public utilities, direct state investment in heavy manufacturing, and provision of ample incentives to private Brazilian firms were essential components of the Brazilian "model." Where domestic investors could not be found, decision makers in democratic as well as authoritarian governments called upon foreigners. Policymakers encouraged multinational participation in joint ventures, either with local Brazilian partners or with the state, except in a handful of sectors exclusively reserved for "national capital," among them petroleum exploration and port management. Net foreign direct investment, shown in Table 13.3, which was negligible in the early 1950s, rose to around 0.5 percent of GDP in the late 1960s and averaged around 1.0 percent of GDP through the 1970s.

Overall, the aim of "Brazilianizing" industrial production was not as big a success as the aim of achieving rapid industrial growth. As of 1970,

sectors overwhelmingly dominated by multinational investment included the marketing-driven tobacco industry, as well as others relying on relatively sophisticated technology, such as vehicles and transportation equipment, pharmaceuticals, and rubber products. Although foreign firms also predominated in the electrical machinery, machinery, and chemicals sectors, these industries had significant local capital participation as well. Brazilian firms led in the production of leather products, printing and publishing, and in several other less capital-intensive sectors, as well as in metal fabrication (Evans 1979, 114–115). Government enterprises produced steel and ran mines and public utilities. Of the 5,113 largest nonfinancial enterprises in Brazil in 1974, private Brazilian corporations held 48 percent of total assets, multinationals 15 percent, and state-owned enterprises (SOEs) 37 percent (Bacha and Lamounier 1993, Table 3). Brazilians had to accept “dependent development” with strong links to international financing, technology, and markets (see, *inter alia*, Cardoso and Faletto 1979; Evans 1979). Still, government economic experts (“technocrats”) shaped the sectoral pattern of the country’s growth in lasting ways.

Other possible national economic goals received much less attention and considerably fewer resources than rapid industrial growth. Most importantly, Brazil had persistent and, in the highest growth periods, rising income inequality. In 1960, 10 percent of all Brazilians earned 40 percent of all personal income. This share rose to 48 percent by 1970, where it has remained. The personal income share of the bottom 50 percent of the population was 18 percent in 1960 but only 14 percent in 1980 (Maddison et al. 1992, 82). These figures, particularly when combined with data on regional disparities, made Brazil one of the most unequal societies in the world. Brazil’s rapid, state-led industrialization benefited middle- and upper-income groups more than lower-income groups and benefited urban dwellers in the “modern” regions in the southeast around São Paulo, Rio de Janeiro, and Belo Horizonte more than other Brazilians.<sup>3</sup>

### **FINANCIAL REGULATIONS IN SUPPORT OF INDUSTRIAL GROWTH, 1950–1980**

Brazilian government leaders believed that the purpose of the financial sector was to support industrialization policies.<sup>4</sup> Table 13.4 shows the rough relationship of the main sources of long-term industrial financing. These were gross new foreign loans (column 1), new corporate equity and debenture issues (columns 2 and 3, respectively), and loans from the National Economic and Social Development Bank (or BNDES, shown in column 4), for all practical purposes the only domestic source of long-term industrial credit.



**TABLE 13.4**  
**Brazil: Financing from Abroad, the Capital Markets, and**  
**Domestic Long-Term Credit Compared**  
 (Percent of Gross Domestic Product)

<i>Year</i>	<b>1</b> <i>Gross New Foreign Loans</i>	<b>2</b> <i>New Corporate Issues</i>	<b>3</b> <i>Alternate Series for New Issues</i>	<b>4</b> <i>BNDES New Loan Approvals</i>	<b>5</b> <i>Foreign Direct Investment (Net)</i>
1950	0.18				
1951	0.20				
1952	0.16				
1953	0.18				
1954	0.50				
Mean	0.2				0.0
1955	0.43				
1956	1.08				
1957	1.30				
1958	1.54				
1959	1.92				
Mean	1.2				0.4
1960	1.39			0.5	
1961	2.36			0.6	
1962	1.33			0.4	
1963	0.86			0.4	
1964	0.76			0.4	
Mean	1.3			0.4	0.3
1965	1.31	0.27		0.9	
1966	1.77	0.12		1.0	
1967	1.65	0.16		1.0	
1968	1.64	0.37		1.0	
1969	3.15	0.79		1.0	
Mean	1.9	0.3		1.0	0.4
1970	3.33	0.71		1.5	
1971	4.1 <sup>1</sup>	2.06		1.4	
1972	7.4	1.43		1.6	
1973	4.8	1.26		1.8	
1974	7.8	1.17		3.3	
Mean	5.5	1.2		1.9	0.9
1975	5.7	1.12		4.2/3.6 <sup>1</sup>	
1976	5.3	0.88		4.9/4.2 <sup>1</sup>	
1977	5.4	0.81		1.8	
1978	7.3	0.45	0.23 <sup>1</sup>	4.3	
1979	5.5		0.17	2.2	
Mean	5.8	0.7 <sup>2</sup>		3.4 <sup>2</sup>	1.0
1980	4.9		0.29	2.4	
1981	6.1		0.78	2.9	
1982	5.5	0.80 <sup>1</sup>	0.78	1.7	
1983	4.1	0.47	0.46	1.8	
1984	4.7	0.40	0.39	2.1	
Mean	5.1	0.5 <sup>2</sup>	0.54	2.2	0.8

TABLE 13.4 (continued)

Year	1 <i>Gross New Foreign Loans</i>	2 <i>New Corporate Issues</i>	3 <i>Alternate Series for New Issues</i>	4 <i>BNDES New Loan Approvals</i>	5 <i>Foreign Direct Investment (Net)</i>
1985	1.1	0.31	0.31	1.6	0.4
1986	1.3	0.50	0.48	1.6	
1987	0.8	0.14			
1988	1.8	1.14			
1989	0.7	0.50			
Mean	1.1	1.4 <sup>2</sup>			
1990	0.8	0.42			
1991	1.0				

Notes: 1. New series begins here.  
2. Mean incorporates data from more than one source.

All figures should be treated with caution.

Davidoff Cruz's figures, used in Table 13.6, ought to give a slightly smaller gross loan total than Col. 1 here, as they exclude loans directly to the Brazilian government. In fact, Cruz's totals are about one-fifth larger than Col. 1 for the decade 1972–1981, during which the two series overlap.

Sources:

GDP, ALL COLS.: 1950–1979 from IBGE (1987); 1970–1992 from World Bank, *World Tables*.  
COL. 1: Gross foreign capital inflows, 1950–1970 from Fishlow and Cardoso (1987); 1971–1991 from World Bank, *World Tables*.  
COL. 2: 1965–1978 from Ness and Pereira (1981, 24); 1982–1990 from Comissão de Valores Mobiliários (1991).  
COL. 3: *Relatório* of Banco Central do Brasil and *Conjuntura Econômica*, various years.  
COL. 4: 1960–1976 from BNDES (1977, 14); 1975–1986 from Lees et al. (1990)  
COL. 5: Table 13.3

(BNDES loans to all but the largest borrowers were on-loaned through commercial and private investment banks.) Column 5 of Table 13.4 reproduces the data on foreign direct investment from Table 13.3. The table shows that each of the three main sources of financing Brazilian industry (foreign loans, domestic loans, and the stock market) was important, but foreign loans were first among equals. As early as the late 1950s, new inflows of foreign borrowing clearly had become more important in terms of financing Brazilian investment than additions to direct investment, whereas domestic capital market issues and BNDES loans each financed as much new investment as direct investment by multinational corporations.<sup>5</sup>

All postwar Brazilian policymakers had reservations about the wisdom of borrowing large sums from foreigners; the nationality of the country's bankers always remained a volatile issue. Nonetheless, Brazilian economic policymakers were pragmatists. If industrialization required truck with foreign bankers, then successive finance ministers were wary but nonetheless eager. Before the mid-1960s, the single largest recipient of foreign

**TABLE 13.5**  
**Brazil: Foreign Debt, 1965–1990**

<i>Year</i>	<i>Foreign Debt, Total (Current US\$ billions)</i>	<i>Debt + Exports (percent)</i>	<i>Debt + GNP (percent)</i>
1965	3.6	226	15
1970	5.1	186	12
1975	23.7	273	20
1980	70.8	305	30
1985	104.6	360	23
1990	116.2	370	23

*Notes:* 1965-75 = includes long-term debt only  
1965 = uses Gross Domestic Product (GDP)  
Other years = use Gross National Product (GNP)

*Sources:* Computed from data drawn from Fishlow and Cardoso 1987; the World Bank; the International Monetary Fund; the Economist Intelligence Unit.

loan credits was the National Economic and Social Development Bank (BNDES), created in 1952 to plan and finance the modernization of Brazil's industrial infrastructure (Willis 1986). Policymakers in the late 1960s, particularly then Finance Minister Antônio Delfim Netto, explicitly decided to stimulate the economy by heavy reliance upon foreign borrowing, among other measures (Fishlow 1989; Frieden 1991, 95–142; Moura da Silva 1980). Brazil began to mine the Euromarkets well before this practice became fashionable throughout Latin America. The external debt grew dramatically between about 1970, when it was only \$5.1 billion, and 1985, when it reached \$104.6 billion.

