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Brazil's dilemma: Dependency, debt, and democracy

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Rocha, Geisa Maria, Ph.D.

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41
BRAZIL'S DILEMMA: DEPENDENCY, DEBT, AND DEMOCRACY

BY

GEISA MARIA ROCHA

VOLUME I

A dissertation submitted to the Graduate Faculty in
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Chair of Examining Committee

8/29/89
Date


Executive Officer

Irving L. Markovitz

Howard Lentner

Benjamin Rivlin
Supervisory Committee

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PART ONE

CONTENDING PERSPECTIVES ON DEVELOPMENT: A CASE FOR DEPENDENCY

Introduction

The foreign debt crisis of Latin America and its devastating socio-economic effects in the 1980s are the most recent and concrete evidence of the fundamental contradictions between international finance and national interests, between the short-term gains of global profit makers and the long-term economic development of Third World countries. The crisis, therefore, challenges the theoretical assumptions of Western growth theories in both their liberal neo-classical/modernization and orthodox Marxist versions, which we may refer to as the developmentalist perspective (see discussion in chapter 1).

Since the 1950s, the claim that there are no conflicts between the interests of international capital and national development has been the most pervasive theme of the developmentalist perspective. As such, the import of capital from the more developed industrial countries in its various forms - aid, direct investment and credit - has been the blueprint for rapid economic development, defined strictly in terms of high growth rates of GNP or per capita GNP as an end in itself, and thus for moving capital-scarce "traditional" or "feudal" societies into the "respected" status of "modern" or "capitalist, high-mass consumption" societies.

In effect, the major theoretical assumptions of the developmentalist perspective are - and have always been - that traditional, backward societies must replicate the idealized unilinear evolutionary growth experienced by

the now modern, capitalist industrial countries. The more the former are linked with the latter the faster the replication of the economic growth process which would automatically and inevitably cure unemployment, inequality and poverty, and hence achieve social goals. Significantly, economic growth would also be instrumental for the development of the Western model of political democracy, thus completing the replication process.

Developmentalism is, however, more than just a set of theoretical assumptions. Its major features are the formulation of specific growth models for the local reproduction of the major characteristic of mature capitalist countries - high mass consumption - and the prescription of concrete policies to achieve this goal. The policies are aimed at integrating the developing countries into the international capitalist system and particularly at qualifying them for ever increasing amounts of foreign capital, the agent of the transition and replication process.

While this view obviously implies that change results primarily from exogenous stimuli, that is, from the expansion of capitalism, developmentalism nevertheless assumes that development and underdevelopment are outcomes of internal processes, occurring in relative isolation from international influences. Yet if for developmentalists "internal processes" simply refer to domestic economic policies and politics that may or may not provide an ideal investment climate for the expansion of international capital, this assumption seems logical. As the World Bank, a representative par excellence of developmentalism, notes in its 1985 World Development Report, "...the economic policies of developing countries are the fundamental determinant of the level of capital inflows",¹ hence of capital accumulation and industrialization, and that "...The key issues are the government's efficiency and its political strength to resist interest groups that oppose

policy changes",² that is, market-oriented reforms to promote the free international flows of trade and investment (i.e., liberalization of foreign exchange and import controls, end of tariff protection and subsidies to national industry, and greater hospitality to foreign investment and loans).

The evidence suggests that the policies prescribed by developmentalism were eagerly endorsed and efficiently implemented in the last two decades by dominant political elites in developing countries aspiring to emulate the consumption patterns, life styles and even surpass the rates of industrial growth that are found in the center of the capitalist system, with virtually complete freedom from domestic political constraints. Not only in Latin America, but throughout most of the developing world, elites in countries with differing domestic class and political structures deliberately opted for integration of their economies into the international financial and productive system and consequently into external reliance on flows of capital, particularly flows of financial capital, for local growth and capital accumulation. That they have now found themselves caught up in a common debt crisis with many similar ramifications should tell us less about the deficiency in their implementation of policies prescribed by developmentalism and more about the limitations of the theory and the growth strategy it prescribes.

This case study of Brazil, the largest debtor country in the developing world, attempts to answer the following questions. What is the nature of the foreign debt and capital accumulation crisis of the 1980s, when Brazil has been forced to sharply contract domestic investment and total output, and the larger developmental crisis, when wages, employment and living standards have fallen to levels of a decade ago in order to generate resources to service the foreign debt? Is the perverse transfer of financial

resources abroad and the consequent economic regression of Brazil that now threaten the consolidation of the country's fragile democratic institutions the result of poorly implemented policies in the past? Did domestic political constraints force the military government to deviate from wise economic policies? Or is the crisis that beset the new transitional regime to democratic rule the result of the deficiency of the developmentalist theory and its contradictory growth strategy offered and adopted in the country during two decades of authoritarianism? These are crucial questions directly related to the real world of policy-making and to the resolution of the crisis as developmentalism, represented by international creditors (private and public alike), financial institutions and most political elites in Brazil, view the current events as a kind of short-term economic setback which resulted solely from inefficient past internal policies, not from the development choices made, hence the advisability of continuing unchanged along the same course.

It is my view, however, that the developmental crisis in Brazil, the consequence of the transformation of the debtor country into a net capital exporter to the industrialized world as debt service payments and remission of profits far outweigh both new lending and direct investment, not only has become the main obstacle to Brazil's long-term economic growth and political democracy, but also has challenged the wisdom of continuity in development strategies.

In effect, the developmental crisis of the 1980s tells us the extent to which external factors have strongly shaped the domestic political and economic processes of many countries in the Third World, but not in the manner predicted by the developmentalists. It thus brings new support to the dependency perspective which attempts to understand and evaluate the

nature of the process by which economic growth is achieved. Rejecting developmentalism's basic unit of analysis, the nation-state, the dependency approach argues that domestic national processes do not occur in relative isolation from international influences. Rather, it is the global expansion of the capitalist system and its various forms of structural interactions with national societies that condition, or set constraints and limits to, their development process. I believe that the crisis of the 1980s demonstrates the validity of the theoretical framework of the dependency perspective.

Since the late 1960s, the dependency approach for the study of the socio-political nature of Latin American economic development process has been striving to show in a historical-structural fashion that the growth strategy based primarily on external reliance on flows of capital entails heavy economic, political and social costs and will not enable the region to replicate, in the long-term, the historical pattern of capitalist development in the West. Dependency assumes that "fundamental differences separate global profit makers and those primarily interested in national accumulation",³ which make it impossible to replicate in the "periphery" the automatic, unilinear evolutionary capitalist development experienced in the "center" of the system, as the convergence thesis would have it. Instead, this imported growth model has produced in some parts of the periphery a capitalism with a very special nature, labeled "dependent development", or a "new situation of dependency."

"Dependency" implies a situation of external reliance by Third World countries on flows of goods and capital (foreign investment, loans and aid) from center countries of the capitalist world economy. "Dependent development" is a special instance of dependency that refers to cases where capital accumulation and diversified industrialization are occurring in a

peripheral country, despite the fact that this economic growth is externally conditioned in significant ways.⁴ The development model that is taking place in certain countries of the periphery is thus evaluated by dependencistas strictly in the terms defined by the developmentalists themselves, that is, high rates of capital accumulation, and not in more welfare-oriented terms that involve the quality of life.⁵ It is only in this sense that dependency is compatible with development. But the key question for dependencistas is: who is controlling the capital accumulation process? It is here that the dependency approach lays out the basic difference between capitalist development in the center and capitalist development in the periphery, between the internal social structures of the center and those of the periphery.

Thus, dependencistas argue that this capitalist development occurring in some countries of the periphery is characterized not only by levels of inequality that are extreme in comparison to those found in developed countries, but also by external determination of the rate and direction of capital accumulation because crucial decisions on investment, production and consumption take place outside the dependent countries.⁶ Despite the rapid industrialization and the impressive growth rates in countries experiencing dependent development, they remain as dependent on the center economies as in the pre-1930 period of classic dependence characterized by primary product export economies. The form of dependency has changed, but the sources of vulnerability and external control remain. In short, dependency implies a situation of "vulnerability to the external economy and important limitations on local control of even the internal productive apparatus."⁷

The dependency approach, however, further assumes that this foreign-controlled capitalist development occurring in Latin America is not

mechanically determined or imposed by external dominance in a quasi-colonial situation. Rather, it is the product of structural interactions of external economic forces with internal political forces (classes, states and enterprises) whose values and interests coincide with those of the foreigners they support. As Cardoso and Faletto explain the internal political dynamics of dependency:

...there is no such thing as a metaphysical relation of dependency between one nation and another, one state and another. Such relations are made concrete possibilities through the existence of a network of interests and interactions which link certain social groups to other social groups, certain social classes to other classes.⁸

In this way, by looking at the external and internal dimensions of dependency, historical-structural analyses attempt to show not only the global constraints to peripheral development, but also the variety of developmental paths taken through the concrete action of domestic classes and status groups. Economic processes are thus explained as social processes and the behavior of social groups and institutions becomes crucial to the analysis of development.

This case study of Brazil will demonstrate that the historical-structural dependency approach provides an adequate framework to explain the relationship between politics and economics, between international finance and Brazilian political forces since the nineteenth century so that we can better understand the developmental outcomes of such interactions. This study may also contribute to evaluate dependency propositions vis-a-vis those from contending theoretical perspectives about the impact of foreign capital on developing countries. As Gary Gereffi explains in his empirical study of dependency:

...at the structural level of socio-historical configurations, where the idea of situations of dependency is located, the question of falsifiability is not relevant. Comparative sociological concepts are not falsified or confirmed but rather

are judged as useful or not useful according to whether they illuminate significant areas of social reality (in the fashion of Weberian ideal types). At the level of dependency processes, on the other hand, the falsifiability of hypotheses about the developmental outcomes implied by dependency situations is possible. Contrary to the opinion of some critics, then, the dependency perspective can and does generate testable propositions.⁹

Thus, I will now state some major propositions taken from the dependency literature to be demonstrated empirically with the case of Brazil.

Main propositions

In this study of Brazil, the largest debtor country in the periphery of the world capitalist system, I will show that the foreign debt crisis and the consequent capital accumulation crisis of the 1980s were created by the pursuance of the very policies recommended by Western developmentalism: integration of the economy into the financial and productive global system and external reliance on flows of capital, particularly flows of financial capital, for local growth and accumulation. When global interest rates rose and easy flows of financial capital were interrupted in the early 1980s, local capital accumulation collapsed, exposing the extreme vulnerability of the economy to fluctuations in international financial markets and the important limitations on local control over even national economic policy-making, inherent in the model of growth adopted.

I will argue that the crisis of the 1980s in Brazil has resulted from the fundamental contradictions between international finance and national interests, between the short-term gains of global profit makers and the long-term economic development of Brazil, inherent in the developmentalist growth model historically adopted in the country. The contradictions are also manifested politically by external constraints on state autonomy as the representatives of international financial capital

become major political forces in national economic policy making and by the reinforcement and accentuation of social inequality and poverty as the burden of stabilization programs imposed to ensure debt repayments is mostly placed on the working and lower classes. The weakening of the state's capacity to respond to social pressure and carry out badly needed redistributive reforms thus becomes one of the basic obstacles to the consolidation of democracy in Brazil. These are the political and economic consequences to be expected resulting from dependent development or the new situation of dependency, as argued by dependencistas.¹⁰

Scholars have applied the dependency approach primarily to analyze the impact of productive capital, that is, of direct investments by Transnational Corporations (TNCs) on the periphery. I propose in this study to apply the analytical insights of the approach to the important area of international financial capital, that is, of indirect (portfolio) investments by Transnational Banks (TNBs) on the periphery.

The arguments above sum up the substantive concerns of the dependency approach which will be evaluated historically with respect to four phases of the relationship between international finance and Brazil's political forces: the first phase, 1822-1930, the primary product export economy or the period of classis dependence or outward growth; the second phase, 1930 to 1945, the period of horizontal import substituting industrialization (ISI); the third phase, 1945 to 1964, the period of vertical ISI and the internationalization of the economy, or the new situation of dependence (more precisely after 1955); and the fourth phase, 1964 to 1984, the consolidation and crisis of dependent development under military rule.

The evidence presented in this study shows firstly that the high levels of industrial development and economic growth attained in the new situation of dependency have not been able to eliminate many of the patterns

associated with classic dependence, the most evident of which are: the extreme vulnerability of the economy to external shocks and its continued chronic external disequilibrium, i.e., balance of payments (BOP) crises, heavy burden of foreign indebtedness and the consequent massive transfer of resources abroad; important limitations on the autonomy of the national economic system and of policy decisions for development, and the exclusion of the mass of the population from participation in development. Secondly, which follows logically from the first, the data shows that the process of industrialization in Brazil is not simply repeating the experience of the modern, capitalist industrial countries of Europe and the United States where the process of capital accumulation has always been based on domestic control.

These assumptions of dependency have often been rejected by developmentalists whose empirical work strives to show the positive contribution of foreign capital to peripheral growth.¹¹ Based on research done in the 1970s, when the conflicts between the interests of the periphery and international capital appeared to be overshadowed by the formidable expansion of Eurocurrency loans and foreign direct investment, such works held a general belief that capitalist development in the periphery would finally replicate capitalist development in the center. The evidence suggests, however, that the ongoing capital accumulation crisis of the 1980s as a result of net transfer of financial resources to the industrialized countries has finally seriously challenged developmentalism's unilinear assumption of local transformation and the claim that there are no conflicts between the interests of international capital and local development. As Peter Evans has recently noted:

Capitalist development occurs on the periphery, but it remains fraught with the same problems that dependency theorists first

enunciated. Alliances may be formed with TNCs, but fundamental conflicts between the interests of transnational capital and national development remain, just as the dependencistas argue.¹²

Having posed the problem and stated the major propositions that will be demonstrated empirically with the case of Brazil, I will now critically review the contending theoretical perspectives on development and make explicit their fundamental differences and implications in order to show that the dependency approach offers better explanations of reality. Chapter 1 is the subject of this theoretical discussion.

NOTES

1. World Development Report 1985, International Capital and Economic Development (New York: Oxford University Press, 1985), p. 43.
2. Ibid. p. 69.
3. Peter Evans, "After Dependency: Recent Studies of Class, State, and Industrialization", Latin American Research Review, Vol. XX, No. 2, 1985, p. 152.
4. Peter Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton: Princeton University Press, 1979), pp. 32-33.
5. Fernando Henrique Cardoso, "Associated-Dependent Development: Theoretical and Practical Implications", in Alfred Stepan (ed.), Authoritarian Brazil: Origins, Policies and Future (New Haven: Yale University Press, 1973), pp. 142-76.
6. See Fernando Henrique Cardoso and Enzo Faletto, Dependency and Development in Latin America (Berkeley, California: University of California Press, 1979); Fernando Henrique Cardoso, As Ideias e seu Lugar: Ensaio Sobre as Teorias do Desenvolvimento (Petropolis: Editora Vozes Ltda., 1980); Peter Evans, Dependent Development; Evans, "After Dependency"; Evans and Gary Gereffi, "Foreign Investment and Dependent Development: Comparing Brazil and Mexico", in Sylvia Ann Hewlett and Richard S. Weinert (eds.), Brazil and Mexico: Patterns in Late Development (Philadelphia: Institute for the Study of Human Issues, 1982) and Gary Gereffi, The Pharmaceutical Industry and Dependency in the Third World (Princeton: Princeton University Press, 1983).
7. Evans and Gereffi, "Foreign Investment and Dependent Development", p. 117.
8. Fernando Henrique Cardoso and Enzo Faletto, Dependencia e Desenvolvimento na America Latina: Ensaio de Interpretacao Sociologica (Rio de Janeiro: Editora Zahar, 1973), p. 140.
9. Gary Gereffi, The Pharmaceutical Industry and Dependency, p. 43.
10. See Cardoso and Faletto, Dependency and Development, Peter Evans, Dependent Development, Evans and Gereffi, "Foreign Investment and Dependent Development" and Gereffi, The Pharmaceutical Industry and Dependency.
11. See, for example, Bill Warren, Imperialism, Pioneer of Capitalism (London: Verso, 1980) and David G. Becker, The New Bourgeoisie and the Limits of Dependency: Mining, Class, and Power in "Revolutionary" Peru (Princeton: Princeton University Press, 1983).
12. "After Dependency: Recent Studies of Class, State, and Industrialization", p. 158.

CHAPTER 1

DEVELOPMENTALISM AND DEPENDENCY REVISITED

This chapter begins with a critical analysis of the developmentalist perspective as the prevailing paradigm in the social sciences for the study of economic and political development in the Third World. While developmentalism is most identified with the liberal neo-classical/modernization approach that posits a mechanical and determinist evolutionary growth path for developing countries based on the replication of the experience of the "model" capitalist industrial nations, this perspective is also espoused by orthodox Marxists.

Developmentalism, however, has been challenged by the dependency approach that views the development process as essentially the product of complex relationships between external and internal socio-political structures of domination, or what have been called "concrete situations of dependency." This chapter explains the dependency approach and contrasts it with "stagnationist theories" in order to show where the base for the critiques of the theoretical framework of the approach resides. Dependency analyses are then evaluated and their weaknesses revealed, particularly the neglect of the character and dimension of foreign linkages dominated by financial connections between Transnational Banks (TNBs) and Latin American borrowers, primarily the state, making the state the central link with international financial capital. It is argued that the historical-structural method of Brazilian sociologist Fernando Henrique Cardoso remains the best framework to describe and explain the nature of the Latin American

development process because it captures the interplay of international economic forces and internal political forces and integrates into the analysis the socio-political context in which development takes place.

The liberal neo-classical version of developmentalism

The central mechanism of the liberal neo-classical economic growth model for Latin America, generally known as "unbalanced growth" and associated with the name of the economist Albert Hirschman,¹ was simple. Foreign capital and technology would be channeled to the modern sector of a given country's economy, especially to its infrastructure and industry. This enrichment, in turn, would transform the modern sector into an "engine of growth" which would "push" or "pull" the initially neglected traditional rural sector upwards, so that the benefits of the process would "trickle down" to the mass of the people, and balanced, self-sustaining growth would be set in motion. Once this concentrated but short-run stimulus of external inputs occurred, it was argued, the rate of capital investment would increase and national economic growth would eventually become "automatic", generating its own supply of internal savings and creating an internal market sufficient for self-sustaining growth, as industry was supposed to provide productive employment for the masses. This process is, of course, identified with W.W. Rostow's distinct, linear stages the Western countries allegedly passed through.² And the successful completion of the stages of growth would allow the borrowers to repay their industrial country benefactors.

In addition to foreign sources, capital could also come from within. Liberal theorists such as Arthur Lewis assumed that redistributive income policies would retard economic growth and that capital accumulation had to be intensified through greater shift of income distribution in favor of profits.³ Domestic consumption, especially by the poor, had to be restrained

and real wages had to be held down in order to maximize the savings of society. The necessity for a high rate of capital accumulation thus resulted in the argument against internal redistribution on the grounds that the propensity to save is greatest among the high income groups.

Furthermore, applying to developing countries the hypothesis of the inverted U curve developed by the late Nobel laureate economist Simon Kuznets to explain the experience of Western Europe and North America, liberal economists have argued that the best way to benefit all classes of society would be to pursue short-run income concentrating policies in order to stimulate rapid economic growth which would lead "automatically" to greater income equality in the long-run.⁴ Thus, inequality is considered simply a by-product of capitalist development and the market would eventually produce general welfare.⁵ So was the path followed by modern Western countries to be copied by the aspiring candidates to modernity. It is not difficult to understand the haste with which elites in developing countries have used neo-classical economics as a basis for growth models, which have proved a convenient diversion from distributional issues. Economic growth, not political action, would achieve social goals.

The change in orientation of liberal theory from laissez-faire capitalism to the "welfare state" under the influence of Keynesian economics does not apply to less developed countries, however, only to domestic policies in the already developed countries. Government efforts to intervene in the market to promote equitable income distribution and to provide social services would disrupt the growth process.⁶ Less developed countries' resolution of domestic inequalities must be postponed for the sake of capital accumulation. In the process of growth, income will ultimately trickle down to all segments of society. Rather than worrying initially about income distribution in a poor country where all you have to distribute

is poverty, the strategy is to plan and to grow first. This is the "grow now, trickle later" approach.

As the result of these "short-term" income concentrating strategies would necessarily be a very weak internal demand structure in less developed countries, the wizards of the liberal doctrine had an answer to this "simple" problem. Export promotion or export-led growth, based on the assumption of free trade and ever-growing external demand for the low-wage products of those countries - considered their major comparative advantage - would more than compensate for insufficient demand at home, and, most important, would help out with their increasing BOP deficits, the natural consequence of servicing foreign capital (direct investment income and interest and amortization on external debt). Thus, international trade has been seen as the engine of growth and development.

Liberal neo-classical theorists like Gerald Meier, Jacob Viner, Ragnar Nurkse, Gottfried Haberler, Milton Friedman and Peter Bauer,⁷ all argue in favor of specialization according to comparative advantage in less developed countries and in favor, of course, of free trade policies in those countries according to the teachings of the classical formulators of free trade and comparative advantage doctrines, Smith and Ricardo.⁸ And those scholars count on the help of international financial institutions such as the International Monetary Fund (IMF) and the World Bank, which were designed to promote this ideology of laissez-faire and economic liberalism, to effectively translate their theoretical assumptions into practical policy in protectionist and inward oriented developing countries.⁹

It should be stressed, however, that while the free trade/investment and, of course, international payments by means of exchange liberalization, as well as income concentrating aspects of laissez-faire capitalism were recommended for Latin America, it was the development strategy of government

planning within the liberal neo-classical paradigm that permeated the works of many economists.¹⁰ Diagnosing the problem of Latin America as consisting basically of a lack of capital to finance investment, hence the need for "foreign savings", as well as of the imperfections of the market caused by the low level of development and of non-rational behavior, that is, non-maximizing, entrepreneurial behavior of the people, pure laissez-faire would not work there. Substantial government planning would thus be required to overcome these obstacles to capitalist development.¹¹

The government was to play a major role in promoting and directing the process of industrialization through the coordination and integration of the various sectors of the economy by becoming an active producer in the infrastructural and basic industrial spheres necessary for production and growth as neither local capital nor foreign direct investment were willing to tackle, given the large cost and low initial profitability. The government's role would also be to directly stimulate the private sector which had not been able to demonstrate the same spirit of initiative and innovation characteristic of its counterpart in advanced countries - the Protestant ethic, as Max Weber argued, or the absence of the "achievement motive", as David MacClelland argued - by providing credit and tax exemptions, by subsidizing imports and by underpricing key inputs from public enterprises.¹² The intention was that the public sector's expansion would support the growth of the private sector in a process of capital accumulation by the private sector itself.¹³

The capital resources for the successful execution of the planning strategy would, of course, be generated by foreign savings in the form of public and private loans, aid and also private and foreign investment. They would raise productivity, which would raise income and savings, increase the size of the market, lead to more investment and turn the "vicious circle

of poverty: into a benign circle. As Nurkse argued, interestingly enough citing Raul Prebisch of the United Nations Economic Commission for Latin America (ECLA):

...outside help in one form or another - in the form, say, of foreign investment - is necessary to bring about the initial improvement in productivity and real income that is required for any substantial domestic savings to come about. Foreign investment, according to this widely held opinion, is the redeeming force that has to be invoked to break the circle on the supply side of capital formation in low-income countries. Foreign investment is regarded as necessary to bridge the transition period; once an increase in productivity has been achieved, a flow of savings will result, or can be extracted, from the increased real income.¹⁴

It is not only the liberals, however, that espouse these developmentalist assumptions regarding necessary and "short-term" stages of income concentration and reliance on foreign capital that developing countries have to go through in order to replicate in the long-term the growth pattern of the model capitalist industrial societies. Orthodox Marxists also make a strong case for the necessity of internal inequality and external reliance on flows of capital for the replication process.

The orthodox Marxist version of developmentalism

Across the political spectrum there has been little disagreement on the basic objective of achieving higher rates of growth: the diffusion of capitalism from the center to the periphery would result in the latter eventually catching up with the former. In Marx's dictum that "The country that is more developed industrially only shows, to the less developed, the image of its own future,"¹⁵ catching-up was only a matter of time.¹⁶ According to his dialectical process, imperialism would spread the progressive bourgeois stage of capitalist development to all nations, creating the conditions for its own demise. The inevitably sharpening contradictions of this mode of production would create the necessary conditions for the seizure of state power by the exploited industrial working class and the transformation of society in a socialist direction.

But capitalism, the system characterized by the relationship between free wage labor and capital, or by the division of labor uniquely able to develop the productive forces of society, and its by-product, the increase in social inequalities, was a necessary stage through which every country had to go before advancing to the highest stage of self-emancipation of the working class. This, at any rate, appears to have been the view of Marx himself.¹⁷ Thus, evolutionary orthodox Marxism shares with its liberal neo-classical counterpart the belief that all societies progress inevitably through a single, fixed linear scheme and that the path followed by the developed Western countries will have necessarily to be replicated by the less developed countries.¹⁸

Recent works in the orthodox Marxist tradition such as Bill Warren's Imperialism, Pioner of Capitalism (1980), Marcussen and Torp, Internationalization of Capital: Prospect fot the Third World (1982) and David Becker, The New Bourgeoisie and the Limits of Dependency (1983), reassert Marx's surely invalidated expectations that capitalism was capable of developing the whole world in the image of the advanced countries and that the working class would then inherit an advanced planet.¹⁹ They portray the process of the development of the productive forces (usually defined in terms of high growth rates of GNP and GNP per capita like the liberals) being sped up by the largest transfer of center housed capital to the periphery, which occurred in the 1970s, thus creating the conditions for "indigenous, national capitalism" there in exactly the way that Marx would have predicted. This is particularly the case in the work of the late Bill Warren.²⁰

The primary "agent of change" for this version of developmentalism, however, has also increasingly come to be the state which assumes the role of promoter of capitalism as the local private bourgeoisie can not play the economic "revolutionary" role that Marx assigned to it.²¹ This new interest

in the state has rescued Marxism from its earlier overemphasis on economic determinism and on the assumption that the state was simply an extension of control by the dominant class.²² Nevertheless, even though Marx's industrializing national bourgeoisies cease to be the primary agents of change, capitalism is developing anyway and its success is seen as bringing forth the contradictions which will lead to a political struggle at the right moment in history (but not yet!) and a socialist overthrow of the system.

In the meantime, what is important for both versions of developmentalist theories of growth - liberal neo-classical and Marxist - is to rapidly accumulate capital. As development is treated as a purely economic phenomenon and defined strictly in terms of capital accumulation or development of the forces of production as an end in itself,²³ and not in more welfare oriented terms that involve the improvement in the quality of life of the people at large and, by implication, substantial reductions in unemployment, inequality or poverty, such developmentalist arguments imply a conception of historical progress in which the suffering of victims is seen as inevitable and ultimately justified. Growing inequality is interpreted as a necessary element in a process of development which would enable the problem of the majority of the people to be resolved in the future. Ultimately, whether by "trickling down" or revolutionary change, the mass of the people would achieve a modern standard of living. As the late British economist Dudley Seers aptly put: "One can in fact talk of a Chicago-Marxist paradigm."²⁴

If growth has not occurred, then the reason must lie in "internal obstacles", the analysis of which is, in effect, the theory of underdevelopment contained in the developmentalist paradigm.²⁵ Obstacles to growth may be the already mentioned lack of entrepreneurship or need for achievement,²⁶ but also traditional customs and values, religion, land concentration, oligarchic

power and most important, reactionary economic nationalism which obstructs foreign capital and free trade, the carriers of progressive capitalism.²⁷ How can Marxism, with its disdain for nationalism be so warmly embraced by many intellectual nationalists in the periphery?

Modernization

Parallel to the prevailing economic orthodoxy and conceived primarily as its political counterpart at the outset of the 1960s, the modernization school related the neo-classical model of growth for backward countries with the development of the Western model of political democracy. Its major assumptions, at any rate those of Gabriel Almond, the most influential scholar in this tradition, were that political modernization was synonymous with representative democracy and that the process of modernization was therefore very simply to be understood as one of "transition" in which backward or "traditional" polities would increasingly resemble the American model.²⁸ The implicit goal of development thus appeared to be the creation of societies that replicate the political-economic system of the United States: a private enterprise economy and a "high-mass consumption" society, to use Rostow's term, combined with a representative, democratic political structure.

Soon, however, more perceptive American political scientists, like the conservative Samuel Huntington, began to concern themselves with the political implications of this exclusionary economic model for the effective maintenance of dominant elites implementing it and for the effective diffusion of capital which flourishes only under "good political investment climate." It was easy for him to see that the model recommended would, of course, increase inequalities of social classes and therefore exacerbate political tensions. Thus, a shift of emphasis from "democracy" to "political "stability" and "order" in developing countries rapidly occurred during the mid 1960s.

Huntington linked modernization to social mobilization and participation and indicated its destabilizing aspects. But he also argued that "economic development increases economic inequality at the same time that social mobilization decreases the legitimacy of the inequality. Both aspects of modernization combine to produce political instability."²⁹ How could the growth model prescribed by the orthodox economic doctrines be encouraged if political stability and order were the priority? The answer must be found in his well known proposition that only strong political institutions could curb the demand of the masses and allocate economic resources authoritatively. For him, the degree of government, not its form, was the crucial distinction.³⁰ Huntington then proceeded to argue for strong political parties which could mobilize and organize mass popular support and for single party regimes which could effectively "dominate social forces."³¹ Thus, for him, authoritarian patterns of order offered a viable solution to the chaos of the transition period.

It was, therefore, in the Soviet Union, and not in the United States, that ruling elites in the developing areas would search for the lesson of how to accumulate and concentrate power to ensure political order as the liberal growth model was being put into practice. The elitist theses of revolutionary bureaucratic organization developed by the "political Marxist" Lenin and set out in What is to be Done? (1902),³² appears to have been studied with some care and fully adopted by the counter-revolutionary Huntington as the ideal way to effectively impose and maintain a new order: power must first be concentrated in the hands of an elite, then expanded to assimilate newly mobilized social groups; only later, and then conditionally, may it be dispersed.³³ The empirical evidence presented in subsequent chapters will show that the similarity with the Brazilian political process since 1964 is striking. In fact, it is no coincidence that Huntington was

a political consultant to both Medici and Geisel governments (see chapter 9).

We can not go much further in this sketch of the work of Samuel Huntington, but it is important to point out that an argument can be made that it was Stalin who built the Soviet stable bureaucratic political order after the unstable Leninist phase. The crucial difference between Lenin and Stalin's phases appears to lie in "...the difference in the roles of the masses; Lenin saw them as an active force, preparing the way for a quick rise to power. The Stalinists see their role as passive, always effectively controlled, summoned as occasion demands to strike, riot or parade."³⁴ And it is, of course, the latter view which comes closer to Huntington's. Surprisingly, he only pays tributes to Lenin!

Then again, the important point of this discussion is that as in the economic realm developmentalists converge in the political not only with orthodox Marxists, but also Leninists and even Stalinists, forming the core of suggestions that were freely extended to dominant ruling elites in "transitional" societies and fully put into practice by them. While the model of capital accumulation would have to follow the capitalist democracies, the model of accumulation of power, a pre-condition for the former, would have to follow the lessons of self-proclaimed revolutionary communists, whose theory, after all, also originated in the West.

This established liberal developmentalist paradigm met strong criticisms in intellectual circles in the 1960s from the Latin American dependency school (see discussion below) which effectively mounted a vigorous attack on its basic assumptions. This model, however, did not run out of steam in the early 1970s as some analysts hasten to argue.³⁵ The resilience of the liberal view is seen in its subtle counter-attack under the guise of "public policy of development" which since the 1970s has continued to influence policy-making in developing countries.

The new approach, variously described as "the new political economy", "rational choice", "public choice", "policy studies" and "growth with equity" or the World Bank's "poverty oriented",³⁶ represent a great deal of continuity with the earlier work, particularly in its focus on order and elite maintenance. The growing emphasis on political economy, which was revived precisely by the dependency school in the 1960s, is a distinct form of liberal political economy, consisting of rational choice models, decision-making and policy-analysis approaches to monitor the implementation of the still relevant models of economic and political development for the "transitional" countries. As Richard Higgott observes:

...Modernization failed to develop an empirically based problem-solving orientation that could provide a framework for analysis. In many ways, therefore, the growth of a public policy approach to development has been an exercise in making relevant the major aspects of modernization theory policy. The focus on policy has thus provided continuity in that it provides a way of "managing" and administering the diffusion of aid, technology and cultural rationality and of ensuring the creation and support of Western oriented decision-making elites.³⁷

Similarly, Irene L. Gendzier in her Managing Political Change (1985) makes the following comment:

For defenders of the genre, development theories were capable of being reformed. Hence the problem was worthy of continued consideration. For critics of the genre, the failure of the very same interpretations in question was so blatant as to undermine additional efforts at their reconstruction. What both such reactions overlooked, however, was the extent to which the assumption underlying political development theories and interpretations persisted. On the level of policy, and in the general approach to political change in the Third world to be found among scholars, the educated public, and the media, it was by no means clear that the views identified with political development studies were defunct.³⁸

The strength of the developmentalist theories, however, resides in the fact that they have been eagerly endorsed and put into practical policy decisions by the dominant political elites, not only in Latin America, but throughout most of the developing world since the 1950s. The diffusion of an "international political culture" brought about by the transfer of Western

ideas, values and institutions as Almond and some Marxists predicted, has occurred. Whether the ruling elites sincerely believed in the wisdom of neo-classical political and economic doctrines or simply embraced them as a crude justification for the enhancement and maintenance of their power and concentration of the benefits of this imported style of growth, it is by now beyond doubt that far from being forced on them, the elites deliberately opted into such models and never made any secret of their preferences or concealed their probable political and social costs. Development strategies have been conscious political choices. Surely, the data in this study will establish that such is the case of Brazil.

Theory and praxis: the case of Brazil

The Brazilian "economic miracle" between 1968 and 1973 was heralded as an example of successful growth model based on developmentalism's prescriptions and recommended by Nobel laureate Milton Friedman, among others, as a guide to other developing countries in all continents. How does the Brazilian "model" conform to developmentalism?³⁹

The Brazilian economy is clearly not the example of pure economic liberalism and has been characterized by substantial state intervention since the 1950s, or even before, since Vargas' Estado Novo in the 1930s. Yet it is a good example of the orthodox approach which has allowed a role for planning and active government policy to support the process of capital accumulation by the private sector. The military government after 1964 maintained and even expanded the state sector, but the priority of the regime was "to make market capitalism work", utilizing a "technocratic" ideology of efficiency and growth.⁴⁰ The government intervened with price, wage, tax, tariff policy to try to keep markets operating efficiently in what has been called a "planning augmented orthodox approach."⁴¹ Furthermore, after the drastic orthodox stabilization program imposed in Brazil between

1964 and 1967, export oriented growth was the focus of the new development strategy of the military government which embarked on an aggressive promotion of diversified, or manufactured, exports with foreign investment by TNCs playing a key role.⁴²

Underlying the new system was international finance. Foreign loans maintained the temporary financial equilibrium of the economy as import-intensive industrialization and growing profit repatriation by TNCs - and the service of the foreign debt itself - demanded ever larger amounts of foreign exchange as well as expanded the entrepreneurial role of the state in the infrastructural and basic inputs industries both to serve as a market for foreign capital goods and as an attraction to TNCs engaged in the luxury consumer goods sector.⁴³ In effect, what makes Brazil stand out as a typical example of a country implementing policies prescribed by developmentalism, even before the military came to power in 1964, is the major feature of the country's growth strategy: integration of the economy into the productive and financial global system and reliance on external flows of capital, particularly flows of financial capital. And the Brazilian state has been the promoter of this strategy.

Carlos Geraldo Langoni, a Chicago-trained government economist, who was Brazil's Central Bank Governor between 1979 and 1983, explains the Brazilian growth strategy:

During the past twenty years, Brazil chose a development strategy based on rapid growth financed by foreign loans and characterized by a strong presence of the state in the economy...External debt-driven growth would not have been possible without a powerful state as the borrower, and without its indirect role to stimulate, through different mechanisms, the external indebtedness of the private sector.⁴⁴

Furthermore, rapid economic growth under the military regime was accompanied by an authoritarian pattern of order just as Huntington would

have it. Authoritarianism was put into practice after 1964 under the guise of "national security doctrine",⁴⁵ which argued that political order is a prerequisite for efficient economic growth and for the stability required to attract foreign investment, the long held view of U.S. counter-insurgency advisers throughout Latin America. The doctrine, whose principles incorporated "internationalism", became in fact the ideological instrument to justify and promote the internationalization of the economy as "foreign capital was strategically incorporated in the politico-institutional project of the military based on the national security doctrine."⁴⁶

The reconciliation of growth with distributive concerns, the true meaning of economic development, was utterly disregarded by the internal ideologues of developmentalism committed primarily to political order and economic growth. In fact, one of the major orientations for Brazilian planning during the past two decades was the Kuznets' theory or "economic law".⁴⁸ Key policy-makers consistently argued that concentration of income was an inevitable and temporary phase of economic development and that redistributive measures would only slow growth. The best way to help the poor from this point of view was to grow as fast as possible rather than attempt to intervene to establish more democratic government, greater union freedom, vigorous tax and land reform, large investment in basic food crops, primary education, low income housing and income redistribution.

In his Distribuição de renda e desenvolvimento econômico no Brasil, published in 1973, Langoni defended this "market forces" theory by arguing that "increasing inequality is an inevitable consequence of economic development" which will "automatically" correct itself as a country develops, so that "the cure is not redistributive policies but the promotion of accelerated growth."⁴⁹ In the preface to Distribuição de renda, Antonio Delfim Netto, who was the Minister of Finance between 1967 and 1973 and then

Planning Minister between 1979 and 1984, accused those who favored a more egalitarian Brazil of indulging in a "veritable confidence game which would end up leaving the nation dividing up the misery more equitably."⁵⁰

Furthermore, Mario Henrique Simonsen, the Minister of Finance between 1974 and 1979, argued convincingly in favor of income concentration and authoritarianism which was regarded as the most effective way to prevent the eruption of "premature" social aspirations. In 1974, in the preface to Murilo Melo Filho's O modelo brasileiro, he asserted:

Organizing the aspirations of society into a feasible program of action is the great challenge to government officials of the modern world, and it is unfortunately necessary to admit that many of them have been unable to accomplish this task. It is also unfortunate but true that universal suffrage frequently rewards those candidates who promise to divide resources into parts whose sum is greater than the whole. This leads to an excessive emphasis on "distributive policies" whose consequences include rapid inflation, external indebtedness, the failure of growth and social disorder...While a large part of the world continues to struggle with these problems, Brazil has stood apart, since the revolution of 1964, as an island of rationality.⁵¹

As this study will show, all the conditions that the internal and external ideologues of developmentalism claimed as necessary and sufficient for sustained economic growth - and for the stability which TNCs desire - were in fact met: the absence of an effective organized labor movement, of free and direct elections and of any trace of national populist (i.e., nationalist and distributive, in their opinion) tendencies at the core of the government; an absolute guarantee of stimuli and incentives for the TNCs and the larger national enterprises (public as well as private); brilliant performance of export expansion (if we do not overlook the exceptionally favorable condition of external demand between 1968 and 1973); and a "certificate" of good conduct from the centers of international finance which kept the money flowing to maintain the financial equilibrium of the country.

What has been in practice the developmental outcome associated with the developmentalist perspective and its unilinear pretension? Is Brazil finally replicating the autonomous, self-sustaining and automatic growth experienced in the West, based on dynamic internal impulses such as domestic savings, the domestic market, continued business reinvestment and - above all - based on the domestic control of capital accumulation? While these are questions to be empirically investigated in the subsequent chapters, we can briefly summarize some ongoing events that anybody familiar, by way of newspapers, with the foreign debt crisis and the larger developmental crisis in Brazil and in Latin America in general, already knows.

Since the crisis began in 1982, debt payments have been met by trading off growth and swapping debt for foreign equity in national industries. Orthodox economic stabilization programs, prescribed by international creditors, are imposed on debtor countries to contract domestic demand and investments through drastic curtailment of imports, state investment programs and subsidies as well as monetary restrictions, credit and wage freezes in order to generate large surpluses in the debtor's balance of trade to be transferred to commercial bank creditors. These policies are pursued despite their obvious political and economic costs to fragile transitional regimes to democratic rule in terms of growth of output, investment plans, employment and current living standards, particularly of the working and lower classes who had received few, if any, of the benefits of earlier economic expansion. Most significant still, since the sudden interruption of easy flows of financial capital when the crisis began, capital transfers have been from the periphery to the center of the capitalist system. Evaluating the past five years of economic regression in Latin America, an editorial of The New York Times of January 2, 1988, summarized the situation:

...Earlier strategy has not worked. Despite new loans and austere recovery programs, economic and social conditions in the debtor

countries went from bad to worse. Astonishingly, debtors were exporting capital, paying out more for interest than they got in new money.

Similarly, The Economist reported on January 9, 1988 that in Brazil:

the rate of business investment fell from 20 percent of GDP in 1986 to around 16 percent in 1987, while remissions of profits by local subsidiaries of multinationals firms are expected to increase for the third consecutive year. In 1986 remissions even outweighed investments (that is, there was net business disinvestment).⁵²

The resilience of developmentalism

Developmentalism assumes that the foreign debt crisis has resulted from inefficient past internal policies, and not, of course, from the type of growth which took place. It therefore prescribes short-term solutions as "policy reforms" in debtor countries and advises them to continue unchanged along the same model of reliance on foreign capital. Thus, commenting on Latin America's debt crisis, Martin Feldstein, former chairman of President Reagan's Council of Economic Advisers, concludes that "...I will stick with muddling-through via modest increases in debt and equity as the most promising way to achieve satisfactory growth and the eventual return of the debtors to the financial markets."⁵³

Furthermore, in his address to the Annual Meetings of the World Bank and the IMF on September 29, 1987, former Treasury Secretary James Baker reaffirmed the guiding principles of his debt strategy first enunciated in Seoul, South Korea in 1985 and which has remained the basis for other recent U.S. debt plans.⁵⁴ The principles are: (1) the need for the "restructuring" of debtors' economies, that is, free market-oriented policy reforms, such as privatization of state enterprises, liberalization of exchange rates, the promotion of free trade and export-led growth (even in the face of increasing protectionism in industrial countries)⁵⁵ and (2) the need to encourage more flows of direct investment and substantial new lending from private banks and the World Bank. Significantly, he also urged the World Bank

to increase efforts to help with debt-for-equity swaps in debtor countries.⁵⁶ As Alan Riding of The New York Times reported on March 6, 1988:

...For foreign bankers and IMF economists, the problem stems not from interest payments but from huge state sectors that suck up scarce resources and feed inflation. They argue that with "structural reforms", a euphemism for more austerity, things will get better...In countries that have recently emerged from years of military rule, it is the debt and not the army that is now considered the main threat to democracy.

The "structural reforms" recommended by developmentalists, however, will only increase the foreign indebtedness of developing countries and intensify the denationalization of their economies through debt-for-equity swaps in whatever is left of their national industries. The orthodox economic adjustment of the borrowers supervised by the IMF, whose raison d'etre is to create the conditions for the continued servicing of the foreign debt, is at the same time a condition for the extension of the same old panacea: more credit, aid and direct investment. This follows from the major feature of developmentalism which is the prescription of policies aimed solely at qualifying the countries for ever increasing amounts of foreign capital, and not at enabling them to generate their own internal supplies of savings or reduce import intensive industrial technology.⁵⁷

Again, debtors are told that foreign capital is attracted only to countries implementing the "right policies" that is, ensuring a good investment climate which only austerity provides. Politically, this advice amounts again to concentration of power in the ruling elites, whose chances of success in the implementation of such policies are small as long-suppressed demands for redistributive measures have been loudly expressed. Naturally, those economies have not yet reached the stage of "mature capitalism" and still need help from those who already have. In this way we see the resilience of the liberal model which continues to be accepted by

ruling groups in the periphery. Why this is so is the subject of our discussion of the historical-structural dependency analysis.

From the other side of the political spectrum, an argument could be made that the intensification of the contradictions of capitalism in the periphery as a result of the debt crisis in its most concrete form - declining real wages and the increasing immiseration of the masses - would have created the "specific" conditions for their emancipation. On this question, however, to my knowledge, Marxists have been surprisingly silent. Would it be that those Latin American countries have not yet reached "mature capitalism", are still "semi-capitalist", or exhibit "particular combination and articulation of different modes of production", that is, capitalist and non-capitalist modes in which the latter dominates,⁵⁸ and more of the same old prescription is still necessary? Until the theorists come forward with a position we may assume that the answer has to be in the affirmative. It can surely be argued, however, that the problem is not really capitalist destruction of pre-capitalist modes. This has been largely achieved. The problem is the inability of capitalism to absorb those displaced from the traditional socio-economic institutions associated with "pre-capitalism."

On the other hand, if the existence of a deep capital accumulation crisis is finally acknowledged, the simple reasoning of the orthodox Marxist version of the Western theories of growth (as well as, of course, the liberal) would most certainly be that since capitalism is one, its expansion in backward regions necessarily follows the same pattern as it did in today's industrial countries, i.e., recessions once in a while.⁵⁹ Thus, the foreign debt crisis of the periphery, the accumulation crisis and other contradictions are nothing more than evidence that capitalist development is in fact occurring there and fast (hopefully in all sectors of its economic structure). Any

challenge by recalcitrant and indebted elites in the periphery to the existing rules of the game of international finance would be, as always, considered as regressive ideologies in their nationalist and populist guises. However, the question of the danger of collapse of fledgling transitional regimes to democratic rule in the periphery as a result of these contradictions has not been addressed either. This is even more surprising in view of the fact that democracy is hailed by Marxists (even when democracy was nonexistent in most of the Latin American countries during the 1970s, as in the work of the late Bill Warren's Imperialism: Pioneer of Capitalism [1980]) as the opportunity for the political advance of the proletariat.

The weakness of these theories of evolutionary diffusionism lies in their ahistorical assumption that peripheral capitalist development does not differ from that of the center and hence that capital accumulation crises in the former just follow the cyclical nature of capitalist accumulation which affects all capitalist countries. In short, capitalist development in the periphery will replicate the historical pattern of the center.⁶⁰

It is striking that these theories conveniently neglect the fact that while capitalist development in the center was mainly an endogenous process, in the periphery it has been primarily an exogenous process, and in fact, the direct result of its contact with the center. Paradoxically, this is the very basic assumption that permeates the work of the diffusionists who see the logic of international capitalism as the main dynamic force in the development of the periphery, Karl Marx, for one, stated that capitalist development will not be produced in the backward regions of the world by the development of their own productive

forces, as was the case of Western Europe, but by the impact upon them of the capitalism of Western Europe itself.⁶¹

It is precisely this impact of the advanced countries upon the periphery that accounts for the impossibility of the replication in the latter of the evolutionary experience of the former. Peripheral economies have been integrated into a global system that is very different from the world in which the industrialized countries grew. A most obvious change is the existence of the modern industrial countries themselves who determine and control the rules of the game in the global trading and investment system and in the global financial institutions. This is why the interests of advanced countries and those of the periphery are not the same.

It is only with concrete historical studies of the interplay between the financial, commercial and investment sectors of the center economies and specific countries in the periphery that we may determine the forms the expansion of capitalism has taken in the latter and how they differ from the historical pattern in the former. The historical-structural dependency approach explained below provides an appropriate framework for the study of the special dependent nature of capitalist development in the periphery, an issue which is of little interest for the externalist developmentalist paradigm which, above all, assumes a total harmony of interests between the center and the periphery.

Historical-structural analysis of concrete situations of dependency

Since the 1960s the Latin American dependency perspective has been attempting to critically evaluate the outcome and implications of the developmentalist growth strategy implemented by the region's ruling elites, and Brazil has served as a model for the analyses. Dependencistas argue that the major features of the post-war Brazilian economic growth has been the increasing foreign control over the capital accumulation and industrialization process in the country, as crucial decisions on investment, production and consumption take place outside the country, and the exclusion of the mass of the population from the benefits of this growth.⁶² Labeled "dependent development" or a "new situation of dependency" this capitalist development occurring in Brazil is a special instance of dependency that implies both capital accumulation and diversified industrialization, although the rate and direction of accumulation are externally determined. As Peter Evans argues:

If we join Cardoso in defining development as "the accumulation of capital and its effect on the differentiation of the productive system" (1974:67), then dependent development implies both the accumulation of capital and some degree of industrialization on the periphery. Dependent development is a special instance of dependency, characterized by the association or alliance of international and local capital. The state also joins the alliance as an active partner, and the resulting triple alliance is a fundamental factor in the emergence of dependent development.⁶³

Dependent development, therefore, is defined strictly in terms of capitalist accumulation and not in more welfare-oriented terms that involve the quality of life.⁶⁴ It is then an economic growth process destituted of distributional concerns that developmentalism promotes in the periphery of the capitalist system.

Yet while external dominance is the starting point for dependency analyses, their focus is on the interplay between external and internal socio-political structures or what have been called "concrete situations of dependency". In the words of Cardoso:

The novelty in the analyses of dependency has not consisted in emphasizing external dependence of the economy, which was already demonstrated by ECLA. It has come from another angle: from the emphasis now placed on the existence of structural and total relations that link the peripheral situations to the center. The studies of dependency have shown that the interests of the central economies (and their classes) articulate inside the underdeveloped countries with the interests of the local dominant classes. Thus, there is a structural articulation between the center and the periphery, and this articulation is total: it is not limited to circulation in the international market, but penetrates into the society, linking the interests of external and internal groups and classes, and generates political pacts which lead to the state... The emphasis that was placed (by ECLA) solely on global relations between the external (imperialism) and the internal (nation) has become mediated, in dependency analyses, by the process of class struggle. In this way, development is no longer a purely economic question, but a political question. ⁶⁵

Therefore, "concrete situations of dependency" are characterized "by the forms of articulation between the global economy and the local economy, between international domination and local class domination in each dependent country." ⁶⁶ Thus, this emphasis on the internal structures and political options of the dependent nations allows the social, political and economic aspects of development to be dealt with as an integrated whole.

Cardoso's historical-structural method for the analysis of concrete situations of dependency emphasizes "the historical transformation of structures by conflict, social movements and class struggle."⁶⁷ It attempts to explain how the general trends in capitalist expansion are transformed into specific relationships between men, classes and states, how these specific relations in turn react upon the general trends of the capitalist system, how internal and external processes of political domination interact with each other, both in their compatibilities and their contradictions, how the economies and polities of Latin America are articulated with those of the

center, and how their specific dynamics are thus generated. Cardoso and Faletto, in their seminal work Dependency and Development in Latin America, first published in Spanish in 1969 and translated into English in 1979, argue that:

...It is necessary to elaborate concepts and explanations able to show how general trends of capitalist expansion turn into concrete relations among men, classes and states in the periphery. This is the methodological movement constituting what is called the passage from an "abstract" style of analysis into a "concrete" form of historical knowledge. In this sense, the history of capital accumulation is the history of class struggles, of political movements, of the affirmation of ideologies, and of the establishment of forms of domination and reactions against them...So the analysis of structural dependency aims to explain the interrelationships of classes and nation-states at the level of the international scene as well as at the level internal to each country...It cannot be conceived as if consideration of external factors or foreign domination were enough to explain the dynamic of societies. The real question lies in the interrelationships at both levels. Emphasis has to be laid not only on compatibilities but also on contradictions between these two levels. 68

Cardoso and Faletto accepted as a given that peripheral economies are conditioned by the global economic system centered in the West. Dependent situations are those "that have their main features determined by the phases and trend of expansion of capitalism on a world scale."⁶⁹ What is crucial to them, however, is how and under what circumstances each dependent economy in Latin America is linked to the center, that is, how concrete forms of dependent relationships develop. The key question is therefore one of political power - how class alliances are formed and political decisions are taken in each country in different historical periods (outward expansion, 1850-1939; spontaneous ISI, 1930-1945 and the new international division of labor, after 1955).

Cardoso and Faletto then outline basic situations of dependency in Latin America within each phase in the transformation of the world capitalist system in order to show that they are a product of concrete interaction of social groups and classes. During the period of "outward

growth", exports were actively pursued by the politically dominant groups, the agrarian oligarchies. The independence movement did not attempt to transform internal productive structures; it was aimed at eliminating Iberian interference in the commercialization of products to and from England and northern Europe. Two distinct situations of national dependency thus emerged. The situation of export-economy controlled by the national bourgeoisie (typically cash-crops as in Brazil, Argentina and Colombia) and the situation of foreign controlled export enclave economies (especially mining interests as in Mexico, Chile, Bolivia, Peru and Central America). Both situations were "dependent" because production was geared solely to external demand and because the marketing of exports was determined by prices, quotas, etc..., imposed in the international market by financial and commercial interests who controlled it in the center countries. The vulnerability of the Latin American economies to fluctuations in the world market was thus dramatic, undermining national autonomy and state control of the economy.

The different situations of dependency had distinct effects on the evolution of internal social and political structures and on developmental outcomes. Thus, when the export-oriented economies collapsed during the Great Depression, the transition to the early phase of ISI or "inwardly directed development" was accomplished through distinct local political alliances very much characterized by the structures inherited from the precrisis period. In the enclave situations, such as Mexico and Chile, where the local bourgeoisie was weak, early development was attained with the state playing a major role supported by middle- and lower-class groups. In Mexico, the oligarchy had been destroyed during the revolution, and in Chile, the alliance was successful because of the emergence of the middle class during the final period of export-oriented growth. In Bolivia, Peru and Venezuela, the agro-

exporting oligarchies were able to remain in power during the world crisis and internal development began much later (in Peru not until the 1960s) when alliances of middle sectors, workers and peasants (as in the case of Bolivia) succeeded in replacing oligarchic domination. In Central America, however, the transformation of the "agrarian oligarchy" into "agrarian capitalist exporting groups" did not produce significant internal development. As Cardoso and Faletto observe with respect to situations of enclave economies:

It should be pointed out that, although the Great Depression directly and adversely affected the modern sector - that is, the enclave - in those countries, it did not threaten the dominance of the oligarchic groups, because it did not touch the latter's economic foundation, which was the hacienda...The response to popular pressure, which was directed by segments of the middle class, was armed force on the part of the dominant oligarchy and enclave. In these conditions, creating a domestic market required previous policy to be changed as it was in Chile, Mexico, Venezuela, and later, Peru. The economic consequences of the "transition" - that is, the rise of the middle class or, in some cases, the transformation of the most privileged strata of these classes into a nascent bourgeoisie - did not derive from the world economic crisis, as it did in countries with a national export economy. 70

Thus, in the nonenclave situations, such as Argentina, although the world depression did not displace oligarchic domination, export-oriented entrepreneurs had invested considerably in production for the internal market and the crisis of the export sector intensified the conditions favoring industrialization. In Brazil, the export-oriented oligarchies collapsed with the world crisis, and the state, as in Chile and Mexico, assumed a major developmental role with the support of a complex alliance of urban entrepreneurs, nonexport agrarian elites, popular sectors and middle-class groups. As Cardoso and Faletto note:

Although Argentina initially made more progress in its structure of production, by the 1930s its industrial policy was less effective than that of Brazil. Thanks to Brazil's socio-political scheme, a domestic market was formed a decade earlier than in Argentina. 71

Finally, in Colombia, although the oligarchic-bourgeois classes blocked access of the middle groups to power and the oligarchic pact was maintained, development

was nonetheless produced by the bourgeois sector.

After World War II a new situation of dependency emerged in countries like Brazil, Argentina and Mexico, known as the internationalization of the internal market or associated-dependent development. This new form of dependency, however, did not arise simply from the operations of external factors; it arose from a particular configuration of class alliances within each country whose interests coincided with those of the foreigners who were looking for new markets.⁷² The concrete political alliance of foreign, state and local capital which emerged promoted a type of industrialization based on massive investments by subsidiaries of TNCs producing consumer goods for the growing urban upper and middle class markets in these countries. By the 1970s the situation of diversified export promotion had emerged in Brazil and Mexico.⁷³ However, despite the fact that impressive industrialization has been attained and state autonomy has increased in promoting a nationalistic logic of capital accumulation, that is, one that gives local capital accumulation priority over global profit maximization by TNCs, dependency has not been eliminated in that decision making structures remain located outside the countries.⁷⁴ Despite the fact that foreign capital and the state may be able to discover shared interests in local capital accumulation, fundamental differences separate global profit makers from those primarily interested in national development. As Peter Evans argues:

While circumstances have pushed the multinational into becoming an important instrument for the industrialization of certain areas of the periphery, there remain contradictions between the logic of growth as seen from the perspective of the multinational and the development of the periphery as seen from a broader perspective - contradictions more severe than those which separate corporations and society in the countries of the center...The consequence of industrializing on the basis of this logic is the exclusion of most of the population from the potential benefits of industrialization.⁷⁵

In delineating the various forms of situations of dependency, the aim of Cardoso and Faletto and also Evans was to show not only the nature of

dependent structures and how they differ from the structures found in advanced countries, but also the multiple developmental paths taken through the concrete action of local classes, thus departing from mechanistic interpretations that emphasize the determination of internal by external structures.⁷⁶ In Cardoso and Faletto's words:

In mechanistic conceptions of history, Latin American economies are perceived as having always been determined by the "capitalist system", as it has developed on a global scale. Fundamental periods of change at the international level, it is contended, marked the significant moments of transformation of Latin American economies. In these interpretations, general characteristics of capitalism replace concrete analyses of specific characteristics of dependent societies...by excluding from the explanatory model social struggles and the particular relations (economic, social and political) that give momentum to specific dominated societies, these kinds of interpretation oversimplify history and lead to error: they do not offer accurate characterizations of social structures, nor do they grasp the dynamic aspect of history actualized by social struggles in dependent societies...We do not pretend to derive mechanically significant phases of dependent societies only from the "logic of capitalistic accumulation." 77

In his study of the dependency approach, Gabriel Palma concludes that: "The most successful analyses are those which resist the temptation to build a formal theory, and focus on "concrete situations of dependency".⁷⁸ Palma shows that the novelty of the historical-structural analysis is not in its assumption that Latin American economies are an integral part of the world capitalist system in a context of increasing internationalization of the system as a whole, or in arguing that the central dynamic of that system lies outside the region and that therefore its options are limited by the development of the center. Furthermore, the novelty of this approach is not in its acceptance as a starting point of the analysis of the insertion and location of the Latin American economies in the world capitalist system, or extending the analysis of international determinants of the region's development but in showing

...how the general and specific determinants interact in particular and concrete situations. It is only by understanding the specificity of movement in these societies as a dialectical unity of both, and

a synthesis of these "internal" and "external" factors, that one can explain the particularity of social, political and economic processes in the dependent societies. Only in this way can one explain why, for example, the single process of mercantile expansion should have produced in different Latin American societies slave labor, systems based on the exploitation of indigenous populations, and incipient forms of wage labor.⁷⁹

Finally, it should be stressed that explicit in Cardoso's historical-structural analysis of dependency, and one of his most important insights, is the distinction he draws between the concept of "state" and "regime." He places the dependent capitalist state in Latin America in the context of a neo-Marxist sense of the state as embodying an alliance or "pact of domination" that exists "among social classes or fractions of dominant classes and the norms which guarantee their dominance over the subordinate strata."⁸⁰ The state's pact of domination determines which social forces control and whose interests prevail in a given political order. The regime form, on the other hand, refers to the "rules of the game" and merely establishes the political procedures and institutions through which the dominant alliance exercises its power. Cardoso's distinction between state and regime is thus important for understanding the continuity of the role of the state in Brazil before and after the change of regime in 1964, for, the "bureaucratic-authoritarian state" was in reality a form of regime, not of state.

According to Cardoso, and as we have already discussed, the dominant alliance of the dependent capitalist state in Brazil since the mid-1950s has been composed of foreign capital, the internationalized sector of the bourgeoisie (that is, associated with foreign capital) and the public and entrepreneurial bureaucracy. The essential feature of the state is that it pursues policies aimed at accelerating capital accumulation through controlling the labor force. When in the early 1960s lower-class mobilization and political turmoil threatened the dependent capitalist state and its structure of domination, democratic procedures were quickly discarded

to eliminate all sources of working class and peasant power in order to concentrate income for further capital accumulation and to ensure the stability required by foreign capital. Thus, the structure of domination was maintained and further strengthened by shifting from a democratic to an authoritarian regime form.

Cardoso's framework neatly applies to the recent trend toward redemocratization in Latin America, and in Brazil in particular. As we will show in this study (Chapter 9), redemocratization may be very well attributed dialectically to the contradictions of dependent development which brought the country to the brink of collapse in the early 1980s. The debt crisis and the consequent output losses resulting from austerity programs imposed on Brazil to accumulate trade surpluses necessary to service the debt alienated not only the working and lower classes, but also the middle and upper classes, particularly the industrial sector, whose support was essential for the stability of the BA regime. But Brazil's transition to democracy, closely monitored by the military, whose withdrawal from office in 1985 has not constituted a withdrawal from political power, is likely to once again defend and stabilize the dependent capitalist state and its structure of domination. The viability of a new democratic regime within the parameters of dependent capitalis however, will depend not only on whether and how the dominant classes are able to resolve the economic crisis inherited from the BA regime, but also on the extent to which the dominated classes accede to socio-economic reforms which are likely to be very limited.

Therefore, in this case study of Brazil I will attempt to follow Cardoso's historical-structural methodology, the dialectical analysis of specific characteristics of local structures and processes and the mechanisms through which their maintenance and transformation are made possible. As

Cardoso and Faletto put it:

We conceive the relationship between external and internal forces as forming a complex whole whose structural links are not based on mere external forms of exploitation and coercion, but are rooted in coincidences of interests between local dominant classes and international ones, and, on the other side, are challenged by local dominated groups and classes. In some circumstances, the networks of coincident or reconciled interests might expand to include segments of the middle class, if not even of alienated parts of working classes. In other circumstances, segments of dominant classes might seek internal alliance with middle classes, working classes, and even peasants, aiming to protect themselves from foreign penetration that contradicts their interests. External domination in situations of national dependency (as opposed to purely colonial situations where the oppression by external agents is more direct) implies the possibility of the "internalization of external interests." 81

Cardoso's historical-structural dependency analysis, however, has been often ignored by critics of the dependency approach, who prefer, instead, to concentrate their efforts on the approach's weakest exponent. Why this is so, is the subject of our following discussion.

Critiques of historical-structural dependency analysis or Frank's "stagnationist theory"?

The dependency perspective has been criticized from both sides of the political spectrum and its explanatory framework rejected by developmentalists, both liberal and Marxist. But the theses consistently rejected, however, are not those developed by Cardoso, but those associated with Andre Gunder Frank, the Chicago-trained economist who popularized, for the English-speaking world, simplistic hypotheses of external domination and the impossibility of capitalist development in Latin America. Even now that more than a quarter of century has passed since its first publication in 1967, the work of Gunder Frank continues to draw the attention of the critics of the dependency approach. Furthermore, Frank is still wrongly assigned the honors of being the founder of the Latin American dependency approach, even after the seminal work of Cardoso and Faletto Dependency and Development in Latin America (1969) was translated into English in 1979. 82

Frank is not the founder of the Latin American dependency approach. Rather, he attempted to transform it into a "stagnationist theory" to explain Latin American underdevelopment. Perhaps due to the language barrier some scholars have not been able to grasp that dependency writings stem from an indigenous Latin American tradition dating back from the 1930s.

Efforts to write on the colonial period and to present a comprehensive critique of both orthodox and ECLA-Keynesian analyses can be seen in early works of such Latin American intellectuals such as the Argentinian historians Silvio Frondizi (1947 and 1959) and Sergio Bagu (1949), and particularly the Brazilian historian Caio Prado, Jr., the editor of the Revista Brasiliense, published in Brazil in the 1950s. In all their works we see the direct influence of Marx before the North American neo-Marxian current (particularly Paul Baran) had its presence felt in Latin America.

Frank's critique of the supposedly dual structure of Latin American societies was nothing new to this tradition. The works of the Brazilian Gilberto Freyre, dating back from the 1930s, were already inaugurating the debate of capitalism versus feudalism in Brazil,⁸³ which reached its high point in the works of Caio Prado on the myth of feudalism in Brazil since colonial times, also published in the 1950s in the Revista. Frank, in fact, utilized Prado's pioneer analysis of the structure of Brazilian agricultural production for export since the sixteenth century to construct his stagnationist thesis of "capitalist development of underdevelopment", that is, the essential structural features of underdevelopment instituted by Portugal at that time have persisted to the present day. But it is important to note that Prado disagreed with the premature socialist solution advocated by Frank.⁸⁴

By defining feudalism and capitalism as social systems governed by relationships of exchange, or trade, and circulation of merchant capital,

Frank provoked the rage of orthodox Marxists who define feudalism and capitalism as social systems based on modes of production and who consider capitalism essentially a progressive system necessary for the development of the productive forces of society.⁸⁵ In effect, in Frank's analysis capitalism is portrayed as a retrogressive system and only socialism can bring development, that is, the liberalization of the forces of production.

Is Frank's stagnationist theory Marxist? Ian Roxborough suggests that the answer must be negative, which justifies the attacks of orthodox Marxists. He argues that:

In common with a familiar post-Stalin transformation of Marxism in the Third World, socialism, for these radical theorists of underdevelopment (such as Franz Fanon, Regis Debray and Gunder Frank), came increasingly to be viewed as a recipe for economic growth rather than as the self-emancipation of the working class. As economic growth and capital accumulation took the centre of the stage, the notion of the "proletariat" became increasingly divorced from any association with the industrial working class. The rationale for a socialist revolution stemmed from the imperatives of capital accumulation rather than from the felt needs of the working class to transcend its situation of exploitation and alienation... Thus it is that a lumpentheory of lumpendevelopment produces in its turn a lumpensolution of lumpensocialism.⁸⁶

But Frank went beyond his arguments of the myth of feudalism and the need for socialism and he constructed hypotheses of mechanical external dominance of Latin America which eliminate the dynamic proper of the societies. His thesis of metropolis-satellite relationships, a dichotomy which differs little from the modernization theory's traditional-modernity dichotomy, through which the surplus generated in the satellites is necessarily drawn off towards the metropolises, hence the impossibility of capitalist development in the former, leads him to develop a strong "subsidiary thesis" which is very much questionable:

If it is satellite status which generates underdevelopment, then a weaker or lesser degree of metropolis-satellite relations may generate less deep structural underdevelopment and/or allow for more possibility of local development.⁸⁷

As Cardoso has convincingly demonstrated, development (or lack of it) does not take place only for reasons external to the "satellite economies". It will depend upon internal political structures which may or may not seize the opportunity when "ties are weak" and may or may not offer challenges when "ties are strong". Part Three of this case study treats the 1930s and will show that it took longer than Frank leads us to believe for Brazilian domestic power groups to promote a strategy of "autonomous development". Without doubt, the interruption of capital export from the center provided a unique opportunity which Vargas seized to mobilize domestic resources in the direction of industrialization. However, after the creation of the Estado Novo in 1937, the conscious state-led industrialization strategy was the result of internal pressure from groups, particularly the military, which had always opposed Vargas' free trade belief and which favored a nationalist solution to the crisis of the primary export economy. On the other hand, as Part Four will show, Brazil's ties became stronger with the center after 1945 not as a result of external imposition, but of internal acceptance by dominant groups that came to power and whose interests converged with those of foreigners. Therefore, it is only with concrete analysis of specific characteristics of dependent societies and their local socio-political process, that we can explain

...the different moments at which sectors of local classes allied or clashed with foreign interests, organized different forms of state, sustained distinct ideologies, or tried to implement various policies or defined alternative strategies to cope with imperialist challenges in diverse moments of history. 88

In Capitalism and Underdevelopment in Latin America, first published in 1967, Frank makes an interesting comment in a footnote when dealing with the Brazilian case:

My aim was to interpret the military coup and its economic consequences against the background of history and in terms of a theoretical model capable of accounting for the development of underdevelopment in

Brazil as a whole. As the reader will observe, this concern with the events of 1964 colors the treatment of the entire history of Brazil... 89

A serious argument can be made that Frank's hypothesis of capitalist development of underdevelopment was very much influenced by the stabilization measures that the military regime implemented in Brazil between 1964 and 1967, which reinforced the contraction of industrial growth and of the economy in general begun by the Goulart regime in 1963 (see Chapter 6 for the analysis of the stabilization program under Goulart and Celso Furtado). Chapter 7 shows, however, that the stabilization period of a transient nature under the military regime was designed by government policy-makers who believed in the wisdom of neo-classical doctrines and who solely wanted to please international finance (so did Goulart!) with IMF-inspired austerity measures in order to obtain a deferral of the foreign debt repayment burden of the early 1960s and to qualify for fresh credit and attract foreign direct investment.

The same cycle repeats itself in the 1980s. Economic stagnation, income concentration and repression were more the result of conscious policy designed by orthodox Brazilian economists such as Roberto Campos and Octavio Gouveia de Bulhões than by the "invisible hand" of capitalist development of underdevelopment. The neo-classical liberal paradigm which influences policies in the periphery is the instrument through which capitalist expansion, not its blockage, is made possible. Indeed, after 1968 foreign-induced capitalist accumulation in Brazil was again "successfully" under way, a fact Frank denies with his case for the impossibility of capitalist development under conditions of dependency.⁹⁰ As Cardoso argues, "Development and dependency are no longer separate and contradictory notions."⁹¹

Thus, Frank's simplistic theses of external domination, and the impossibility of capitalist development in Latin America do not represent

the ideas of scholars working in the historical-structural tradition and whose analyses show a qualified introduction of global constraints by appreciating the variety of developmental paths taken through the concrete action of classes and status groups. This study attempts to show precisely this conception.

Nevertheless, the importance of Frank's work can not be underestimated. His work, like Caio Prado's, grew out of the reaction in Latin America to both liberal neo-classical and orthodox Marxist views on development, particularly those prevalent among the communist parties in the region as well as in the Economic Commission for Latin America (ECLA). As such, critical studies on dependency by developmentalists, particularly orthodox Marxists, still rely on Frank's "defiant" stagnationist theses to reject the explanatory framework of the dependency approach and to develop new theoretical constructs out of or in opposition to Frank. As Marxists attacks have been more trenchant than those of the liberal developmentalists, we will briefly refer to two major issues they raise, that is, the nature of capitalism in the periphery and the elitist ideology of the dependency approach, and attempt to offer a response.

Capitalism: progressive or regressive

Frank's central notion of capitalist development of underdevelopment in the periphery has served as an intellectual springboard for developments in Marxist theory on the basis of critiques first raised by Laclau.⁹² Critical works by orthodox Marxists were thus developed with the explicit aim of showing that capitalism is a progressive system capable of developing the forces of production in the periphery. Representatives of such works are Taylor's "modes of production" (1979), Warren's "progressive imperialism" (1973, 1980), Marcussen and Torp's "internationalization of capital" (1982) and Becker's "post-imperialism" or "post-dependency" (1983, 1984 and 1987).⁹³

When Marcussen and Torp point out the weakness of the dependency approach, they do so solely on the basis of Frank's, and particularly Amin's works:

When the dependency theorists saw the relations between center and periphery as a situation of deadlock, in which the countries of the Third World were continuously being deprived of their economic surplus - a situation they could only avoid by breaking with the world market - our study indicates that there seems to exist now a possibility for a capital accumulation process within the context of capitalist development, at least in some countries of the periphery, by virtue of the world market. 94

David Becker's "post-dependency" thesis is also constructed by relying on Frank. In his article "Development, Democracy and Dependency in Latin America: a Post-Imperialist View" (1984) he rejects the dependency approach and argues convincingly that industrialization under the auspices of foreign capital (TNCs) is a fact in Latin America. Citing Colin Leys, he argues:

...It (post-imperialism) does not distort or wave away observed reality, does not substitute nationalism for class analysis, and does not fall back upon static, teleological explanation. It does not picture capitalism as uniformly progressive, instead its portrait simply includes the fact that: "some of what is happening...is... still development: painful, wasteful, and ruthless, like early capitalism everywhere, but development nonetheless...In the sufferings of the masses...there is also a certain potential for advance. The failure to recognize and grapple with this renders dependency theory misleading and hence impotent in relation to those areas where the advance has occurred." 95

What Marcussen and Torp and Becker do not seem to realize, however, is that rejection of stagnationist theses and recognition of capitalist development in the periphery do not pose a challenge to the historical-structural dependency approach. Cardoso attacked stagnationist theses effectively more than a decade ago, well before their works were published.⁹⁶ Why then is dependency so often rejected and derided? It seems to me that critiques of the approach have gone astray by relying solely on Baran's and Frank's stagnationist analyses. The problem here, as Portes notes, is that:

These writings have created the erroneous impression that dependency analyses continue to be concerned with the same quasi-colonial situation of economic stagnation and foreign control of export enclaves. On the contrary, contemporary dependency studies address a situation in which domestic industrialization has occurred along with increasing economic denationalization; in which sustained economic growth has been accompanied by rising social inequalities, and in which rapid urbanization and the spread of literacy have converged with the even more evident marginalization of the masses.⁹⁷

Becker's work, however, merits some attention because he not only rejects stagnationist theses on empirical grounds, but also attempts to invalidate the major thesis of the dependency approach, that is, although capitalist development occurs in the periphery, fundamental conflicts between the interests of international capital and local accumulation remain. Thus, Becker attempts to show in his study on Peru's development during the 1968-80 period of military rule that there is "no necessary inconsistency" between the interests of foreign capital and local accumulation through his analysis of how TNCs, local bourgeoisie and state interact in Peru's mining industry.⁹⁸ He argues that this "bonanza development" - mineral export bonanza - "was to become a principal source of new capital and foreign exchange" for the state's program of vastly accelerated industrialization.⁹⁹ Becker leaves us with the impression that the crisis of capital accumulation was successfully confronted in Peru, a "new bourgeoisie" consolidated, and, dialectically, a new politically powerful proletariat emerged, though not yet ready for socialism.¹⁰⁰

But Becker's "bonanza development" does not conform with the economic and political realities of Peru in the 1970s because it ignores the variable under study in the present work. The major source of finance for the state's investment projects was not the "profitable" mining industry, but the international capital market. This was so because reliance on primary products implies vulnerability to the international economy as the Peruvian government soon found out, but Becker did not. By 1976, Peru's massive foreign

debt servicing was beyond the capacity of the country to pay and the drastic fall in price of copper and the failure of the expected oil bonanza led to a formidable BOP and capital accumulation crisis.¹⁰¹ As Peter Evans has recently remarked in a critique of Becker's work: "...Reliance on copper exports as a basis for development seems less like 'bonanza development' and more like a situation of dependency." 102

The BOP crisis and capital accumulation crisis in 1976, ignored by Becker, was caused primarily by the failure of "bonanza development" to reduce dependency, or, as Stallings put it, by "the inevitable dilemmas of dependent capitalist development."¹⁰³ International banks came to the rescue only after the new Peruvian military government of General Francisco Morales Bermudez (General Juan Velasco Alvarado was overthrown in 1975 as a result of the growing economic crisis) complied with the Banks' demands to let them monitor harsh orthodox stabilization measures in the country, a fact that illustrates the extent to which the "new consolidated bourgeoisie" lost political power over crucial decisions about economic development. This was followed by IMF intervention in 1977-78 as the financial situation did not improve, that is, trade deficits and oppressive debt servicing remained. The result of the financial crisis and the forced austerity was economic stagnation, unemployment and the obvious political and economic weakening of the working class, as the biggest effect of austerity was on wages and salaries. The government placed the country under martial law when workers attempted to exercise their mechanism of defense (strikes), jailing hundreds of leftist labor leaders. As Stallings remarks, "...the power of the workers was simply not sufficient to outweigh that of the financial community." 104

The events of 1976-78 - and beyond - not only showed the power of international finance over Peruvian national economic policy-making, but also of TNCs which "...began to regain much of the economic and political power they

had lost during the Velasco years."¹⁰⁵ In short, the events showed the fundamental contradictions that exist between the interests of global profit makers and national capital accumulation inherent in the type of Peruvian dependent capitalist development chosen by the military regime, the very thesis of the dependency approach that Becker set out to invalidate. But, as Gary Gereffi reminds us, and which applies to Becker's intellectual endeavours:

Empirical studies of dependency have tended to confuse the costs or problems of industrial development as it occurs anywhere with the more specific costs associated with foreign-controlled development. These studies have failed, in other words, to adequately distinguish problems of capitalism from problems of dependency. 106

Nevertheless, critiques of the dependency approach by Marxists, abound. In a much cited critique, Philip K. O'Brien attempted to find similarities in the works of Frank and Cardoso by suggesting that:

It is not clear that Frank denies the possibility of a dependent industrialization (Cardoso's conception of peripheral industrialization being carried out by multinational corporations); what he does deny, is the possibility of an independent, autonomous industrialization. If Cardoso is arguing that reforms in oligarchic structures would, for example, help the conditions of the rural masses, then he really is questioning Frank's 'development of underdevelopment' thesis. But it is not at all clear that Cardoso would disagree with Frank on the increasing immiserization of the mass of the population. As neither the 'development of underdevelopment' nor 'dependent development' is sufficiently spelt out, it is not clear what the differences are. 107

What O'Brien does "deny", however, is the major difference between Frank and Cardoso on the role of capitalism in the periphery, surprisingly a key issue to orthodox Marxists. While Frank's concern is clearly to deny the progressiveness of the system and the possibility of development - even dependent - taking place in the periphery within a capitalist framework, 108 Cardoso's, on the contrary, is to acknowledge it. Thus, he says:

By development...we mean "capitalist development." This form of development, in the periphery as well as in the center, produces as it evolves, in a cyclical way, wealth and poverty, accumulation and shortage of capital, employment for some and unemployment for others.

So we do not mean by the notion of "development" the achievement of a more egalitarian or just society. These are not consequences expected of capitalist development, especially in peripheral economies. 109

Therefore, contrary to the assumption made in many Marxist critiques, dependency studies do recognize capitalist development in the periphery with its developmental and distorted effects, captured in Cardoso's concept of dependent development. Frank, to the contrary, asserts that in order for development to occur capitalism has to be superseded. This issue was easily grasped by liberals such as Robert W. Jackman in his empirical study of dependency and Richard A. Higgot.¹¹⁰ The latter, in his study of development theories, makes quite a provocative point by putting together as references to the following remark, both Bill Warren and Cardoso: "Some peripheral states have quite clearly demonstrated a capacity for some sustained growth and a consequent improvement in their structural position in the international economy, no matter how slight [Warren, 1973 and also Cardoso, 1973]." 111

All the above comments directly apply to the work of the late Bill Warren who cites the same O'Brien quotation in order to lump together Frank and Cardoso.¹¹² In effect, Warren's work, first elaborated in 1973 in his article "Imperialism and Capitalist Industrialization" in The New Left Review, was meant to criticize the dependency approach solely based on Frank's assertion that capitalism caused underdevelopment.

It is not the purpose of this study to review the most distorted analysis of the development process in the periphery ever presented by a Marxist (but quoted with approval in Marxist works such as Becker's). This has been done effectively by many perceptive scholars.¹¹³ What should be mentioned here, however, is that, in addition to the obviously ahistorical and generalized account of industrialization in the Third World, Warren's fallacious conclusion that the countries are currently embarking on a path of

autonomous industrialization is absolutely unacceptable on the basis of concrete evidence. Warren undermined stagnationist theses (as Cardoso and others also did before him by showing that industrialization was a fact in some peripheral countries) with his extravagant quantitative work to prove that capitalism is uniformly developing productive forces everywhere. But for Warren to jump from his wrong view that the gap between the rich and poor is narrowing through his developmentalist index of economic development - GNP and GNP per capita rates - to the assertion that this growth is primarily independent and national, is to take a leap into the dark.

The case of "newly industrializing countries" such as Brazil, which Warren chooses to emphasize, following the World Bank, as ultimately successful examples of "grass roots, indigenous capitalism development" are the countries most dependent on the international financial system. In fact, their financial dependence was exacerbated by the type of industrialization highly recommended by developmentalists, such as Warren. As this case study of Brazil will show, contrary to Warren's argument, the development of the productive forces there has been largely externally induced by massive penetration of foreign investment, and primarily loans, which now strain the country's growth and turn it into a prisoner of international finance.

Warren, as a good developmentalist, makes the following assertion:

That the trade and investment relationships of developed to underdeveloped countries inherently tend to cause chronic balance of payments and debt problems for the latter (especially if they aim for rapid growth) is incorrect in principle; in practice it has been frequently disproven, and the recurrent payments problems of many countries can be shown to be due to specific (incorrect) policies rather than inherent tendencies. 114

This historical study of the relationship between international finance and Brazil since the nineteenth century refutes Warren's claims. Brazil's chronic BOP deficits and exchange crises have not been the result of "incorrect policies". On the contrary, payment problems have traditionally been caused

by the implementation of the very policies recommended by developmentalists, that is, heavy reliance on foreign capital in its loan and direct investment forms as the instrument of growth and financial stability. As such, it is the service account deficit (where profit repatriation, dividends and interests are recorded in the BOP), a structural deficit almost impossible to be removed as continuous large surpluses in the trade balance to eliminate such service deficits have not been a characteristic of the structural trade relations between center and periphery, that is the ultimate cause of the recurrent foreign indebtedness and external disequilibria of the country. In other words, foreign capital is the very cause of the deficit it finances (see especially chapter 9).

Warren's suggestion that the BOP and reserves of those success stories showed favorable trends in the 1960s and 1970s ¹¹⁵deliberately distorts the fact that those "improvements" were accomplished not through export earnings, even though countries such as Brazil pursued an aggressive export-led growth strategy as recommended by developmentalism, but through an increasing foreign debt whose crisis now unfolds.

Had Warren chosen to investigate the specific features of industrialization in the periphery instead of portraying an undifferentiated picture, he would have certainly discovered that they differ fundamentally from those in the capitalist center. But as we have already had the opportunity to note in this chapter, developmentalists do not concern themselves with the nature of the process of capital accumulation in the periphery (that is, who is controlling the process), only with its growth rate in order to justify their claim that capitalist development in the periphery is replicating capitalist development in the center. In effect, Warren's work is an attempt to show that most Third World countries are going through a progressive phase of capitalism, much as Western Europe had done in the nineteenth century.

Warren's major thesis is that political independence was the most important stimulator of "indigenous capitalism" in the Third World and that dependency theory as "nationalist mythology" has failed to recognize it. Hence his weak challenge that "the case for dependency must therefore rest on the claim that a new type, or 'form' of dependent relationship has taken root."¹¹⁶ Aside from the obvious fact that industrialization - where it has in fact occurred - has been primarily financed and controlled by foreign capital, the most interesting paradox in Warren's work is that, while he derides dependency's "utopian criteria of 'nationalist and autonomous development'", he falls into the same trap with his utopian criteria of successful "indigenous, independent and national" capitalist development occurring now in the periphery. In effect, an "indigenous" development would entail in the first place the rejection of the basic Western developmental models which are adopted in most of the Third World. As Gunnar Myrdal stated three decades ago in his Economic Theory and Underdeveloped Regions:

In this epoch of the Great Awakening, it would be pathetic if young economists in the under-developed countries got led astray by the predilections of the economic thinking in the advanced countries, which are hampering the scholars there in their efforts to be rational, but would be almost fatal to the intellectual strivings of those in the under-developed countries.

I would instead wish them to have the courage to throw away large structures of meaningless, irrelevant and sometimes blatantly inadequate doctrines and theoretical approaches, and to start their thinking afresh from a study of their own needs and problems. This would then take them far beyond the realm of both outmoded Western liberal economics and Marxism. ¹¹⁷

In addition to the issue of progressive-regressive capitalism, Marxists also attack the dependency approach on the grounds of "elitism" and the weakness of its "research agenda", to use Becker's term.

The issue of elitism

Frank's simplistic thesis of external domination has also given rise to generalized attacks on the dependency approach as an elitist ideology

aimed at legitimizing the dominant classes in Latin America, or in the Third World in general. It is typical of some Marxists to deride dependency scholars as representatives of the ruling classes allegedly portrayed in their works simply as the "exploited of the capitalist world system." 118

Or, in Warren's words:

Most important, the domination of working-class movements in the Third World by populist nationalism has been reinforced by the ideological outlook of "neo-colonialism", which tends to divert and dampen internal class struggles by orienting discontent towards external alleged enemies. 119

Similarly, Becker makes the following harsh comment on the supposedly elitist ideology of the dependency approach:

...dependencismo remains an ideological force to be reckoned with. Paradoxically though it may seem, in insinuating itself into the popular consciousness throughout Latin America, dependencismo is performing yeoman service in helping to legitimate the new capitalist order. By plausibly attributing the present economic difficulties to an international economy that no Latin American government can hope to alter, it enables the local dominant classes to avoid being held responsible for them.

...Equally unconvincing is its implicit Leninist elitism, which today's more sophisticated working classes have seen through and do not admire. Consequently, dependencismo disarms popular class action that seeks a middle way between insurrectionism and 'economism'. 120

The discussion of the dependency approach, however, has already made clear that it does not assume that dependent development is externally imposed or is the "systemic product of world capitalism" as Becker would have it.¹²¹ Rather, it is posited by dependencistas that dependent development is the product of choice of internal dominant political elites whose values and interests coincide with those of the foreigners they support. In this way, dependency, being the outcome of domestic class relations, is by consent, not imposition. The task of dependencistas is thus to illuminate this type of development and those local dominant classes who promote it.

In effect, those who blame the hazards of the international economy for domestic difficulties - and not the type of growth which took place - are

the policy makers themselves, most of them with impeccable developmentalist credentials. Thus, in 1977, Mario Henrique Simonsen, then Brazilian Minister of Finance, made the following remark in a lecture at the Escola Superior de Guerra (Superior War College):

Since it was not possible to anticipate that the price of petroleum would quadruple at the end of 1973, it seemed natural to accelerate economic development by the easiest route, leaving the more difficult part for an era in which the country would already have achieved a reasonable level of per capita income. The unhappy coincidence was the occurrence of the petroleum crisis precisely at the moment in which we were reaching the highest point of international dependency. 122

Similarly, a decade later, Simonsen joined Bela Balassa (of the World Bank), Gerardo M. Bueno (a former Mexican government official) and Pedro-Pablo Kuczynski (an international financier), in arguing that:

..External events were the proximate source of the Latin American crisis of the early 1980s. A hospitable external environment is essential if the hemisphere is to achieve the economic and political goals (here enumerated). Global economic interdependence requires that the industrial countries, particularly the United States, complement new development strategies in Latin America (of export-oriented growth) with sustained and supportive policy efforts of their own. 123

The charge of elitism in the dependency approach as well as of the weakness of its "research agenda" comes generally from the fact that the key actors in the studies are the dominant groups: state, rural oligarchies, the national and international bourgeoisie and in some cases various middle-class groups. Very few works focus on the subordinated classes. 124 However, this follows from the major focus of the approach that is to explain the forms of articulation between international domination and local class domination in order to "help the political movements to see clearly the limits and possibilities of their action in the context of Latin American dependency." 125 As Jonathan Fox correctly observes in his review of Peter Evans' Dependent Development:

...it is necessary to keep in mind the importance to theory of maintaining a practical relevance...The sooner and better the Brazilian elites have been understood, with their high degree of historical continuity and unusually stable "tripod" division of labor and power, the sooner and better the popular forces in Brazil will be able to exploit their contradictions and weakness. 126

By critically analyzing the development strategies in Latin America and how they are put into practice by the dominant political elites, the dependency approach provides powerful insights into the process that Cardoso refers to as the "double exploitation" of the masses. He explains that:

After the passage from the colonial situation to situations of dependency of national states, it is observed that: (a) the passage implies the creation of states in answer to the interests of local property-owning classes; (b) these, however, have their structural situation defined within the larger framework of the international capitalist system and are thus connected and subordinated to the conquering bourgeoisies of the Western world and to those classes which succeed them; in this way alliances are established within the country, even though in contradictory form, to unify external interests with those of the local dominant groups; and (c) as a consequence, the local dominated classes suffer a kind of double exploitation. 127

Therefore, only by recognizing that they are prey to this "double exploitation" can the dominated classes attempt to politically liberate themselves, a task which is impossible to perform if they are guided by the ultra dogmatism of Marxists who insist on focusing only on the national class struggle and neglecting the major issue of the relationship between the internal and external process of political domination.

Financial dependency: the alliance of the Brazilian state and international finance

I have emphasized throughout this chapter that I consider the historical-structural method of Cardoso the best framework to describe and explain the nature of Latin American development. This does not imply, however, that the utilization of this approach has produced analyses which explain everything. In fact, the major weakness of the Latin American dependency tradition and its followers has been the overemphasis on the character and

dimension of foreign linkages dominated by TNCs with direct investment and physical presence in the region. Thus, it overlooked those dominated by financial connections between TNBs/international lending agencies and Latin American borrowers, primarily the state, making the state the central link with international finance.

Direct foreign investment by TNCs was at the heart of dependency analyses in the 1960s and 1970s and even in the early 1980s.¹²⁸ The transnational corporations and the internationalization of productive or industrial capital were depicted in those dependency works as the moving force behind the postwar growth in some countries of the periphery. While showing the inherent instability of this growth model because the masses were systematically excluded from its benefits, dependency scholars were generally optimistic about the success of capital accumulation in countries such as Brazil, called the "semi-periphery" by Evans (the term was coined by Wallerstein).¹²⁹

Cardoso's model of "associated-dependent development" and Evans' "dependent development" were based on the alliance of the state, TNCs and the modern sector of the Brazilian economy to account for the impressive growth rates during the populist regimes of the 1950s as well as during military rule. Evans' work showed the contradictions between TNC's strategy of global profit maximization and the interests of Brazil. But his major concern was to demonstrate how the Brazilian state successfully manoeuvred with the transnational corporations to ensure a degree of national capital accumulation in the country. In fact, Evans was clearly impressed by the ways the state manipulated TNCs to encourage Brazil's rapid industrialization.¹³⁰

These sophisticated analyses, however, lost much of their empirical validity because the "triple alliance" collapsed following the exhaustion of the Brazilian "miracle" with the external shocks after 1973. In an attempt to maintain a level of capital accumulation that private capital,

whether foreign or local, was no longer able to sustain, the state stepped up its intervention in the economy by relying almost exclusively on foreign loans which became even more accessible to it as a result of transnational banks recycling of OPEC surpluses. BOP problems, already evident by 1970, were simply exacerbated, culminating in a financial crisis over which the state could exert little control (see chapter 9).

Most significant, financial capital, or indirect foreign investment, was already displacing industrial capital in the 1950s as the most important source of foreign capital flows to Brazil, and after the military coup of 1964 this became even more evident, but was not captured in dependency analyses. As will be shown in Parts Four and Five, behind the "triple alliance" and at its foundation, international financial capital was maintaining the equilibrium of the BOP, as import-intensive industrialization and growing profit repatriation by TNCs and, of course, the service costs of the foreign debt itself, demanded ever larger amounts of foreign exchange, as well as expanding the entrepreneurial role of the state in the infrastructural and basic inputs industries both to serve as a market for foreign capital goods and as an attraction to TNCs engaged in the luxury consumer goods sector. The Brazilian growth strategy thus depended in the first instance on the alliance of international finance and the state, and in the absence of foreign loans, the state would not have been able to "bargain" with TNCs in order to ensure a degree of national capital accumulation, at least in the short-term.

As a consequence, the major contradictions of dependent development were not really those between the interests of international industrial capital and national development as dependencistas have argued, but between the global profit maximization strategies of international financial capital and the interests of Brazil. Massive interest payments on the foreign loans and, eventually, net transfer of resources abroad have indeed become

the main obstacles to Brazil's long-term capitalist development and to the establishment of a stable bourgeois democratic society.

The country's foreign borrowing after 1974 was increasingly being used up by the servicing of the debt itself. The debt was expanding and ultimately became a vehicle for financing itself, not for financing further economic expansion (see chapter 9). If profit repatriation by TNCs depends to a certain extent on their productive enterprises in the host country, foreign debt has to be serviced whether the debtor's economy is expanding or stagnating.¹³¹ The servicing of financial capital is thus totally divorced from production and in fact is most often secured by cutting domestic investment and social welfare programs. In this way, the state's room for manouever with international financial interests became drastically reduced. In addition to being responsible for the fore'gn debt of all its enterprises, the state also became the unconditional guarantor of all debt of the private sector, including subsidiaries of TNCs, a condition imposed by the creditors in exchange for the rescue operations following the financial crisis erupted in 1982.

Evans and Gereffi argue that "Unlike commodities, flows of capital... especially flows of direct investment, bring with them external control over the internal productive apparatus."¹³² But when flows of loan capital are taken into consideration, they may well bring with them external control over even national economic policy making, thus undermining the state's "relative autonomy" of decision making. As the events of the 1980s indicate, and this study will bring evidence to bear (see chapter 9), transnational banks and their agents, the international credit organizations such as the IMF, have become major, if not dominant, political forces in national economic policy making rarely attempted by TNCs. By imposing drastic orthodox stabilization programs on the indebted Brazilian economy

to ensure the repayment of its past loans and as a condition for new ones as a kind of short-term relief from the burden of interest payments, international financial centers set limits upon the country's capital accumulation process, harm its productive system, undermine its political autonomy and play havoc with its social fabric. It is the weakening of the state's capacity to respond to domestic social demands as a result of the debt burden that constitutes a concrete restriction to the consolidation of stable democratic institutions in Brazil after two decades of authoritarian rule. Thus, the consequences of the "strategy" of dependent development may have been even more detrimental to Brazil than most dependency analyses have suggested. As Anglade correctly observes:

The contemporary Latin American state might be acquiring an increasing degree of autonomy vis-a-vis the dominant classes in civil society, but at the same time it is facing growing external constraints as a result of foreign indebtedness and the operations of the world financial system, which reduce its capacity for autonomous decision making...The approach of 'dependent-associate' development put forward by Cardoso... has not fully incorporated the implications of the changes in the world economy and in the nature of dependency which might significantly modify its basically optimistic prognosis about the future of capital accumulation in countries such as Brazil...This new form of dependency means a new form of vulnerability of the processes of capital accumulation in the periphery, and casts further doubts about their ability to continue in a progressive and cumulative way.¹³³

While Latin American financial dependency with the consequent loss of state autonomy has been most evident during the ongoing foreign debt crisis, our examination of the historical relationship between international finance and Brazilian political forces will show that this form of dependency is not really new and that the issue to be dealt with is its continuity and exacerbation. Foreign indebtedness, vulnerability of the capital accumulation process and external constraints on state autonomy resulting from financial dependency are recurrent themes throughout Brazil's history.

Thus, in chapters 2 and 3 I will show that foreign indebtedness and stabilization policies have haunted successive Brazilian governments since the country's independence from Portugal in 1822.¹³⁴ As the landmark work of the late Brazilian economist Valentim F. Bouças, Historia da Divida Externa (1950) informs us, even before the IMF existed Brazilian governments had to convince orthodox European bankers of the correctness of their economic and financial policies in order to qualify for foreign credit. International financial interests occupied a central place in the country's economic and political life in the nineteenth century in its role designed to sustain the old international division of labor under the auspices of the British free trade doctrine. The principles of laissez-faire became the unquestionable ideology and practical policy of Brazil's export-oriented ruling oligarchies who believed in the "natural" role of the country as a supplier of agricultural products and as an importer of manufactured goods.¹³⁵ The London merchant banks and financial houses not only financed the independence of Brazil from Portugal in 1822 and the trade deficits of the Empire between 1822 and 1861; but when coffee became the main export product and reversed the trade balance after 1862, British banks continued financing both the massive service deficits created by their own past loans and coffee valorization policies of the oligarchies (that is, price support schemes to slow the decline of world coffee prices) in view of the vulnerability of the single export crop economy to price changes in the international market.

It is not surprising, therefore, that international financial interests continued to be major forces in the country in the post-1945 period when old doctrines reemerged with new clothes to suit the new international division of labor in the capitalist system under the leadership of the United States. Allowing for increasing capital

accumulation and import-intensive industrialization in some parts of the periphery, the new international order was quickly embraced by the Brazilian political dominant elites. Brazil became a profitable market for capital and intermediate goods from center countries to develop its luxury consumer goods industry under the aegis of subsidiaries of TNCs. The import bill as well as the service of those foreign corporations (profit repatriation and dividends) was financed, of course, with loans from the new official international lending institutions and private suppliers' credits from the exporting countries, since the foreign exchange reserves accumulated during the war were exhausted with the free trade policies adopted in the immediate period by the Brazilian financial authorities.

Chapters 5 and 6 show that the internationalization of the Brazilian economy and the growth model of extreme reliance on foreign loans began in fact in the 1950s during the period generally associated with populism and ISI. The same burden of foreign debt servicing and BOP pressure characteristic of the nineteenth century constituted the major economic constraints on Brazil's political elites during the boom of the 1950s. The inability of populist regimes to impose and/or sustain orthodox stabilization measures for an extended period demanded by foreign creditors, however, was met with the most powerful economic sanction: the contraction of loans. The evidence shows that this was the major determinant of the economic and political crisis which unfolded, the resolution of which was the military coup d'etat of 1964 and the immediate imposition of effective economic austerity in Brazil in the context of an increasing authoritarian political order. The stagnation of the economy during the stabilization years of 1964-67 made it possible to accumulate trade surpluses to solve the country's external disequilibrium and recreate the conditions for new inflows of loans (see chapter 7).

Yet as chapter 9 will demonstrate, the era of debt-driven growth under authoritarian control proved to be transitory and ended with an even more profound and extensive economic crisis than the one which precipitated the military takeover in 1964. The extreme vulnerability of the economy to international shocks had, if anything, increased. The consequent financial crisis, stabilization programs demanded by foreign creditors, loss of state control, severe output losses and the transformation of Brazil into a net exporter of capital to the industrial countries, undermined the military's claim to continuation in power as the essential support from civilian groups ended. The contradictions of dependent development proved to be beyond the control of the authoritarian regime and even toppled it. Yet the debt legacy of two decades of military rule is certainly a formidable constraint on Brazil's democratic prospects because a democratic regime can not service the debt, impose austerity policies and also meet domestic social demands.

This study will demonstrate, therefore, that the developmentalist strategy of dependent industrialization chosen by Brazil's dominant political elites allows for international financial capital to expand the productive forces of the country at one time and to retard them at another. This prevents Brazil from "replicating" the historical path followed by the West, where capitalist development has always been based on domestic control - a fact conveniently disregarded by the growth theories - and delays its transition to the mythological stage of "modern" or "mature capitalist" nation ripe for a proletarian revolution, in a vexatious way which escapes the attention of developmentalists, liberal and Marxist alike. As Anglade argues:

In Western Europe, the USA, and Japan, the process of continuing reproduction of capital is - and has always been - based on domestic savings and on the domestic control of capital accumulation...In Brazil, the insufficiency of domestic savings and the absence of a domestic control over the process of capital

accumulation are inherent in the model of growth which was adopted; as such, they are the ultimate cause of the crisis and a structural obstacle to the capitalist development of the country.¹³⁶

But Latin American dependency scholars have also been guilty of seriously neglecting in their historical-structural studies the ways in which international financial capital has shaped the destinies of countries in the region, particularly Brazil, since the early nineteenth century. Those countries were inserted into the global system not only as exporters of primary goods for the center's industrialization process, as it is always maintained, but also as importers of British money capital whose servicing financed Great Britain's traditional trade deficits caused by excessive imports to feed its manufacturing factories.

In the specific case of Brazil, the state has since then been the major link with international financial centers in order to promote whatever growth strategies best accommodate the interests of the dominant capitalist class as a whole. But ever since national independence in 1822 international financial capital has severely undermined the autonomy of the Brazilian state over the economy by setting constraints and limits to policy decisions for development. This work is thus a study of Brazil's development path taken through the concrete action of domestic classes and status groups and the constraints imposed by financial dependency that have accompanied it.

NOTES

1. See The Strategy of Economic Development (New Haven, Conn.: Yale University Press, 1958). See also the new publication of this work (Westview Press, 1988) where Hirschman adds a postscript: "A Dissenter's Confession: The Strategy of Economic Development Revisited."
2. See his The Stages of Economic Growth, A Non-Communist Manifesto (Cambridge: Cambridge University Press, 1960).
3. See "Economic Development with Unlimited Supplies of Labour", Manchester School of Economics and Social Sciences, 1954, 22, pp. 139-91. See also "Some Reflections on Economic Development", Economic Digest, Pakistan Institute of Development Economics, Karachi, Vol. 3, No. 4, Winter 1960, reprinted in Gerald M. Meier, Leading Issues in Economic Development (New York: Oxford University Press, 1976), Third Edition, pp. 256-258.
4. It has been considered a valid generalization in liberal analysis that relative income inequality increases in the early phases of economic growth before ultimately decreasing as the latter periods of growth are reached, the so-called curvilinear relationship (the inverted U) between inequalities and the level of economic development. The mechanisms underlying this trend are the classic factors pointed out by Kuznets, based on the experience of the advanced countries, such as the nature of intersectoral shifts (from agriculture to industry) and the changing nature of the labor force (from unskilled to skilled) that industrial development necessarily entails. But as Kuznets also noted with respect to the U.S., Germany and the U.K.: "The long swing in income inequality is also probably closely associated with the swing in capital formation proportions - in so far as wider inequality makes for higher, and narrower inequality for lower, countrywise savings proportions." Hence, the neo-classical prescription for developing countries - but not by Kuznets himself - that capital accumulation must take precedence over social equity and which is readily translated into policy choices in many of those countries. See Simon Kuznets, "Economic Growth and Income Inequality", American Economic Review, Vol. 45 (March 1955), No. 1, pp. 3-26; reprinted in Mitchell A. Seligson (ed.), The Gap Between Rich and Poor: Contending Perspectives on the Political Economy of Development (Boulder, Colorado: Westview Press, 1984), p. 31.

The application of Kuznets theory to developing countries as the Brazilian economist Carlos Geraldo Langoni did to Brazil (see his Distribuição de renda e desenvolvimento econômico no Brasil, Rio: Expressão e Cultura, 1973), leads us to believe that social inequalities will inevitably decline with economic development since those countries are simply replicating the path of the industrialized nations. This is a rather narrow theoretical construct which abstracts the economy totally from its historical and political settings. At a minimum, the mere existence of the more advanced industrial nations themselves makes the replication process untenable. At a maximum, state policies which maintain or increase inequality in the short-run may reinforce and accentuate it in the long-run. Finally, it is not at all clear that upper-income groups in developing countries have high savings propensities as did those of today's developed countries. On the contrary, the evidence suggests that income concentration in developing countries sustain more the high consumption pattern of the wealthy than savings and productive investments (see chapter 8 of this study for the evidence from Brazil).

5. See debate on the issue in Mitchell A. Seligson (ed.), The Gap Between Rich and Poor.

6. See W. Galenson (ed.), Labor and Economic Development (New York: John Wiley, 1959).

7. See Meier, The International Economics of Development (New York: Harper and Row, 1968); Viner, International Trade and Economic Development (Glencove, Long Island: Free Press, 1952); Nurkse, Equilibrium and Growth in the World Economy (Cambridge, Mass.: Harvard University Press, 1961); Haberler, International Trade and Economic Development (Cairo: National Bank of Egypt, 1959); Friedman, Essays in Positive Economics (Chicago: University of Chicago Press, 1955 and Capitalism and Freedom (Chicago: University of Chicago Press, 1962); Peter Bauer and B. Yamey, The Economics of Underdeveloped Countries (New York: Cambridge University Press, 1967) and Bauer, Dissent on Development (London: Weidenfeld and Nicolson, 1976).

8. Liberal neo-classical theory assumes that international trade solves the problem of economic inequalities between nations as there would be an equalization of prices for the factors of production and, as a result, a tendency toward an equalization of incomes among nations. But the economist Gunnar Myrdal in his Economic Theory and Underdeveloped Regions (London: Gerald Duckworth, 1957), departing from the orthodoxy, argued that:

It would be difficult to find a single case where English classical economists actually recommended that Britain should make a sacrifice for the welfare of the rest of the world. When, for instance, they recommended free trade as a general policy, it was not on the ground that free trade would be to the good of the world but because it would be in the interest of their own country. (p. 146).

Furthermore, Myrdal made the following comment regarding the applicability of economic theories developed in advanced countries to the problems of underdeveloped countries:

The theory of international trade and, indeed, economic theory in general have never been developed to comprehend the reality of great and growing economic inequalities and of the dynamic processes of underdevelopment and development...Much of this theory is a rationalization of the dominant interests in the industrial countries where it was first put forward and later developed... Much of the advice in trade and payments matters which is currently given to underdeveloped countries has the same weak foundation in a theory which is not relevant to the problems of those countries. This means that this advice is scientifically unfounded and in practice misleading.

9. See Cheryl Payer, The Debt Trap: The IMF and the Third World (New York: Monthly Review Press, 1974) and Teresa Hayter, Aid as Imperialism (Penguin Books, 1971).

10. It was, of course, Keynes (General Theory of Employment,

Interst and Money, 1935) who initiated the doctrine of state intervention in the economy during the Great Depression with a view to eliminate from capitalism its anarchic character and periodic crises, already stressed by Marx. But again, Keynesian economics was not applied in its "welfare state" aspect, only as a "help" for capital accumulation in the periphery. It should also be noted that Nurkse, unlike Hirschman, promoted balanced growth. However, the economist strongly recommended international specialization. See his Equilibrium and Growth in the World Economy. For his input on planning see Problems of Capital Formation in Underdeveloped Countries (Oxford: Basil Blackwell, 1953).

11. See discussion of the subject in Charles K. Wilber and Kenneth P. Jameson, "Paradigms of Economic Development and Beyond", in Charles K. Wilber (ed), The political Economy of Development and Underdevelopment (New York: Random House Business Division, 1988), Fourth Edition, pp. 3-27; P. W. Preston, Theories of Development (London: Routledge and Kegan Paul, 1982) and James Weaver and Kenneth Jameson, Economic Development: Competing Paradigms (New York: University Press of America, 1981).

12. See discussion in Guido Mantega, A economia politica brasileira (Sao Paulo: Polis/Vozes, 1984).

13. The strategy of planning was first followed in Brazil during the government of Juscelino Kubitschek (1956-1961). In this respect, the controversy over the entrepreneurial state as a powerful agent of capital accumulation in a process of "state capitalism" neglects the fact that state intervention in production was intended in Brazil to support the process of capital accumulation by the private sector itself. Thus, the public sector in Brazil does not really accumulate capital through its productive activities. Instead, it subsidizes prices to the private sector generating massive losses to itself (see especially chapter 9 of this study).

14. Problems of Capital Formation in Underdeveloped Countries, p. 57. See chapter 5 for a discussion of ECLA's development strategy and its similarity with the prevailing neo-classical orthodoxy.

15. Capital, Volume One (New York: Vintage Books, 1977), p. 91.

16. The writings of Marxists such as Lenin clearly suggest a trend for capital to be exported from the advanced countries to the periphery. See his Imperialism: The Highest Stage of Capitalism (New York: International Publishers, 1979).

17. See discussion of the issue in Gabriel Palma, "Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment?", World Development, Vol. 6, 1978, p. 885; Dudley Seers, "The Congruence of Marxism and Other Neo-classical Doctrines", IDS Discussion Paper no. 136, 1978 (Institute of Development Studies, University of sussex); Ian Roxborough, Theories of Development (New Jersey: Humanities Press, 1979), p. 38; Christian Anglade and Carlos Fortin, The State and Capital Accumulation in Latin America, Volume I, Brazil Chile and Mexico (Pittsburg, Pa.: University of Pittsburgh Press, 1985), pp. 3-4, 9-14; Albert Szymanski, The Logic of Imperialism (New York: Praeger,

1981, pp. 23-30; Peter F. Klaren and Thomas J. Bossert (eds.), Promise of Development: Theories of Change in Latin America (Boulder, Colorado: Westview Press, 1986), p. 6 and David F. Ruccio and Lawrence H. Simon, "Radical Theories of Development: Frank, The Modes of Production School, and Amin", in The Political Economy of Development and Underdevelopment, ed. Charles K. Wilber, p. 124.

18. The striking similarity of Marxism and liberal neo-classical doctrine is best analyzed by Dudley Seers, "The Congruence of Marxism and other Neo-classical Doctrines". As the late economist put it:

Marx himself of course had recognized that capitalism could play a constructive role in breaking down the remnants of feudalism - indeed the well known eulogy of capitalism in the 'Communist Manifesto' itself might seem more appropriate to the pages of Fortune. (p. 2).

19. See discussion in R. B. Sutcliffe, "Industry and Underdevelopment Re-examined", in The Political Economy of Development and Underdevelopment, p. 441.

20. Warren's Imperialism, Pioneer of Capitalism (London: Verso, 1980), is the best example of developmentalism from an explicitly Marxist position. On policy conclusions Warren is in complete agreement with writers such as Peter Bauer, whom he quotes with approval. Bauer is, of course, normally put in a very different category - the neo-classical or (in its purest form)"Chicago school."

21. See especially H.S. Marcussen and J.E. Torp, Internationalization of Capital: Prospect for the Third World (London: Zed Press, 1982) and David Becker, The New Bourgeoisie and the Limits of Dependency: Mining, Class, and Power in "Revolutionary" Peru (Princeton: Princeton University Press, 1983). In Becker's work it is not at all clear whether the "new bourgeoisie" would have emerged without the support of a strong nationalist state between 1968-75.

22. See especially Ralph Miliband, The State in Capitalist Society, an analysis of the Western system of power (New York: Basic Books, Inc., Publishers, 1969).

23. See Bill Warren, Imperialism, Rostow, The Stages of Growth and Peter Bauer, Dissent on Development.

24. "The Congruence of Marxism and other Neo-classical Doctrines", p. 86. As Seers explains, Marxism is, of course, strictly a particular form of neo-classical doctrine. It shares with the Chicago School a common origin in the classical writers, Adam Smith and David Ricardo. Both derivative schools, like their ancestors, were developed in Western Europe, more specifically, Britain. Both doctrines assume competitive markets and the overriding importance of material incentives. They are both basically internationalist and optimistic, technocratic and economist ("economism" means that progress is seen as essentially material, the necessary and, in the end, sufficient condition for advance on the political, social and cultural fronts). In particular, they both treat economic growth as development and as due primarily to capital accumulation. Writing on the

similarities between the doctrines, Seers further argues that:

If that seems shocking, it is because we have become accustomed to placing theories, people and governments in a right-left dimension. By adding a nationalist axis at right angles, we get a more useful map for today. All types of neo-classical economist, being fundamentally anti-nationalist, are then perceived as really not far apart (p. 1).

See also Seers, "Patterns of Dependence", in Jose J. Villamil (ed.), Transnational Capital and National Development (New Jersey: Humanities Press, 1979).

25. See Charles K. Wilber and Kenneth P. Jameson, "Paradigms of Economic Development and Beyond", in The Political Economy of Development and Underdevelopment, p. 8.

26. See David C. McClelland, "The Achievement Motive in Economic Growth", in Bert F. Hoselitz and Wilbert E. Moore (eds.), Industrialization and Society (Paris: UNESCO, 1963), reprinted in Mitchell A. Seligson (ed.), The Gap Between Rich and Poor, pp. 53-69.

27. Warren, Imperialism and Peter Bauer, Dissent on Development.

28. See Almond and James S. Coleman, The Politics of Developing Areas (Princeton: Princeton University Press, 1960).

29. Samuel Huntington, Political Order in Changing Societies (New Haven, Yale University Press, 1968), p. 59.

30. Ibid. pp. 1-2.

31. Ibid. p. 432.

32. For a very interesting analysis of Lenin's reinterpretation of Marx and his reduction of Marxism to a set of political tactics, see Frederic L. Bender, The Betrayal of Marx (New York: Harper and Row, 1975).

33. See discussion in Donald Cruise O'Brien, "Modernization, Order and Erosion of a Democratic Ideal: American Political Science, 1960-70", in David Lehmann (ed.), Development Theory (Totowa, N.J.: Frank Cass, 1979), pp. 49-76.

34. P. Selznick, The Organizational Weapon: A Study of Bolshevik Strategy and Tactics (Glencove, Long Island: Free Press, 1952), First Edition, pp. 256-57.

35. See, for example, Tony Smith, "Requiem or New Agenda for Third World Studies?", World Politics, Vol. XXXVII, July 1985, No. 4, pp. 532-561.

36. See Richard A. Higgott, Political Development Theory: The Contemporary Debate (New York: St. Martin's Press, 1983) and Martin Staniland, What is Political Economy? A Study of Social Theory and Underdevelopment (New Haven: Yale University Press, 1985).

37. Higgott, Political Development Theory, p. 100.
38. Managing Political Change (Boulder, Colorado: Westview Press, 1985), p. 3.
39. This section treats only in summary, of course, some major characteristics of the post-1964 military regime. Chapters 5 and 6 of this study will make clear that the bases of the "model" were launched by Vargas (1951-54) and, particularly Kubitschek (1956-61). In fact, the continuity of the capital accumulation model from the 1950s is striking.
40. See Albert Fishlow, "Some Reflections on Post-1964 Brazilian Economic Policy", in Alfred Stepan (ed.), Authoritarian Brazil (New Haven: Yale University Press, 1973), p. 80.
41. See James Weaver and Kenneth Jameson, Economic Development: Competing Paradigms, p. 38.
42. See Peter Evans and Gary Gereffi, "Foreign Investment and Dependent Development: Comparing Brazil and Mexico." In this respect it is interesting to note that liberal theorists revised the classical formulation to include the promotion of manufactured exports in developing countries, although still within the confines of comparative advantage. A major reason for the adoption of this policy was the argument put forth by economists such as H. Chenery, that it was not the lack of resources but the allocation of resources which was the major problem for most Third World countries. Import substitution policies had resulted in the misallocation of resources owing to insulation from market regulation. The promotion of manufactured exports, on the other hand, requires a greater sensitivity to market conditions and, as a result, enhances efficiency of production. See discussion of the subject in R. Dan Walleri, "The Political Economy Literature on North-South Relations", International Studies Quarterly, Vol. 22, No. 4, December 1978, pp. 595. In the case of Brazil, however, the emphasis placed on export promotion after the late 1960s was prompted by the need to increase foreign exchange earnings to service a growing foreign debt (see chapters 8 and 9).
43. In economics parlance, the role of external finance in "maintaining the financial equilibrium" of an economy is explained in terms of the "foreign exchange gap" (FE gap) or "trade gap" and is distinct from the "savings gap". The theory of foreign exchange-limited growth formulated by H.B. Chenery and A.M. Strout (in Gerald Meyer, Leading Issues of Economic Development, pp. 333-343 and John Donnelly, "External Debt and Long-term Servicing Capacity", in H. Jon Rosenbaun and William G. Tyler (eds.), Contemporary Brazil: Issues in Economic and Political Development (New York: Praeger Publishers, 1972), p. 96) postulates that over certain phases of a country's transition to self-sustaining economic growth, the FE constraint may dominate ex ante over the savings constraint. Because of a narrow and relatively inflexible economic structure, there are many capital and intermediate goods, essential to the development process, that cannot yet be produced domestically. For this reason, there exists a minimum level of import requirements consistent with the country's level of income, rate of economic growth, and pattern of consumer demand. Should the country's export-based capacity to import increase at a slower rate than the minimum level of

imports required to maintain the target rate of growth, a FE gap will be created. When the FE constraint prevails over the savings constraint as the most effective limit on a country's economic growth, (1) the country's FE gap, rather than the savings-investment gap, determines the amount of net external financing consistent with a predetermined target GDP growth rate; (2) the level and growth of the country's external debt is primarily a function of the cumulative size of the FE gap over a period of time and of the terms on which gross external financing is acquired to cover the gap, net of debt service payments on previous financing; and (3) should the net inflow of external capital be less than the amount required, the resulting shortage of imports will produce internal disequilibrium in the form of frustrated savings, underutilization of existing productive capacity, unemployment and a decline in economic expansion.

With its distinction between savings and foreign exchange gaps, this theory helps considerably in the understanding of the role of foreign finance as performing two independent functions: (1) supplementing domestic savings and helping capital formation and (2) providing FE and helping BOP. However, this theory of FE gap does not emphasize the importance of the FE spent with foreign services - the invisibles in the current account of the BOP- through which developing countries transfer capital to the industrial countries in the form of debt service, profit remittances, technical assistance, royalties, transport, insurance and travel. Thus, BOP disequilibria of developing countries, and hence foreign exchange-limited growth, most often results not from trade deficits, but from structural services deficits which are difficult, if not impossible, to be removed. And this is a major constraint on long-term growth in so far as foreign capital starts absorbing a large share of domestic income. Thus, foreign capital may be the cause of the deficit it finances. This process turns into a vicious circle when FE (both from exports and from new inflows of loans) is required just to keep servicing past debt and not to increase the capacity to import which in fact drastically declines, and capital formation and growth are also hampered. But it is when the inflows of loans are overwhelmed by the outflow of FE for interest and amortization payments or when the inflows are suddenly interrupted that developing countries become net capital exporters to the center of the capitalist system and the trade off between growth and debt payments begins. As we will show in this study, this has been the case of Brazil (see particularly chapter 9).

Finally, it is interesting to compare Brazil in the twentieth century with the United States, as a debtor country, in the nineteenth century. According to the World Bank in its 1985 World Development Report (p. 12) capital inflows to the U.S., particularly between 1870 and 1890, the economic take-off period, were around 1 percent of its GNP and never exceeded 6 percent of its domestic investment. In Brazil, by contrast, external public debt outstanding alone reached 22.5 percent of GDP in 1978, 43 percent in 1982 and 50 percent in 1983, accounting for less than 6 percent of domestic investment between 1979 and 1981 (see table 9.10). Furthermore, the U.S. as well as Canada, New Zealand and Australia, did not become "mature debtors", that is, their debt service was paid with export earnings and not with new loans. As chapter 9 shows, the bulk of Brazil's inflows of loans between 1973 and 1981 was used to service old ones (see also table 9.10). Between 1979 and 1981 Brazil's foreign borrowing was almost entirely used up

by the servicing of the loans it raised in the 1970s. After 1982 Brazil became a capital exporter as interest payments exceeded new inflows. The experience of Brazil as a debtor country is thus radically different from that of the U.S. even considering only economic indicators. As this study shows, however, the basic difference between capitalist development in the center and capitalist development in the periphery is in their respective internal social structures since development strategies are domestic political decisions.

44. A crise do desenvolvimento: uma estratégia para o futuro (Rio de Janeiro: Jose Olympio Editora, 1985), p. 117.

45. See Alfred Stepan, The Military in Politics: Changing Patterns in Brazil (Princeton: Princeton University Press, 1971) and Sonia Regina de Mendonça, Estado e Economia no Brasil: Opções de Desenvolvimento (Rio de Janeiro: Graal, 1986).

46. Mendonça, p. 95.

47. See Guillermo O'Donnell, "Reflections on the Patterns of Change in the Bureaucratic-Authoritarian State", Latin American Research Review, Vol. XIII, No. 1, 1978, pp. 3-38.

48. See Charles L. Wright, "Income Inequality and Economic Growth: Examining the Evidence", The Journal of Developing Areas, 13 (October 1978), p. 65 and Edward N. Muller, "Financial Dependence in the Capitalist World Economy and the Distribution of Income Within Nations", in Mitchell Seligson (ed.), The Gap Between Rich and Poor, p. 279.

49. Distribuição de Renda, pp. 81-121, esp. p. 110.

50. Ibid. p. 13.

51. O Modelo Brasileiro (Rio: Bloch Editores, 1974), Terceira Edição, p. 2.

52. The Economist, 9-15 January, 1988, p. 65.

53. In The Economist, 27 June, 1987, p. 25.

54. On March 10, 1989, U.S. Treasury Secretary Nicholas F. Brady announced a new debt plan which consisted of debt service reduction estimated at around 20 percent over three years, varying from country to country. Under the new initiative, commercial banks, on a voluntary basis, would accept a reduction in interest and principal payments while, in return, the World Bank and the IMF would guarantee that the remaining debt would actually be paid. But the U.S. administration maintained the principles of the 1985 Baker plan: that debtor countries should "restructure" their economies, that is, sell off state-owned enterprises and reduce barriers to foreign competition and that they accept more debt-for-equity swaps; that they need continued lending from abroad to foster growth, and that the countries' problem be dealt with by individual solutions, rather than with across-the-board solutions like a radical reduction of all their debt. See The New York Times of March 11, 1989, pp. 35-37 and The Wall Street Journal

of March 22, 1989, p. 11. The Brady plan, as the debt strategy is known, has raised high expectations in Latin America that debt relief on the part of commercial bank creditors is forthcoming. But the debt reduction contemplated, 20 percent, does not appear to be enough given the magnitude of the debt problem of the region and, above all, it is voluntary. While the IMF and the World Bank would offer incentives it is the commercial banks that would have to reduce principal and interest. Furthermore, preferences would be given to countries deemed to be of strategic importance to the U.S., such as Mexico, Venezuela and the Philippines and other debtors like Brazil and Argentina would have to wait because they are forming new governments or they can not meet IMF's required economic reforms. See The New York Times of April 9, 1989, pp. E 1 and 2 and April 10, 1989, p. D2.

55. This is the so-called export-led adjustment scenario that sees the revival of economic growth in the industrial countries as the key to debt relief. According to this view, economic growth in the industrialized nations, particularly in the U.S., would revive demand (and hence the price) for the debtors countries' commodities and other exports, thus enabling them to service their debt and return to economic growth themselves. However, the shortsightedness of this view is revealed in the fact that it neglects to consider the adverse impact on debtor nations of protectionism in the U.S. and elsewhere as well as of high international interest rates resulting from the large American federal budget deficit. As such, the short-term export-led scenario sidesteps the major long-term issue in the debt problem: the burden of interest payments and the need for commercial banks to accept a reduction in their profits. In fact, only with a drastic reduction in interest payments can the problem of the debt burden be solved on a long-term basis. the Brady Plan, while addressing this issue, gives commercial bank creditors the option to voluntarily reduce interest payments. As of this writing, nothing has really been accomplished.

56. The Wall Street Journal of October 1, 1987, p. 31.

57. See Cheryl Payer, The Debt Trap, p. 46.

58. See John G. Taylor, From Modernization to Modes of Production (London: The Macmillan Press, Ltd., 1979), pp. ix, xii.

59. See discussion of the Marxist debate in Anglade and Fortin (eds.), The State and Capital Accumulation in Latin America and Charles K. Wilber (ed.), The Political Economy of Development and Underdevelopment.

60. In this respect, the import substitution process that has occurred in this century in the periphery is the most obvious example of the very different characteristics from the industrial revolution of the center count (see chapters 4, 5 and 6 of this study).

61. See discussion in Gabriel Palma, "Dependency: A Formal Theory of Underdevelopment or a Methodology for the analysis of Concrete Situations of Underdevelopment?", p. 887.

62. Fernando Henrique Cardoso and Enzo Faletto, Dependency and Development in Latin America; Peter Evans, Dependent Development and Evans

and Gary Gereffi, "Foreign Investment and Dependent Development."

63. Evans, Dependent Development, pp. 32-33.

64. Fernando Henrique Cardoso, "Associated-Dependent Development: Theoretical and Practical Implications", in Alfred Stepan (ed.), Authoritarian Brazil, pp. 142-76.

65. As Ideias e Seu Lugar: Ensaio Sobre as Theorias do Desenvolvimento (Petropolis: Editora Vozes Ltda. em co-edicao com CEBRAP, 1980), p. 11. In this connection, see chapter 5 of this study for a discussion of ECLA's economic doctrine and the movement toward a more historical-structural political and social analysis of Latin American economic development.

66. Cardoso, As Ideias e Seu Lugar, p. 71.

67. Cardoso and Faletto, Dependency and Development in Latin America, p. x.

68. Ibid., p. xviii.

69. Ibid., p. xxiii.

70. Ibid., pp. 125-126.

71. Ibid., p. 101.

72. Ibid., p. 157.

73. Evans and Gereffi, "Foreign Investment and Dependent Development".

74. Cardoso, "Associated-Dependent Development", p. 146 and Cardoso and Faletto, Dependency and Development, pp. 160-61.

75. Dependent Development, p. 12.

76. In the work of Andre Gunder Frank, external dominance mechanically determines internal structures. See his Capitalism and Underdevelopment in Latin America, Historical Studies of Chile and Brazil (New York: Monthly Review Press, 1969).

77. Dependency and Development, pp. xix, xv.

78. "Dependency: A Formal Theory of Underdevelopment", p. 882.

79. Ibid., p. 910.

80. Cardoso, "On the characterisation of Authoritarian Regimes in Latin America", in David Collier (ed.), The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979), p. 38.

81. Dependency and Development, p. xvi.

82. See, for example, the work of Douglas Friedman, The State and Underdevelopment in Spanish America: The Political Roots of Dependency in Peru and Argentina (Boulder, Colorado: Westview Press, 1984), p. 4.

83. See Cardoso, "the Consumption of Dependency Theory in the United States", Latin American Research Review, Vol. 2, no. 3, 1977, p. 12.

84. The major articles published by Prado in the Revista Brasiliense are reprinted in his book A questao agraria (Sao Paulo: Brasiliense, 1979). See also discussion of Frank and Prado in Guido Mantega, A economia politica brasileira, pp. 213-261.

85. See especially Ernesto Laclau, Politics and Ideology in Marxist Theory (London: Verso, 1977).

86. Theories of Development, pp. 134 and 136.

87. Capitalism and Underdevelopment in Latin America, p. 11.

88. Cardoso and Faletto, Dependency and Development, p. xvii.

89. 1969 edition, p. 145.

90. It is interesting to note that, although from a different perspective, Brazilian economist Celso Furtado also developed stagnationist theses to explain Brazil's economic crisis of the 1960s. Criticizing ECLA's model of ISI, he argued that the major internal structural obstacle to Brazil's late capitalist development was inadequate demand as a result of income concentration, capital intensive industrialization and low wages of the working class. Ironically his Um projeto para o Brasil was published in 1968, the year the "miracle" began. It is clear that Furtado's problem simply lay in his insistence in tying the dynamism of Brazilian industrialization to the demand structure of wage earners. But it was already obvious since the mid 1950s (see chapter 6) that the type of ISI implanted in Brazil was stimulated precisely by the country's high profile of income concentration which created the restricted, by considerable, internal market for the "boom" of luxury consumer durables, such as the automobile and domestic appliances. Thus, Brazil's ISI was hardly oriented towards the consumption of wage earners and their low income was not an internal obstacle for the expansion of capitalism, but a condition for the accumulation of capital. After 1968 this trend intensified and the "miracle" showed that there was no relation between stagnation and insufficient aggregate demand, at least in the short-run.

Christian Anglade applied Furtado's thesis of insufficient aggregate demand in a recent analysis of Brazil's capital accumulation crisis. He suggests that Brazil's income concentration and low aggregate domestic demand remains one of the major causes of the crisis. See his "The State and Capital Accumulation in Brazil", in Anglade and Fortin (eds.), The State and Capital Accumulation in Latin America, pp. 52-138.

91. "Associated-Dependent Development", p. 149.

92. "Feudalism and Capitalism in Latin America", New Left Review, No. 67 (May-June 1971).

- 93. See Taylor, From Modernization to Modes of Production; Bill Warren, Imperialism: Pioner of Capitalism; Marcussen and Torp, Internationalization of Capital and David G. Becker, The New Bourgeoisie and the Limits of Dependency; Becker, "Development, Democracy and Dependency in Latin America: A post-imperialist view", Third World Quarterly, 6 (2), April 1984, pp. 411-430 and David Becker, Jeff Frieden, Sayre Schatz and Richard L. Sklar, Postimperialism: International Capitalism and Development in the Late Twentieth Century (Boulder, Colorado: Lynne Rienner, 1987). "World Systems Theory: of Immanuel Wallerstein and his followers Samir Amin and Arghiri Emmanuel - and later even Frank himself - was an attempt to "improve" or "refine" dependency, not to reject it. See Wallerstein, The Modern World-System. Vol. 1, Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century (New York: Academic Press, 1974) and "The Rise and Future Demise of the World Capitalist System: Concepts for Comparative Analysis", Comparative Studies in Society and History 16 (September 1974), pp. 387-415. See also Arghiri Emmanuel, Unequal Exchange: A Study of the Imperialism of Trade (New York: Monthly Review Press, 1972) and Samir Amin, Accumulation on a World Scale: A Critique of the Theory of Underdevelopment (New York: Monthly Review Press, 1974).

94. Internationalization of Capital, p. 164.

95. "Development, Democracy and Dependency", p. 429.

96. Autoritarismo e Democratizacao (Rio de Janeiro: Paz e Terra, 1975), pp. 27-43.

97. Alejandro Portes, "On the Sociology of National Development: Theories and Issues", American Journal of Sociology, Vol. 82 (July 1976), p. 75.

98. See The New Bourgeoisie and the Limits of Dependency.

99. Ibid. p. 61

100. Ibid. p. 342.

101. See Barbara Stallings, "Peru and the U.S. Banks: Privatization of Financial Relations", in Richard R. Fagen (ed.), Capitalism and the State in U.S.-Latin American Relations (Stanford, Calif.: Stanford University Press, 1979), pp. 217-253; Stallings, Banker to the Third World, U.S. Portfolio Investment in Latin America, 1900-1986 (Berkeley: University of California Press, 1987), pp. 243-292. See also Daniel M. Schydrowsky, "The Tragedy of Lost Opportunity in Peru", in Jonathan Hartlyn and Samuel A. Morley (eds.), Latin American Political Economy: Financial Crisis and Political Change (Boulder, Colorado: Westview Press, 1986), pp. 217-242.

102. "After Dependency: Recent Studies of class, State and Industrialization", p. 152.

103. "Peru and the U.S. Banks", p. 237.

104. Ibid. p. 247.

105. Ibid. 142

106. The Pharmaceutical Industry and Dependency in the Third World, pp. 71-2.

107. "A Critique of Latin American Theories of Dependency", in Ivan Oxaal, Tony Barnett and David Booth, Beyond the Sociology of Development: Economy and Society in Latin America (London: Routledge and Kegan Paul, 1975), p. 23.

108. This view is also expressed by Martin Staniland, What is Political Economy?", pp. 119-120.

109. Cardoso and Faletto, Dependency and Development, p. xxiii.

110. See Jackman, "Dependence on Foreign Investment and Economic Growth in the Third World," in Mitchell Seligson (ed.), The Gap Between Rich and Poor, pp. 211-227 and Higgott, Political Development Theory, p. 561.

111. Higgott, p. 56.

112. Imperialism: Pioner of Capitalism, p. 162.

113. Criticisms of Warren's work have been best presented by James Petras, Critical Perspectives on Imperialism (New York: Monthly Review Press, 1978), pp. 103-136 and Aijaz Ahmad, "Imperialism and Progress", in Theories of Development: Mode of Production or dependency?, edit. by Ronald H. Chilcote and Dale L. Johnson (Beverly Hills, Calif.: Sage Publications, 1983), pp. 33-73.

114. Imperialism, pp. 176-77.

115. Ibid. p. 178.

116. Ibid. p. 171.

117. pp. 101-2.

118. Friedman, The State and Underdevelopment in Spanish America, p. 204.

119. Imperialism, p. 185, f.n. 59.

120. "Development, Democracy and Dependency in Latin America", p.430.

121. The New Bourgeoisie and the Limits of Dependency, p. 341.

122. Quoted in Jose Serra, "Three Mistaken Theses Regarding the Connection Between Industrialization and Authoritarian Regimes", in David Collier (ed.), The New Authoritarianism in Latin America, p. 160.

123. Toward Renewed Economic Growth in Latin America, Washington, D.C.: Institute for International Economics, 1986), pp. 9-10.

124. An example of dependency work that concentrates on the working class is Kenneth Paul Erickson and Patrick V. Peppe, "Dependent Capitalist Development, U.S. Foreign Policy, and Repression of the Working Class in Chile and Brazil", in Latin American Perspectives, III, Winter 1976, pp. 19-43.

125. Cardoso, As Ideias e Seu Lugar, p. 63.

126. "Has Brazil Moved Toward State Capitalism?", Latin American Perspectives, Issue 24, Winter 1980, Volume VII, No. 1, p. 84.

127. "The Consumption of Dependency Theory in the United States", p. 13.

128. See especially Cardoso and Faletto, Dependency and Development and Peter Evans, Dependent Development. But also see, for example, Theotonio dos Santos, "The Structure of Dependence", The American Economic Review, Vol. 60 (May 1970), pp. 231-236; Oswaldo Sunkel, "Big Business and Dependencia: A Latin American View", Foreign Affairs, April 1972; T. H. Moran, Multinational Corporations and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974 and Franklin Tugwell, The Politics of Oil in Venezuela (Stanford: Stanford University Press, 1975).

129. See Immanuel Wallerstein, The Modern World System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century

130. Evans's views on the advantages for Brazil of the "triple alliance" were considerably watered down in later works. See Gary Gereffi and Peter Evans, "Transnational Corporations, Dependent Development and State Policy in Brazil and Mexico", in Latin American Research Review, vol. XVI, no. 3 (1981), pp. 31-64 and Evans and Gereffi, "Foreign Investment and Dependent Development: Comparing Brazil and Mexico", pp. 111-168.

131. It should be noted that during the 1970s, subsidiaries of TNCs in Brazil resorted to foreign borrowing as a form of financing their investment needs, rather than equity or risk capital. As will be discussed in Chapters 7 and 9, investment through loans assured the parent TNCs of profit repatriation independent of economic results obtained in productive activities since interest payments on loans are contractual obligations established according to international norms and much less vulnerable to government control than profit repatriation.

132. "Foreign Investment and Dependent Development", p. 116.

133. The State and Capital Accumulation in Latin America, pp. 14 and 26.

134. The principles of "sound finance" or monetarism have been, of course, the current orthodoxy since the nineteenth century, when it was felt by bankers (and Marx, incidentally) that the effect of the downswing of the trade cycle was to reduce wages to reasonable proportions, eliminate inefficient enterprises and restore profitable capital accumulation - the effect transmitted from center to periphery by the gold standard. In Latin America, stabilization policy has been a constant feature of economic debate since independence because of the effect of the world trade cycle on export earnings, and thus the need for politically sovereign governments frequently to adjust domestic economic policy to an exogenously determined BOP. With the Great Depression of the 1930s and the collapse of world trade and capital flows, the international gold standard was finally abandoned. In Latin America, there was a general reaction against the principles of "sound finance" and an attempt to implement a strategy of counter-cyclical monetary intervention (even before Keynes wrote his General Theory of Employment, Interest and Money, 1935) and to produce import substitutes at home simply because the countries

could no longer pay for their imports with exports nor could they obtain foreign loans. It was after World War I that the Bretton Woods system was established to reconcile the exchange rate stability of the "golden age" of international trade with the insistence of countries on managing their own economies. The Bretton Woods system, designed by the U.S. to guarantee a world economy open to its trade and investment, was called the par value system, of "fixed but adjustable" exchange rates and the IMF's task was to regulate the regime of fixed exchange rates and provide bridging finance to countries with temporary external deficits. See discussion of this issue in E. V. K. Fitzgerald, "Stabilization and Economic Justice: The Case of Nicaragua" in Charles K. Wilber (ed.), The Political Economy of Development and Underdevelopment, p. 248; Celso Furtado, Formacao Economica do Brasil (Rio: Fundo da Cultura, 1959), pp. 220-224 and Cheryl Payer, The Debt Trap, pp. 22-23.

135. Whereas in Europe liberalism was an essentially bourgeois ideology, that is, an instrument of the commercial and industrial businessmen in their fight against the privileges accorded to the rurally based aristocracy, in Brazil just the opposite occurred, and economic liberalism was transformed into the ideological arm of the Brazilian rural aristocracy. As already discussed, in its purely economic aspect, liberalism affirmed the superiority of the market economy, regulated by the price system, as opposed to any system of state intervention in the economy. According to liberals, no protectionist measures should be taken and the task of controlling the economic system should be left to the natural processes of competition, excluding those who are less efficient. Whereas in Europe the most efficient, most competitive group was the bourgeoisie, in Brazil, in the short-term at least, only the exporters of agricultural crops could compete under the terms proposed by liberalism. Thus, liberalism became the ideological tool of the Brazilian rural aristocracy, an ideology that would in practice oppose the emergence of an industrial entrepreneurial class. In this sense, it is easy to see the narrowness of cultural explanations of underdevelopment that emphasize lack of entrepreneurship or need for achievement.

136. "The State and Capital Accumulation in Contemporary Brazil", p. 53.

PART TWO

INTERNATIONAL FINANCE AND CLASSIC DEPENDENCE, 1822-1930

The international trading and financial system of the nineteenth and early twentieth centuries was centered in Great Britain. The London merchant banks and financial houses, which had replaced Amsterdam as the world financial center during the period of the Continental Wars (1793-1815) took a keen interest in the Latin American countries as fields of profitable investment as soon as they became independent. The very first series of bonds issued by the London capital market on behalf of Latin American governments in 1822-25 were for the purpose of discharging substantial debts resulting from the acquisition of arms during the last stages of the wars of independence. After 1850, however, the major role of British loan capital in Latin America was to integrate the peripheral economies into the international division of labor based on the classic theory of comparative advantage and to preserve their financial equilibrium since specialization in the export of a few agricultural commodities, and hence reliance on the international market for prosperity, resulted in periodic liquidity crises.

The insertion of the peripheral Latin American countries into the world economy designed by British free trade theorists was thus not only as exporters of primary products and markets for Great Britain's manufactured goods, but first of all as importers of British loan capital. Great Britain's increasing trade deficits were more than offset by the investment income from its capital export which financed excessive imports

to sustain its industrialization process. Latin American countries in fact played a much larger role in the British dominated international trading and financial system than has been accounted for in traditional dependency writings. And few countries played this role better than Brazil.

Chapter 2 examines how Great Britain created the conditions for Brazil's dependency on British loan capital and consequently for draining off massive investment income from the country, drastically restricting the autonomy of the national economic system and the possibilities of development. Great Britain accomplished this task by imposing on Brazil both coercively and subtly the rules of its international trading and financial system. In the first case, in 1822 England forced the new nation to accept a commercial treaty in exchange for British recognition of independence which gave British imports unimpeded access to the Brazilian market for 15 years while excluding Brazil's exports of sugar from its market. The consistent trade deficits of the Empire were, of course, financed by onerous loans raised in the London capital market.

In the second case, when coffee became the main export product and reversed the trade balance after 1862, British free trade doctrine became the unquestionable ideology of Brazil's ruling coffee oligarchies who believed in the natural role of the country in the international division of labor as a supplier of agricultural products and an importer of manufactured goods. In fact, British liberal economic doctrine, the very first version of the developmentalist theory of growth adopted in Brazil by the dominant classes, created a concrete situation of dependency that retarded the country's industrialization process for 100 years and reinforced the dependence of the economy on British loan capital to finance its chronic external disequilibrium.

The evidence suggests that a distinguishing feature of classic dependence or the period of outward growth was, without doubt, Brazil's reliance on a single export product with the consequent vulnerability of the economy to the vicissitudes and instabilities of the world market, undermining national autonomy and state control over the economy. What clearly emerges from the data, however, is that the major pattern of classic dependence was Brazil's extreme reliance on flows of British loan capital to maintain the financial equilibrium of the vulnerable export-import economy with the resulting transfer to Great Britain of a large part of the surplus of coffee exports in the form of debt service payments. And the continuous massive outflow of capital imposed severe constraints on domestic economic policy making. Therefore, the situation of dependency not only retarded the emergence of an industrial entrepreneurial class in Brazil, but it reinforced the country's role in the international division of labor as a reliable supplier of the investment income that financed Great Britain's imports to feed its manufacturing factories as well as new capital exports.

Although after the First World War Great Britain's absolute economic preeminence in Brazil declined as the U.S. became the major source of loan capital and manufactured goods, British doctrine of free trade remained the ideological tool of the Brazilian ruling oligarchies who reversed much of the industrialization the country attained during the War. As Chapter 3 shows, in the 1920s, American loan capital continued to sustain the coffee oligarchies in a fast deteriorating world economy until the crisis of the liberal international trading and financial system brought with it a major crisis in the vulnerable export-import economy. And although Vargas's policies in the 1930s redefined Brazil's terms of dependency, the high levels of industrialization and economic growth attained subsequently were not able to

eliminate many of the patterns associated with classic dependence described in chapters 2 and 3: the extreme vulnerability of the economy to external shocks, chronic external disequilibrium with the consequent heavy burden of foreign indebtedness, massive transfer of resources abroad and important limitations on the autonomy of the state.

CHAPTER 2

THE EMERGENCE AND CONSOLIDATION OF CLASSIC DEPENDENCE, 1822-1914

The genesis of Brazil's financial dependency

Inflows of British loan capital were the first link of the new nation of Brazil with the international economy of the early nineteenth century. And the nation was born in debt. Under the direct intervention of Great Britain, Brazilian independence was only recognized by Portugal after Emperor Pedro I agreed to pay in 1824 two million pounds sterling to compensate Portugal for all losses caused by the independence. In liquidation of the sum, the Rio treasury took over 1,440,000 of a 1,500,000 pounds debt which Lisbon contracted in London in 1823 with the sole purpose of fighting the Brazilians and 600,000 pounds for palaces and other royal properties left in Brazil.¹ The political independence of Brazil was thus bought from Portugal and financed by British loan capital triggering a process of total financial dependency and allowing the British an almost absolute control over the government treasury.

The genesis of the progressive indebtedness of Brazil is actually found in a bill presented by the British themselves as the price charged for their services in securing Portugal's recognition of Brazilian independence and also for their own recognition of the new nation. The first item of the bill was a commercial treaty renewing for 15 years the special privileges Britain had enjoyed for centuries in Portuguese commerce, that is, a monopoly in shipping, commerce and investments. The second item of the

bill was a treaty suppressing the slave trade and ending the institution of slavery.

Two specific articles of the commercial treaty that D. Pedro was forced to ratify in 1827 show how Great Britain paved the way for Brazil's financial dependency and consequently for draining off massive investment income from its loan to the country, drastically restricting the autonomy of the national economic system.² Article XX secured the continuation of the low import duty of 15 percent on British imports which England had enjoyed since 1810. Although Britain demanded the additional pledge by Brazil that no other country, Portugal excepted, should be conceded a lower rate than that granted to itself, by virtue of most favored nation stipulations, the Empire was forced to grant to the other powers the same low rate.³ Since Brazil relied heavily on import duties for revenues, this low import duty was the underlying cause of the consistent deficit of the Empire which was to be financed by British loans.

Furthermore, Article XXII of the commercial treaty recognized England's preferential rates in favor of products from the British West Indies, thus preventing Brazil's exports of sugar and other tropical products from having access to the British market. Related to this Article was British pressure to suppress the slave traffic and end the Brazilian institution of slavery in order to protect the West Indies sugar cane growers by weakening Brazil's labor force and hence the sugar production.⁴ Thus, as a result of the commercial treaty, during the reign of Pedro I Brazil consistently imported more than it exported and the trade deficits were, of course, financed by the loans floated in London. As Table 2.1 shows, between 1821 and 1860 Brazil's trade balance was always in deficit. Table 2.1A also shows the government's very high expenditures with imports.

Laura Randall observes that:

If Great Britain had not granted preferential treatment to the British West Indies, then it is possible that Brazil could have increased its exports to Britain by a large enough sum to pay for its imports. Brazil was faced with interest and commission charges on the loans that would not have had to be paid if the necessary trade could have been earned directly. However, exclusion of Brazilian imports and the granting of loans was profitable to Britain.³

The profitable nature of those loans can be captured by simply mentioning the lending rates that were established in the British bond market. Table 2.2 shows Brazil's foreign loans between 1824 and 1931, the nominal value of the loans, their price and actual proceeds (before commissions and fees were deducted) and their purposes. In addition to the nominal interest rate of 5 percent, there was the "discount" or risk premium, that is, a deduction made in advance from the nominal value of the loan to compensate lenders for the expected losses arising from defaults. Thus, although the nominal value of the 1829 Brazilian loan was 769,800 pounds sterling, the country actually received only 400,000 pounds since the price of the issue was 52; for each nominal 1,000 pounds Brazil received only half, that is, 520! Again, the nominal value of the 1839 loan was 411,200 pounds and Brazil netted only 312,500 since the price of the issue was 76. And this continued throughout the Empire and the Old Republic and consequently, a great part of the capital borrowed by Brazil remained with the British. In fact, as Henry William Spiegel observed: During the century of expansion of Brazilian public debt (1824-1931) the actual proceeds from the bonds varied between 80 and 90 percent of their par value and they may have been closer to 80 percent or less if account is taken of commissions and brokerage fees."⁶

According to J. Fred Rippy, the commissions paid to the financial agents were very high. The commissions exacted for floating the Brazilian loans in 1824 and 1825 were 128,000 pounds or 4 percent each. Later loans

Table 2.1 Real Exports and Imports, 1821-1914
(millions of contos de reis)

Year	Exports	Imports	Balance
<u>In 1821 currency:</u>			
1821	20,119	21,260	- 1,141
1822	20,761	23,645	- 2,884
1823	21,397	20,119	1,277
1824	21,308	22,753	- 5,448
1825	22,081	23,592	- 1,491
1826	12,549	14,116	- 1,567
1827	16,596	17,911	- 1,315
1828	16,955	16,864	90
1829	16,373	17,410	- 1,037
1830	18,832	22,537	- 3,705
1831	26,423	27,363	- 866
1832	25,516	25,781	- 265
<u>In 1832 currency:</u>			
1832	31,815	32,146	- 331
1833	20,522	17,820	2,702
1834	36,284	36,394	- 110
1835	33,949	37,638	- 3,689
1836	41,856	41,608	249
1837	26,526	35,168	- 8,642
1838	24,698	30,038	- 5,340
1839	34,526	41,040	- 6,514
1840	35,158	42,620	- 7,462
1841	33,129	45,893	- 12,764
1842	27,515	39,453	- 11,938
<u>In 1840 currency:</u>			
1840	43,192	52,359	- 9,167
1841	40,714	56,399	- 15,686
1842	33,808	48,475	- 14,668
1843	34,145	42,132	- 7,987
1844	35,566	44,895	- 9,329
1845	38,584	45,287	- 6,703
1846	46,604	45,357	1,248
1847	47,361	50,333	- 2,972
1848	46,688	38,164	8,524
1849	46,946	43,009	3,936
1850	51,015	54,846	- 3,831
1851	63,653	72,226	- 8,573
1852	58,976	82,181	- 23,205
1853	67,680	80,258	- 12,578
1854	68,467	76,483	- 8,015
1855	80,631	75,717	4,914
1856	83,850	82,481	1,470
1857	98,396	107,570	- 9,174
1858	79,269	107,338	- 28,069
1859	86,280	102,833	- 16,653

Table 2.1 (Continued)

Year	Exports	Imports	Balance
<u>In 1840 currency:</u>			
1860	93,981	94,039	- 58
1861	101,493	101,945	- 452
1862	102,491	93,841	8,650
1863	107,660	87,164	20,496
1864	113,229	108,479	4,750
1865	113,727	106,231	7,496
1866	122,852	107,760	15,093
1867	113,005	103,534	9,471
1868	101,544	77,049	24,496
1869	123,039	101,187	21,852
1870	140,138	119,661	20,477
1871	130,200	125,860	4,340
1872	153,704	121,142	32,562
1873	180,731	133,299	47,432
1874	157,641	126,977	30,664
1875	183,058	147,108	35,950
1876	150,003	140,646	9,357
1877	154,886	124,254	30,632
1878	137,898	121,003	16,896
1879	140,596	112,655	27,941
1880	158,537	123,809	34,728
1881	163,060	126,846	36,214
1882	143,328	124,478	18,850
1883	136,938	132,233	4,704
1884	144,788	135,088	9,700
1885	135,762	107,059	28,703
1886	117,562	119,094	- 1,532
1887	190,524	149,808	40,716
1888	168,014	152,615	15,398
1889	220,749	185,566	35,183
1890	204,324	186,018	18,306
1891	211,203	188,980	12,223
1892	239,908	204,517	35,391
1893	249,384	204,258	45,126
<u>In 1890 currency:</u>			
1890	280,665	255,520	25,145
1891	289,800	273,029	16,771
1892	329,564	280,946	48,618
1893	342,735	280,718	62,018
1894	326,066	290,285	35,784
1895	348,007	311,968	36,040
1896	302,977	298,130	4,847
1897	281,980	250,403	31,509
1898	267,878	252,001	15,877
1899	273,755	241,795	31,959
1900	279,762	180,601	99,161
1901	428,692	223,280	205,412
1902	387,840	248,277	139,563
1903	392,852	257,353	135,500

Table 2.1 (Continued)

Year	Export	Import	Balance
<u>In 1890 currency:</u>			
1904	416,909	275,260	141,649
1905	479,134	318,042	161,093
1906	567,765	354,493	213,272
1907	581,962	435,978	145,984
1908	469,351	377,236	92,115
1909	676,032	394,263	218,769
1910	668,862	508,270	160,592
1911	709,775	561,157	141,548
1912	793,894	674,521	119,372
1913	694,109	712,299	- 18,189
1914	490,480	364,642	125,837

Source: Laura Randall, A Comparative Economic History of Latin America, Volume 3, Brazil (Ann Arbor: University Microfilms International, 1977), pp. 216-218.

Table 2.1A Percentage Distribution of Government Revenue, 1823-1831

Source	1823	1924	1825	1826	1827	1828	1829	1830	1831
Imports	42.0	23.1	49.7	44.5	20.3	28.1	45.4	25.3	22.1
Exports	11.0	5.2	12.1	11.1	7.4	4.6	4.0	5.3	7.1
Maritime	.3	.2	.4	.4	.4	.2	.4	.2	.2
Interior	33.0	27.6	31.9	21.9	21.9	67.1	13.3	32.2	28.0
Loans	10.0	4.3							
Sequestrations	2.3	1.6							
War and navy subscriptions	.8	.7							
Voluntary contributions	.8	.1							
Extraordinary	-	<u>37.2</u>	<u>5.9</u>	<u>3.5</u>	<u>45.2</u>		<u>36.9</u>	<u>37.0</u>	<u>42.6</u>
Total A millions	3,802	9,618	4,749	5,394	12,068	7,258	14,406	18,213	22,141
B millions	4,400	10,311	4,749	5,394	12,068	7,258	14,464	24,760	22,141

Source: Laura Randall, A Comparative Economic History of Latin America, Volume 3, Brazil (Ann Arbor: University Microfilms International, 1977), p.212, Table 10-1.

Table 2.2 Brazil: Foreign Loans, 1824-1931
(Federal Government only, in thousand pounds sterling)

Year	Nominal Value	Price of the Issue	Funds Received ¹	Purpose of the loan	Source
1824	£3,686,200	81.4	£3,000,000	Establish independence	UK
1825	2,000,000	-	-	Owed to Portugal for independence	UK
1829	769,200	52	400,000	Service the 1824 loan	UK
1839	411,200	76	312,500	Cover deficits	UK
1843	732,600	85	622,702	Service the 1825 loan	UK
1852	1,040,600	91.7	954,250	Service the 1825 loan	UK
1858	1,526,500	95.5	1,425,000	Prolongation of D. Pedro II railway	UK
1859	508,000	100	508,000	Service the 1829 loan	UK
1860	1,373,013	88.1	1,210,000	Aid to three railroad companies	UK
1863	3,855,300	85.6	3,300,000	Payment of past loans and floating debt	UK
1865	6,693,600	74.5	5,000,000	Paraguayan War expenses	UK
1871	3,459,600	89	3,000,000	Cover deficits, floating debts, service previous loans	UK
1875	5,301,200	94.3	5,000,000	Same	UK
1883	4,599,900	87	4,000,000	Same	UK
1886	6,431,000	93.3	6,000,000	Cover deficits and consolidate debt	UK
1886	6,297,300	95.3	6,000,000	Consolidate floating debt and make funds available to pay newly freed work force	UK
1889	19,837,000	86.8	17,212,000	Consolidate debt	UK
1893	3,710,000	80	2,968,000	Railroad extension	UK
1895	7,442,000	85	6,325,700	Refund floating debt	UK
1898	10,000,000	86.1	8,613,717	Funding Loan	UK
1901	16,619,320	83	13,794,036	Purchase of gold interest-guarantee railroads	UK
1903-5	8,500,000	92.5	7,860,000	Rio de Janeiro Port Works	UK
1906	1,100,000	100	1,100,000	Payment of debts of Loyde Brasileiro	UK
1907	3,000,000	95	2,850,000	Taubate Coffee Price Stabilization	UK
1908	15,000,000	-	-	Coffee Price Stabilization	UK
1908	4,000,000	96	3,840,000	Cover deficits and service previous loans	UK
1908-9	FR.100,000	100	100,000	Railroad	France

Table 2.2 (continued)

Year	Nominal Value	Price of Issue	Funds Received ¹	Purpose of the Loan	Source
1909	Gold Francs				
	40,000,000	95	38,000,000	Port of Recife	France
1910	£10,000,000	87.5	£ 8,750,000	Consolidate debt	UK
1910	1,000,000	90	900,000	Annual subsidy to Loyde Brasileiro	UK
1910	GF 100,000,000	79	78,981,284	Railroads	France
1911	£ 4,500,000	92	4,140,000	Rio de Janeiro Port Works	UK
1911	2,400,000	83	1,992,000	Railroads	UK
1911	GF 60,000,000	83	49,800,000	Railroads	France
1913	FR 25,000,000		£10,670,000	Port works, railroads and payment on treasury bonds	UK
1913	£ 7,500,000			Coffee price stabilization	UK
1913	11,000,000	97	10,670,000	Cover deficits	UK
1914	4,200,000			Coffee price stabilization	UK
1914	14,502,396	100	14,502,396	Second Funding Loan	UK
1916	FR25,000,000	90	22,500,000	Payment of debts of railroads	France
1921	\$50,000,000	90	45,000,000	Cover deficits	US
1922	£ 9,000,000	92.5	£ 8,325,000	Coffee price stabilization	UK/US
1922	\$25,000,000	96	\$24,000,000	Cover deficits	US
1922	FR14,850,000	90	13,365,000	Payments of debts of railroads	France
1926	\$60,000,000	83.7	50,214,305	Refund floating debt/exchange stabilization	US
1927	£ 8,750,000	86.2	7,542,553	Consolidation of floating debt	UK
1927	\$41,500,000	87.8	36,448,495	Consolidation of floating debt	US
1930	\$ 6,500,000			Cover deficits	UK

Table 2.2 (Continued)

Year	Nominal Value	Price of Issue	Funds Received ¹	Purpose of Loan	Source
1931	Two series			Third Funding Loan	
	1.	£2,648,939			UK
		\$29,884,545			US
		FR66,000,000			France
	2.	£7,881,814			UK
		FR135,000,000			France
1931	FR 155,000,000			Payment of French loans	France

¹Before commission and other funds were deducted.