Policymakers were not completely naive about the dangers inherent in future indebtedness. Other policies were crafted to ensure that the country could pay its debts as they came due. Both exports and gross national product (GNP), reflecting private producers' responses to lush government-funded incentives, also grew during those years (World Bank 1980). Due mainly to profitable coffee exports, Brazil historically had run a merchandise trade surplus (see Table 13.3). The surge in imports, funded with foreign borrowing, led to a merchandise trade deficit through the 1970s. By the end of the decade, however, rising industrial and semi-manufactured exports helped to restore the country's trade surplus—but were not sufficient to produce a current account surplus, mainly due to interest payments on past debt (column 2 of Table 13.3). Nevertheless, Brazil's debt-to-export and debt-to-GNP ratios (Table 13.5), although double the levels of the mid- to late 1960s, were still not as high as in many other highly indebted countries.

The institutional arrangements for foreign loans were particularly interesting. Most developing countries either couple a largely unregulated foreign exchange transactions regime with mostly private-sector international borrowing or they combine both capital controls and direct sovereign borrowing. From the 1960s on, large Brazilian industrial companies (under Decree Law 4131) and Brazilian private banks (under Banco Central do Brasil Resolution 63) could borrow directly from international banks. Still, the Banco Central do Brasil (BC) retained final approval rights for all foreign loans (on the central government's ability to channel foreign financing to priority uses, see Frieden 1991, 95–142). Although the BC seldom blocked loans at the last minute, it frequently manipulated the incentives between domestic and foreign credit markets, mainly by means of differential tax and interest rates. For example, when Brazil's trade deficit ballooned with the 1973–74 rise in world petroleum prices, the local private sector became reluctant to expose itself to the increased exchange rate risk that private firms perceived (correctly) to be associated with loans denominated in foreign currency. Policymakers responded by effectively cutting off domestic credit to state-owned enterprises (SOEs), forcing them, if they wished credit, to help offset the country's trade deficit by borrowing overseas—even if the state enterprise itself had no particular need for foreign exchange (Moura da Silva 1980).

Table 13.6, which covers all Brazilian foreign borrowing excluding the comparatively small portion borrowed directly by the Banco Central do Brasil, reveals several interesting facts about borrower characteristics. The initial borrowers were either industrial firms themselves or Brazilian banks (including Brazilian subsidiaries of foreign banks). Bank borrowers, in turn, on-loaned the money to industrial and commercial firms not large enough to be known to the multinational bank lenders. Columns 1–3 show that nonfinancial firms borrowed directly almost three-quarters of total funds, suggesting that the lion's share of the benefits of cheap international credit in the 1970s went to larger firms. The other breakdown in Table 13.6 is by ownership of the borrowing firm. Column 4 shows that privately owned Brazilian firms, including banks and industrial companies, borrowed the smallest amount abroad during the 1970s, and their relative foreign borrowings decreased during the decade. Brazilian subsidiaries of foreign firms, shown in column 5, took out about one-third of the total loans in 1972, and their share of foreign borrowings fell through the decade. State firms, including industrial SOEs and state banks, began the decade with only one-third of the foreign obligations but ended with two-thirds.

**TABLE 13.6**  
**Brazil: Long-term Foreign Borrowing by Borrower Characteristics, 1972-1981**  
 (Percent of Gross Domestic Product)

Year	BORROWER SECTOR (cols. 1-3 = 100%)			BORROWER OWNERSHIP (cols. 4-6 = 100%)			TOTAL (US\$ Millions)
	1 Industrial Firms (by Law 4131) (%)	2 Banks (by Resolution 63) (%)	3 Industrial Firms (by Import Credit) (%)	4 Brazilian Private (%)	5 Foreign Private (%)	6 State Enterprise (%)	
1972	42.4	24.9	32.8	28.5	34.7	36.8	5,894.0
1973	48.7	18.3	33.0	25.0	29.5	45.5	5,850.0
1974	43.3	22.4	34.3	16.2	35.9	47.9	7,185.2
1975	52.6	12.9	34.4	9.7	34.9	55.4	7,169.0
1976	40.1	16.5	43.4	8.0	33.6	58.2	9,539.4
1977	47.1	12.8	40.1	8.8	31.4	59.8	10,319.7
1978	55.8	19.3	25.0	11.4	28.3	60.3	15,834.9
1979	61.0	11.1	27.9	10.4	16.3	73.3	14,177.0
1980	36.2	26.4	37.4	12.0	20.4	67.5	13,279.7
1981	42.1	30.3	27.5	16.5	23.2	60.3	18,031.4

**Notes:** Does not include funds directly borrowed by the Banco Central do Brasil.

"Industrial Firms" means all nonfinancial businesses.

This table understates the amount of foreign credit ultimately borrowed by the private sector because <sup>public</sup>private banks were far more likely to on-loan foreign funds to private businesses than were private banks to on-loan to the public sector.

Davidoff Cruz's totals for gross new loans are about 20 percent higher than those in other sources consulted.

**Source:** Computed from Davidoff Cruz 1984, 101, 127, 155.

One long-term consequence of the fact that most Brazilian loans were taken out not by the Banco Central or the finance ministry, but were negotiated by large industrial firms or local banks, was that Brazilian companies, as compared to their counterparts in other indebted developing countries, became fairly sophisticated in the ways of international financial markets. Brazil's business community as a whole became remarkably sensitive to the volatile relationship between international and domestic interest rates. Managers of state firms developed similar expertise.

A second source of funds for industrial investment promoted by government policies was equity investment through the capital markets, as shown in Table 13.7. Policymakers in the mid 1960s, under the first military president, General Castello Branco, had hoped to stimulate large amounts of new, voluntary savings that would be available for long-term industrial investment through a series of reforms of financial legislation. Among the more important regulatory innovations were the creation of what was to have been an independent central bank; the inauguration of indexed treasury securities to avoid monetization of public deficits; the freeing of previously controlled interest rates at commercial banks; and the chartering of new types of financial intermediaries, most notably investment banks, to offer long-term loans and underwrite corporate equity issues through the capital markets. To broaden the investor base, policymakers also decreed new tax incentives for the middle class on investments in selected mutual funds managed by private commercial and investment banks.

The financial reforms of the years 1964 to 1967 were insufficient to dramatically alter the characteristics of industrial finance. With the exception of the funds from the new tax incentive mutual funds (known as "157 funds"), the stock markets principally functioned as a means of registering and formalizing new infusions of capital from those families that already held controlling interests in firms. The capital markets did not serve as an important conduit for unrelated investors to put their money in potentially risky, but also potentially highly profitable and relatively liquid, corporate assets. The secondary market in corporate securities was very thin, and there were virtually no formal protections of the rights of minority investors. Trading volume remained low throughout the 1960s. In the early 1970s, the stock market experienced a classic boom and subsequent bust, as trading volume rose from 1.5 percent of GDP in 1969 to more than 9 percent in 1971, then fell below 5 percent the following year (see Table 13.7).

To the extent that a capital market did exist, activity was highly concentrated in a few issues. Of 5,285 large firms in 1975, including private,

**TABLE 13.7**  
**Brazil: Corporate Securities, 1965–1992**

<i>Year</i>	<b>1</b> <i>Value of Stocks Traded (% GDP)</i>	<b>2</b> <i>Value of Stocks Traded, Alternate Series (% GDP)</i>		<b>3</b> <i>Number of Listed Firms in All Stock Exchanges</i>	<b>4</b> <i>Market Capitalization (São Paulo only, U.S. Millions)</i>	<b>5</b> <i>Percentage of All Trades in Top 10 Shares</i>
1965	0.48					
1966	0.24					
1967	0.31					
1968	0.34					
1969	1.52					
1970	2.71					
1971	9.14		April 1971 Crash			
1972	4.89					
1973	3.51					
1974	1.83					
1975	2.41					
1976	1.54					
1977	1.40					68
1978	1.27					
1979	1.14					
1980	1.17					39
1981	0.61					
1982	0.82	2.17		1,135		
1983	1.33	1.56		1,152		50
1984	2.65	4.93		980	30,616	58
1985	5.63	9.85		995	59,075	61
1986	7.05	11.20		1,020	35,127	55
1987		3.44		999	17,000	59
1988		5.49		969	30,973	
1989		3.81	May and Nov. 1989 Crashes	994	44,141	
1990		1.19		901	17,600	
1991					± 43,000	
1992					± 40,000	

**Sources:**

**COL. 1:** 1965–1974 from Goldsmith 1986, 422.

1975–1986 from Lees et al. 1990, 295.