Sources: Pinto Ferreira, Capitais estrangeiros e dívida externa do Brasil (São Paulo: Editora Brasiliense, 1965); Valentim F. Bouças, Historia da dívida externa da União (Rio: Edições Financeiras, 1950), Segunda Edição; José Maria Bello, A History of Modern Brazil (Stanford: Stanford University Press, 1966); Caio Prado Junior, Historia Economica del Brasil (Buenos Aires: Editorial Futuro, 1960); José do Nascimento Brito, Economia e Finanças do Brasil (Rio, 1945) and Liberato Castro, Historia Financeira e Orçamentaria do Imperio do Brasil desde a sua Fundação (Rio, 1889) in Laura Randall, A Comparative Economic History of Latin America; J.F. Normano, Brazil: A Study of Economic Types (Chapel Hill, University of North Carolina Press, 1935); Richard Graham, Britain and the Onset of Modernization in Brazil, 1850-1914 (Cambridge: Cambridge University Press, 1968) and J. Fred Rippy, British Investment in Latin America, 1822-1949 (Hamden: Archon Books, 1959).

would reach commissions as high as 500 thousand pounds and percentages of 4.5 and 5.⁷ In his British Investment in Latin America, Rippy observed that:

Nor were these commissions by any means the only golden streams that flowed into the coffers of the financiers. Market manipulations probably brought in another million or more. Profits were obtained from interest and sinking-fund payments made in advance and left on deposit; interest and amortization for the first year and a half seem to have been subtracted from the proceeds in most instances and retained to help peg the market. Bills of earlier creditors were bought up at a discount and exchanged for bonds; agency fees were collected for remitting dividends; and the financiers using the cash received from bond sales, often served as purchasing agents for the Latin American governments.

After all the commissions, fees, discounts and printing costs had been deducted and service funds for the first eighteen months withheld, the Latin Americans found themselves close to the short end of the deal, with cash in hand equivalent to about 50 per cent of the contracted debt. For a net of some 12 million pounds sterling they had obligated themselves to the extent of more than 21 million.⁸

The early loans raised in the London bond market by the Brazilian government, while benefitting the English bond selling bankers, speculators, brokers and Brazilian officials and agents, were a tremendous burden on the country. To establish independence, Brazil floated its first loan in 1824 receiving three million pounds sterling while having a nominal debt of 3,686,200 pounds (see Table 2.2). The bulk of the proceeds of this early loan was simply used to pay the expenses of diplomatic missions and only 600,000 pounds of the total amount received went to the Banco do Brasil.⁹ The country's financial difficulties were aggravated since this debt, combined with the two million pounds raised to pay Portugal, meant that the country had to pay more than 300,000 pounds a year in interest and amortization.¹⁰ In 1828, servicing the foreign debt absorbed 11 percent of the government budget.¹¹

Brazil then turned to the British in 1829 for another loan to service the accumulated debt. The 1829 loan is known in Brazil's history as the

"ruinous loan". Table 2.2 shows that the nominal debt was 769,200 pounds, but Brazil netted only 400,000 pounds. Furthermore, the interest rate on this loan was much higher than the earlier loans (10 percent) and the government was able to obtain it only after the Rio customs house receipts were pledged as the guarantee. Valentim Bouças wrote that: "At the exchange rate of 24 5/8, the equivalent of 400,000 pounds sterling in mil reis was 3,898,400\$, costing Brazil to service the loan 17,909,383\$917, or 461 percent more than the capital received which was almost entirely used to pay interest on the loans contracted between 1824 and 1825." ¹²

The financial and commercial deals Great Britain imposed on Brazil, however, placed the Brazilian constitutional monarchy in a precarious position. The two million pounds raised in London to pay Portugal for the independence under the pressure of the British gave rise to a storm of protest in the Assembly. The loan was a secret article not published along with the Portuguese treaty recognizing the independence and presented to the Assembly as a fait accompli. ¹³ Furthermore, the signing of the commercial treaty in 1827 provoked serious objections and alienated a large part of the Portuguese or Absolutist Party which favored an absolute monarchy under D. Pedro. The treaty suppressing the slave trade completely alienated the support of the dominant party of the Empire, the Brazilian or Patriot Party, which favored a constitutional monarchy independent of Lisbon and where the landowners were the most powerful group. ¹⁴

In an early move that illustrates the constraints of dependency, Pedro I, to meet British demands, resorted to absolute power and ignored the will of the Assembly and the dominant party of the Empire. The liberty of the press, though nominally guaranteed, was extinguished; presidents of provinces who exercised arbitrary authority were promoted and legislative powers were arrogated by the cabinet. As Manchester put it:

Other factors than his relations with England undoubtedly influenced the Prince in the adoption of his autocratic course. But it is evident that only absolute power in his hands could have enabled D. Pedro to concede the price demanded by England for its old ally Portugal and to pay in full the bill rendered by Great Britain for its services in securing the recognition of the Empire by the mother country and by the European nations. 15

D. Pedro I lost completely the support of the Patriot Party with his absolutist actions to meet the economic demands of Great Britain and in 1831 the dominant party of the Empire expelled the Prince. As Manchester observed: "England's price for its recognition was a serious contributing factor to the downfall of the founder of the Brazilian nation." 16

In 1840 D. Pedro II began his reign with a first priority: to establish its legitimacy and financial responsibility by paying past debts. As Table 2.2 indicates, the first loan obtained was floated in 1843 to pay Portugal the sum due under the treaty of 1825 and had all the resources of the empire as a guarantee, especially the country's entire customs receipts. The loan of 1852 was also used for the same purpose. Again, the loan of 1859 was raised to simply pay the 1829 loan. The loan of 1863 was used as payment of these past loans and floating debt. So were the loans raised in 1871, 1875, 1886, 1888 and 1889. The loan of 1843 was the last, however, to have a specific customs receipts guarantee, the remainder being floated on the general credit of the nation which became more firmly established with the rapid expansion of coffee exports.

Yet the trade surpluses created by the production of coffee neither became the catalyst for industrial growth nor reversed Brazil's chronic financial dependency on Great Britain. On the contrary, British loans performed a key role in integrating the coffee economy into an expanding world market and in maintaining its equilibrium whenever market fluctuations brought deficits. Consequently, the possibilities of industrialization in Brazil were drastically restricted because a large part of the export surplus

was left with the British in the form of both debt service payments and increasing imports of manufactured goods. But, above all, the consolidation of classic dependence in the second half of the nineteenth century was made possible by the British doctrine of laissez-faire capitalism which became the tool of Brazil's ruling coffee oligarchies who believed in the natural role of the country in the international division of labor as a supplier of agricultural products and as an importer of manufactured goods. As Peter Evans observes: "Reliance on a single export product was one of the defining features of classic dependence. Extreme reliance on imports was an equally central feature."¹⁷ Foreign loans, however, were at the foundation of the vulnerable import-export economy.

The consolidation of classic dependence

In 1850 coffee became the major export product and ushered Brazil into a new epoch. Coffee production began slowly in the 1820s and during the 1840s it advanced from Rio de Janeiro upwards along the Paraíba Valley in São Paulo state. The capital invested in this coffee expansion was Brazilian. This capital, accumulated and concentrated largely in the gold mining economy of Minas Gerais and the foreign trade of Rio, began to be channeled into the coffee sector of the East-Central region.¹⁸ Although the British came to control transportation and the marketing of the coffee output, it was Brazilians who controlled the national productive system.¹⁹

From 1862 to the outbreak of the First World War Brazil's trade balance was always favorable as can be seen in Table 2.1. The proportion of coffee in Brazil's total export value fluctuated between roughly one half to 70 percent during the period 1850-1930 and the nation held a virtual monopolistic position in the world coffee economy. The expansion of the economy was also due to the increase in import taxes after higher rates were imposed (30 percent) when the commercial treaty with England expired

in 1844. But the abolition of British traditional privileges in Brazil did not alter England's economic and financial supremacy in the country until the First World War.²⁰ As the coffee economy prospered, British investment in Brazil grew. Table 2.3 indicates that more than half of the investment, at times almost three fifths of it, was in loans to the Brazilian oligarchic state in the form of bond issues. According to Rippy, ranked according to the amount of total British capital invested in Latin America, Brazil occupied first place from 1824 to 1889, dropping to second place from 1890 to 1948 and then moved back into first by 1949.²¹ And Great Britain's policy of free trade guaranteed a market for Brazil's primary exports to enable the debtor country to service its loan. After 1850, as Albert Fishlow observes, "Financial and real flows went together."²²

With the growth of coffee exports came the growth of the railroads leading to the coffee plantations. In the 1850s it was national capital which built the first and most important coffee railroad to connect Rio de Janeiro with the Paraíba Valley. This marked the beginning of the entrepreneurial role the Brazilian state would play in the economic development of the country, but it also reinforced the alliance of the state and international finance as British loans, in addition to direct investment, were also directed towards the infrastructure of the economy which the expanded export of coffee required.

To attract British investment the Brazilian state enacted a law in 1852 in which interest of between 5 and 7 percent on railroad loans would be guaranteed. But even with this incentive British capital was very cautious about moving in. As Frank noted: "...Foreign capital did not enter these areas to take over the ownership and administration of enterprises that were originally Latin American until they had been demonstrated to be brilliant investment opportunities and until England

needed to find a market for its steel."²³ Thus, the oligarchic state found itself forced to counter the reluctance of British capital to invest in the infrastructure of the country and in 1855 the Estrada de Ferro Dom Pedro Segundo was created with the state owning most of the stock.

As soon as the railroad company was organized, however, and the British financiers saw in it a field of profitable investment, it was able to raise a loan in the London market of over one and a half million pounds with state guarantee that the interest would be paid. In 1871 and 1875, after the railroad became fully state property, large loans were raised again in London for further construction (see Table 2.2).

Although railroads accounted for the bulk of British direct investment (see Table 2.3), almost all the Brazilian lines were dependent on the London bond market. In addition to state owned, private Brazilian companies also borrowed heavily in London. Thus, the Estrada de Ferro São Paulo e Rio borrowed 600,000 pounds in 1874 and 164,200 in 1879. In 1890, the state bought this railroad and the British loan became part of the public debt. Almost five million pounds were borrowed by private railroad companies in Minas Gerais.²⁴

In the São Paulo region, Companhia Mogyana borrowed in the London market 483,700 in the late 1880s and the Sorocabana raised 230,000 pounds in 1877. In 1892 Sorocabana bought up the Estrada de Ferro Ituana which had borrowed 150,000 pounds from Britain four years earlier. When Sorocabana found itself in financial difficulties and could not service its loan, British bondholders tried to acquire the railroad in lieu of repayment. The federal government intervened, however, and eventually the company became the property of the state of São Paulo.²⁵

Rippy makes the following observation about the real beneficiaries

of those railroad loans:

...Four groups are most likely to benefit from such investments: (1) bond-selling bankers and speculators; (2) shipping companies; (3) officials and agents of the recipient countries and (4) manufacturers, managers and other technicians from investing countries. 26

In fact, the capital raised on the London financial market or directly transferred to Brazilian enterprises by British firms remained largely in England to finance the purchase of British railway equipment. Even so, the terms imposed on Brazil by most of the railroad bonds were such that once repayment was begun, the capital was rapidly repaid several times over. In addition, given the falling Brazilian exchange rate, these loans became indeed onerous. Companhia Paulista, for example, borrowed 150,000 pounds in 1878 to be repaid over a period of 20 years. Because of the declining value of the Brazilian currency, the loan was repaid only with the greatest difficulty. The final payment was made on schedule in 1898 but it represented more than twice the total number of milreis originally borrowed.²⁷ Furthermore, since the rate of return on the loans invested in the railroads was guaranteed by the state, by the 1880s, government expenses from the guarantees reached 6 percent of the value of imports.²⁸ Later, the government suspended the loan guarantees and acquired direct ownership of many railroads so that by 1929, two-thirds of them were state-owned.

The building of railways, while responsible for a sharp increase in exports, brought about even greater imports from Britain and did not contribute directly to the broadening of the internal market and the growth of industries in Brazil.²⁹ Imports from Great Britain grew from 16 million pounds in 1850 to over 40 million at the beginning of the twentieth century.³⁰ Equally important, the expansion of exports through the railway system, and accordingly, the increase in foreign exchange earnings, encouraged British financiers to export more loan capital to Brazil. As Table 2.3 shows, total British investment, including public and private securities rose from 38.8

million pounds in 1880 to 223.8 in 1913 and the country's foreign public debt rose from 23.1 million pounds in 1880 to 117.4 million in 1913.³¹ But the bulk of the foreign debt was used to finance BOP deficits which were themselves mostly caused by the service costs of that debt.

Table 2.3 United Kingdom Investment in Brazil, 1865-1949
(millions of pound sterling)

Year	Total Nominal Investment	Government Bonds	Railways	Miscellaneous ¹	Rate of Return
1865	20.3	13.0	5.4	1.8	6.0
1875	31.0	20.3	6.3	4.2	6.0
1880	38.8	23.1	11.6	4.2	6.0
1885	47.6	23.2	17.0	7.3	6.0
1890	68.6	37.0	26.0	5.6	6.0
1895	93.0	52.4	33.1	7.4	6.0
1900	90.6	45.4	33.6	11.0	6.0
1905	123.0	83.3	24.0	15.5	6.0
1910	151.4	100.4		26.1	4.8
1913	223.8	117.3	52.3	54.1	4.8
1928	285.7	165.0	49.5	71.2	4.9
1930	287.3	168.7			5.3
1939	260.7		37.4		1.88(1931/40)
1949	170.5	93.6	25.2	51.6	3.2

¹

The major part of this capital was concentrated in public utilities which amounted to 828 thousand pounds sterling in 1865, 2.7 million in 1875, 2.9 million in 1880, 3.0 in 1885, 3.3 in 1895, 6.6 in 1905 and around 40 million at its peak in the late 1920s.

Sources: J. Fred Rippey, British Investment in Latin America, 1822-1949, pp. 150-154 and Randall, A Comparative Economic History of Latin America, p. 232.

The contradictions of financial dependency

Although some railroad construction and the building of the Port of Rio were tied to British loans, a look at table 2.2 above clearly shows that the bulk of the proceeds of the loans was used to balance the external accounts of the import-export economy and not really to undertake productive investments. In fact, the evidence suggests that Brazil's financial dependency

drastically restricted the possibility of industrialization in Brazil because a large part of the surplus from the export economy was clearly left in the hands of the British in the form of debt service payments.

A distinctive feature of the Brazilian import-export economy was a chronic BOP deficit. Recourse to foreign loans, at first considered a temporary expedient of the Empire to finance the deficit, became a permanent solution to cover the service of past loans and thus guarantee the country's financial equilibrium. In no other way was the dependence of Brazil on the British more marked than on the flows of loans. In fact, the vulnerable economy was sustained by British loans and the absence of those loans would have made it untenable. As will be discussed shortly, it was British loan capital that rescued the coffee economy from serious financial crises in 1898 and 1914 when coffee prices fell in the world market. It was also British loans that financed the state's coffee support policy to protect the revenue of the oligarchies when the price of the product again declined in the early 1900s. Richard Graham summarized the situation: "Their size [of the loans] and frequency are impressive evidence of Brazil's dependence on Great Britain. The import-export economy would have faced much rougher sledding if it had not been for these loans."³² As chapter 3 shows, the sudden interruption of this external financing in 1930 caused the collapse of the economic and political system.

All the loans negotiated in Britain by the Brazilian government were handled by the House of Rothschild which was named sole financial agent for Brazil in 1855. According to the contract, signed by Francisco Inacio de Carvalho, later Barão de Penedo, the Rothschilds were to handle all funds sent by Brazil for payment of dividends, salaries or other expenses; do all the buying for the government; and pay all the dividends on Brazilian debts. The British investor in Brazilian government bonds bought them from the

Rothschilds and accepted their recommendations.³³

Penedo was a great friend of the British, writes Richard Graham. Despite the fact that Penedo's predecessor had been dismissed for allegedly being more loyal to the bankers than to Brazil, Baron Lionel de Rothschild frequented Penedo's house and advised him on Brazil's foreign loans. Officials and agents of Brazil shared in the sales commission or profit with the international agents and Penedo admitted to have received some £200,000 in this way over the years. Penedo was Minister in London from 1855 until 1889 and his anglophile successor, Joao Artur de Souza Correa, following in his footsteps, became a very good friend of the Rothshilds.³⁴

After 1862, when coffee exports reversed the trade balance (see Table 2.1) and despite the expansion of the economy, Brazil's BOP deficit was by no means eliminated and continued to be financed by foreign loans.³⁵ The deficit was caused primarily by the expenditures on the service account, the invisibles: interest on past loans, profit remission and dividends, insurance and transportation. Massive inflows of loans were in turn required to finance the current account deficit which necessarily increased Brazil's foreign indebtedness in an unending vicious circle. To repay past **debts** Brazil thus became more dependent on new loans and more dependent on Great Britain.

The service of the foreign debt (interest and amortization) was very heavy. In 1850, debt service absorbed 40 percent of Brazil's export earnings and between 1861 and 1930, debt service was usually 60 percent of export earnings and between 10 and 20 percent of total federal expenditures.³⁶ Until the Great Depression, debt service amounted to between 35 and 40 million pounds sterling per year.³⁷

With the exception of periods in which heavy public indebtedness was contracted for war purposes (such as the Paraguayan War) and consolidations

of the public debt, inflows of foreign loans were always lower than debt servicing resulting in capital flows from Brazil to Great Britain. During one exceptionally favorable period in 1886-1889, capital imports reached 14.5 percent of total exports, whereas servicing on foreign capital amounted to 14.6 percent. During a less favorable period, 1876-1885, imports of capital declined to 5.3 percent whereas servicing stood at 12.2 percent.³⁸ Spiegel observed that during the period 1861 to 1930: "It is remarkable that the proceeds from foreign loans did not suffice for financing the services of the loans as well as other invisible items in the balance of payments and that the large export balances were necessary, apparently throughout the whole period to achieve these ends."³⁹

Indeed, the price Brazil paid for its foreign debt was very high, of which Spiegel further wrote:

From 1860 to 1930 the increase in the face value of the foreign debt and the export balances add up to some 927 million pounds (increase in debt was 380 million; accumulated export excess 547 million). Of these receipts, apparently some 120 million went into debt amortization, although there are authorities which quote a figure of 180 million. Estimates of the total debt service, including interest and amortization, are available for the federal debt only. For the period from 1860 to 1930 they add up to 212 million pounds. For the states and municipalities, amortization was 107 million pounds during that period. This would add up to 319 million pounds. The amount of interest payments for the state and municipal loans can only be surmised. It probably was between 100 and 150 million pounds and perhaps closer to the higher figure. Since the terms of these loans were generally inferior to those of the federal government, interest probably absorbed a higher proportion of their total debt service. Altogether the payments for the service of the foreign debt would thus account for 420 to 470 million pounds. This is considerably more than the total debt incurred between 1860 and 1930 (380 million pounds), of which less than one-third had been amortized during the period and of which only some 80 percent had been made available to the debtor. The export balances were thus necessary because the payments for debt service exceeded the receipts for increments in debt although the latter was expanding all the time.⁴⁰

It is undeniable that the progressive foreign indebtedness of Brazil (see Table 2.4 below) considerably retarded its industrial growth since the export surpluses of the coffee economy were transferred to Great Britain

in the form of debt service payments. In this way, Brazil played a very important role in the British centered international economic system of the nineteenth and early twentieth centuries as a reliable supplier of the investment income that financed Great Britain's trade deficits. As Robert Gilpin notes: "Britain had become a rentier economy by the close of the century and was living off the income from its vast overseas investments." ⁴¹

But the role of Brazil in the international division of labor designed by the British was created by the first version of the developmentalist theory of growth, the British free trade doctrine, which became the unquestionable ideology of the Brazilian export-oriented ruling oligarchies. The doctrine made it extremely difficult the emergence of an industrial entrepreneurial class in Brazil and reinforced the financial dependency of the country on Great Britain.

Laissez-faire capitalism and the concrete situation of dependency

Until 1860-70, the sugar interests of the Northeast and the coffee growers of the center of Brazil (Minas Gerais, Rio de Janeiro and São Paulo) prevailed politically in the game of regional alliances. ⁴² With the abolition of the institution of slavery in 1888 and the fall of the Empire in 1889, Brazil's export economy moved toward a full capitalist path. The introduction of free labor ruined the sugar interests of the Northeast who completely lost their political dominance. The formation of the federalist republican form of government under the Constitution of 1891 consolidated the domination of the coffee oligarchies in the system based on regional alliances. ⁴³

The structure of Brazilian society under the Old Republic represented two basic classes, of which Brazilian economist Luiz Bresser Pereira wrote:

...The rulers, landed gentlemen intimately involved in the high-level commercial exportation of coffee and importation of manufactured goods, and the ruled, an enormous rural subproletariat living in extreme

misery. Between the small ruling class, totally alienated by the foreign interests on which they depended, and the immense ruled class, a small middle class could be found living in the cities - a parasitical middle class supported fundamentally in the public employ, in a system where the government functioned as the agent of employment and policing, at the orders of the dominant oligarchy.⁴⁴

From 1891 and until the Great Depression the Republican government, following the steps of the Empire before it, relied heavily on the London bond market as long as the money borrowed was only used to balance the external account of the economy and not to transform the internal productive system of the country. In fact, the House of Rothschild, Brazil's major creditor, was never really inclined to extend loans to encourage industrialization in the country since it would result in the development of peripheral industries in competition with the center's production, thus threatening British supremacy in the export of manufactured goods. But industry in Brazil would also threaten the interests of the domestic agro-exporting oligarchies who believed, according to the strict principles of British laissez-faire capitalism, that the natural role of Brazil in the international division of labor was to supply agricultural products. An alliance of international finance and the Brazilian ruling oligarchies was thus formed to consolidate Brazil's export-led growth in the second half of the nineteenth century, thus retarding considerably the country's industrialization process.

An early evidence of this primary-export and anti-industrialization alliance is provided by the frustrated attempt of the Brazilian government to issue industrial loans in London in 1892. The Rothschilds immediately telegraphed the Minister of Treasury criticizing the plan and the creditor's opposition was used as a strong argument in the Brazilian senate by their local allies against the bill. According to Grahan, the Rothschilds and their domestic supporters were accused of combating this measure because it

would tend to reduce imports of manufactured goods from England.⁴⁵ Significantly, among the defenders of the House of Rothschild in the senate was Campos Sales, a large coffee planter who was to become President of the Republic in 1898 and bind Brazil to its role as a producer of primary products (see discussion below).

Although the link between politics and economics in British capital export is the subject of a heated debate,⁴⁶ the lending decisions of the Rothschilds seemed to have been heavily shaped by their government's policy of free trade. In refusing to extend loans to Brazil for industrial purposes, the financial house guaranteed not only the uninterrupted supply of primary products for British industrial expansion, but also a captive market for British manufactured goods. Great Britain's economic and political influence in Brazil would thus be assured. ECLA, using Herbert Feis as a reference, observes that not all foreign lending was "market oriented."⁴⁷ The Commission points out that:

The decisions of private lenders were obviously often influenced by political considerations. As a matter of fact, the governments of the lending countries had many means of inducing the private banks to agree or to refuse to float the securities of the borrowing countries. For example, in Great Britain the government, while it did not attempt formally to regulate capital investment, except to prevent fraud and activities judged socially unwholesome, maintained an informal relationship with the major institutions specializing in the floatations of foreign securities, especially through the Board of Governors of the Bank of England.⁴⁸

The fact remains, however, that British industrial expansion did not depend on investment of production capital in the periphery, but on assuring its supply of primary products.⁴⁹ For that reason, in Brazil, the Rothschilds were primarily tied to the profitable export sector and the coincidence of interests between the foreign creditors and the local ruling elites against industrialization was glaring during the Old Republic. The oligarchies were, of course, interested in the expansion of agricultural exports which provided them with enough income to buy all the luxury goods they needed from England and British free trade thus became their ideology and practical policy. This

policy concentrated income in a few hands, limited the internal market and discouraged domestic industry. As Peter Evans observes,

Behind the extreme reliance on imported goods lay a lack of local industry, and behind both of these lay the distribution of income generated by the primary export economy. The major difference between the incomes of the immigrants who worked the coffee plantations and the slaves that had preceded them was that the immigrants received their incomes in cash. They were pushed as close to subsistence as possible, so close that many of them decided to return home...As long as the planters could afford to buy their luxuries from Europe and the workers could hardly afford to buy at all, there was little room for industrial profits.⁵⁰

Brazilian coffee planters were naturally against a change in the structure of their country's economy and any sort of government intervention on behalf of industry. And international financiers strengthened those domestic interests for foreign loans could rarely be used for projects that would build Brazil's industrial potential. One of the most influential spokesmen for coffee interests in the Chamber of Deputies was Aureliano Candido Tavares Bastos, a defender of the British liberal doctrine of free trade. He urged the government to undertake only those public works that would lead to expanded exports and not to accept foreign loans unless they were used in such projects.⁵¹ When Brazilian advocates of industrialization began to raise the issue of protective tariffs or credit policies in the 1880s they were defeated and until 1930 . . . such attempts were largely unsuccessful. Thus, the Rothschilds could indeed count on the collaboration of local interests who ensured that foreign loans would in no way be earmarked for industrial projects.

Nevertheless, despite the belief of the political elite that industry in Brazil was "unnatural", already by 1889 there were more than 600 industrial plants developed in Sao Paulo, with textiles accounting for 60 percent of industrial production.⁵² But much of the capital for this early spontaneous ISI in the industrial sector was generated not in the London financial market, but domestically, as a result of the cotton boom of the 1860s and the increase in coffee prices and receipts from 1870 to 1889.⁵³ Industrial production

with the founding of the Republic in 1889 and the generous monetary policy of Rui Barbosa, the Finance Minister of the Provisional Republican Government.⁵⁴

By 1895 there were 1,088 manufacturing plants, and by 1907, 3,258.⁵⁵

The rapid increase in industry between 1907 and 1913 was the result of the government coffee valorization policy (see discussion below) as coffee planters invested their profit in manufacturing.⁵⁶ As Evans observes:

...Brazilian planters with capital to invest could not buy mills in Manchester. Some of them continued, of course, to keep their money in coffee plantations, but others became the allies of the commercial and industrial bourgeoisie that was gradually forming in the shadow of the coffee economy.⁵⁷

Yet except for textiles and a few other items, virtually all manufactured goods were imported. Whatever concessions by the government to Brazil's rudimentary industry appeared to have occurred, were nothing more than fiscal expedients dictated by the needs of the national treasury to cover its deficit and not with the purpose of stimulating infant industries. The often-mentioned Law of Similar, promulgated in 1890 by Rui Barbosa and then rewritten in 1911, which prohibited tariff exemption for imports would would compete with similar goods already produced within the country, was primarily a fiscal measure intended to finance the deficit. As Dean observed: "A major cause of tariff increases was the tendency of the federal government to pay off its debts by funding them abroad. The foreign loans had to be redeemed in gold, and the only way to acquire it was by placing a surcharge on the tariff."⁵⁸ As Chapter 4 shows, industrialization in Brazil was only possible with the overthrow of the oligarchic system in 1930 by a complex political alliance of urban entrepreneurs, nonexport agrarian elites and middle class groups.

Even being the by-product of government financial expedients, however, protection of industry in the 1890s faced bitter attacks by foreign and domestic defenders of the coffee export oligarchies and the doctrine of free

trade, like the influential Bastos before and Leopoldo de Bulhões, who designed the tariff of 1897 reducing it by 25 percent. These interests succeeded in gaining a large audience for their ideas among the most powerful politicians of the time and thus retarded considerably Brazil's industrial growth. This illustrates the extent to which situations of dependency are the product of concrete interaction of local social groups and classes. As Cardoso notes,

After the passage from the colonial situation to situations of dependency of national states, it is observed that: (a) the passage implies the creation of states in answer to the interests of local property-owning classes; (b) these, however, have their structural situation defined within the larger framework of the international capitalist system and are thus connected and subordinated to the conquering bourgeoisies of the Western world and to those classes which succeed them; in this way alliances are established within the country, even though in contradictory form, to unify external interests with those of the local dominant groups; and (c) as a consequence, the local dominated classes suffer a kind of double exploitation. ⁵⁹

In 1898 the presidential candidate Campos Sales, another spokesman for the coffee business, promised in his campaign speeches to avoid "inopportune protectionism" for industry.⁶⁰ Indeed, once in power, Campos Sales faded any hopes of industrialization and thus bound the economy to its traditional monoculture and exports. Campos Sales carried out his task with the full support of the Rothschilds who, in exchange for a "funding loan" to rescue the export economy from a financial crisis in 1898, demanded harsh domestic stabilization measures in an early version of what is now known as conditionality. In fact, the financial crisis of the dependent economy in 1898 is an illustration of the dangers of reliance on the world market for a single primary product and on the international capital market for BOP financing. Vulnerability of the economy to external shocks and severe constraints on domestic policy-making are the two major consequences resulting from dependency.

The Republican government, like the Empire before it, relied heavily on foreign loans to service existing debts. As Table 2.2 shows, between 1893 and 1895 the government borrowed from the Rothschilds more than 9 million pounds net of commission and interest charges, of which more than 6 million pounds were used to "refund floating debt", a kind of debt rollover procedure. But the new loans only served to increase the payment deficits for the repayment obligations increased by 11.500 million pounds.⁶¹ It was precisely this debt service burden which precipitated the financial crisis of 1898 when Brazil experienced an abrupt decline in foreign exchange from export earnings.

An important feature of the international financial system of the nineteenth century was that bondholders were vulnerable to defaults which occurred with some regularity. The early British investment boom in Latin America government bonds of the 1820s, for instance, was short, quickly interrupted by serious capital losses. All Latin American governments that had floated loans in London between 1822 and 1825, including Brazil, defaulted. Brazil, however, with the "ruinous" loan of 1829 (see discussion above) was the only Latin American country which resumed payments on its early loans. All the others continued in default for many years.^{62.}

In 1883 the Corporation of Foreign Bondholders of London was formed and "Settlement Committees" established to deal with defaults. According to the World Bank:

Defaults were typically settled in negotiations with bondholder committees on terms that seldom preserved more than a small fraction of the original capital value. Negotiations explicitly assessed the borrowers' ability to undertake policy reforms; this "capacity to repay" formed the basis for determining how much debt should be forgiven. In most cases, existing debt was consolidated and extended with a significant reduction in principal and interest due; interest arrears were often waived entirely.⁶³

Although the debt renegotiations of the nineteenth century sharply contrasts with those of the late twentieth in so far as British lenders allowed ceilings on interest payments in accordance with the capacity of the debtor country to pay, the stabilization policies British investment banks imposed on debtors on behalf of bondholders as a condition for debt reschedulings were similar to those the IMF imposes on behalf of commercial banks which are the final holders of the loans (see Chapter 9).⁶⁴ In the 1898 Brazilian financial crisis, the Rothschilds demanded drastic deflationary policies and a mortgage on Brazilian assets, especially the Rio customs revenue in exchange for a "funding loan" which amounted to a consolidation of existing debt, a postponment of amortization and a moratorium on interest payments.

To meet its external obligations, Brazil relied on the vulnerable single-export crop economy whose prosperity was at the mercy of the international market. After 1896, the economic crisis in the United States caused the price of coffee to fall sharply from over 4 pounds a bag in 1893 to less than a pound and a half in 1899.⁶⁵ Although Brazil continued to export more than it imported and ran trade surpluses as the demand for coffee was rising rapidly (see Table 2.1), export earnings naturally fell and the government's difficulties in servicing the foreign debt increased. So did the cost of foreign exchange as the exchange rate fell from 19 pence in 1894 to 7 in 1898 (\$15). According to Caio Prado and Jose Maria Bello, British financial circles fostered the decline of the exchange rate by speculating freely on it in order to reap great profits.⁶⁶

Over 240,000 contos had to be paid for servicing the foreign debt out of a total revenue of 343,000 contos and the government began resorting to short-terms loans from local branches of foreign banks. That expedient failed, however, and with the press strongly suggesting defaulting on the

foreign debt, the foreign creditors pressured the Brazilian government into finding a long-term solution to its liquidity crisis.

In a situation of virtual bankruptcy the Brazilian government decided to follow the precedent set by President Saenz Pena of Argentina who had refunded that country's foreign debt in the early 1890s.⁶⁷ In 1898 President-elect Campos Sales went to London and appealed to the Rothschilds for a large loan to consolidate Brazil's debt while at the same time securing a moratorium on its repayment which would give him a breathing space to bring order out of the financial chaos. Although the Rothschilds were at first against the plan, they later agreed to act as agent since British capital invested in Brazil amounted to more than 90 million pounds. The London bankers themselves proposed a settlement, of which Bello wrote:

They proposed a loan of 10 million pounds, to be guaranteed by all of Brazil's customs duties, and by the revenue of the central railroad of Brazil and of the water supply services in Rio de Janeiro. For its part, the government was to withdraw from circulation paper equal to the value of each loan installment, figured at 12 pence per milreis. This paper was to be turned over to the foreign banks, in trust, and burned in public. The government would further agree not to contract any new debts during the period of the moratorium.

In London, Campos Sales obtained from the Rothschilds some changes in their original proposal. The rate of exchange for the paper currency withdrawn from circulation was set at 18 pence instead of 12; the time allowed for interest payments was increased to three years, and for amortization payments to 10 years; and the special guarantees for the loan were limited to the customs duties collected in Rio de Janeiro, the other customs houses becoming subsidiary. Although the government planned to burn the paper money, it was to have the option of leaving it on deposit to be used to purchase bills of exchange.⁶⁸

The funding loan of 10 million pounds, of which Brazil netted 8 and a half million, bailed it out of the immediate financial crisis. In this way the Rothschilds continued to preserve Brazil's financial equilibrium and to allow the government to sidestep the consequences of its vulnerable economy. But this time, besides increasing the foreign debt, this financial rescue

also allowed foreign creditors to determine Brazilian domestic economic policy and tie future income to repayment of the loan. The Rothschilds demanded a letter from Campos Sales personally committing himself to the orthodox deflationary program called for in the agreement which included a rigid monetary and exchange rate stabilization. Thus, Brazil signed its first "Letter of Intent" in 1898 directly to foreign bankers, before the establishment of the IMF and its policy of conditionality (see discussion in Part Five). Fishlow observes that "while it is hyperbolic to claim that the foreign banks practically demanded the control of the country's economy, it is clear that the element of intervention was greater than in the case of Argentina. Funding loans were not all finance and no adjustment."⁶⁹

This bold action taken by Brazil's foreign creditors was clearly an early version of stabilization programs monitored by the umbrella IMF on behalf of commercial creditors. Nineteenth century international lenders, however, did not, of course, rely on multilateral institutions to supervise their imposed "structural reforms" on debtor countries. They did it by themselves in order to restore the debtors' finances and to make the peripheral countries safer havens for further lending. In Brazil, international creditors gained a firm stronghold with the imposed adjustment. By monitoring every step of the financial agreement and ensuring its implementation, the Rothschilds established powerful positions in the Brazilian government and exercised an almost absolute control of the national treasury. As Caio Prado wrote:

...In this way, the interests of international finance became intimately associated with Brazilian economic life. It was the consolidation of a situation of dependency that began much earlier but that by now had reached its definitive equilibrium. Brazil became a stable place for the export of British loan capital which would find in the country the most advantageous opportunities.⁷⁰

The power of international finance in Brazil, however, can not be overestimated. Its success would not have been complete without the assistance of domestic allies. Campos Sales, a large coffee planter, and his free trade

Finance Minister Joaquim Murтинho, shared the same orthodox principles of the Rothschilds which were to be a blow to any hopes of industrializing Brazil at the time. Murтинho's views on Brazil's financial problems in 1898 sounded very much like contemporary IMF analysis: the country's problem was essentially to balance the treasury's finances according to the orthodox principle of "sound finance" in order to attract foreign capital. It was, therefore, absolutely necessary to deflate the currency, cut expenses, increase taxes, tighten credit, abandon public works, return to agriculture and withdraw the government from industrial activity which could flourish only under free, private enterprise.⁷¹

Murтинho's views were put into practice and the drastic deflationary monetary and fiscal policy imposed on the Brazilian economy caused immediately a crisis for Brazil's rudimentary industry because of the simultaneous increase in taxes and tightening of domestic credit. As Randall points out:

Money in circulation fell from 779,966 contos in 1898 to 675,547 in 1902. On a per capita basis money supply fell from 46 to 36 milreis. Although the value of the milreis increased from 0.15 to 0.24 (U.S.), the crucial point for local businessmen was that debts had been in milreis with a lower purchasing power, and that they had to pay them off at a time when prices were falling; a number of firms that would have required constant or rising prices to survive therefore failed. As the government accepted social Darwinism, these failures were accepted as a natural consequence of the competitive struggle, and ultimately beneficial to the nation. The most spectacular and important failure which followed the cancellation of emission powers by the Brazilian Congress on July 22, 1899, was that of the Banco da Republic in 1900.⁷²

Campos Sales' administration became the most unpopular in Brazil during the Old Republic as the increased taxes raised the living costs of the population, especially of the urban poor. His extreme monetary deflation had provided a screen behind which bankers and speculators both foreign and domestic reaped excellent profits.⁷³ The President was labelled a puppet of the British financiers and his low-tariff policy was attacked by domestic industrialists as merely being a tool of the British manufacturing industries

in order to force Brazil to import everything from England.⁷⁴ Furthermore, Campos Sales was constantly charged for being interested only in the affairs of the coffee exporting oligarchies.

Nevertheless, the orthodox stabilization program which lasted four years had the results expected from Brazil's creditors: payments on the debt were resumed on schedule and Brazil's credit abroad was promptly reestablished. Actually, the well known free trade advocate Leopoldo de Bulhões who became Finance Minister in 1909 began to pay off the funding loan a year before 1911, the time prescribed in the Campos Sales agreement. As Bello observed: "The treasury, saved by the people's increased poverty, had been refilled, and the European bankers had regained their confidence in Brazil as a field for profitable investment...the Rothschilds were sincere in their praises of Campos Sales at the end of his term of office."⁷⁵

Campos Sales stands in Brazilian politics as the only elected president who was indeed able to carry out a stabilization program to its completion. The execution of the unpopular austerity measures, however, was made possible only by his increasingly authoritarian methods and excessive powers, making Brazil's democracy a sham. Campos Sales' most spectacular political maneuver to diminish the independence of Congress and assure him almost unanimous support for his financial plans was his system of control through the governors, the so-called "politics of the governors" that ensured the monopoly of the two most powerful states of São Paulo and Minas Gerais in the presidency of the Republic until 1930.

Being a Paulista himself, Campos Sales began negotiating directly with the governors of large states, particularly Minas Gerais. In return for their political support for the deflationary program, the governors were rewarded with patronage public works projects to favor the oligarchies of their states as well as with electoral fraud and manipulation in favor of

their Republican parties. This state of affairs degraded Republican politics throughout the Old Republic and precipitated the "revolution" of 1930 (see Chapter 4). Bello gives an idea of how Brazil's political structures were shaped by the constraints imposed by financial dependency. He wrote that:

An extension of his political plan, Campos Sales secured the support of some large states, principally Minas Gerais, whose governor declared his support to be unconditional. In exchange, the recognition of mandates in the new chamber and partly reelected senate would favor the local parties that sided with the government. By serving their interests, Campos Sales won their backing for the execution of his financial policy. Thus, any evidence of victory at the polls by the opposition in the states was disregarded in advance; the candidates put up by the local governments were automatically seated. The old comedy of democratic elections in Brazil was being officially sanctioned.

However, the most serious consequences of Campos Sales' political horse-trading with the governors was the immediate consolidation of the state oligarchies. The groups that had gained control of the states were made up mainly of former members of the monarchic parties. They calmly went about setting up powerful machines devoted to graft, bribery and violence. Although the Congress of 1900 had the same vicious origins as the congresses, including the Imperial Parliaments that preceded it, it was the one that gave up its last pretense of free political power.

The Union was converted into feuding groups, large and small, concerned much more with their regional interests than with those of the nation as a whole. Their demographic and economic superiority gave Sao Paulo and Minas the leading positions in political control. Pernambuco, Bahia and the state of Rio de Janeiro were the other "big states" that had numerous representatives in the Legislative bodies. The small states gravitated into the orbits of the big ones, as if imitating the international balance-of power game. 76

Campos Sales left office at the end of 1902, but his "politics of the governors", an expedient to build reliable domestic support for the implementation of unpopular deflationary measures in order to satisfy foreign creditors, dominated the Old Republic with the national government alternating between the ruling oligarchies of São Paulo and Minas Gerais. But the tremendous external depreciation of the currency in the 1890s and the overwhelming profits made by the exporting groups gave political rise to new social groups created by the gradual differentiation in the urban economy. Among the new forces disrupting the stability of the system after 1900 were the

middle classes, civilian and military personnel, white collar workers, and industrial groups who resented losses caused by exchange depreciation as well as the control of the government by the exporting oligarchies through electoral fraud and manipulation.⁷⁷ Thus, the conflicts and redefinitions of interest among classes and groups in Brazil began to emerge out of the contradictions of the situation of dependency. And the contradictions continued to be generated by the alliance of international finance and the export-oriented ruling oligarchies.

The coffee valorization policy

Since Campos Sales' financial policies restored Brazil's credit abroad, successive foreign loans continued to be raised with the purpose of building public works to expand exports, as the influential Bastos had urged the government to do. Table 2.2 above shows that between 1903 and 1905 the Brazilian government borrowed 8 and a half million pounds to be used in the improvements of the ports of the Republic, guaranteed by a first claim against a special two percent tax, to be paid in gold, on all imports and other revenues from ports and docks.

Loans such as those helped to sustain the oligarchic political system through "the politics of the governors" for they were used purely for electoral support. Railroads, ports, highways and drought-control projects were extended by the national government to the "small" states as patronage projects. As Erickson put it: "These patronage projects usually enabled the landed elites in the recipient states to increase their income by producing or marketing a larger crop, and they in turn used the additional receipts to build and maintain their political clienteles."⁷⁸ This state of affairs which lasted throughout the Old Republic gave rise to fiery debates in congress and in the press over the uses made of foreign loans.⁷⁹

Furthermore, states and municipalities could freely contract foreign loans as they enjoyed a definite financial autonomy. Part of their revenue was

derived from export taxes so that a state like Sao Paulo which was at the center of the coffee economy, possessed a source of revenue from the foreign trade passing through it. Bello summarized the situation by saying: "The states and municipalities following the example set by the federal government, mortgaged their best source of revenue to European bankers, many of them made commitments far beyond their most optimistically viewed ability to fulfil."⁸⁰ Significantly, in 1906 the state of Sao Paulo borrowed three million pounds to support the price of coffee.

In fact, one of the most interesting ways in which international financiers helped the coffee oligarchies to sustain themselves in view of changes in the international market was in the well known coffee valorization policy which began in 1906 and became federal government policy until the 1960s. When steady declines in coffee prices and overproduction in excess of world consumption after 1906 threatened to force future coffee prices still lower, the ruling oligarchies of the coffee producing states requested federal government protection of their revenue. At a meeting held in 1906 in Taubate, a city in the state of Sao Paulo, coffee interests outlined a price stabilization policy in which the government was to intervene in the market and purchase the surpluses. Such buying would be financed by means of foreign loans and servicing of the debt would be covered by a tax levied in gold on every bag of coffee exported.⁸¹

This first price-boosting scheme, however, was put into operation by the coffee producing state themselves, under the leadership of Sao Paulo and without federal government support. President Rodriguez Alves refused to endorse the plan and rejected the proposed special exchange rate for coffee, stating that it threatened to disrupt the government's ability to maintain the exchange rate. But the government was finally compelled to take upon itself the major responsibility for carrying out the task and Alves' successor,

Afonso Pena of Minas Gerais, became the first president to adopt the valorization plan. Furtado observed that "the financial success of the experiment consolidated the victory and strengthened the political power of the coffee planters, and for more than a quarter of a century - until 1930 - they succeeded in imposing their economic policy on the federal government."⁸²

At first, this policy of state intervention on behalf of the economy, albeit the export sector, encountered resistance from Brazil's traditional creditors, the House of Rothschild, which published a letter in violent terms against the coffee valorization plan. Caio Prado and Celso Furtado suggested that as German, French and American financial groups showed interest in the plan, the Rothschilds consented and became the agent after all, fearful that the other groups would take advantage of the situation, searching as they were for an opportunity of breaking into a well-defended stronghold of the financial house.⁸³

Other considerations may also have influenced the Rothschilds in accepting the deal, however. By 1905 British investment in Brazil amounted to 123 million pounds of which 68 percent was in government loans (table 2.3 above) and coffee export earnings provided the source of foreign exchange that ensured past debt repayments. Therefore, new capital inflows would be necessary as the price of coffee was declining and so the supply of foreign exchange. Although the valorization scheme was a clear violation of the strict British laissez-faire doctrine, the London financiers were very flexible and bent their government's policy whenever it interfered with the ability of their clients to meet debt obligations.

The bank consortium that was eventually organized in 1906 to support the coffee price, although dominated by the British financiers, included the German banks Gesellschaft and Desdner, the French Societe Generale and marked for the first time the presented of the American First National City Bank in Brazilian foreign loans.⁸⁴

As Table 2.2 above indicates, in addition to the three million pounds borrowed by the state of Sao Paulo in 1906, the federal government borrowed three million pounds in 1907 and 15 million pounds in 1908 to finance the Taubate agreement. In 1910 Brazil was already consolidating its coffee debt in a new loan of 10 million pounds where the Rothschilds received a 4.5 percent commission. Between 1913 and 1914 loans of more than 11 million pounds were also raised to continue the support of coffee prices.

Table 2.4 below shows the increase in the foreign indebtedness of Brazil between 1905 and 1915, including loans raised by the federal government, states and municipalities. The total foreign debt increased from 127 million pounds sterling in 1905 to 245 million in 1915 and the bulk of it was used to finance the coffee support program as well as to meet the service costs of the debt itself. This period of heavy indebtedness coincides with what Peter Evans calls "the apogee of classic dependence" as the median annual trade surplus was 50 percent of imports.⁸⁵ Yet this favorable trade balance was only possible with the support given by international finance to the coffee valorization policy of the oligarchies and did not offset the country's traditional deficit in the current account on the BOP as the foreign debt had to be serviced.

Indeed, however successful and profitable the coffee support policy and the export surpluses generated from it might have been for the domestic and foreign interests connected with it, the resulting massive debt contracted abroad, and which was substantially increased in the 1920s also for the coffee support program in the context of a rapidly deteriorating international economy (see Chapter 3), did not give rise to any productive investment. As Celso Furtado observes:

The accumulation of coffee stockpiles...had its counterpart in debts contracted abroad. Hence there was no net investment, because what was invested in Brazil through the accumulation of stockpiles was disinvested abroad in the contracting of debts. It was as though the

stockpiled coffee had been purchased by foreign firms which were postponing in their own interest the shipment of the merchandise abroad. The accumulation of coffee financed from abroad was therefore similar to an exporting process.⁸⁶

Furthermore, the debt-led coffee support program was clearly an expedient to maintain the financial equilibrium of the vulnerable export-import economy. The government's withholding of supplies made it possible to maintain high prices on the international market and hence ensure a favorable trade balance. While protecting the income of domestic coffee planters, however, the scheme was illusory for BOP purposes, bringing only temporary relief since the foreign loans had to be serviced with the very foreign exchange generated by the coffee export earnings. And it was precisely the debt service burden that precipitated the financial crisis of 1914 when Brazil suffered a heavy decline in foreign exchange earnings as a result of changes in international coffee prices. Comparing the 1898 and 1914 financial crises, Fishlow observes that:

In 1898 the principal problem was a decline of 64 percent in coffee prices over the preceding five years, and especially in the last two. In 1914 it was a fall in price of 38 percent in two years, reducing export proceeds that had already been adversely affected by the end of the rubber boom.⁸⁷

Again, Brazil's financial crisis of 1914 illustrates how reliance on the international market for a single export crop undermines state control over the economy.

The second funding loan and the First World War:
a new spurt of industrial growth

Already after 1910 both the volume and value of Brazil's exports had declined, reducing sharply the nation's foreign exchange supply and thus its ability to service the foreign obligations. In 1913 Brazil's traditional favorable trade balance was in deficit for the first time since 1862 (as Table 2.1 above shows, the exception was a very small trade deficit in 1886). A loan of 11 million pounds from the Rothschilds did not help the financial

difficulties, but only served to compound them since Brazil had to spend an even greater share of foreign exchange earnings to service this and past debts. In addition, the Rothschilds obtained a commission of 522,500 pounds or 4 3/4 percent of the loan.⁸⁸ Finally, on the eve of the First World War imports declined 50 percent. Since import duties provided 60 to 70 percent of government revenues,⁸⁹ government deficits increased sharply from 76,748 contos de reis in 1913 to 222,898 (1 conto= 1000 mil reis) in 1914.⁹⁰

Attempts by President Hermes da Fonseca to raise additional foreign loans were unsuccessful and the government began printing money to cover the budget deficit. This caused a fall in the price of Brazilian currency in terms of foreign exchange, thus aggravating even more the country's ability to service the foreign debt.

As in 1898, Brazil was in a situation of virtual bankruptcy. If the country could not generate export surpluses, it needed more capital inflows to service past debts increasing even more its external indebtedness. Brazil had no other option but to negotiate with the Rothschilds a second funding loan of 14 and a half million pounds on June 17, 1914, just before the outbreak of the War in August. This second funding loan was guaranteed by all of Brazil's customs duties and consisted of postponement of interest payments for three years and amortization payments for 13 years.⁹¹ Due to the exceptional circumstances of the war in Europe, however, and the inability of creditors to impose austerity measures on the country, this financial rescue brought a new temporary equilibrium to Brazil's external accounts that ultimately benefitted the country's fledgling light industries.

Not much recognition has been given to the importance of the relaxation of Brazil's traditional debt service burden and the consequent savings in foreign exchange during the First World War. Yearly charges of amortization and interest were sharply reduced as a result of the 1914 debt

refinancing and Brazil was unable to borrow abroad and accumulate more debt as the inflow of European capital was completely interrupted. Thus, according to Warren Dean: "Annual costs of amortization and interest, nearly £64,000 between 1909 and 1913, fell to an average £47,000 during the war. The Brazilian economy, therefore, generated about \$135,000,000 more in effective demand during the war years than it had from 1909 to 1913."⁹² This had, of course, a highly positive effect on Brazil's industries.

Analysts of Brazilian industrialization such as Caio Prado, Werner Baer and later Vilela Luz and Cardoso, have always asserted that the First World War gave an additional impetus to Brazilian industry as a result of the reduction in the flow of manufactured goods from Britain while exports remained high. Caio Prado further maintained that the decline in the exchange rate also benefitted local manufacturing. As Table 2.5 shows, the balance in favor of exports did increase during the war as compared with the five previous years, but not spectacularly as coffee trade declined drastically from 1915 to 1918 both because of the war and because of a severe frost that occurred in 1918.⁹³

Thus, while imports of British manufactured goods declined because of the war, so did financial flows from Brazil to Britain as debt service payments. In addition, as already mentioned, Brazil's creditors were not in a position to demand a stabilization program in exchange for the second funding loan as they had done in 1898. The growth of light manufacturing in Brazil between 1915 and 1919 was the result of both the decline in imports and debt service.

Yet the war created industrialization was reversed in the 1920s by the Brazilian dominant classes, whose strong belief in free trade remained unshaken. As chapter 3 shows, the international financial system, now controlled by the U.S. which emerged from the war as the main source of

Table 2.4 Brazil: Foreign Debt of the Federal Government, States and Municipalities, 1890-1937
(In million pounds sterling)

Year	Nominal Value of Total Debt incurred	Accumulated Reduction	Total Debt Outstanding
1890	69	38	31
1895	80	40	40
1900	92	46	46
1905	127	48	79
1910	189	60	129
1915	245	82	163
1920	249	98	151
1925	290	106	184
1930	394	127	267
1935	412	152	260
1937	412	170	242

Source: Henry William Spiegel, *The Brazilian Economy*, p. 138, Table 21.

Table 2.5 Commercial Balance of Brazil 1904-1918

Years	Exports (thousands of contos)	Imports (contos)	net (contos)	net (thousands of pounds)
1904-1908	3,827	2,678	+1,149	+70,739
1909-1913	5,058	4,056	+1,002	+68,733
1914-1918	5,262	3,779	+1,583	+79,400

Source: Warren Dean, *The Industrialization of Sao Paulo*, p. 88, Table VI-1

capital flows, continued to sustain the coffee oligarchies in a fast deteriorating world economy until the crisis of the liberal trading and financial system brought with it a major crisis in the vulnerable export-import economy.

In summary, Chapter 2 showed how a concrete situation of dependency arose in nineteenth century Brazil that drastically retarded the country's industrialization process. With the expiration of the commercial treaty with Great Britain in 1844 and the reversal of the trade balance with coffee exports in the 1860s, British political control sharply declined in Brazil. But the economic and financial control of Great Britain over Brazil

was not altered as the ruling coffee oligarchies accepted as their own the British free trade ideology. The role of Brazil in the international division of labor designed by British economic theorists as a market for manufactured goods and as a reliable supplier of both agricultural exports and investment income from British loan capital was thus more by consent than by imposition. As the data showed, the major feature of the period associated with classic dependence or outward growth was Brazil's extreme reliance on flows of British loans to maintain the financial equilibrium of the vulnerable export-import economy with the consequent transfer to England of a large part of the surplus of the coffee economy in the form of debt service payments. In fact, the first version of the developmentalist theory of growth promoted in Brazil a prosperity consistent with the interests of Great Britain and the local dominant export oriented coffee oligarchies. But this prosperity was heavily conditioned by the international economic environment which sharply deteriorated in the 1920s.

NOTES

1. A thorough examination of Brazil's foreign indebtedness in the nineteenth century is Valentim F. Bouças, Historia da Divida Externa da União (Rio: Edições Financeiras, 1950), Second Edition.
2. D. Pedro was forced to sign the infamous commercial treaty because unless immediate recognition of Brazilian independence by England was secured, Portugal would have refused to grant recognition, resulting in anarchy and the division of Brazil into smaller republics. See Alan K. Manchester, British Preeminence in Brazil, its Rise and Decline (New York: Octagon Books, Inc., 1964), p. 193.
3. See Caió Prado Junior, Historia Economica Del Brasil (Buenos Aires: Editorial Futuro, 1960), p. 150 and Manchester, British Preeminence in Brazil, pp. 201-210.
4. The suppression of the slave traffic proved impossible of solution during the formative period of the Empire, although Great Britain succeeded in forcing Brazil to sign agreements which nominally abolished the slave trade under conditions which would enable the British to employ their cruisers to enforce the prohibition. See Manchester, British Preeminence in Brazil, pp. 211-217.
5. A Comparative Economic History of Latin America, 1500-1914, Volume 3, Brazil (Ann Arbor: University Microfilms International, 1977), p. 102.
6. The Brazilian Economy: Chronic Inflation and Sporadic Industrialization (Philadelphia: The Blakiston Company, 1949), p. 138.
7. British Investment in Latin America, 1822-1949 (Hamden: Archon Books, 1959), p. 22.
8. Ibid.
9. Pinto Ferreira, Capitais Estrangeiros e Divida Externa do Brasil (Sao Paulo: Editora Brasiliense, 1965), p. 162.
10. Ibid.
11. Liberato de Castro Carreira, Historia Financeira e Orçamentaria do Imperio do Brasil desde a sua Fundação (Rio: 1889), p. 135.
12. Historia da Divida Externa, pp. 55-56.
13. Manchester, British Preeminence, p. 218.
14. Ibid., p. 191.
15. Ibid., p. 218.
16. Ibid., p. 219.
17. Dependent Development, The Alliance of Multinational, State, and Local Capital in Brazil (Princeton: Princeton University Press, 1979), p.59.
18. Warren Dean, The Industrialization of São Paulo, 1880-1945

(Austin: University of Texas Press, 1969), p. 19 and Andre Gunder Frank, Capitalism and Underdevelopment in Latin America, Historical Studies of Chile and Brazil (New York: Monthly Review Press, 1969), pp. 167-168.

19. Brazil thus differed from Chile, Peru, Bolivia and Mexico, enclave economies where the national bourgeoisie lost control of the external sector. See Fernando Henrique Cardoso and Enzo Faletto, Dependency and Development in Latin America, pp. 66-73.

20. Although after 1870 France and Germany began challenging British supremacy in Latin America, Great Britain was still the dominant economic power in the area until 1914. French investment in Brazil at the end of 1914 totalled \$501 million, whereas British investment reached the amount of \$1.2 billion. See ECLA, External Financing in Latin America (New York: United Nations, 1965), pp. 16-17.

21. British Investment in Latin America, p. 150.

22. "Lessons from the Past: Capital Markets during the Nineteenth century and the Interwar Period", International Organization, Vol. 39, no.3, Summer 1985, p. 413.

23. Andre Gunder Frank, Lumpenbourgeoisie: Lumpendevelopment, Dependence, Class, and Politics in Latin America (New York: Monthly Review Press, 1972), p. 67.

24. Richard Graham, Britain and the Onset of Modernization in Brazil, 1850-1914 (Cambridge: Cambridge University Press, 1968), p. 54.

25. Ibid. p. 56.

26. British Investment in Latin America, p. 173.

27. Graham, Britain and the Onset of Modernization in Brazil, p. 56.

28. Peter Evans, Dependent Development, p. 84.

29. ECLA, External Financing in Latin America, p. 19.

30. Evans, Dependent Development, p. 59.

31. ECLA, External Financing, p. 91

32. Britain and the Onset of Modernization, p.100

33. Ibid. p. 101.

34. Ibid. p. 102.

35. Data on Brazil's current account became available only after World War II. Therefore, the discussion of the BOP in the nineteenth century is based on the trade balance and information on debt service.

36. Caio Prado, Historia Economica del Brasil, p. 156 and Henry William Spiegel, The Brazilian Economy, p. 141.
37. Ibid.
38. Celso Furtado, The Economic Growth of Brazil: A Survey from Colonial to Modern Times (Berkeley: University of California Press, 1965), p. 175n.
39. The Brazilian Economy, p. 139.
40. Ibid. pp. 139-140.
41. The Political Economy of International Relations (Princeton: Princeton University Press, 1987), p. 308.
42. Cardoso and Faletto, Dependency and Development in Latin America, p. 89.
43. Ibid, pp. 89-91.
44. Development and Crisis in Brazil, 1930-1983 (Boulder, Colorado: Westview Press, 1984), p. 10.
45. Britain and the Onset of Modernization, p. 107.
46. For a review of the literature on British capital export see Barbara Stallings, Banker to the Third World, U.S. Portfolio Investment in Latin America, 1900-1986 (Berkeley: University of California Press, 1987), Chapter 1.
47. Albert Fishlow is one of the few scholars that have challenged Feis' view of the political connection. He argues that British lending practices were very different from those of France and Germany, Britain largely undertook "market-oriented foreign investment", while political considerations clearly played a part in French and German investment. See "Lessons from the Past", pp. 386-87 and 392.
48. External Financing in Latin America, p. 21.
49. Cardoso and Faletto, Dependency and Development, p. 66.
50. Dependent Development, p. 60.
51. Graham, Britain and the Onset of Modernization, p. 109.
52. Caio Prado, Historia Economica del Brasil, p. 296.
53. Warren Dean, The Industrialization of Sao Paulo, p. 37 and Laura Randall, A Comparative Economic History of Latin America, p. 135.
54. For an interesting account of Barbosa's unorthodox and "structuralist" policies see Randall, pp. 160-172.
55. Prado, p. 301.

56. Prado, Historia Economica del Brasil, p. 301 and Dean, The Industrialization of São Paulo, p. 86.
57. Dependent Development, p. 61.
58. Industrialization of Sao Paulo, p. 87.
59. "The Consumption of Dependency Theory in the United States", Latin American Research Review, 12 (1977), no.3, p. 13.
60. Nícia Vilela Luz, A Luta pela Industrialization do Brasil (São Paulo: Difusão Europeia do Livro, 1961), p. 176.
61. Randall, A Comparative Economic History, p. 172.
62. Rippy, British Investment in Latin America, pp. 26-29.
63. World Development Report 1985 (New York: Oxford University Press), pp. 14-15.
64. An interesting comparison of investment banks of the nineteenth century and commercial banks of the twentieth is found in Albert Fishlow, "Lessons from the Past: Capital Markets during the Ninettenth Century and the Interwar Period".
65. Celso Furtado, The Economic Growth of Brazil, pp. 194-95.
66. Caio Prado, Historia Economica, p. 251 and Jose Maria Bello, A History of Modern Brazil (Stanford: Stanford University Press, 1966), p. 105.
67. For a discussion of Argentina financial crisis in 1890, the so-called Baring Crisis which threatened the British banking system, see Fishlow, "Lessons from the Past", pp. 383-439 and David Felix, "Alternative Outcomes of the Latin American Debt Crisis: Lessons from the Past", Latin American Research Review, 22 (2), 1987, pp. 3-46.
68. Jose Maria Bello, A History of Modern Brazil, pp. 160-61.
69. "Lessons from the Past", p. 411.
70. Historia Economica del Brasil, p. 253.
71. Bello, A History of Modern Brazil, p. 166 and Vilela Luz, A Luta pela Industrializacao do Brasil, pp. 78-82.
72. A Comparative Economic History, pp. 176-77.
73. Bello, p. 171.
74. Vilela Luz, pp. 176-77 and Graham, Britain and the Onset of Modernization, p. 300.
75. A History of Modern Brazil, pp. 167-68.
76. Ibid., p. 169.

77. Celso Furtado, The Economic Growth of Brazil, pp. 191-92 and Cardoso and Faletto, Dependency and Development, p. 91.
78. Kenneth Paul Erickson, "Brazil: Corporative authoritarianism, Democratization, and Dependency", in Latin American Politics and Development, eds. Howard J. Wiarda and Harvey F. Kline (Boulder, Colorado: Westview Press, 1985), p. 169.
79. Bello, A History of Modern Brazil, p. 250.
80. Ibid. p. 210.
81. The Economic Growth of Brazil, p. 195.
82. Ibid. pp. 196-97.
83. Caio Prado, Historia Economica del Brasil, p. 264 and Celso Furtado, The Economic Growth of Brazil, p. 196.
84. Prado, pp. 263-64.
85. Dependent Development, p. 57.
86. Furtado, The Economic Growth of Brazil, p. 212.
87. "Lessons from the Past", p. 411.
88. Pinto Ferreira, Capitais Estrangeiros e Divida Externa, p. 139.
89. Peter Evans, Dependent Development, p. 58.
90. Laura Randall, A Comparative Economic History, p. 249.
91. Pinto Ferreira, Capitais Estrangeiros, p. 140.
92. Warren Dean, The Industrialization of Sao Paulo, p. 89.
93. Ibid. p. 95. Dean maintains that the challenge to industry posed by the First World War seems to have consisted mainly in the maintenance of equipment and production rather than in the expansion of domestic outlets since the importation of capital goods and of raw materials essential to industry was more sharply reduced than the importation of consumer goods, consisting mostly of foodstuffs, pp. 90-91.

CHAPTER 3

THE CRISIS OF CLASSIC DEPENDENCE 1919-1930

The First World War interrupted completely the inflows of loans into Latin America. Nevertheless, the interruption was of short duration, for in 1919 the region began once again to receive a substantial amount of external financing. Great Britain, however, was no longer the main supplier. The U.S. emerged from the war not merely as a net creditor country, but as the major source of capital flows. The strong financial position of the U.S. was manifested primarily in the surpluses of the trade and current accounts on the BOP, surpluses that the Americans were determined to maintain. Consequently, free trade was not consistent with the interests of the new international economic and financial power.

In contrast with British capital export of the pre 1914 period, then, American financial flows in the 1920s were not part of an integrated trade exchange. While American manufactured exports were aggressively promoted in Latin America, high levels of protectionism were maintained in the U.S. market for primary products. And American loans provided the means of financing BOP deficits abroad. Indeed, between 1924 and 1928, the boom years of American lending, massive foreign loans were extended to Latin American governments to finance growing stocks of unsold primary products and debt service on accumulated foreign debts. Thus, the liberal British trading system of the prewar years which had served to guarantee debtors a market for their products virtually disappeared. When the Great Depression struck and the system collapsed after 1929, the U.S. did not undertake the

function of lender of last resort to provide international liquidity as Great Britain had previously done, causing widespread defaults and even debt repudiation which exacerbated the slump in world economic activities.¹

For the export oriented Latin American economies, the 1920s symbolized the limits of classic dependence and Brazil provides an excellent illustration of this process. But the historical-structural analysis shows that external factors by themselves can not explain domestic economic processes. The behavior of social groups and institutions is crucial.

International finance and the coffee valorization policy

The year 1919 was a prosperous one for Brazil. The country experienced an industrial boom during the war as a result of the decline in imports of manufactured goods and debt service payments to Great Britain. By 1919, there were around 5,936 national light industries (nondurable consumer goods such as textiles, leather goods, processed foodstuffs and clothing) in the country.² Furthermore, exports reached the unprecedented sum of 130 million pounds, coffee alone contributing with 72 million pounds. As imports totalled 71 million pounds, Brazil had a very favorable trade balance of 59 million pounds as table 3.1 below show.

President Epitacio Pessoa who came to office in 1919 soon began to assess the postwar prospects for the Brazilian economy. He believed that the country should not count on an indefinite export boom since as soon as the effects of the war had been cleared up, Europe would try to rebuild its industries and reestablish foreign trade. In a message to congress he vehemently criticized excessive tariff protection, easy credit and emissions of paper money to help national industry. In fact, the economic policies followed in Brazil after the war illustrate the extent to which situations of dependency are the product of domestic political alliances. These alliances maintained and strengthened the links of Brazil's dominant classes with foreign interests.

Thus, since President Pessoa's accurate estimate that the postwar export bonanza would not last, why did he show such a negative attitude towards Brazilian infant industries? Pessoa, a spokesman for the coffee oligarchies, strongly believed that industry in Brazil was "unnatural" and his concern was to preserve Brazil's position in the international division of labor as a supplier of primary products and an importer of manufactured goods. Soon, his free trade policy reversed Brazil's war-created industrialization by allowing European and especially American manufactured goods to flood the domestic market. In addition to destroying the non-competitive domestically produced goods, Pessoa's import orgy in 1920 completely dissipated the foreign exchange gained in 1919. The president's liberal policy had far reaching consequences for Brazil, however, since the period of outward growth was coming to an end.

Significantly, while the Brazilian ruling coffee oligarchies continued to adhere resolutely to the British doctrine of free trade that had nurtured their wealth in the pre-1914 period, the new financial center did not. The U.S., unlike Great Britain before it, did not keep an open market for primary products. As David Felix remarks:

In general, the U.S. in the 1920s wanted to be the premier international capital exporter while protecting its export surplus. The temporary resolution of this contradiction was accelerating capital exporting, which had its own fatal contradictions, however.³

Indeed, the major feature of the 1920s was the drastic deterioration in world prices and demand for most primary products and the consequent massive foreign borrowing by peripheral countries to finance a growing stockpile of unsold commodities and debt service on accumulated foreign debt. For Brazil, the limits of classic dependence were reached in the decade.

As Table 3.1 shows, imports soared in 1920, but significantly,

exports fell drastically resulting in a trade deficit. The price of coffee in New York fell from over five pounds a bag in 1919 to three pounds in 1920 and to a little over one pound at the beginning of 1921, rising to two pounds and a half later in the same year. The percentage of coffee in total exports fell from 65.3 to 49.1 in 1920.⁴ The economic instability was mostly reflected in the steady fall of the exchange rate from 18½ to 7 pence per milreis in 1920 and 2½ in 1921.⁵ Coffee exports in fact played a crucial role in determining the value of Brazilian currency on the foreign exchange.

It was then that President Pessoa decided to borrow \$50 million from the U.S. in May 1921, the very first loan made by the federal government with the New York investment bank Dillon, Read and Co., although some states of the Republic were by then already clients of New York banks as indicated in Table 3.3 below. The purpose of the loan was not really to undertake public works to protect the Northeast against droughts as justified by the President. The loan was contracted to finance the 1920-21 BOP deficit caused not only by the trade deficit, but also by the repayments of the 1914 funding loan (see Table 2.2 above). In fact, the public works were soon abandoned.⁶ The fresh inflows of loans, however, prevented further declines of the exchange rate which stabilized between 7½ and 8 pence per milreis.⁷ Furthermore, a 1922 U.S. loan of \$25 million for the purpose of railroad electrification was also used to cover BOP deficits (see Tables 2.2 above and 3.3 below).

What marked the Pessoa administration, however, was his unconditional support for the coffee valorization policy as pressure from the oligarchies - and from the BOP - was mounting steadily with the continuous fall of price and demand for coffee in the international market, especially in the U.S., which became the largest importer of the product as well the largest Brazilian customer, taking over about 38 percent of all Brazilian exports in the 1920s.⁸

Table 3.1 Brazil's foreign trade, 1919-1930
(millions of pounds)

Year	Exports of Coffee	Total Exports	Imports	Balance
1919	72.0	130.0	71.0	+59.0
1920	52.8	107.5	125.0	-17.5
1921	34.7	58.6	60.5	- 1.9
1922	44.2	68.6	48.6	+20.0
1923	47.1	73.2	50.5	+22.7
1924	71.8	95.1	68.3	+26.8
1925	74.0	102.9	84.4	+18.4
1926	69.6	94.2	80.0	+14.0
1927	62.7	88.7	79.6	+ 9.1
1928	69.7	97.4	90.7	+ 6.7
1929	67.3	94.8	86.6	+ 8.2
1930	41.2	65.7	53.6	+12.1

Sources: Affonso de Taunay, Historia do Cafe no Brazil (Rio, 1941), Vol. XII, p. 217 and J.F. Normano, Brazil: A Study of Economic Types (Chapter Hill, University of North Caroline Press, 1935), p. 43.

As discussed in chapter 2, the resort to foreign loans to support the price of coffee was an expedient of the government to maintain the financial equilibrium of the vulnerable export economy. With Brazil's reliance in just one export crop to pay for both imports and the traditional debt service abroad, the government had no other option but to borrow to defend the price of its most important source of foreign exchange as the government's withholding of supplies made it possible to maintain high prices on the international market. As Furtado points out: "Financing for those inventories [coffee] had largely been obtained from foreign banks. The intention had been to preclude external disequilibrium in this manner." ⁹

But while mostly benefitting the coffee oligarchies with excessive credits and thus causing a domestic inflationary process harming the majority of the population, the coffee scheme was illusory for BOP purposes. It brought only temporary relief since the service of the foreign loans annulled most of the gains in the trade balance. Furthermore, repeating Furtado's

comments on the developmental outcomes of the coffee valorization policy, the whole process did not bring any new investments to the country, rather, there was a disinvestment in the contracting of debts abroad in the form of debt service payments.¹⁰ As we have seen, the massive borrowing backfired in 1914 and it would again in 1930 with the collapse of the international financial system. Although Vargas continued the coffee program in the 1930s, the financing was made internally instead of externally, due, of course, to the interruption of inflows of foreign loans, a change which would have far-reaching economic and political repercussions in Brazil as national industry reached an unparalleled growth (see chapter 4).

In the meantime, in August 1921, President Pessoa declared that coffee valorization was not a problem of the state of Sao Paulo, it was a question of the entire national economy. In October he sent a message to Congress proposing the "permanent defense" of coffee and in 1922 the government established the Institute for the Permanent Defense of Coffee.¹¹ The Institute's major purposes were to lend money to coffee growers at low rate of interest against unsold coffee stocks and to regulate the flow of the product to the international market through purchase and storage.

To begin the operation, the federal government borrowed 9 million pounds, netting 8,325 million. This loan, carrying 7½ percent interest,¹² was made through a syndicate of Rothschild, Baring Brothers and J. Henry Schroeder of London and the American Bank Dillon, Read and Co. The English banks lent 7 million pounds and the American bank two million pounds, the equivalent of \$9.7 million (see Tables 2.2 above and 3.3 below). The government bought up some surplus coffee and stored it in warehouses in Brazilian ports, succeeding in preventing a further drop in prices which stabilized at 3.15 pounds a bag in 1922. In addition, the treasury discounted a note for four million pounds at the Banco do Brasil raising the loan to £13 million for the coffee program. Pessoa's administration also created the

rediscount department in the Banco do Brasil to increase credit to coffee planters, hence the inflationary process in the 1920s.¹³

Pessoa's policy of free trade and coffee protection, however, gave rise to strong criticism in Congress, the press and among industrial groups who favored tariff walls. But the opposition to the President increased drastically when the conditions under which the loan of 9 million pounds was contracted, was made public. The direction of the coffee defense operation was given to the foreign banks! A committee composed of representatives of the House of Rothschild, Baring Brothers, Schroeder and the British enterprise Brazilian Warrant Co., which conducted the warehouse business and financed the coffee trade, controlled the sales of the coffee stock which was, after all, the guarantee or collateral of the loan. There was just one Brazilian representative in the sales committee.¹⁴

But it was only after Arthur Bernardes of Minas Gerais took office in November 1922 as the new President of the Republic that the onerous contract of the loan with the international financiers was finally disclosed in congress. The contract established that the maturity of the loan would have to be ten years, during which time the product of the coffee stock sales would be deposited with the creditor banks to be applied to the payment of the debt only in 1932. Brazil would pay $7\frac{1}{2}$ percent interest on the loan while receiving only 3 percent for the deposit of the money from the sales. The stock, the guarantee of the loan, would be sold in annual parcels of only 435 thousand bags during the 10 years. This was the motivation behind the obligation of the 10 year maturity period of the loan as the bankers were in no hurry to terminate this profitable arrangement. In addition, the contract prohibited any further defense operation which was not carried out by the same sales committee. The contract would have given the committee the right to control the Brazilian coffee market during 10 years.¹⁵

President Bernardes was able, however, to change some of the clauses of the contract. The ten year maturity period was eliminated and the country became free to pay the loan as soon as it could, thus also eliminating the burden of yearly interest payments which the bankers wanted to force on Brazil for 10 years. The sales committee also finally agreed to withdraw the stipulation of the fixed annual sales of only 435 thousand bags of coffee and began to liquidate the stock. Brazil was again able to control the defense operation, but the Pessoa administration became, of course, completely discredited.

The Bernardes government at first continued the program of the permanent defense of coffee as Sao Paulo controlled both the ministry of finance and the Bank of Brazil, whose rediscount department was enlarged to provide easier credit to coffee planters. In 1923, the emissions of paper money reached their highest point as the paulistas quickly went beyond the emission limits set by law. Between 1920 and 1923 the amount of currency in circulation, the cost of living and the price of foreign exchange all doubled, increasing Brazil's yearly commitments abroad. In 1922 Brazil remitted abroad as debt service payments 32.1 percent of its revenue.¹⁶

The inflationary pressures created by the government credits to coffee planters, however, strengthened the political opposition of the middle class, particularly young army officers who profoundly resented the planters' control of the government. The unsuccessful coup of Sao Paulo army officers (called lieutenants or tenentes) in July 1924 was caused by the anarchical financial situation in the country as their manifesto "complained against inflation as though it were as great a crime as electoral fraud."¹⁷ Significantly, the 1930 Vargas' "revolution" can be traced back to this lieutenants' rebellion, which divided the political oligarchy. The lieutenants desired fundamental social and economic changes in Brazil and believed it could

be achieved only by a cadre of non-political technocrats. As we will discuss in chapter 4, it was this position that Vargas took after 1937 with the establishment of the Estado Novo.

The Bernardes administration was not only under these domestic pressures, however. A British financial delegation composed of representatives of Brazil's traditional creditors arrived in Rio and made clear to the President the impossibility of securing further loans under such inflationary environment. According to Warren Dean, the creditors "humiliated him [Bernardes] with suggestions on how to balance the federal budget."¹⁸ The most important suggestion was the complete termination of federal intervention in the coffee economy, leaving the defense to the coffee producing states themselves.¹⁹

With all these pressures, Bernardes reversed his financial policy of easy credit to coffee planters and embarked into a deflationary one. Being from Minas Gerais, he quickly removed the paulistas from the ministry of finance and the Bank of Brasil and began withdrawing paper money from circulation. By May 1926 he had burned 316,000 contos (\$50 million) and the exchange rate rose from 5 6/8 pence per milreis in 1923 to 7 9/64 in 1926.²⁰ But to accomplish the deflationary policy against the coffee oligarchies, Bernardes resorted to the use of "laws that curtailed the freedom of the press, prolonged the state of siege, and disbanded state political machines that had been adverse to him...He obtained changes in the Constitution of 1891...intended to strengthen the authority of the federal government, especially the power of the executive."²¹

Furthermore, fearing financial sanctions from Brazil's creditors abroad, Bernardes immediately carried out their suggestion and withdrew the federal government entirely from the coffee valorization program. The government's warehouses and coffee marketing functions were transferred to São Paulo in December 1924 when the state's own Institute for the Permanent

Defense of Coffee was established.²² In 1925, the states of Minas Gerais and Rio de Janeiro also began their own coffee defense schemes.

The São Paulo Institute resorted immediately to foreign loans to be able to carry out its defense program. As Table 3.2 below shows, in early 1925 the Institute obtained its first loan of 10 million pounds from Lazard Brothers of London. Special taxes in gold were collected to guarantee the loan service. According to Warren Dean, this loan spared the coffee planters the consequences of Bernardes' deflation, leaving the industrialists, however, highly vulnerable as a result of the domestic credit squeeze.²³

The Institute had absolute control of the market and was free to fix prices by withholding shipments and accumulating enormous stocks. During 1925, coffee prices in the U.S. reached its all time high of 22 cents a pound, although in November of that year prices began heading downward. But it was Lazard Brothers of London, the major financial source of the Institute's operations which controlled the organ entirely.²⁴

As Table 3.2 shows, between 1921 and 1930 most coffee loans to the state of São Paulo and to the Institute itself were extended by Great Britain. Thus, although between 1915 and 1930 Brazilian public loans (federal government, state and municipalities) raised in London reached 54.3 million pounds and in New York, 86.5 million pounds, coffee loans were still the monopoly of the British.²⁵ But this situation resulted from U.S. foreign loan policy in the 1920s.

U.S. foreign loan policy in the 1920s

The São Paulo Institute had attempted to raise its first loan in the United States, but the Harding administration opposed any loans from American banks to support Brazil's coffee defense policy on the grounds that the American consumer would pay more for the product.²⁶ Probably to weaken the U.S. position in Brazil, the British bankers quickly agreed to finance the Institute. In fact, according to Robert Neal Seidel, some U.S. officials

Table 3.2 Coffee Loans 1921-1930
(In millions of pounds and dollars)

Year	Nominal Debt	Borrower	Source of Funds
1921	\$ 10.0	Sao Paulo State	US
1921	\$ 27.2 ^a	Sao Paulo State	UK
1925	£ 10.0	Sao Paulo Coffee Institute	UK
1926	\$ 0.5 ^b	Sao Paulo Coffee Institute	US
1926	\$ 70.0	Sao Paulo State	UK
1928	\$ 17.5 ^c	Sao Paulo State	UK
1929	£ 5.0	Sao Paulo State	UK
1930	\$100.0	Sao Paulo State	US and UK

Source: Affonso de Taunay, Historia do Cafe no Brasil (Rio, 1941), Vol. XII, pp. 201, 219, 281 and Vol. XIII of 1942, p. 356.

a, b, c figures not available in pounds sterling

viewed the operation as "strengthening the British presence in Brazil, particularly the Brazilian Warrant Co., which was instrumental in negotiating the loan and one of the large takers of the bonds."²⁷

U.S. foreign loan policy to South America in the 1920s was premised on the belief that American loans should be for "productive uses." This productive criterion meant that foreign loans and investments would have to facilitate American trade, thus involving the use of the "tied loan" or of "stipulation" in loan contracts to ensure purchase of American goods. A loan was productive if devoted to industrial or agricultural development yielding returns to American exporters and eventually benefitting the entire American economy. As Paul Drake observes:

In the 1920s, the U.S. government encouraged foreign lending to generate purchases of exports and return payments on interest and principal. To facilitate that process, the U.S. government would encourage *faissez-faire* practices abroad, generally promoting the overseas expansion of U.S. traders, companies, investors and banks.²⁸

Unsound loans were those to assist foreign monopolies, for armaments and to cover foreign countries' budget deficits.²⁹ Thus, Secretary of Commerce Herbert Hoover mounted a campaign against Brazilian coffee monopoly and U.S. bankers heeded the advice of the State Department not to sell Brazilian bonds in the American market to help support coffee prices. Furthermore, the U.S. began helping competition from the world's second largest coffee producer, Colombia. As Seidel observes: "Bureau personnel made plans for developing the Colombia coffee industry, which included (besides the railroad) an agrarian bank, a 'proper warehousing and financial system', and promotion to establish Colombia brands on the American market."³⁰

The Harding administration had in fact attempted to maintain a watch over any loan offerings made to the American public. In March 1922, the U.S. government announced that banks were to inform the State Department

before making a loan.³¹ However, only on rare occasions was a loan blocked and, in addition, the apparent initial cooperation between bankers and the government regarding loans to foreign governments soon broke down and bankers did not even inform the government of flotations of foreign issues in the U.S. Finally, U.S. criterion for "sound foreign loans" to Latin America were rarely observed by bankers or even by U.S. officials, of which Seidel wrote:

The admonition that loans be for productive purposes was a sort of covering law that masked many infractions of the other strictures and made American loans to South America an exception to the general loan policy. Loans were made, more often than not, to cover South American government deficits, refund previous debt, and balance budgets. After all, the best guarantee of all other American investments was a strong central government. Similarly, security was sought in legal protections as well as in the good faith of the South American governments. Security, moreover, was exacted in the form of fiscal oversight by American agents if not also by direction of revenue collecting agencies.³²

Furthermore, as Felix observes, in the 1920s,

The U.S. investment banks plunged into foreign lending with characteristic American brio. Bonds underwritten by smaller Wall Street firms usually passed through one or two layers of underwriting syndicates before being retailed, each layer taking its underwriting cut. Large New York banks bypassed anti-branch-banking laws by organizing "security affiliates" to retail domestic and foreign bonds. The marketing procedures created gross spreads of up to 14 percent between the nominal bond price and the amount actually received by the foreign borrower. To keep the supply of bonds flowing through these marketing systems, foreign borrowers were pursued aggressively. Overseas agents, finders fee, direct bribes of officials of borrowing governments, and deceptive prospectuses became standard operating procedure, according to U.S. Senate Hearings held after the collapse.³³

In the specific case of Brazil, although American investment banks were already actively lending to states and municipalities since the early 1920s (see Table 3.3 below), U.S. policy on loan capital export to the country changed radically with the inauguration of the new Brazilian president, the Paulista Washington Luis, in November 1926. The fact was that Luis immediately embarked on an exchange rate stabilization based on the gold

standard in order to make Brazil an attractive place for American trade and investments. The President's "structural reforms" to attract foreign capital, an early version of the financial internationalization of the economy (see chapter 9), were the major domestic cause of the crisis of the dependent export economy as they exacerbated the vulnerability of the economy to external shocks.

Financial internationalization and the crisis of the
export economy

The U.S. had been very critical of Bernardes policy of raising the exchange value of the milreis because it had created serious problems for American exporters.³⁴ But after a month in office, Washington Luis pleased the Americans with a monetary reform that included the stabilization of the milreis at a lower rate and the creation of the stabilization fund, and the reinstatement of the gold exchange standard, declaring the Brazilian currency convertible on the basis of a fixed rate of exchange. As Siedel observes: "The movement toward gold standard currencies in South America and the progressive reform of economic institutions was more critical in American eyes than balanced budgets."³⁵

Exchange rate stabilization in Brazil was, of course, an instrument of protection for the coffee exporting oligarchies whose profits could be reduced by a sudden rise in the exchange rate due to the inflationary effects of the valorization policy. But, exchange rate stabilization was also the most important step to guarantee foreign capital inflows, given the sensitivity of foreign investors to exchange rate volatility in peripheral countries. In fact, Washington Luis' monetary reform was primarily designed to maintain the confidence of international financiers in Brazil.³⁶ As Celso Furtado points out:

In the textbooks of the classic age of the gold standard, Latin American monetary systems, with their floating exchange rates and

chronic non-accelerating inflation, were regarded as aberrant phenomena, comparable to the movement of the satellites of the planet mars...It was in this spirit that important international financial groups, intent on maintaining the regularity of external debt service payments and interested in the transfer of dividends on the substantial direct investments beginning to be made in the region after the First World War, pressed Latin American governments to reform their monetary systems, offering technical assistance for this purpose. This ushered in the phase of reforms in the issue systems and the creation of central banks.³⁷

It is not at all clear whether foreign advisers were brought in by Washington Luis to "restructure" Brazil's monetary system in 1926. At least, Brazil, unlike Guatemala, Colombia, Chile, Ecuador, Bolivia and Peru, did not receive financial advisory missions headed by Edwin W. Kemmerer, professor of economics at Princeton University. Kemmerer, known in Latin America as the "money doctor", was a sort of one-man IMF that the State Department sent to Latin American debtor countries in the 1920s to stabilize exchange rates and control domestic credit by establishing the gold standard, a central bank, and strict bank regulations, thus making the countries safer havens for American trade and investments.³⁸ Nevertheless, it was the prescriptions offered by Kemmerer that Washington Luis followed and the domestic reforms were adopted under the active stimulus of international banks.³⁹ As Table 3.3 below shows, American financial capital indeed flowed to the country in response to the stabilization prospects.

Washington Luis' monetary reform lowered the exchange rate to 5 pence per milreis from 7 9/64 left by the Bernardes administration. The reform consisted of three sequential phases: stabilization of the exchange rate, convertibility and coinage of the gold cruzeiro to replace the milreis. The new standard for the milreis was fixed at 200 miligrams gold which corresponded almost exactly to 40 milreis to the pound sterling from 30 milreis before the stabilization, thus depreciating the Brazilian currency abroad by 10 milreis in each pound.⁴⁰ A special agency, the stabilization fund (Caixa de Estabilizacao, an early version of a central bank) was created

and granted authority to issue paper money (actually, credits to coffee planters) against Brazil's gold credits (in fact, an increasing debt) in London and New York. All present and future gold in the country was transferred to the fund.

International finance, therefore, came to play two crucial roles in Brazil after 1926: it sustained both the BOP and domestic liquidity. In fact, the increase in domestic liquidity depended on the continuous inflows of foreign loans to the stabilization fund. As it will be discussed shortly, this early experiment in what is known as the financial internationalization of the economy drastically increased the vulnerability of the economy to external shocks and completely undermined state control over national economic policy making. It should be noted at this point that the post-1964 military regime in Brazil also adopted far reaching structural reforms to internationalize the country's financial system. It was the inflows of foreign loans to the newly created domestic financial institutions (private and public investment banks, public development banks and private commercial banks) that guaranteed the equilibrium of the BOP and domestic liquidity as the foreign loans were "repassed" in cruzeiros to national industry. As in the 1930s, when foreign loans were completely interrupted, the dependent economy also suffered a major financial and developmental crisis in the 1980s (see chapters 7, 8 and 9).

In the meantime, to get his plan started, Washington Luis obtained from Dillon, Read and Co. \$60 million resulting in the shipment of almost \$45 million of gold for the stabilization fund (see Tables 2.2 above and 3.3 below). But the inflows of loans led to a rapid domestic inflationary process as the government converted the foreign currency into contos to provide credit to coffee planters. Washington Luis printed almost one million contos between 1926 and 1930,⁴¹ the largest emission of paper money in the history of the Old Republic. This expansion of credit thus led

to the overproduction of coffee in 1929-30 at precisely the time when price and the demand for the product drastically declined in the international market (see discussion below). The President's "inflationary stabilization" to defend coffee prices, however, was reflected politically in the restoration of the freedom of the press and suspension of the state of siege imposed by Bernardes in 1925-26 during his deflationary measures .⁴²

Andre Gunder Frank correctly observed that "...Washington Luis proclaimed himself a great friend of the U.S....His main concern was with the BOP and with prompt Brazilian payments on its foreign debt. And the President gave full support to the entry of foreign capital, especially American." ⁴³ Indeed, as Table 3.3 below indicates, massive flows of American loans began pouring in Brazil after 1926. According to Max Winkler, U.S. private direct investment and portfolio investment in Brazil increased from \$55 million in 1914 to \$624 million in 1932, the bulk of which between 1926 and 1930, during Washington Luis' administration. ⁴⁴ And the foreign debt doubled. In only four years it was increased by 100 million pounds. Table 2.4 above shows that the nominal value of total debt incurred by 1925 was 290 million pounds and by 1930 it was 394 million pounds. In fact, the late 1920s have striking parallels with the late 1970s, when massive foreign borrowing took place just to service past loans within the context of a deteriorating world economy (see chapter 9).

Although Brazil's trade balance was still favorable during 1926-30, the export boom was clearly over. As Tables 3.1 and 3.4 show, after 1925 the volume and value of exports began to decline sharply. As David Felix observes, the deteriorating market conditions originated in an oversupply of primary products and in structural changes in the economies of center countries, in the

diminishing importance of Britain as an open market for primary imports and rising agricultural protectionism and import substitution in primary goods after 1925 by industrial Europe and the U.S. Even Britain joined in by subsidizing its domestic sugar beet industry.⁴⁵

The adverse conditions in the international market meant that Brazil's small trade surpluses were, of course, not enough to cover the traditional service account deficit on the BOP and made the country still more dependent on new inflows of foreign loans. In 1927, Washington Luis raised two large loans to consolidate Brazil's floating debt, that is, the President borrowed more just to pay old loans. A loan of 8.7 million pounds from the deficit-financing House of Rothschilds (Table 2.2 above) put Brazil as the only Latin American country that was still able to float substantial new sterling issues in the late 1920s.⁴⁶ This loan was not enough, however, and the President obtained further credits from the American bank Dillon, Read and Co., in the amount of \$41.5 million, netting \$36.4 million (Table 2.2 above and 3.3 below).

Furthermore, Table 3.3 shows that in addition to the federal government, states and municipalities of the country resorted to massive foreign borrowing after 1925, highly stimulated by Washington Luis' policy. And American investment banks always demanded collateral for state loans. A case in point was the 1928 \$1.7 million loan to the state of Maranhão, when a property mortgage and a lien on taxes were the forms of the collateral.⁴⁷ The contract authorized an American collecting agency to manage the public utilities and handle the revenue produced by them and also collect taxes as additional collateral for the loan.⁴⁸

American creditors also always attempted to obtain certain advantages in extending loans to the states. In 1929, the contract for the loan of \$6 million to the state of Rio de Janeiro with J.G. White and Co. guaranteed this investment firm the job as consulting engineer and New York purchasing agent for Engineers Corporation, a subsidiary of J.G. White Engineers Co. As Seidel observes: "It would not be inappropriate to conclude that Rio's desire for a loan enabled the bankers...to drive a bargain more advantageous to their interests that was formerly the case."⁴⁹

Table 3.4 shows that debt service as a percentage of the trade balance (column E) jumped from 80.6 percent in 1926 to 252.2 percent in 1928, falling slightly to 213 percent in 1929 and 162.8 percent in 1930. In 1929, the government had to use Brazil's foreign exchange reserves in order to meet its external obligations (column G) as inflows of foreign loans (column C) were not enough to finance the service account, which in addition to debt service, also includes profit remission and dividends, transportation, insurance and travel. When inflows of loans were interrupted completely after 1930 and export earnings drastically declined, Brazil defaulted (see Chapter 4).

As already observed, the stabilization of the exchange rate and the cheapening abroad of the price of the Brazilian currency also attracted massive foreign direct investment, 80 percent of which from the U.S. As table 3.3 shows, the local subsidiaries of American companies soon resorted to the Wall Street securities market. In 1927, for example, public issues of more than \$19 million were floated in the U.S. for foreign owned public utility companies in Brazil, mostly electric power companies. The following year, the Brazilian Traction, Light and Power firm issued \$22 million in bonds in the U.S. and the Rio Grande Electric Energy Company floated another issue of \$24.570 million.

Significantly, while the stabilization of the exchange rate was an incentive to attract foreign loans, the preservation of the stabilization was in itself completely dependent on the inflows of foreign loans. A fixed exchange rate was assured by the adoption of the gold standard with the creation of the stabilization fund. The increase in the fund's reserves by the favorable movement of foreign loans ensured the increase in domestic liquidity. Indeed, domestic financial stability depended crucially on the inflows of foreign loans.⁵⁰ The vulnerability of the economy to external shocks was obvious.

Table 3.3 United States Portfolio Investment in Brazil
(In thousand of U.S. dollars)

Securities	Amount Issued	Amount Refunded	Price
1916			
São Paulo (city) 6's, 1919-31	\$ 5,500,000	-	96.09-100
Brazilian Traction, Light & Power 6's, 1919	7,500,000	-	99
1919			
Santa Catarina 6's	5,000,000	-	
São Paulo (city) 6's, 1943	8,500,000	-	95½
Rio de Janeiro (city) 6's, 1922-31	10,000,000	-	-
Brazilian Traction, Light & Power 6's, 1922	7,500,000	\$ 7,500,000	97½
1921			
Brazil 8's, 1941 (federal government)	25,000,000	-	97½
Brazil 8's, 1941 (federal government)	25,000,000	-	98½
São Paulo 8's, 1936	10,000,000	-	97½
Rio de Janeiro 8's, 1946	12,000,000	-	97 3/4
Rio Grande do Sul 8's, 1946	10,000,000	-	99½
1922			
Brazil coffee 7½'s, 1955 ^a	9,720,000	840,000	97
Brazil 7's, 1952 (federal government)	25,000,000	-	96½
Porto Alegre 8's, 1962	3,500,000	-	99
São Paulo (city) 8's, 1952	4,000,000	-	100
Rio de Janeiro 8's, 1947	13,000,000	10,000,000	103
Santa Catarina 8's, 1947	5,000,000	5,000,000	101
Ceara 8's, 1947	2,000,000	-	98
Bahia 8's, 1942	5,000,000	-	99½-100½
Paulista Railway 7's, 1942	4,000,000	-	99
1923			
Maranhão 8's	1,500,000	-	-
Sergipe 8's	1,000,000	-	-
1925			
Santos 10½ notes, 1927	1,700,000	-	-
São Paulo 8's, 1950	15,000,000	-	99½

Table 3.3 (continued)

Securities	Amount Issued	Amount Refunded	Price
1926			
Brazil 6½'s, 1957 (federal government)	\$ 18,500,000	-	90½
Brazil 6½'s, 1957 (federal government)	35,000,000	-	90
Porto Alegre 7½s, 1956	4,000,000	-	96
São Paulo (state) 7's, 1956 ^b	7,500,000	-	96½
São Paulo Coffee Institute 7's	473,950	-	97½
Brazil Babassu Corporation 7% pfd.	2,500,000	-	-
Rio de Janeiro Wireless	1,000,000	-	-
1927			
Brazil 6½'s, 1957 (federal government)	41,500,000	-	-
Pernambuco 7's, 1947	6,000,000	-	97¾
Rio Grande do Sul 7's, 1967	10,000,000	-	98
Rio Grande do Sul Municipalities 7's, 1967	4,000,000	-	97
Rio de Janeiro Treasury Notes	1,187,000	-	-
São Paulo (city) 6½s, 1957	5,900,000	-	98
Bahia Corporation 7% pfd.	1,500,000	-	25
Brazil Gold & Diamond Corporation	1,000,000	-	-
Ford Industrial Co. of Brazil	100,000	-	-
Cia. Telephonica Rio Grandense	1,000,000	-	-
Cia. Brasileira de Energia Eletrica	11,000,000	-	-
Cia. Linhas Circular e Trilhos Centraes		-	-
Cia. Francana de Eletricidade		-	-
Pan American Industrial Corporation	3,500,000	-	-
Ribeirao Preto Power & Light	3,600,000	-	-
1928			
Maranhão 7's, 1958	1,750,000	\$ 1,500,000	94
Minas Gerais 6½'s, 1958	8,500,000	-	97½
Parana 7's, 1958	4,860,000	-	98
Porto Alegre 7's, 1968	2,250,000	-	97½
Rio de Janeiro 6's, 1933	1,770,000	-	99
Rio de Janeiro 6½'s, 1953	30,000,000	13,000,000	97
Rio Grande do Sul 6's, 1968	23,000,000	-	94½
São Paulo 6's, 1968	15,000,000	-	94½

Table 3.3 (continued)

Securities	Amount Issued	Amount Refunded	Price
1928			
São Paulo 6's, 1968	\$17,500,000	-	-
Minas Gerais 6½'s, 1958	8,750,000	-	-
Brazilian Portland Cement Corporation	3,000,000	-	-
Brazil Rubber Concession	1,500,000	-	-
Brazilian Traction, Light & Power	22,000,000	-	-
Cia. Energia Eletrica rio Grandense	24,570,000	-	-
Cia Carres Porto Alegre			
Itabira Iron Ore, Ltd.	-	-	-
Pernambuco Tramways & Power Co.	-	-	-
Santos Improvement Co.	-	-	-
1929			
Rio de Janeiro (state) 6½'s, 1959	6,000,000	-	91½
Minas Gerais 6½'s, 1959	8,000,000	-	-
1930			
São Paulo (coffee) ^c	35,000,000	-	-

Source: Max Winkler, Investments of U.S. Capital in Latin America (Boston: World Peace Foundation Pamphlets, 1928), Vol. XI, No. 6, pp. 92-93 and Foreign Bonds, An Autopsy (Philadelphia: Roland Swain Co., 1933), pp. 182-187; 243-244.

- ^a This loan was made in London and New York by a syndicate of Rothschild, Baring Brothers and Co., H. Henry Schroeder and Co., and Cillon, Read and Co. The British banks lent seven million pounds and the U.S. bank, two million pounds.
- ^b This loan, for São Paulo public works, was also made in London and New York. British banks lent two million pounds and the U.S. bank, \$7.500 million.
- ^c This loan was made in New York and London. The U.S. bank lent \$35 million and the British banks, 10 million pounds.

Table 3.4 Brazil: Foreign Public Debt and Some Data on the Balance of Payments, 1925-1931
(In millions of pounds sterling)

Years	Debt Service (A)	Trade Balance (B)	Net Inflows of Foreign Loans (C)	Net inflows of Foreign Loans related to Foreign Debt (D)=(C)-(A)	Debt Service as % of Trade Balance (E)= $\frac{(A)}{(B)}$	Debt Service as % of total Inflows of Foreign Loans (F)= $\frac{A}{(B) + (C)}$	Foreign Exchange Reserves G
1925	10.2	18.4	3.0	- 7.2	55.4	47.7	11.2
1926	11.6	14.4	25.8	14.2	80.6	28.9	28.6
1927	13.3	9.1	24.0	10.7	146.2	40.2	19.8
1928	16.9	6.7	23.5	6.6	252.2	56.0	13.3
1929	17.3	8.1	2.5	- 14.8	213.6	163.2	- 6.7
1930	19.7	12.1	18.0	- 1.7	162.8	65.4	10.5
1931	20.4	23.7	-	- 20.4	86.1	86.1	3.3

Source: Marcelo de Paiva Abreu, "A dívida pública externa do Brasil, 1931-1943", Pesquisa e Planejamento Economico, Rio de Janeiro, 5 (1), June 1975, p. 44, Table 3.

The crisis of classic dependence

The vulnerability of the Brazilian economy to fluctuations in the international capital markets became obvious when in the second half of 1928 the U.S. embarked on a deflationary policy, tightening the previous easy credits of Wall Street. The consequent rise in short-term interest rates in the New York financial market provoked a sharp decline in the volume of capital outflows, already affected by the speculative boom in the Wall Street stock exchange which redirected American investments. Furthermore, aware of Latin America's high level of foreign indebtedness, American bankers reduced their exposure to the area and in the first months of 1929 they abruptly interrupted capital flows.⁵¹

While loans could still be raised in London at lower rates, by the middle of 1929 the new U.S. monetary policy was having its impact in the London financial market. In July, pressure from foreign banks and monetary authorities without access to the New York market caused a drastic reduction in British reserves. In August, the Federal Reserve raised again the rediscount rate and so did the Bank of England to defend its reserves, resulting in a virtual closing of the London market to long-term foreign loans. These developments in the international financial system and the interruption of flows of foreign loans brought to an end the exchange rate stabilization of Washington Luis, causing a major financial crisis. In the external front, the inevitable exchange rate depreciation drastically increased debt service since more cruzeiros would be required to repay the same amount of debt. Domestically, the stabilization fund was soon depleted of its gold reserves. But the Brazilian economy was doubly vulnerable: it relied excessively on both the international financial and trading system for its stability and both collapsed simultaneously.

The impact on Brazil of the sharp reduction of inflows of foreign loans was aggravated by the crash of the New York Stock Exchange in October 1929 and the subsequent drastic drop in the volume of world trade and the prices of commodities. The excessive printing of currency aided by the inflows of foreign loans enabled the Sao Paulo Institute to extend massive credits to coffee planters for new coffee plantations culminating in the overproduction of 1929/30 which reached 29 million bags while exports amounted to only 14.3 million and prices began falling violently. Coffee prices fell from 4.71 pounds a bag in 1929 to 1.80 in 1932-34, a decline of 62 percent.⁵² Therefore, not only did the price of coffee fall, but the demand for the product was also declining. As Peter Evans remarks: "Real crisis for the dependent economy required falling prices combined with a stagnant market...What happened in the thirties provides the best illustration of the dangers of dependence."⁵³ But for the dependent Brazilian economy, the severity of the external shocks was revealed in the reduction not only of export earnings, but also of foreign borrowing which sustained both the BOP and domestic liquidity.

With their income falling, the São Paulo coffee oligarchies appealed to the federal government for immediate aid in the form of a new issue of currency. Instead, Washington Luis suspended the coffee surplus purchase program, lowered the previous fixed price of coffee on the world market in the hope of increasing total sales, embarked on an orthodox fiscal policy and continued to adhere strictly to the gold standard with its consequent deflationary impact as the gold reserves of the stabilization fund began to be drastically reduced, thus reducing the real liquidity of the economy.⁵⁴

The policies adopted by Washington Luis were, of course, precisely the classical orthodox prescriptions - very much still in fashion - to extract domestic resources to pay foreign creditors. As Paul Drake observes,

when the Great Depression struck and export earnings declined, American creditors recommended austerity measures to indebted Latin American governments. He said that:

From 1929 to 1931, U.S. advisers recommended [to overextended Latin American governments] balancing the budget, slashing domestic expenditures, sustaining the gold standard, meeting foreign obligations and awaiting the revival of the world economy. But neither U.S. government officials nor bankers came forward with any significant emergency relief...To the contrary, The U. S. Congress aggravated the situation by passing the highly protectionist Hawley-Smoot tariff of 1930.⁵⁵

Washington Luis' deflationary measures were obviously a blow to Brazil's rudimentary industries whose orders fell off and production declined. But the Paulista President's suspension of the coffee scheme during a major world crisis contradicted his unconditional support for the São Paulo oligarchies. The President's economic adjustment strategy had heavy political costs, however. It cost him the loyalty of São Paulo when he attempted to impose another Paulista in the presidency in 1930 when, by the rules of the oligarchic game, it was the turn of Minas Gerais in the national government (see chapter 4).

As Table 3.2 above shows, the state of São Paulo was still able to obtain the so-called "coffee realization loan" of \$100 million in early 1930, contracted in New York and London in an attempt to prevent further coffee price declines. This loan, however, was the very last loan to the state of São Paulo and committed it to end the coffee defense program. Without foreign loans to sustain the storage of coffee and credit to coffee growers, the Sao Paulo Coffee Institute collapsed.

Furthermore, to compound Brazil's financial crisis, the gold standard and convertibility served only to facilitate a major capital flight from the country. The entire gold reserves accumulated by foreign loans in the stabilization fund in the amount of 31 million pounds had completely disappeared by December 1930.⁵⁶ Brazil was thus caught without its gold

reserves and with its rapidly declining foreign exchange earnings. The deepening world depression and the complete interruption of European and American capital flows led Brazil to default on its foreign debt (see chapter 4).

As the crisis of the liberal trading and financial system unfolded in 1930 causing a major crisis in the reflex-type Brazilian economy, another event of that year would bring fundamental transformations in Brazil's political and economic processes: the overthrow of the oligarchic Republic. The subsequent chapter treats the 1930s, a turning point in Brazil's development process.

In summary, chapter 3 showed how the concrete situation of dependency that arose in nineteenth century Brazil was maintained and strengthened by the dominant classes in the 1920s and provided insights into the developmental outcomes resulting from such situation. The free trade ruling coffee oligarchies reversed much of the war-induced industrialization in order to preserve Brazil's "natural" position in the international division of labor, now under the leadership of the U.S., as a supplier of primary goods and as an importer of manufactured goods. Financial dependency was thus reinforced to maintain the equilibrium of the vulnerable export-import economy as deteriorating conditions in the international market for primary products led to massive foreign borrowing to finance coffee price support schemes and debt service on accumulated foreign debt. The evidence presented in this chapter suggests that the crisis of the export economy after 1929 had important domestic causes, the major one being the monetary reforms of 1926, designed to guarantee the confidence of international finance in Brazil. The exchange rate stabilization, the creation of the stabilization fund and the strict

adherence to the gold standard were powerful instruments to attract American loan capital in the late 1920s to finance BOP deficits and maintain domestic financial stability. But the reforms also drastically exacerbated the vulnerability of the economy to external shocks and completely undermined state control over the economy. Thus, when the Great Depression struck, the dependent economy was hit not only by the violent decline of its foreign exchange earnings from both exports and borrowing, which impaired its ability to continue servicing the foreign debt, but also by the reduction of the resources (foreign loans) of the stabilization fund which sharply reduced the real liquidity of the economy. It was up to the "revolutionaries" of the 1930s to rescue the Brazilian economy from collapse and reverse much of its financial dependency. Yet the high levels of industrialization attained subsequently were not able to eliminate many of the patterns associated with classic dependence analyzed in chapters 2 and 3.

NOTES

1. Analyses of the international conditions prevailing in the 1920s are found in Barbara Stalling, Banker to the Third World: U.S. Portfolio Investment in Latin America, 1900-1986; David Felix, "Alternative Outcomes of the Latin American Debt Crisis: Lessons from the Past", Latin American Research Review and Albert Fishlow, "Lessons from the Past: Capital Markets during the Nineteenth Century and the Interwar Period", International Organization .

2. Caio Prado, Historia Economica del Brasil, p.298.

3. "Alternative Outcomes of the Latin American debt Crisis", p. 24.

4. Affonso de Taunay, Historia do Cafe no Brasil (Rio, 1941), Vol. XII, p. 28.

5. Ibid., p. 76 and 170.

6. Jose Maria Bello, A History of Modern Brazil, p. 256.

7. Affonso de Taunay, pp. 57-58 and 165.

8. Robert Neal Seidel, Progressive Pan Americanism: Development and U.S. Policy Toward South America, 1906-1931 (Cornell University: Dissertation Series, 1973), p. 419.

9. Economic Growth of Brazil, p. 201.

10. Ibid. p. 212.

11. Affonso de Taunay, pp. 62, 75.

12. In the 1920s, interest rates reached 8 percent, much higher than the pre-1914 period, when 5 percent interest prevailed.

13. Affonso de Taunay, pp. 84 and 171.

14. Ibid. pp. 127 and 137.

15. Ibid. p. 158.

16. Valentim F. Bouças, Brazil Economic Data (London, July 1933), p. 34. The data Baoucas compiled in this document was for the Washington Conversations in May 1933 and World Monetary and Economic Conference in London in June 1933.

17. Warren Dean, The Industrialization of São Paulo, p. 137.

18. Ibid.

19. Affonso de Taunay, pp. 195-96.

20. Dean, p. 137 and Taunay, p. 225.

21. Bello, pp. 250-252.

22. Affonso de Taunay, Historia do Cafe no Brasil, p. 203.
23. Warren Dean, The Industrialization of Sao Paulo, p. 137.
24. Caio Prado, Historia Economica del Brasil, p. 267.
25. Marcelo de Paiva Abreu, "A divida publica externa do Brasil, 1931-1943", Pesquisa e Planejamento Economico, 5 (1), June 1975, p. 39.
26. Max Winkler, Foreign Bonds, an Autopsy (Philadelphia: Roland Swain Co., 1933), pp. 243-44.
27. Progressive Pan Americanism, p. 473.
28. "Debt and Democracy in Latin America, 1920s-1980s", in Debt and Democracy in Latin America, edited by Barbara Stallings and Robert Kaufman (Boulder, Colorado: Westview Press, 1989), p. 44.
29. Seidel, Progressive Pan Americanism, pp. 519-520.
30. Ibid., pp. 494-495.
31. Albert Fishlow, "Lessons from the Past", p. 421.
32. Seidel, p. 549.
33. "Alternative Outcomes of the Latin American Debt Crisis", p. 19.
34. Seidel, p. 553.
35. Ibid., p. 549.
36. Marcelo de Paiva Abreu and Winston Fritsch, "As lições da historia: 1929-33 e 1979-80?", Divida Externa, Recessão e Ajuste Estrutural: O Brasil diante da Crise, Persio Arida (org.) (Rio: Paz e Terra, 1983), Terceira Edição, p. 28.
37. Economic Development of Latin America: Historical Background and Contemporary Problems, Second Edition (Cambridge: Cambridge University Press, 1976), p. 96.
38. Paul Drake, "Debt and Democracy in Latin America", pp. 47-48 and Robert Neal Seidel, Progressive Pan Americanism, p. 245.
39. Marcelo de Paiva Abreu and Winston Fritsch, "As lições da historia", p. 28.
40. Pinto Ferreira, Capitais Estrangeiros e Divida Externa do Brasil, pp. 152 and 156.
41. Ibid., p. 157 and Affonso de Taunay, p. 472.
42. Jose Maria Bello, A History of Modern Brazil, p. 257.

43. Capitalism and Underdevelopment in Latin America, p. 174.
44. Foreign Bonds, an Autopsy, p. xv.
45. "Alternative Outcomes of the Latin American Debt Crisis",
p. 22.
46. Ibid., p. 26.
47. In the 1920s, three types of collateral were used by American lenders. One was a property mortgage, often on the project being constructed. The second type was a lien on taxes, with a U.S. citizen placed in charge of collecting the tax. A third form of collateral was the "negative pledge", a provision that the borrower would not provide collateral for any other loan without also doing so for the loan covered by the negative pledge. According to Barbara Stallings, 18 percent of loans in the 1920s were covered by property taxes; 38 percent by tax liens; 6 percent by a combination of property mortgages and tax liens and 38 percent by negative pledges. See Stallings, Banker to the Third World, p. 133.
48. Seidel, Progressive Pan-Americanism, p. 556.
49. Ibid.
50. Abreu and Fritsch, "As lições da historia", p. 38.
51. Between 1920 and 1924, loans to Latin American governments represented 16.6 percent of total government loans extended by U.S. investment banks. But between 1925 and 1930, Latin American loans represented 48.8 percent of total loans as the volume of Western European government bonds and Canadian issues declined sharply. See Stallings, Banker to the Third World, p. 72.
52. Celso Furtado, The Economic Growth of Brazil, p. 205 and Economic Development of Latin America, p. 184.
53. Dependent Development, p. 58.
54. Abreu and Fritsch, "As lições da historia", pp. 28-29.
55. "Debt and Democracy in Latin America", p. 49.
56. Celso Furtado, The Economic Growth of Brazil, p. 201.

PART THREE

THE INTERRUPTION OF INTERNATIONAL CAPITAL FLOWS AND ITS
IMPACT ON BRAZIL'S DOMESTIC PROCESSES, 1930-1945

The 1929 Depression marked the beginning of a period of about 15 years during which hardly any foreign loans flowed in to Latin America. What were the effects of the collapse of the international financial system on Brazil, a country that relied excessively on foreign loans to sustain the vulnerable export-import economy? Instead of reverting toward subsistence agriculture, the country experienced the growth of horizontal import-substituting industrialization (ISI), which is to say, the development of local manufacturing of light consumer goods.

Chapter 4 shows, however, that although Getulio Vargas has often been regarded as the spearhead of the Brazilian industrial revolution, during his provisional and constitutional years (1930-1937) economic and financial policy pursued did not at all depart from his predecessors. In fact, Vargas' priority was not to bring an industrial transformation in Brazil, but rather to keep up debt payments in order to maintain the country's international creditworthiness and save the export-import economy from collapse in the expectation that free international trade and normal flows of foreign loans would somehow return. Ironically, despite the President's desire to preserve Brazil's traditional place in the international division of labor and his efforts to implement austerity measures to satisfy foreign creditors, his policy turned out to prove an exceptional opportunity for the growth of domestic light industry during the world depression.

It was only after the coup of 1937 that created the Estado Novo (New State), when the limits of the export economy were reached, that a conscious state-led industrialization strategy emerged. Vargas, pressured by the nationalist military and industrial groups, was then instrumental in creating a state apparatus able to promote a drastic change in the country's economic structure.

In fact, the nationalist dictatorship solution to the crisis of the dependent economy was very much the product of the unavailability of international resources. The drying up of foreign loans provided a unique opportunity which Vargas seized to mobilize domestic resources in the direction of an autonomous growth strategy. Yet the key to the expansion of Brazilian industrialization in the 1930s lay in Vargas breaking the former cycle of foreign indebtedness on which the export economy had rested, thus redirecting scarce resources from debt service payments into domestic industrial investment.

Chapter 4 examines the various creative responses of the Vargas government to the financial and developmental crisis of the dependent Brazilian economy, finally achieving a drastic reduction in the country's commitment abroad and saving the necessary foreign exchange for the growth strategy of ISI that flourished. It shows that it was the unilateral suspension of debt payments between 1938-39 that provided Vargas with the bargaining tool he needed to change the terms of negotiation with the creditors and to set the terms of debt repayment according to the real capacity of the country. By doing that, supported by powerful domestic groups, Vargas redefined substantially the terms of national dependency in the direction of greater autonomy. Thus, Brazil's industrialization in the 1930s is explained more by the behavior of domestic social groups and institutions than by external influences alone.

CHAPTER 4

VARGAS AND THE REDEFINITION OF THE TERMS OF NATIONAL DEPENDENCY

The 1930 "revolution"

The civil-military movement of October 1930 prevented President-elect Julio Prestes from taking office in November, bringing to an end oligarchic domination. The breakdown of the old regime had important internal causes as it resulted mainly from conflicts within the dominant sector of the oligarchic alliance itself over control of national power. Violating the rules of the game, President Washington Luis, a Paulista, attempted to impose another Paulista in the presidency, when the national government was to be rotated from Sao Paulo to Minas Gerais.

Political alliances were soon broadened against the dominant oligarchies and included urban middle sectors like the young military, the nationalist and non-political technocratic tenentes who since the revolts of the 1920s wanted fundamental changes in the country, as well as industrial groups and civilian administrative personnel. According to Cardoso and Faletto:

When some of the regional groups of domination [like the ranch owners of the South and sugar plantations owners in the Northeast] broadened the scheme of political alliances to reinforce themselves against the nationally dominant oligarchies, they opened the way to the new urban groups. The latter immediately began to harass the dominant sector of the old oligarchic alliance - the coffee growers of Sao Paulo and Minas Gerais - until a new agreement on the control of power was reached. ¹

It is also clear, however, that the crisis of the export economy after 1929 greatly contributed to the downfall of the oligarchic political

system. The effective power of the Washington Luis government was severely undermined by the collapse of export earnings and the contraction of foreign loans. Furthermore, the President imposed deflationary measures and refused to support the price of coffee. The austerity policy to please foreign creditors only served to alienate even further industrialists and particularly the members of the Sao Paulo coffee oligarchy which turned against the President. As Peter Evans observes, "Had Washington Luis been willing to support the price of coffee, the Paulistas might have felt more like opposing Vargas and the 'revolutionaries'".² Contrary to some observers that stress the negative impact of the Great Depression on Latin American "democracies", however, the dictatorship that emerged in Brazil in the mid 1930s proved to be much more responsive to national interests than the oligarchic system of the pre-1930.³

The Liberal Alliance (Aliança Liberal) of Getulio Dornelles Vargas that came to power in 1930 symbolizes, in Cardoso and Faletto's terms, the "transition period" in which some sectors of the urban middle class were incorporated into the process of domination. They observe that:

The old oligarchic capitalist alliance was replaced by a centralist policy that respected local agro-exporting interests, but created the necessary urban economic base for an industrial and mercantile bourgeoisie. This aided the differentiation of social structures by creating a new "middle" class and the expanding working class...There was still no participation of the masses. The political process had incorporated into the alliance of power no more than a few sectors of the middle class. While some of these were oriented toward production for the domestic market, they all still excluded the masses from the centers of decision-making.⁴

The economic interests of the defeated coffee oligarchies, however, were not really harmed by the "revolution" of 1930. Once in power, Vargas' first priority was to pursue a policy of compromise with the coffee growers, buying up surplus coffee stocks even when these had to be destroyed.⁵ But the President's support of the coffee sector was also heavily influenced by Brazil's BOP crisis. Vargas believed that the recovery of the world

economy would bring a favorable international price for the country's major export crop and provide sufficient foreign exchange to cover imports and service the foreign debt inherited from the Old Republic. Indeed, Vargas was very much interested in preserving Brazil's international creditworthiness. As Warren Dean noted: "The ministry of treasury was almost totally preoccupied with the deteriorating balance of trade, which compressed the flow of imports and embarrassed its efforts to service the external debt."⁶

The consolidation of the domestic market would be achieved by direct state action only when the limits of the dependent export economy were reached and under the pressure from domestic power groups, particularly the nationalist military and the industrial bourgeoisie, who had never shared Vargas' free trade beliefs. The coup of 1937 and the establishment of the Estado Novo substantially redefined the terms of national dependency in the direction of greater autonomy. Before then, the spurt of horizontal ISI was the by-product of a policy aimed primarily at supporting Brazil's traditional export crop and appeasing foreign creditors.

The growth of ISI: a by-product of the foreign debt legacy

On coming to power in November 1930, Getulio Vargas was faced with a financial crisis of unmanageable proportions, both in the internal and external fronts, inherited from Washington Luis.⁷ Domestically, the gold reserves of the stabilization fund were completely depleted as a result of the monetary reforms discussed at length in chapter 3. In the external front, the BOP was being pressured both by the drastic reduction in the value and volume of exports and by the interruption of the normal flows of foreign loans. Furthermore, the burden of debt service was exacerbated by the currency devaluation caused by the failure of the system of convertibility and by the fall of coffee prices. The exchange rate fell from the already low 5 pence per milreis to 3 pence.⁸

Table 4.1 below indicates that Brazil's total public foreign debt outstanding in 1930 (federal, states and municipalities and including the coffee debt) was 253 million pounds sterling, of which 163 million referred to sterling bonds and 77 million of dollar bonds. At the end of 1930, 64.5 percent of the total debt in circulation corresponded to British loans, 30.3 percent to American loans and the rest, especially to French loans. The predominance of sterling bonds in 1930, in spite of larger American capital inflows in the 1920s, is explained by longer amortization periods of the British loans and by the postponement of amortization payments between 1898 and 1910 of the loans included in the 1898 funding loan and between 1914 and 1927 of the loans included in the 1914 funding loan.

Table 4.2 shows Brazil's total foreign debt service, the trade balance, total debt service as percentage of the trade balance, of total export earnings and of government revenues between 1929 and 1945. In 1930, total debt service was 19.7 million pounds, representing 162.8 percent of the trade balance (12.1 million pounds), 30 percent of export earnings (see table 4.3 for total exports) and 31.2 of government revenues. In 1931, total debt services was 20.4 million pounds, representing 86.1 percent of the trade balance (23.7 million pounds), 38 percent of export earnings and 32.4 percent of government revenues. With foreign reserves extremely low in 1931 (3.3 million pounds) and without new inflows of foreign loans to finance the BOP deficit, Brazil negotiated its default (see discussion below).

Vargas' early approach to the BOP crisis was simply to maintain good behavior with foreign creditors by pursuing a policy of economic austerity in the belief that the recovery of the international economy and the resumption of normal flows of foreign loans were the only solution for the country's economic and financial difficulties. Thus, in early 1931, Vargas

received warmly the Niemeyer mission, a delegation of British bankers who advised the President to pursue a deflationary policy in order to preserve Brazil's credit abroad. According to Warren Dean, Vargas

...assured the country that the 'measures suggested by Niemeyer are, in general terms, the same that constitute the program of the provisional government', and he assumed that acquiescence to the international bankers would cause an inflow of new investment from abroad. All that was needed to attract the 'indispensable capital' was 'firmness, direction, tranquility and equilibrium'.⁹

Dean further commented that "The industrialists, on the other hand, probably agreed with Simonsen's opinion of the mission that it 'sought principally to organize in Brazil a tax collecting apparatus designed to better assure the service of the debt and the amortization of foreign capital invested here'." ¹⁰ Until England went off the gold standard in September 1931, Vargas indeed adopted a formal orthodox policy to satisfy the British bankers in the belief he would obtain additional loans in London.

As a corollary to his commitment to give debt payments first priority, Vargas was determined to protect the coffee market and promote new export crops, especially cotton.¹¹ In fact, Vargas had the same traditional view of presidents before him of the "natural" role of Brazil in the international division of labor as a supplier of primary products and "an excellent market for imports".¹² Industrialization "created disequilibrium and social disorder".¹³ The President even shared the coffee planters' resentment against "artificial industries that manufacture with imported raw materials, increasing the cost of living for the benefit of privileged industrialists." ¹⁴ Thus, soon after the "revolution", the British Chamber of Commerce reported to its members that it could

be gathered from pronouncements made by many of the new rulers that there is a general recognition of the fact that Brazil's general and future well-being lies in the development of agriculture, pastoral, and mineral exploitation, and not in the setting up of an industrial structure which can exist only under cover of an outrageous tariff.¹⁵

Table 4.1 Brazil: Public Foreign Debt in Circulation, 1929-45*
(millions of pounds sterling)

Year	Sterling Loans	Dollar Loans	Franc Loans	Gulden Loans	Total
1929	153.2	70.9	12.4	1.0	237.5
1930	163.0	76.6	12.4	0.9	252.9
1931	156.7	107.6	17.6	1.1	283.0
1932	154.8	109.5	18.0	1.0	283.3
1933	161.2	73.9	19.7	1.0	255.8
1934	162.2	76.1	22.8	1.1	262.4
1935	160.4	75.2	22.5	1.2	259.3
1936	157.9	74.5	16.0	0.9	249.3
1937	156.4	71.4	11.4	0.9	240.1
1938	156.3	76.4	9.4	1.0	243.1
1939	156.3	90.7	9.5	1.1	257.6
1940	152.7	82.5	3.5	0.6	239.3
1941	150.8	78.9	3.5	0.6	233.8
1942	146.7	75.5	3.5	0.6	226.3
1943	145.0	71.4	3.5	0.6	220.5
1944	119.5	59.5	3.5	0.6	183.1
1945	110.9	54.3	3.5	0.6	169.3

*It should be noted that, as the figures were converted in millions of pounds sterling, the fluctuations of the debt in circulation (year to year) may be the result of the real debt fluctuations, exchange rate fluctuations of the pound sterling in relation to the other currencies or of both fluctuations.

Source: Marcelo de Paiva Abreu, "A divida publica externa do Brasil, 1931-1943", Pesquisa e Planejamento Economico, 5 no. 1 (Rio de Janeiro, 1975), p. 40, Tabela I.

Table 4.2 Brazil: Data on debt service, 1929-45

Years	Millions of pounds sterling					Trade Balance	Total Debt Service as % of Exports	Total Debt Service as % of Trade Balance	Total Debt Service as % of Gov. Revenues	Foreign Exchange Reserves
	Sterling Loans	Dollar Loans	Franc Loans	Gulden Loans	Total *					
1929	10.5	6.4	0.1	0.2	17.3	8.1	18.3	213.6	19.2	-6.7
1930	12.0	7.0	0.5	0.2	19.7	12.1	30.0	162.8	31.2	10.5
1931	10.4	9.0	0.7	0.3	20.4	23.7	38.0	86.1	32.4	3.3
1932	4.7	1.9	-	0.1	6.8	20.7	13.3	32.9	4.1	13.9
1933	4.7	1.1	0.4	-	6.2	11.3	11.7	54.9	5.6	5.1
1934	3.8	1.6	1.6	-	7.1	16.1	12.2	44.1	12.8	9.0
1935	4.6	2.4	0.4	-	7.5	9.1	13.6	82.4	14.1	1.6
1936	5.0	2.7	0.3	-	7.9	17.8	12.2	44.4	13.5	9.9
1937	5.3	3.0	0.2	-	8.5	3.3	12.1	257.6	10.9	-5.2
1938	-	-	-	-	-	0.1	-	-	-	0.1
1939	-	-	-	-	-	10.0	-	-	-	10.0
1940	2.0	1.4	-	-	3.4	-	5.5	...	4.3	-3.4
1941	2.4	1.6	-	-	4.1	15.0	4.9	27.3	4.0	10.9
1942	2.5	1.5	-	-	4.0	35.1	4.2	11.4	5.1	31.1
1943	2.4	1.5	-	-	3.9	31.3	3.6	12.5	4.4	27.4
1944	11.2	7.6	-	-	18.8	32.5	13.9	57.9	18.3	13.7
1945	6.5	4.3	-	-	10.8	43.5	7.0	24.8	9.4	32.4

* It is not clear whether these figures include the redemption, between 1940 and 1943, of 6.1 million pounds sterling and 22.2 million dollars in bonds (nominal value).

Source: Same as Table 1, pp. 43, 44 and 83, Tabelas 2, 3 and 7.

One of the first actions of the Provisional Government was in relation to the coffee crisis. Decree no. 19.688 of February 11, 1931 signed by both the President and his Finance Minister Jose Maria Whitaker, resumed the coffee support policy under federal government control.¹⁶ John Wirth observed that:

Wall Street and London bankers wondered if Brazil would honor its commitments; their worries were dispelled, however, by the government's determination to stabilize coffee prices and increase exports. The goal was to mend financial fences, obtain credit, and regain the ability to pay. Hence orthodoxy was the order of the day.¹⁷

If Vargas' decision to support coffee prices to avoid the increasing downward trend of prices in the international market and ensure the necessary foreign exchange to service the debt pleased international financiers, the President was unconsciously adopting a policy which brought unprecedented benefit to the economy as a whole during the world depression. Although international coffee prices continued to decline during the 1930s, the significance of the policy for the domestic economy lay in the fact that the financing for the purchase of coffee surpluses was internal, not external with the aid of foreign loans as was the practice before 1930. In this classic analysis of how domestic purchasing power was maintained at relatively constant level, despite the world depression that reduced Brazilian exports, Celso Furtado wrote that while the external financed coffee support policy did not bring any net investments to the country,

...this was not true of coffee stockpiles financed internally, once the basis for such financing was credit expansion. Purchase of coffee for stockpiling entailed generation of income, which was added to the income produced by the expenditures of the consumers and investors. When in 1931 a million contos were injected into the economy for buying up and destroying coffee, purchasing power was being created that would partly counterbalance the reduction in expenditures by investors, which had been cut by some two million. Thus, a sharper decline in demand was avoided in those sectors indirectly dependent upon income created by exports.¹⁸

Although Vargas was still making an unproductive investment in goods that would later be burned, he was maintaining the level of employment and consequently the level of aggregate demand. The Brazilian government was

following, by chance, Keynesian policy before the General Theory of

Employment, Interest and Money was written. According to Furtado:

At first it seems absurd to harvest the product in order to destroy it... But to guarantee minimum sales prices was in reality to maintain the employment level in the export economy, and, indirectly, in the productive sectors linked to the domestic market. A contraction of great proportions in the monetary income of the export sector was to be avoided, thereby proportionally reducing the effects of increased unemployment in other sectors of the economy...What is important to take into account is that the value of the product destroyed was much less than the amount of income created. We were, in reality, building the famous pyramids Keynes would describe years later.¹⁹

Vargas' coffee policy had a fundamental importance in the growth of domestic industrial investments in Brazil because it was linked to the devaluation of the currency which was even further depreciated by the credit expansion utilized in the financing of coffee stockpiles. The drastic decline in Brazil's foreign purchasing power resulted in an approximately 50 percent rise in the price of imports of manufactured consumer goods at the same time that domestic purchasing power was being maintained.²⁰ Thus, the collapse of the importing capacity created a great opportunity for profitable investment in production for the domestic market. Since the primary-export growth model adopted prior to 1930 depended on the volume of external demand and hence there was no need to increase the size of the domestic market, the significance of this new model was that internal demand, which had been formerly irrelevant to growth, was now an essential component of it.

Industrialization was also aided by import controls imposed to adjust to the BOP crisis in the short-term. In March 1931 Vargas prohibited the importation of machinery for all consumer goods industries considered in a state of overproduction. While this action, which lasted between 1931 and 1937, was clearly against industrial expansion and was taken primarily to expand the trade surplus to service the foreign debt (as Table 4.3 shows, imports declined sharply after 1930), it was also a protection for domestic

industries, especially the textile, shoe, hat and paper which were already well established in Brazil at the time.²¹ Other import controls were imposed and domestic industries expanded. Warren Dean observed that: "The controls placed on the economy were measures of desperation, a constant rearguard action to save an existing system rather than attempt to bring a new one into being."²² Nevertheless, despite Vargas' motivations, industrialization in Brazil was already a reality. In the external front, however, the President was faced with a foreign exchange crisis in 1931 which led him to negotiate a default with Brazil's foreign creditors.

Table. 4.3 Brazil's Foreign Trade, 1930-1938
(millions of pounds sterling)

Year	Export	Import	Balance
1930	65.7	53.6	12.1
1931	49.5	28.7	20.2
1932	36.6	21.7	14.9
1933	35.7	28.1	7.6
1934	35.2	25.4	9.8
1935	33.0	27.4	5.6
1936	39.0	30.0	9.0
1937	42.5	40.6	1.9
1938	36.3	35.8	0.5

Source: Affonso de Taunay, Historia do Cafe no Brasil (Rio, 1942), Vol. XIX, p. 101.

The 1931 funding loan: a negotiated default

Although Vargas was determined to preserve Brazil's international creditworthiness in the hope that normal capital flows would soon reemerge, the foreign exchange reserves of Brazil were completely depleted in 1931 (see Table 4.2 above). It thus became evident that the President was not able to continue meeting the country's foreign obligations. In September, after England went off the gold standard which resulted in a drastic devaluation of the pound, Vargas, still believing in the possibility of

the normalization of capital movements, instructed his Finance Minister Whitaker to negotiate a temporary funding loan with Brazil's creditors in the traditional style of the Old Republic. As Brazilian economist Marcelo de Paiva Abreu observes:

The excessively generous initial Brazilian reaction in 1931 to the balance of payments crisis may be explained partially as a specific manifestation of an orthodox economic policy adopted under British influence by Whitaker, the Finance Minister of Vargas between 1930-31 and as the inability of the authorities to recognize that the country was facing a long-term crisis. ²³

In fact, there was really nothing radical nor dramatic in this often mentioned default, since it amounted to just another expedient of debt refinancing: new loans were negotiated to meet debt service obligations on existing debt. What Vargas was doing, and this is what Abreu calls "excessive generosity", was merely increasing his country's debt through a consolidating loan which was used to pay interest on the federal debt due from October 1931 to October 1934. Amortization of principal of all foreign loans, however, was postponed until 1934, with the exception of the 1898 and 1914 funding loans which were considered to have "superior status" and continued to be serviced.

This arrangement obviously benefitted British creditors since the funding loans did not include American credits, paving the way for a bitter dispute over the distribution of the spoils among creditors in later negotiations with the Brazilian government (see discussion below). Furthermore, the British forced a Brazilian concession in servicing state guaranteed loans in "dollars equivalent", that is, in pounds gold, instead of pounds sterling, which was extremely harmful to Brazil. This British insistence came after the UK went off the gold standard in 1931 and remained in force until the 1933 dollar devaluation.

Despite the preferential treatment to British interests, the funding loan of 1931 was bitterly opposed by Niemeyer, the representative of the

House of Rothschilds in Brazil. He argued that Brazil's trade balance in 1931, 20.2 million pounds (see Table 4.3 above), was compatible with the service in full of all federal loans and recommended to the government harsh domestic austerity measures to reduce domestic demand in order to expand exports and facilitate debt service payments.²⁴ Furthermore, there were problems among financial and commercial British creditors. In early 1932, the British Ambassador observed that the House of Rothschild was concerned only with obtaining its loan payments, forgetting that there were other Brazilian commitments abroad such as commercial (trade credits) payments.²⁵

If a comparison is made with the funding loans of 1898 and 1914, the 1931 debt reorganization did not consist of a moratorium on interest payments as in the former periods. In 1898 and 1914 interest payments were postponed for three years and amortization of principal was postponed for much longer periods, 10 years in 1898 and 13 years in 1914, thus providing Brazil with a much larger breathing space to reorganize its finances until exports recovered. If a comparison is also made with debt renegotiations in the 1980s (see chapter 9), the practice of funding loans to prevent unilateral defaults has been substituted for the practice of debt rescheduling, when arrangements are agreed upon for postponing payments of principal or interest or otherwise changing the terms of repayment or of interest charges. Nevertheless, postponement of interest is, of course, never included in those agreements with commercial bank creditors.

The 1931 funding loan which was concluded in March 1932 by the new Finance Minister Oswaldo Aranha (1931-1934) was issued in two series of 20 and 40 years as follows (see also Table 2.2 above):

20 years	40 years
£ 2,648,939	£ 7,881,814
\$ 29,884,545	Fr. 135,000,000
Fr. 55,000,000	

In this way, Vargas was still committing himself to annual debt servicing of almost 24 million pounds a year (see Table 4.2 above), increasing the country's debt with this additional loan and merely postponing a major BOP crisis with this short-term arrangement. Had Vargas been committed to domestic industrial development at this stage, he would have, instead, redirected interest payments to vital capital goods imports to expand domestic industry; but as he was still basing his hopes on a resurgence of liberalism and international free trade, the decree to suspend all payments on the foreign debt was not issued until the limits of the export economy were finally reached in 1937. As Felix correctly observes:

The Latin American elites presiding over the initial defaults were true believers in the multilateral trading and financial system that had nurtured their wealth. The initial expectation was that the suspensions and the accompanying devaluations and exchange controls were merely temporary aberrations from orthodoxy. As earnest of their good intentions, they set aside counterpart funds in local currency for the delinquent debt service.²⁶

The funding loan of 1931, however, marked for the very first time the involvement of the federal government in the absolute control and full knowledge of the magnitude of Brazil's total public foreign debt, particularly, the remittances abroad as debt service. Incredible as it may sound, Valentim Bouças informs us that from 1824 until 1931:

...the payment of interest and amortization on our loans was made in the following way: a few days before the service was due, the agents of foreign creditors delivered little written messages to the finance ministers. I saw it many times. The agents would then say: "It should be remitted tomorrow a certain amount of millions of pounds sterling to the House of Rothschilds, or a certain amount of millions of dollars to Dillon, Read and Co., in New York." What is shocking to know, the remittances were effected without any prior verification on the part of the Brazilian authorities...Furthermore, in view of the total lack of control, the government made many unnecessary new loans at higher interest rates just to pay old ones.²⁷

In 1932, under the initiative of Finance Minister Oswaldo Aranha, the Commission on Economic and Financial Studies was created with the objective of promoting a meticulous study of the Brazilian foreign debt. It was only

then that a systematic organization of the foreign debt was undertaken and the government began to control service payments, thus becoming aware of the real value of past remittances abroad. Bouças, who was the Secretary-General of the Commission, observed that:

During that time, the representative of the House of Rothschild approached the finance minister and requested the urgent remittance of a certain amount in millions of pound sterling. This request was then submitted to the Commission for the necessary control. For the very first time, since 1824, a verification of the facts was undertaken. It revealed an excess of 100 thousand pounds sterling in the request of the creditors. From 1824 to 1931 there was never any verification whatsoever! 28

In view of the statements of Valentim Bouças, an economist considered in Brazil and abroad as an expert on Brazil's finances, the analysis of chapters 2 and 3 on the consequences of financial dependency for Brazil becomes mild. In fact, what Bouças reveals is that more than draining off a large part of the surplus of the country, the House of Rothschild may have actually been engaged in deceptive practices.

Meanwhile, Vargas continued to implement austerity measures as it was a prerequisite for the funding loan of 1931. As Oswaldo Aranha stated: "In general, revolutions throughout the world are, and have been, spendthrift. But ours was the first to economize. Efforts to balance the budget and reduce expenditures are reasons for Brazilian pride and respect, and for praise from our creditors."²⁹ But economic austerity led to strong domestic opposition to Vargas.

The attempted coup of 1932

Further measures to pay heed to international financiers alienated the powerful state of São Paulo. The attempted counter-revolution known as the "Constitutionalist Revolution" of July 1932 has always been explained in only political and nationalist terms: the desire of the Paulista Democratic Party (the party of the liberal constitutionalists) for free elections, constitutional government and also local autonomy, as a strong federal

government was inimical to São Paulo's deep-seated regionalism.³⁰ Although there is no doubt that Vargas' delaying tactics on new elections provoked the resentment of the constitutionalists who were pivotal in the Liberal Alliance, the deflationary fiscal policy Vargas needed to implement in order to balance the budget displeased the middle class of the large cities and especially the coffee planters of São Paulo, the very sector Vargas was attempting to save from collapse with the valorization scheme.

While Vargas was increasing government spending and running a budget deficit with the coffee support policy, he was at the same time attempting to reduce the deficit by increasing taxes. Thus, he began decreeing taxes which appeared to planters to be a kind of confiscation.³¹ The land survey carried out by the tenentes was in preparation for an increase in the state land tax. Vargas' interventor³² in São Paulo, the unpopular tenente João Alberto, had already raised the ad valorem rates from 0.5 to 1.0 percent.³³

What really triggered the Paulistas' ultimate desire to regain control over the economy of the state through their armed rebellion, however, was Vargas' imposition of exchange controls in September 1931, an austerity measure primarily intended to save foreign exchange to keep up debt service payments and appease foreign creditors as the negotiations for the funding loan were being held. As Dean wrote:

Required to sell their foreign exchange to the Bank of Brazil at a confiscatory rate, they (coffee planters) chose to believe that the purpose of the measure was to support a horde of bureaucrats in idleness at Rio de Janeiro. In fact, the government was using the money to pay off foreign loans that were largely incurred by Paulista presidents. ³⁴

The curtailment of imports through the exchange controls (the decline of imports in 1932 is clearly indicated in Table 4.3 above) has often been regarded as evidence of Vargas' commitment to the development of domestic manufacturing industries since the measure obviously provided further protection for them. However, it was simply another expedient to convince creditors

of the Brazilian government's intentions of honoring international commitments. Exchange controls may be justified as a subsidy to national industry only if raw materials and capital goods imports to industry are imported at the favored rate, as the government may subsidize the imports it allows by selling exchange to favored importers at the official rate, which is lower than the free (or black) market rate.³⁵

While after 1937 Vargas intentionally made use of exchange controls to protect manufacturing and expand Brazilian industrialization, this was not the case with the 1931 controls as the "artificial" industries dependent on imported raw materials could not function. Iron and steel imports declined from an average 59,000 tons a year from 1927 to 1929 to just 9,352 tons in 1932.³⁶ The replacement of machine became extremely difficult during Vargas' austerity program as imports of iron and steel products and machinery declined from 157,000 to 22,732 tons during the same period.³⁷ Thus, while industrial output grew by about 50 percent between 1929 and 1937 and primary production for the domestic market increased by more than 40 percent in the same period,³⁸ by 1938 textile clothing and food products accounted for 56 percent of industrial output and basic industry for only 13 percent.³⁹

As Brazilian industry expanded and sought to replace foreign goods, however, a new demand for imports was unavoidably fostered. Celso Furtado explains that industrialization oriented toward replacing the demand for imported goods itself creates a demand for imports. As the domestic industries grew in size and complexity, as well as capitalization, the need to import larger quantities of capital goods, intermediary products and raw materials was advanced even further. Would Vargas continue to service the foreign debt with scarce foreign exchange that might have purchased new equipment for domestic industry, deficient railroads, ports and shipping? Or would he become finally committed to Brazilian industrialization and abandon

economic liberalism and free trade? Although the President took the very first steps to reduce the debt burden, until the coup of 1937 he was not prepared to embark on a nationalist development strategy.

The burden of the foreign debt and the Oswaldo Aranha scheme

In view of the reaction against his government in 1932, Vargas after 1933 took a series of measures aimed at appeasing the opposition. He provided further financial assistance to the coffee producers, including a reduction of 50 percent in their bank debts.⁴⁰ Elections for a Constituent Assembly were held in May 1933 to satisfy the liberal constitutionalists and by July 1934 the Assembly produced a new Constitution with guarantees of free elections.

Thomas Skidmore observed that: "Since the fall of President Washington Luis, national politics had consisted of a series of uneasy compromises between liberal constitutionalists and authoritarian nationalists."⁴¹ The Constitution of 1934 reflected that reality, as the proposals of the nationalists tenentes for a strong state role in the areas of economic development and social welfare were incorporated in the provision on the "Economic and Social Order". But the tenentes also won their way in proposing indirect presidential elections as they felt "that if there had to be elections, they should be indirect, on the grounds that the general electorate could never be counted upon to favor radical change."⁴² Thus, Getulio Vargas was elected by the Chamber of Deputies in July 1934 and direct elections were scheduled for January 1938.

The provision of state intervention to promote economic development in the Constitution, however, remained a dead letter as Vargas was committed to economic liberalism. Import restrictions, exchange controls and protective tariffs imposed on the economy obeyed the same imperative need to adjust to the external disequilibrium and service the foreign debt, rather than been measures deliberately designed to further the development of Brazil's industries.

In fact, when Vargas was able to make new debt arrangements with foreign creditors in 1934, he moved to unfreeze the exchange and simplify the tariff and between 1934 and 1937 the controls were totally relaxed.⁴³ As John Wirth pointed out: "Brazil, which had reluctantly adopted the emergency measures, anticipated a return to more conventional and more 'respectable policies'."⁴⁴

In early 1934 Vargas began the first steps in the direction of a formal recognition that Brazil could no longer play according to the rules of international finance. Yet a new debt arrangement with the foreign creditors, the government's most unorthodox action before 1937, was still another expedient designed by the pro-American Finance Minister Oswaldo Aranha to allow the continuation of payments during the Great Depression in the expectation that capital flows and international free trade would soon be restored under U.S. leadership and credit.

The short-term arrangement of 1931 increased Brazil's foreign debt and failed to stabilize the country's finances. Already in 1933 Brazil had to make further arrangements with creditors in order to make payments on commercial arrears (loans contracted to pay commercial arrears are meant to pay for past imports not yet paid for lack of foreign exchange and not for future imports) and profit remittances in the amount of 11.8 million pounds as foreign exchange was exhausted.⁴⁵ Although the principal was postponed until 1934 in the funding loan, Brazil was still committed to make annual interest payments of around 24 million pounds between 1931 and 1934, a time when the trade balance was declining rapidly. Table 4.4 shows that Brazil could not keep its pledge of liberal intentions with the creditors and soon fell into arrears. Furthermore, when the principal came due in 1934, it became impossible to pay.

In early 1934 the Brazilian government announced that only partial payments would be made on the interest and principal of the outstanding foreign

loans. This partial repudiation of the debt, which was to be temporary, is known as the Aranha scheme, based on Brazil's ability to pay, thus linking for the first time debt servicing and export earnings.

On February 5, 1934, Finance Minister Oswaldo Aranha, who, together with Otto Niemeyer, conceived the plan, signed decree 23.829 establishing the conditions under which the remittances abroad would be effected during the period April 1934 to March 1938. Brazil would endeavor to repay every loan in accordance with its future economic performance, that is, if the trade surplus was good for the country one year, then the creditors could expect to receive payments; if, however, the opposite was the case, then Brazil would hardly have to service its obligations.⁴⁶ It is particularly interesting to observe that Niemeyer, the representative of the Rothschilds in Brazil, helped Aranha in organizing the debt scheme, indicating that the British creditors already recognized the incompatibility between debt servicing, under the contractual basis, and the long-term capacity of Brazil to generate foreign exchange from exports.

All of the country's public foreign loans were organized into seven categories according to their "quality" and each was then assigned a certain annual percentage of that year's export earnings. The lower the category, the smaller the proportions of interest and amortization payments. Periodically, the government would undertake a revision of those payment scales and modify them in accordance with the performance of exports.

More specifically, the interest on the loans of the first category, funding loans, and the second, 1930 coffee loan, would be completely serviced according to the contractual basis. The interest on the loans of the third category, all loans guaranteed by the federal government and the São Paulo Coffee Institute loans, would receive only 30 percent of the total payments in the first year, increasing to 50 percent in the fourth year. The interest on the loans of the fourth category, loans to the federal government without

guarantee and some loans to the state of São Paulo, 25 percent, increasing to 40 percent. The payment on the loans of the fifth category, some state loans, 20 percent, increasing to 35 percent. The payment on the loans of the sixth category, state loans and municipalities, 10 percent, increasing to 15 percent, and finally, those of the seventh category would not receive payment at all. The loans of the first category would receive 100 percent of the contracted amortization payments and those of the second category, 50 percent, while amortization payments of all the other loans would be postponed.⁴⁷

Furthermore, all debts were to be paid in the respective creditors' national currency at the current value of the coupons held. Apparently, this decision was made to check the flow of currency and gold leaving the country and allow a considerable reduction in Brazil's debt to Europe in terms of dollars since European currencies had been more heavily devalued than the dollar.⁴⁸

The division of the spoils among the different loans, however, became the most difficult part of the scheme, not the determination of Brazil's capacity to pay, which all creditors agreed, was between 7 and 8 million pounds annually, given the trade balance in the period. The division of the loans into categories obviously favored the British as Niemeyer was organizing them with Aranha. Actually, the intervention of Niemeyer was to ensure the protection of British interests, particularly those of the House of Rothschild (funding loans) to the detriment of Lazard Brothers' coffee loans.⁴⁹

The American creditors deeply resented their exclusion in the initial stages of the negotiations and exercised all possible pressure to correct what they perceived to be unfair. The American Ambassador in Rio de Janeiro received instructions to inform Aranha that his government "does not have the desire to invoke, as an argument, the existence of a strong U.S. trade deficit with Brazil...and expects that the U.S. does not be compelled by the facts to use

bilateral trade agreements of compensation (barter)."⁵⁰

In the final agreement the Americans obtained the lowering of the Sao Paulo Coffee Institute loans (in pounds sterling) from the third category to the fifth, of the Sao Paulo State loans (also in pounds) from the old fourth category to the new sixth (old fifth), the promotion of the Rio Grande do Sul dollar loan to the new sixth category and the improvement of the conditions offered to the loans of the new seventh category (50 percent of sterling loans and 50 percent of dollar loans). The new category eight (old seventh) would not receive payments. Total payments increased from 7.1 million pounds in the first year to 9 million in the fourth (see Table 4.5 below).

These changes, however, were not detrimental to the Aranha scheme, involving an increase in interest payments of only 0.3 million pounds during the four year plan.⁵¹ Furthermore, the real loss to British creditors as a result of the American rearrangements of the categories was minimum. Nevertheless, the British representative obtained, as a compensation for the improvement of the American position, a promise of the Brazilian government to spend, during the four year period, the amount of 0.4 million pounds in the redemption, at market price, of the sterling bonds classified in the lower categories.⁵²

Although Aranha's four year plan was conceived as an honorable expedient to allow the continuation of debt payments during the Great Depression when the interruption of normal capital flows and the sharp decline in the volume of world trade strained Brazil's debt servicing capacity, it was without doubt a bold step in the history of Brazil's dealings with foreign creditors. The plan was subjected to a great deal of criticism, not only from foreign creditors, but also from domestic proponents of free trade, who feared the effect that it would have on Brazil's credit. Political instability in Brazil in the early 1930s, however, was a major factor convincing

the British and American governments to pressure their bankers into accepting the debt reduction scheme.

In the early 1930s political stability in Brazil was threatened by the emergence of two radical national political movements. On the left, one faction of the Communist Party of Brazil, the "legalist" wing, organized a popular front movement called the National Liberation Alliance (Aliança Nacional Libertadora, or ANC). The platform of the ANC called for the repudiation of imperialist debts, the nationalization of foreign-owned firms and the liquidation of the latifundia system.⁵³ On the right, a fascist movement called Integralism had also been gaining strength. The movement desired to increase commercial relations with Italy and Germany. The Integralists also felt that Brazil should not be so concerned with honoring its financial obligations with the very nations which had caused the depression and had economically colonized their homeland.⁵⁴

Both movements were seeking the support of the middle class in the direction of a radical economic and political change in Brazil. It was their demands for a repudiation of the foreign debt that strengthened the bargaining position of the Brazilian government and helped to convince American and British creditors to accept the Aranha scheme. It was also this radicalism of Brazilian politics that would give Vargas the opportunity to close the semi-democratic political system and impose his authoritarian nationalist regime in 1937 when he was faced with a serious foreign exchange crisis. Significantly, as will be discussed shortly, the very demands of the radicals were partially met by the new dictator.

Although by 1937 the Aranha scheme would fail as Brazil's BOP crisis could not be really solved by temporary expedients, the scheme reduced substantially the burden of debt servicing between 1934 and 1937 by reducing real interest payments in relation to the contractual basis of the loans (see table 4.5 below). From 24 million pounds, which was not paid in any case,

Brazil reduced its yearly remittances abroad to between 7.1 and 8.5 million pounds. The plan also involved a reduction of the principal by the reduction in real interest payments and because there was no new borrowing requirements. As Table 4.5 indicates, total debt outstanding in 1934 was 262.4 million pounds, by 1937, it was 240.1 million. Furthermore, as Table 4.2 above shows, debt service as percentage of government revenues also declined from 32.4 percent in 1931 to 10.9 percent in 1937. Most important, the Aranha scheme interrupted the policy of funding loans by which the foreign debt was being indefinitely increased. Significantly, the scheme would serve as the basis for further negotiations in 1940 and 1943 which slashed in half the already reduced payments (see discussion below).

"Never again", Oswaldo Aranha wrote Getulio Vargas in his introduction to the scheme, "should Brazil contract new debts to pay off old ones. It always assumed new loans to service old ones. The reality is that paying debts with new loans only drove the nation deeper into indebtedness rather than solving its economic and financial difficulties."⁵⁵ But the reduction in debt payments did not lead to industrial investments in Brazil. On the contrary, the foreign exchange saved was used in a flood of consumer goods imports which easily competed with the domestically produced goods.

Debt and trade, 1934-37

The stabilization of export values and the lightening of the debt burden after 1934 made possible an increase in the flow of imports (see Tables 4.3 above and 4.5 below). But the bulk of the imports was not essential industrial products such as raw materials and capital goods. Instead, there was an "orgy of imports", most of it consumer goods from the U.S., which easily competed with the domestically produced counterparts and caused a foreign exchange crisis in January 1935 (Table 4.5 shows that the trade balance in 1935 was not enough to cover debt service payments). This move by Vargas

Table 4.4 Trade balance and debt service payments, 1930-1933
(in millions of pounds sterling)

Year	Exports	Imports	Trade Balance	Debt Payments
1930	65.7	53.6	12.1	19.7
1931	49.5	28.7	20.2	20.4
1932	36.6	21.7	14.9	6.8
1933	35.7	28.1	7.6	6.2

Sources: Same as Tables 4.2 and 4.3 above

Table 4.5 Oswaldo Aranha Scheme^{*}
(millions of pounds sterling)

Year	Total Debt Outstanding	Exports	Imports	Trade Balance	Debt Payments
1934	262.4	35.2	25.4	9.8	7.1
1935	259.3	33.0	27.4	5.6	7.5
1936	249.3	39.0	30.0	9.0	7.9
1937	240.1	42.5	40.6	1.9	8.5
1938	243.1	36.3	35.8	0.5	Suspended

Sources: Same as Tables 4.1, 4.2, 4.3 and 4.4 above.

may be interpreted as still another attempt at appeasing the Democratic Party, the representative of urban middle class interests, whose consumption pattern was supported by free trade. But it also seems to be a clear indication of Vargas' indifference to Brazil's industrial expansion as he failed to develop a schedule of priorities or to discipline imports in line with the requirements of an industrializing country as suggested by Roberto Simonsen, the President of the Center of Industries of São Paulo (FIESP), the most important organ which represented the interests of the national industrial bourgeoisie.

Tables 4.6 and 4.7 below show how foreign exchange was utilized in imports between 1925 and 1945 and Table 4.8 indicates the growth rates of imports. While it is clear that after 1931 there was an increase in the participation of capital goods in total imports, between 1934 and 1937, a period of considerable reduction in debt servicing, the government in fact did not

discriminate in favor of capital goods and raw materials for the benefit of national industry. In 1935, for example, 18.5 percent of total imports was durable and non-durable consumer goods while industrial capital goods was only 6 percent of total imports. Again, in 1936, 17.2 percent of total imports was consumer goods, and only 5.1 percent was industrial goods (Table 4.6).

Vargas' trade policy, however, was heavily shaped by Brazil's debtor status. The constitutional president needed to placate the U.S., a creditor nation seeking liberal, free trade agreements to counter the aggressive bilateral barter trade policies of Germany, which had begun a strong economic recovery after 1934 and was offering industrial equipment in payment for Brazilian primary exports, especially cotton.⁵⁶ That Vargas did not take advantage of the opportunities opened up by Germany in securing capital goods for Brazilian basic and manufacturing industries clearly illustrates the constraints imposed by financial dependency. It also shows, however, the extent to which the redefinition of the terms of national dependency in the direction of greater autonomy took longer than some studies would lead us to believe.⁵⁷ The transformation of classic dependence would emerge not only from external influences, but primarily from the redefinitions of interest among Brazil's dominant classes. Before then, the opportunities provided by the external environment were not seized by domestic social groups.