**COL. 2:** Gross Domestic Product from World Bank, *World Tables*.

Trading values from Comissão de Valores Mobiliários, hereafter CVM 1991.

**COLS. 3, 4:** 1982–1990 from CVM 1991.

1991–1992 from Economist Intelligence Unit 1993, no. 1.

**COL. 5:** Lees et al. 1990, 301.

state, and multinational enterprises, only about 6 percent, or 312, were publicly traded. In almost all of these 312, the controlling blocs of shares were held off the market (Moura da Silva 1980, 98–99). Those private firms whose shares did trade usually kept at least 50 percent of equity in family hands, making takeover battles or shareholder challenges to management practically unheard of. Table 13.7 shows that, as of 1977, 68 percent of all trades on the main São Paulo exchange were concentrated in ten corporate equity and debt instruments (Lees et al. 1990, 300). New corporate issues, shown in Table 13.4, averaged only about 1 percent of GDP annually in the 1970s. A major reason for the relative failure of the attempt to create decentralized capital markets was that industrial firms had better options for raising funds abroad and in domestic credit markets. Loan funds were relatively inexpensive, and they posed no threat at all to control by the firms' historical owners.

Domestic credit markets, the third source of industrial finance, also did not evolve as the financial reformers of the mid-1960s had hoped. Because of continued inflation, private investment banks declined to make long-term loans. The lending activities of the federal government's industrial development bank, the BNDES, expanded instead. From the late 1960s on, long-term credit for private industry, except for loans associated with construction and purchase in the residential housing sector, came almost entirely from the BNDES. The BNDES, in turn, drew its funds from foreign borrowing, a relatively small amount of direct budgetary subsidies, reinvested earnings on past loans, and from fees as investment manager for large compulsory deposit funds held in state-run savings and commercial banks. These deposits originated with unemployment funds for mostly blue-collar workers and pension-cum-special-purpose savings funds for white-collar workers.

Despite the dominance of the BNDES as the ultimate source of credit for industrial investment, private banks—as well as the public commercial banks of individual states—were the final lenders for most loans to Brazil's industry. These final lenders, however, received large portions of the funds they loaned to their customers either from abroad (the "Resolution 63" loans shown in column 2 of Table 13.6), or from various subsidy programs through which federal public banks—among others the BC and BNDES—routed special-purpose loan funds through local banks. Consequently, although it was mainly private banks that extended the loans, the central government had a large say in the allocation and cost of credit.<sup>6</sup>

From the late 1960s through the late 1970s, credit from Brazilian banks to business borrowers was extremely affordable. Firms engaged in "desirable" production, which usually implied more sophisticated and/or more



capital-intensive sectors, ranging from cement and metal smelting to chemicals and machinery, could get very cheap credit. The World Bank estimated that only 37 percent of total credit to the private sector carried free-market interest rates in 1973, an already low figure that dropped to 21 percent in 1978, the final year surveyed. The same World Bank team estimated the average *nominal* interest rate in the subsidized portion of the market in 1977 and 1978 at 16 percent. Given that annual inflation in wholesale prices was 41 percent in 1977 and 39 percent in 1978, these numbers suggest a large giveaway component. The total subsidy was about 54 percent of central government revenues, or 5.5 percent of GDP, in each of these two years, although these figures include agricultural as well as industrial loans (World Bank 1984, 34–39). Welch's data, on which Table 13.8 builds, demonstrate that, even if assorted service charges are included, real interest rates in the nonsubsidized portions of the credit markets (columns 2 and 4) were not exorbitant, although high inflation made nominal rates high and real (post facto) rates volatile (Welch 1991).

### **THE BRAZILIAN ECONOMIC AND FINANCIAL "MODEL" FALLS APART: 1980 AND AFTER**

Brazil's state-led industrial and financial progress from the 1950s through 1970s had important political consequences. An expanding economy through most of the 1950s gained presidents Vargas and Kubitschek great popularity.<sup>7</sup> Economic crisis was a major reason for the change of government in 1964 by military coup d'état. After 1964, Brazil's military leaders rationalized their continued political control by pointing to their supposedly incorrupt, economically successful government. However, in the late 1970s, as compared to the early years of the decade, the economic growth rate dropped by half and inflation doubled. The authoritarian regime's gradual loss of political support from the business community and urban middle class closely paralleled the slow but steady worsening of macroeconomic conditions after 1974.<sup>8</sup> Furthermore, although the economic policies of the late 1970s and very early 1980s—including the expansion of foreign borrowing and subsidized domestic credit—bought time for the military regime in the short to medium run, these policies had severely adverse economic consequences in the longer term (Fishlow 1989). The beginnings of organized opposition from business leaders to continued military rule surfaced as early as 1974; in 1979 several of Brazil's most prominent industrialists published an open letter suggesting that the military rulers step down (Skidmore 1988, 202). As Brazil's economy stagnated during the 1980s, business and middle-class opposition to military rule

increased. Economic distress propelled the return to civilian, democratic rule in 1985. Unfortunately, economic management in the decade following redemocratization was as flamboyant as ever. Thus far, democracy itself has survived, although under conditions of a pervasive, low-level economic crisis.

Table 13.1 above showed the worsening of macroeconomic indicators after 1980. Growth fell to an average of only 1.6 percent in the early 1980s, while mean annual inflation was 148 percent. In the late 1980s, growth picked up to 4.3 percent—perhaps saving democracy—but inflation sped to an annual *average* rate of 703 percent and actually ended the decade near 2,000 percent. As successive macroeconomic “shock treatment” plans failed, public confidence in the ability of the government to manage the economy eroded.<sup>9</sup> Furthermore, income distribution continued to worsen. In 1960, 60 percent of the economically active population earned 25 percent of all income; by 1990 this share had plummeted to only 16 percent. The portion of income going to the top 20 percent of Brazilians, meanwhile, went from 55 to 66 percent. In fact, during this thirty-year period, the percentage share of national income received by every quintile except the top one shrunk (Bacha and Lamounier 1993, Table 5). Until 1980, continued high growth and the perception of expanding opportunity made lack of equity bearable, but recession and slow growth after 1980 stripped away the veneer of progress for all. By some measures—primarily the extension of voting rights to all citizens above the age of sixteen, irrespective of literacy and other qualifications that previously had been used to disqualify poor Brazilians from expressing their opinions—Brazil after 1985 appeared to have become a genuine mass democracy. By other measures, chiefly access to equal protection under the law for the poor and marginalized, even the rudiments of modern liberal democracy had not yet arrived.

Politicians, who wished to remain in office, believed it was more important to satisfy the elite—the business community, the urban middle class, and other high-income groups, which together comprised less than one-fifth of the total population—than to satisfy the masses. During earlier macroeconomic crises, such as the ones in the early 1960s and the early 1980s, the business community turned against the democratic regime in power, signaling to the military that an intervention would, as in 1964, or would not, as in 1984–85, be acceptable. But for many reasons that are discussed later, the cream of Brazil’s business community, although grumbling about incompetence at the top, remained broadly supportive of democracy—despite the truly astonishing inflation of the late 1980s and early 1990s.

The course of industrial finance in Brazil parallels (and, of course, partially caused) the increasingly bumpy trajectory of the economy as a whole.

Throughout the 1980s, as compared to the 1970s, the financial resources for industrial investment (whether coming from abroad, from Brazil's own stock markets, or from the National Economic and Social Development Bank) shrunk dramatically. Predictably, industrial investment also fell as a share of GNP.<sup>10</sup>

The most obvious change in investment financing was the sudden scarcity of foreign finance. The Latin American debt crisis spread from Mexico to Brazil in late 1982, less because of any demonstrated inability on the part of Brazil to meet scheduled debt payments than because Brazil's multinational bank creditors generalized from their experience with Mexico and began to refuse to renew the now customary high level of credits to Brazil. Creditors acting individually to protect themselves collectively succeeded in provoking the very crisis they had feared. Aggregate annual long-term capital inflows in the early 1980s, averaging about 5 percent of GDP, only slightly exceeded interest payments on the foreign debt. By the late 1980s capital inflows were only 1 percent of GDP, much less than outgoing interest payments, not to mention amortization of the loan principal (see Tables 13.3 and 13.4). Foreign direct investment also fell noticeably in the 1980s.

Nontraditional sources of foreign finance in the very late 1980s and early 1990s partially offset the fall in both international loans and foreign direct investment. Rapid equity market growth among several newly industrializing economies, in East Asia and Latin America, combined with low interest rates in major world economies such as the United States, contributed to a boom in so-called "emerging markets" from which Brazil benefited. As of July 1993, the total net worth of the main "country funds" operating exclusively in Brazil was \$563.8 million, not including Brazilian securities held by funds that invested in more than one country, or monies that had entered under one of the older, less attractive, institutional mechanisms for foreign portfolio investment available before changes in Brazilian law of the very late 1980s.<sup>11</sup> Because many Brazilian firms continued to reap a profit for their owners, even if their earnings came from astute financial management rather than from sales, their price-to-book value remained attractive (Helbling 1992, 10). By the end of December 1986, the price-earnings ratio of the twenty-five most actively traded stocks, weighted to reflect market capitalization, stood at the internationally very competitive level of approximately seven.<sup>12</sup>

A trend of particular interest to international financiers still bullish on Brazil was the privatization of large SOEs, beginning with steel mills and other industrial firms. The sale of state firms did not directly affect the availability of financing for private firms. However, privatization can stimu-

late the capital markets and, in the medium run, help reduce the public debt. Although privatization had been part of the lexicon of central government promises since the Figueiredo administration (1979–1985), only with the worsening of public finances under Collor (1990–92) did the sale of large firms finally begin in earnest (Schneider 1990). In fairness, it should be noted that among the reasons for the long delay was the fact that the BNDES, in charge of Brazil's privatizations, having learned from the hasty and mistake-prone privatizations carried out in Argentina after 1989, insisted that all privatization auctions be thoroughly planned in advance (Armijo 1994).

Through November 1992, privatization sales had raised almost \$4.5 billion.<sup>13</sup> It was difficult to estimate the share of foreign capital in this figure because the Collor government offered investors substantial incentives if they purchased domestic government debt securities instead of using foreign debt-equity swaps. These securities included "privatization certificates," which the Collor government had pressed on unwilling domestic banks in exchange for a portion of their holdings of treasury securities as part of the government's 1990 stabilization plan, as well as debentures and other securitized debts of SOEs. Ultimately, foreign debt papers accounted for only 1.5 percent of the purchase price of nine large firms privatized in 1991–92, which together sold for a total of almost \$2.8 billion (Baer and Villela 1992, 18). The Brazilian Constitution of 1988 set a 40 percent limit on foreign ownership of privatized SOEs, but by April 1993 the central government's acute revenue needs had impelled a campaign by the federal executive to convince Congress to extend the limit.<sup>14</sup>

In addition to new foreign portfolio investment, intermediated through Brazilian capital markets in the early 1990s, several of Brazil's large companies returned directly to the Euromarkets—this time not for traditional bank loans but to place medium-term, two- to three-year corporate debentures. The state petroleum company, Petrobrás, was by most measures Brazil's largest firm. In 1991, it employed more than fifty-five thousand workers with an annual income from sales and other sources of \$11.4 billion and net profits of 9.5 percent. Petrobrás's shares, 49 percent of which were in private hands, were among the three most actively traded stocks on Brazilian exchanges for every year from at least the early 1970s through the early 1990s.<sup>15</sup> Needing capital investment, and recognizing that funds were not available domestically, Petrobrás's managers requested and received permission from the Banco Central do Brasil to float debentures in the Euromarkets. By the end of 1992, the SOE had raised about \$1 billion in medium-term funds. By early 1993, Brazil's two largest public-sector commercial banks, the Banco do Brasil—before 1965 the country's monetary

authority and the largest commercial bank into the early 1990s—and Banespa, the commercial bank of the state of São Paulo, had also floated Euroissues, as had several privately owned financial institutions, including Banco Real (\$100 million) and Banco Nacional (\$100 million).<sup>16</sup> These debentures represented the first return to international capital markets of private, not multinational-affiliated, Brazilian firms. The funds were to be on-loaned to top Brazilian clients, especially to exporters, whose earnings were best protected from foreign exchange risks. Nonetheless, aggregate foreign financing from all sources, including loans, direct investment, portfolio investment in Brazil, and global issues by Brazilian firms, remained scarce as compared to earlier boom periods, including the entire 1970s.

The second major financial arena was Brazil's domestic capital markets. The early 1980s saw a flurry of minor changes in regulations aimed at increasing investment in corporate securities. Some policymakers hoped that stimulation of private equity investments would provide a partial solution to the financial problems companies faced. The federal government, confronting rising fiscal pressures, also wanted to end the tax break that had generated the significant amount of individual investments in the new issues market through the "157 funds," first created in 1967. Private, commercial, and investment banks, which had earned substantial management fees on the "157 funds," opposed their abolition, but eventually settled for a new financial regulation permitting—and in some cases requiring—private pension funds to invest a portion of their resources in the capital markets.

Efforts to stimulate domestic capital markets led to a mixed success at best. Brazil's total market capitalization in the 1980s was quite large but extremely volatile, as Table 13.7 reveals. The extreme volatility of the value of stocks traded as a percentage of GDP (columns 1 and 2 of Table 13.7) gives some idea of the wild ride offered by Brazil's financial markets. Beginning the decade modestly at under 2 percent of GDP, the value of shares traded shot above 11 percent of GDP during the euphoria that followed the messianic announcement of the first major "heterodox shock" plan, the 1986 Cruzado Plan. When the plan crashed, equity trading did too, falling to only about 3.5 percent of GDP in 1987. Two smaller crashes, in May and November of 1989, were not directly attributable to macroeconomic conditions but instead derived from a major financial scandal and its aftermath. Trading over the year as a whole registered a drop by about one-third compared to 1988. In 1990, the Collor Plan caused a further fall in total yearly trading values—by two-thirds. "Normal" Brazilian financial markets were so volatile, however, that no real panic ensued in either 1989 or 1990.

The total value of all equity in publicly traded firms ranged from lows of approximately \$17 billion in 1987 and 1990—associated in both years with failed stabilization plans—to a high of \$59 billion in 1985, when democracy returned. Year-end market capitalization in 1992 was about \$40 billion despite almost three years of recession. From 1985 to 1989, total new primary share and debenture issues averaged \$1.69 billion annually (CVM [Comissão de Valores Mobiliários] 1991),<sup>17</sup> hardly enough to compensate for the dearth of funds coming from other avenues. The value of new issues as a share of GDP (shown in Table 13.4) was less in the 1980s than it had been in the 1970s. In fact, although trading volumes in the stock markets boomed, through 1990 the number of listed firms actually fell. In 1980, 421 of Brazil's 500 largest firms were listed as publicly traded companies; by 1990, only 374 were.<sup>18</sup>

The situation for industrial financing through domestic credit markets was no rosier than that of foreign finance or new issues in the capital markets. The amount of available credit shrunk just as its cost rose markedly. During the 1980s, the BNDES increasingly turned to stock participations rather than loans to ease the repayment burdens on troubled firms. One consequence, of course, was that its funds were tied up longer, so less was available for new credits. Long-term credit from the BNDES, which had been as high as 3.4 percent of GDP in the late 1970s, averaged only 2.2 percent in the early 1980s (see Table 13.4). Meanwhile, total loans to the private sector, including working capital and other short-term credit to industry as well as all consumer and mortgage lending, dropped in the early 1980s, averaging about 45 percent of GDP as compared to 55 percent in the previous five years. Through the late 1980s and early 1990s it was highly variable, as successive dramatic anti-inflation policies recast the rules of financial intermediation from one day to the next. In 1989, for example, a year of vigorous growth coupled with quadruple digit "superinflation," total credit to the private sector amounted to almost 70 percent of GDP. In 1990, the year of the draconian Collor Plan, total credit to the private sector dropped to only 35 percent of GDP.<sup>19</sup>

Furthermore, real interest rates in the 1980s increased quite dramatically, as Table 13.8 shows. Column 2 shows that real working capital effective loan rates, or the actual direct cost of credit, including commissions, compensating balances, and taxes on financial operations, for unsubsidized short-term loans from investment banks averaged about 9 percent annually in the late 1970s but rose to over 17 percent between 1980 and 1984. Real monthly interest rates, in this case not including associated charges, for bank certificates of deposit, Brazil's closest equivalent to the U.S. prime rate, were negative in the late 1970s but averaged 1.2 percent in the early