Thus, to keep up debt payments was still the first priority of Vargas and his close advisors, such as former Finance Minister Oswaldo Aranha, who became Ambassador to Washington in 1934. In addition to strong U.S. ideological opposition to Brazil's bilateral trade with Germany (and the fear of Brazil's displacement of American cotton exports to the German market), barter trade would not produce the foreign exchange earnings on which Brazil's BOP largely depended. While bringing capital goods for the expansion of ISI, the nonconvertible German "compensation marks" would not enable Brazil to meet

Table 4.6 Brazil's imports by sector as percentage of total imports, 1925-1945

Years	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
1925	9.8	10.8	20.6	10.2	53.7	0.3	54.0	4.5	0.4	3.5	6.8	15.2
1926	11.7	10.1	21.7	10.9	51.9	0.1	52.0	3.7	0.2	3.9	7.5	15.4
1927	10.5	9.8	20.4	13.1	51.5	0.3	51.8	3.3	0.8	3.8	6.8	14.7
1928	11.6	11.2	22.7	9.9	51.6	0.4	52.0	3.3	1.2	4.0	7.0	15.4
1929	10.2	10.8	21.0	11.6	49.9	0.4	50.3	4.2	1.2	4.3	7.5	17.1
1930	11.3	6.7	18.0	15.4	54.2	0.3	54.5	3.7	0.8	3.9	3.7	12.1
1931	9.1	6.3	15.4	17.4	56.7	0.3	56.7	2.4	0.6	2.9	4.3	10.2
1932	10.8	7.0	17.8	15.2	55.8	0.4	56.2	2.6	1.0	3.7	3.6	10.8
1933	10.8	8.3	19.1	13.3	55.1	0.4	55.5	2.7	1.4	3.2	4.8	12.1
1934	9.3	9.6	18.8	12.3	53.4	0.5	53.9	4.1	1.4	3.9	5.5	15.0
1935	8.3	10.2	18.5	12.3	50.9	0.9	51.7	6.0	1.6	3.0	6.9	17.5
1936	7.6	9.6	17.2	12.1	52.1	0.7	52.7	5.1	1.7	4.6	6.5	17.9
1937	5.9	9.9	15.8	12.2	51.8	0.7	52.5	6.0	1.7	4.0	7.8	19.5
1938	6.0	10.8	16.9	11.1	50.2	0.7	50.8	7.0	1.5	4.2	8.5	21.2
1939	6.2	10.9	17.1	13.6	46.1	0.9	47.0	8.3	1.5	4.0	8.4	22.3
1940	5.3	9.4	14.7	16.7	50.6	0.8	51.3	5.5	1.0	3.3	7.5	17.3
1941	5.2	10.1	15.4	15.2	49.1	0.6	49.7	7.3	0.9	4.3	7.3	19.7
1942	5.6	7.2	12.7	15.4	53.0	0.9	53.8	9.7	0.6	3.3	4.5	18.1
1943	5.2	4.5	9.7	13.8	49.2	0.6	49.8	17.4	0.5	2.5	6.3	26.7
1944	7.0	2.5	9.5	9.3	55.1	1.0	56.1	14.2	0.6	2.7	7.5	25.0
1945	9.2	4.4	13.6	9.9	53.4	1.0	54.4	9.4	1.1	3.4	8.2	22.1

Source: Marcelo de Paiva Abreu, "A dívida pública externa do Brasil, 1931-1943", p. 79, Table. 5.

- | | |
|--------------------------------|--|
| (1) Non-durable consumer goods | (10) Capital goods for construction industry |
| (2) Durable consumer goods | (11) Transportation Equipment |
| (3) = (1) + (2) consumer goods | (12) = (8) + (9) + (10) + (11) capital goods |
| (4) Fuels and lubricants | |
| (5) Industrial raw materials | |
| (6) Agricultural raw materials | |
| (7) = (5) + (6) raw materials | |
| (8) Industrial capital goods | |
| (9) Agricultural capital goods | |

Table 4.7 Brazil's imports by sector, in millions of pounds sterling, 1925-1945

Years	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
1925	8.3	9.1	17.4	8.6	45.3	0.3	45.6	3.8	0.3	3.0	5.7	12.8	84.4
1926	9.3	8.0	17.3	8.7	41.4	0.1	41.5	3.0	0.2	3.1	6.0	12.3	79.9
1927	8.4	7.8	16.2	10.4	41.0	0.2	41.3	2.6	0.6	3.0	5.4	11.7	79.6
1928	10.5	10.1	20.6	9.0	46.8	0.4	47.2	3.0	1.1	3.6	6.3	13.9	90.7
1929	8.9	9.3	18.2	10.0	43.3	0.3	43.6	3.6	1.0	3.7	6.5	14.9	86.7
1930	6.1	3.6	9.7	8.2	29.1	0.2	29.2	2.0	0.4	2.1	2.0	6.5	53.6
1931	2.7	1.9	4.6	5.3	17.1	0.1	17.1	0.7	0.2	0.9	1.3	3.1	30.1
1932	3.3	2.1	5.4	4.6	17.0	0.1	17.1	0.8	0.3	1.1	1.1	3.3	30.5
1933	4.5	3.5	8.0	5.5	22.9	0.2	23.0	1.1	0.6	1.3	2.0	5.0	41.5
1934	3.9	4.0	7.9	5.2	22.4	0.2	22.6	1.7	0.6	1.6	2.3	6.3	41.9
1935	3.8	4.7	8.5	5.6	23.4	0.4	23.7	2.8	0.7	1.4	3.2	8.0	45.9
1936	3.6	4.5	8.1	5.7	24.3	0.3	24.6	2.4	0.8	2.1	3.0	8.4	46.7
1937	3.9	6.6	10.5	8.2	34.7	0.5	35.1	4.0	1.1	2.7	5.2	13.1	66.9
1938	3.6	6.5	10.1	6.7	30.2	0.4	30.6	4.2	0.9	2.5	5.1	12.8	60.2
1939	3.6	6.4	10.0	8.0	27.1	0.5	27.6	4.9	0.9	2.4	4.9	13.1	58.8
1940	3.3	5.8	9.1	10.4	31.4	0.5	31.9	3.4	0.6	2.0	4.7	10.7	62.1
1941	3.6	7.0	10.6	10.5	33.9	0.4	34.3	5.0	0.6	3.0	5.0	13.6	69.1
1942	3.3	4.2	7.5	9.1	31.3	0.5	31.7	5.7	0.4	1.9	2.7	10.7	59.0
1943	4.1	3.5	7.6	10.8	38.5	0.5	39.0	13.6	0.4	2.0	4.9	20.9	78.3
1944	7.2	2.6	9.7	9.5	56.5	1.0	57.5	14.6	0.6	2.8	7.8	25.6	102.5
1945	10.1	4.9	15.0	10.9	58.9	1.1	60.0	10.4	1.2	3.8	9.0	24.4	110.3

Source: Same as Table 4.6, p. 80, Tabela 6.

Note: 1 to 12 same as Table 4.6. 13= total imports.

Table 4.8 Value of Imports by Use, Growth Rates, 1926-45

Years	Total Imports	Capital Goods Imports	Transport Equipment Imports	Consumer Goods Imports	Durable Consumer Goods Imports	Non-durable Consumer Goods Imports
1926	- 5%	- 4%	- 5%	- 1%	- 12%	12%
1927	- 4	- 5	-10	- 6	- 3	-10
1928	11	19	17	27	29	25
1929	- 4	7	3	-12	- 8	-15
1930	-38	-56	-69	-47	- 61	-31
1931	-64	-52	-35	-53	- 47	-56
1932	11	6	-15	17	11	22
1933	36	52	82	48	66	36
1934	1	26	15	- 1	11	-13
1935	10	27	39	8	12	- 3
1936	2	5	- 6	- 5	- 4	- 5
1937	43	56	73	30	47	8
1938	-10	-2	- 2	- 4	- 2	- 8
1939	- 2	2	- 4	- 1	- 2	-
1940	6	-18	- 4	- 9	- 9	- 8
1941	11	27	6	16	21	9
1942	-15	-21	-46	-29	- 40	- 8
1943	13	95	81	1	- 17	24
1944	31	22	59	28	- 26	76
1945	8	- 5	15	55	88	40

Source: Same as Tables 4.6 and 4.7, p. 86, Tabela 8.

its financial commitments to the free trade creditors.

Aranha was influential in the negotiations for the U.S. Brazilian liberal trade treaty of February 1935, hoping that such a commercial treaty would produce large trade surpluses for Brazil in return for higher scales of debt repayments, as specified in his debt scheme. But the easy Brazilian acceptance of the American free trade treaty was made possible by the BOP crisis of January 1935 when a financial mission was hastily sent to Washington and London to make arrangements on commercial arrears. According to Wirth: "The January 1935 exchange crisis placed Brazil in a humiliating situation and sharply curtailed the Brazilians' freedom of maneuver among the powers."⁵⁸

While guaranteeing a market for Brazil's traditional agricultural products, particularly coffee, and foreign exchange to service the debt, the liberal treaty's major feature was the Brazilian concessions in reducing the protective tariffs for domestic industries, tariffs which, in the first place, were implemented to save foreign exchange to pay the debt and not really to foster the expansion of the industries. Brazil lowered duties on light industrial goods, such as radios, some textiles, rubber goods, office equipment - goods that were already produced in the country - and agreed to maintain trucks and autos on the free list.⁵⁹ Furthermore, as the U.S. wanted, Brazil returned to free exchange in February 1935, a clear sign of economic liberalism. Thus, by accepting the American treaty based on reciprocity and most-favored nation clause and neglecting German's bilateral offers of industrial goods, the Vargas government objective was to preserve Brazil's traditional role as an exporter of primary products in a new international economic system under U.S. leadership.

Although a trade agreement was made with Germany in January 1936 (but not a formal treaty) and pressure was mounting from economic nationalists, particularly the army, for exchanging Brazilian primary products for German

capital goods, aside from procuring railroad equipment and safeguarding vital imports "Brazilian policy-makers expressed no marked leaning toward development projects - expanding exports came first. Hence they had no nationalist development ideology to support and sustain an independent trade policy." ⁶⁰ In fact, Vargas did not commit himself unequivocally to support Brazil's industrialization process until 1940, when the National Steel Company was established. But the first steps in that direction were finally taken in 1937 when the President redefined his interests vis-a-vis those of the foreigners he had supported.

The nationalist option: Vargas' Estado Novo, 1937-1945

Tables 4.3 and 4.5 indicate that between 1935 and 1937 there was a sharp increase in imports as a result of both the lightening of the debt burden and the liberal trade treaty with the U.S. This "orgy of imports", most of it consumer goods (Table 4.9) to please the middle class, intensified during the months of August, September and October of 1937 with the encouragement of the government. ⁶¹ Total imports reached 40.6 million pounds in 1937, the highest in the decade, as exports amounted to 42.5 million pounds. Brazil was faced with a formidable foreign exchange crisis, unable to cover vital imports and to maintain payments on the foreign debt. Most significant, from the middle of 1937 the U.S. was pursuing a deflationary policy and the tightening of credit meant that inflows of loans had completely ceased. The situation in Brazil, therefore, called for drastic measures that could not have been implemented within the constitutional regime. Vargas' nationalist dictatorship solution was as much the product of the unavailability of international resources which sustained the export-import economy as of Brazil's institutional weakness.

The coup d'etat of November 10, 1937 and the imposition of the authoritarian Estado Novo is generally explained only in political terms:

Vargas' desire to remain in power beyond his legal term which was to expire in 1938; the Army's hostility to liberal democratic politics; the radicalism of Brazilian politics since the early 1930s and the belief of the military and political elites that only Vargas "could save Brazil from the extremes of right and left." ⁶²

To be sure, increasing street violence and the culmination in 1935 of an attempted communist revolt by the National Liberation Alliance (ANC, constituting the radical urban middle class, both civil and military and the Communist Party) led Congress to approve a state of siege and strengthen the emergency powers of the federal government against the "subversives." And during 1936 and 1937 Vargas ruled by decree as emergency powers and repression continued unabated. However, Vargas dramatized the threat from the left for the middle class, the conservative state politicians and the military and even fabricated a communist revolutionary plot to obtain congressional approval to suspend constitutional rights on October 1. The political crisis was finally used by Vargas to close the semi-democratic system on November 10, when he was confronted with a major foreign exchange crisis whose only possible solution depended on stern measures which could not have been quickly carried out within the constitutional regime.

Vargas explained in his speech of November 10 that Brazil must forgo the "democracy of parties", which threatens national unity. But he also mentioned a financial crisis brought about a sudden "decline in the price of coffee and the reduction in export earnings."⁶³ Although it is true that the price of coffee had fallen by two cents, exports did not decline on that account. Tables 4.3 and 4.5 above indicate that the value of exports in 1937 was the highest in the decade as cotton and other export crops improved significantly. The crisis occurred not because the price of coffee had fallen, but because of the excessive inflows of consumer goods imports to please the middle class. As table 4.8 above clearly shows, in 1937 durable

consumer goods imports grew 47 percent, the highest growth rate between 1926 and 1945. Dean correctly observes that "Vargas' insistence on the significance of the price of coffee is understandable; it was a variable beyond his control and therefore politically neutral. To have admitted, or to have it called to his attention that his government's permissive attitude towards imports was to blame would have been extremely embarrassing." ⁶⁴

What clearly demonstrates the relation between the financial crisis and the coup, however, was the announcement by Vargas in the same speech of the decision to unilaterally suspend all payments on the foreign debt, the very measure that could have been implemented quickly only in an authoritarian context. In fact, ten days after assuming dictatorial powers, Vargas issued the decree law suspending all payments during three years. Furthermore, by late December, the government declared a monopoly in the sale of foreign exchange and imposed a tax on all exchange transactions, additional measures that would have been subjected to the criticism of the press and the congress. As we discussed above, the attempted counter-revolution of 1932 was precisely the result of the 1931 exchange controls. In implementing the exchange monopoly the Bank of Brazil was directed to allocate funds for the remission abroad of profits by foreign corporations only after imports had been covered.

Vargas argued that Brazil was forced to unilaterally suspend the payments on the foreign debt in view of the impossibility of servicing it and at the same time maintain the essential imports for the reequipping (reaparelhamento) of the national economy and the army. ⁶⁵ It is particularly relevant to note that by justifying the decision not to pay in terms of "either we pay the foreign debt or we do not reequip the army and the economy", Vargas was at the same time mobilizing the support of the army for the new regime, reducing domestic criticism and satisfying the Integralists who were his political supporters and were publicly against the payment of the foreign debt.

Furthermore, as Vargas needed the crucial support of the armed forces to guarantee the stability of the Estado Novo, only by stressing the need for economic development - the long-evident desire of the nationalist tenentes and also of the higher military who for national security purposes wanted a modern steel industry, oil refineries and railroad equipment - could he have made the decision to suspend debt payments and impose strict regulations for the remission abroad of earnings by foreign corporations. The Estado Novo soon imposed regulations on the foreign dominated petroleum industry and demanded that refineries be owned only by Brazilian nationals as the military wanted control over the strategic sectors of the economy.⁶⁶

From 1938 until late 1944 the Estado Novo rested upon the support of the army who regarded the dictatorship as an instrument of economic development. And indeed it was. But before we discuss the expansion of industrialization and the role of the state in forstering it, the significance of Vargas' suspension of debt service payments should be emphasized.

The significance of the suspension of debt service

If a dictatorship is held to be more willing and capable than a democracy to enforce drastic austerity and plunge the country into recession to satisfy foreign creditors, Vargas certainly did not follow the rule (see chapter 9 for the contrast with the military right-wing dictatorship in the early 1980s). Instead of continuing to accept the subordination of domestic concerns to the maintenance of debt payments and the transformation of Brazil into a net capital exporter as inflows of loans had completely ceased, Vargas' nationalist dictatorship channeled the necessary foreign exchange for the inward growth strategy of ISI that flourished (see discussion below).

The real significance of Vargas' action on the foreign debt in 1937, however, was the bargaining power his government would have in any further negotiations with the international creditors. The temporary suspension of debt servicing pressed creditors into accepting Brazil's repayment terms when

negotiations resumed between 1940 and 1943. As will be discussed below, the real reduction in the principal of the foreign debt and the absolute reduction in debt servicing to minimum levels were the result of the initiative now held by the Brazilians in any settlement with their creditors. Table 4.1 above indicates the reduction of total outstanding debt, from 240.1 million pounds in 1937 to 169.3 million pounds in 1945 and Table 4.2 shows the reduction in debt servicing between 1940 and 1943 both in terms of export earnings and government revenues. Furthermore, Table 4.11 below indicates the real and apparent gains from Brazil's negotiations with creditors since the funding loan of 1931. Table 4.11 makes it clear that the significance of the 1937 unilateral suspension was, in fact, more the real gain obtained after the negotiations of 1940 and 1943 reduced debt payments than the apparent gain of the suspension itself during 1938 and 1939 which amounted to only a temporary postponement of the external obligations. It will become obvious, however, that the short-term suspension made possible an increase in essential industrial imports to expand horizontal ISI.

This marks the first time in the history of the Republic that the Brazilian government showed a determination to use the debtor nation's strength in negotiations with foreign creditors. The success achieved with international finance and the corresponded expansion of autonomous industrialization under national auspices during the period symbolized Brazil's redefinition of the terms of dependency.

The financial crisis of 1937, and particularly Vargas' final realization that normal flows of loan capital were not forthcoming as a result of the deflationary policy in the U.S., were in fact a major consideration for the creation of the Estado Novo. The abandonment of economic liberalism and the option of a nationalist and autarchical growth strategy to secure greater national autonomy was Vargas' response to the unavailability of international

resources. The only alternative was to embark on a state-led industrialization strategy by mobilizing internal resources and export earnings to pay for vital imports as well as redirecting the large transfers of resources abroad in the form of debt payments into domestic priorities. Vargas' view of the "natural" role of Brazil in the international division of labor as a mere exporter of primary products had definitely been superceded.

The reaction of the creditors in 1937

What were the reactions of Brazil's foreign creditors to Vargas' unilateral moratorium? Could there have been any retaliatory measures within the depressed international financial context? The answer to this question will show the crucial link between debt and trade in the 1930s and the priority given to trade in the response of the U.S., the only creditor that was in a position to pressure Brazil.

The reaction of the British creditors was well summarized by The Economist of November 13, 1937, reflecting the views of the Corporation of Foreign Bondholders and the Foreign Office: "The suspension of debt payments by the Brazilian government is the most cynical measure the London financial market can recall." The British creditors, however, were in a much weaker position than the Americans to retaliate. In clear contrast with the U.S., whose market for Brazilian exports was extremely important, the United Kingdom imported very little from Brazil, as Argentina was the major supplier of raw material. Although the British did contemplate the use of the Debts Clearing Office Act of 1934, the precarious Brazilian trade balance made the threat highly impractical.⁶⁷

Vargas did not make overtly use of the German card as a threat to any commercial sanctions that could be forthcoming from the U.S., although as already mentioned, after 1936 Brazil had a new trade agreement with Germany. It could be argued, however, that Vargas' justification of payments suspension

in terms of maintaining essential imports for the reequipping of the national economy could have been an implicit threat of expanding trade relations with Germany which was anxious to provide heavy equipment to Brazil in exchange for primary products.

In fact, the moderate response of the U.S. was inspired precisely by the German threat. On the one hand, the Good Neighbour Policy and Pan-Americanism of Roosevelt to counterbalance German political influence in Latin America was certainly a consideration. On the other hand, there was the possibility that any American retaliation could involve the imposition by the Brazilians of new restrictions to trade, which would conflict with the basic objectives of the foreign economic policy of the Roosevelt administration, that is, the defense of multilateral trade in opposition to Germany's bilateral trade deals. Thus, while the British creditors attempted to maximize financial payments, the U.S. clearly concentrated on its strategic, political and economic objectives in Brazil. According to Fishlow:

Peripheral default was secondary in the foreign economic policies of the Roosevelt administration. Resumption of payment was not central to the New Deal strategy of economic recovery, nor was it crucial to restoring the solvency of the banks, because they were intermediaries rather than ultimate investors in the securities. Default was also inconsequential to the continuing surpluses in the U.S. balance-of-payments. Indeed, making reciprocal trade agreements and assuring markets for US exports were the principal objectives in dealing with Latin American countries. The potentially divisive subject of debt, to the disappointment of the bondholders, was not even discussed.⁶⁸

The American banks were unable to obtain government support to protect the interests of the bondholders. The Foreign Bondholders Protective Council (FBPC) founded in 1934 was not an independent organization from the American government as the British Corporation of Foreign Bondholders (CFB) was. This semi-official character of the FBPC explains its prompt acquiescence to the foreign policy considerations of the Roosevelt administration. During the 1940 and 1943 negotiations with Brazil, the FBPC and the State Department

sent their respective representatives, but there was no doubt who had the power to make the decisions.⁶⁹

The response of the U.S. government to Brazil's moratorium was rewarded by Vargas. The possibility of U.S. loans for development projects and Vargas' intention of maintaining the traditional political and military ties with the U.S. in the spirit of Pan-Americanism were very much reflected in his domestic policy. The President's major concern was to balance ultra nationalists in the armed forces who were ready to trade Brazilian products for German capital goods, especially steel, and who argued convincingly that by expanding trade with Germany through barter the nation would not have to shoulder an additional burden of foreign debt.⁷⁰ When the military signed a large artillery contract with Krupp in March 1938, Aranha, whom the military openly distrusted, became the foreign minister. Aranha, with the support of pro-American business groups and a few key individuals such as Valentim Bouças (a pro-American importer and international go-between) tried to combat German economic and political penetration by lining up U.S. credits for industrial goods.⁷¹ Thus, Vargas' policy of close relations with the U.S. had already been defined since the outset of his new regime. But even though ties with the dominant power in the capitalist system remained strong, Vargas was able to renegotiate the terms of national dependency in the direction of greater autonomy.

The Estado Novo and Industrial Expansion

Vargas' interest in Brazilian industrial development is first shown by his action to suspend debt payments in order to have the necessary foreign exchange to cover essential imports. That was indeed the first occasion in which he decided that the need to import vital industrial products was pressing enough to take precedence over meeting traditional external obligations. His pronouncements afterwards also confirm the regime's

intention to industrialize Brazil. In April 1938 he noted the deteriorating terms of trade and the vulnerability of Brazil's economy: the value of its primary exports was constantly declining while the price of manufacturing imports remained the same and therefore, the substitution of domestic manufacturers for foreign was now imperative.⁷²

The Estado Novo's trade policy changed accordingly. Already in January 1938 there was an increase in the flow of metals, machinery and fuels at the expense of other imports as a result of the imposed monopoly of exchange (see Table 4.6 above). Late in the year Vargas announced that the government would license imports according to a scale of priorities: transportation equipment and machinery would be favored; consumer goods would be discouraged, thus implementing the policy that Simonsen, the representative of the national industrial bourgeoisie had formulated and defended in the Foreign Trade Council in 1937.⁷³ The proliferation of import controls and tariff barriers provided a strong stimulus for profitable local manufacturing of previously imported consumer goods.

Imports of capital goods and expansion of local industry were also stimulated by Vargas' Five Year Plan. In 1938, he decreed the "Special Plan of Public Works and Equipment for National Defense." Oil field equipment, road building machinery, railroad stock and other capital goods began flowing into Brazil (see Tables 4.6 and 4.7). The first Five Year Plan was completed at the end of 1943 and another immediately followed.

Industrialization was also aided by the Second World War. A considerable expansion of import-substitutive industries took place, including cement, plate glass, canning, automobile tires and rubber products, machine tools, inorganic chemicals, electric motors, plastics, explosives and office machines. While some observers maintain that during the war industrial expansion was the result of full utilization of previously installed capacity

as imports of industrial equipment were reduced,⁷⁴ the figures in Tables 4.6 and 4.7 above show that between 1938 and 1945 essential imports increased. In fact, between 1925 and 1945, the highest percentage of capital goods and raw material imports were reached precisely between 1938 and 1945.

This leads to important conclusions. First, the suspension of debt service payments between 1938 and 1939 made possible the maintenance of higher levels of capital goods imports (see Table 4.6, column 12). It is true that total imports declined in 1938 and 1939 (Table 4.7, Column 13), but it can be argued that had payments continued, the fall would have been more drastic for industrial goods which remained stable between 1937 and 1939. Second, considering the period of the Estado Novo as a whole (1937-1945), the drastic reduction in debt service payments between 1940 and 1943 (see Table 4.2 above), when the negotiations with creditors resumed, was the major source of resources for the expansion of industrial activity in Brazil both in terms of foreign exchange and government savings. As Table 4.2 above shows, from 10.9 percent of government revenues in 1937, debt service payments declined to 3.7 percent in 1940 and 3 percent in 1943, thus enabling the government to redirect resources to domestic productive investments. Finally, Table 4.9 below shows gross domestic product and sectorial indexes between 1928 and 1945. It clearly indicates the strong performance of national industry after 1937 when the nationalist Estado Novo was established and with it, a powerful interventionist and entrepreneurial state.

The role of the state and the national industrial bourgeoisie

The changes of perspective of the new regime in the economic front were duly accompanied by changes on the political front. The Democratic Party, the representative of the urban middle class was eliminated from the governing coalition. The Republican Party was restored to power, and with it, the representatives of the national industrial bourgeoisie. In fact, it was

Table 4.9 Brazil: Gross Domestic Product and Sectorial Indexes, 1928-1945 (1939=100)

Year	Gross Domestic Product	Agriculture	Industry	Government	Transport	Electric Energy	Commerce
1928	67	76	58	65	67	46	64
1929	67	77	56	72	71	48	63
1930	66	79	52	79	59	47	60
1931	65	75	55	73	61	47	62
1932	68	79	56	85	57	48	63
1933	74	89	61	76	61	53	70
1934	80	93	68	87	64	60	76
1935	83	92	77	82	71	67	82
1936	92	100	91	80	78	74	94
1937	95	100	93	90	85	80	96
1938	98	102	96	96	92	87	98
1939	100	100	100	100	100	100	100
1940	99	91	105	106	100	106	100
1941	107	98	117	104	106	116	110
1942	105	96	112	110	107	127	106
1943	113	103	124	110	112	139	116
1944	118	104	130	127	121	154	120
1945	121	103	135	144	123	166	123

Source: Marcelo de Paiva Abreu, "A dívida pública externa do Brasil, 1931-1943", p. 86, Tabela 9.

the industrialists who most benefitted from the political and economic transformation in Brazil after 1937. Although they did not control the policy making machinery, for the very first time in Brazil the policies formulated and implemented served primarily their interests.

For the industrial bourgeoisie, and even for those who defended the liberalism of the 1934 Constitution, the authoritarian political character of the Estado Novo was considered the necessary foundation for the economic modernization the class spoused.⁷⁵ Significantly, the central role the military envisaged for the state to play in the industrialization of Brazil was already defined in the "developmental project" of the national industrial bourgeoisie. In the 1933 Constituent Assembly, Simonsen took the same position of the young nationalist military (tenentes) when he defined state intervention in the economy in the broadest possible terms: "Through the execution of public works; through the operations of public services; through the institution of credit organization; through the regulation of commerce; through its intervention in the administration of economic enterprises; as an industrial producer; through engaging in trade...All this, and by less direct means as well, as long as the object was to promote the creation of wealth."⁷⁶ As such a political alliance emerged between the bourgeoisie and the military in support of a powerful interventionist and entrepreneurial state that would foster the industrialization of Brazil.

Although state interventionism was a characteristic of the Vargas regime from the beginning, my discussion has shown that it was not designed to accelerate the process of industrialization, as the President was concerned with the adjustment to the BOP crisis. Simonsen and the nationalist tenentes had their views somewhat reflected in the 1934 Constitution, but the provision of a strong state in the area of economic development remained a dead letter as Vargas was committed to economic liberalism in the middle

of the world depression. It was with the Estado Novo that the state, in part under the pressure from the higher military, became the leading actor in the development process. In the new Constitution the state was to have the right to intervene in the economy "in order to supply the deficiencies of individual initiative and coordinate the factors of production so that conflicts may be avoided or resolved and a consideration of the interests of the nation, represented by the state, may be introduced."⁷⁷ The ideology of developmentalist-nationalism, which was to characterize the decade of the 1950s (see Chapters 5 and 6), was thus born with the Estado Novo.

In fact, the major feature of the Brazilian development model during the Estado Novo, which became almost institutionalized afterwards, was the central role the state assumed in promoting and directing the process of industrialization. The state intervened in the economy in two major ways: indirectly, by providing stimulants for the economy such as taxes, exchange controls, import quotas, credit and wage controls and directly, by becoming an active producer in the infrastructural and basic industrial spheres through the creation of public enterprises, autarchic and state-controlled, accompanied by a centralized state bureaucracy.

Indirect state intervention: the corporative state

That the national industrial bourgeoisie was the major beneficiary of the new policy can be seen by first examining the indirect intervention of the state in the economy and how it was aimed from the start to support the process of capitalist accumulation by the private sector.

The most important action by the state in supporting private accumulation was, without doubt, its domination of the labor force. Labor laws decreed between 1930 and 1945 provided the state with direct control over trade-union structure, finance and personnel. Vargas enacted an Italy-style corporative labor code and set up sindicatos (trade-unions) to represent and control labor and capital in the spirit of "class collaboration".

Kenneth Paul Erickson, a leading scholar on the subject, observed:

According to its professed doctrine, the Estado Novo was merely to watch over and superintend the activities of these various groups; and, by so doing, it would look after the interests of the entire nation. There is an interesting parallel between this function of the state and the poder moderador, or "moderating power", of the Brazilian monarchy a century earlier. In both cases one of the specific functions of the state was to prevent a single party, group, or sector from abusing the power of government or taking unfair advantage of the others. In protecting the interests of society as a whole, the absolute supremacy of the state was not to be challenged.⁷⁸

The authoritarian corporative structure, however, was used by the state primarily to manipulate the workers and prevent them from organizing themselves to fight for their own interests. State sponsored puppet organizations ensured control over the labor force for the benefit of the bourgeoisie. Furthermore, the employers soon refused to follow the labor laws and the rights of workers in job stability, in dismissals and even vacation were not respected.⁷⁹ Dean observed that "the war served to extend even further the advantages industrialists had been granted in dealing with workers and to justify the state's almost complete extinction of workers' rights."⁸⁰ Union meetings were restricted, the ten-hour workday was restored and sanitary standards reduced. Workers in military plants and in those plants designated as militarily essential were forbidden to quit, or transfer to other jobs, or even absent themselves. The textile sector, which was designated militarily essential for the purpose of these regulations, was given the right to enforce them.⁸¹ Thus, the comment by Brazilian social scientist Sonia Regina de Mendonça that the state allowed the industrial bourgeoisie to accept only the authoritarian aspect of the political system, not the corporative.⁸²

The major support given to private accumulation, however, was the establishment of the minimum wage law, decreed in May 1940, thus preempting the possibility of a direct confrontation between labor and capital. The

intent of this law was to reduce to the maximum level possible the payroll costs of the industrial bourgeoisie. The costs of education and health, for example, were not included in the calculation to establish the minimum wage, as Table 4.10 below shows. The minimum wage law also became the basis for establishing the price of all the urban labor force, from the skilled industrial worker to the professional in the service sector of the economy. Furthermore, the commission in charge of the task used as a point of reference the low wages prevailing in agriculture. The established minimum wage for industrial workers, although higher than those received by rural workers, were still low enough not to affect the process of capital accumulation in the industrial sector. This led Christian Anglade to argue that:

This meant that a process of capital transfer from agriculture into industry was not required, contrary to what happened in Argentina. With profits guaranteed in both sectors of production, what might otherwise have been a potential source of conflict between the landowners and the industrialists was avoided in Brazil. Instead, their alliance led to a populist pact first administered by Vargas, and maintained until 1964. The cornerstone of that pact was the existence of a large labour surplus on which were based both the alliance between the two sectors of the dominant class and their efficient and low cost control over the industrial labour force.⁸³

In fact, corporatism and populism did not threaten the interests of the landowners - duly represented in the institutions of the Estado Novo - for the peasants were to be permanently isolated from the process and the benefits of industrialization. Thus, the developmentalist alliance of Vargas came to include the most backward groups of landholders alongside the industrial bourgeoisie and the urban middle class which cooperated politically with the working class. As Cardoso and Faletto explain:

Development results...from the interaction and struggles of social groups and classes that have specific ways of relating to each other. The social and political structure is modified insofar as new social classes and groups succeed in imposing their interests on or accommodating them to previous dominant classes in society.⁸⁴

Thus, Vargas structured the admission of new social groups to the political

system without destroying old ones. And when, in the early 1960s, Goulart attempted to incorporate peasant sectors into the system, "the limits of populism as a form of mobilization of the masses and as a development policy were reached."⁸⁵

Although populism will be examined in chapters 5 and 6, the definition of the concept is important at this point since Vargas used populism in order to manipulate the labor force and strengthen his corporative state. According to Erickson, populism refers to

...nationalist political movements that arise when incipient industrialization brings on rapid social change. Populist movements generate broad mass support in the working class and certain middle strata, and they proclaim apparently antiestablishment policies. At base, these are cross-class rather than proletarian movements. Populist leaders come not from the proletariat but rather from the ruling class, and they mediate between industrialists and workers.⁸⁶

Erickson then classifies populist leaders into two major types: classical populist or paternalist administrative, and the radical populist which was evident in Brazil between 1953 and 1954 and in the early 1960s. From 1930 to 1945 Vargas was a populist in its classical phase as he appealed to the working class for support but at the same time applied the strict corporative controls to prevent its political and economic autonomy.⁸⁷

Vargas stepped up his populist rhetoric after 1940 to ensure his political survival in an eventual reopening of the political system as he realized that the Estado Novo would not survive the war. In a speech in 1943 Vargas promised that workers would participate in post-war Brazil's development together with "new groups that are full of energy and enthusiasm, capable of faith and of carrying out the tasks of our development."⁸⁸ In 1945 he created the Brazilian Labor Party (PTB) and urged all Brazilian workers to join the party, promising social welfare and working class political participation. Vargas used the party to return to power in 1951 as a democratic politician (see chapter 5).

Table 4.10 Proposals for the minimum wage for the capital in the Sao Paulo Commission

	Proposal of the Workers		Proposal of the Employers		Decision of the President	
	Mil-reis	%	Mil-reis	%	Mil-reis	%
Food	96	40	90	56.5	96	48
Housing	50	21	30	19	44	22
Clothing	50	21	20	12.5	32	16
Higyene	34	14	10	6	18	9
Transportation	10	4	10	6	10	5
TOTAL	240	100	160	100	200	100

Source: Sonia Regina de Mendonca, Estado e Economia no Brasil: Opções de Desenvolvimento (Rio: Graal, 1986), p. 29, Quadro I.

It is fascinating to see how Vargas managed to have both of the best of both worlds. First, by guaranteeing the profit of the industrial bourgeoisie with a cheap labor force and second, by promoting extensive social welfare benefits to the working class, thus manipulating the labor force for his own political ambitions. His reputation of "Father of the Poor" (Pai dos Pobres) hides the fact that it was the workers themselves who paid not only for the social services but also for the instruments that exercised control over them. I refer here to the compulsory trade union tax (imposto sindical) established in 1940 and which was the basis of the government manipulated labor structure.

The imposto sindical was equivalent to the amount of one day's wage per year deducted from the worker's pay check. Besides providing considerable financial resources to the government, the imposto was to be used by law for the very social services the working class believed the state was granting to it. Furthermore, the imposto sindical strengthened state control over the sindicatos as it was the Ministry of Labor which distributed the funds. Most important, the purpose of the social service orientation of the

unions was to "divert workers' attention from economic activities which might contribute to militant class consciousness."⁸⁹

The "class harmony" of corporatism and the political participation of the workers that populism offered were a facade to hide the primacy of capital accumulation by the industrial bourgeoisie. Erickson's extensive work on corporatism in Brazil led him to conclude,

Corporatism's control function has played an important role in Brazil's economic growth, because it has guaranteed autonomy for government policy-makers. By preventing labor from acting freely to demand a greater share of output, it has allowed economic planners to divert a larger share of resources to capital accumulation in industry. In other words, the corporative system constitutes an instrument for exacting sacrifices from the working class in the name of the common good.⁹⁰

The corporatist state established by Vargas would be a major attraction to foreign direct investment after 1955 when the process of vertical ISI began, that is to say, local production of durable consumer goods, such as the automobile, and of capital and intermediate goods, as it guaranteed social stability in terms of labor docility and low wages. But it was the entrepreneurial state that created the conditions for the expansion of the private sector and served as the major channel for the foreign loans which sustained the strategy of dependent development.

Direct state intervention: the state as entrepreneur

As we saw in chapter 2, the role of the state as an entrepreneur began with the very first railroads in the 1850s. But it was with the Estado Novo that a self-consciously interventionist and entrepreneurial state emerged. And it was the reduction of transfers abroad that provided much of the domestic resources for state investment in infrastructure and basic industries.

Thus, the state-owned shipping lines were consolidated into Lloyd Brasileiro. Vasp, the state-controlled airline of the state of Sao Paulo was created and the government took over the administration of a number of ports and the Bank of Brazil took on the power of a central bank.⁹¹ Most important,

however, was the role of the state in the creation of the steel and petroleum industries, the key to future industrial development. In fact, the most significant action of the Estado Novo was the construction of an integrated steel mill at Volta Redonda, in the state of Rio de Janeiro, the first industrial plant in this strategic sector. The National Steel Company (Companhia Siderurgica Nacional, CSN) was officially founded in 1941 and a year later the state created the Companhia do Vale do Rio Doce to mine iron ore, thus complementing its initiative in the steel industry. During the Second World War, the Fabrica Nacional de Motores (FNM) and the Companhia Nacional de Alcalis were founded.

Although the entrepreneurial role of the state will be discussed in subsequent chapters, it should be stressed at this point that state intervention in production was intended since Vargas' Estado Novo to support the process of capital accumulation by the private sector, and not to promote "state capitalism".⁹² State enterprises began to be concentrated on infrastructure and basic inputs industries, characterized by a large volume of capital, long maturity rates and low levels of profitability that neither local nor foreign capital was willing to tackle. The major beneficiary of state industries, however, has been the private consumer goods sector which receives low cost inputs. The supporting role of the state in a process of private capital accumulation became more pronounced after the mid 1950s as the direct intervention of the state in production increased in mining, petrochemical and electricity. But it was also this interventionist state, inherited from Vargas, that became the channel for foreign loans when the process of vertical ISI was initiated. State-owned basic industries, especially steel, energy, telecommunications, transportation were the major link with international finance and their expansion was only possible with massive foreign borrowing (see especially chapter 9).

Already in 1941, the state owned Volta Redonda steel mill was built with loans from the Export-Import Bank (Eximbank). The \$20 million loan marked the inauguration of a long and close relationship between the state sector and the Eximbank, a U.S. government agency created in 1934 to stimulate trade. The Eximbank, whose credits were given only for the purchasing of U.S. goods, together with other official lending institutions, would take the place of private banks in the international financial system between 1945 and the 1960s (see chapters 5 and 6).

Three things about the National Steel company should be emphasized, however. First, pressure from the military who demanded the creation of basic industries to make Brazil powerful and militarily secure, was a decisive factor leading to the construction of the state enterprise. Second, it should not be forgotten that the Estado Novo's new industrial policy of self-sufficiency followed worldwide events. Vargas' realization that the European powers were heading for war made it imperative the need for an autarchic national economy. Third, the issues of the Brazilian foreign debt and the U.S. financial assistance to build the steel mill were very much related.

The steel issue and the 1940 foreign debt negotiations

It is generally known that Vargas successfully maneuvered between German and American rivalry to obtain the financial commitment of the U.S. for the steel plant. In February 1939 Oswaldo Aranha informed the Eximbank that if the U.S. did not extend credit for the steelworks, Germany would. While scholars agree that Aranha won a commitment from the Eximbank to finance the purchase of equipment with this line of argument,⁹³ it should be recognized that at the same time Aranha was informing Secretary of State Cordell Hull that it was the intention of the Brazilian government to resume payments on the foreign debt on July 1, 1939.⁹⁴ Furthermore, Aranha was repeatedly

assuring Caffery, the U.S. ambassador to Brazil that Vargas had decided to adopt a policy of complete cooperation with the U.S. Aranha's idea consisted of a revival of his 1934 scheme by "formulating a policy in which Brazil would pay the foreign debt according to its ability, but based on the balance of trade with each creditor country, which would naturally favor the Americans and harm the British."⁹⁵

Aranha's commitment that Brazil would begin servicing the debt again and soon clearly exceeded his instructions and was subjected to strong domestic criticism, particularly among the nationalist armed forces. Finance Minister Souza Costa vetoed the resumption of debt payments on the promised date, but effected a symbolic payment of \$1 million in New York and informed the American creditors that it was indeed the Brazilian government's intention to resume debt payments in the near future.⁹⁶

What prompted Souza Costa to submit a concrete proposal for another temporary solution of the debt question in January 1940, however, was the American threat that credits from the Eximbank would not be forthcoming for the steel mill unless a solution to the debt problem was found.⁹⁷ Thus, the view that Vargas' bargaining position in the German American rivalry was the single factor accounting for the \$20 million loan should be reconsidered in face of the above facts, which, instead, show a very strong bargaining position on the part of the Americans.

This should not be understood as a weakness of the Brazilians, who, although forced to resume negotiations on debt payments, nevertheless held the initiative. Souza Costa proposed to resume interest payments for four years on the basis of 50 percent of the payments established in the 1934 Aranha scheme, much less than the real capacity of Brazil to pay at the time (Table 4.2 above indicates the favorable trade balance and foreign exchange reserves accumulated during the war). The proposal was accepted thus showing that

the suspension of payments during 1938 and 1939 pressed the creditors into accepting Brazil's repayment terms and in fact changed the terms for discussion of the debt burden after 1940. Decree no. 2.085 of March 1940 established the Souza Costa Plan for the period April 1, 1940 to March 3, 1944.

Aranha, who was in charge in the final stages of the negotiations, again to balance the nationalists in the armed forces who did not want the resumption of payments, favored the Americans over the British creditors and accepted the U.S. proposal to consider as the basis of the new scheme, the last year of his plan (1937) which provided for higher scales of payments (see Table 4.5 above) and to rearrange the categories to favor their loans. Again, the American creditors were concerned with the distribution of the reduced spoils among the different loans and not really with the level and terms of payment. Thus, according to their proposal, the first, second and third categories would receive 50 percent of interest payments made in the last year of the Aranha scheme; the fourth, fifth, sixth and seventh categories, 40 percent in the first year of the new scheme and 50 percent in the last. Amortization payments would be 40 percent of the payments also based on the last payments in 1937. Total payments would increase from 4 million pounds in the first year to 4.3 million pounds in the last year of the new scheme.

The British, whose interest was to receive any payment whatsoever, accepted the American proposal, which also involved less payments for the sterling loans of the first category, that is, the funding loans. The British, however, obtained from Brazil the commitment to spend during the four year plan the amount of 1.6 million pounds in the redemption, at market price, of sterling bonds of the lower categories. Britain was again in a weak position to exercise any pressure because it was still Argentina which supplied most of the vital food products for the British war effort. There was, however,

bitter disagreements between the Foreign Office and the Corporation of Foreign Bondholders (CFB), which insisted on receiving the payments on the basis of the original contracts and not on the basis of the already reduced Aranha scheme.

Ironically, the British underestimated their needs for Brazilian raw materials during the 1940 debt negotiations. After 1941 it was Brazil which began supplying the products for the British war efforts, resulting in Brazil's rapid accumulation of sterling reserves until the end of the war. Although the reserves were frozen in London during the war according to an agreement between Britain and Brazil, they served to stimulate the reopening of new debt negotiations in 1943, a year before the expiration of the Souza Costa Plan and which brought a final solution to Brazil's foreign debt.

Table 4.2 above reveals that Brazil's debt service burden between 1940 and 1943 was substantially reduced in relation to payments before the suspension. From 8.5 million pounds in 1937, the last year of the Aranha scheme, Brazil paid 3.4 million pounds in 1940, 4.1 million in 1941, 4.0 million in 1942 and 3.9 million in 1943. Table 4.1 above also shows that total foreign debt outstanding in 1939 was 257.6 million pounds and in 1943, it was reduced to 220.5 million. Thus, while it was the U.S. that convinced the Vargas' government to reopen negotiations in order to obtain the loan from the Eximbank for the steel mill, the Brazilians after suspending payments between 1938 and 1939 took advantage of the situation and set the terms of repayment. After concluding the 1940 agreement, Souza Costa admitted that Brazil was in condition to pay between 5 and 5.5 million annually, more than it actually would have to.⁹⁸

The 1943 final settlement of the foreign debt

The real significance of Vargas' suspension of debt payments in 1937 was the bargaining power his government had in the 1943 debt negotiations. It was then that a final satisfactory solution was found. While at the beginning of the 1930s Brazil paid (and increased its foreign debt) beyond its real capacity to pay as a result of its unfavorable trade balance, the opposite occurred between 1940 and 1945, when total debt payments were indeed much less than could have been justified by the economy's excellent trade performance as the terms of trade improved and foreign reserves were rapidly accumulated (Table 4.2 above). In fact, 1943 was ripe for Brazil to initiate negotiations because if the country had waited until the end of the Souza Costa Plan (1944), it would have been much more difficult to avoid higher payments in view of the increasing foreign reserves.

At the beginning of 1943 Souza Costa decided to open negotiations with the British creditors for a final agreement on the foreign debt motivated by Brazil's sterling reserves accumulated in London which amounted to 12 million pounds. Souza Costa was correctly anticipating that the post-war international market would not be as favorable to Brazilian exports and that the reserves would be used to import the necessary capital goods for the expansion of industrialization. Thus, that was the ideal time to solve once and for all the foreign debt burden of Brazil. He was then willing to pay 7.5 million pounds annually (4 million in interest payments and 3.5 million in amortization) as well as an additional 26 million to amortize, to the maximum possible level, the debt in circulation.

After three months of negotiations with the British (without American participation), Souza Costa offered two options: Plans A and B. Plan A provided for a reduction in interest payments without reduction of principal and the payments would be 70 percent of the last year of the

Aranha scheme, amounting to 7.3 million pounds (4.4 million in interest payments and 2.9 million in amortization). Plan B, provided for a reduction of the principal with partial payments in cash. The cash payments would amount to 20.7 million pounds, thus redeeming 85.6 million pounds of the debt in circulation, almost 40 percent of the total public debt, while annual payments would amount to 8.1 million pounds (4.4 million in interest and 3.7 million in amortization). Interest rates varied between 4 and 8 percent.

Souza Costa First Proposal

Annual Service	Millions of pounds		
	Original Obligation	Plan A	Plan B
Interest		4.4	4.4
Amortization		2.9	3.7
Total	24	7.3	8.1

Paiva Abreu argues that by negotiating secretly with the British, Souza Costa was attempting to take advantage of an eventual disagreement between the U.S. and Britain. In fact, Souza Costa skillfully "revealed" to the American creditors in June 1943 that negotiations were being held with the Corporation of Foreign Bondholders, the American position hardened with regard to their traditional rearrangement of the loan categories. This time, fundamentally altering the structure of the Aranha scheme to the detriment of the sterling loans.⁹⁹

The American creditors wanted to lower the old second and fifth categories of the Aranha structure and promote the third category, which consisted of dollar loans. But they also wanted higher Brazilian payments of 9.7 million pounds annually (6.4 million of interest and 3.3 million of amortization). Souza Costa considered the proposal unacceptable and

strategically avoided to involve himself in the distribution of the spoils among the different loans, arguing that the rearrangement of the categories was essentially a British-American question.¹⁰⁰ The rearrangement between dollar and sterling loans achieved by the U.S., however, led to higher payments than originally proposed by Souza Costa.

The final structure of the agreement followed the Brazilian proposal referred to above, but the classification of the loans into categories was not mentioned, probably to avoid the harm done to the sterling loans. Plan A provided annual payments of 7.7 million pounds (5.2 million in interest). Plan B involved annual payments of 8.4 million pounds (4.9 million interest) as well as cash payments of 22.9 million pounds to redeem 79 million pounds of the total debt at a discount of 29 percent. The interest payments in arrears, the result of the suspension between 1938 and 1939, would be paid at 25 percent of the rates prevailing in the 1940 agreement. The higher categories, the funding loans, would be paid at 12.5 percent of the contracted interest rates.

Final 1943 Debt Agreement

Annual Service	Millions of pounds		
	Original Obligation	Plan A	Plan B
Interest		5.2	4.9
Amortization		2.5	3.5
Total	24	7.7	8.4

Much of the reduction of the debt was the result of options in favor of Plan B.¹⁰¹ As Table 4.1 above indicates, the total foreign public debt was reduced from 200.5 million pounds in 1943 to 169.3 million in 1945. In terms of cruzeiros, the decline was even more rapid because of the appreciation of that currency relative to those in which the value of the bonds was expressed. The total debt was 20 billion cruzeiros in 1938, 15 billion

in 1943 and 11 billion in 1946. Nevertheless, Brazil's final payment of the foreign debt inherited from the Old Republic, what became known as "External Consolidated Debt" in Central Bank reports, took place only in 1987. It was a mere \$274 million on the top of \$120 billion contracted in the 1970s (see chapter 9).

Table 4.11 below shows Brazil's foreign exchange gains resulting from the successive reduction of debt service payments between 1932 and 1944, considering that the contracted obligation was in the order of 24 million pounds annually (interest and amortization). Column 1 shows the "apparent gains" which simply represent the postponement of payments bringing short-terms relief to the BOP, that is, Brazil was still committed to make future payments. Column 2 shows the "real gains", representing the real reduction in interest payments after the 1934 and 1940 negotiations. It is clear the relevance of "apparent gains" in so far as debt service reduction allowed for increased industrial imports discussed above. The "apparent gains" corresponded to 53 percent of total imports in 1932, 12 percent in 1937 and 40 percent in 1938-39 when Vargas unilaterally suspended debt payments.¹⁰² But it is the increase in "real gains" after negotiations with creditors were resumed in 1940 that represented Brazil's achievement.

The 1943 agreement expressed the abandonment of the principle that the superior status of the funding loans would have priority so that the American position prevailed. The reduction of the principal and interest bore more heavily on Britain than on the U.S., not only because Britain was the larger creditor, but also because there was in fact blatant discrimination against the sterling loans. The CFB and The Economist reacted strongly against the agreement on the grounds that the payments were excessively reduced given the capacity of the Brazilian government to pay and that priority should have been given to the funding loans. On December 25, 1943,

The Economist charged that the British Bondholders were sacrificed to Pan-Americanism and Good Neighbor Policy of Roosevelt.

Although the 1943 agreement was a landmark in Brazil's foreign debt negotiations, it should be noted that the Vargas government could have utilized all the frozen sterling reserves in London as cash payments to reduce even more the principal of the foreign debt. By the end of the war Brazil had accumulated 50 million pounds as a result of exports to England. The so-called "accumulated sterling balances" was a part of an agreement that Brazil accepted in good faith to help the British war efforts and would be returned to Brazil in the form of British industrial equipment after the war. Between 1948 and 1952, however, when the Brazilian government decided to import the equipment, the British informed that imports could not be paid with the accumulated balances in London and refused to liberate them.¹⁰³

The resulting bitter dispute between Brazil and England led to forceful Brazilian purchase of British public utilities companies in Brazil. 22 million pounds of the reserves were used in this way. In 1948, for example, the government bought the Brazilian Railways for 15 million pounds.¹⁰⁴ It can thus be argued that the British avenged the discrimination against their loans in the 1943 agreement as Brazil's export earnings were ridiculously utilized in the purchase of old and decaying British property in Brazil and not for essential industrial imports.

Nevertheless, it is undeniable the service rendered to Brazil by Vargas' Estado Novo in substantially reducing the country's historical foreign debt and initiating its industrialization process on an autonomous basis. Furthermore, the immense foreign reserves accumulated during the war with export earnings were preserved as a result of the timely 1943 foreign debt agreement which set the terms for low remittances abroad. For the very first time

Table 4.11 Brazil's foreign exchange gains from debt agreements and debt suspension, 1931-1944* (millions of pounds sterling)

Years	Apparent gains (1)	Real gains** (2)
1932	16.2	0.4
1933	16.8	0.4
1934	15.9	5.7
1935	15.5	7.3
1936	15.1	6.9
1937	14.5	5.6
1938	23.0	1.4
1939	23.0	2.0
1940	19.6	9.4
1941	18.9	9.2
1942	19.0	9.0
1943	19.1	8.2
1944	4.2	38.4

*This calculation results from the comparison between what was actually paid by Brazil and what should have been paid if the securities were quoted at par.

**These figures do not include for 1944 the gains resulting from reduction in interest rates and in the principal of the debt after the 1943 agreement. The immediate gains related to the cash payments in case of Option B (if all creditors preferred this option) would have been 45 million pounds sterling. The 1946 Annual Report of the Council of the Corporation of Foreign Bondholders provides the exact figures as well as the number of acceptances to Plans A and B.

Source: Marcelo de Paiva Abreu, "A divida publica externa do Brazil, 1931

the traditional deficitary current account on the BOP was in surplus. Post war Brazilian power groups, however, did not take advantage of this anticipated foreign exchange relief and did not understand the importance of foreign reserves for financial autonomy and self-sustaining economic growth. They, in fact, reversed much of Vargas' nationalist policies.

On October 29, 1945, the military removed Vargas from office as the Estado Novo lost the support of the political elite when the war came to an end. The new groups that came to power accepted as their own the doctrine of

free trade and economic liberalism and rapidly exhausted the huge foreign exchange reserves (see Table 4.12) in an orgy of consumer goods imports for the middle class (see Table 4.8 above). Any industrialization program could only continue on the basis of reliance on flows of foreign loans to preserve the equilibrium of the BOP. As the subsequent chapter shows, a new situation of dependency emerged in the 1950s to begin the early stages of vertical ISI.

Table 4.12 Brazil's Gross Monetary Reserves, 1937 and 1945
(millions of dollars)

Year	Gold	Foreign Exchange Assets	Total
1937	32.0	18.0	50.0
1945	354.0	312.0	666.0

Source: United Nations Commission for Latin America (ECLA), External Financing in Latin America (New York: United Nations, 1965), p. 26, Table 22.

In summary, chapter 4 provided evidence for a major proposition of the historical-structural dependency approach that development does not take place only for reasons external to the dependent economy. Development indeed depends upon internal political structures and their responses to external dependence. As we showed, it took longer than some studies suggest for Brazilian domestic power groups to promote a strategy of autonomous industrialization and reverse Brazil's historical financial dependence. Without doubt, the interruption of inflows of foreign loans provided a unique opportunity which Vargas seized to mobilize domestic resources in the direction of industrialization. However, after the creation of the Estado Novo in 1937, the conscious state-led industrialization strategy was the result of internal pressure from groups, particularly the

military and the national bourgeoisie, which had always opposed Vargas' free trade policy and which favored a nationalist solution to the crisis of the primary export economy. And these groups were crucial in supporting the President's break with financial dependence in order to redirect scarce resources from debt service payments into domestic industrial investments. Therefore, it is only with concrete analysis of specific characteristics of dependent societies and their local social political process that we can explain

...the different moments at which sectors of local classes allied or clashed with foreign interests, organized different forms of state, sustained distinct ideologies, or tried to implement various policies or defined alternative strategies to cope with imperialist challenges in diverse moments of history.¹⁰⁴

In the 1930s, the interests of Brazil's dominant classes clashed with those of the foreigners, but after 1945 they again converged. This is the subject of chapter 5.

NOTES

1. Dependency and Development, p. 91.
2. Dependent Development, pp. 85-6
3. See Paul Drake, "Debt and Democracy in Latin America, 1920s-1980s", in Debt and Democracy in Latin America, pp. 39-58.
4. Dependency and Development, pp. 92-94.
5. Celso Furtado, Economic Development of Latin America, p. 166.
6. The Industrialization of São Paulo, p. 196.
7. It is interesting to know that Vargas was the Finance Minister during the first two years of the Washington Luis administration.
8. Pinto Ferreira, Capitais estrangeiros e divida externa, p. 154.
9. The Industrialization of São Paulo, p. 185.
10. Ibid.
11. Caio Prado, Historia Economica del Brazil, p. 331 and John D. Wirth, The Politics of Brazilian Development, 1930-1934 (Stanford: Stanford University Press, 1970), p. 21.
12. Peter Evans, Dependent Development, p. 86.
13. Ibid.
14. Warren Dean, The Industrialization of São Paulo, p. 183.
15. Ibid.
16. Affonso de Taunay, Historia do cafe no Brasil (Rio, 1942), Vol. XIII, p. 412.
17. The Politics of Brazilian Development, p. 10.
18. The Economic Growth of Brazil, p. 213.
19. Formação Economica do Brasil (Rio: Fundo de Cultura, 1959), p. 220, 222 and 224.
20. Luis Bresser Pereira, Development and Crisis in Brazil, 1930-1983, p. 19.
21. Ibid.
22. The Industrialization of São Paulo, p. 205.
23. "A divida publica externa do Brasil, 1931-1943", Pesquisa e Planejamento Economico, Rio de Janeiro 5 (11), Junho de 1975, p. 76.

24. Ibid. pp. 48-49.
25. Ibid.
26. "Alternative Outcomes of the Latin American Debt Crisis", p. 28.
27. Historia da Divida Externa da Uniao (Rio: Conselho de Economica e Financas do Ministerio da Fazenda, 1956), Part IV and V, Vol. XV da Serie Financas do Brasil, pp. 136, 142.
28. Ibid. p. 137.
29. In John Wirth, The Politics of Brazilian Development, p. 10.
30. Thomas Skidmore, Politics in Brazil, 1930-1964 (New York: Oxford University Press, 1967), pp. 15-20.
31. Warren Dean, The Industrialization of São Paulo, p. 192.
32. This was the title given to the federally appointed governor who was also invested with legislative powers.
33. Warren Dean, The Industrialization of São Paulo, p. 192.
34. Ibid.
35. Cheryl Payer, The Debt Trap: The IMF and the Third World (New York: Monthly Review Press, 1974), p. 17.
36. Warren Dean, The Industrialization of São Paulo, p. 194.
37. Ibid.
38. Celso Furtado, The Economic Growth of Brazil, p. 220.
39. Gunder Frank, Capitalism and Underdevelopment in Latin America, p. 176.
40. Celso Furtado, The Economic Growth of Brazil, p. 221n.
41. Politics in Brazil, p. 30.
42. Ibid. p. 19.
43. Marcelo de Paiva Abreu, "A divida externa do Brasil", p. 81.
44. The Politics of Brazilian Development, p. 21.
45. Paiva Abreu, "A divida externa do Brasil", p. 49.
46. Valentim Boucas, Divida Externa (X), Comercio e Mercados (Setembro 1977), p. 27.
47. Paiva Abreu, "A divida externa do Brasil", p. 50.

48. ECLA, External Financing in Latin America, p. 27.
49. Paiva Abreu, "A divida externa do Brasil", p.52.
50. Ibid., p. 51.
51. Ibid.
52. Ibid.
53. Thomas Skidmore, Politics in Brazil, p. 21.
54. Theodore Michael Berson, "A Political Biography of Dr. Oswaldo Aranha of Brazil, 1930-1937 (Ann Arbor, Michigan: University Microfilms, 1971), p. 169.
55. In Valentim Boucas, Divida Externa (X), p. 27.
56. John Wirth, The Politics of Brazilian Development, p. 29.
57. See especially Gunder Frank, Capitalism and Underdevelopment in Latin America. See also Stanley E. Hilton, Brazil and the Great Powers, 1930-1939 (Austin: University of Texas Press, 1975). Hilton maintains that Vargas was strongly committed to industrialization before the establishment of the Estado Novo, but his work concentrates, instead, on the Brazilian government's bilateral commercial agreements with Germany involving the exchange of raw materials for armaments, not for capital and intermediate goods to develop national industry (see especially chapter 4 of Hilton's book). Further, Hilton's work neglects the constraints imposed by Brazil's external public debt on foreign trade policy between 1930 and 1937 and hence the need to appease the free trade creditors, particularly the U.S. through a policy of economic liberalism. The evidence on the low priority that Vargas gave to national industry before 1937 is presented in Table 4.6 which shows Brazil's imports by sector as percentage of total imports between 1925-45.
58. The Politics of Brazilian Development, p. 41.
59. Ibid., p. 44.
60. Ibid., p. 43.
61. Warren Dean, The Industrialization of São Paulo, p. 200.
62. Thomas Skidmore, Politics in Brazil, pp. 25, 29-30.
63. Getulio Vargas, A Nova Política do Brasil, Vol. 6 (Rio de Janeiro: Jose Olympio, 1938), pp. 26-28, Speech pronounced on October 11, 1937.
64. The Industrialization of São Paulo, p. 208.
65. Getulio Vargas, A Nova Política do Brasil, pp. 26-28.

66. See Peter Evans, Dependent Development, p. 87. Again, Stanley Hilton's Brazil and the Great Powers, 1930-1939 portrays the Brazilian army as excessively preoccupied only with defense requirements, and not with industrialization. See especially chapter 4 of Hilton's work.
67. Marcelo de Paiva Abreu, "A dívida externa do Brasil", p. 56 and Paiva Abreu and Winston Fritsch, "As lições da história: 1929-30 e 1979-80?", p. 33.
68. "Lessons from the Past: Capital Markets during the Nineteenth Century and the Interwar Period", p. 429, my emphasis.
69. Paiva Abreu, "A dívida externa do Brasil", p. 71.
70. John Wirth, The Politics of Brazilian Development, p. 64.
71. Ibid., p. 91.
72. Warren Dean, The Industrialization of São Paulo, p. 209.
73. Ibid., p. 214.
74. See Bresser Pereira, Development and Crisis in Brazil, p. 21.
75. Sonia Regina de Mendonça, Estado e Economia no Brasil: opções de desenvolvimento (Rio: Graal, 1986), p. 20.
76. In Warren Dean, The Industrialization of São Paulo, p. 213.
77. Ibid., p. 210.
78. The Brazilian Corporative State and Working-Class Politics (Berkeley: University of California Press, 1977), p. 18.
79. Mendonça, Estado e Economia no Brasil, p. 39.
80. Dean, The Industrialization of São Paulo, pp. 224-225.
81. Ibid., pp. 225-226.
82. Estado e Economia no Brasil, p. 30.
83. "The State and Capital Accumulation in Contemporary Brazil", in The State and Capital Accumulation in Latin America, edited by Christian Anglade and Carlos Fortin (Pittsburgh, Pa.: University of Pittsburgh Press, 1985), Volume I, p. 56.
84. Dependency and Development, p. 14.
85. Ibid., pp. 142-143.
86. "Brazil: Corporative Authoritarianism, Democratization, and Dependency", in Latin American Politics and Development, edited by Howard J. Wiarda and Harvey F. Kline (Boulder, Colorado: Westview Press, 1985), Second Edition, p. 175.

87. The Brazilian Corporative State, pp. 49-50.
88. In Thomas Skidmore, Politics in Brazil, p. 40.
89. Erickson, The Brazilian Corporative State, p. 37.
90. Ibid., p. 183.
91. Peter Evans, Dependent Development, p. 87.
92. On the debate on state capitalism in Brazil see Jonathan Fox, "Has Brazil moved toward State Capitalism?", Latin American Perspectives, No. 24, Volume VII, Winter 1980, No. 1.
93. See Wirth, The Politics of Brazilian Development, Warren Dean, The Industrialization of São Paulo and Skidmore, Politics in Brazil.
94. Paiva Abreu, "A divida externa do Brasil", p. 58.
95. Ibid.
96. Ibid.
97. Ibid., p. 59.
98. Ibid., p. 63.
99. Ibid., pp. 64-65.
100. Ibid.
101. The exact figures as well as the number of acceptances of Plans A and B can be found in the 1946 Annual Report of the Council of the Corporation of Foreign Bondholders, p. 20.
102. Paiva Abreu, "A divida externa do Brasil", p. 78.
103. Herculano Borges da Fonseca, "A resposta ao desafio da divida externa", Carta Mensal (Rio de Janeiro: Confederação Nacional do Comercio, Conselho Técnico), Volume 30, No. 353, Agosto de 1984.
104. Cardoso and Faletto, Dependency and Development, p. xvii.

PART FOUR

INTERNATIONAL FINANCE AND DEPENDENT DEVELOPMENT
UNDER POPULISM, 1945-1964

After World War II the structure of financial flows to developing countries completely changed and became more complex as financial actors multiplied. The Bretton Woods Conference of 1944 outlined a postwar international economic order reflecting the national interest of the United States which emerged as the major creditor country and led to the creation of the IMF and World Bank. The purpose of these institutions was to uphold the free trade ideology of the U.S. and to monitor a world economy open to American trade and investment.¹ Soon Brazil, and Latin America in general, began to participate in the new international financial network as the new capital export center was searching for profitable markets.

While Brazil experienced great strides in light industrialization without foreign financing between 1930 and 1945, foreign inflows of loans became once again crucial determinants of BOP performance as the huge foreign exchange reserves accumulated during the war were soon dissipated on a flood of consumer goods. This revealed the indifference of the government to the importance of foreign exchange for self-sustaining development and indicated the return of free trade and economic liberalism.

When a developmentalist alliance emerged in the 1950s promoting industrialization, the foreign exchange necessary for the high level of imports and for the servicing of foreign direct investment (profit repatriation

and dividends) was obtained by means of foreign loans as Brazil's terms of trade drastically deteriorated. Brazil indeed managed to accelerate industrialization through the transfer of foreign financial capital, but it did that at the expense of the autonomy of the national economic system and of policy decisions for development. Thus, the old forms of external financing changed for Brazil, but the same situation of dependency on imports of loan capital which emerged in the early 1800s continued in a striking similarity.

Chapters 5 and 6 of Part Four examine how a concrete new situation of dependency developed in postwar Brazil and evaluate the developmental outcomes of such situation. At the first level, the historical-structural analysis concentrates on the forms of articulation between the interests and ideologies of the new groups that came to power after 1945 and those of center economies and their financial sectors, expressed in specific state action and choices of growth strategies. I will show that concrete political action was taken by Brazilian power groups to integrate the country into the new international division of labor and incorporate foreign financial and industrial interests into the internal developmentalist alliance of the state sector, the industrial bourgeoisie and the urban middle and working classes that would accelerate Brazil's capitalist development. But it was primarily the interaction of international finance and the state sector that maintained the equilibrium of the economy in its new role as a market for capital goods from center countries. In this way, economic subordination was simply reinforced by the new international division of labor and by the control exerted by the new centers of international finance.

At the level of developmental outcomes, the focus is on the relationship between foreign control and national development. If the empirical investigation verifies the central contention of the dependency approach, we will find that

Brazil's postwar industrialization based on external reliance on flows of financial capital was inherently distorted and unstable because, as crucial decisions about economic growth became concentrated more and more in the hands of foreigners, national goals conflicted with their interests. If by national goals we mean a wider distribution of the benefits of industrialization, this assumption of the dependency approach is basically correct. The evidence indeed shows that not only did the mass of the population continue to be excluded from participation in the boom of the 1950s, but benefits of industrial growth favored foreign interests more than Brazil.

A concentration on the local process of capital accumulation itself shows, however, that the consequences of alliances with international finance are even more detrimental than most dependency studies on TNCs' postwar behavior in developing countries suggest. As maximization of profits by transnational corporations depends on their productive enterprises in the host country, their interests are compatible, to at least some extent, with local accumulation. In contrast, the servicing of financial capital is totally divorced from production and is most often met by cutting domestic investment. In fact, a developing country that incurs a heavy burden of foreign debt is subject by the creditors to implement orthodox economic stabilization programs that contract industrial growth and the economy in general as well as eliminate whatever welfare-oriented programs that may exist in order to transfer available resources abroad as debt repayments. Thus, the maximization of profits by international financial interests is generally secured with economic stagnation, mass unemployment and severe income inequalities in the debtor countries. This has been particularly the case in Brazil in the 1980s (see chapter 9), but it was also the case in Brazil in the early 1960s as chapters 6 and 7 make clear.

Furthermore, at a minimum, the process of capital accumulation becomes extremely vulnerable insofar as international creditors have the power to extend or refuse to extend further loans and international market fluctuations may produce a sudden deterioration in the terms of trade of local primary products that provide the foreign exchange to service the debt. But ultimately, as Anglade correctly observes: "It is the autonomy of state action which is limited by the pursuit of a model of capital accumulation which generates self-reproducing contradictions over which the state loses control."² Thus, while most sophisticated dependencistas have shown that in the postwar international division of labor, although fundamental contradictions remain, there exists a basic consensus between foreign and local industrial capital on the issue of accumulation, and state autonomy has increased in maneuvering with TNCs,³ this is certainly not the case with international financial capital whose interests have, since the nineteenth century, remained unchanged.

Therefore, as chapters 5 and 6 show, the fundamental contradictions between the interests of international finance and national development were the major feature of the debt-driven growth of the 1950s.⁴ The contradictions reached the breaking point in the early 1960s (1962-1963), when debt service payments created irreconcilable pressure on Brazil's capacity to import, becoming the main obstacle to growth. Foreign loans, justified by the internal and external ideologues of developmentalism as a necessary instrument of economic growth, of the "transition" process, and BOP equilibrium turned into the major source of economic stagnation and financial disequilibrium as well as of the loss of state autonomy in the conduct of domestic economic and political decisions which became absolutely subordinated to the interests of foreign creditors.

Furthermore, when the state could no longer reconcile the pressure from foreign creditors for austerity measures and "policy reforms" as a

condition for short-term relief (rescheduling and refinancing) from the heavy burden of foreign debt with those from domestic groups opposing the deflationary policy, the limits of capital accumulation and of the populist alliance itself were reached. A sharp decline of inflows of loans forced the government to drastically curtail imports and state investment, thus paralyzing economic activities in Brazil. The economic crisis of the dependent economy that unfolded illustrates the dangers of reliance on foreign loans: vulnerability of the economy to the power of foreign creditors in refusing to extend further loans and severe limitations on local control over national economic policy-making. The political consequences of financial dependence was the emergence of an authoritarian regime capable of implementing orthodox stabilization measures in order to satisfy international creditors and recreate the conditions for new inflows of loan capital.⁵

To understand how this structurally conditioned response to domestic crisis came about, it is necessary to look at the new postwar forms of the interaction of international finance and Brazilian political forces. As in the past, the international financial system provided not only opportunities, but also severe constraints on domestic policy making. Chapters 5 and 6 will thus examine the nature of this interaction and its developmental outcomes. But first of all we need to specify the new mechanisms for international financial flows and the purpose they served.

The postwar mechanisms for international financial flows

The international financial system that emerged after World War II to sustain the new international division of labor under the leadership of the U.S. consisted primarily, of course, of mechanisms to promote free trade and stimulate U.S. domestic economic activity.⁶ During the first postwar decade, the main source of foreign financial capital to Brazil was the U.S. Eximbank, a government agency which provided long-term loans tied to

the purchase of U.S. industrial equipment to state enterprises engaged in infrastructure and basic industries. But after 1955, the most important foreign source of export credits to the Brazilian state sector was medium-term private suppliers' credits to sustain the luxury consumer good based industrialization.⁷ These were credits extended by the exporting company and often guaranteed by the exporters' government, such was the case of the governments of Austria, Belgium, England, France, Germany, Holland, Italy, Japan, the U.S. and Switzerland, the so-called Hague Club of creditors.

Therefore, the shift from long-term official credits to medium-term private credits carrying high commercial terms of repayment as the single most important source of financing constituted the distinguishing feature of inflows of loan capital to Brazil. And the terms of private trade finance were clearly not appropriate to the country's development needs, resulting in massive foreign indebtedness and chronic BOP deficits as debt repayments exceeded new loans, and in the eventual need to resort to the IMF, the guarantor of the postwar international financial system. As the World Bank itself, the other major pillar of the Bretton Woods system, stresses in its 1985 World Development Report:

In recent years several developing countries have used short-term export credits to finance their long-term investments, thus exacerbating their external debt position. Such problems arise because the basic purpose of export credits is the promotion of exports, not development; and some developing countries do not have machinery for reviewing and controlling the use of export credits. ⁸

This position of the World Bank regarding suppliers' credits has been well known since the 1950s and early 1960s when most payments crises were due largely to repayments of suppliers' credits falling due, as was the case of Brazil, the Philippines and Ghana. But, as Payer critically observes:

The Fund and Bank object to this type of credit [suppliers' credits], they say, because of the burden that high interest rates and bunched

repayments represent to the balance of payments...The irresponsible accumulation of heavy debts of this type threatens to bring the entire aid/debt/dependency system crashing down from its own weight, which probably accounts for the alarm of the Fund and the Bank... It may be suspected, however, that one reason this type of credit is so objectionable to these institutions is that it has, in the past, made it possible for some governments to evade IMF requirements.⁹

This was certainly true in Brazil in 1958, when the Kubitschek government rejected IMF programs while obtaining private suppliers' credits. But what is the "problem" with IMF programs?

IMF stabilization programs

One of the principles established by the postwar financial agreements at Bretton Woods was that the IMF was to be the main source of external financing for BOP deficits.¹⁰ The Fund itself gives only short-term loans for the specific purpose of alleviating BOP difficulties, but a country requiring large loans is subject to "conditionality", that is, the implementation of policy changes prescribed by the institution, or better, by the industrial countries that control the institution, that must be made before the loans are released. To guarantee that changes are made, the Fund provides credit in several stages as the borrower adapts to agreed "stabilization program" guidelines. The technique of the "stand-by" arrangement was thus developed by the IMF during the decade of the 1950s through which loans may be suspended if the policy objective of the Fund is not being observed.¹¹

The IMF became the center of financial operations in Brazil and elsewhere in the developing world as its "seal of approval" of economic policies in a given country is required by foreign creditors, official and private alike. With the exception of the late 1960s and the decade of the 1970s, when TNBs were searching for profitable investment outlets to recycle their surplus capital irrespective of the debtor's economic performance, IMF's imprimatur has been the rule.

The IMF is the representative par excellence of the developmentalist perspective discussed in chapter 1 of this study. As such, it prescribes policies aimed solely at qualifying countries for ever increasing amounts of foreign capital, and not at enabling them to generate their own internal supplies of savings or to reduce import intensive industrial technology which would, of course, reduce considerably the trade and investment income of industrial nations. As Payer observes:

The Fund displays an obtuse indifference, curious for a body which claims the position of balance of payments adviser, to the fact that this year's aid is the debt repayment burden of future years. It even assumes...that the recipients can plan on receiving large amounts of aid into an indefinite future. Therefore, the Fund does not advise nations on how to reduce their imports and stand on their feet economically, but coaches them on how to qualify for increased quantities of new credit...The potential for repeated payments crises and 'rescue operations' stretches into the indefinite future in a vicious circle: an IMF program is made the condition for further debt relief, but the IMF program perpetuates the colonial economic pattern and the 'aid' can never be fully paid back. The poor countries will have to run faster and faster just to stay in the same place.¹²

According to Payer, the basic components of any IMF stabilization program consist of:

- (1) Abolition or liberalization of foreign exchange and import controls;
- (2) Devaluation of the exchange rate;
- (3) Domestic anti-inflationary programs, including:
 - (a) control of bank credit; higher interest rates and higher reserve requirements;
 - (b) control of the government deficit; curbs on spending; increases in taxes and in prices charged by public enterprises; abolition of consumer subsidies;
 - (c) control of wage rises;
 - (d) dismantling of price controls.
- (4) Greater hospitality to foreign investment.¹³

Payer stresses that the attention usually given to the Fund's anti-inflationary policies is misplaced. The foundation of the IMF's orthodoxy is its commitment to the free flows of goods and capital across national borders, duly reflected in the first item of the demands, the liberalization of foreign exchange and import controls.¹⁴ Thus, devaluation of the currency

and anti-inflationary policy are the two corollaries to liberalization. The first is necessary in order to reequilibrate foreign trade by lowering the price of exports and raising the price of imports as the removal of controls will logically worsen the shortage of foreign exchange and will exacerbate the disequilibrium of the BOP. But in stimulating exports, devaluation also forces the price of local products, particularly food, to rise on the domestic market because less will be available for local consumption, thus hitting the poor severely.¹⁵ As Payer says: "It is an explicit and basic aim of IMF programmes to discourage local consumption in order to free resources for exports."¹⁶ But devaluation of the currency also has a strong impact on debt servicing costs as local borrowers had obtained dollar loans and more cruzeiros would be required to repay the same amount of dollar debt. This partially explains the twin problems of massive public sector deficits due to inflated interest payments on the foreign debt and a private sector in danger of bankruptcy for the same reason. This is particularly true in the 1980s (see chapter 9).

The second corollary to exchange liberalization, anti-inflationary policy, is to maintain the stability of the exchange. As Payer explains:

Critics of the Fund's stabilization programmes usually miss their mark, however, because they ignore...that the anti-inflationary policy is the necessary corollary of exchange liberalization and exchange stability, which represent the Fund's *raison d'etre*. Just as the absence of exchange controls necessarily implies the setting of an exchange rate which will mediate supply and demand without the aid of controls, so if that exchange rate once achieved through devaluation, is to be maintained without further devaluations *ad infinitum*, then the government must keep domestic demand relatively stable so that the exchange rate may stay stable. ¹⁷

The deflationary policies of the Fund, aimed at reducing domestic demand to restore the equilibrium of foreign transactions (i.e., to pay off foreign creditors), by affecting government spending, taxation, wage and credit policy, touch the very heart of national sovereignty as the government loses its autonomy of decision making, for the Fund attempts to exercise

full control over economic policy decisions. The Fund's orthodox policies also, of course, provoke the opposition of the various social groups as austerity measures go directly against their interests: stabilization hurts local business and depresses the real income of the electorate. This was precisely the dilemma faced by successive governments in Brazil during the country's relatively competitive political system between 1945 and early 1964 when the major feature of the economy was once again foreign indebtedness, BOP problems, inflation and the external constraints expressed in the form of pressure from Brazil's creditors discussed in chapters 2 and 3.