**TABLE 13.8**  
**Brazil: Interest Rates to Corporate Borrowers, 1973-1991**

Year	1 Working Capital Effective Nominal (annual)	2 Working Capital Effective Real (annual)	3 On-loaned Foreign Credit, Effective Nominal (annual)	4 On-loaned Foreign Credit, Effective Real (annual)	5 CDB, Nominal (monthly)	6 CDB, Real (monthly)	7 "Overnight," Real (monthly)
1973	34.0	10.6	34.6	5.9			
1974	38.5	7.0	49.9	16.9			
1975	39.7	4.1	57.0	12.7			
1976	52.9	4.4	56.8	9.2			
1977	59.7	16.8	49.4	8.0	2.33	0.17	0.77
1978	70.4	18.4	68.5	12.3	3.89	2.32	3.26
1979	83.5	0.1	187.1	47.9	3.75	-3.33	-4.50
1980	88.0	-13.4	105.9	-5.2	6.16	0.24	-0.59
1981	141.7	25.7	162.4	36.4	6.16	2.27	2.90
1982	160.3	24.6	248.9	64.3	8.26	2.20	2.62
1983	266.8	13.4	333.2	34.7	9.57	-0.32	-0.38
1984	348.6	36.4	303.7	22.9	12.19	1.72	0.75
1985	314.2	32.1	310.4	22.2	12.33	1.56	0.97
1986					9.49	1.56	0.97
1987					15.19	2.07	-1.68
1988					30.03	0.96	1.13
1989					62.21	7.23	8.56

	1	2	3	4	5	6	7
Year	Working Capital Effective Nominal (annual)	Working Capital Effective Real (annual)	On-loaned Foreign Credit, Effective Nominal (annual)	On-loaned Foreign Credit, Effective Real (annual)	CDB, Nominal (monthly)	CDB, Real (monthly)	"Overnight," Real (monthly)
1990					22.53	4.10	4.38
1991					31.98	6.75	7.12

## Notes:

Col. 1-4: "Effective" loan rate includes commissions, compensating balances, and tax on financial operations.

Col. 1-2: "Working Capital" rates refer to investment banks.

Col. 3-4: "On-loaned Foreign Credit" refers to Resolution 63 loans taken out by banks in Brazil and reloaned to domestic borrowers.

Col. 5-6: "CDB" (*certificado do depósito bancário*) is the CD rate. In Brazil, this rate performs a benchmark function similar to the U.S. prime rate although, of course, the CDB is a deposit rate and the prime a loan rate.

Col. 7: "Overnight" rate represents deposit funds, open to relatively small savers as well as large firms, which are linked to the rates of Treasury securities and are almost as liquid as a demand deposit account (although without check-writing facilities).

## Sources:

Col. 1-4: Welch 1991.

Col. 5-7: For 1977-1985, Gomes de Almeida 1988.

Col. 5-7: For 1986-1991, Economist Intelligence Unit 1993.



1980s, 2.7 percent in the late 1980s, and 5.4 percent in 1990–91 (see column 6). Other interest rates behaved similarly. To survive in the 1980s, more and more businesses had to sink their profits into financial market operations rather than into new plants and equipment. Borrowing in order to invest seemed increasingly foolhardy.

### **INDUSTRIAL FINANCE, STRATEGIES OF FIRMS**

From a macroeconomic viewpoint, the 1980s, not to mention the early 1990s, looked increasingly bleak. Still, many large Brazilian firms became adept at remaining profitable despite extremely high inflation.

The analysis of large numbers of corporate balance sheets confirms the trend toward increasing use of loan finance throughout the 1970s. Unfortunately, most available studies do not disaggregate foreign loans and domestic borrowing. In one study of more than four thousand privately owned Brazilian companies, the share of bank debt in total sources of new financing (aggregating reinvested profits, additions to equity, and loans) was 42 percent in 1970 and 49 percent in 1972. By 1975, loans as a share of total new resources averaged 61 percent (Calabi et al. 1981, 199–201; Moura da Souza 1979). As stated earlier, new foreign loans to Brazil as a whole fell drastically in the 1980s, especially after 1985. A second study, this time of sixty-two of the largest Brazilian firms during the years 1975 to 1984, shows that the share of working capital (shorter-term loans) in total funds stayed relatively constant, going from an average of 25 percent of total liabilities in 1975 to a high of 31 percent in 1981, then falling back to 24 percent in 1984 (Rodrigues 1986; updated in Lees et al. 1990, 315–325). Long-term loans, however, fell from almost 24 percent in 1975 to just under 15 percent in 1984. As longer-term loans fell, so did industrial investment.

At first glance, the businesses in the second study appear to contradict this trend. They reduced their holdings of liquid securities (government and corporate debt instruments) from almost 8 percent of total assets in 1975 to only 5 percent in 1984. The author of the second study, Domingos Rodrigues, attributes the fall in holdings of liquid securities to the Brazilian recession of the early 1980s, suggesting that many firms found it necessary to cash in their liquid assets to meet short-term obligations (Rodrigues 1986, 53). Cash holdings also shrank due to rising inflation, whereas the holdings of shares of other firms increased from 8 to 25 percent of total assets, tripling their importance in nine years. Although data on which shares were most sought after by the firms in the study was not available, this shift may represent holdings of equity of associated firms with over-

lapping directorates and fortunes—another protective mechanism for loosely associated business groups during hard times.

Rodrigues's study (1986) demonstrates that, as the macroeconomic environment became more chaotic, corporate profits came to depend more heavily upon agility in financial management. Nonoperational receipts as a share of total receipts tripled from less than 3 percent in 1975 to 9 percent in 1984 for the Brazilian firms in the sample, and exploded from 2 percent to almost 14 percent for sixteen large foreign-controlled firms he also examined. The shift toward nonoperational receipts probably reflects both declining sales due to the recession of the early 1980s and the increasing need for successful businesses to earn profits through skillful money management. Firms found it necessary to be very aware of where their money was parked, even temporarily.

Both anecdotal data and the sharp rise in real interest rates, shown in Table 13.8, suggest that after 1985 firms placed an increasing share of their total assets in highly liquid securities, particularly in inflation-indexed government debt. Ernest Bartell interviewed a nonrandom sample of successful business leaders in São Paulo in 1988 and 1991. He noted that several executives of industrial firms complained that their primary operating responsibilities had switched from production and sales to daily financial management, including almost daily decisions about in which bank "overnight" fund to park temporary excess cash. The branch manager of a multinational bank employed a computer-generated financial management program that was more sophisticated than that used by the home office in the United States (Bartell 1991, 12–13). By late 1989, as much as \$90 billion changed hands daily in Brazil's overnight market. The president of a major private bank told a reporter that fully 90 percent of his bank's activity involved trading in this market in treasury securities and deposit instruments backed by them.<sup>20</sup> By the late 1980s many large industrial firms had opened their own in-house financial trading operations where dealers stayed in constant contact with domestic money markets. Those firms eligible for export credits could raise money abroad and invest it at very high local rates. The *Financial Times* reported that in 1992 certificates of deposit in Brazil offered a 27 percent return over international rates (Lamb 1993).

Balance sheet trends and interview data record this shift by prudent industrial managers away from productive investment and into a variable mix of financial assets. Falling industrial investment, of course, was bad for the economy as a whole. Nonetheless, individual firms did not necessarily do badly. The Brazilian business magazine, *Exame*, reported aggregate data on growth and profitability for the five hundred largest nonfinancial firms in Brazil each year for more than a decade. Table 13.9 summarizes some recent

results from the *Exame* data. (Naturally, the sample changed from year to year, and the criteria for inclusion were complex. Still, the data give the single best picture of how the largest, most successful Brazilian businesses fared.) Table 13.9 shows that, in the 1980s, the largest, most successful Brazilian firms had both slower sales growth and a smaller proportion of debt in their total financing than they did in the 1970s. These findings are consistent with the generally more difficult macroeconomic conditions and slower growth in credit availability already chronicled. Curiously, however, profits held comparatively steady between the macroeconomically buoyant 1970s and the difficult 1980s, whether measured as a percentage of net worth or of total sales.

At least for the top firms, the 1980s as a whole, and particularly the latter 1980s, clearly were "good" years in terms of profits. Of course, the firms that made the *Exame* list in the 1980s may not have been the same companies that did well in the 1970s. Nevertheless, the consistent profitability of top firms is interesting, given the difficulties of Brazil's macroeconomic environment. Furthermore, since shareholders' equity in Brazil was calculated at current—that is, inflation-indexed—values, not the lower historical values used in some countries, the after-tax profits as a share of net worth shown in the table may look smaller in comparative perspective than they actually were. Cross-national comparative studies attempting to employ equivalent concepts consistently rated Brazil, in the 1970s, 1980s, and even the early 1990s, as an extremely profitable business environment.

The best, easily accessible analysis of one firm's financial options is Melissa H. Birch's case study of Corning Brasil, the Brazilian subsidiary of Corning Incorporated, formerly Corning Glass Works (Birch 1991). The Corning study focused on alternative methods of financing a new productive investment rather than on the point emphasized here, which is that during the 1980s and 1990s many firms decided to defer production in favor of financial investment. Corning Brasil was a subsidiary of a multinational firm and thus faced a somewhat different mix of challenges and opportunities than did Brazilian firms. Nevertheless, its story illustrates several unique aspects of Brazil's investment environment.<sup>21</sup>

In 1988, Corning Brasil, with the agreement of its U.S. parent, planned to undertake a \$50 million new investment to produce Visions, its new line of stove-top, glass-ceramic cookware. Among the attractions were Brazil's large, domestic market, which in 1982 had responded positively to test marketing of Visions, and the possibility of using Brazil as a comparatively low-cost yet high-quality export platform. Of the total investment planned, \$45 million was allocated to new machinery and equipment. Of this sum, \$20 million would be sourced from Brazil and the remainder from

**TABLE 13.9**  
**Brazil: Performance of 500 Largest Nonfinancial Firms, 1973–1990**

<i>Year</i>	<b>1</b> <i>Real Sales Growth (%)</i>	<b>2</b> <i>Profits after Tax: Net Worth (%)</i>	<b>3</b> <i>Profits after Tax: Sales (%)</i>	<b>4</b> <i>Debt: Total Assets (%)</i>	<b>5</b> <i>Liquid Assets: Debt (%)</i>
1973		15.2	7.0	51.0	121
1974	19.0	16.0	6.8	54.0	115
1975	14.8	13.3	5.4	56.7	117
1976	7.8	14.8	5.6	56.3	119
1977	4.5	13.8	5.7	58.7	114
1978	13.5	9.7	4.3	55.3	106
1979	7.5	7.9	2.3	56.6	109
<b>Mean, 1975–79</b>	<b>9.6</b>	<b>11.9</b>	<b>4.7</b>		
1980	7.1	14.3	3.4	57.5	103
1981	–4.4	9.2	2.5	55.6	99
1982	3.2	9.8	3.0	52.7	98
1983	–4.3	7.7	2.3	52.7	90
1984	3.9	12.7	4.4	46.7	101
<b>Mean, 1980–84</b>	<b>1.1</b>	<b>10.74</b>	<b>3.1</b>		
1985	9.0	13.2	4.7	44.9	103
1986	–1.4	13.3	5.6	41.3	112
1987	5.8	6.5	2.4	41.4	109
1988	3.7	10.8	3.7	42.2	116
1989	0.1	14.0	4.9	41.7	105
<b>Mean, 1985–89</b>	<b>3.4</b>	<b>11.56</b>	<b>4.3</b>		
1990	–16.5	1.4	0.4	49.0	93

*Note:* Observe the relative constancy of profits, whether measured against net worth or sales, as compared to the variability and generally declining growth of sales.

*Source:* *Exame—Melhores e Maiores* (September 1984 and August 1991): 24–25.

the United States. Birch tracked the choices confronting Corning Brasil, including the mixture of debt and equity financing and dollar versus local currency (then the cruzado) denominated loans.

Initially, Corning's goal was to go primarily for equity financing, which could be raised both internationally and in domestic capital markets (up to a maximum of 25 percent of the new share capital). Additions to foreign equity in Brazil had the advantage of increasing the base of "registered" capital, in other words, the officially counted foreign direct investment eligible for computing allowable dividends to be sent abroad. While Brazilian law did not limit repatriation of profits per se, the tax assessed rose

after annual dividends equal to 12 percent of registered capital had been sent abroad, rose again at 16 percent, and hit effectively punitive levels after 25 percent of the registered capital had been remitted as dividends in a given year.

At the same time, Corning was not anxious to increase equity overly rapidly, since U.S. investors tended to evaluate the health of a company in terms of its return on equity. Although the usual rule for Corning subsidiaries was to finance new investment with a debt-to-equity ratio of up to 2:1, the uncertainties of Brazil's financial markets, coupled with the sometimes extremely high real interest rates of the late 1980s, had caused the managers of Corning Brasil to keep an overall debt-to-equity ratio of 1:1, even though this had the potential disadvantage of increasing overall equity for Corning's worldwide operations, with possible adverse effects on the firm's image in the United States.

From the six months or so of feasibility studies and internal corporate consultations that the case chronicles, one can observe the Brazilian tendency to alter important financial rules of the game on very short notice. In the Corning case, the Brazilian government switched gears in response to U.S. trade pressures, but it could equally well have done so because of domestic political bargaining. On July 1, 1988, Brazil abolished the additional financial tax on imported capital equipment financed by debt, thereby causing a sudden drop in price. Imports financed by swaps of Brazilian foreign debt, purchased in international secondary markets at a substantial discount and then exchanged for cruzados at a rate fixed in a monthly auction held by Banco Central do Brasil, suddenly looked attractive, although they had not before. This significant change in federal government policy made Corning strategists abruptly abandon the financing options they had been considering and begin to assess the advantages of a higher share of debt. To be successful, businesses operating in Brazil had to be sufficiently agile to roll with such regulatory punches—which the government administered with great frequency.

Foreign banks were eager to finance the proposed expansion of Corning Brasil. Birch quotes the treasurer of Corning's U.S. parent office: "[T]he banks were prisoners of the system, so there were some pretty good deals for us" (Birch 1991, 5). Foreign commercial banks, obligated to extend fresh credits by debt rescheduling packages negotiated with the Brazilian government and various official and semi-official intergovernmental bodies, such as the International Monetary Fund and the U.S. Federal Reserve, had money to lend. All of the foreign banks' incentives led them to prefer to lend to Brazilian subsidiaries of large, advanced industrial country corporations, such as Corning. The borrower's commitment to bear the exchange risk of a foreign loan, for example, was not legally enforceable in

Brazil, which made it much more attractive from the foreign bank's viewpoint to structure the deal as an intracompany loan, in which ultimate responsibility for repayment would lie with the U.S. parent (Birch 1991, 14).

A final peculiarity of Brazil's enterprise environment is illustrated by the openness with which the principals at Corning apparently discussed with Birch the (formally illegal) option of selling dollars on the black market. Corning officials did not, of course, explicitly suggest that this was one of their possible choices. Nonetheless, they had to consider the premium between black market and official prices of U.S. currency when deciding whether to attempt to purchase discounted Brazilian sovereign debt, hoping to swap it with the Banco Central do Brasil for close to its full-face value in Brazilian currency at the monthly auction. Multinational firms that did not need additions to their "registered" capital (and, presumably, Brazilian firms with export earnings that somehow could be disguised) encountered no particular barrier to exchanging relatively large sums of foreign currency in the parallel market (Birch 1991, 7). Although the black market was not formally recognized, its operations were open, even respectable. Major urban newspapers, for example, quoted the previous day's official and black market rates in a small box on their front pages for easy reference. Keeping track of the parallel market in dollars was simply one more aspect of sound corporate financial management.

Taken together, the information available on Brazilian firms—drawn from analysis of large numbers of balance sheets, interviews with corporate owners and managers, and a review of the financial strategies of a multinational subsidiary—reveals the volatility of Brazilian patterns of industrial financing. The innovations in Brazilian financial regulation, many of which dated from the mid-1960s reforms, originally had been designed to permit industrial investment and growth despite the economy's persistent tendencies toward inflation. Inflation indexing of financial instruments, for instance, was supposed to encourage the holding of financial assets by individual investors who otherwise might be reluctant to hold their savings in liquid form. Similarly, clever government intervention in the rules governing foreign borrowing by different categories of borrowers, such as private versus state-owned enterprises, kept the inflows of foreign loans high throughout the 1970s, despite the increased wariness of some borrowers after 1974. Over the long run, however, those very peculiarities of financial regulation that made inflation seem relatively benign allowed many large firms to remain profitable even when the economy as a whole was in crisis—and even when the firms themselves declined to invest. Brazil's financial regulations, as a system, served to insulate many—although, of course, not all—industrial firms from the true costs of rising macroeconomic disarray.