Other postwar sources of capital to Brazil

Another official source of financial capital to Brazil functioning alongside the IMF was the US Agency for International Development (AID), the US bilateral aid program for the Latin American region. AID was the most overtly political of the agencies and funds were distributed to serve American foreign policy objectives in the region, regardless of specific projects presented for AID loans. In the early 1960s, AID became politically involved in Brazil's Northeast region with the specific aim of constructing a strong opposition to the Goulart regime.¹⁸

Inflows of private foreign industrial capital or foreign direct investment by TNCs, mainly from the U.S., also provided an important source of capital to Brazil after World War II. TNCs were attracted to the country as a result of deliberate government subsidy policies such as favorable exchange rates and import conditions during the Vargas and Cafe Filho stabilization programs in 1953 and 1955, respectively, and of course, during the Kubitschek government (1956-61), which embarked on an aggressive program of vertical ISI, which is to say, the development of local manufacturing of consumer durables, capital and intermediate goods which, in the opinion of the government authorities, were causing the big drain on the BOP.

One common motive for a transnational corporation to undertake foreign investment is a threat to an existing export market. In Brazil the threat came precisely from the strategy of ISI which restricted the imports of manufactured goods through tariff protection. The protectionist policies led the corporations to invest in Brazil in order to get around the trade barriers.

Yet not productive capital, but financial capital through the massive foreign borrowing by the Brazilian state was the heart of the ISI policy of the Kubitschek government (see chapter 6). ISI, of course, did not diminish the total volume of imports, it merely changed their composition which now included capital and intermediate goods. As the state openly subsidized the high levels of imports by the local subsidiaries of TNCs, the foreign exchange necessary was obtained through loans in the form of private trade credit, suppliers' credits, already discussed.

But it all began when the free trade doctrine of orthodox laissez-faire capitalism was accepted by the new postwar Brazilian elites, dissipating the country's foreign exchange reserves accumulated during the war. As such, to launch a moderate developmentalist strategy to "deepen" horizontal ISI, the second Vargas administration (1951-54) resorted to foreign loans from the Eximbank and Brazil soon reverted to its debtor status which had prevailed before 1930. In fact, the origin of Brazil's postwar external indebtedness is found not in the Kubitschek government, but in the Vargas government. Chapter 5 will now examine the consequences for Brazil of its reliance on external flows of financial capital during the first postwar decade.

NOTES

1. See Joan Edelman Spero, The Politics of International Economic Relations (New York: St. Martin's Press, 1985) and Cheryl Payer, The Debt Trap: The IMF and the Third World (New York: Monthly Review Press, 1974).
2. "The State and Capital Accumulation in Contemporary Brazil", in Anglade and Fortin (eds.), The State and Capital Accumulation in Latin America (Pittsburg: University of Pittsburgh Press, 1985), p. 67.
3. See Peter Evans, Dependent Development (Princeton: Princeton University Press, 1979) and Cardoso and Faletto, Dependency and Development in Latin America (Berkeley, California: University of California Press, 1979).
4. In this connection, in a recent article about the World Bank, The Economist, known for its economic liberalism, made the following comment: "A commercial banker would be shocked at the thought of lending only to shareholders, and only to the least creditworthy among them. But the World Bank is a development agency aiming to promote development in poor countries, not to maximise profits" (13-19 February 1988:70). In Brazil, in the 1950s and early 1960s, the role of the World Bank was very small, if any. The bulk of credits came from private supplier's credits carrying hard commercial terms of repayment which resulted in a build-up of debt service payments exceeding gross capital inflows. As chapter 6 shows, the credits extended to Brazil were indeed aimed at maximizing profits, not at the promotion of development.
5. In this respect, our interpretation differs from that of Guillermo O'Donnell who argues that authoritarianism should be seen as a requirement to effect the "deepening" of the economy, that is, a movement toward a new stage of growth based on the production of intermediary and capital goods. By 1964, however, Brazil had advanced considerably in "deepening" the economy and that was not the most important problem faced by the economy. In fact, as we will discuss in chapters 5 and 6, "deepening", the movement from horizontal ISI to vertical ISI, began with the second Vargas' administration in the early 1950s and was consolidated by Kubitschek. According to Jose Serra, the military "undeepened" the economy with the stabilization measures. See Guillermo O'Donnell, Modernization and Bureaucratic-Authoritarianism: Studies in South American Politics (Berkeley: University of California Press, 1973) and Jose Serra, "Three Mistaken Theses Regarding the Connection between Industrialization and Authoritarian Regimes", in David Collier (ed.), The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979), pp. 99-163. On the relationship between stabilization and authoritarianism see also Cheryl Payer, The Debt Trap, Albert O. Hirschman, "The Turn to Authoritarianism in Latin America and the Search for its Economic Determinants", in Collier (ed.) and Michael Wallerstein, "The Collapse of Democracy in Brazil: Its Economic Determinants", Latin American Research Review, Vol. XV, No. 3, 1980, pp. 3-43. On the recurrent financial crisis and the need of successive Brazilian governments to tailor the country's economic and political decisions to the constraints imposed by its debt abroad, see the work of Thomas E. Skidmore, Politics in Brazil, 1930-1964 (New York: Oxford University Press, 1967).

Furthermore, interpretations of Brazil's economic stagnation after 1962, such as economic cycles, exhaustion of ISI and underconsumption miss the point. As chapters 5 and 6 make clear, it was the contraction of foreign loans and the at empt of the Goulart administration in 1963 to impose austerity measures to please international creditors in order to obtain BOP relief that played a major role in the paralysis of economic activities in Brazil and which was further reinforced by the orthodoxy of the post-1964 military regime. For the different interpretations referred above, see Celso Furtado, Diagnosis of the Brazilian Crisis (Berkeley: University of California Press, 1965); Furtado, Subdesenvolvimento e Estagnacao na America Latina (Rio: Editora Paz e Terra, 1966) and Um Projeto para o Brazil (Rio: Paz e Terra, 1968).

6. See Barbara Stallings, Banker to the Third World: U.S. Portfolio Investment in Latin America, 1900-1986 (Berkeley: University of California Press, 1987), p. 83.

7. Suppliers' credits are often called "short-term suppliers' credits", but they may have maturities as long as five or ten years, and are thus short-term not for BOP accounting purposes, but in the sense that often the loan will have to be paid back before the project it finances is producing.

8. 1985 World Development Report, p. 97.

9. The Debt Trap, p. 47.

10. It should be noted that the IMF was not conceived to deal with Third World financial problems, but rather, was designed specifically to regulate the regime of fixed exchange rates (as opposed to floating rates in which market forces, rather than government regulations, determine currency value) among industrial countries (e.g. by policing exchange restrictions) to ensure stability, predictability and orderly growth of international trade transactions. Furthermore, the IMF's task was to provide bridging finance to industrial countries with short-term trade deficits. See, on the subject Joan Spero, The Politics of International Economic Relations. It follows that, since BOP problems in the Third World are often caused by long-term structural service deficits, and not short-term trade deficits, short-run solutions imposed by the IMF - deflation, or the reduction of the level of economic activities (which means putting people out of work and reducing real wage levels) and devaluation, or the lowering of exchange rate - exacerbate the problem. The wrong "medicine" prescribed to debtor countries by the IMF may, in fact, have devastating socio-economic effects as we will show in this study.

11. See Payer, The Debt Trap, p. 25.

12. Ibid., p. 47.

13. Ibid., p. 33.

14. In this connection, the economist Gunnar Myrdal made the following comment in his Economic Theory and Underdeveloped Regions, written three decades ago:

The advice under-developed countries are now often gratuitously given to abstain from interfering with foreign trade, and from tampering with the foreign exchange is in most cases tantamount to advice not to bother about economic development (p. 94).

15. The issue of devaluation's effects on food price increases is also dealt by The Economist, "Economic Focus: Exchange Rate Policy", 15-21 April, 1980, p. 71.

16. Payer, The Debt Trap, p. 42.

17. Ibid., p. 36.

18. For an inside experience with AID and its involvement in Brazil, see Joseph A. Page, The Revolution that Never Was, Northeast Brazil, 1955-64 (New York: Grossman Publishers, 1972). See also on the subject, Riordan Roett, The Politics of Foreign Aid (Nashville: Vanderbilt University Press, 1972).

CHAPTER 5

THE EMERGENCE OF A NEW SITUATION OF DEPENDENCY, 1945-1954

After accepting the free trade doctrine which exhausted Brazil's foreign exchange reserves between 1946 and 1947, the postwar political elites "concluded" that the country's capitalist development could not be attained with domestic resources alone. This conclusion was also reached by the United Nations Economic Commission for Latin America (ECLA), whose foundation in 1948 marked the beginning of an intellectual movement offering concrete proposals for the industrialization of the region. The import of capital from the new international financial institutions, which were in fact waiting in the wings, was thus promoted and justified by ECLA and the populist regimes in Brazil as the necessary instrument to speed up the growth process with financial equilibrium and improvement in living standards.

This chapter focuses on the economic and political consequences of a process of financial dependency that began when the second Vargas administration (1951-54) launched the early stages of vertical ISI in Brazil. Although the year 1955 is generally considered by dependency analysts as the turning point in the development process of Brazil, it was with Vargas that the transition from horizontal ISI to vertical ISI began and that the postwar alliance of the state and international finance emerged. The return of economic liberalism to Brazil in the early postwar years with the consequent deterioration of the country's external accounts set the pace for much of

what was in store for the country in the future: any industrialization program could only continue on the basis of external reliance on flows of loan capital to maintain the temporary equilibrium of the BOP.

Liberalism returns to Brazil

The wave of political and economic liberalism that swept Brazil after 1945 was the result of both external and internal factors. In the first case, the principles of political liberalism that emerged in the immediate postwar period in opposition to fascism had strong effects on any kind of authoritarian political regimes whose countries had fought alongside the Allies. In this sense, the Estado Novo was a contradiction. At the same time, this political liberalism had its parallel in the economic realm reflecting the consolidation of the United States as the center of the capitalist system and its preference for open markets for American goods and capital exports.¹ Bretton Woods embodied the interests of the world's major credit country by favoring the restoration of free exchange rates in international transactions and an end to protectionism. Thus, there was international pressure against models of economic development based on nationalist solutions with strong state protectionist policies such was the case of the Estado Novo.²

In the second case, domestic political opposition to Vargas began with the 1943 "Manifesto dos Mineiros" calling for Brazil's redemocratization. Soon, international liberalism served as the symbol for the organization of the heterogeneous opposition to Vargas under the União Democrática Nacional (UDN) formed in 1945. The major group around the UDN consisted of the liberal constitutionalists of the 1930s, composed mainly of the middle and upper classes of the major urban centers, including particularly professionals and technicians in the service of foreign firms and some industrialists who believed that the economic policy of Vargas had harmed them.³ The opposition also included, of course, the import and export sectors who were against the industrialization

policy of the Estado Novo.

The UDN began a strong campaign in favor of a return to political and economic liberalism, demanding an immediate abolition of state intervention in the economy, opposing protectionist tariffs for industrialization and strongly favoring foreign capital.⁴ But the newly founded political party did not propose to dismantle Vargas' corporatist structure, especially the government's manipulated labor union system.⁵

Vargas' ambiguity about free elections led to his overthrow by the Army in October 1945.⁶ But the process of "redemocratization" was conditioned by the same rules of the game of traditional politicians. In 1945, two parties were formed around Vargas, the Partido Social Democratico (PSD) and the Partido Trabalhista Brasileiro (PTB). The first consisted mainly of the traditional politicians in the rural areas, the non-exporting latifundistas, but also some sectors of coffee growers, whom Vargas had courted by maintaining the existing land tenure of the pre-1930 period. The PSD also included the urban bourgeoisie and technocrats of the Estado Novo. As Skidmore remarks, "This combination of nouveau industrialists and old-style politicians was to give the PSD its uniquely 'non-ideological' position in the postwar era."⁷

The PTB was made up of the organized urban working class, a privileged minority within the total labor force in Brazil. The PTB clearly represented the efforts of Vargas to preempt the left which had reemerged as a political force after 1945 and to mobilize working class support for his own political ambitions. Although the UDN was the representative of the new liberalism, it was the coalition PSD-PTB which became the center of the populist regime in Brazil until 1964. The UDN, with its elitist and moralist discourse would come to power only in 1961 during the short-lived presidency of Janio Quadros, but it remained the eternal opposition to Vargas and his followers. The UDN forces, however, were the ultimate victors with the right-wing military

coup d'etat in 1964 (see chapter 7).

The dissipation of foreign reserves and the origins of
Brazil's postwar financial dependency

General Eurico Gaspar Dutra, the candidate of the PSD, was elected President in December 1945 and in September 1946 the fourth constitution of Brazil was approved by a Constituent Assembly. The constitution rejected state intervention in the economy and upheld the principles of economic liberalism which Dutra quickly translated into a policy of free exchange rates and free capital movements. But the constitution preserved the strong executive created by the Estado Novo and its corporatist structure.⁸ Politically, liberalism meant an electoral system that excluded the illiterate population, which accounted for more than half of the nation's citizens.

The return of Manchester-type orthodox laissez-faire capitalism between 1946 and 1947 was disastrous to Brazil. The foreign exchange reserves that Vargas had accumulated during the war with export earnings and the substantial reduction of the country's historical debt servicing burden (as Table 4.12 above shows, the foreign reserves amounted to \$666 million in 1945) were exhausted within a year and a half in a flood of unproductive imports when it would have been possible to institute a program for the acquisition of machinery, equipment and technology from abroad.

The acceptance of the free trade doctrine and the permissive import policy of consumer goods through a liberal exchange policy of the newly founded Superintendency of Money and Credit (SUMOC), the monetary authority, showed the ignorance of the Dutra administration in not understanding the importance of foreign exchange for national autonomy in the financial, economic and political realms. The accumulation of reserves had given Brazil the first and only opportunity in its history to rid itself of the traditional

debtor status and foreign intervention in its decision making process. For the first time Brazil's traditional deficitary current account of the BOP was in surplus.

But the opportunity was lost in the hands of government officials, in particular, the neo-classical monetarist economists Eugenio Gudin (the Brazilian delegate to Bretton Woods), Octavio Gouveia de Bulhoes (the future director of SUMOC in 1954 and Finance Minister of the military regime in 1964) and Correa e Castro (Dutra's Finance Minister) who strongly believed in the doctrine of free trade and comparative advantage and in the "natural" role of Brazil as an exporter of primary products and importer of manufactured goods.⁹ "Agriculture", Gudin argued, "is the only economic activity for which we demonstrate a capacity"¹⁰ and Brazil was described by Correa e Castro as "essentially an agrarian country."¹¹

Table 5.1 below shows Brazil's foreign trade during the period 1944-48, revealing the increasing imports between 1946 and 1947 which led to a trade deficit in 1947.¹² Table 5.2, using data from Conjuntura Economica, gives us an interesting picture of the BOP for the period 1947-49 and its increasing disequilibrium. Although imports increased immediately after the end of the war, Brazil recorded repeated and relatively high surpluses in the trade balance so that between 1945 and 1949 the trade surplus reached \$1.2 billion. Table 5.2, however, clearly reveals that the service account (the invisibles) amounted to more than \$1 billion in the quinquennium, with more than 50 percent of the net expenses only in the item transportation (including freight and insurance on merchandise) but also with profits and dividends by direct foreign investment exceeding net inflows (foreign capital and its earnings are presented in Table 5.3).

The trade surplus was in this way practically wiped out with the payments on the service account and Brazil recorded a surplus in current account of only \$31.8 million annually in the period, already showing its

inability to continue the amortization of the foreign debt contracted before 1930. Table 5.2 also shows the capital account, indicating that between 1945 and 1949 Brazil was still a capital exporter as debt amortization (\$300 million for the period as a whole) exceeded capital inflows, both autonomous long terms loans (\$81 million) for specific development projects, that is, tied to equipment imports, and compensatory short-and medium-term loans (\$118 million) for BOP support.

Table 5.1 Brazil's Foreign Trade, 1944-48
(million cruzeiros)

Years	Exports	Imports	Balance
1944	10,727	7,997	2,730
1945	12,148	8,617	3,581
1946	18,230	13,029	5,201
1947	21,179	22,789	-1,610
1948	21,697	20,985	712

Source: Raouf Kahil, Inflation and Economic Development in Brazil, 1946-1963 (Oxford: Claredon Press, 1973), Table VI.10, p. 253.

Attempt at stabilization

In an effort to correct the increasing disequilibrium of the BOP Dutra began implementing IMF style deflationary measures in 1947, marking the very first involvement of the institution in Brazil. Exchange controls, however, were imposed to restrict imports instead of devaluation of the currency to promote exports, as favored by the IMF.¹³ Significantly, postwar foreign exchange controls in Brazil would be the major mechanism used to solve BOP problems as well as stimulate ISI during the 1950s and, simultaneously, the target of attacks from foreign creditors and domestic export sectors.

The economist Rouf Kahil praises "the very first serious attempt at stabilization" in Brazil, but he also informs us of the disturbing results: banking crisis, business failures, unemployment and a fall in dustrial growth rate from 8.17 percent in 1946 to less than 5 percent in 1947.¹⁴ Furthermore,

Table 5.2 Brazil: Balance of Payments, 1945-49
(in millions of US dollars)

Goods and Services	
1. Merchandise (FOB)	1,210.2
2. Services (net)	-1,017.3
2.1 Travel	-52.0
2.2 Transportation (including freight and insurance on merchandise)	-546.0
2.3 Interest	-78.0
2.4 Investment income (foreign direct investment profit remission)	-136.0
2.5 Other government	-59.0
2.6 Other private	-146.3
3. Transfers	-34.0
Current account	158.9
Annual average	31.8
Capital account (source of foreign financing)	
1. Loan capital	-95.0
1.1 Autonomous loans (import financing)	81.0
1.2 Compensatory loans (BOP support)	118.0
1.3 A ortization	-294.0
2. Risk capital	66.0
2.1 Direct foreign investment	66.0
2.2 Brazilian investment abroad	-
3. Other capital	-8.0
3.1 Commercial arrears and credit	22.0
3.2 Subscriptions and contributions	-37.0
3.3 Other	7.0
Total capital inflows (net)	-37.0
Annual average of inflows	-7.4

Source: "Desequilíbrios externos desde o pos-guerra: origens e fontes de financiamento", *Conjuntura Económica* 31 (11), Nov. 1977, Table I (desequilíbrio em transações correntes-origens e evolução), p. 169 and Table II (fontes de financiamento dos desequilíbrios externos), p. 171.

the minimum wages prevailing in 1943 were maintained by the imposition of a wage freeze. Given the inflationary rate of 21.8 percent in 1947 (see Table 5.6 below), the real value of the wages deteriorated by 30 percent.¹⁵ In order to prevent unrest as a result of this policy, Dutra intervened in labor unions, purging their leadership, and suppressed the Communist Party.¹⁶

The credit restrictions, however, led to a violent press campaign in Brazil denouncing the disastrous policy of the financial authorities. Dissatisfied members of the government coalition were bankers and, of course, the industrial bourgeoisie, who were joined by a young group of economists around the National Confederation of Industries in Rio de Janeiro. Their strong opposition to the anti-industrialization, monetarist outlook of the Dutra government stimulated the early debate over the question of Brazil's economic development between monetarist and structuralist economists which was further enhanced by the "Abbink Mission" (a Joint Brazil-US Technical Commission) in 1948.¹⁷

Having at its co-chairmen Bulhões and the American economist John Abbink, the findings of the Commission reflected their economic liberalism in neglecting industrialization and insisting on orthodox financial and fiscal policies. The economists supporting the industrial bourgeoisie criticized the Commission on the grounds that "The policy of credit restriction recommended by the report is contrary, in the present situation, to the objective of economic development, which first requires, for a more productive utilization of the factors of production, an adequate expansion of credit."¹⁸

As a result of strong criticism from the important sectors of the political coalition which supported his government, Dutra departed from the economic austerity program at the end of 1948 and began expanding credit to court the bourgeoisie in spite of the stern warnings of the IMF.¹⁹

Furthermore, the exchange controls imposed in 1947 turned out to be a powerful stimulant for industrialization as the import regulations worked against consumer goods and in favor of machinery, raw materials and fuel.

After 1948 the exchange controls were utilized by the government to protect national industry from foreign competition and guarantee priority to the importation of essential industrial goods to Brazilian companies in order to substitute previously imported non-durable consumer goods in an attempt to reduce the demand for foreign exchange.²⁰ Between 1948 and 1950 raw materials represented 37 percent of total imports and industrial equipment, 35 percent.²¹

Other factors also helped industrialization. The terms of trade for Brazil improved after 1949, and the Korean War resulted in a strong international demand for primary products, particularly coffee, until 1954. In addition, the maintenance of an overvalued cruzeiro was a disincentive to the export sector which diverted investment into production for the domestic market and an incentive to national producers who were able to import machinery and raw materials at a very low price, thus aiding the industrialization process without creating inflationary pressures.²² As Table 5.6 below shows, in 1948 the annual rate of inflation was only 3.4 percent, in 1949, 4.5 percent, increasing to 9.2 percent in 1950.

This economic policy, however, would be the target of international and domestic pressure during Vargas' second administration (1951-54), leading the President to abolish exchange controls and institute free exchange rates for most international transactions which naturally benefitted the movement of foreign capital into and out of the country (see Table 5.3 below). Furthermore, the new mechanism, known as "multiple exchange system", was a de facto devaluation of the cruzeiro to promote exports and solve the foreign exchange crisis the country faced in 1952-53. With these liberal measures,

the result of economic stabilization, the model of "easy" ISI was exhausted. Any industrialization program could thus only continue on the basis of external reliance on flows of capital (see chapter 6).

In any case, in whatever direction Brazil moved, the eternal dilemma of international imbalances continued and was also the dark side of those prosperous years of export boom and growth of light ISI which characterized the last years of Dutra and the beginning of Vargas' second administration. The policy of overvaluation of the cruzeiro in 1948 aimed at discouraging the export sector and cheapening the price of industrial imports benefitted primarily foreign capital. The overvalued cruzeiro made the outflow of capital very attractive and between 1948 and 1953 the transfer abroad of profits and dividends by direct foreign investment exceeded almost every year the net inflows of capital (in 1954, the outflow was the direct result of the stabilization measures as will be discussed), as column 3 of Table 5.3 indicates. The resulting deficit in the current account of the BOP was quickly covered by the inflow of loans as columns 4 and 8 show, although in 1948 and 1950 the loans were not enough to cover the deficit. But the short-term relief the loans provided for the BOP would represent a burden, in the form of interest payments and amortization, in the future. A foreign exchange crisis would thus occur in 1952-53, the refinancing of which was the origin of Brazil's postwar external indebtedness.

A close look at Table 5.3 for the period under consideration as a whole (1947-63) reveals in a nutshell the dependency of Brazil on foreign loans, their predominance over foreign direct investment and the vulnerability of the debt-driven growth of the 1950s. After 1955 and until 1961, the annual average inflow of foreign direct investment increased sixfold to \$91 million as a result of facilities granted to foreign investors in 1955, the famous Instruction 113 of SUMOC, discussed in chapter 6. However, column 4 of this

Table indicates that the annual average inflow of foreign loans during the period was \$492 million. Column 2 (remittance of profit and dividends by foreign firms), columns 5 and 6 (amortization and interest on loans) explain why inflows of loans were constantly required.

Table 5.3 further reveals that in 1962 and 1964 there was a drop in the inflow of foreign direct investment from the 1961 level, of more than 30 percent in 1962, and of a further 66 percent in 1963. Though remittance of foreign profits also declined (the result of a restrictive profit remittance law in 1962), the net balance for foreign direct investment fell in relation to the 1958-61 average by roughly 50 percent, but remained positive at a level that exceeded that of the 1955-61 period as a whole. The blow to the Brazilian economy in 1962 and 1963 was the simultaneous drop in the inflows of loans. And it is here that we see the vulnerability of a growth model excessively dependent on foreign loans.

With the contraction of loans in 1962 and 1963, the total balance of capital inflows for the two years was negative, a deficit of \$60 million per year. The financial and economic crisis which unfolded in those years was the result of a net outflow of capital, in the form of debt service and amortization amounting to \$135 million in 1963 alone, hence the drastic fall of imports and public investment and the end of Brazil's rapid postwar development (see chapter 6). GNP growth rates fell from 10.3 percent in 1961 to 5.3 percent in 1962 and 1.5 percent in 1963 and per capita GNP fell from 7.2 percent in 1961, 2.3 percent in 1962 and -1.3 percent in 1963.²³

Before we turn to Vargas' second administration and begin our analysis of the political and economic consequences of Brazil's financial dependency, we will briefly examine the development of a new reformist ideology in Latin America aimed at promoting the region's industrialization. The

Table 5.3 Movement of Foreign Capital and its Earnings, 1947-1963 (millions of U.S. dollars)

	Risk Capital			Loan Capital				Total Balance (8)
	Net capital inflow (1)	Remittances ¹ of profits (2)	Balance (3)	Inflow (4)	Amortization (5)	Interest (6)	Balance (7)	
1947	36	- 23	13	278	- 58	- 13	207	220
1948	25	- 38	- 13	9	-138	- 23	-152	-165
1949	6	- 41	- 35	119	-107	- 21	- 9	- 44
1950	3	- 47	- 44	52	- 88	- 27	- 63	-107
1951	-4	- 70	- 74	222	- 31	- 20	171	97
1952	9	- 15	- 6	110	- 61	- 21	28	22
1953	22	- 94	- 72	551	- 6	- 33	472	400
1947-53 (Total)	97	-328	-231	1,341	-529	-158	654	423
1947-53 (Average)	14	- 47	- 33	192	- 76	- 23	93	60
1954	11	- 53	- 42	369	-134	- 44	191	149
1955	43	- 44	- 1	145	-198	- 34	-87	-88
1956	89	- 24	65	248	-215	- 67	- 34	31
1957	143	- 26	117	307	-242	- 67	- 2	115
1958	110	- 31	79	626	-324	- 58	244	165
1959	124	- 25	99	589	-398	- 91	100	199
1960	99	- 40	59	763	-410	-106	247	306
1961	108	- 31	77	874	-564	-107	203	280
1954-61 (Total)	727	-274	453	3,921	-2,485	-574	862	1,315
1954-61 (Average)	91	- 34	57	492	-311	- 72	108	165
1962	71	- 18	53	358	-282	-113	- 37	16
1963	31	-	31	259	-342	- 83	-166	-135
1962-63 (Total)	102	- 18	84	617	-624	-196	-203	-119
1962-63 (Average)	51	- 9	42	309	-312	- 98	- 102	- 60

¹ Excluding reinvestments

Source: Raouf Kahil, Inflation and Economic Development in Brazil, p. 213, Table V.9

foundation of the United Nations Economic Commission for Latin America (ECLA) in 1948 marked the beginning of an intellectual movement offering concrete proposals for the deliberate industrialization of the region in order to reduce its historical dependence on exports of primary products and consequently its extreme vulnerability to price fluctuations in the international market. It should be noted at the outset, however, that ECLA's doctrine differed little from the neo-classical approach and was in fact heir to the classical school (liberal and Marxist). As Cardoso notes, "In ECLA's analyses we see the coexistence of classical, Marxist, Keynesian and neo-classical explanations of the market mechanism and of economic growth."²⁴

Although ECLA repudiated the theory of international trade of the developmentalist approach (see chapter 1) by recommending ISI, the Commission's development strategy of planning and state investment programs in infrastructure and basic industries to stimulate the private sector was very much within the prevailing neo-liberal orthodoxy discussed in chapter 1. Thus, ECLA's recommendations did not differ from the liberal Joint Brazil-US Commission (1951-53), a US government plan to extend technical assistance and long-term loans to state enterprises in the area of infrastructure and basic industries (see discussion below). The Joint Commission's work gave impetus to the first attempt at state planning in Brazil under Vargas' National Rehabilitation Plan. This led to the establishment of the National Bank for Economic Development (BNDE) whose technicians worked closely with ECLA in an effort at systematic overall planning, thus complementing the work of the Joint Commission.

ECLA'S APPROACH

1950 was the year in which ECLA launched the "Latin American Manifesto", the famous Prebisch report on the problems of Latin American economic development.²⁵ ECLA openly criticized the theory of international

trade showing that the international division of labor which conventional theory claimed was "naturally" produced by world trade was of much greater benefit to the center (where manufacturing production is concentrated) than to the periphery (which was destined to produce primary products). According to ECLA, long-term deterioration in the terms of trade in the periphery (that is, the deterioration of the prices the periphery receives for its commodity exports relative to the prices of the manufactured goods it imports from developed countries) would impede development there as capital goods and other manufactured imports became expensive and foreign exchange earnings declined. ECLA thus affirmed that trade relations between the center and the periphery tended to reproduce the conditions of underdevelopment and to widen the gap between the developed and underdeveloped countries.²⁶

The solution to this disparity would be to "deepen" horizontal ISI, that is, the development of a process of vertical ISI, involving the manufacturing of durable consumer goods, capital and intermediate goods. This is known as "inward growth", based on industrialization to satisfy the demands of the internal market, as opposed to "outward growth" of the pre-1930 era when export activities were meant to satisfy the demands of the international market (see chapters 2 and 3).

But this process of industrialization could not be expected to take place spontaneously, as in the 1930s (see chapter 4), for it would be inhibited by the international division of labor which the center would attempt to impose and by a series of structural obstacles to growth internal to the Latin American economies (mainly the traditional exporting sectors). ECLA then went beyond theoretical pronouncements to offer packages of policy recommendations intended to promote a process of deliberate or "forced" ISI. They included state planning and intervention in the economy, both in formulation of economic policies oriented towards industrialization, such as

tariff protection against high cost imports, and as a direct productive agent in infrastructural and basic areas where large amounts of slow-maturing investments were needed, such as power, roads, raw materials and upon which domestic industry could arise and support itself.²⁷ State enterprises and mixed public-private enterprises were thus urged in order to break "bottlenecks" and ensure investments in areas where the private sector lacked the will or the resources to venture. As discussed in chapter 1, these were the same recommendations of the "revised" neo-classical approach.²⁸

The ideology of developmentalist nationalism (nacional desenvolvimentismo) which characterized Brazil in the 1950s was promoted by ECLA, but the roots can be traced back to the economic nationalism of the tenentes and the state-directed industrialization efforts of the Estado Novo (chapter 4). Moreover, the debate between interventionism and liberalism could already be seen in the decade when Roberto Simonsen, the leader of the Brazilian industrial bourgeoisie, attacked the traditional neo-classical ideas of Eugenio Gudín, the representative of the exporting oligarchies. With the death of Simonsen in the 1940s, ECLA became the great advocate of industrialization and state planning in Brazil, from Vargas' National Rehabilitation Plan (1951-54), Kubitschek's Trajet Plan (1956-61) and the projected Three-Year Plan of Goulart (1963).

There is an additional important aspect of ECLA's doctrine that should be stressed, however, if we are to understand why it was practiced by regimes conspicuously liberal with foreign capital and why the "nationalist, autonomous inwardly looking" industrialization proposed by the Commission took a path different from that expected.

ECLA and foreign capital

ECLA's reformist nationalist doctrine was limited to the criticism of agro-exporting activities and trade transactions between the center and the

periphery which supported the interests of the exporting oligarchies and were thus responsible for perpetuating what the Commission believed to be feudal and pre-capitalism structures of Latin America. For ECLA, underdevelopment was the absence of capitalism and the Commission's objective was to promote autonomous capital accumulation in the region. But "foreign savings" were viewed as the driving force for autonomous capital accumulation in the capital-scarce region. ECLA favored long-term loans over direct investment, although the latter was not really discarded as a contribution to higher rates of growth.²⁹

In these terms, ECLA proposed a path for "national" development based on industrial activities in order to reduce Latin America's traditional dependency on the international market for primary products and to alleviate BOP problems, but without restriction to the external help which would support the so-called "inward development" and without any consideration for the financial dependency of the region on loan capital which would necessarily result. Thus, ECLA's famous criticism of the "feudal-commercial/imperialist" alliance,³⁰ which prevented the full development of capitalism in Latin America, gave the Commission a nationalist veneer which covered its open invitation to foreign capital willing to contribute to capital accumulation in the periphery. As Brazilian social scientist Guido Mantega argues, "ECLA's doctrine, with its unfolding ideology of developmentalist nationalism, guided the steps of the populist governments in Brazil, opening the way for the implantation in the country of monopoly capitalism and the highest stage of imperialism."³¹

In this way, it is not difficult to see that while ECLA's heterodox trade theory was in clear violation of the laissez-faire liberal aspect of the prevailing orthodoxy, the other major aspect of the latter was upheld: the free movement of capital. Furthermore, ECLA did not distance itself

from neo-classical doctrines in applying Keynesian analysis and recommending state intervention and expansion of the domestic market through wage policies and land reform aimed at boosting effective demand for the growth of industrialization. In fact, most economists no longer consider it illegitimate for the state to intervene in the market to promote stable growth and to correct the imbalances and dislocations produced by the imperfections of the market. The Commission's approach to capitalist development in Latin America implicitly assumed that the improvement in living standards would be automatic and spontaneous and an inevitable consequence of industrialization, revealing its affinity with the fundamental point of the classical and neo-classical doctrines.³² For both, capitalism is a system of economic organization which, with more (for some) or less (for others) state intervention, is perfectly capable of reaching and distributing social progress. It was only in the early 1960s that ECLA began dealing directly with the "social question," thus producing studies on income distribution in Latin American and even questioning its former analysis.³³

Finally, ECLA identified itself with neo-classical doctrine in that it argued that the absence of capitalism was the cause of Latin American underdevelopment. It is interesting to note here that ECLA's critique of the "feudal-imperialist" alliance was also invoked by Marxists in Latin America who followed Lenin and the lines of the 1920 Third International. These Marxists also identified feudal and pre-capitalist relations in Brazil and elsewhere as the cause of underdevelopment and argued that only capitalism could destroy feudalism, thus offering a solution to the problems of backwardness and a path to development. As with ECLA's formulation, the state and the national bourgeoisie were also depicted by the Marxists as potential agents in this necessary capitalist development.³⁴ Thus, as analyzed in

chapter 1, liberal neo-classical and Marxist approaches do offer very similar diagnoses of the problems of underdevelopment.

ECLA's strategy and dependent development

The international context became very favorable after 1955 for the diffusion of capital to Brazil as the center countries were ready to respond to the invitation of the developmentalist "nationalist" political elites who had translated ECLA's doctrine into practice. In the case of foreign industrial capital, after the postwar economic recovery in the center, TNCs were searching for new markets and cheaper production sites for their manufacturing process. The protectionist policies were precisely what led the foreign firms to invest in Brazil in order to get around the tariff walls. In addition, as we will discuss soon, several deliberate measures were taken by the "nationalists" to attract the TNCs to the profitable and dynamic sector of the economies (consumer goods), such as state intervention in producing the necessary infrastructure and basic industries and in providing favorable exchange rates and import conditions for the foreign firms which were not available to local companies. Industries would thus be located in Brazil, but it would not mean that they were Brazilian in ownership.

Furthermore, as TNC's productive structure is geared to the manufacturing of luxury goods, demand for automobiles, television, etc., would have to come from a small number of very wealthy consumers, given the fact that the bulk of the Brazilian population was very poor. This would reinforce the already high income concentrating policies in the country to guarantee an internal market for the high-income commodities.

How was it politically possible to implement ECLA's strategy of capital accumulation in Brazil? The ideology of developmentalist nationalism was used by the populist regimes of the 1950s to harness support from all

classes of society, particularly the growing working class, thus providing a cover for the priority of capital accumulation over distribution as well as the penetration of foreign capital. Hence, the ambiguity of populism as a political front to reconcile the "deepening" of industrialization with the emergence of the masses whose vote strength the politicians depended on.

The contradictions of populist regimes led them to incredible jugglery: while promoting capital accumulation with its concentrating policies, they at the same time promised great social reforms that were not possible to be delivered. Furthermore, while implementing policies to attract foreign capital, the populists dressed themselves with nationalist clothes and attacked international imperialism as the source of Brazil's economic and financial problems. According to Vargas' comments in 1951, "Populism should consist, at the same time, of popular government and reactionary ministry."³⁵ The government was to dress itself with popular clothes while the ministry pursued a frank capitalist policy. In the short-run, at least, developmentalist populism was very useful as a means to overcome domestic class tensions.

By the 1960s it became clear, even to ECLA itself, that the autonomous capitalist strategy ~~proposed~~ had taken a path different from that expected. Attempts at reformulating the doctrine and the movement towards a more historical-structural analysis of Latin America followed.³⁶ In the view of critical dependency analysis of the model of accumulation proposed by ECLA, this resulted in an increasing dependence on foreign direct investment, the beginning of an associated-dependent development model and the emergence of a new international division of labor in which the periphery was integrated into the international capitalist productive system through "the opening of the domestic markets to external control."³⁷

Furthermore, in the new international division of labor, the periphery acquires capital goods, technology, and raw materials from the center nations, and export profits, along with its traditional raw materials and a few manufactured items produced by the subsidiaries of TNCs, but there occurs a denationalization of the older import-substituting industries already established.³⁸

Although concentrating only on TNCs and neglecting to see that underlying the new system was international financial capital, dependency analyses were correct in criticizing ECLA's ISI model of growth as it led to increasing BOP problems, foreign indebtedness, unemployment, widening rather than narrowing income differentials, greater vulnerability of the economy to external shocks and a continuing dependence on the export of a limited range of agricultural products. Above all, it was increasingly clear that the mass of the Brazilian population was not participating in the benefits of economic growth. However, although ECLA's development strategy did not bring about an autonomous industrial process, dependency analyses showed that foreign capital did contribute to local capital accumulation.³⁹

As already discussed in chapter 1, the movement toward a more historical-structural analysis of Latin American development resulted from the narrow economic focus of ECLA's analysis. While the major concern of the Commission was with the external dependence of Latin America on the center in terms of trade relations, hence the proposal of autonomous industrialization, it had ignored the specific class interests and the relationship between classes which led to the continued reproduction of the structures of dependency.

It was this neglected socio-political aspect of Latin American development that came to integrate the historical-structural approach to

to analyze the region's situations of dependency. As Cardoso and Faletto argue: "ECLA's economic theories and critiques were not based on an analysis of social process, did not call attention to imperialist relationships among countries, and did not take into account the asymmetric relations between classes."⁴⁰ Furthermore, as Ian Roxborough notes: "The crucial distinction between the two approaches is that in the second approach (dependency as a set of structures) the internal dynamics of the dependent social formation are fundamentally different from the internal dynamics of the social formation of advanced capitalism."⁴¹ This distinction will now be made clear with the analysis of the forms of articulation between the interests of Brazilian dominant classes and those of center economies and their financial sectors, expressed in specific state action and choices of growth strategies. In this way, the political dimension of dependency is emphasized and economic processes are explained as social processes.

Vargas and the postwar alliance of the state and international finance: the early phase of vertical ISI

The old leader returned to power in Brazil with the presidential elections of October 1950. The PSD-PTB coalition so well nurtured by Getulio Vargas after 1943 provided the base for his triumph in the face of a staunch anti-Getulista UDN campaign. Vargas' attention was soon turned to the emerging debate over Brazil's development strategy: free trade and liberalism or state intervention and deliberate industrialization according to ECLA's doctrine? ⁴²

As discussed in chapter 4, Vargas had always been ambiguous in the pursuit of concrete policies of industrialization. The President's belief in free trade was only challenged in 1937 by the inability to obtain foreign capital and by the pressure of the army and the industrial bourgeoisie. It can be said that Vargas' ambivalence continued in his second administration as he clearly accepted the traditional rules of the

international financial system and attempted to conciliate the interests of the heterogeneous political forces in Brazil for a moderate developmentalist approach. The result was a contradictory policy with orthodox and nationalist contents which ultimately contributed to the political crisis that cost him his life.

Nevertheless, Vargas initiated the early phase of vertical ISI in Brazil. Some observers argue that the "deepening" of horizontal ISI only began after 1955.⁴³ The production of consumer durables, especially the automobile, in fact began with the government of Kubitschek. The production of capital and intermediate goods, however, began with Vargas. The growth of domestically produced capital goods went from 54.2 percent in 1947 to 72.9 percent in 1954 at a time when imports more than doubled, demonstrating the development of the production goods industry in Brazil during the period.⁴⁴

Vargas' willingness to integrate Brazil into the postwar international financial system is seen by his quick acceptance of the recommendations of a Joint Brazil-US Economic Development Commission (created in 1949 and operative between 1950-53) aimed at U.S. extension of technical assistance and long-term loans for the development of infrastructure and basic industries in Brazil. The Brazilian representatives in the Commission included old faces of the Estado Novo, such as Valentim Bouças, but also new exponents of the neo-classical doctrine as was the case of the economist Roberto Campos, the future Planning Minister and architect of the economic stabilization of the military regime between 1964 and 1967.

The objective of the Joint Commission was the elaboration of concrete projects, primarily public sector projects, that could attract foreign capital. The Commission frankly stated that its projects were

conceived so as to be "technically adapted to the requirements of foreign financing institutions, such as the Export-Import Bank and the Bank for International Reconstruction and Development." ⁴⁵ As Tables 5.4 and 5.5 below indicate, the Eximbank was the major source of foreign financing to which Vargas immediately turned. But this form of international capital transfer was intended to facilitate the inflow of private direct investment by helping to create investment opportunities and by financing essential infrastructure. This was the ultimate aim of the Joint Commission.

One of the first results of the Commission's recommendations was the creation in 1952 of the National Bank for Economic Development (BNDE), a state credit agency to coordinate the implementation of the Joint Commission projects and to act both as a channel for foreign loans and as a provider of local counterpart financing.⁴⁶ In addition, in February 1953 SUMOC Instruction 48, an executive action, abolished the exchange controls and adopted a more flexible exchange rate policy (see Table 4.11 below) aimed at encouraging foreign investment, further indicating Vargas' implementation of the Commission's advice.⁴⁷ But these measures, as we shall see, were also prompted by the need of the Brazilian government to please international creditors in the refinancing of the BOP crisis in 1952-53. As Skidmore observed:

These changes also helped to convince international financial authorities and foreign investors that Brazil was prepared to maintain a measure of financial equilibrium with the outside world by the measured use of the price mechanism and free exchange rates - the classical forces emphasized by the proponents of the neo-liberal formula.⁴⁸

It was with Vargas' mild version of developmentalism, embodied in his National Rehabilitation Plan and the creation of the BNDE, that the postwar alliance of the state sector and international finance emerged. Between 1952 and 1956 the Eximbank was the major source of foreign finance,

often tied to the purchase of U.S. industrial equipment, to the BNDE which channeled the credits to state enterprises engaged in infrastructure and basic industries. The Eximbank provided \$51.6 million to the newly established BNDE, and with its guarantee, the Eximbank provided \$105 million to the National Steel Company (CSN); \$17.4 million to the mining Companhia Vale do Rio Doce; \$15 million to São Francisco Hydroletrica and \$38 million to Loide Brasileiro.⁴⁹ The Banco do Brasil, the largest state controlled commercial bank that provides short-term lending to agriculture, industry and exports, also borrowed \$375 million during the period (1952-54). However, \$300 million of this sum, as will be discussed shortly, was not for productive investment, but for the financing of the foreign exchange crisis in 1952-53. As this study will show, it would become typical for state enterprises and state banks to borrow abroad in order to obtain foreign exchange to cover BOP deficits. In fact, after 1955 this was more the rule than the exception (see particularly chapter 9 dealing with the 1980s).

It is important to stress that the establishment of the BNDE was recommended by the Joint Commission to "create the conditions" for the inflow of foreign capital in the form of long-term loans and to be the agent for channeling the funds to public investments. During the decade of the 1950s, and particularly after 1964, the BNDE became a pivotal link in channeling foreign finance into the Brazilian economy and the guarantor of foreign borrowing by public and private enterprises in Brazil. As we will see in Chapters 7, 8 and 9, the BNDE and its supplementary network of state and regional development banks were at the heart of Brazil's indebted industrialization of the late 1960s and 1970s.

Between 1952 and 1956 the BNDE distributed its credits to the following public sector projects: basic industry (largely steel production), 37 percent; infrastructure (largely electricity), 32 percent, and

transportation, 29 percent.⁵⁰ According to Nathaniel Leff, between 1952 and 1964, approximately 84 percent of the BNDE's finance went to the public sector's industries.⁵¹ However, during the Kubitschek administration (1956-61), in the drive to promote the automotive as well as the electrical appliances industries, private firms, mostly foreign, were classified as "basic industries", which meant that they could receive financial assistance from the BNDE.⁵² Thus, according to Werner Baer, between 1952 and 1962 the BNDE's foreign loans were distributed in the following way: transport, 24.8 percent; electric energy, 25.4 percent; basic industry, 48.1 percent, and agriculture, 1.7 percent.⁵³

Table 5.4 Export-Import Bank Loans to Brazil, 1945-1956

Years	Millions of U.S. Dollars
1940	46.117
1945	47.500
1946	115
1947	7.500
1948	7.378
1949	3.806
1950	36.960
1952	137.995
1953	305.610
1954	2.565
1955	81.812
1956	226.856

Source: Pinto Ferreira, Capitais Estrangeiros e Divida Externa do Brasil (Sao Paulo: Editora Brasiliense, 1965), p. 170

Table 5.5 Eximbank Loans to Brazil, by sectors
1945, 1960 (In millions of U.S. Dollars)

Sectors	Amount
Public (state enterprises and banks)	746.6
Electric Bond and Share	48.5
Other American Firms	69.3
Brazilian Firms	28.0
European Firms	0.8
Non-identified	11.0
TOTAL	904.2

Source: Same as Table 5.4, p. 170.

Yet the major source of funds for state investment and for the state's transference to the private sector under the form of long-term credits through the BNDE came not from foreign loans, but from domestic inflation or "forced savings" (and after 1964, especially from the new employee pension fund, as chapter 7 shows) which served as a mechanism to transfer income from the consuming classes (mainly the wage earner class) to the investing classes.⁵⁴ As Table 6.1 below indicates, the contribution of foreign capital (both loans and direct investment) to Brazil's capital formation during the period 1950-59 was indeed small, only 14.59 percent, but needless to say, the major role of "foreign savings" was - and has always been - to finance current account deficits.

Inflation and populism

It is obvious that the expansion of investments had to be accompanied by an increase in savings and a reduction in consumption. But given the low standard of living of the majority of the Brazilian population in the early 1950s, the surplus would have to come from either the wealthy minority or from the upper categories of the urban workers. The first alternative was attempted through a 15 percent increase in income tax which went to the BNDE funds,⁵⁵ but the second was politically impossible as populist presidents depended on the urban workers for their political base.

Beginning with Vargas, the attempt was made to reconcile a distributive policy with capital accumulation to cement the populist pact of the state bureaucracy, the industrial bourgeoisie, the working class, some sectors of the urban middle class and even the traditional landowners (non-exporting latifundistas) for developmentalism. The result was indirect taxation via inflation which in fact affected wage earners more strongly (Table 5.6 below shows the annual rates of inflation between 1939 and 1966). The weakness of organized labor until the early 1960s made the process

possible. Thus, inflation was the result of populist governments whose overriding aim consisted in winning the allegiance of the urban masses by promising minimum wage increases, improvement in the social insurance system and subsidies for public transportation and basic foodstuff (like wheat and black beans), while at the same time promoting capital accumulation and serving the interests of the industrial and financial bourgeoisie.⁵⁶

It should be noted, however, that after 1955, the government opted for inflation to obtain domestic resources for accumulation, rather than increasing income tax or even holding down the level of consumption of the wealthy minority, because the success of the ISI program of durable goods depended on internal demand and thus on the consumption of the upper and middle classes. Hence, the impossibility of accumulation accompanied by a reduction in the consumption pattern of the wealthy and the necessity of inflation and income concentration.

In 1954 Vargas raised the minimum wage by 100 percent, allowing an increase in real wages of almost 50 percent. Table 5.7A shows the minimum wage, its increase and cost of living increases between January 1952 and February 1964, according to a very conservative source. Table 5.7B shows the median industrial wages between 1949 and 1959, indicating a 31 percent increase in real wages during the period. But as Brazilian economist Paul Singer explains, wages conspicuously lagged behind productivity, which increased 138.5 percent between 1949 and 1959. As employment increased only 18.5 percent as a result of the increasing use of labor-saving technology, there was an increase of 102 percent in labor productivity, of which two thirds were appropriate by capital.⁵⁸ Thus Singer and Bresser Pereira argue that this was at the roots of the brutal income concentration during the period when the richest 5 percent of the population held 27.69 percent of the national income in 1960 and the bottom 50 percent held only

17.71 percent of the income (see Table 7.3 below for the changes in income distribution between 1960 and 1970).

Table 5.7C shows real wage indexes from 1952 to 1974, indicating that after 1958 and until 1964 the working class began to gradually suffer substantial losses in real wages as a result of accelerating inflation (see Table 5.6 below). After 1964 it was a result of deliberate economic stabilization policies of the military regime which is discussed in chapter 7. It is interesting to note in Table 5.7C that the decline in real wages was particularly severe during the Goulart administration (September 1961 to March 1964), usually identified with pro-labor policies (see discussion in chapter 6). As Erickson and Peppe argue, "This type of economic development [dependent development] began reducing unskilled workers' real wages even before the aggressively anti-labor coup of 1964."⁵⁹ This is corroborated by Brazilian economist Lara Resende who shows that real minimum wages fell approximately 20 percent between 1961 and 1964 despite frequent readjustments.⁶⁰ (see Table 7.1 below).

Thus, the privileges granted to the working class by the populist governments were illusory as the prices continued to increase benefitting accumulation. In fact, Baer argues that inflation did have a highly positive effect on Brazil's capital accumulation in the latter part of the 1950s. As the inflation rate increased, so did the rate of real growth, which was, on the average, higher than previously, as Table 5.8 shows. But Baer also shows the effects of inflation on the urban, and particularly, on the rural workers who were not covered by minimum wage legislation until 1964.⁶¹

Economist Raouf Kahil in his Inflation and Economic Development in Brazil shows how and why wage increases granted to the proletariat by the populist regimes were ephemeral:

Whereas the legal money wages were repeatedly raised by presidential decrees, the rapid erosion of real wages, the frequent disappearance of articles of necessity from the urban markets, the deterioration, or relative contraction, in the supply of essential services were obviously caused by the hated speculators and foreign public utility companies. Further, urban workers were far from realizing that their pay increases and the creation of redundant jobs so generously offered by the authorities were to a large extent outweighed by the resulting narrowing of employment possibilities in the private sector (as capital intensive methods of production were displacing labor intensive); and more importantly, that they were nullified by other government measures which resulted in the transfer of increasing resources from the production of popular consumer goods to that of capital and luxury consumer goods. Nor could they understand that their real incomes were directly reduced by the authorities whenever they decreed a substantial rise in the relative cruzeiro price of coffee, permitted too rapid an expansion of bank credit, or took measures that increased the budget deficit, whether to subsidize imports or to expand public consumption and investment. 62

The inequitable effects of inflation, however, could not be clearly discerned by the manipulated working class so long as inflation was moderate and accompanied by rapid GDP growth (see Table 5.8). It was only after 1959, and particularly after 1962, that popular enthusiasm with developmentalist populism gave way to political and social conflict as inflation accelerated, foreign investors and creditors deserted the country and the disequilibrium of Brazil's external accounts could no longer allow economic growth.⁶³ But the roots of the problem began much earlier.

Financial crisis and the origin of Brazil's postwar foreign indebtedness

The major sources of capital to the state for the launching of the early stages of vertical industrialization in Brazil were, therefore, domestic inflation and foreign long-term loans (autonomous loans to finance equipment imports, as explained above). What about export earnings? From 1949 and until 1954 a boom in the export sector (Table 5.14 below) brought enough foreign exchange that could have enabled Brazil to import essential capital goods without recourse to excessive foreign credits. How was the foreign exchange generated by exports spent? Why did Brazil experience its first

Table 5.6 Cost-of-living Index, the State of Guanabara, 1939-1966
(1953=100)

Year	Annual average		December	
	Index	Annual change (percent)	Index	Annual change (percent)
1939	21.6	-	23.1	-
1940	22.2	4.2	24.7	6.9
1941	24.6	10.8	27.7	12.1
1942	27.4	11.4	32.4	17.0
1943	30.3	16.6	33.8	4.3
1944	34.1	12.5	38.7	14.4
1945	39.7	16.4	44.1	14.0
1946	46.3	16.6	53.5	12.1
1947	56.4	21.8	56.7	6.0
1948	58.3	3.4	58.7	3.5
1949	60.9	4.5	62.2	6.0
1950	66.5	9.2	69.1	11.1
1951	74.5	12.0	76.6	10.9
1952	87.4	17.3	92.5	20.8
1953	100.0	14.4	108.0	16.8
1954	122.4	22.4	136.3	26.2
1955	150.7	23.1	162.4	19.1
1956	182.2	20.9	197.6	21.7
1957	211.9	16.3	224.0	13.4
1958	242.9	14.6	262.7	17.3
1959	338.0	39.1	399.4	52.0
1960	437.4	29.4	494.3	23.8
1961	582.9	33.3	707.7	43.2
1962	884.0	51.7	1099.0	55.3
1963	1507.0	70.4	1985.0	80.6
1964	2889.0	91.7	3704.0	86.6
1965	4787.0	65.7	5385.0	45.4
1966	6764.0	41.3	7600.0	41.1

Source: Mario Henrique Simonsen, "Inflation and the Money and Capital Markets of Brazil", in *The Economy of Brazil*, ed. Howard S. Ellis (Berkeley: University of California Press, 1969), p. 136, Table 1.

Table 5.7A Brazil: Minimum Wage (State of Guanabara)
1952-1964

Date of Readjustment	Minimum Wage (NCr\$/month)	Increase as percent of previous wage	Increase (%) in cost of living since previous Readjustment
Jan. 1952	1.20	-	-
July 1954	2.40	100.0	54.4
August 1956	3.80	58.3	51.4
January 1959	6.00	57.9	47.8
October 1960	9.60	60.0	70.0
October 1961	13.44	40.0	42.2
January 1963	21.00	56.3	67.1
February 1964	42.00	100.0	109.5

Source: Eugenio Gudin, "The Chief Characteristics of the Postwar Economic Development of Brazil", in The Economy of Brazil, ed. Howard S. Ellis (Berkeley: University of California Press, 1969), p. 17, Table 12.

Table 5.7B Median Industrial Wages, 1949-1959

Year	Annual medium wage (Cr\$ old)	Index (1949=100) Wage	Cost of living (Rio de Janeiro)	Real Wage
1949	11.800	100	100	100
-				
1952	17.550	149	143	104
1953	20.000	170	164	104
1954	26.500	225	200	113
1955	32.500	275	247	112
1956	42.300	359	298	121
1957	53.000	450	347	130
1958	61.400	520	399	130
1959	85.000	720	551	131

Source: Paul Singer, A crise do "milagre", Interpretacao critica da economia brasileira (Rio de Janeiro: Paz e Terra, 1982), Sexta Edicao, p. 42, Tabela 7.

Table 5.7C Index of Annual Average of Real Monthly Minimum Wage in Guanabara, Brazil: 1952-1974

Year	Real wage index (1960=100)	Year	Real wage Index (1960=100)
1952	95	1963	92
1953	83	1964	90
1954	115	1965	82
1955	113	1966	76
1956	105	1967	75
1957	134	1968	73
1958	101	1969	71
1959	115	1970	69
1960	100	1971	69
1961	115	1972	71
1962	100	1973	75
		1974	71

Source: Kenneth Paul Erickson and Patrick V. Peppe, "Dependent Capitalist Development, U.s. Foreign Policy, and Repression of Working Class in Chile and Brazil", in Latin American Perspectives 3 (Winter 1976), p. 23, Table 4.

Table 5.8 Real Domestic Product and Industrial Production (average annual growth rate by period)

Period	Real Domestic Product (%)	Industrial Output (%)
1940-1945	4.7	6.2
1946-1950	7.3	8.9
1951-1955	5.7	8.1
1956-1961	6.0	11.0
1962-1965	1.9	2.4

Source: Luis Bresser Pereira, Development and Crisis in Brazil, 1930-1983 (Boulder, Colorado : Westview Press, 1984), p. 22, Table 2.1

serious postwar financial crisis in 1952 and 1953 during such a favorable condition in the international market?

Tables 5.2 and 5.3 above and 5.10 below show that after the postwar exhaustion of foreign exchange reserves, the growing deficit on the current account of the BOP, the result of invisible foreign services (heavy

repatriation of profits by foreign firms exceeding net inflows, dividends, foreign transport and debt service) was financed by short-term foreign loans (compensatory loans from the IMF and commercial arrears and credit). The trade surplus of those years was thus not enough to cover both imports and foreign services which now included, in addition to the continuation of heavy outflow of profits by foreign firms, interest and amortization on the old and new loans (both autonomous for equipment imports and compensatory loans for BOP support). The situation worsened in 1951 and 1952 when Vargas relaxed the exchange controls to permit stockpiling of imported industrial material during the Korean War. A financial crisis eventually erupted in 1952-53 as the current account deficit jumped from \$468 million in 1951 to \$707 million in 1952.⁶⁴

Table 5.9 shows the BOP and its disequilibrium for the period 1950-56. Although imports in fact increased from \$934 million in 1950 to \$1.7 billion between 1951 and 1952 and Brazil recorded a trade deficit in 1952 of \$243 million,⁶⁵ the country had a trade surplus above \$1.5 billion in the period as a whole. The surplus was insufficient, however, to cover the service account which accumulated a deficit near \$2.5 billion, in addition to amortization on loans of \$652 million which is recorded in the capital account. Thus, Brazil reverted to its previous debtor role with annual deficits on the current account of \$138 million. With the refinancing of the BOP crisis in 1953, Brazil's foreign public debt nearly doubled, from \$638 million at the end of 1952 to \$1.2 billion at the end of 1953.⁶⁶

Table 5.10 shows the source of foreign financing of the external disequilibrium according to the nature of the operations between 1947 and 1955. In 1951 and 1952 the BOP deficit was financed by a huge backlog of commercial arrears and IMF compensatory loans. In 1953, the deficit had to be refinanced with short- and medium-term compensatory loans from the Eximbank in the amount of \$300 million at higher rates of interest (around 4.5 percent),

even though the trade account was in surplus in that year (\$423 million), revealing the vexatious deficit in the service account (Tables 5.3 above and 5.14 below). After the increase in imports in 1951 and 1952, Brazil could not cover \$541 million in 1952 which were recorded in commercial arrears and credits. To regularize the payments Vargas resorted, in addition to the U.S. Eximbank, to European commercial banks which lent \$158 million. This rescue operation was repeated in 1954, with American commercial banks lending \$200 million, guaranteed by Brazil's gold reserves, to cover imports not yet paid for. It was also in 1953 that the first swap operations occurred, obtaining \$48 million in 1953 and \$71 million in 1964.

A brief note on swap operations is necessary at this point. So-called swap operations consist of foreign exchange obtained by the Brazilian monetary authorities through the headquarters of TNCs operating in Brazil. The government, in return, provides the subsidiaries the amount equivalent in the local currency (at that time cruzeiros). At the end of the swap operation's term (short-term, usually one year), the subsidiary provides the cruzeiros to the monetary authorities who, in turn, pay the headquarters in dollars. Swap operations were a loss to the Brazilian government and as Conjuntura Economica argues, "generated external commitments which touched the very limits of the country's sovereignty."⁶⁷

The short-term character of swap operations and the risk involved in the exchange generated great transference of capital from Brazil to the foreign creditors. Although the subsidiary of foreign firms provided the same amount of cruzeiros received initially, the Brazilian monetary authorities had to acquire dollars at the high rates prevailing in the exchange market. In 1965, for example, the military government had a loss of Cr\$330 billion with the exchange risk, representing half of the deficit

of the treasury in that year.⁶⁸

In the meantime, the foreign exchange crisis in 1952-53 marked the origin of Brazil's postwar external indebtedness, and the short-term relief had a political price: the imposition of stabilization policies in Brazil demanded by foreign creditors and which contributed to the political crisis that cost Vargas his life.

The political consequences of financial dependency

Brazil's increasing indebtedness, BOP deficits and the fear of foreign creditors that their loans were in jeopardy were the precipitating factors for stabilization in Brazil in 1953. And it was a political liability for Getulio Vargas. The institution of exchange liberalization and the implementation of a wage and credit freeze would threaten the political order by generating intensive opposition and social agitation. Vargas began pursuing a contradictory economic policy with orthodox and nationalist content, aimed at cushioning the negative effects that austerity would bring to his political base, particularly the working class. As Skidmore observed: "He would need political 'cover' for the stabilization plan then in formulation. A vigorous pro-labor approach would help to provide this cover."⁶⁹ Thus, Vargas found in nationalism and radical populism the short-run solution to the difficulties imposed by Brazil's heavy burden of foreign indebtedness.⁷⁰

Vargas reorganized his ministry to be able to introduce the stabilization measures without antagonizing his political base. The new Finance Minister was his old friend Oswaldo Aranha, known for his connection with foreign financiers (see chapter 4). But the new Labor Minister was João (Jango) Goulart, a politician who had the reputation of collaboration with communist and other militant labor leaders. Thus, while courting the proletariat, Goulart's appointment alarmed center opinion, industrialists,

Table 5.9 Brazil: Balance of Payments, 1959-56
(millions of US dollars)

Goods and Services	
1. Merchandise Trade (FOB)	1,536.0
2. Services (net)	-2,458.0
2.1 Travel	- 109.0
2.2 Transportation	-1,117.0
2.3 Interest payments	- 253.0
2.4 Investment income (profits remittances by D.F.I.)	- 340.0
2.5 Government	- 187.0
2.6 Other private	- 452.0
3. Transfers	- 46.0
Current account	- 968.0
Annual average	- 138.3
Capital account (source of foreign financing of the current account)	
1. Loan capital	636.0
1.1 Autonomous loans (import financing)	569.0
1.2 Compensatory loans (BOP support)	719.0
1.3 Amortization	- 652.0
2. Risk capital	173.0
2.1 Direct foreign investment	173.0
2.2 Brazilian investment abroad	-
3. Other capital	- 92.0
3.1 Commercial arrears and credit	- 156.0
3.2 Subscriptions and contributions	-
3.3 Other	64.0
Total capital inflows (net)	717.0
Annual average of inflows	102.4

Source: Conjuntura Economica, op.cit., Tabela 1 and Tabela 2, pp. 169 and 171.

Table 5.10 Sources of Financing of External Disequilibrium, by the nature of the operation, 1947-55 (in million of US dollars)

	1947	1948	1949	1950	1951	1952	1953	1954	1955
1. Autonomous loans (import financing)	32	9	40	28	38	35	44	105	143
1.1 Equipment	...	...	...	...	...	...	...	...	84
1.2 Wheat	...	...	...	...	...	...	...	...	-
1.3 Currency	...	...	...	...	...	...	...	...	59
2. Compensatory loans (BOP support)	142	-41	65	-110	49	512	-30	224	67
2.1 Commercial arrears and credits	72	-22	28	-106	26	541	-563	-46	-8
2.2 Financing and refinancing operations	70	-56	38	-3	24	-28	486	200	61
2.2.1 IMF	-	-	38	-	28	-28	28	-	-
2.2.2 Eximbank	-	-	-	-	-	-	300	-	45
2.2.3 USA Treasury	-	-	-	-	-	-	-	-	-
2.2.4 AID	-	-	-	-	-	-	-	-	-
2.2.5 USA Banks	-	-	-	-	-	-	-	200	-
2.2.6 European Banks	-	-	-	-	-	-	158	-	-
2.2.7 Other	70	-56	-	-3	-4	-	-	-	16
2.3 Swap operations	-	-	-	-	-	-	48	71	15
2.4 Gold	-	37	-1	-1	-1	-1	-1	-1	-1
3. TOTAL (1+2)	174	-32	105	-82	87	547	14	329	210

Source: Same as Tables 5.2 and 5.9, p. 172, Tabela 3.

middle class voters and conservative military officers, and triggered the strongest attacks from the extreme right-wing opposition, the UDN.

In October 1953 the "Aranha Stabilization Plan" was announced. This orthodox plan consisted of the abolition of the exchange controls and the institution of exchange liberalization, in addition to removing any limitations on the remittance of profits and dividends by foreign firms and interest and amortization on loans.⁷¹ The new "multiple exchange system" established by SUMOC Instruction 70 to allow most international transactions at the "free market" rate had a twin objective: to stimulate the inflow of foreign capital (and, of course, foreign exchange to bring relief to the BOP) and to expand exports for it was a de facto devaluation of the cruzeiro, by making exports cheaper and imports expensive, thus reducing demands for foreign exchange and correcting the BOP deficit.

Under the "multiple exchange system", the government allotted a fixed sum of foreign exchange to each of several different categories of imports, from those considered most essential to luxury goods. This exchange was auctioned off to the importers willing to pay the highest price for it. Through this system the traders were forced to pay a higher price for the privilege to import, thus reducing their windfall profits and diverting the extra cruzeiros into the government treasury. The effect was a multiple exchange rate system, with the rate within each category determined by supply and demand. This multiple exchange rate was also used to subsidize the domestic price of wheat and oil, two imports which had an immediate impact on urban consumers, in the form of bread and buss fares.

According to Payer, this is the continuum of the IMF's exchange rate preferences:

1. stable, unitary exchange rate; devaluation when necessary, but infrequently;

2. "floating" or "crawling peg" exchange rates (permitted where stable rate could not be maintained without tightening controls;
3. simple multiple exchange rates; perhaps only two rates, with the majority of transactions at the "free market" rate;
4. complex multiple exchange rate systems;
5. exchange controls
6. state trading, as in centrally planned economies where the exchange rate has no effect on trading decisions. ⁷²

Thus, Brazil moved from item no. 5 to no. 4 of the IMF preferences in 1953. But in 1957, again under pressure of the IMF and GATT, the government ended the complex multiple exchange rates and reduced the number of exchange categories from 5 to 2, thus moving from no. 4 to no. 3 of the IMF list. In 1961, UDN President Quadros reformed the foreign exchange system and all transactions were to take place at the free market rate, but soon after his resignation the subsidies of wheat and oil crept back. The subsidies were a major problem for Goular (see chapter 6). With the military coup in 1964 and the subsequent orthodox stabilization program, Brazil moved to no. 2 of the IMF preferences (see chapter 7).

But in addition to the new exchange rate system, Vargas also began to expropriate a portion of coffee's foreign exchange earnings in order to finance the BOP deficit and also essential industrial imports, angering the export sectors who turned against him. Under the so-called "confisco cambial" (exchange confiscation), coffee exporters had to convert their dollar earnings at an exchange rate considerably lower than the rates paid by importers. According to Leff, through this taxation, the government was able to appropriate for itself 50 percent in some years of the value of coffee exports.⁷³ This system of confisco cambial was in force between 1953 and 1963.

The practical effect of the multiple exchange rate system was that imports fell from \$1.5 billion between 1951 and 1952 to \$1.1 billion in 1953 (see Table 5.14 below). But the new system also served as a powerful

Table 5.11 Exchange Rate
(Cr\$ per unit; Annual average)

Year	U.S. Dollar		Pound Sterling	
	Free Market	Official Rate	Free Market	Official Rate
1945	-	19.50	-	78.90
1946	-	19.42	-	78.28
1947	-	18.73	-	75.41
1948	-	18.72	-	75.42
1949	-	18.72	-	69.88
1950	-	18.72	-	52.42
1951	-	18.72	-	52.42
1952	-	18.72	-	52.42
1953	43.32	18.72	117.75	52.45
	-	25.82	-	72.05
1954	62.18	25.82	169.81	72.05
	-	33.82	-	94.57
1955	73.54	33.82	203.12	94.57
	-	43.82	-	120.62
1956	73.59	43.82	203.17	120.62
1957	75.67	43.82	206.76	120.62
	-	51.32	-	143.54
1958	130.06	51.32	370.87	143.64
	-	70.00	-	195.95
	-	80.00	-	223.95
1959	159.83	100.00	434.56	279.81
1960	199.26	100.00	554.28	279.81
1961*	274.85	100.00	694.25	279.81
	-	200.00	-	559.83

* First half

Source: Werner Baer, Industrialization and Economic Development in Brazil (Homewood, Ill.: Richard D. Irwin, Inc., 1965), pp. 271, 272, Table 3A-3 (D).

instrument for channeling imports towards sectors considered essential for industrialization. According to Leff, Instruction 70 was the major instrument of protection offered to the growing domestic ISI industries until 1956-57 when tariff legislation (tariffs as high as 60, 80 and 150 percent) was passed. Leff argues that:

The new system also put the de facto protection given many industrial products on a much firmer institutional basis. Protection was no longer considered as an emergency response to a transitory balance of payments crisis but was looked upon as an established institution for dealing with a long-term problem. The selection of priorities for importation also constituted a more conscious effort to develop ISI of manufactured products. Hence, Instruction 70 proved to be a major milestone⁷⁴ in Brazilian protection and policy support for industrialization.

Yet Instruction 70 also benefitted capital outflow from Brazil. As Table 5.3 above shows, the year 1953 recorded the largest remittance of profits by foreign firms between 1947 and 1963: \$94 million, while the inflow of risk capital was only \$22 million. Also in 1954, capital outflow continued, amounting to \$53 million, while inflows were only \$11 million. Thus, the liberalization demanded by foreign creditors did not reverse the situation of the BOP. Rather, it contributed to causing yet more deficits and dependence on loans to cover them.

Nationalism and populism: cover for orthodox stabilization

To initiate the implementation of the second part of the stabilization program, deflationary monetary and fiscal policy, Vargas began pursuing a nationalist strategy aimed at diverting popular attention. The first step was the Petrobras bill which became law also in October when the Aranha stabilization plan was announced.

In 1951 Getulio Vargas had proposed the creation of a state enterprise which would be given a monopoly of the drilling of oil.⁷⁵ The proposal to nationalize Brazil's oil gave rise to a long political battle, but between 1952 and 1953 the debate over oil policy and the need to exclude

foreign investment (mainly American) from this strategic industry, turned into a radical nationalist campaign with the Communist Party at the vanguard.

Vargas joined the attacks of the left on foreign imperialism even after the bill had become law. Thus, on December 21, 1953, the President publicly charged that his plans for Petrobras and his new proposal for Eletrobras (a similar state solution for the area of electrical power in the hands of foreign firms) were being "sabotaged by private enterprises which have in cruzeiros two hundred times the capital that they invested in dollars, so that they can send it abroad labeled as dividends...Instead of dollars producing cruzeiros, it is cruzeiros that are producing dollars and emigrating." 76

Vargas was right in his charges against capital outflow. The President, however, was using this nationalist rhetoric against foreign companies simultaneously with the exchange liberalization put into practice and which was a clear invitation to foreign investment in Brazil! Furthermore, the creation of Petrobras was more than a sign of "authentic" nationalism. It was also the result of deliberate investment policy in a bottleneck area recommended by ECLA. But the nationalist appeal of the campaign was useful to build public support and particularly to divert workers' attention from the deflationary policy as the issue aroused great enthusiasm among them.

The nationalist aspect of Vargas' strategy, however, deepened political divisions in Brazil. As the Communist Party was at the center of the strong anti-foreign campaign, the extreme right-wing UDN used the Marxists to spread fears among the conservative middle class and the traditional classes who opposed industrialization (the export sectors) that a communist revolution would be the next logical step. Vargas public identification with left-wing radicalism also alarmed center opinion, particularly the staunch anti-communist military. The President's strategy

of combining nationalist rhetoric and practical orthodox policy, therefore did not succeed in harnessing the support of all domestic groups in Brazil.

The military, however, was divided on the issue of foreign capital in the oil industry. According to Ianni, between 1947 and 1953 two positions were delineated:

In 1947 when the debate on the petroleum problem in Brazil became public, two generals were identified with or delineated the principal positions. General Juarez Tavora proclaimed an "accommodation to national and foreign interests." Considering the same relations of the national economy with world capitalism, General Horta Barbosa adopted different conclusions. "Research, extraction and refining constitute parts of a whole whose possession ensures economic and political power. Petroleum is a resource for collective use, a creator of wealth. It is not admissible to confer on a third party the exercise of an activity that conflicts with national sovereignty. Only the state should exploit it in the name and in the interest of the highest ideals of the people." This was the orientation that prevailed in the law that created Petrobras six years later. It is important to remember, however, that the period from 1947 to 1953 was saturated with major political struggles involving students, the proletariat, elements of the middle class, the military, intellectuals, politicians, police, Standard Oil of Brazil, connivances, conciliations, and violence.⁷⁷

Vargas' nationalism also angered American businessmen and bankers who regarded the creation of Petrobras as an act of "irresponsible radicalism."⁷⁸ Furthermore, relations with the U.S. were already strained as the new administration in Washington was openly hostile to the extension of public aid to developing countries. President Eisenhower formally terminated the Joint US-Brazil Economic Commission and stressed the need for Brazil to create the proper "climate" for private U.S. investment.⁷⁹

This new U.S. policy, in turn, strengthened the arguments of radical nationalists who charged that the U.S. was aiming at protecting the interests of American capital whose *raison d'etre* was the extraction of excessive profits from Brazil. Again, Vargas joined the left's attacks and stepped up his nationalist rhetoric, but Aranha's orthodox stabilization program was also being implemented.

In a speech on January 31, 1954, Vargas charged that foreign firms were not only remitting excessive profits, they were also committing fraud in their invoicing of shipments so as to take illegal profits out of Brazil. In fact, capital outflow continued until 1955 (see Table 5.3 above) and BOP problems persisted despite the exchange reforms and a sharp cut in imports. Most important, the drastic fall in the value of Brazil's exports of primary products, particularly coffee, in the international market in the wake of the 1953 foreign exchange crisis, exacerbated BOP pressures and reinforced Brazil's dependence on short-term foreign financing such as swap operations (Table 5.10 above).

Vargas, of course, had continued with the coffee valorization policy discussed in chapter 4 in order to maximize foreign exchange earnings. The policy, however, backfired in 1954. Early that year coffee prices had reached record levels in the New York market (97 cents a pound). But the Brazilian government insisted on maintaining a price above even the rising market level which resulted in a boycott of Brazilian coffee by the American market. The government attempted to peg the price of coffee to 87 cents per pound (50 percent above its high December 1953 price and more than six times the 1945 level). As a consequence, other coffee producers took up the slack and the volume of coffee exports fell in 1954 by 30 percent and their dollar value by 13 percent, thus contributing to the \$230 million deficit in the BOP on current account in 1954.⁸⁰

According to Cardoso and Faletto, when the price of coffee began to weaken on the world market in 1954,

...the Vargas alliance reached its limits. Part of the sector joined the urban middle class opposition to which were added not only domestic but also international financial groups. A new fall in coffee prices was seized upon by the United States to bring pressure to bear on Vargas, whose nationalist policy had gone rather far.⁸¹

But what put an end to Vargas' populist alliance was the implementation of the second aspect of the orthodox economic stabilization package - anti-inflationary measures - demanded by international financial interests and supported by conservative domestic sectors tied to foreign capital, particularly the sectors around the UDN.⁸² Getulio Vargas' nationalist posture to deal with credit and wage freeze was untenable as this policy would affect directly his political base which he was attempting to maintain. With working class demands for wage increases to compensate for growing inflation and the pressure of the industrial bourgeoisie -already hurt by the devaluation of the cruzeiro which made imports very expensive - for the continuing access to easy credit, deflationary monetary and fiscal policies would be a political liability for Vargas.

GDP growth rate in 1953 had fallen from 8.7 percent in 1952 to 2.5 percent and per capita GDP from 5.6 percent in 1952 to -0.5 percent in 1953.⁸³ By the early months of 1954, the median wage of industrial workers had fallen in terms of food by nearly 26 percent from its 1946 level and the price of clothing had risen even more sharply.⁸⁴ It was thus expected that the government should attempt to redress the balance by raising the minimum wage. According to Kahil, the stabilization program could still succeed if wages were kept to a non-inflationary level.⁸⁵

Workers' strikes and demonstrations demanding wage increases were sweeping the country, and in order to court the proletariat, in February 1954 Goulart, the Labor Minister, called for 100 percent increase in the minimum wage of commercial and industrial urban workers. Significantly, Goulart was dismissed on the same day representing an important concession by Vargas to the industrial bourgeoisie, the middle class and particularly the military.⁸⁶ It was also a reassurance to international financial centers of his commitment to stabilization measures. But it also showed the president's

political weakness and his loss of control over the situation as Goulart had been the key to his populist strategy to serve two masters: the Brazilian working class and the country's foreign creditors.