One final tale illustrates the quick response needed from Brazilian corporate financial management. It also provides an example of the strong incentives that have existed in recent years for firms to disobey laws. In March of 1990, the new government of Fernando Collor froze most deposits with the financial system and treasury securities for eighteen months in a desperate move to shrink the money supply drastically and head off impending monthly inflation of 50 to 60 percent. The freeze affected almost 75 percent of all financial assets; only noninterest-bearing demand deposits were untouched. Financial asset holders reacted angrily to the president's "nuclear attack." Hundreds of corporate lawyers generated suits against the government while accountants and traders searched for loopholes, legal or at least untraceable. The Banco Central declared that the cruzado, in use since the *Plano Cruzado* shock policy of March 1986—even though it had lost three zeros and had since become the "new cruzado"—was replaced by the new cruzeiro. The government outlawed indexed contracts, froze prices and wages, declared itself ready to prosecute retailers who held goods off the markets in anticipation of eventual price rises, and promised to cut government spending.

The flurry of legal challenges soon caused the administration to yield on three points. The blocked cruzado accounts were still allowed to be used for payment of income taxes to states and municipalities, whose financial troubles by the late 1980s were even more severe than those of the central government. Charitable organizations could continue to receive cruzado-denominated donations. Finally, short-term business debts—usually suppliers' credits—to other firms incurred before the freeze also could be paid with cruzados, and the recipient would have normal access to these funds.

The loopholes proved more than sufficient. Within a few weeks informal (and illegal) markets in tax liabilities and unused charitable donation quotas emerged. Income tax collection had always been difficult for all levels of government. Many seemingly respectable businesses operated with two sets of books, justifying tax evasion as rational self-preservation in an irrational environment produced by government incompetence. Consequently, during the Collor Plan of 1990, states and municipalities, even those with honest administrations, were only too happy to receive payment of taxes they were owed but perhaps did not expect to receive—even if the process of collection involved a substantial kickback to the payer. Firms with tax liabilities but not in need of immediate cash arranged to "sell" their tax debt to another corporation that needed liquid funds. In some cases, local government officials gladly manufactured tax bills, splitting the proceeds among themselves and the cash-poor firm. Similar practices were common with respect to charitable donations. The process of

falsifying intercorporate invoices so they predated March 15 was the third and most straightforward route.

On March 19, the first working day after declaration of the freeze, liquid financial assets amounted to 9.5 percent of GDP, or approximately \$33.25 billion. The credit squeeze was supposed to drastically “cool down” the economy. Yet by the end of April, near-money financial assets were up to 12.5 percent of GDP, or \$43.75 billion. Within two months, all but roughly 20 percent of the ostensibly frozen assets had been liberated by means of one artifice or another. In the end, it was primarily small businesses and individual depositors who suffered since they lacked the financial sophistication and contacts to free their blocked funds before the scheduled release in September 1991.<sup>22</sup> It was small wonder that multinationals often sent their star talent to work in Brazil for six months or more; the combat experience proved invaluable.

### **SERIOUS FINANCIAL REFORM AT LAST? A POSTSCRIPT AS THE *PLANO REAL* COMPLETES ITS SECOND YEAR**

Major financial reforms that could improve the Brazilian business environment include (1) decisive lowering of inflation and (2) reduction of the complexity, high variability, and overall level of state involvement in credit allocation. The virtues of price stabilization are self-evident despite the fact that many Brazilian businesses, as noted, have learned to live with inflation, even if not precisely embrace it. As for the goal of lessening government involvement in credit markets, it is worth recalling that, even in the pro-liberalization 1990s, few Brazilian analysts are as categorically opposed to an activist state as, for example, their counterparts in Chile or Argentina.<sup>23</sup> Still, there are no defenders (except perhaps the lawyers specializing in corporate finance) of the fact that, for more than two decades, important rules of financial taxation in Brazil changed monthly, if not weekly, necessitating an enormous expenditure of energy within the business and financial community simply to remain current.<sup>24</sup>

Nonetheless, numerous political and social barriers to serious financial reform remained in the early 1990s. In 1986, an indirectly elected civilian government took office after some twenty-odd years of military rule. A few months later, Congress removed the literacy requirement for voting, and Brazil became a genuine mass democracy. Recently, democracy has often been considered to be inimical to economic (and thus to financial) reform.<sup>25</sup> The newly empowered lower classes, who usually bear the brunt



of the recession associated with stabilization efforts, are typically blamed for “populist” policies aimed at promoting growth while ignoring inflation. If the present analysis is correct, however, the preferences of the Brazilian masses, magnified by the country’s transition to democracy, were *not* necessarily the main cause of the failures of economic reform in Brazil.

Clearly, the repeated failures of ever more ambitious stabilization programs since 1986 had many causes. One cause, whose exact weight can only can be guessed, was the fact that Brazil’s regime of national financial regulations, taken as whole, enabled some prominent members of the business and financial communities to live comfortably with inflation. Brazilian stabilization remained elusive partly because Brazilian business leaders, including both industrialists and bankers, were ambivalent about ending inflation. Few actually preferred inflation to an environment with stable prices. But, for many who had adapted to continuous and escalating price increases, inflation with continued economic growth (even at a level less than the country’s potential) was clearly preferable to painful, recessionary economic adjustment. In fact, more than one observer edged toward the conclusion that Brazil might have been better off in the long run had the macroeconomic indicators of the 1980s been more unequivocally terrible. This might have jolted Brazilians into recognizing the gravity of their economic problems.<sup>26</sup> Political leaders, unable to move without the support of the business community, found themselves immobilized.

That policy immobility existed at least through early 1994 is indisputable. A sample of front-page headlines from the May 24, 1993, international weekly edition of Brazil’s premiere business newspaper, *Gazeta Mercantil*, neatly—and very typically—illustrates the disputes over economic policy choice that divided the administration and policy-relevant elites, including politicians and business leaders. One lead story notes that Fernando Henrique Cardoso, newly appointed finance minister (and the third successor to Marcílio Marques Moreira, with whom this chapter began), stated that bringing inflation down, “even at the expense of sacrificing growth,” would be his priority. The new minister also said that “the highest growth rate that can be realistically hoped for is 1.2 percent.” Another story (beginning inside on page four) offers an analysis similar to that of the finance minister. It is headlined: “No industrial investment can be expected until a modicum of economic stability is restored.” However, the front-page leader for a third story (on page eight) states, “Planning Minister Alexis Stepanenko sees no need for higher interest rates. Inflation isn’t a problem, he says.” Finally, a fourth story (on page thirteen) gives a clue about the reasons for Stepanenko’s position. That story’s leader reads, “Industry is poised for growth, a survey shows.” Clearly, the finance minister did not have all the

relevant political actors in his corner. In fact, President Itamar Franco, who assumed office following Collor's impeachment for financial improprieties in December 1992, himself voiced skepticism about the need for economic reforms drastic enough to produce recession.

In early 1994, however, Finance Minister Cardoso announced his *Plano Real*. Unlike its six predecessors since the return of democracy in 1985, the *Plano* was to be implemented gradually and on the basis of full public knowledge and discussion with congressional and state-level politicians. Often these politicians had power bases that made them not only independent of the country's president but also beholden to various economic interests, many of whom benefited from policies that contributed to inflation. By the time the new currency actually came into use on July 1, 1994, Fernando Henrique Cardoso had become a presidential candidate. He won a decisive victory in the first round in October, mainly on the strength of the (so far) successful stabilization plan.

The *Plano Real* pegged the new currency, the *real*, to the U.S. dollar, although less rigidly than Argentina's superficially similar "currency board" system. The *Plano* also implemented an extremely tight domestic monetary policy. In May 1995, one credible source reported real (that is, corrected for inflation) annual interest rates as high as 40 percent (Foster 1995, II). An overvalued exchange rate, along with significant trade liberalization, helped to keep domestic prices low but also created a trade deficit for the first time in more than a decade. The main challenge to policymakers was to maintain faith in the *Plano*. In practical terms, this meant convincing Brazilians not to return to informal inflation indexing, always in the past the prelude to a full-fledged rush to the reinstatement of formal indexing, virtually overnight.