Now Vargas felt an even stronger need to assume an anti-foreign nationalist posture in order to cover his stabilization program and court the working class. In his annual message to congress on March 15, 1954, the President reported that the "free exchange market has proved itself an inadequate instrument for achieving the objectives which led to its creation: it has not led to an expansion of exports, nor stimulated the inflow of capital." He explained that the disequilibrium in the BOP was neither "transitory nor superficial", but the symptoms of "a profound structural crisis in the area of our relations with the foreigners - with grave repercussions on the internal economy of the country."⁸⁷

The structural nature of BOP deficits

Vargas' charges were quite correct. BOP deficits in Brazil are indeed of a structural nature, that is, mainly the result of invisible foreign services. As Conjuntura Economica explains:

Balance of payments disequilibrium of developing countries result from two causes: (1) fall in the value of their primary products in the international market or excess imports and (2) growing capital transfers to the industrialized countries through foreign services (transport, debt service, technical assistance, royalties, profit remittances, travel). The first (trade deficit) is characterized as of a conjunctural nature (such was the case in Brazil in 1951 and 1952), that is, of a short-term nature and the IMF was designed to deal with this type of BOP disequilibrium. The second (service deficit) is of a structural nature, difficult to be removed. The removal of such deficits would require that the developing countries with increasing disequilibrium attained continuous large surpluses in the trade balance, as the only alternative to growing foreign indebtedness. On the other hand, high volumes of direct foreign investment have been recommended as an alternative, although the final effect on the BOP is debatable.⁸⁸

Tables 5.12 and 5.13 below, based on ECLA's calculations, show the heavy burden of foreign capital servicing (foreign direct investment and foreign debt) during Vargas years and which was aggravated in the subsequent

period. Table 5.13 shows the percentage of foreign exchange earnings (mainly exports) that Brazil had to spend on foreign capital servicing. Thus, the so-called inadequate import capacity of Brazil during the 1950s must be largely attributed to the enormous proportions of its foreign exchange earnings spent on invisible foreign services and not only to the deterioration of the terms of trade as ECLA had previously argued.

Furthermore, Table 5.14 indicates Brazil's purchasing power of exports and import capacity for the period 1947-1963. Column 2 shows the slowly deteriorating terms of trade after 1954. But an even more disturbing development is revealed in columns 4 to 8: because of the increasingly heavy burden of foreign exchange payments for services and debt amortization, Brazil's current capacity to import not only remained unchanged, but actually declined from 1956 onwards, and its industrialization thus became more and more dependent on the net inflow of foreign capital. As the latter increased from 1952 onwards, however, total import capacity continued to expand almost continuously, but only until 1959. It dropped by nearly a third in 1960; and though it rose again in 1961, it remained in the following two years far below the level it had reached in the mid-fifties (this problem is discussed in depth in chapter 6).

The above argument is corroborated by Brazilian economist Maria da Conceição Tavares who argues that:

As a result of the decline of exports after 1954 and the increase of the foreign debt, Brazil's import capacity was reduced. If imports of essential intermediary goods are added to the service of loans, we can see that the balance to import other goods and services had already been reduced in 1959 by less than 30 percent of export earnings. Therefore, only with a new inflow of capital could Brazil maintain total imports.⁸⁹

Tavares shows that the balance to import other goods and services (among which industrial equipment predominated), fell from \$1 billion in 1953 to \$940 million in 1954, \$783 million in 1955 until it was reduced to

Table 5.12 Brazil: Service Payments on Long-Term Foreign Capital
(millions of dollars), 1946-1960

Years	Direct Investment Income ^a (1)	External Long-term Debt Service			Total Service payments on long- term foreign capital (1+4) (5)
		Interest ^b (2)	Amorti- zation ^c (3)	Total (2+3) (4)	
1946-50	298.8	99.0	512.9	611.9	911.7
1951-55	509.0	208.0	575.0	783.0	1,292.0
1956-60	297.0	461.0	1,551.0	2,012.0	2,309.0

^aIncludes reinvested earnings

^bCovers interest paid by Brazilian residents on short- and long-term liabilities to foreigners

^cCovers reimbursements on long-term loans granted to Brazilian official and private sector, including reimbursements on deferred import payments and balance of payments loans. The figures have been adjusted to exclude some large reimbursements on deferred import payments which were immediately refinanced by BOP loans (\$300 million in 1953).

Source: ECLA, External Financing in Latin America (New York: United Nations, 1965), p. 191, Table 157.

Table 5.13 Brazil: Service Payments on Long-term Foreign Capital as percentage of foreign exchange earnings on current account

Years	Direct Investment Income	External Long-term Debt Service	Total Service Payments on long-term Foreign capital
1946-50	5.0	10.1	15.1
1951-55	6.2	9.5	15.7
1956-60	4.0	26.5	30.5

Source: Same as Table 5.12 above, p. 199, Table 163.

Table 5.14 Purchasing Power of Exports and Import Capacity (million US dollars of 1953)

Years	Value of Exports (1)	Effect of movement in terms of trade (2)	Purchasing Power of Exports (3)	Services Net (4)	Amortization (5)	Current Import Capacity (6)	Net inflow of capital (7)	Total Import Capacity (8)	Total Imports (9)
1947	1,961	-1,079	882	-195	- 36	651	33	684	778
1948	2,005	-1,122	883	-204	- 46	633	20	653	675
1949	1,803	- 847	956	-202	- 93	661	37	698	824
1950	1,562	- 109	1,453	-304	- 91	1,058	31	1,098	1,004
1951	1,686	- 84	1,602	-418	- 24	1,160	35	1,195	1,521
1952	1,375	- 138	1,237	-292	- 53	992	57	1,049	1,480
1953	1,539	-	1,539	-554	- 46	1,139	91	1,230	1,116
1954	1,331	453	1,784	-391	-154	1,239	128	1,367	1,618
1955	1,526	275	1,801	-390	-177	1,234	168	1,402	1,392
1956	1,665	217	1,882	-466	-237	1,179	413	1,592	1,324
1957	1,530	260	1,790	-459	-310	1,021	574	1,595	1,647
1958	1,480	281	1,761	-434	-456	871	675	1,546	1,661
1959	1,806	163	1,969	-574	-580	815	850	1,665	1,862
1960	1,813	18	1,831	-681	-594	556	625	1,181	1,874
1961	1,976	- 59	1,917	-499	-434	984	878	1,862	1,770
1962	1,812	- 290	1,522	-404	-353	765	534	1,299	1,630
1963	2,045	- 348	1,697	-317	-422	958	358	1,316	1,598

Notes: (4) Includes transferred income from foreign capital and (7) middle- and long-term capital, excluding reinvestment and compensatory financing. Trade deficits occurred in 1947, 1952, 1960 and 1962.

Source: Raouf Kahil, Inflation and Economic Development in Brazil, 1946-1963 (Oxford: Clarendon Press, 1973), p. 198, Table V.3.

only \$370.9 million in 1959.⁹⁰ It was in these circumstances of a deteriorating BOP that the developmentalist alliance redefined its position vis-a-vis foreign capital, whose entry in the country after 1955 became highly favored. But as we already know by now, foreign capital is the very cause of the deficit it finances. As we will show in chapter 6, the crisis of the early 1960s was again the result of financial dependency.

The end of stabilization and of Vargas

The data presented above thus confirm Vargas' charges against capital outflow. But the President was using this argument, again, as a nationalist cover for his deflationary policy and this proved to be impossible to rally working class support. In fact, it succeeded in alienating the workers who were waiting for their wage increase and who had suffered the most severe losses during the stabilization. According to Erickson, the labor ministry's expenditures averaged 1.4 percent of total annual outlays during 1953-54 as compared to 2.4 percent between 1951-52 and the spending cuts came most from social security funds.⁹¹ During 1951 and 1952, transfer allocations for social welfare averaged 79 percent, but between 1953-54, those transfers dropped to less than 37 percent.⁹²

Furthermore, with Goulart gone and with an eye on the 1955 presidential elections, the opposition concentrated the attacks on Vargas himself. The UDN and the conservative press's inflammatory charges of corruption and subversion were reinforced by declarations of a Vargas' former foreign minister, that the President was secretly negotiating with Peron of Argentina the formation of a block against the U.S. The fears of a syndicalist state were duly exploited by the UDN among the middle class, the industrial bourgeoisie and particularly the military.⁹³ Vargas' blend of orthodoxy and nationalism was no longer effective and the policy turned into the weapon of the opposition.

With almost all social groups against him, Vargas threw himself in a bold populist strategy to rebuild working class support. On May 1, the international workers' holiday, Vargas announced in an aggressive speech that the increase in the minimum wage would be 100 percent.

The opposition of the industrialists, the middle class and the military was quickly mobilized against Vargas' actions on the minimum wage. The working class, however, deprived by Vargas himself of organizational autonomy did not mobilize in his support. According to Skidmore, the President did not make any effort to mobilize the workers, indicating that the populist strategy rested on a mere threat.⁹⁴

Vargas' supporters within the Palace officials, however, attempted to assassinate the leader of the UND's inflammatory anti-Getulista campaign, the journalist Carlos Lacerda, apparently without the President's prior knowledge (the assassination attempt was traced to the personal body-guard of Vargas). The political scandal provided the army with the opportunity to demand the President's resignation. But on August 24, 1954, Vargas responded by committing suicide leaving the famous letter in which he made his strongest nationalist appeal:

Once more the forces and interests against the people are newly coordinated and raised against me...A subterranean campaign of international groups joined with national groups revolting against the regime of workers' guarantees. The law of excess profits was stopped in Congress. Hatreds were unchanged against the justice of a revision of minimum salaries...I assumed the government during an inflationary spiral that was destroying the value of work. Profits of foreign enterprises reached 500 percent yearly. In declarations of goods that we import there existed frauds of more than \$100,000,000. I saw the coffee crisis increase the value of our principal product. We attempted to defend its price and the reply was a violent pressure upon our economy to the point of being obliged to surrender...I fought against the looting of Brazil. I fought against the looting of the people. I have fought bare-breasted. The hatred, infamy and calumny did not beat down my spirit. I gave you my life. Now I offer my death. Nothing remains. Serenely I take the first step on the road to eternity and I leave life to enter history. ⁹⁵

In summary, chapter 5 showed the economic and political consequences of a new situation of dependency that began with the return of the free trade doctrine and the exhaustion of foreign exchange reserves in the early postwar years. The acceptance of economic liberalism by the Brazilian political elites, with the resulting deterioration of the country's external accounts, thus set the pace for much of what was in store for its capitalist development in the future: any industrialization program could only continue on the basis of reliance on foreign loans to finance the high levels of essential imports and the servicing of foreign direct investment, which during the period was particularly onerous.

Indeed, the process of financial dependency and its contradictions began precisely when the second Vargas administration (1951-54) quickly integrated Brazil into the postwar international financial system. It thus initiated a policy with orthodox and nationalist contents in order to conciliate the interests of Brazil's heterogeneous political forces for the launching of the early stages of vertical ISI in the country. As we showed, the major features of the postwar economy were once again the same that characterized classic dependence: foreign indebtedness, massive transfer of resources abroad, BOP crises, inflation and the external constraint on state autonomy expressed in the form of pressure from Brazil's creditors. For the democratic populist regime, however, these traditional external constraints were especially severe because it was impossible to reconcile the interests of international finance for orthodox stabilization measures with those of its domestic political base, particularly the working class. Yet this externally conditioned growth model with its political liabilities was consolidated in the mid-1950s by the populists and ultimately destroyed the democratic system of Brazil.

NOTES

1. See Barbara Stallings, Banker to the Third World: U.S. Portfolio Investment in Latin America, 1900-1986 (Berkeley: University of California Press, 1987) and Joan Edelman Spero, The Politics of International Economic Relations (St. Martin's Press, 1985), Third Edition.

2. See Sonia Regina de Mendonça, Estado e Economia no Brasil: Opções de desenvolvimento (Rio de Janeiro: Graal, 1986), p. 40.

3. See Kenneth Paul Erickson, "Brazil: Corporative Authoritarianism, Democratization and Dependency", in Howard J. Wiarda and Harvey F. Kline (eds.), Latin American Politics and Development (Boulder, Colorado: Westview Press, 1985), Second Edition, p. 176 and Mendonça, Estado e Economia no Brasil, pp. 40-41.

4. Mendonça, p. 43.

5. Erickson, "Brazil: Corporative Authoritarianism", p. 174.

6. Vargas' political career did not end, of course, with this coup. In 1946 he was elected Senator in two states and deputy in six states and the Federal District. He accepted a PSD senate seat from his home state of Rio Grande do Sul. In the democratic election of 1950, Vargas won the presidency.

7. Politics in Brazil, 1930-1964: An Experiment in Democracy (New York: Oxford University Press, 1967), p. 56.

8. Erickson, "Populism and Political Control of the Working Class in Brazil", in Proceedings of the Pacific Coast Council on Latin American Studies Vol. IV, 1975, p. 118.

9. See Guido Mantega, A economia politica brasileira (São Paulo: Polis/Vozes, 1984), p. 26.

10. Quoted in Warren Dean, The Industrialization of São Paulo (Austin: University of Texas Press, 1969), p. 235.

11. Quoted in Skidmore, Politics in Brazil, p. 70.

12. As chapters 5 and 6 show, treating the period under consideration as a whole (1945-64), Brazil had trade deficits only in 1947, 1952, 1960 and 1962. Although the terms of trade did deteriorate in the 1950s, the chronic current account deficit on the BOP was caused primarily by the service account (foreign services, including, of course, profit remittance and dividends by foreign firms and interest on the foreign debt). This is an issue, surprisingly, not put to a serious investigation and indeed even subject to error. Skidmore's Politics in Brazil, 1930-1964, a thorough study of Brazil's postwar financial problems does not deal with the service deficit directly and most often refers erroneously to the trade deficit. This is particularly true of his 1977 work, "The Politics of Economic Stabilization in Postwar Latin America", in James M. Malloy (ed.), Authoritarianism and Corporatism in Latin America (Pittsburgh: University

of Pittsburgh Press, 1977), where he presents a table on Brazil's BOP, confusing trade balance with current account balance (p. 168). As the appendix of this study explains, using the World Bank as a source, current account balance is the sum of net exports of goods, nonfactor services (travel, transportation, insurance), net factor income (profits and dividends, interest, technical assistance, commission) and net transfer. Skidmore's error was repeated by Michael Wallerstein, in his 1980 very interesting work, "The Collapse of Democracy in Brazil", Latin American Research Review, Vol. XV, No. 3, 1980, who used Skidmore's data to argue that "From 1948 to 1954, the growth of imports outran the earnings from exports and the resulting trade deficits, covered by short-term credit, precipitated attempts to carry out a stabilization program", (p. 28). In his most recent work, The Politics of Military Rule in Brazil, 1964-85 (New York: Oxford University Press, 1988), Skidmore continues to regard the trade surplus to be "rare for post-45 Brazil", (p. 44).

13. Under Article XIV of the IMF, countries were permitted for a "transitional period" in the immediate postwar period, to maintain exchange restrictions and multiple currency practices. But from 1952, any country retaining such restrictions has been obliged periodically to "consult" with the Fund. The Fund is entitled to recommend in its report to the directors that a country give up its restrictions and can, if the country fails to comply with IMF recommendations, declare it ineligible to use the Fund's resources and eventually require it to withdraw from Fund membership. The procedure of consultation applies whether or not a country has an immediate need for financial support from the Fund. See Teresa Hayter, Aid as Imperialism (London: Penguin Books, 1971), pp. 37-38.

14. Inflation and Economic Development in Brazil, 1946-1963 (Oxford: Clarendon Press, 1973), pp. 259-260.

15. Andre Lara Resende, "A politica brasileira de estabilizaçãõ: 1963/68", Pesquisa e Planejamento Economico, Vol. 12, Dezembro de 1982, No. 3, p. 776.

16. Paul Singer, A crise do "milagre" (Rio: Paz e Terra, 1982), Sexta Edicao, p. 34.

17. The Brazilian monetarist economist Roberto Campos, the architect of the stabilization policies of the military regime in 1964, praised the work of the Commission as the first approach to macro-economic policy formulation in Brazil. See his "A Retrospect over Brazilian Development Plan", in Howard Ellis (ed.), The Economy of Brazil (Berkeley: University of California Press, 1969), pp. 317-344.

18. Quoted in Skidmore, Politics in Brazil, p. 73.

19. Raouf Kahil, Inflation and Economic Development, p. 277.

20. Paul Singer, A crise do "milagre", p. 35.

21. Ibid., p. 36.

22. Ibid.

23. Luis Bresser Pereira, Development and Crisis in Brazil, 1930-1983 (Boulder, Colorado: Westview Press, 1984), p. 140.

24. As Ideias e seu Lugar (Petropolis: Editora Vozes Ltda., 1980), p. 55.

25. El Desarrollo Economico de America Latina y Algunos de sus Principales Problemas (New York: Nacoes Unidas, 1950).

26. Twenty years later Arghiri Emmanuel would propose a Marxist theory of "unequal exchange" in his Unequal Exchange: A Study of the Imperialism of Trade (New York: Monthly Review Press, 1972). Criticizing Ricardo's theory of comparative costs and the natural advantages of countries participating in exchange and concentrating on the differences of specialization in the international division of labor and unequal wage levels between the wealthy and poor countries, Emmanuel exposed the exploitation of the latter via international trade. However, the orthodox Marxist Charles Bettelheim, who commented on Emmanuel's work, strongly criticized him for "mutilating" Marxist concepts and ignoring the exploitation of the working people everywhere and the exploitation of some classes by others: "This current rejects the leading role of the proletariat, substituting for the fundamental conflict recognized by Marxism, namely, that between bourgeoisie and proletariat, another conflict, namely that between 'advanced' countries and 'underdeveloped' ones, or between 'rich' and 'poor' countries". Quoted in Ronald H. Chilcote, Theories of Development and Underdevelopment (Boulder, Colorado: Westview Press, 1984), p. 107.

27. See Gabriel Palma, "Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment", World Development, Vol. 6, 1978, pp. 906-909 and Guido Mantega, A economia politica brasileira, pp. 32-41.

28. One of the earliest and most significant critiques of liberal theory came with the German Friedrich List (1916, originally, 1885). He made two major departures from the British school. First, he emphasized the role of the state in promoting economic growth and development rather than the self-regulating market. Second, he argued that free trade would perpetuate Britain's domination of the nineteenth century global economy. To prevent Britain from flooding the continent and Germany with manufactures, List recommended protective tariffs behind which German industry could flourish. See his The National System of Political Economy (London: Longmans, Green, 1916).

29. Fernando Henrique Cardoso, As Ideias e seu Lugar, p. 9 and Guido Mantega, A economia politica brasileira, p. 40.

30. Ian Roxborough, Theories of Development (New Jersey: Humanities Press, 1979), pp. 30-31 and Gabriel Palma, "Dependency: Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment?", p. 907.

31. A economia politica brasileira, p. 64.

32. *Ibid.*, p. 42.

33. Cardoso, As Ideias e seu Lugar, p. 46.
34. See Palma, p. 907, Mantega, p. 14 and Roxborough, pp. 30-31.
35. Quoted in Mantega, p. 31.
36. See Cardoso, As Ideias e seu Lugar.
37. Cardoso and Faletto, Dependency and Development in Latin America, chapter VI.
38. See Oswaldo Sunkel, "Big Business and Dependencia: A Latin American View", in Foreign Affairs, April 1972.
39. See Cardoso and Faletto, Dependency and Development.
40. Ibid., p. viii.
41. Theories of Development, p. 44.
42. A few months after Vargas' inauguration, ECLA published a study in which it recommended state intervention in the capital and intermediate goods industries as well as in infrastructure, such as transportation and hydroelectric power and fuel. See Recent Development and Trends in the Brazilian Economy (Mexico City, 1951). UN Document E/CN 12/217.
43. See Peter Evans and Gary Gereffi, "Foreign Investment and Dependent Development: Comparing Brazil and Mexico", in Sylvia Ann Hewlett and Richard S. Winert (eds.), Brazil and Mexico: Patterns of Late Development (Philadelphia: ISHI, 1982), pp. 111-168.
44. See Paul Singer, A Crise do "milagre", p. 39 and Luiz Bresser Pereira, Development and Crisis in Brazil, p. 24.
45. The Development of Brazil: Report of the Joint Brazil-U.S. Economic Development Commission (Washington, D.C.: Institute of Inter-American Affairs, 1954), p. vi.
46. See Roberto Campos, "A Retrospect over Brazilian Development Plan", p. 327 and Werner Baer, Industrialization and Economic Development in Brazil (Homewood, Ill.: Richard D. Irwin, Inc., 1965), pp. 108-109.
47. See Guido Mantega, A economia politica brasileira, p. 69.
48. Politics in Brazil, p. 96.
49. See Pinto Ferreira, Capitais estrangeiros e divida externa do Brasil (Sao Paulo: Editora Brasiliense, 1965), pp. 170-171.
50. Nathaniel H. Leff, Economic Policy-Making and Development in Brazil, 1947-1964 (New York: John Wiley and Sons, Inc., 1968), p. 40 and Paul Singer, A crise do "milagre", p. 41.
51. Leff, p. 53.

52. Baer, Industrialization and Economic Development, pp. 68-69.

53. *Ibid.*, p. 198.

54. See Baer, p. 194. The main theoretical arguments for inflationary financing of development programs derive from the Keynesian theory of income which argues that inflation will promote growth in two ways: by redistributing income from workers and peasants, who are assumed to have a low marginal propensity to save, to capitalist entrepreneurs, who are assumed to have a high marginal propensity to save and invest; and by raising the nominal rate of return on investment relative to the rate of interest, thus promoting investment. See Harry G. Johnson, "Is Inflation the Inevitable Price of Rapid Development or a Retarding Factor in Economic Growth?", in Gerald M. Meier, Leading Issues in Economic Development (New York: Oxford University Press, 1976), Third Edition, p. 312.

But the causes of inflation in Latin America have been the focus of a heated debate among structuralist and monetarist economists (the latter, of course, duly reflected in the IMF). The former stresses the unresponsiveness of supply (because of structural bottlenecks) to increasing demand, the latter blame excessive demand created by faulty government policies. The most comprehensive study of inflation in Brazil between 1946 and 1963, Raouf Kahil, Inflation and Economic Development in Brazil, submits each of the specific bottlenecks proposed by the structuralists to empirical test and finds them wanting. Kahil concludes that: "The immediate causes of the persistent and often violent rise in prices, with which Brazil was plagued from the last months of 1948 to the early months of 1964, are pretty obvious: large and generally growing public deficits, together with too rapid an expansion of bank credit in the first years and, later, exaggerated and more and more frequent increases in the legal minimum wages." (p. 329). Kahil, however, goes beyond that conclusion. In the last pages of his book, he links the study of inflation in Brazil with the study of the structure of politics. Thus, he says: "There is reason to think that the factors ultimately responsible for the inflationary process were chiefly political not economic... Thus, however reluctant I may have been so far to move out of the strictly delimited field of economics, I am now irresistibly led by my search for the primary causes of inflation to make some incursion into the closely related field of political economy." (p. 330).

55. Singer, A crise do "milagre", p. 40.

56. See Kahil, pp. 327-334; Singer, pp. 39-40, 52 and 105, and Mendonça, p. 43.

57. Singer, A crise do "milagre", pp. 100-105.

58. *Ibid.*, p. 52.

59. "Dependent Capitalist Development, U.S. Foreign Policy and Repression of the Working Class in Chile and Brazil", in Latin American Perspectives 3 (Winter 1976), p. 24.

60. A politica brasileira de estabilização: 1963/68", p. 776.

61. Industrialization and Economic Development, p. 110.

62. P. 332.

63. Singer argues that, in addition to the heavy burden of debt service payments, inflation - itself the result of the need to accelerate capital accumulation in order to meet the government's domestic and foreign obligations without sacrificing either the consumption of the upper classes and the votes of the working class - and its "distributive injustice", was the other major contradiction of developmentalism in the 1950s and early 1960s. Dialectically, inflation strongly contributed to "proletariat consciousness." As he says: "In this way, a dialectical relationship between inflation and democracy emerged: the more the prices increased, the more effective became popular participation in the political process and the more popular mobilization intensified, the more rapidly the prices increased." See A crise do "milagre", p. 53.

64. Eugenio Gudin, "The Chief Characteristics of the Postwar Economic Development of Brazil", in Howard Ellis (ed.), The Economy of Brazil, p. 8.

65. "Desequilibrios externos desde o pos-guerra: origins e fontes de financiamento", Conjuntura Economica, Rio de Janeiro, 31 (11), Novembro de 1977, p. 170.

66. John Donnelly, "External Debt and Long-Term Servicing Capacity", in H. Jon Rosenbaum and William G. Tyler (eds.), Contemporary Brazil: Issues in Economic and Political Development (New York: Praeger Publishers, 1972), p. 98.

67. Conjuntura Economica, 31 (11) Novembro de 1977, p. 173.

68. Ibid., p. 174.

69. Politics in Brazil, p. 113. In a later work ("The Politics of Economic Stabilization in Postwar Latin America"), Skidmore asked an interesting question: "Is the precipitating factor (for stabilization) rapid price increases or deficits in the BOP? If the latter, to what extent have governments attached a separate priority to reducing the rate of price increases, once the BOP deficit is significantly reduced and the outstanding foreign debt satisfactorily refinanced?" (p. 182). In this study, my findings lead me to believe that the precipitating factor for international creditors' demands for stabilization is undoubtedly BOP deficits. In fact, after Brazil balanced its external accounts in 1955 and despite the considerable acceleration of inflation afterwards, net inflows of foreign loans increased substantially, revealing the loose relationship between inflows of foreign capital and inflation. It was only after 1958 when Brazil's external financial disequilibrium was growing that foreign creditors again began demanding stabilization. But it was only after 1962, when Brazil's debt service burden was beyond the country's capacity to pay - and there was a danger that the country might default - that inflows of loans contracted and anti-inflationary measures were demanded as a condition for refinancing the foreign debt. As explained in the introduction to this chapter, anti-inflationary policy is but the corollary to exchange liberalization and stability. As Vargas did in 1953, Goulart also attempted to introduce "realistic" exchange rates in April 1963 and February 1964 to please the IMF, but the policy faltered as the

elimination of import subsidies was politically impossible. Furthermore, as we will see in chapter 9, even after the harsh stabilization of the post-1964 military government, inflation continued, particularly in the 1970s, but it was not an impediment to capital inflows until the BOP crisis of the early 1980s.

70. Erickson explains that "radical populist" periods are those "in which government officials, usually the president and labor minister, raised hopes or fear that they were actually transferring power to the working class. In Brazil, radical populism was evident in 1953-54 and 1963-64." See his "Populism and Political Control of the Working Class in Brazil", p. 132. Those were precisely the periods in which the government was attempting stabilization and resorted to "radical populism" as a cover for the orthodox policies.

71. See Baer, Industrialization and Economic Development, p. 53 and Singer, A crise do "milagre", pp. 37 and 45.

72. The Debt Trap, p. 34.

73. Economic Policy-Making and Development in Brazil, p. 24.

74. Ibid., pp. 16-17.

75. For a thorough analysis of the oil issue in Brazil see John D. Wirth, The Politics of Brazilian Development. See also Erickson, "State Entrepreneurship, Energy Policy, and the Political Order in Brazil", in Thomas c. Bruneau and Philippe Faucher (eds.), Authoritarian Capitalism: Brazil's Contemporary Economic and Political Development (Boulder, Colorado: Westview Press, 1981), pp. 141-177.

76. Quoted in Skidmore, Politics in Brazil, p. 100.

77. Octavio Ianni, Crisis in Brazil (New York: Columbia University Press, 1970), p. 135.

78. Skidmore, Politics in Brazil, p. 118.

79. Singer, A crise do "milagre", p. 40.

80. Kahil, Inflation and Economic Development, pp. 296-297.

81. Dependency and Development in Latin America, p. 152.

82. Throughout the 1950s, the UDN favored the IMF monetarist doctrine and the equilibrium of Brazil's external accounts, that is, prompt foreign capital servicing. This was also particularly true of the export sectors which had turned against Vargas' policy of industrialization and his instrument to achieve the aim, that is, exchange controls, multiple exchange rates and particularly the exchange confiscation. In the course of the 1950s, coffee planters protested vigorously against this taxation, rallying behind the slogan of a "single exchange rate" according to which their dollar earnings would be converted at the same (much higher) rate that applied to imports, thus allying themselves with the IMF and international creditors' opposition to multiple exchange rates and their repeated demand for exchange rate "consolidation", accompanied by

devaluation and deflationary policies. See Leff, Economic Policy-Making and Development in Brazil, pp. 25-26.

83. Skidmore, Politics in Brazil, p. 170.

84. Kahil, Inflation and Economic Development, pp. 294-295.

85. Ibid., p. 295.

86. Vargas was under strong pressure from the military because at the beginning of February when it was widely rumored that Goulart was going to recommend a 100 percent increase in the minimum wage, junior army officers protested their low salaries. According to Skidmore: "The officers warned that if the minimum wage were to be approved, it would mean that an unskilled worker would earn almost as much as a university graduate. The nervousness over status was unmistakable." See Politics in Brazil, p. 128.

87. Quoted in Skidmore, pp. 131-132.

88. Conjuntura Economica, 31 (11), Novembro de 1977, p. 175.

89. Quoted in Singer, A crise do "milagre", p. 45.

90. Ibid.

91. "Populism and Political Control of the Working Class in Brazil", p. 135.

92. Ibid., pp. 135-136.

93. Skidmore, Politics in Brazil, p. 132.

94. Ibid., p. 137.

95. The full text of the letter, translated by The New York Times of August 25, 1954, was reprinted in E. Bradford Burns (ed.), A Documentary History of Brazil (New York, 1966), pp. 369-371.



BRAZIL'S DILEMMA: DEPENDENCY, DEBT, AND DEMOCRACY

BY

GEISA MARIA ROCHA

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CHAPTER 6

CONSOLIDATION AND CRISIS OF THE NEW SITUATION
OF DEPENDENCY, 1955-1964

The final phase of Brazil's transition from periphery to semiperiphery is best characterized by the consolidation of the postwar alliance of the state and international finance. Dependencistas, however, have characterized this period that began in 1955 as "the internationalization of imperialism" or "the internationalization of the internal market" because local manufacturing of consumer durables became increasingly foreign-owned. Yet the heart of the Kubitschek's industrialization policy (1956-61) was the massive foreign borrowing by the state to obtain the necessary foreign exchange for imports and for the servicing of the foreign firms themselves. As such, behind the "triple alliance" and at its foundation, it was international finance that was maintaining the financial equilibrium of the economy.

BOP problems, however, were soon exacerbated as a result of the eventual reverse flow of foreign exchange to service the foreign loans, combined with profit remittance by the foreign firms. In fact, because of the already heavy burden of foreign exchange payments for debt service by 1956, Brazil's capacity to import declined from then onwards and its industrialization thus became more and more dependent on the net inflow of foreign loans. This growing indebtedness, in turn, produced a situation (between 1959 and 1963) where more loans were required just to service past debt, allowing private and official creditors to exert considerable power over

national economic policy making because of their ability to withhold or expand loans. This traditional Brazilian problem returned with a vengeance, and combined with the concentration of income among the middle and upper classes, was the major feature of the model of capital accumulation. As a way to produce "autonomous" industrialization, improve the financial equilibrium of the economy and the living conditions of the majority of the population, ISI was a costly illusion. For Kubitschek's successors, particularly João Goulart, it was a nightmare.

What has to be made clear first, however, is that the crucial domestic decisions taken on the development path of Brazil between 1954 and 1955 were heavily shaped by the orthodox stabilization program imposed on the country in those years by the transitional government of Café Filho to solve the BOP problems inherited from Vargas. I believe that international financial centers were very much encouraged with the liberal policies adopted by Eugenio Gudin and Octavio Gouveia de Bulhões, the architects of the stabilization plan and the major proponents of foreign investment in Brazil in the decades of the 1950s.

Instruction 113 of SUMOC and dependent development:
a stabilization policy

The transitional government of Café Filho that succeeded Vargas (1954-55) was committed to harsh orthodox monetary stabilization. With Eugenio Gudin, the Finance Minister (who was also a member of the IMF's board of governors) and Octavio Gouveia de Bulhões, the director of SUMOC, working closely with the IMF, the government attempted a serious deflationary policy by curtailing public expenditures, freezing wages (at the level of the May 1954 increase) and restricting the expansion of commercial bank credit. SUMOC directives 106 and 108 of October 1954 provided for a rise in the rate of rediscount from 6 percent to 8 percent and prescribed that commercial banks

deposit with the monetary authorities 50 percent of any increment in their accounts, causing a banking crisis in 1955.¹

While federal expenditures increased in 1955 by only 24 percent as against 35 percent in 1954, government deficits continued to rise.² The government, in fact, did not succeed in reducing the rate of inflation, which jumped from its annual rate of 14.4 percent in 1953 to 22.4 percent in 1954 and 23.1 percent in 1955 (see Table 5.6 above). Yet, while inflation continued, the government was able to reduce the current account deficit from \$230 million in 1954 to \$30 million in 1955, even though world coffee prices, as already noted, dropped 30 percent from the peak reached during the Korea War and its aftermath. It did so by sharply cutting imports which in 1955 dropped by \$226 million. As indicated in Table 5.14 above, imports in 1954 reached \$1.618 billion and in 1955, \$1,392 million and in 1956 there was also a further decline, \$1,324 million. This marks the end of the "easy" phase of ISI in Brazil.

Stabilization was relaxed in May 1955 when a developmentalist alliance of the banking, industrial and commercial bourgeoisie - which would be decisive in the formulation of economic policy from now on - strongly protested the monetary and fiscal policy of Gudin and Bulhões. As Café Filho began expanding credit, the economists promptly resigned.

But what marked the Gudin-Bulhões-IMF stabilization program was the famous SUMOC Instruction 113.³ As in 1953 when Vargas stabilization policy allowed capital to move freely into and out of the country at the free rate of exchange in order to encourage foreign direct investment - and foreign exchange to solve the BOP crisis -, "the major factor influencing the government in the new policy was the desire to use foreign investment as a means of improving the country's deteriorating balance of payments situation."⁴

Instruction 113, a liberal policy aimed at importing capital to

solve the chronic BOP problem, was a discretionary decree of SUMOC, independent of legislative sanctions. It was, in fact, a further facility and subsidy to foreign capital, particularly with regard to favorable exchange rates, granted to both foreign investors for remission of profits and importation of industrial equipment - without the need for exchange cover - and to foreign creditors for the amortization and interest on long-term loans.⁴ Instruction 113 was used by Kubitschek to its limit to promote vertical ISI in Brazil, marking the beginning of what has been called "associated-dependent development" or the "internationalization of the internal market."⁵

Baer explains how Instruction 113 was obviously advantageous to foreign investors, an advantage not granted to the national industrial bourgeoisie:

Without it, he [the foreign investor] would have had to send dollars to Brazil at the free market rate and with the cruzeiros bought he would have had to repurchase dollars in the auction market at a higher price. The degree of benefit could be measured by..."the difference between the cost of foreign exchange in the relevant auction category and the free market rate." This difference was considerable for dollar imports, while for non-dollar imports it was much smaller; but this disappeared after currency convertibility was achieved in most of the major exporting countries by the end of 1958.⁶

Instruction 113 was, therefore, a government policy born out of stabilization measures that, as dependencistas have argued, allowed international capital to dominate Brazil from within the country, rather than as previously only from without. As Table 5.3 above makes it clear, however, direct investment was by no means predominant. Between 1956 and 1960 risk capital was outweighed by suppliers' credits and came to only one-third of all capital inflow which amounted to approximately 8 percent of all Brazil's fixed investment.⁷ Significantly, Leff notes that, for the period 1947-60, "In reality, total foreign investment, and particularly direct foreign private investment, have played a relatively small role in Brazil's capital formation and growth."⁸

Nathaniel Leff is quite correct as the findings of this study have also shown that the major role of foreign investment, particularly loans, in Brazil is to maintain the financial equilibrium of the country by providing the foreign exchange necessary to cover BOP deficits which, ironically, are caused in the first place by the servicing of the investments themselves. Table 6.1 below provides evidence for the small contribution of long-term foreign investment (risk and loan capital) to Brazil's capital formation between 1950 and 1959. Foreign investment's contribution to Brazil's growth was only 14.59 percent, with national capital contributing 85.41 percent, most of which deriving from government budget deficits covered by expansion of the money supply, hence inflation.⁹

According to Baer, foreign savings' contribution to Brazil's capital formation was smaller than 10 percent between 1952 and 1962. He argues, however, that "foreign savings...made it possible to import the capital equipment without which domestic capital formation might have been severely hampered."¹⁰ But this credit for equipment imports, mostly used and technically obsolete,¹¹ only postponed the "hampering" of capital formation in Brazil as the credit had to be serviced with interest and amortization payments. Thus, after 1956 the heavy burden of foreign exchange payments for foreign capital servicing became a major factor responsible for the decline of Brazil's capacity to import. And after 1961 it became the major obstacle to further capital formation as the inflow of foreign capital was overwhelmed by the outflow of foreign exchange for interest and amortization payments (see discussion below). Nevertheless, international financial capital played, as in the past, a major role in shaping Brazil's domestic processes. An analysis of the Kubitschek's years and beyond will show how.

Table 6.1 Foreign Investment and Capital Formation in Brazil, 1950-59

Year	Capital Formation (gross) Cr\$ billion (1)	Long-term Foreign Investment		Gross Inflow Cr\$ billion (4)	Contribution of Foreign Capital to Brazil's capital formation (%) (5)
		Gross Inflow US\$ million (2)	Exchange Rate Cr\$/US\$ (3)		
1950	28.9	55	18.72	1.0	3.46
1951	57.8	226	18.72	4.2	7.27
1952	71.4	119	18.72	2.2	3.08
1953	58.5	573	20.71	11.9	20.34
1954	113.9	380	29.10	11.0	9.66
1950/54	330.5	1,353	-	30.3	9.17
1955	112.7	188	40.34	7.6	6.74
1956	133.1	337	44.08	14.8	11.11
1957	170.4	450	48.32	21.7	12.73
1958	206.4	728	64.60	47.0	22.77
1959	354.1	713	97.02	69.2	19.54
1955/59	976.7	2,416	-	160.3	16.41
1950/59	1,307.2	3,769	-	190.6	14.59

Source: Pinto Ferreira, Capitais estrangeiros e dívida externa do Brasil
(São Paulo: Editora Brasiliense, 1965), p. 22.

Kubitschek and the developmentalist alliance

Juscelino Kubitschek and João Goulart, the candidates of the PSD-PTB alliance, were elected President and Vice-President in the national elections of 1955.¹² Promising "Fifty Years' Progress in Five", Kubitschek indeed promoted an extraordinary expansion of industrialization in Brazil, particularly of the consumer durables (automobile and electrical appliances) and the capital goods industries. As Tables 5.8 above and 6.2 below indicate, between 1956 and 1961, real domestic product grew at 6.0 percent and industrial output at 11.0 percent. How was the nature of this economic growth and how was the political strategy followed to achieve it?

Beginning with the second question, as already discussed, ECLA's ideology of autonomous industrialization and national capitalism captured in the slogan developmentalist nationalism (desenvolvimentismo nacional, but which will be referred to simply as developmentalism because "national" is a misnomer) cemented the populist pact of the state bureaucracy, the industrial bourgeoisie and the urban middle and working classes that had arisen under Vargas. But the ideology of developmentalism and its promise of better living standards for the masses was aimed particularly at diverting the attention of the workers from class consciousness. As Brazilian social scientist Sonia Regina de Mendonça argues, the ideology of developmentalism,

...penetrated into the working class movement and diverted its attention from the defense of specific class interests or the struggle against the system into the problems of national economic development and democratic claims...There emerged what has been called "political syndicalism" where the theme of class struggle was substituted by developmentalist nationalism...The political stability of the Kubitschek government was thus secured by "populist syndicalism" and the ideology of developmentalist nationalism.¹³

Toward the other major sector of the populist alliance, the industrial bourgeoisie, Kubitschek adopted a policy of easy credits, continued protection from imports and the maintenance of a high level of domestic demand, thus assuring it profitable markets. Most important, the bourgeoisie welcomed

foreign capital, anticipating its multiplying effect on the rate of profit and allying with foreign enterprises that would bring equipment into the country without the exchange charges. As Mendonça aptly put it, "The bourgeoisie, contrary to the illusion of some, promptly assumed the model of internationalization and never defended autonomous industrialization."¹⁴ Or, as Cardoso argues, the Brazilian bourgeoisie "is limited to integrating itself into the scheme of international capitalism, to associating itself with international capitalism as a dependent and minor partner."¹⁵

Nevertheless, the industrial bourgeoisie was depicted by many nationalist and Marxist intellectuals as the major agent in the "autonomous" industrialization of the 1950s and the representative of the interests of all progressive forces in Brazilian society. The government financed Institute of Brazilian Studies (Institute Superior de Estudos Brasileiros or ISEB) established in 1955, became the most important forum to disseminate ECLA's doctrine of industrialization, the ideology of developmentalism, and to promote the role of the bourgeoisie as the authentic and dynamic vanguard of the "revolution" in Brazil. The bourgeoisie would lead the proletariat and the middle class in the struggle against the privileges of the agro-exporting oligarchies and their interest in maintaining Brazil as an exporter of primary products. The solution to Brazil's underdevelopment with all its social injustice and political tension, according to the ISEB, must be rapid industrialization and to that end Brazil needed the cooperation of all, including foreign capital.¹⁶ Guido Mantega notes that, by the late 1950s, the intellectuals of the ISEB "continued blaming the traditional sectors of Brazil and their imperialist allies for the low living standards of the population even though industrial accumulation had already become the new hegemony in the country."¹⁷

But the privileges of the traditional landowners and coffee growers were well protected under Kubitschek, who, like Vargas before him, never raised the land question. Although coffee growers continued to protest "exchange confiscation", they were treated with periodical increases in the "bonus" paid to exporters and continuous generous government support, largely unsuccessful, to arrest the decline in world coffee prices.

Finally, the ideology of developmentalism was very attractive to the middle and upper classes, whose traditional taste for imported status goods would now be satisfied through domestic production by the subsidiaries of TNCs. In this way, premature imitation of consumption patterns typically of advanced industrialized societies, in particular the U.S., was reinforced by Kubitschek's vertical ISI program and an income concentration policy that guarantee internal demand by the wealthy minority.¹⁸

Therefore, Kubitschek was well prepared politically to consolidate Brazil's industrialization began under Vargas (despite the former President's contradictory nationalist policy), with an ideology capable of harnessing all classes of society and particularly of promoting political stability. Yet the major political strategy of the president was the transformation of the state into the leading actor in the industrialization process. Having inherited from Vargas the foundations of an interventionist state, Kubitschek expanded its role to support the process of capital accumulation by the private sector, by stimulating and channeling industrial activity, providing huge amounts of forced savings for investment purposes and becoming an active producer in the infrastructural and basic industrial spheres.

The growth of the state's role in the economy, however, both as a direct producer and regulator, had a major cause: the need to manage BOP crises. President Kubitschek explained well the indirect role of the state (as the manager of BOP crisis) in his 1959 annual message to Congress:

Whether in supplementing foreign exchange credits necessary for the financing of federal projects or in lending support to private, domestic enterprises in obtaining loans from abroad, the responsible authorities advanced various modalities of action, careful, however, of the prospects of our medium- and long-term balance of payments in order to avoid a disproportionate foreign obligation.

One of those modalities of action consisted in attracting direct foreign investment by means of encouraging incentives to establish certain industries, as, for example, the automobile industry. In other cases we fell back upon the official entities for credit, both domestic and foreign - the International Bank for Reconstruction and Development, The Export Import Bank of Washington, the Instituto Mobiliare Italiano, the Assurance Credit de France, and some others - by means of opening bank credits in favor of the National Economic Development Bank (BNDE) or guaranteed by them. In raising foreign resources it is not unusual to call upon a seller's credit or the granting of long- and medium- term credits by the supplier of machinery, whether or not guaranteed by the government of the exporting country.

In this aspect the results have been satisfactory in relation to the ongoing projects. For \$80 million registered in 1955 with SUMOC as loan capital, in 1956 and 1957 \$302 and \$261 million were registered respectively. In 1958 the registration was raised to \$397 million. As for direct investments, these figures were raised by \$31 million in 1955, \$56 million in 1956, \$109 million in 1957 and \$104 million in 1958. 19

In a nutshell, Kubitschek's policy of determined external indebtedness in all its details was explained by the President himself. We will now examine the role of the state and the nature of the high rates of growth during the period 1956-61 in order to show the vulnerability of this growth which led to its end in 1962-63.

The role of the state and the foundations for
the post-1964 "model"

Kubitschek's famous Target Plan (Programa de Metas) for the period 1956/61 was the culmination of the planning approach first promoted by the Joint Brazil-US Commission (1951/53) and also by a Joint Group of BNDE and ECLA economists between 1953-55, under the leadership of Celso Furtado, with the explicit objective to complement the works of the Joint Commission. As discussed in chapter 1 dealing with neo-classical development theory, the role of the state sector in the planning approach is, of course, to provide incentives to the private sector. And so was ECLA's strategy.

The major objective of the Target Plan was thus to have the state promote and direct the process of industrialization by the private sector through (a) the coordination and integration of the various sectors of the economy by becoming an active producer in the infrastructural and basic industries necessary for production and growth as neither local capital nor foreign direct investment were willing to tackle, given the high cost and low initial profitability and (b) the direct stimulation to the private sector by providing long-term credit at negative interest rates through the BNDE, guaranteeing foreign borrowing, subsidizing the import of machinery, equipment and basic components through favorable exchange rates, subsidizing key inputs from state enterprises, providing tax exemptions and protecting the domestic market from foreign competition.²⁰ Commenting on Kubitschek's Target Plan, Anglade argues that:

The economic role of the state was thus clearly defined: outside oil production, which was a politically sensitive area in which foreign capital could not be allowed, state action was to be limited to creating the conditions favorable to the expansion of the private sector.²¹

It is clear that the Target Plan assigned to the state the supporting role in a process of private capital accumulation and was not intended to promote state capitalism.²² The expansion of state enterprises in infrastructure (transportation and energy), raw materials (minerals and petroleum) and intermediary products (steel) was intended to be complementary to the manufacturing industries as those state investments are basically inputs to the manufacturing sector, largely controlled by private foreign firms. The extraordinary growth in public investment can be illustrated with the following data: in 1956 the public sector, including state enterprises, accounted for only 28.2 percent of total investment in the gross formation of capital; in 1960, this percentage had reached 48.3 and by 1964, 60 percent of investment was made by the public sector.²³

Mantega summarizes the role of the state in the Target Plan by saying that: "Not only did the state take control of the least profitable sectors of the economy which required massive injection of capital and long-term maturation, but also it did everything possible to cheapen the cost of labor, food and fixed capital for the private sector."²⁴ Thus, indirect state intervention in wage, fiscal and credit policies, inflation, import controls, exchange rates, etc...is also a major form of the supporting role of the state. As I have emphasized before, at the heart of the role of the state in Brazil is the need to maintain the financial equilibrium of the economy by managing BOP crises and thus provide a stable climate for foreign and domestic private investment - a concrete form of indirect state intervention in the economy.

The complementary role of the state sector continued unchanged under the post-64 "bureaucratic-authoritarian" regime which consolidated the capitalist model of dependent accumulation implanted in 1956 (see chapters 7 to 9). As Bacha argues in his analysis of the state after the 1964 coup, the state promoted "a division of tasks where the state took up the heavier responsibility of supplying at low costs the domestic market with basic inputs and external economies which were used by the MNCs for their own expansion both domestically and in export markets."²⁵

But the foundations of the bureaucratic-authoritarian regime were also implanted during Kubitschek as the following developments illustrate. To stimulate the private sector, the President established by decree "executive groups" to approve the projects contained in the Target Plan, thus bypassing congress on economic policy-making.²⁶ The groups controlled the supply of technology and financing (through the BNDE) to the private sector, thus giving special treatment to favored industries for importing manufacturing equipment, raw materials and components. The most important groups were those

established to stimulate the largely foreign-controlled automotive industry (GEIA) and the national shipbuilding industry (GEICON), indicating the government's preference for those sectors. Mendonça stresses that the establishment of "executive groups" was the major political strategy used by Kubitschek to launch the model of associated-dependent development. She notes that:

What the nationalist euphoria of the 1950s masked,,, was the establishment of the bases of the post-64 bureaucratic-authoritarian regime, made viable by the gradual strengthening of the executive... Crucial decisions on economic policy making were taken by the technocrats of the executive groups. 27

This is corroborated by Bresser Pereira who points out that: ",,, between 1956 and 1961...the new president surrounded himself with a team of technocrats, many of them foreign-educated and under the influence of ECLA ... which saw itself as a true bureaucratic class in a position to assume increasing control of the national economy and to plan for its development."28 Furthermore, Leff's study of Brazil's economic policy making between 1947 and 1964 concludes that: "The Brazilian government has had a substantial degree of autonomy from interest groups or socio-economic class pressures in the making of economic policy." 29 Thus, the "relative autonomy" of the state vis-a-vis civil society appears to have been substantial during the populist period. . At the same time, however, the state faced severe external constraints as a result of financial dependency, thus reducing its capacity for autonomous decision making (see discussion below).

Observers that have emphasized the "novel" aspects of the post-64 political and economic models have been, for the most part, misguided because the foundations for the BA regime as well as for the economic "miracle" between 1968-73 were launched by Vargas and Kubitschek. 30 Table 6.2 below shows that between 1958 and 1961 the Brazilian economy grew according to a pattern of unbalanced growth recommended by neo-classical development theory (see chapter 1)

in which industrial production was emphasized to the detriment of agriculture, similar to the "miracle" years shown in Table 6.3. By the early 1960s, domestic production provided 99 percent of the total domestic supply of consumer goods, 91 percent of intermediate goods and 87 percent of capital goods. In 1963, metal products, electrical machinery, transport equipment and chemical products accounted for 44 percent of gross industrial value added, up from 19 percent in 1939 and 23 percent in 1949.³¹ As Serra holds and Leff's study agrees, the pre-1964 regime fostered the "large and complex investments involved in deepening" relatively efficiently, and he does not grant the post-64 military regime any greater skill at planning.³² If there was anything new after 1964, it was the imposition of harsh stabilization measures on Brazil which, in fact, "undeepened" the economy. The authoritarian regime was better equipped to impose austerity than its democratic predecessor because it was less vulnerable to social pressure and more able to repress opponents. But as chapter 7 demonstrates, austerity was the condition to allow the continuity in the development of the model of accumulation adopted in 1956 and its major aspect, foreign indebtedness, highly recommended by foreign and domestic ideologues of the developmentalist theory of growth as the necessary instrument of economic development and BOP equilibrium.

The economic contradictions of developmentalism

The domestic financing of the Target Plan came from forced savings, or inflation, already discussed in chapter 5. But the program of ISI required, of course, foreign exchange both for imports of capital equipment which the state openly subsidized to TNCs and for the servicing of those foreign corporations (profit repatriation and dividends). As a result of the combination of stagnating exports, slowly deteriorating terms of trade and the increasingly heavy burden of foreign exchange payments for service and amortization of past loans already discussed at length, Brazil's current

Table 6.2 Brazil: Growth Rates, 1958-61

	1958	1959	1960	1961
GDP	7.7	5.6	9.7	10.3
Agriculture	2.0	5.3	4.9	7.6
Industry	16.2	11.9	9.6	10.6

Source: Christian Anglade, "The State and Capital Accumulation in Contemporary Brazil", in Christian Anglade and Carlos Fortin (eds.), The State and Capital Accumulation in Latin America, Volume 1 Brazil, Chile, Mexico (Pittsburgh: University of Pittsburgh Press, 1985), p. 55, Table 2.2.

Table 6.3 Brazil: Growth Rates, 1968-73

	1968	1969	1970	1971	1972	1973
GDP	11.2	9.9	8.3	12.0	11.1	14.0
Agriculture	4.5	3.8	1.5	11.3	4.1	3.6
Industry	13.3	12.1	10.5	11.8	12.7	16.0

Source: Same as Table 6.2 above, p. 54, Table 2.1

capacity to import declined from 1956 onwards and its industrialization thus became more and more dependent on the net inflows of foreign loans as indicated in Table 5.14 above.³³ As John Donnelly points out:

The Kubitschek government realized, of course, that the adoption of such a development plan in the face of a stagnating export-based capacity to import would give rise to large and persistent foreign exchange gaps of an essentially structural character. Associated with the new five-year target plan, therefore, was the absolute necessity of adopting an aggressive strategy of foreign borrowing to insure that the planned foreign exchange gaps would be sufficiently financed...That the foreign exchange gap replaced the savings-investment gap as Brazil's dominant resource gap in the postwar period, and thus became the principal determinant of the country's external financing requirements, has been corroborated by several empirical studies.³⁴

It is here that we see that behind the "triple alliance" and at its foundation, international finance was maintaining the financial equilibrium of the economy and supporting the state in its most important indirect role: the manager of BOP crises. It was foreign suppliers' credits that made it possible for the state to guarantee foreign exchange at the most favorable terms to private domestic importers of industrial equipment that is, to subsidiaries of TNCs. According to Eugenio Gudín, the opponent of such policy and defender of free market measures:

The exchange advantage granted holders of these suppliers' credits can be measured by taking the difference between the market rate of exchange and the cost of exchange rate, plus surtaxes established by SUMOC. These figures show that, during the period 1955-60, nearly one-half of the cruzeiro cost of the equipment and machinery imported by Brazilian industry was paid by the nation [Table 6.4].

The resulting subsidy can be measured by multiplying the differences in rates by the value of the suppliers' credits imports [see Table 6.5]. This subsidy, amounting to nearly one billion dollars, does not include the benefits of the same nature...for the period 1951-53, through the grant of import licenses for machinery and equipment at the parity rate (Cr\$18.72 to the dollar, when the free rate was twice as much). Such was one of the costs paid by the nation, by consumers in general and by agriculturists in particular, for industrialization.³⁵

The political and economic costs of suppliers' credits "paid by the nation" to subsidize TNCs was overwhelming, however. The data presented below will show precisely that. We will also demonstrate the proposition that

Table 6.4 Difference between market rate and cost of exchange rate (plus surtaxes)

Year	Market Rate	Cost of exchange rate plus surtax	Difference
1955	73.54	(3-23-55) 33.82	39.72
1956	75.67	(for the year)33.82	41.85
1957	78.00	(9-12-57) 43.83	86.18
1958	130.00	(5- 9-58) 51.82	78.18
1958	130.00	(10-3-58) 70.00	60.00
1959	159.83	(1 -9-59) 80.00	79.83
1960	199.26	(12-31-60) 100.00	99.26

Source: Eugenio Gudín, "The Chief Characteristics of the Postwar Economic Development of Brazil", in Howard S. Ellis (ed.), The Economy of Brazil (Berkeley: University of California Press, 1969), p. 10, Table 5.

Table 6.5 Subsidy to industry
(Millions; new cruzeiros converted to US\$ at market rate)

Year	Cr\$	US\$
1955	3.178	43.2
1956	10.588	139.9
1957	22.493	172.7
1958	27.429	211.0
1959	26.104	163.2
1960	24.021	120.6
	Total	US\$ 850.6

Source: Same as Table 6.4 above, p. 11, Table 6.

while international finance allied with the state in its industrialization drive, it was also the former which set the limits for the country's capital accumulation process with the contraction of loans in 1962 and 1963. This was the major determinant of the economic and political crisis which unfolded, ultimately destroying Brazil's democratic political system. We will first examine the economic costs.

Table 6.6 shows the growth in GDP and external public debt between 1947 and 1966. It is interesting to compare Table 6.1 above, foreign investment and capital formation in Brazil with Table 6.6. While capital inflows (risk capital and loans) contributed to only 14.59 percent of domestic investment between 1950 and 1959 (according to Baer, 10 percent between 1952 and 1962 and to Leff, 8 percent, between 1956 and 1960), external public debt outstanding alone reached 14.5 percent of GDP between 1957 and 1961 and 22.3 percent between 1962 and 1966. The data raise serious questions about the role of foreign capital, particular loans, in the economic development of Brazil in the 1950s since the high proportion of capital inflows to GDP in only a decade financed a very low percentage of domestic investment. Furthermore, as we will now show, the costs of the inflows were extremely high, touching the very limits of the country's sovereignty.

Table 6.7 shows the BOP of Brazil between 1957 and 1962. Comparing this Table with Table 5.2 (for the period 1945-49) and Table 5.9 (1950-56), we see that the trade surplus was in fact drastically reduced from \$1.2 billion and \$1.5 billion, respectively, to \$245 million between 1957 and 1962. But the deficit in the service account amounted to almost \$2.2 billion! Thus, Brazil recorded average annual deficits on the current of \$318 million, bringing the gross public foreign debt to approximately \$3.2 billion at the end of 1962, as compared to \$1.2 billion at the end of 1956, and international reserves reduced to \$285 million, the lowest since 1947.³⁶

Table 6.6 Growth in GDP and External Debt, Five-Year Averages, 1947-66

Years	Annual GDP Growth Rates	Millions of U.S.\$	External Public Debt Outstanding*		As percent of exports
			Annual rate of change	As percent of GDP	
1947-51	5.4	590	- 2.2	5.2	46.5
1952-56	5.0	1227	+ 25.2	7.7	82.6
1957-61	7.0	2201	+ 13.2	14.5	167.3
1962-66	3.7	3545	+ 10.2	22.3	239.0

Source: John Donnelly, "External Debt and Long-term Servicing Capacity", in H. Jon Rosenbaum and William G. Tyler (eds.), Contemporary Brazil: Issues in Economic and Political Development (New York: Praeger Publishers, 1972), p. 97, Table 5.1.

* John Donnelly adopts the definition of external public debt employed by the Central Bank of Brazil (formerly SUMOC) and is nearly identical with the one used by the World Bank provided in the appendix to this study. Brazil's external public debt is thus defined to include all debt that is an obligation of the national government, a political subdivision, an agency of either, or of an autonomous public body, and payable to creditors outside the debtor country in foreign exchange, goods, or services, such debt having (a) an original maturity of one year or more and (b) a contractual scheme for repayment of principal and interest. This definition includes private debt, provided foreign exchange for repayment of the debt is guaranteed by an organ of the government (e.g., debt arising from suppliers' credits). Excluded from this definition are debts arising from (a) commercial arrears, swaps, lines of credit, and other forms of short-term credit operations and (b) private direct investments, since the return flow of profits and dividends on these investments is variable rather than fixed.

Most interesting is the capital account of the BOP in Table 6.7 (source of foreign financing of the current account). Again, comparing the data presented in this Table with Tables 5.2 and 5.9 above, we see that autonomous loan capital (that is, loans for specific development projects tied to equipment import) increased twofold, from \$569 million between 1950 and 1956 to \$2.4 billion between 1957 and 1962. This increase, however, little served the foreign exchange needs of Brazil, as amortization payments on the foreign debt amounted to almost \$2 billion, an extremely high amount if we consider the total debt itself, \$3.2 billion at the end of 1962.

Table 6.8 provides the sources of foreign financing of the external deficit according to the nature of the operations from 1956 to 1963. This Table reveals that the deficit on current account not covered by net autonomous loans had to be financed and refinanced by medium-term BOP loans and short-term compensatory operations. Significantly, currency loans, the major form of capital inflows in the 1970s, also increased from 1959 to 1961. Table 6.8 shows, in a nutshell, the burden of the foreign debt: more loans were required just to finance the service of past loans. The year 1958 would be the beginning of this "debt trap."

Table 6.8 also shows that in 1958 the financing of debt service obligations was obtained from the Eximbank in the amount of \$100 million in addition to \$37 million from the IMF. Short-term compensatory loans became especially important in 1959 and 1960 when Kubitschek broke with the IMF and resorted to \$115 million and \$125 million of swap operations through the Bank do Brasil (see discussion below). Furthermore, commercial arrears, amounting to \$68 million in 1960, also recurred for the first time since 1952. This Table also indicates that between 1961 and 1963 Brazil had to obtain emergency loans to alleviate the burden of debt servicing, again, from the Eximbank and also from the U.S. Treasury, AID, American and European commercial banks, and

Table 6.7 Brazil: Balance of Payments, 1957-62
(In millions of US dollars)

Goods and Services	
1. Merchandise (FOB)	245.0
2. Services (net)	-2,188.0
2.1 Travel	- 188.0
2.2 Transportation (including freight and insurance on merchandise)	- 538.0
2.3 Interest	- 563.0
2.4 Investment Income (foreign direct investment profit remission)	- 171.0
2.5 Other government	- 147.0
2.6 Other private	- 581.0
3. Transfers	31.0
Current Account	-1,912.0
Annual Average	- 318.7
Capital Account (source of foreign financing)	
1. Loan capital	1,038.0
1.1 Autonomous loans (import financing)	2,383.0
1.2 Compensatory loans (BOP support)	652.0
1.3 Amortization	-1,997.0
2. Risk capital	653.0
2.1 Direct Foreign Investment	653.0
2.2 Brazilian investment abroad	-
3. Other capital	272.0
3.1 Commercial arrears and credit	163.0
3.2 Subscriptions and contributions	- 103.0
3.3 Other	212.0
Total capital inflows (net)	1,963.0
Annual average of inflows	327.2

Source: *Conjuntura Economica* 31 (11), Novembro 1977, Table I, p. 169 and Table II, p. 171.

Table 6.8 Sources of Financing of External Disequilibrium, by the nature of the Operations, 1956-63 (In millions of US dollars)

	1956	1957	1958	1959	1960	1961	1962	1963
1. Autonomous loans (import financing)	231	319	373	439	347	529	343	287
1.1 Equipment	158	223	268	290	224	274	233	188
1.2 Wheat	-	24	22	23	-	60	35	32
1.3 Currency	73	72	83	126	123	195	75	68
2. Compensatory loans (BOP support)	-41	47	173	93	294	239	390	248
2.1 Commercial arrears and credits	-	-	-	-	68	-68	163	14
2.2 Financing and refinancing operations	-28	37	195	-21	61	310	120	188
2.2.1 IMF	-28	37	37	-21	48	40	-18	5
2.2.2 Export Import Bank	-	-	100	-	3	101	81	80
2.2.3 USA Treasury	-	-	-	-	-	35	10	30
2.2.4 AID	-	-	-	-	-	50	25	25
2.2.5 USA Banks	-	-	58	-	10	48	-	-
2.2.6 European Banks	-	-	-	-	-	36	22	31
2.2.7 Other	-	-	-	-	-	-	-	17
2.3 Swap operations	-12	11	-21	115	125	-5	47	-30
2.4 Gold	-1	-1	-1	-1	40	2	60	76
3. TOTAL (1+2)	190	366	546	532	641	768	733	535

Source: Same as Table 6.7 above, p. 172, Table III.

also swaps and accumulation of commercial arrears. The latter became especially important in 1962 (\$47 million in swap loans and \$163 million in commercial arrears) when Goulart, confronted with declining capital inflows and a sharp drop in export earnings, was unable to obtain sufficient amounts of BOP financing net of debt servicing on previous BOP loans as a result of his political inability to impose IMF austerity measures in Brazil (see discussion below). Brazil's deficits on current account during 1962-63 amounted to \$721 million and, as a consequence of the sharp drop in the inflow of autonomous loans, private and official, the overall BOP on current and capital account showed a deficit of \$622 million in 1962-63.³⁷ Finally, between 1960 and 1963 Brazil had to sell gold from its reserves, obtaining almost \$180 million, again to alleviate the burden of the foreign debt.

In 1961 President Quadros was able to negotiate a partial consolidation and rescheduling of debt service with the Hague Club and obtain substantial new credit to relieve temporarily the debt burden. This was possible due to the President's attempt at imposing IMF stabilization measures on Brazil, particularly his major reform of the foreign exchange system (see discussion below). Table 6.8 shows the increase in new credits in 1961, as compared to 1959 and 1960 and also the European refinancing of approximately 5 percent of total debt service payments on suppliers' credits due over a three year period, \$36, \$22 and \$31 million in 1961, 1962 and 1963, respectively. These loans enabled the BOP to be in surplus in 1961, the only exception during the period 1957-1963. Table 7.11 below clearly shows this exception. But, as a rule, debt rescheduling is a means of postponing the debt problem, rather than solving it, as the rescheduled debt would still have to be paid back in the future with interest charged on the deferred payment.

The costs of the externally conditioned growth model, or dependent development, can best be understood by looking at the terms on which the

country obtained external financing. The increasing preeminence of autonomous loan capital shown in Tables 6.7 and 6.8 was accompanied by a radical change in its character: a decreasing proportion of long-term official credits in favor of an increasing proportion of medium-term private suppliers' credits (see Tables 6.9, 6.10 and 6.11 below). In contrast with the first postwar decade, when practically all autonomous loans took the form of long-term trade credits originating with official international lending institutions (particularly the Eximbank), medium-term suppliers' credits accounted for 67 percent of gross autonomous loans between 1957 and 1961, while long-term credits disbursed by official agencies represented only 33 percent.³⁸ More than 90 percent of all suppliers' credits came from the Hague Club countries, England, France, Germany, Italy, Japan and the U.S.³⁹ At the end of 1960, with a total debt of \$3.1 billion, 40.2 percent (\$1.2 billion) of which consisted of suppliers' credits.⁴⁰ Table 6.10, using data from ECLA, shows that at the end of 1961, 50.1 percent of the total external public debt consisted of suppliers' credit and in 1962, 50.7 percent. It should be noted, however, that short-term debt is not included in ECLA's figures of total external public debt.

Conjuntura Economica argues that the dependence of Brazil on suppliers' credits is attributed to the lack of appropriate sources of external financing for developing countries.⁴¹ Table 6.9 shows, however, that it was only after 1957 that suppliers' credits increased dramatically, when long-term credit to Brazil from international agencies became contingent upon implementation of IMF stabilization. Suppliers' credits thus made it possible for Kubitschek to evade IMF requirements, as will be discussed soon. Therefore, it was the "conditionality" of the IMF, but also the lack of foresight of the Kubitschek government that, in the final analysis, led Brazil into obtaining external finance in the form of private suppliers' credits carrying hard commercial

Table 6.9 Medium-Term Liabilities, 1955-1966
(in millions of US\$)

Year end	Compensatory Financing	Suppliers' credits	Total
1955	1,044	683	1,682
1956	918	780	1,698
1957	862	962	1,824
1958	999	1,011	2,010
1959	902	1,126	2,028
1960	913	1,115	2,027
1961	1,153	1,326	2,479
1962	1,203	1,394	2,597
1963	1,221	1,431	2,652
1964	1,190	1,441	2,631
1965	1,350	1,487	2,837
1966	1,285	1,655	2,940

source: Eugenio Gudín, "The Chief Characteristics of the Postwar Economic Development of Brazil", p. 12, Table 7.

terms of repayment, the burden of which the President would leave for his successors.

Table 6.11 shows the progressive deterioration of the terms of Brazil's foreign debt as a result of extreme reliance on suppliers' credits. This Table reveals that more important than the absolute level of external debt was the repayment structure of the outstanding debt. In the first postwar quinquennium, it would have taken an average of 11 years to repay the entire external debt; by the fourth quinquennium, the average life of a much higher level of outstanding debt had contracted to only 5 years. Between 1947 and 1951 the average maturity period was 17 years and the average effective rate of interest was 2.7 percent. The heavy concentration of medium-term maturities, which first occurred in the refinancing of the 1952-53 financial crisis with medium-term BOP loans, was aggravated by excessive reliance on suppliers' credits between 1957 and 1961. By 1962-66, the maturity structure had shortened to 6.5 years and the rate of interest had climbed to 5.0 percent.

Table 6.10 Brazil: Comparison between privately placed debt, disbursed and outstanding, and total external public debt, disbursed and outstanding, 1955, 1961 and 1962 (millions of US dollars)

Year	Total Debt at Year End (1)	Privately Placed Debt (2)	(2) as a percentage of (1) (3)
1955	1,242.8	357.0	28.7
1961	2,013.7	1,009.7	50.1
1962	2,141.0	1,086.2	50.7

Source: ECLA, External Financing in Latin America (New York: United Nations, 1965), p. 206, Table 169.

Table 6.11 -Average Terms of Brazil's Outstanding External Debt,
by Quinquennia, 1947-66

	1947-51	1952-56	1957-61	1962-66
Average amount of external debt (million \$)	590	1,227	2,201	3,545
Average life of outstanding debt (years)	11.1	7.4	6.3	5.0
Effective maturity rate (years)	16.7	9.4	7.8	6.6
Effective rate of interest (percent)	2.7	2.8	3.0	5.0

Source: John Donnelly, "External Debt and Long-term Servicing Capacity", p. 101, Table 5.2

Notes: The average life of outstanding debt is calculated by dividing the level of external debt outstanding at the end of each year by the total of debt service payments (amortization and interest) scheduled for payment in the following year. The figures thus obtained indicated the number of years it would take to liquidate the debt outstanding, provided no new debt was incurred.

The effective maturity rate is calculated by dividing the level of outstanding external debt at the end of each year by the amortization payments scheduled for the next year.

The effective rate of interest is determined by dividing scheduled interest payments by the level of outstanding debt in any given year.

Scheduled debt service payments are based on outstanding external debt, inclusive of undisbursed portions, as registered with the Central Bank. For this reason, scheduled debt service payments are not identical with actual debt service payments recorded in the balance of payments.

Associated with the shortening of the overall maturity structure was an increasing share of amortization payments in total debt service payments; it increased from 69 percent in the first quinquennium to 78 percent, 82 percent and 75 percent respectively, in the next three quinquennia.⁴²

It is also important to note that the average life of outstanding debt arising from suppliers' credits between 1957 and 1961 was 4.5 years, less than half of the average life of debt arising from development credits extended by official credit institutions, and that the effective maturity rate on suppliers' credit was 4.5 years, compared with 18 years for autonomous loans from official sources and 6.5 years for BOP compensatory loans. The effective rates of interest were 7.4 percent on outstanding suppliers' credit debt, 4.5 percent on official outstanding debt and 3.1 percent on BOP compensatory loans.⁴³

Much of the increased cost of external financing between 1962-66 must be attributed to rescheduling operations (1961 and 1964) as well as to the hardening of aid terms in the early 1960s. As Donnelly explains:

The harder the terms, the sooner will the buildup of debt service payments begin to exceed gross capital inflows and the greater the danger that the country will prematurely become a 'mature debtor' and confront a transfer problem in servicing the debt.⁴⁴

This is, of course, what happened in the early 1960s and would happen again in the early 1980s. In this connection it should be noted that in the nineteenth century, the United States, Canada, New Zealand and Australia, did not become "mature debtors". Their debt service was paid with export earnings and not with new loans.⁴⁵

Finally, Tables 6.12 and 6.13 are the best indicators of the vulnerability of Brazil's economic growth during the period. Table 6.12 shows that net loan capital movements diminished the country's total capacity to import in the early 1960s resulting in the slowdown of economic growth and

revealing the contradictions of a model of capital accumulation based on extreme reliance on external flows of loans. Debt service payments became the main obstacle to growth after 1961 as they created irreconcilable pressure on Brazil's capacity to meet other external payments. The fall in intermediate imports (29 percent in 1961 and 12 percent in 1962) interrupted the economic expansion and initiated the economic downturn.⁴⁶

The outflow of amortization and interest is compared in column 2 of Table 6.12 with new gross inflows of long- and medium-term loans (autonomous and BOP). Debt service averaged 62 percent of new loan disbursements in the second quinquennium and 82 percent in the third quinquennium, but more than offset gross disbursements of loans averaging \$457 million in the fourth quinquennium.⁴⁷ In 1963 alone, there was a net outflow of capital of \$135 million when new inflows of loans were not sufficient to cover amortization and interest payments (see also Table 5.3 above). Instead of augmenting Brazil's total capacity to import - and grow - in the early 1960s, net inflows of loans diminished it and intensified the need for short-term compensatory operations (Table 5.14 above has already indicated this problem). Adding the net balances of other autonomous external capital (private direct investment) and all other capital income payments (patents, rents, royalties) to the general net balance of loan capital, increases the average net drain on Brazil's foreign exchange position from \$4 million per year to \$8 million between 1962 and 1966.⁴⁸

Debt service payments constitute a first priority claim on freely convertible current account earnings (export earnings) and it is not an exaggeration to say that foreign creditors do control a debtor country's export earnings. Column 3 of Table 6.12 shows the external debt service ratio, the measure that best indicates the short-term vulnerability of the economy to a liquidity crisis. It shows the proportion of current account receipts

preempted by debt service payments in any given year. The higher the ratio, the greater the rigidity in the BOP, the greater the opportunity cost of debt servicing (or previous borrowing) in terms of competing import claims for foreign exchange and the greater the need to obtain compensatory financing when autonomous loans decline.

With the stagnation of export earnings during the 1950s and the corresponding increase in external indebtedness, Brazil's debt service ratio increased from an average of less than 8 percent in the first postwar quinquennium to nearly 30 percent in the last two quinquennia, as indicated in column 3 of Table 6.12. The debt service ratio would be even higher when other contractual income payments (e.g. patents, rents, royalties, technical assistance) were included in the calculations as well as remittances of profits and dividends, shown in column 4.

Table 6.13 shows in column 2 the very high debt service ratios recorded in 1959 (33.3 percent), in 1960 (37.1 percent) and in 1962 (33.1 percent), indicating the great pressure of debt service, hence the need for short-term swap loans during those years. In 1963, the ratio was 32 percent.⁴⁹ Column 3 of Table 6.13 further shows that total service payments on long-term capital (direct foreign investment and long-term loans) reached in 1960 41.3 percent and in 1962, 39.4 percent of foreign exchange earnings on current account. In 1963, they reached 45 percent, well beyond the capacity of the country to pay.⁵⁰ Thus, these tables reveal, in a nutshell, the economic contradictions of developmentalism in Brazil: foreign indebtedness, promoted by the internal and external ideologues of developmentalism as the necessary instrument of growth and BOP equilibrium, turned into the major source of stagnation and financial disequilibrium. The political contradictions would reach the breaking point during Kubitschek's successors, particularly Goulart, when domestic decisions became absolutely subordinated to the constraints imposed by the massive foreign debt.

Table 6.12 Indicators of Growth in Actual Debt Service Payments, by
Quinquennia, 1947-69

Years	Average Debt Service Payments ^a (million \$)	Debt Service as percent of Gross loans ^b	Debt Service as percent of Current Account Receipts	All Capital Service ^c as percent of Current Account Receipts
1947-51	103	184.9	7.5	11.4
1952-56	163	62.3	10.2	14.5
1957-61	434	83.1	28.9	33.5
1962-66	461	102.9	28.2	32.1
1967-69	653	105.3	30.3	----

Source: John Donnelly, "External Debt and Long-term Servicing Capacity", p.105, Table 5.4

^a Interest and amortization payments. The high net outflow of capital for the first quinquennium reflects the rapid retirement of Brazil's bonded external debt of the pre-1930 period as we saw in chapter 4. After the debt settlement in 1943 the external public debt in bonds declined from \$597 million at the end of 1947 (then 96% of total external public debt) to less than \$100 million in the fourth quinquennium (2% of total debt).

^b Includes gross autonomous loans and balance of payments loans

^c Includes debt service plus remittances of profit and dividends on foreign direct investment, patents, royalties, rents and payments for technical assistance.

Table 6.13 Brazil: Service Payments on Long-Term Foreign Capital as a percentage of Foreign Exchange Earnings on Current Account

Years	Direct Investment Income	External Long- Term Debt Service	Total Service Payments on Long- Term Foreign Capital
1959	3.6	33.3	36.9
1960	4.2	37.1	41.3
1961	4.0	28.7	32.7
1962	6.3	33.1	39.4

Source: ECLA, External Financing in Latin America, p. 200, Table 164.

The political contradictions of developmentalism

As already discussed, the financial difficulties of Brazil began in 1958 when Kubitschek was faced with the urgent need to obtain additional BOP financing. This year was also characterized by strong pressure from the country's foreign creditors for the implementation of IMF stabilization measures as a condition for debt relief. Kubitschek, however, was confronted with the same domestic political opposition to the unpopular anti-inflationary policies of credit and wage freeze and the elimination of import subsidies of wheat and oil that characterized the Vargas' second administration (see chapter 5). When in 1958 the U.S. made approval of a \$300 million BOP loan contingent upon IMF stabilization, Kubitschek simply abandoned the austerity plan that had been drafted by his Finance Minister Lucas Lopes and the director of the BNDE, Roberto Campos, and broke off negotiations with the Fund, a gesture of defiance which won him great admiration inside Brazil. To quote Skidmore's summary of the situation:

In June 1959, Kubitschek made his choice. Amidst the heated political atmosphere, he instructed his representatives in Washington to break off negotiations with the IMF. Faced with a choice between continuing the drive to fulfill his targets and the need to constrict the domestic economy to satisfy foreign creditors and Brazilian anti-inflationists, Kubitschek opted for the former. He had decided that

it was too late in his presidency, now already beginning to be overshadowed by the succession question, to carry out the stabilization plan outlined in 1958... He would leave the problems of inflation and foreign indebtedness to his successor.⁵¹

Following the break with the IMF, Kubitschek, as already discussed, stepped up his reliance on high-cost borrowing from private sources abroad, suppliers' credits and short-term swap loans, to deal with the increasing BOP disequilibrium. Thus, as the long-term official loan from the U.S. was contingent upon implementation of IMF stabilization, which was politically impossible for the President to accept, the private loans, although carrying hard commercial terms, did not have "strings attached" and, most important, their payments would come due after Kubitschek left the presidency.⁵² What I am clearly suggesting is that the roots of the crisis in 1963-64 lay not in the economic policies of Goulart, but in the economic policies of Kubitschek. Goulart inherited a full-scale debt repayment crisis that could no longer be postponed and during his presidency the contradictions inherent in Brazil's development strategy reached the breaking point. As Michael Wallerstein correctly observes:

Kubitschek sought to maximize both short-term economic growth and political support under the constraint of a deteriorating balance of payments. His solution was to borrow abroad at a rate that could not be maintained for long. When, by 1958 Kubitschek was unable to obtain more long-term loans, he turned to short-term loans. It was a successful strategy of reaping the benefits and deferring the costs until someone else would be president. For Kubitschek's political popularity the strategy may have been optimal, but for his successors, caught between the IMF and national bankruptcy, it was disastrous. 53

Before we turn to the Goulart presidency, which is our main concern here, we should briefly look at the short-lived Quadros government and how it was possible for the President to receive temporary debt relief from the foreign credits in the form of new money and a refinancing the loans falling due (see Table 6.8 above) even though anti-inflationary measures collapsed.