This chapter, therefore, does not conclude with firm predictions. The recent macroeconomic record is good. Investment recovered from 14 percent in 1993 to 17 percent in 1994,<sup>27</sup> and there was 4.1 percent real GDP growth in 1993 and 5.3 percent in 1994. Even given the dramatic inflation and macroeconomic turmoil of the late 1980s and early 1990s, Brazil has become one of the international financial community's most popular "emerging market" countries, receiving an annual average of \$1.4 billion in net new foreign direct investment from 1987 to 1993, plus an average of \$2 billion in portfolio equity investment each year from 1990 to 1994. In the 1990s, voluntary and non-publicly guaranteed new private debt (in the form of bonds and commercial bank lending) also began to reappear for the first time since the early 1980s. In both 1992 and 1993, for example, Brazil received more than \$5.5 billion in new foreign loans.<sup>28</sup> It should be emphasized that many of these positive changes occurred in the context of

continuing high inflation, which was 2,148 percent in 1993.<sup>29</sup> The *Plano Real* did not stabilize inflation until mid-1994.

Macroeconomic policy results since the introduction of the *Plano* have been better. In 1995, real GDP growth was a reasonable 4.2 percent, while inflation was less than 19 percent—considered an acceptable level in Brazil (Key Facts 1996). Trade and regulatory liberalization continued. With the May 1996 sale of the Light, the \$2.2 billion government-owned Rio de Janeiro electric power generation and distribution firm, privatization revenues in the 1990s reached \$11.6 billion (Castellani and Magnavita 1996). Nonetheless, not all figures were happy. By mid 1996, real interest rates, as high as 5 percent a month, made long-term loans still a virtual impossibility for small and medium-sized Brazilian businesses (Flanders 1996). The largest firms did as they had done in the 1970s and borrowed overseas, this time not in the form of long-term commercial bank loans but in the capital markets. Brazilian corporate debt and equity issues in global markets rose from almost \$6 billion in 1994 to \$9.6 billion in 1995 (Wheatley 1996). By mid-1996, the Banco Central was maintaining close to \$60 billion in foreign exchange reserves in order to retain investor confidence in an overvalued currency in the context of large new capital inflows and a current account deficit of 2.8 percent of GDP in 1995.

On the political front, President Fernando Henrique Cardoso has long-standing democratic credentials and shows a valuable instinct for compromise, coupled with persistent leadership in pressing for a few key goals, including the crucial macroeconomic goals of reducing public sector debt and reforming the tax structure. Of course, Cardoso can expect substantial resistance from both the fragmented Brazilian Congress and powerful state-level politicians. Compared to past decades, however, there is a much stronger societal consensus for making the sacrifices necessary to overcome inflation.<sup>30</sup> Moreover, there is every reason to believe that Brazil's economic regulatory framework is becoming more stable and less susceptible to continuous, politically motivated redesign. The officer corps appears to have retired from politics permanently. The *Plano Real's* end to horrendous inflation has even brought a marginal, but genuine, redistribution of income in the direction of Brazil's poor citizens and geographic regions.<sup>31</sup> Each of these good results is linked to the greater weight given to popular preferences in a mass democracy, as compared to an elite-dominated authoritarian regime.

Overall, cautious optimism probably is in order.

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## Notes

1. Loss of control or strategic inaction? *Latin American Regional Report—Brazil* (November 28, 1991): 2.
2. Scholarly controversy continues over the degree to which government deficit spending in the late 1950s actually caused the subsequent inflationary spiral of the early 1960s. Cohen (1987), for example, asserts that the principal causes of the economic crisis of the early 1960s were failures of political leadership under conditions of a weak and unconsolidated democracy.
3. Using various definitions and methods, most researchers have concluded that Brazilian policies overall probably worsened both intergroup and interregional income distribution. See, for example, Baer (1995, 275–300); Hewlett (1980); and Malan and Bonelli (1990).
4. For more details on the political economy of Brazilian financial development, see Armijo (1993).
5. Unfortunately, data are not available in all the forms that one would wish, nor are data from different sources entirely comparable. Table 13.3, showing net foreign direct investment and net capital flows of all kinds (from loans to foreign aid in the form of grants to worker remittances), suggests that direct investment was larger than foreign capital inflows through the mid 1960s. Table 13.4 is limited to foreign loans but gives a gross, rather than a net, figure and compares that to the only available direct investment figure, which tracks net flows. Table 13.4 suggests that loans became more important in the 1960s than the multinational direct investment in the previous decade. Since gross foreign loans and net direct investment may be the most accurate measures of foreign confidence in the Brazilian economy, the comparison in Table 13.4 seems the more meaningful.
6. The federally owned Banco do Brasil functioned as the central bank until the financial reforms of the mid 1960s. Although its relative size has been shrinking steadily, even in the early 1990s, it remained the country's largest single bank by any measure: total value of deposits or loans, number of depositors, or number of bank branches. From the early 1970s, it operated aggressively in the Euromarkets and even intermediated a meaningful portion of Brazil's own sovereign debt, especially the international

bond issues of the Brazilian Treasury. The Banco do Brasil does not figure prominently in this story of industrial credit, however, because its long-term lending activities were concentrated in the agricultural sector.

7. Vargas's 1954 decision to commit suicide rather than allow the senior military command to push him out of office was one of the few major political crises in Brazil not directly linked to overwhelming macroeconomic troubles. See Skidmore (1967).
8. Scholarly opinion differs on whether Brazil's military rulers left power primarily because of societal pressure (see Diniz 1984), or for reasons internal to the military (Skidmore 1988; Stepan 1988).
9. The major stabilization efforts from the restoration of democracy in 1985 through 1993 were the Cruzado Plan of March 1986, the Cruzado II Plan of November 1986, the Bresser Plan of June 1987, the Summer Plan of January 1988, the Collor Plan of March 1990, and the Collor II Plan of March 1991. See Bresser Pereira (1993, 47–50) for stabilization highlights through early 1992.
10. Private investment as a share of GDP slid from about 16 percent in 1980 to just above 12 percent in 1990. Public-sector investment, meanwhile, swooped from its peak of 12 percent of GDP in 1977 to less than 4 percent in 1990 (see Bacha and Lamounier 1993, graph 3).
11. *Gazeta Mercantil*, International Weekly Edition (July 19, 1993): IV.
12. *Prospectus: The Brazil Fund, Inc.* (March 31, 1988): 23.
13. The Economist Intelligence Unit (EIU), *Brazil: Country Profile, 1992-93*, 15–16.
14. *Gazeta Mercantil*, International Weekly Edition (April 5, 1993): 4.
15. *Exame: Melhores e Maiores* (August 1991): 69.
16. *Gazeta Mercantil*, International Weekly Edition (March 15, 1993): I.
17. Comissão de Valores Mobiliários [CVM] (1991).
18. *Exame: Melhores e Maiores* (August 1991): 25.
19. These figures are published in issues of *Conjuntura Econômica*. A series through the mid 1980s is in Welch (1988, 194–96).
20. Como vive o país dos 40 por cento. *Veja* (November 8, 1989): 105–106.
21. *Latin American Regional Reports: Brazil* (January 10, 1991): 7, notes a study by Brazilian economist João Eduardo Furtado that concluded that average profit margins in Brazil of 53 percent, and in other Latin American countries such as Venezuela and Colombia (both 54 percent), or Chile (60 percent), compared very favorably with rates of 23 to 30 percent in the industrialized world. Furtado attributed high profits largely to low costs for wages.
22. These techniques are described in *Torneiras e goteiras. Istoé* (May 9, 1990).
23. Numerous writers have remarked upon the large role played by state-led investment and leadership in several of East Asia's success stories. See Woo (1991), as well as some of the chapters in this book.

24. See the numerous asides to this effect in Rosenn (1991).
25. On the difficulties (although not necessarily the impossibility) of painful economic restructuring under democratic auspices, see, for example, Przeworski (1991) or Haggard and Kaufman (1992).
26. Neighboring Argentina had a much worse economic performance almost every year between 1950 and 1988. This negative experience with populist, import-substituting industrialization, alternating with ineffective austerity measures, paradoxically became a political resource for President Carlos Saúl Menem (inaugurated in 1989) when he decided to implement painful austerity measures (Armijo 1994). The extremely tough stabilization policies initiated by Bolivian President Víctor Paz Estenssoro in 1985 met a similar response (Pastor 1992, 67–106).
27. Both figures from Survey on Brazil, *Financial Times* (May 17, 1995).
28. *World Debt Tables, 1994–95*, vol. 2. Country Tables. Washington, DC: The World Bank.
29. Survey on Brazil, *The Financial Times* (May 17, 1995).
30. On the social and political barriers to ending Brazil's inflationary spiral, see Armijo (1996).
31. In 1994, the income share of the poorest 50 percent was 10.4 percent; during 1995, this rose to a still dreadful, but improved, share of 11.6 percent. See Key Facts (1996).

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