When the UDN president Janio Quadros and PTB vice-president João Goulart (who had been independently elected on the PTB's ticket)⁵⁴ were inaugurated in January 1961, Quadros emphasized in his speech the alarming financial situation: a substantial acceleration of domestic inflation and \$2 billion of foreign debt due in the new presidential term and over \$600 million in the first year alone. He told the nation that: "We have spent, drawing on our future to a great extent than the imagination dares to contemplate."⁵⁵

Quadros immediately came to terms with the IMF and the foreign creditors promising a tough orthodox stabilization program in Brazil. Although credit and wage squeeze proved - a sin - politically impossible to be carried out for a long period by an elected president (as Table 5.6 above shows, inflation continued accelerating from an annual rate of 29.4 percent in 1960 to 33.3 percent and 43.2 percent at the beginning and end of 1961 respectively), Quadros was able to implement a major reform of the exchange rate system, the main requirement of IMF stabilization programs, thus pleasing foreign creditors. As we already explained in this study (see introduction to Part Four), the IMF is primarily concerned with exchange liberalization to guarantee the free flows of goods and capital across national borders. And this was precisely what the UDN president did: the multiple exchange rate, hence import controls and subsidies on essential imports such as wheat and oil, were abolished and all exchange transactions were to take place at the free market rate, in addition to a sharp devaluation of the cruzeiro.⁵⁶ SUMOC Instruction 204, 205 and 208 were thus the major mechanisms which opened the way for Quadros to obtain the temporary debt relief already discussed above.

While pleasing international creditors, however, stabilization proved costly to Quadros at home. The familiar political pressure of

workers, industrialists, nationalist intellectuals and middle class consumers immediately followed the restrictions on credit and wage freeze as well as the elimination of the subsidy on imports of wheat and oil, which had caused a drastic increase in the price of bread and public transportation. Quadros had scarcely begun to implement his austerity plan early in 1961, when vice-president Goulart announced to the press that his party, the PTB, would immediately campaign for a rise in the minimum wage.⁵⁷ Shortly after, trade union leaders threatened to begin a general strike unless wages were substantially increased.

By August 1961 the pressure of the industrial bourgeoisie and nationalists was such that Quadros relaxed the credit restrictions in spite of the strong warnings of the IMF, indicating that he, too, would not carry through a stabilization program in Brazil. That the president submitted his resignation to congress in the same month seems to indicate that he believed that by resigning the army would bring him back and his hands strengthened against opponents of stabilization with the emergency powers to govern Brazil by decree that he had previously requested the military ministers.⁵⁸

Congress, however, promptly accepted Quadros' resignation. In the letter, reminiscent of Vargas' suicide note, Quadros charged that "Terrible forces have risen up against me, intriguing against me and defaming me, sometimes under the guise of collaboration."⁵⁹ The resignation of Quadros brought João Goulart to the presidency.

In a 1987 special report on Brazil, The Economist recalls rather amusingly this episode in Brazilian politics:

A conservative with a groucho Marx political style, Mr. Janio Quadros came to power in 1961 and sought the backing of the army to impose austerity on Brazil against the howls of the pork-barrel politicians in congress. He resigned, expecting to be brought back to power by the army. Instead, the soldiers dumped him, allowed his silly, populist, cowboy vice-president João Goulart, to take over and make 60 a hash of the economy, and then moved in to seize power for themselves.

Goulart and the open crisis: the split of the populist pact

João Goulart, the Getulista Vice-President and leader of the PTB became president of Brazil on September 7, 1961 when a compromise solution in the congress established the **parliamentary system**, thus depriving him of most powers.⁶¹ It was only in January 1963 that a plebiscite returned the presidential system and Goulart gained full presidential powers.

We have already shown how drastic the financial situation of Brazil was during 1962 and 1963. With a foreign debt beyond the country's capacity to repay, largely consisting of short-term loans falling due in the immediate future, Brazil was on the brink of bankruptcy. The foreign debt reached \$3 billion in 1962 and 19.6 percent of interest payments and amortization were due in 1963.⁶² What remains to be seen is how Goulart attempted - and failed - to reconcile the interests of foreign creditors expressed in the form of pressure for economic stabilization as a condition for short-term debt relief with those of domestic pressure groups against the anti-inflationary policies.

Goulart, like his mentor Vargas before him, also attempted (albeit without Vargas' exceptional ability of manipulation) to pursue a contradictory economic policy with orthodox and nationalist contents aimed at courting the increasingly militant left. As was the case with Vargas, the policy also turned into the major weapon of the right and did not succeed in harnessing the support of the popular forces. In fact, the presidency of Goulart was particularly frustrating to the left, which believed that with his ascension to power Brazil finally had a president who would carry out its program.⁶³ As in 1954, the army intervened. This time, however to stay.

During 1962 economic policy drifted without direction. Following the collapse of Quadros' anti-inflationary policies, in October 1961 the minimum

wage was increased by 40 percent (see Table 5.7A above) and the politically sensitive exchange subsidies on the import of wheat and oil were reintroduced. The annual rate of inflation jumped from 43.2 percent in 1961 to 55.3 percent in 1962 (see Table 5.6 above). To the IMF and foreign creditors, Brazil had for all practical purposes abandoned any attempt at reaching the equilibrium of its external accounts, and the response was prompt: the contraction of loans (this is clearly indicated in Tables 5.3, 5.14, 6.8 and 6.12 above). Goulart, as we have seen, resorted to short-term operations (Table 6.8) just to keep Brazil afloat, since in addition to the decline in gross autonomous capital inflows, export earnings fell sharply in 1962 (Table 5.14 above and 7.11 below). But the president was also forced to curtail essential industrial imports (Table 5.14 above and 7.11 below) and public investment, and GNP fell from 10.3 percent in 1961 to 5.3 percent in 1962 and per capita GNP fell from 7.2 percent in 1961 to 2.3 percent in 1962.⁶⁴ Brazil's rapid indebted postwar development was coming to an end.

The acute economic and financial problems of Brazil in 1962 and the certainty that stabilization measures were just a matter of time, were accompanied by increasing political nationalism, radicalization and polarization around the issues of foreign capital and basic social reforms in the country. Two workers' general strikes in July and September paralyzed public transportation and food shortages led to riots in major cities. Leftist-nationalist attacks on foreign capital were launched by Leonel Brizola, the governor of the state of Rio Grande do Sul and brother-in-law of Goulart, who expropriated the local subsidiary of the American International Telegraph and Telephone (ITT), and in September, by congress, which passed a restrictive profit remittance law (Law 4131), infuriating foreign investors, particularly Americans. The law provided that profit remittances could be calculated only on the amount of capital originally brought into the country, and not on the (much larger)

unremitted past profits which had been reinvested in Brazil (see chapters 7 to 9 for the fate of Law 4131 under the post-64 ring-wing military regime).

Finally, and most significantly, together with the political mobilization of urban workers, by the end of 1961 the forgotten rural sector of Brazil had awakened politically with the emergence of the peasant leagues. Demanding the reform of Brazil's archaic land structure, peasants began resisting the usual attempts of landowners to expel them from their subsistence crop lots and unrest spread throughout the sugar zone in the Northeast.⁶⁵ The influence of the leagues spread from the Northeast to Minas Gerais, Bahia, Goias and Rio de Janeiro, where land invasions became more and more frequent. It was in the midst of these pressing political, financial and economic problems that Goulart gained full presidential powers in January 1963.

Economic stabilization and political conflict

Goulart organized his first presidential government to begin the Three-Year Plan, an ambitious stabilization plan. San Tiago Dantas, a leading representative of center and moderate left opinion, was the new Finance Minister and Celso Furtado, the dynamic technocrat and director of SUDENE (The Northeast Development Agency), known for his advocacy of structural reforms in Brazil, was the Minister for Economic Planning. But Goulart, like Vargas in 1953 when confronted with foreign pressure for unpopular anti-inflationary measures, needed to court the trade unions. To this end, the president chose for the Labor Ministry Almino Afonso, an important representative of the radical, nationalist left, known for his commitment to achieving social justice through socialism.⁶⁶ As Skidmore points out: "Afonso's presence indicated that Goulart intended to pursue a double political game."⁶⁷

The Three-Year Plan emphasized the importance of resuming a high

rate of growth and of carrying out basic social reforms (tax, educational, housing and particularly agrarian reform) to facilitate development, while simultaneously curbing inflation. But the Plan also openly acknowledge Brazil's need for more foreign investment, drawing strong criticisms from the nationalist left.⁶⁸ Payer notes that the Plan

...was designed with one eye on Washington in the hope of securing the approval of the IMF, a condition for new credits and/or deferral of the crushing foreign debt repayment burden, which if not deferred or repudiated would eat up 45 percent of Brazil's export earnings.⁶⁹

In fact, during Goulart's presidency domestic political and economic decisions became absolutely subordinated to the needs of the external adjustment. As a 1963 report of SUMOC states:

The new policy [of stabilization] is necessary because incentives to attract foreign capital between 1956 and 1960 resulted in strong BOP pressure and the possibilities of debt repayment are not compatible with the massive short- and medium-term obligations previously assumed to accelerate industrialization.⁷⁰

Thus, an exchange reform and devaluation in January 1963 repeated Quadros' 1961 reform, since as we have already noted, exchange subsidies on imported wheat and oil had been reintroduced and had to be abolished once again to satisfy the IMF. Restrictions on the budget deficit, on the expansion of credit, and on wage increases completed the basic requirements of the IMF. Although there are various interpretations of Brazil's economic stagnation after 1962, such as economic cycles, exhaustion of ISI and under-consumption, it is clear, however, that the contraction of foreign loans during 1962 and 1963 and the monetary and credit restrictions during the first semester of 1963, imposed by the need to please the creditors and obtain BOP relief, played a crucial role in the paralysis of economic activities and political polarization in Brazil.

It is not difficult to understand why Goulart, a politician identified with pro-labor policies, began to emphasize the second aspect of the Dantas-

Furtado Plan, basic social and structural reforms, particularly agrarian reform, not only to facilitate development, but also to improve the distribution of income demanded by organized labor and the nationalist left. This was to be Goulart's main cover for the unpopular anti-inflationary program envisioned by the Plan and which met with fierce opposition from those sectors of society.

Thus, as orthodox stabilization measures were being implemented, Goulart began pushing vigorously for reforms, albeit vaguely, aimed at consolidating his hold over the organized workers and undercutting leftist attacks on his "reactionary" economic policy.⁷¹ In March, the president, without making any effort to obtain congressional votes on specific measures, submitted an agrarian reform bill to the congress providing for compensation in government bonds rather than cash. The bill, however, only succeeded in splitting the PSD-PTB alliance. The rural-based PSD was pushed toward the anti-Goulart and ultra conservative UDN in opposition. The PTB, now under the increasingly influence of the radical left, was skeptical of any social reform without constitutional reform. Furthermore, this most sensitive political issue in Brazil spread beyond congress, alarming centrist opinion among the military and the middle classes which saw Goulart giving in to the pressure from the left. In May, the agrarian reform bill was rejected by the Chamber of Deputies, where the over-representation of rural districts gave landowners great power. Yet the president continued pressing for land reform, serving only to arouse the dissatisfied and alienate the conservatives.

One significant reason of center alarm with the land reform issue was the chance that the Brazilian constitution could be amended to extend the vote to illiterates. Brazil's population was primarily rural. If the rural workers could be organized and persuaded to vote in a bloc, they could exercise a decisive influence at the polls. It is in this respect that

Cardoso and Faletto argue that when Goulart attempted to incorporate peasant sectors into the system, "the limits of populism as a form of mobilization of the masses and as a development policy were reached."⁷² But was Goulart really willing to do that?

In March 1963 rural workers were indeed granted the right to form rural unions and for the first time came under the protection of the minimum wage law. However, land reform, the most important political issue that could have changed economic relations and political power in Brazil, was used by Goulart until March 1964 simply as a rhetorical means to consolidate the support of popular forces. In fact, the president was extremely ambiguous even in his rhetoric and he clearly did not take any concrete action on the issue.

In my view, however, a direct cause of the collapse of the populist alliance was the threat that stabilization policies posed to the alliance's most important partners: the industrial bourgeoisie and the working class. Goulart, contrary to the opinion of most observers, was frankly pursuing an orthodox policy to please foreign creditors, despite his nationalist and reformist rhetoric. The data below shows just that.

Thus, the detrimental effects of Goulart's stabilization policy upon workers and industrialists were immediate. The ending of import subsidies for wheat and oil caused an immediate jump in the price of such basic commodities as bread and bus fares at the very moment that the government was attempting to hold down wages. In February 1963 transport costs increased by 70 percent and the price of wheat and bread by 100 percent.⁷³ As to the impact of the austerity measures on the industrial bourgeoisie, Table 5.14 below shows that the restriction of credit to the private sector in 1963 was the most severe of the decade of the 1960s and as a consequence, investment fell and firms were forced to contract and dismiss

workers.⁷⁴ As Brazilian economist Andre Lara Resende argues:

The reduction in the real liquidity of the economy, particularly in the availability of credit to the private sector in 1963, was not matched in the decade of the 1960s even considering the first years of the stabilization of the post-1964 military regime...One of the possible causes that led Furtado, a strong opponent of monetarist policies to combat inflation, to reduce so brutally the real liquidity of the economy appears to have been the urgency that the situation of the BOP and of the foreign debt imposed in obtaining immediate results in the internal front. The fate of negotiations with American creditors, and the IMF, depended on these internal results.⁷⁵

Table 6.15 below shows growth rates of GNP and per capita GNP between 1960 and 1970, indicating that 1963 was the worst year of the decade. In 1963, GNP growth rate fell to 1.5 percent from 5.3 percent in 1962 and per capita GNP growth rate was negative, -1.3 percent, from 2.3 percent in 1962. Brazil's postwar development had come to an end as the simultaneous acceleration of inflation (annual rates jumped from 55.3 percent in 1962 to 80.6 percent in 1963, see Table 5.6 above) and credit control resulted in a severe tightening of liquidity in the economy (see Table 6.14 below).

The political opposition of the industrial bourgeoisie (centered in the Sao Paulo businessmen movement around the Institute of Social Research and Study, IPES, and the National Confederation of Industry), nationalist intellectuals and trade unions immediately mobilized against Goulart's stabilization, denouncing credit restriction as an unacceptable concession to the IMF which could only hamper development.⁷⁶ In fact, trade unions joined industrialists in their protest against the credit squeeze, following a pattern evident since 1955: the political strategy of unions between 1955 and 1964 consisted of demanding from the government protective tariffs, subsidies and particularly easy credit to the bourgeoisie in order to guarantee increases in both profits and wages.⁷⁷

The National Confederation of Industry accused the Three Year Plan of simply turning into "a program of stabilization" and stated that "the

volume of credit should grow in line with the general level of prices." Furthermore, it said that "In all sectors of industry, there is now a catastrophic fall of sales, abnormal increases of stocks, drastic reduction of orders, unemployment and a complete paralysis of investment."⁷⁸

Strikes, affecting all sectors of the economy, became more and more frequent as workers sought to defend their shrinking real wages by demanding higher minimum wages, family allowances and the Christmas bonus. There were also "solidarity strikes in support of other workers, civil servants, and the armed forces; and, in addition, trade union leaders called, or threatened to call, general strikes for the introduction of agrarian and other basic reforms, for the recognition of the peasant leagues and for the repudiation of the financial policy of the IMF."⁷⁹ Labor disputes grew from 682 in 1961, 741 in 1962 to more than 1,000 in 1963.⁸⁰

That the industrial bourgeoisie and trade unions were united against stabilization shows the weakness of the argument that the old political compromise between capital and labor broke in the early 1960s primarily as a result of the threat that rising wages posed to profits.⁸¹ In spite of the growing militance of the working class, after 1959 real minimum wages began declining and between 1961 and 1964 they fell approximately 20 percent (see Tables 5.7C above and 7.1 below). Data presented by Wallerstein show that the real minimum wage was lower in 1963 than it had been in 1952 and he argues that:

Under Goulart, the veteran politician whose career had been most closely tied to the interests of the working class, the real wages of at least the substantial number of workers receiving the minimum wage fell while profits remained surprising stable in the midst of an economic downturn. In terms of distributional outcomes, Kubitschek's policies were more pro-labor.⁸²

Therefore, the evidence suggests that, at least until March 1964 when Goulart openly turned to the left, the industrial bourgeoisie was less threatened with profit squeeze by pro-labor policies of the President than by his policies of stabilization. And so were workers' wages and particularly jobs.

Table 6.14 Brazil: Indexes of real liquidity in the economy, real growth rates in the last 12 months utilizing the IPA as deflator, 1960-68 (in percentages)

Years	Means of payment	Total of loans to the private Sector	Commercial bank loans to the private Sector
1960 I quarter	8	0	7
II	11	5	12
III	6	6	8
IV	5	5	7
1961 I	12	6	8
II	4	-4	-5
III	3	-5	-6
IV	1	-7	-11
1962 I	-6	-2	-8
II	0	-2	-6
III	3	6	3
IV	12	9	5
1963 I	-6	-4	-15
II	-9	-12	-18
III	-12	-17	-21
IV	-9	-15	-14
1964 I	-6	-14	-15
II	2	-4	-1
III	0	1	5
IV	-7	-7	-6
1965 I	9	2	5
II	17	6	15
III	30	12	23
IV	42	25	41
1966 I	21	16	28
II	1	8	9
III	-12	1	-3
IV	-17	-2	-9
1967 I	-5	2	-4
II	10	14	14
III	18	10	22
IV	20	26	33
1968 I	21	37	43
II	11	32	32
III	10	34	32
IV	10	29	26

Source: Andre Lara Resende, "A politica brasileira de estabilizaco:1963/68" *Pesquisa e Planejamento Economico*, vol. 12, Dezembro 1982, no. 3, p. 766, Tabela 5.

Table 6.15 Brazil: Growth Rate of the GNP and Per Capita GNP 1960-1970
(percentage)

Years	GNP	Population (selected years, in millions)	Per Capita GNP
1960	9.7	70.2	6.6
1961	10.3		7.2
1962	5.3	75.3	2.3
1963	1.5	76.3	-1.3
1964	2.9	78.7	0.0
1965	2.7		-0.1
1966	5.1	84.7	2.2
1967	4.8		1.8
1968	9.3		6.3
1969	9.0		5.9
1970	9.5	93.1	6.4

Sources: Luiz Bresser Pereira, Development and Crisis in Brazil, p. 140, Table 7.1 and Thomas E. Skidmore, "The Politics of Economic Stabilization in Postwar Latin America, p. 170, Table 11.

The collapse of stabilization and populist democracy

In the meantime, Goulart had high hopes that his orthodoxy would convince the IMF and foreign creditors to refinance Brazil's debt burden and extend immediate aid. Foreign creditors, however, decided to keep Goulart on a "short leash."

When Finance Minister Dantas travelled to Washington in March 1963 and signed an agreement with USAID Director David Bell for an immediate aid package of \$400 million, the U.S. government decided to release only a small part of it (see Table 6.8 above), making the rest contingent upon the IMF's "seal of approval" of the stabilization program being carried out. (The IMF mission was scheduled to visit Brazil in May to scrutinize the anti-inflationary Dantas-Furtado program). Furthermore, Dantas' prospects for obtaining a rescheduling of the foreign debt with the Hague Club, like the one in 1961 under Quadros,

were poor. The European creditors were waiting for the IMF's and the US's decision before refinancing Brazil's enormous short-term debt (suppliers' credits).

The lack of support from the U.S. at a time when the critical financial situation of Brazil was exacerbating political radicalization, led Dantas and Roberto Campos, the Brazilian Ambassador in Washington, to consider breaking off negotiations and mobilizing Brazilians for an austerity program for the sake of nationalism (which would have been a clear victory for the left), rather than for the sake of foreign capital. But such a course of action not only would entail the mobilization of domestic resources for development, but also the burden-sharing among all classes of society to a far greater extent than austerity under the IMF, whose burden is mostly placed on the shoulders of the working class. According to Skidmore, the political difficulty of "going it alone" was not lost on Dantas and Campos:

Dantas and Campos concluded that Brazil could not risk relying on her own resources alone because the government lacked "sufficient cohesion", and because Brazilian nationalism was too shallow to generate the necessary political support for the resulting austerity. In effect they were admitting to themselves the severe political limitations that Brazilian democracy placed on the mobilization of domestic resources for economic development. 83

In addition to profit remittances law of 1962, another issue that further strained Brazil's ability to obtain U.S. aid and polarized domestic political opinion was the nationalization of foreign-owned public utilities. When the government announced in April a more than generous agreement with the American and Foreign Power Company (AMFORP), strong nationalist attacks led Goulart to postpone the settlement, referring the disputed matter of the value of AMFORP to a newly appointed evaluation board.⁸⁴ But this move strengthened the right which now associated Goulart with Brizola's radical views on confiscation of foreign capital with minimal, if any, compensation and also on social reforms, with or without congress.

It was in the area of wage policy, however, that Goulart's stabilization policy collapsed and with it, the president's hope to obtain the urgent external financing to relieve the debt burden. And, the end of the orthodox anti-inflationary policy in May was not on account of minimum wage increases, as with Vargas in 1954, but of salary increases for civil servants and particularly the military, whom Goulart could hardly afford to antagonize.

Dantas promised the IMF that he would hold wage and salary increases to 40 percent, but he was unable to convince the cabinet, which agreed, under intense pressure from the military, to a 70 percent hike.⁸⁴ The debate over the issue was still raging in May when the IMF vetoed an extension of immediate aid and further refinancing of Brazil's short-term debt. The increase was finally confirmed by congress in July.

While tightening a financial noose around Goulart's federal government, the U.S. strengthened the political position of certain conservative state governors of the Northeast who opposed Goulart's land-reform rhetoric. As Page argues: "For as U.S. officials determined that the national government of President João Goulart was veering to the left, the Alliance for Progress became a major instrument of a policy to lend support to state governors who were friendly to the U.S."⁸⁵ Ironically, President Kennedy had emphasized land reform in his Alliance for Progress in Latin America!

The USAID mission came into being as a result of the Northeast agreement signed by the U.S. and Brazil in April 1962. Under the terms of the agreement, USAID was to supervise the application of \$131 million in Alliance for Progress funds to be allocated over a two-year period. According to Page, the staff of the U.S. Consulate in Recife began to increase in order to provide cover for the CIA agents disguised as consular officers who "dispensed CIA funds in an attempt to affect the struggle for control of the rural labor movement."⁸⁶

In June 1963 Goulart changed his cabinet, replacing Dantas as Finance Minister and abandoned the stabilization plan that had gained the support of no social group. Goulart was confronted with the same political costs of stabilization which beset Vargas in 1953-54, Cafe Filho in 1955, Kubitschek in 1958-59 and Quadros in 1961. It is tempting here to compare Goulart with Vargas in 1954 when the former president, faced with the opposition from all sectors of society against stabilization, threw himself into a bold radical populist campaign to rescue working class and left support. While in March 1964 this was precisely Goulart's course of action, the president, after the collapse of his stabilization program, still attempted desperately to maintain a centrist policy and appease the right at home and creditors abroad. Despite Goulart's efforts to hold to the center, the U.S. and the Brazilian right had already determined that at that stage he was shifting to the left. In this respect, the ouster of the radical Labor Minister is significant.

The organized labor's opposition to Goulart's economic stabilization policy came mostly from the General Labor Command (CGT), an extra-legal confederation uniting labor leaders of the radical, nationalist left. Almino Afonso, the Labor Minister whom Goulart had appointed to court the trade unions and play a double game when confronted with unpopular anti-inflationary policies, became a vocal supporter of CGT, thus turning against the president. As Erickson explains,

Confronted with opposition based in the labor movement and vocally led by a member of his own cabinet, the president withdrew his support of the CGT and then lent the prestige of his presidency to a parallel but much weaker central labor organization. The threat to withdraw the prestige, patronage, and financial resources which accompanied good relations with the government forced the CGT leaders into retreat, facilitating the ouster of the Labor Minister. The episode is significant because it disproves the argument that Goulart had shifted to the left during this period. To the contrary, he had moved right by weakening labor's left wing and preventing working class leaders from amassing real power in their own hands. This is precisely what one should expect of populist politicians, for they

see the working class as an electoral mass to manipulate and, whatever their humanitarian consideration, only the rarest exceptions among them willingly allow workers to gain access to the levers of power. ⁸⁷

Another clear evidence that Goulart had not moved to the left at that stage was his unwillingness to declare a unilateral debt moratorium strongly demanded by the nationalist left or even to limit debt payments to a fixed percentage of export earnings, as proposed by his Finance Minister Carvalho Pinto, who replaced Dantas. ⁸⁸ Still, Goulart did not want to jeopardize Brazil's international creditworthiness, attempting, instead, to continue placating his creditors.

In October 1963 Carvalho Pinto attempted to rescue the Three-year Plan with a new non-inflationary scheme to capture private savings in order to finance the government budget deficit. This new plan was launched as SUMOC Instruction 255, thus not requiring congressional action. According to it, the Bank of Brazil would sell treasury certificates whose purchase would be required by private banks exceeding their government-authorized credit limits. ⁸⁹ The introduction of treasury bonds into the market was precisely the course of action of the post-1964 military regime to finance the government deficit (see chapter 7).

With this significant gesture, Carvalho Pinto did manage to negotiate a postponement, until 1964 only, however, of payments on short-term loans from the IMF and the U.S. Treasury that came due in September and October. But the Finance Minister was under fire from the banking bourgeoisie who immediately protested SUMOC Instruction 255.

It was also in October that Goulart, faced with violent demonstrations, protests and strikes, including bank employee's strikes throughout the country, requested that congress grant him power to govern under a state of siege for 30 days. From our analysis of the impossibility of implementing austerity measures in a democratic context, this request of the president, like the one

from Quadros in 1961, would indicate that he, too, wanted to carry out the stabilization plan by all possible means. But as Page put it: "Sensing that the President might be groping toward an authoritarian solution after the model of his mentor and idol, Getulio Vargas, both the right and the left vigorously objected." ⁹⁰ Needless to say, SUMOC Instruction 255 was abolished and Carvalho Pinto lost his job. The Three Year Plan was by now beyond rescue.

From then on, right wing groups began actively plotting Goulart's downfall and the left began mobilizing rural and urban workers against Goulart's ambiguous talk of reforms. Still, even with all groups against him, the president did not stop in his desperate attempt to reschedule foreign debt payments. ⁹¹ Thus, with inflation accelerating (in early 1964 inflation reached 91.7 percent annual rate, as Table 5.6 above indicates, and Goulart granted a 100 percent increase in the minimum wage, Table 5.7A above), in a last-ditch effort to appease foreign creditors, but provoking strong attack from the left, in February 1964 Goulart reformed once again the exchange rate system (all transactions were to take place at the free market rate, although the politically sensitive subsidies of wheat and oil continued) and devalued the cruzeiro at 93.3 percent, managing in this way to resume some negotiations with the IMF and European creditors. The U.S., however, which held the key to the debt rescheduling, was not willing to grant a large-scale refinancing of the crushing short-term debt. ⁹²

Goulart, realizing that the prospects for alleviating the burden of the foreign debt were indeed poor, in the face of the intransigent position of the U.S., and that he was losing ground on the left while strengthening his opponents on the right, shifted his strategy in an attempt to meet the demands of the Brazilian left. In March 1964, at a massive left wing rally, the President signed two defiant decrees: the nationalization of all private oil refineries in Brazil and the expropriation and redistribution of private land.

Goulart's adoption of a leftist strategy, however, was more effective in mobilizing the right than the divided and weak left which was unable to provide the support to keep the president in power. On April 1, 1964 Goulart was overthrown by a coup d'etat carried through the right-wing military with strong support from the middle class and the industrial bourgeoisie. As Payer puts it:

The haste with which the U.S. moved to congratulate, recognize and send aid to the new military regime of Brazil was embarrassing even to their sympathizers. Goulart was overthrown on 1 April 1964, the recognition and congratulations followed the next day, and by 5 April The New York Times reported that 'the ouster of the Goulart regime has made a financial rescue operation possible for Brazil,' since Goulart had become 'an obstacle to negotiation and extension of Brazil's towering debt.' 93

Thomas Mann, the U.S. Assistant Secretary of State for Inter-American Affairs was quoted in the April 19, 1964 edition of O Estado de Sao Paulo as saying that:

Last January when we assumed our duties we were convinced that communism would rapidly erode the government of João Goulart in Brazil. Even before assuming our actual position, moreover, we already were following a policy destined to grant aid to certain state governors in Brazil. We did not furnish any money to support the balance of payments or the budget, nor did we take any measures that could directly benefit the central government of Brazil... Now after the replacement of Sr. Goulart, if the government of Brazil supports a stabilization and self-help program, which is the type of development program that we want to see, or in other words, if they accept their responsibilities in the Alliance for Progress, we would be prepared to consider making appreciably more substantial funds available. 94

With Octavio Bulhões as Finance Minister and Roberto Campos as Planning Minister, the two well known neo-classical, monetarist economists who had participated in previous frustrated stabilization programs, the military regime began in 1964 precisely the type of "development program" that the U.S. Assistant Secretary of State wanted to see: a drastic orthodox deflationary program, to the surprise of the bourgeoisie who had strongly supported the anti-Goulart conspiracy against precisely such a course of action. But in order to effectively carry out the unpopular stabilization policies, the regime also

immediately imposed an authoritarian solution: the suspension of the democratic political system that both Quadros and Goulart had previously contemplated.

The new regime's rapid compliance with the demands of foreign creditors was soon rewarded with a substantive rescheduling of debt service obligations on suppliers' credits even before the IMF had a chance to give its "seal of approval" (The IMF authorized a \$126 million "standby agreement" only in February 1965). Negotiations were completed on July 1, 1964 in Paris with the Hague Club.

Furthermore, by August, the restrictive profit remittance law of 1962 (Law 4131) was revoked and immediate and substantial aid from USAID and the World Bank (the Bank's loans were the first to Brazil since 1950) and BOP loans from the Eximbank and the U.S. Treasury followed.⁹⁵ Immediate relief reached \$283 million, or approximately three times that obtained in the 1961 rescheduling. Furthermore, postponement of principal payments (grace period) in 1964 was for two years as compared to only six months in 1961.⁹⁶

Still, as in 1961 the 1964 rescheduling was more a means of postponing the debt problem than of solving it. As Donnelly observes:

Being more concerned with stabilization than with economic growth, the primary objective of the Hague Club members (and the IMF) in extending these debt reschedulings was to 'bail out' Brazil with strictly short-term relief so as to permit uninterrupted debt servicing.⁹⁷

As chapter 7 shows, stabilization measures between 1964 and 1967 did not put the BOP on a stable footing. Rather, they only served to qualify Brazil for ever increasing amounts of foreign loans to finance current account deficits that soon began again to accumulate as a result of the sweeping liberalization of trade and foreign investment regulations the measures were intended to promote in the first place. With the new inflows of loans thus came the same source of vulnerability and external control which characterized Brazil's postwar domestic

processes. In this way, a new phase in the advance of productive forces contained the seeds of its own destruction.

In summary, chapter 6 examined the consolidation of the new situation of dependency that emerged in postwar Brazil and the developmental outcomes resulting from such situation. It showed the concrete political action taken by domestic power groups to integrate Brazil into the new international division of labor and incorporate foreign financial and industrial interests into the internal developmentalist alliance of the state sector, the industrial bourgeoisie and the urban middle and working classes. It demonstrated that it was primarily foreign loans which maintained the financial equilibrium of the economy in its new role as a market for capital goods from center countries, but that it was also international financial interests which set the limits for the country's capital accumulation process when the state could no longer reconcile the conflicting interests of its foreign and domestic partners and the developmentalist alliance fell apart. An authoritarian regime thus emerged in Brazil to ensure that the country's relations with foreign creditors would not be jeopardized by the inability of populist democracy to comply with their demands. Thus, this historical-structural analysis of specific characteristics of local structures and processes showed the mechanisms through which their maintenance and transformation were made possible.

But more than that, at the level of developmental outcomes, the empirical evidence presented in this chapter as well as in the subsequent one supports the contention of the dependency approach that the political and economic contradictions inherent in dependency situations are ultimately resolved in favor of global, rather than local capital accumulation: The growth of a decade was choked off and the democratic political system destroyed so that Brazil could meet the short-term gains of foreign financial interests.

NOTES

1. Raouf Kahil, Inflation and Economic Development in Brazil, 1946-1963 (Oxford: Claredon Press, 1973), p. 300.
2. Ibid.
3. Eugenio Guadin, a staunch anti-Getulista and an outspoken opponent of the industrialization proposals of Roberto Simonsen in the last years of the Estado Novo, was the policy's principal architect. The Finance Minister had great prestige with the conservative Brazilian press as a technical analyst of the country's economic problems. although this opening to foreign capital angered the nationalist economists, they did not yet have a spokesman of sufficient stature to challenge Guadin on technical grounds, as Celso Furtado would emerge to national prominence later. See Nathaniel Leff, Economic Policy-Making and Development in Brazil, 1947-1964 (New York: John Wiley, 1968), p. 62.
4. See, for example, Werner Baer, Industrialization and Economic Development in Brazil (Homewood, Ill.: Richard D. Irwin, Inc., 1965), p. 65; Leff, Economic Policy-Making, pp. 59-66 and Paul Singer, A crise do "milagre" (Rio de Janeiro: Paz e Terra, 1982), Sexta Edicao, pp. 45-6.
5. Cardoso and Faletto, Dependency and Development in Latin America (Berkeley: University of California Press, 1979).
6. Baer, Industrialization and Economic Development, p. 57.
7. Leff, Economic Policy-Making, p. 75.
8. Ibid.
9. See especially, Baer, Industrialization and Economic Development, pp. 101-135; Singer, A crise do "milagre", pp. 100-108 and Luiz Bresser Pereira, Development and Crisis in Brazil (Boulder, Colorado: Westview Press, 1984), pp. 36-40.
10. Baer, Industrialization, p. 110.
11. Singer, A crise do "milagre", p. 105.
12. Not without problems, however. Carlos Lacerda, the eternal anti-Getulista and UDN leader, launched a strong campaign against Kubitschek and Goulart charging that it was the communists who had elected them. A "Brazilian anti-communist crusade" led by Lacerda and involving junior military officers appealed to the higher military to intervene and block the inauguration of the president and vice-president. Instead of a coup to prevent both men from taking office, however, General Lott, the War Minister, staged his own "preventive coup for legality." The liberal UDN had shown again its inability to win. Kubitschek and Goulart were inaugurated on January 31, 1956. See Skidmore, Politics in Brazil, for an account of the episode, pp. 143-158.
13. Estado e Economia no Brasil: Opções de Desenvolvimento (Rio: Graal, 1986), pp. 64 and 66.

14. Ibid., p. 66

15. "Associated- Dependent Development: Theoretical and Practical Implications", p. 163. This aspect of dependent development is best analyzed by Cardoso in Empresario Industrial e Desenvolvimento Economico (Sao Paulo: Difusao Europeia do Livro, 1964). Palma notes that "It was research conducted in the early 1960s into the political position of the 'national bourgeoisie' that convinced Cardoso that the class structure of Brazil was essentially different from that which had served as his implicit model, derived from classical Marxist analysis of the development of class relations in the advanced countries of Western Europe." See Gabriel Palma, "Dependency: A Formal Theory of Underdevelopment or a Methodology for the Analysis of Concrete Situations of Underdevelopment?" World Development, Vol. 6, 1978, p. 911.

16. Among the intellectuals of the ISEB, whose views were highly divergent with respect to foreign capital, but not on the role of the Brazilian bourgeoisie as the vanguard of the "revolution", we can distinguish Helio Jaguaribe, Nelson Werneck Sodre and Candido Mendes. A good work on the ISEB is Caio Navarro de Toledo, ISEB: Fabrica de Ideologias (Sao Paulo: Atica, 1977).

17. A economia politica brasileira (Sao Paulo: Polis/Vozes, 1984), p. 61.

18. The traditional addiction of Latin American elites to European and North American status goods is best examined by David Felix, "Income Distribution and the Quality of Life in Latin America: Patterns, Trends, and Policy Implications", Latin American Research Review, 18, No. 2, 1983, pp. 3-33.

19. Quoted in Octavio Ianni, Crisis in Brazil (New York: Columbia University Press, 1970), pp. 23-24.

20. See Guido Mantega, A economia politica brasileira, pp. 72-76.

21. "State and Capital Accumulation in Contemporary Brazil", in Anglade and Fortin (eds.) The State and Capital Accumulation in Latin America (Pittsburgh: University of Pittsburgh Press, 1985), p. 58, emphasis in original.

22. Jonathan Fox provides a detailed account of the debate on state capitalism vs. the supporting role of the state in Brazil since the early 1930s and the basic issue is, of course, the control over the surplus of society. Looking at the view of Baer, Fitzgerald, Cardoso and Evans, among others, Fox concludes that Cardoso and Evans' model of the "triple alliance" between transnational, state and local capital, whose outlines were set after 1956, provides the best framework for the analysis of the locus of economic decision making power in Brazil and hence of the control over the surplus. In this way, the state's role is one of support to private accumulation and the alliance as a whole will share the benefits, if unequally, of Brazil's national capital accumulation. See Fox, "Has Brazil Moved Toward State Capitalism?", Latin American Perspectives, 24, Winter 1980, Volume VII, No. 1, pp. 64-84.

23. Bresser Pereira, Development and Crisis in Brazil, pp. 35-36.
24. Guido Mantega, A economia politica brasileira, p. 73.
25. Edmar Bacha, "Issues and Evidence on Recent Brazilian Economic Growth", World Development V, 1977 (1-2), pp. 47-67. "External economies" refers to subsidies, such as social and education costs for the labor force, assumed by the government, etc.
26. A good analysis of the executive groups is Edson de Oliveira Nunes and Barbara Geddes, "Dilemmas of State-led Modernization in Brazil", in John Wirth, Edson de Oliveira Nunes and Thomas E. Bogenschield (eds.), State and Society in Brazil: Continuity and Change (Boulder, Colorado: Westview Press, 1987), pp. 104-145.
27. Estado e economia no Brasil, pp. 53, 61.
28. Development and Crisis in Brazil, pp. 27-28.
29. Economic Policy-Making and Development in Brazil, 1947-1964, p. 4.
30. Guillermo O'Donnell is perhaps the best example of a scholar who has emphasized the novelty of the post-64 military regime through his "deepening" hypothesis, thus underestimating the extent of deepening already achieved before 1964. See O'Donnell, Modernization and Bureaucratic Authoritarianism: Studies in South American Politics (Berkeley: University of California Press, 1973).
31. Werner Baer, The Brazilian Economy: Growth and Development (New York: Praeger, 1983), pp. 84-86.
32. Jose Serra, "Three Mistaken Theses Regarding the Connection between Industrialization and Authoritarian Regimes", in David Collier (ed.), The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979), p. 120.
33. In connection with Brazil's poor export performance in the 1950s, some analysts blame faulty government policy such as "unrealistic" exchange rates and the "export surplus" doctrine, that is, a country produces primarily for its own needs and exports only the surplus which is "left over", supposedly adopted in Brazil. See, for example, Raouf Kahil, Inflation and Economic Development in Brazil, pp. 200-212 and Nathaniel Leff, Economic Policy-Making and Development in Brazil, pp. 81-83. However, in addition to the enormous accumulated debt repayment problem creating pressure to overvalue the cruzeiro throughout the 1950s, Albert Fishlow argues that:

It is wrong and ahistorical to ignore that the record expansion of world trade in the 1950s did not favor primary products. Brazil in particular faced competition from lower-cost tropical competitors. Policies and priorities correctly favored industry under such circumstances, and were not as prejudiced against simultaneously exploiting external market opportunities as some retrospective views suggest.

See Fishlow, "Brazilian Development in Long-Term Perspective", The American Economic Review, Vol. 70, No. 2, May 1980, p. 106. Furthermore, Jose Serra has shown the contrast between external demand in the 1950s and the late 1960s and early 1970s: while world exports grew at only 1.8 percent per year in the former period, it grew at 10.3 percent in the latter. This explains in great part the brilliant performance of exports during the "miracle" years (see chapter 8).

34. "External Debt and Long-Term Servicing Capacity", in H. Jon Rosenbaum and William G. Tyler (eds.), Contemporary Brazil: Issues in Economic and Political Development (New York: Praeger Publishers, 1972), pp. 96 and 98.

35. Eugenio Gudin, "The Chief Characteristics of the Postwar Economic Development of Brazil", in Howard Ellis (ed.), The Economy of Brazil (Berkeley: University of California Press, 1969), pp. 10-11.

36. Conjuntura Economica 31 (11), Novembro de 1977, p. 170.

37. Kahil, Inflation and Economic Development, p. 322.

38. John Donnelly, "External Debt and Long-Term Servicing Capacity", p. 99.

39. Ibid., p. 103.

40. Conjuntura Economica 31 (11) Novembro de 1977, p. 174.

41. Ibid., p. 173.

42. Donnelly, p. 100.

43. Ibid., pp. 100, 102 and 103.

44. Ibid., p. 110.

45. See Endividamento e Desenvolvimento, Aspectos Historicos", Conjuntura Economica 30 (4), Abril de 1976, pp. 81-83.

46. Donnelly, p. 108.

47. Ibid., p. 104.

48. Ibid.

49. Tribuna do Economista, October 1973, p. 44.

50. Cheryl Payer, The Debt Trap: The IMF and the Third World (New York: Monthly Review Press, 1974), p. 152.

51. Politics in Brazil, p. 181.

52. In this connection, Payer observes that:

Developing countries are caught in a double bind. If they seek official help on softer than commercial terms, they have to accept outside scrutiny, give up projects that they may sincerely believe essential to their national welfare, and accept conditions which doom their efforts at industrial, diversified development. If they accept suppliers' credits on commercial terms in order to go through with their cherished projects, they are caught away when the payments come due before they are able to meet them. It cannot be stressed too strongly that long-term official aid is necessarily 'development' aid just because it is so labelled, and its terms are somewhat softer. Nor, for that matter, are suppliers' credits necessarily evil just because they are not made on concessional terms. Either loan could be put to wasteful and unnecessary uses; both type have to be paid back eventually. (p. 48).

53. "The Collapse of Democracy in Brazil: Its Economic Determinants", Latin American Research Review, Vol. XV, No. 3, 1980, p. 29.

54. As Skidmore remarks, Goulart's victory "...reflected the apparent schizophrenia of the Brazilian electorate in 1960, choosing an independent as president, and as vice-president a representative of the system which the president-elect had made the target of his campaign." See Politics in Brazil, p. 215.

55. Quoted in Skidmore, p. 194.

56. In my research I was unable to find any work treating the effects of the exchange liberalization and Brazil's economic crisis in the early 1960s. However, as we have discussed at length, exchange and import controls were a major policy instrument that stimulated ISI in the 1950s. Their dismantling must have had some impact on the so-called "exhaustion of ISI."

57. Kahil, Inflation and Economic Development, p. 205.

58. See Skidmore, Politics in Brazil, p. 205.

59. Quoted in Skidmore, p. 206.

60. April 25, 1987, p. 6.

61. It is beyond the purpose of this chapter to look at the political crisis which unfolded over the succession of Quadros. From the discussion of Vargas' second administration, when Goulart was the militant Labor Minister, it is clear that the anti-Getulist right-wing military was highly suspicious of him. Although Goulart had strong support of popular forces (students, labor leaders and nationalist intellectuals) and to a certain extent of center opinion (the "legalist" middle class), it was a division within the army that enabled him to become president. The defection of the Commander of the Third Army centered in Goulart's home state of Rio Grande do Sul, forced a compromise solution, thus preventing

the military ministers' veto of Goulart's succession. See Skidmore, Politics in Brazil, pp. 202-215.

62. Andre Lara Resende, "A politica brasileira de estabilizaçãõ: 1963/68", Pesquisa e Planejamento Economico, Vol. 12, Dezembro 1982, No. 3, p. 764.

63. Bresser Pereira, Development and Crisis in Brazil, p. 84.

64. Ibid., p. 140.

65. For a complete analysis of the unrest in the Northeast in the late 1950s and early 1960s, and the role of the U.S. through the Alliance for Progress with a view to destabilize the Goulart regime, see Joseph Page, The Revolution that Never Was (New York: Grossman Publishers, 1972). See also Riordan Roett, Politics of Foreign Aid in the Brazilian Northeast (Nashville: Vanderbilt University Press, 1972) and Shepard Forman, The Brazilian Peasantry (New York: Columbia University Press, 1975).

66. See Kenneth Paul Erickson, "Populism and Political Control of the Working Class in Brazil", in Proceedings of the Pacific Coast Council on Latin American Studies, Vol. IV (1975), pp. 138-139.

67. Politics in Brazil, p. 235.

68. See Page, The Revolution that Never Was, p. 185.

69. The Debt Trap, p. 152.

70. Cited in Conjuntura Economica 31 (11) Novembro de 1977, p. 170.

71. See Skidmore, Politics in Brazil, p. 246.

72. Dependency and Development in Latin America, pp. 142-143.

73. Lara Resende, "A politica brasileira de estabilizaçãõ", p. 763.

74. According to Kahil, 2500 workers were dismissed from the motor industry and decline in demand led to a drop in production of 10 percent for passenger cars, and of roughly 50 percent for lorries and tractors - a clear indication of a sharp decline of investment. As the economist argues: "Thus, the period was characterized by cost, rather than by demand inflation." See Inflation and Development, p. 321.

75. "A politica brasileira de estabilizaçãõ", pp. 763-64.

76. Ibid., p. 765.

77. Francisco Weffort, Sindicatos e Politica (Ph.D. dissertation, University of São Paulo, 1972), p. 29 as cited in Michael Wallerstein, "The Collapse of Democracy in Brazil", p. 15.

78. Cited in Lara Resende, pp. 769-770.

79. See Octavio Ianni, Crisis in Brazil, pp. 97-98. For a thorough analysis of the strikes of the early 1960s in Brazil see Erickson, The Brazilian Corporative State and Working-Class Politics (Berkeley: University of California Press, 1977), chapter VI.

80. Kahil, Inflation and Economic Development, p. 318.

81. See Cardoso, Empresario Industrial e Desenvolvimento Economico no Brasil (Sao Paulo: Difusao Europeia do Livro, 1964).

82. "The Collapse of Democracy in Brazil", pp. 16 and 24.

83. Politics in Brazil, p. 241.

84. As in 1954 with Vargas, the military was concerned with the erosion of salary differentials. According to Skidmore, "Late in May, a group of officers sent Goulart a detailed message protesting the low level of officers' salaries, pointing out, for example, that a second Lieutenant in the army received only as much as the cook's aide in the merchant marine." See Politics in Brazil, p. 243.

85. The Revolution that Never Was, pp. 137-138.

86. Ibid., pp. 128-129.

87. "Populism and Political Control of the Working Class in Brazil", p. 139.

88. See Pinto Ferreira, Capitais estrangeiros e divida externa do Brasil, pp. 57-59. See also Jornal do Brasil of October 2, 1986, p. 6.

89. Skidmore, Politics in Brazil, p. 268.

90. Page, The Revolution that Never Was, p. 183.

91. I do not agree with Skidmore's argument that, following the collapse of his stabilization plan in May 1963, Goulart "preferred to believe that the real issue at stake was social reform, not the control of inflation." Politics in Brazil, p. 250, emphasis in original. If that was the case why then did Goulart continue desperately attempting to appease foreign creditors with anti-inflationary policies until February 1964? It seems to me that Goulart was well aware of the real issue, desired to implement stabilization measures and knew that only under an authoritarian regime could he have accomplished that, as the military regime would later show. Goulart knew that behind his political problems was the financial crisis and the need to satisfy foreign creditors in order to obtain some sort of debt relief.

92. See Lara Resende, "A politica brasileira de estabilizacao", pp. 770-771.

93. The Debt Trap, p. 155.

94. In Octavio Ianni, Crisis in Brazil, p. 146.

95. See Teresa Hayter, Aid as Imperialism (London: Penguin Books, 1971), p. 135; John Donnelly, "External Debt and Long-Term Servicing Capacity", p. 107 and Payer, The Debt Trap, p. 156.

96. Conjuntura Economica 31 (11) Novembro de 1977, p. 173.

97. "External Debt and Long-Term Servicing Capacity", p. 198.

PART FIVE

CONSOLIDATION AND CRISIS OF DEPENDENT DEVELOPMENT
UNDER MILITARY RULE, 1964-1984

In his well known The Export of Capital from Britain, A. R. Hall wrote in 1968 that between 1870 and 1914 Britain's capital export amounted to some £3,500 billion and that "nothing comparable in terms of proportions of resources devoted to overseas investment had occurred before nor has anything comparable occurred since then. Equally noteworthy, in the light of post 1914 experience, the flow of resources abroad was almost entirely in response to market considerations."¹

Something was occurring, however, even before Hall's book went to print. The rise of the Eurocurrency markets in the late 1950s and early 1960s, ironically centered in London but no longer under its control, would put the largest flow of resources ever seen at the disposal of the international economy without intervention from any monetary authority.² In 1970 the volume of the resources circulating in the Euromarkets was \$100 billion, in 1977 it was more than \$600 billion and by 1982, \$2 trillion.³ The availability of such massive resources resulted in a laissez-faire and internationalization of financial capital never ever dreamed of by a liberal or Marxist economist from the nineteenth century. And it brought a new hope for those from the twentieth who still entertained the idea that capitalist development in the periphery could replicate capitalist development in the center.

This important structural change in the mechanisms for international financial flows, however, would only reinforce the existing division of labor in the capitalist system and consolidate the new situation of dependency that emerged in some peripheral countries after World War II. In Brazil, the new surge of private transnational banking business and their massive transfer of resources to the state sector in the 1970s would shape the country's domestic political and economic processes in a manner that exceeded that of the British investment banks of the nineteenth century.

Part Five (chapters 7 to 9) will thus examine the new phase in the historical relationship of international finance and Brazilian political forces that began with the overthrow of populist democracy in 1964. Chapter 7 will show that, as in the past, relations of dependency do not arise simply from the operations of external factors; they arise from the concrete interaction of domestic social groups and classes which support foreign financial and industrial interests. After 1964, new internal political alliances were established through the state, now controlled by the armed forces, and the interests of international financial capital and the Brazilian dominant classes that appeared as divergent in the previous historical moment were once again reconciled. As Cardoso and Faletto suggest: "The internal socio-political factors - linked naturally to the dynamic of the hegemonic centers - are precisely the ones that may produce policies taking advantage of the 'new conditions' or new opportunities for economic growth."⁴ It is for this reason that our analysis of dependency always begins with its internal manifestations. Thus, the aim of chapter 7 is to show that while Brazil's internal structures and processes were transformed by the very contradictions of dependency, they did not lose their distinguishing dependent characteristic. Rather, dependency structures were maintained and reinforced by the new military regime.

As in the past, however, reincorporation of foreign interests in internal developmentalist alliances that are formed by dominant groups in Brazil not only brings new opportunities for economic growth, but also severe constraints. Cardoso and Faletto's historical-structural dependency study has convincingly demonstrated that alliances with international capital bring with them external control over the national economic system and of policy decisions for development. Thus, it is the developmental outcomes resulting from situations of dependency that is the central concern of chapters 8 and 9. The evidence suggests, however, that dependency analysis have for the most part reached optimistic conclusions about the success of dependent development under the military regime, particularly the belief that state autonomy increased in ensuring the priority of long-term local capital accumulation over short-term profit maximization by international capital.

Thus, chapter 9 shows that the era of debt-driven growth under the authoritarian regime proved to be as transitory as under the populist regime and ended with an even more profound and extensive capital accumulation crisis than the one which precipitated the military takeover in 1964. Then, in the view of the new rulers, the crisis resulted solely from inefficient populist policies, not from the development choices made, hence the need to implement the type of policy reforms favored by the centers of international finance in order to "perfect" the growth model adopted by the populists.

This task was successfully accomplished by the developmentalist technocrats of the new regime, who quickly reintegrated the Brazilian economy into the international financial system and began tapping the resources of the burgeoning Euromarkets. But in the process, the technocracy not only accelerated the rate of capital transfers abroad and the takeovers of domestic industry, but also increased the country's public deficit (and inflation) and foreign indebtedness beyond the imagination of the populists they sought to

discredit. In fact, in 1974 alone, Brazil's borrowing was equal to the total new debt the country had accumulated from the beginning of the nineteenth century to the year 1972: \$7.4 billion. The foreign debt grew from the "populist" \$3.2 billion in 1963 to the "technocratic" \$100 billion twenty years later.

Furthermore, the "reformist" military officers and civilian technocrats did not produce higher rates of domestic savings and investment, but they did, on the contrary, increase the vulnerability of the economy to international shocks to such an extent that when global interest rates rose and easy flows of loans were interrupted in the early 1980s, local accumulation collapsed. The consequent foreign debt crisis (more precisely, as in the past, BOP crisis or foreign exchange crisis) and its devastating socio-economic effects resulting from orthodox stabilization programs demanded by foreign creditors, undermined the military's claims to continuation in power as the essential support from elite civilian groups (particularly the domestic industrial sector which allied with workers and urban middle classes against the regime) ended. Once again, domestic political alliances, the regime itself and the process of domestic capital accumulation crumbled over the contradictions inherent in the developmentalist growth model of extreme reliance on external flows of financial capital historically adopted in Brazil. But the ongoing crisis has finally seriously challenged developmentalism's theoretical assumption of local transformation and the claim that there are no conflicts between the interests of international capital and national development.

To understand how the worst financial crisis in the history of the Republic came about, it is necessary to look at the stabilization program of the first military regime between 1964 and 1967, when developmentalist policy reforms, as prescribed by the World Bank and the

IMF, were adopted. The "free-market oriented policies were aimed at providing Brazil with the export-led growth it needed to repay past debt and buoy foreign confidence in the country's creditworthiness for new inflows of loans it needed to purchase capital goods from center countries within the context of the new international division of labor. In fact, it was the institutionalization of channels through which massive flows of loan capital from the Euromarkets would freely enter the country that constituted the major feature of the reforms between 1964 and 1967. What Brazil did was simply to adapt domestic institutions to the new realities in the international financial system. As such, the roots of the crisis of the 1980s are found not in the oil crisis of 1973-74 nor in the years of the economic "miracle" (1968-1973), as it is often argued, but in the financial "restructuring" which preceded them.⁵

Most significantly still, the developmentalist growth strategy offered and the policy reforms prescribed by international financial centers as a way out of the ongoing crisis in Brazil and elsewhere in the developing world are, of course, the same that were efficiently implemented in the second half of the 1960s as a route to long-term economic prosperity and that guided the 20 years of military rule. As I argued in chapter 1, the socio-economic crisis of the 1980s can not be seen as the result of the government's deviation from "wise" economic policies, but of the development choice made. In these final chapters I will demonstrate that proposition and challenge the wisdom of continuity.

Chapter 7 will thus analyze the initial phase of the military regime (1964-67), characterized by economic liberalism and growing political authoritarianism and chapter 8, the second phase (1968-73), characterized by political repression and the economic "miracle". Finally, chapter 9

will focus on the third and fourth phases of the regime (1974-79 and 1980-84) when the contradictions of the political and economic model were revealed, leading to its inevitable collapse.

NOTES

1. A. R. Hall, The Export of Capital from Britain, 1879-1914 (London: Methuen, 1968), p. 1.

2. Eurocurrency markets are markets in currencies traded outside their respective domestic economies, for example, dollars, German deutsche marks and Swiss francs. The major factors behind their rise were, in short: the reluctance of the USSR and China to hold bank deposits in the U.S., putting instead their dollar earnings on deposit in London; the limitations imposed by the United Kingdom Government on British banks' external use of sterling as a result of BOP pressures, and the restoration of full convertibility of the currencies of the main industrial countries in 1958. The new freedom produced a surge of international banking aided by certain monetary regulations in the United States. Regulation Q, for instance, put a ceiling on the interest rates that banks operating in the U.S. could offer to domestic depositors. Since market rates often went above the ceilings, depositors were naturally attracted to Eurobanks that were not bound by such regulation. Furthermore, general controls of the movement of capital also helped to boost the Euromarkets. One example was the introduction, in 1965, of the Voluntary Foreign Credit Restraint Program (VFCR) in the United States. The specific goal of the VFCR was to limit the growth of foreign lending by U.S. banks. Instead, their foreign branches - which were not subject to the VFCR - took deposits and lent them outside the ceiling. After 1973, the Euromarkets became the major instrument to recycle OPEC surpluses to deficit-ridden developing countries, encouraged by the governments of the industrial nations which were concerned with the higher oil price's recessionary impact on the world economy. For a complete account of the Euromarkets see World Development Report: International Capital and Economic Development (New York: Oxford University Press, published for the World Bank, 1985), chapter 8.

3. Darrell Delamaide, Debt Shock: The Full Story of the World Credit Crisis (Garden City, N.Y.: Doubleday and Company, Inc., 1984), p. 51.

4. Dependency and Development in Latin America (Berkeley: University of California Press, 1979), p. 20.

5. The extreme view is presented by Carlos Geraldo Langoni, who insists that the root of the crisis lies in the years 1978-80 and not before. Thus, in an 1981 essay in the Jornal do Brasil he argues that:

The fundamental problem was the superimposition, beginning in 1978, of the new petroleum shock on the financial shock represented by the foreign interest rates in real terms. The immediate consequence was the impossibility of continuing with the strategy of growth with debt at growing rates, making necessary the transmission of those fiscal and financial limitations to the domestic economy with greater intensity. In this context, the slowing down of the rate of growth, especially in the industrial sector, became inevitable, and its intensity and duration will be conditioned by the ability to overcome the external imbalances.

See Carlos Geraldo Langoni, "A estrategia de ajustamento do setor externo", Jornal do Brasil, September 27, 1981, p. 4 (Caderno Especial).

CHAPTER 7

ECONOMIC LIBERALISM AND POLITICAL AUTHORITARIANISM: THE
CONSEQUENCES OF FINANCIAL DEPENDENCY, 1964-1967

Peter Evans has observed that "General Humberto Castello Branco was more in the mold of General Eurico Gaspar Dutra than in the mold of Getulio Vargas."¹ In fact, the first post-1964 military president, although obviously not possessing foreign exchange reserves to squander as in 1945 (see chapter 5), embarked on a policy of economic liberalism whose consequences for the Brazilian economy were more disastrous than the Dutra period had been. But one of the ironies of the situation was that the restoration of economic liberalism was only possible at the expense of a drastic reduction in political liberalism and it was to Vargas' corporative state that the military resorted.²

The return of economic liberalism to Brazil between 1964 and 1967 was the direct result of the major concern of the military regime: to restore the country's international creditworthiness that had been damaged during the last years of populist democracy. Not only did the regime immediately comply with the traditional demands of foreign creditors and international financial institutions for orthodox stabilization to reduce inflation and repay the foreign debt, but far-reaching institutional reforms were also introduced to promote the free international flows of trade and investment and facilitate the full integration of the Brazilian economy into the world capitalist system according to the new doctrine of internationalism and interdependence.³

As Octavio Ianni argues,

The economic policy put into execution in 1964 is not a program for economic development. It is oriented toward modernizing the economic system of Brazil. It is a policy designed to perfect economic relations and institutions. On a domestic level its functioning must be guaranteed without the risks or tensions generated or aggravated by such structural transformation as become urgent or are imposed upon economic institutions. On a foreign level it is necessary to guarantee the integration of world capitalism and facilitate the movement of production factors. In particular, modernization is patterned to guarantee the functioning of the process of greater capital formation without the obstacles of protective exchange rates, tariffs and fiscal policies or ideologies. ⁴

Two technocrats of "international prestige" were quickly appointed to the key ministries of Finance and Planning to restore the creditworthiness of Brazil and "modernize" the economic system: Octavio Gouveia de Bulhões and Roberto Campos. The economists finally saw the opportunity to fully apply their orthodox monetarist doctrine of "demand-pulled" inflation, implement a program of financial austerity and stabilization to restore the equilibrium of Brazil's external accounts (i.e., pay off the foreign debt) and adopt free-market policies (i.e., trade and financial liberalization) to restore the economy to international competition. Those measures, which were continuously frustrated during the protectionist and "nationalist" period (chapters 5 and 6), were now fundamental to regain the confidence of international finance and recreate the conditions for new inflows of loans, the instrument of long-term development in the view of the technocrats. ⁵

In fact, Campos and Bulhões had for years been major proponents of the traditional developmentalist theory that an underdeveloped economy is by definition an economy that, generating very low rates of savings and hence very low rates of investment, does not have conditions to achieve rapid and self-sustaining growth. Therefore, only with continuous injection of foreign capital could underdevelopment be overcome as "foreign savings" supplement local savings and accelerate the process of capital formation. ⁶ From this

theoretical perspective that Brazil's development could not be achieved without the assistance of foreign capital, a "rational" policy emerged in practice which repudiated what Campos termed "romantic nationalism", provided all possible stimuli to attract foreign loans and direct investment and, particularly, adapted domestic institutions to the new realities in the international financial markets.⁷ But, first of all, international creditworthiness, the key element in this growth strategy, had to be restored and preserved.

The adoption of orthodox economic stabilization and major free-market reforms was thus the first demonstration of "rationality" to the centers of international finance, whose "certificate" of good conduct was fundamental for the inflows of foreign capital the technocrats wished to attract. As Hayter observed: "Brazilian economic policies between 1964 and 1967 under the direction of Dr. Roberto Campos were in fact all that the World Bank, the IMF and AID could desire."⁸ As we will now see, it was a strict alliance of the state and international finance that best characterized the initial phase of the technobureaucratic regime which excluded not only its alleged enemies, the working class and populists, but also its most important original allies, the national industrial bourgeoisie (as I define the economic groups controlled by Brazilians).

To begin the implementation of orthodox stabilization in November 1964 the technocrats counted not only on the support of international finance which provided immediate relief from the crushing foreign debt repayment burden, but also with the armed forces which suspended the democratic political process well in advance and progressively eliminated any pressure against the deflationary measures from the groups directly involved in production. The First Institutional Act of April 9, 1964 granted arbitrary power to the president for 90 days. The expanded powers for the executive

were needed, according to the Act, to carry out "the economic, financial and moral reconstruction of Brazil." The objective was "the restoration of internal order and the international prestige of the country."⁹ To achieve both goals, the regime purged congress, the civil service and universities, removed several governors, suppressed student movements, arrested or exiled labor leaders, dissolved labor unions and peasant leagues and banned strikes. Most disturbing, the regime resorted to torture, particularly in the Northeast's peasant leagues.¹⁰

Without doubt, the control and repression of organized labor was a fundamental aspect of the authoritarianism of the military regime that allowed the technocrats to carry out a stabilization policy that weighed most heavily on the working class. But the exclusion of the national entrepreneurs was certainly a contradiction of a regime that preached the virtues of economic liberalism and private enterprise. In fact, even though the industrial bourgeoisie became one of the greatest beneficiaries of the system after the change of economic strategy in 1967 (see discussion below), the military regime continued to maintain political and economic tutelage over the class. This contradiction, or shall we say, the direction of policy after 1964 was best formulated by one of the most staunch proponents of economic liberalism in Brazil a decade before the coup. Roberto Campos, who has been fond of using the language of modernization theory in his works, argued in 1953 that:

In our institutional reality...the entrepreneurial class does not have, unfortunately, sufficient puritanism (high savings propensities observed in its counterpart in developed countries), justifying, therefore, state intervention to ensure that resources are directed to investment and not spent in ostentatious consumption.¹¹

We will now first examine the impact of Campos' stabilization policies on the working class and then on the national bourgeoisie.

Stabilization and the working class

Protected from popular pressure, Campos began reducing the budget deficit and domestic demand by slashing government expenditures and investments,

increasing taxes and public service rates, abolishing the import subsidies of wheat and oil, restricting the flow of credit to the private sector and systematically reducing the real minimum wage through a policy of keeping wages below the rise in the cost of living so that by 1967 it was more than 30 percent smaller than its 1955 level (see Tables 5.7C above and 7.1 below).¹² In fact, the wage squeeze (arrocho salarial) was at the center of the deflationary policies of the technocrats who singled out excessive wage readjustments during the populist period as the main cause of inflation. As Campos argued in 1966:

The first sin of past laborism was the obsessive preoccupation with massively high wages. These were far beyond the productivity and growth increment possible from production. The natural result of this illusion was acceleration of the inflationary process. ¹³

The data presented in chapter 5 clearly demonstrate the distortion of this analysis. During populism wages conspicuously lagged behind productivity and between 1959 and 1964, the working class began to gradually suffer substantial losses in real wages as a result of inflation (Table 5.7C above and Table 7.1 below).

But the impact of Campos' wage policy on the lives of the unskilled worker of Brazil was devastating. The purchasing power of the 50 percent of Brazilian workers who earned salaries at or near the minimum wage fell by 19 percent between 1963 and 1967 and this is according to conservative government estimates as the Institute de Planejamento Economico e Social (IPEA).¹⁴ According to the Departamento Intersindical de Estatistica e Estudos Socio-Economicos (DIEESE), an independent trade union research organization in São Paulo, the fall in the minimum wage was 25 percent between 1964 and 1967.¹⁵ Just to have an idea of the impact of wage policy we should only recall that government subsidies of basic items in the cost of living, such as bread and transportation, had been eliminated and price controls on food removed to restructure the price mechanism.

Table 7.1 below shows that in February 1964 the real minimum wage index was 126. In March 1965, with the substitution of wage negotiations by the official readjustment formula, the index fell to 103; in March 1966 to 91 and in March 1967 to 83.¹⁶ But the effects of wage policy were not limited to the minimum wage. Table 7.2 indicates that real median industrial wages were also reduced considerably, according to indexes calculated by DIEESE, the conservative Getulio Vargas Foundation (FGV) and the Instituto de Pesquisa Economica e Bolsa de Mercadorias de São Paulo. Although the magnitude of the drop was larger in the former's estimates, the three institutions coincided in showing a serious deterioration of industrial wages between 1964 and 1967.

Mario Henrique Simonsen, one of the creators of the wage policy of the regime, explained his preference for a mathematical formula over wage negotiations in the following terms:

There is considerable advantage in establishing an arbitrary rule for collective wage negotiations. The problem of these negotiations in the modern world, including the establishment of wages at the government level, is that they are aggressively affected by the political power of labor unions, by electoral criteria and by other means totally removed from any theorem of economic efficiency. A formula of this type has the advantage of substituting an endless game of strikes and pressure by a simple arithmetic calculation.¹⁷

Furthermore, to compound the losses of the wage earner, the 1940 law guaranteeing job security after 10 years of service was abolished in 1967 and in its place the technocrats created the Fund for the Guarantee of Time in Service (Fundo de Garantia de Tempo de Servico or FGTS), a compulsory pension fund. The Fund made it easier for firms to dismiss unskilled and semi-skilled workers before the annual wage readjustments so that the workers would be re-employed at lower wage levels.¹⁸ But the FGTS had another important function. It was a powerful instrument of workers' forced savings which became one of the major domestic sources of funds for state investment and for the state's transference to the private sector through the subsidized credits of

Table 7.1 Brazil: Real Minimum Wage Indexes - Rio de Janeiro in the month of readjustment (real minimum wage in Rio deflated by cost-of-living index)

Months	Years	Indexes
January	1952	100
July	1954	127
August	1956	135
January	1959	146
October	1960	136
October	1961	139
January	1963	122
February	1964	126
March	1965	103
March	1966	91
March	1967	83
March	1968	84
May	1969	79
May	1970	78

Source: Andre Lara Resende, "A politica brasileira de estabilizaçāo: 1963/68", Pesquisa e Planejamento Economico, Vol. 12, Dezembro 1982, No. 3, p. 779, Table 7.

Table 7.2 Brazil: Real Median Minimum Wage and Real Median Industrial Wages Indexes

Years	FGV		São Paulo		DIEESE	
	Minimum Wage	Median Wage	Minimum Wage	Median Wage	Minimum Wage	Median Wage
1963	100.0	100.0	100.0	100.0	100.0	100.0
1964	100.4	97.1	102.7	99.1	108.9	105.0
1965	93.4	90.8	98.0	95.3	101.6	98.8
1966	86.2	-	86.9	-	86.1	-
1967	82.8	90.6	86.4	91.9	81.5	89.2
1968	83.7	94.8	83.7	95.1	80.8	91.6
1969	80.6	101.4	79.9	100.5	76.8	96.7
1970	78.9	98.6	80.7	100.7	78.1	97.6

FGV - wages deflated by the cost of living index in Rio (Fundacao Getulio Vargas)

São Paulo - wages deflated by the cost of living in São Paulo (Instituto de Pesquisas Economicas e Bolsa de Mercadorias de São Paulo)

DIEESE - wages deflated by cost of living index in São Paulo

Source: Same as Table 7.1 above, p. 780, Table 9.

the National Development Bank (BNDE).¹⁹ As in the past, the domestic financing of capital accumulation would also come from the same source: the working class. In the meantime, federal expenses with labor and social security were being drastically reduced: from 2.9 percent of total federal expenses in 1963, to 1.0 percent in 1966 and 0.6 percent in 1969.²⁰

There are many causes of the deterioration in income inequalities in Brazil during the decade of the 1960s, but the wage policy - and the labor policy as a whole - of Castello Branco and which became very useful to successive military presidents, was without doubt a very important factor. According to the most conservative calculations, as in Table 7.3 below, 80 percent of the working population saw their share of national income further reduced from the already low levels of 1960. The Gini coefficient, the most used measure of inequality, increased from 0.50 to 0.56, a substantial change indeed for such a short period (by 1976 the Gini increased to 0.64!)

Furthermore, Table 7.4 gives another measure of income inequality, the distribution of income by deciles for households in Brazil in 1970. The first decile represents the 10 percent (of households) with the lowest incomes, the second decile is the 10 percent with the next lowest incomes, and so on to the tenth decile, which is the 10 percent with the highest incomes. The lowest income 10 percent of the population (of households) received only 1.2 percent of total income and the next 10 percent had only 1.8 percent while the top 10 percent received 45.5 percent. Brazil had, by 1970, one of the worst income distribution in the world, again according to very conservative calculations.

The direct consequence of increasing income inequality in Brazil was, of course, the deterioration in the quality of life of the poor, best illustrated with data on infant mortality rates which reflect more the general condition of nutrition than of health. Table 7.5 shows that infant

Table 7.3 Brazil: Income Distribution, 1960 and 1970
(in percentage)

<u>% of economic active population</u>	<u>% of national income</u>	
	1960	1970
Bottom 50%	17.71	14.91
Next 30%	27.92	22.85
Next 15%	26.66	27.38
Top 5%	27.69	34.86

Source: Carlos Geraldo Langoni, Distribuição de renda e desenvolvimento econômico no Brasil (Rio de Janeiro: Expressão e Cultura, 1973), pp. 64-7

mortality rates, which had been declining between 1950 and 1960, were reversed in the major urban centers. In São Paulo, Brazil's industrial capital, 63 out of every 1,000 infants born live died in their first year in 1960, by 1969, 84 out of every 1,000 died. In Belo Horizonte, the infant mortality rates went from 74 to 107 per 1,000 between 1960 and 1970. In Recife, these rates climbed from 151 in 1960 to 205 in 1970.

That malnutrition is a major cause of infant mortality in urban centers in Brazil is revealed in Table 7.6 with comparative data from the study of the Pan-American health Organization for the period 1968-70. The Table shows that while in San Francisco (USA) and Sherbrook (Canada), 18.5 and 18.3, respectively, out of every 1,000 infants born live died in their first year and malnutrition accounted for only 0.6 and 0.4 of the total deaths, in Recife, for instance, 91.2 of every 1,000 died and malnutrition was the major cause of the deaths, 35.6.²¹

The working class, however, was not the only target of the "reformist" technocracy. We now turn to the impact of Campos-Castello Branco's policies on the national industrial bourgeoisie, an issue which is most often overlooked in works dealing with the initial phase of the military regime.

Table 7.4 Percentile Distributions for Households in Brazil, 1970

Population Decile	Percentage of Income
First	1.2
Second	1.8
Third	2.7
Fourth	3.5
Fifth	4.6
Sixth	6.0
Seventh	7.9
Eighth	10.8
Ninth	16.0
Tenth	45.5
	<u>100.0</u>

Source: William Loehr and John P. Powelson, The Economics of Development and Distribution (New York: Harcourt Brace Jovanovich, Inc., 1981), p. 99, Table 5.1

Table 7.5 Brazil: Infant Mortality in some Urban Centers

Year	Recife	Belo Horizonte	Sao Paulo	Goiania
1950	230.4	103.8	89.7	117.5
1960	151.7	74.2	62.9	-
1964	125.6	-	67.7	87.0
1965	148.8	92.3	69.4	90.0
1966	149.4	87.2	73.8	84.0
1967	142.4	98.3	74.4	92.7
1968	153.9	102.3	75.1	46.6
1969	165.3	107.3	83.8	123.1
1970	205.7	107.7	-	98.5

Source: Paul Singer, A crise do "milagre" (Rio de Janeiro: Paz e Terra, 1982), p. 83, Table 15.

Table 7.6 Causes of Infant Mortality
(per 1.000 live births)

City	Immaturity	Mal-nutrition	Immaturity/ Malnutrition	Other	Total
Recife	24.1	35.6	59.7	31.5	91.2
Ribeirao Preto	17.6	12.5	30.1	12.9	43.0
Franca	23.6	23.4	47.0	24.5	71.5
Sao Paulo	21.0	18.3	39.3	25.8	65.1
San Francisco (USA)	10.2	0.6	10.8	7.7	18.5
Sherbrook (Canada)	9.8	0.4	10.2	8.1	18.3

Source: Study of the Organização Pan-Americana de Saude (OPAS) for the period 1968-70 as cited in Ciencia Hoje, Março/Abril 1983, p. 59, Quadro 1.

Liberalism and the national bourgeoisie

Those who backed the coup, the middle class (the sector most hit with the tax reforms and public sector restructuring) and particularly the national bourgeoisie, soon found that the policy reforms of the regime - trade and financial liberalization - contradicted their interests and that they were excluded from the new political alliance of military officer, civil technocrats and international finance. Thus, simultaneously with the credit restriction to national industry (see Table 6.14 above), the free market reforms included liberalization of foreign exchange and import controls, elimination of government subsidies to consumers and Brazilian firms, four successive devaluations of the cruzeiro,²² introduction of export subsidies (tax and credit incentives) to firms engaged in export activities - a distortion of free trade, but conveniently overlooked by the IMF as foreign companies were the major beneficiaries²³ and, above all, the institutionalization of financial mechanisms to guarantee the direct inflow of foreign credit to subsidiaries of TNCs and state enterprises in view of the domestic deflationary squeeze (see discussion below). As O'Donnell observes: "The state and international capital form, in this stage of the BA (bureaucratic-

authoritarian) state, a duo that not only excludes the popular sector but is almost deaf to the expectations and immediate interests of many of its original allies."²⁴

As we attempted to show at some length in chapters 5 and 6, the primary concern of the IMF is not inflation; it is the free flows of goods and capital across national borders guaranteed by free market policies that eliminate protection from imports and subsidies to national industry. Deflationary policies, aimed at reducing domestic demand to restore the equilibrium of foreign transactions (i.e., to generate trade surpluses and pay off foreign creditors), are but a corollary to the liberalization of foreign exchange and import controls and greater benefits to foreign financial and industrial interests. It is in this context that we can understand the priority of the Castello Branco administration, best put by Fishlow: "...the principal aim was not stabilization; it was making market capitalism work."²⁵

Indeed the institutionalization of the monetary correction in 1965 (i.e., widespread indexing of financial claims and liabilities generated within the formal financial system and even its extension to the exchange rate later) was an obvious concession of the authorities to the continuation of inflation, which although drastically reduced from the runaway rates of the Goulart era, was "contained" at 27 percent by 1968 ²⁶ (see table 8.5 below). But the sale of indexed treasury bonds, the anti-inflationary mechanism of the technocracy to finance the government deficit and mobilize domestic savings - first proposed by Carvalho Pinto in 1963 - was also very useful to offset the monetary effect of inflows of foreign loans, thus preventing the acceleration of the inflationary process.

In this respect it is relevant to note at this point that the growth of the public internal debt in the 1970s was the consequence of the policies implemented between 1964 and 1967. Thus, if there was an area the technocrats

could claim full credit was in the drastic reduction of the government deficit from 3.5 percent of GDP in 1963 to 0.1 percent in 1972 and even surpluses throughout the 1970s.²⁷ The form of deficit financing was, of course drastically altered. During the populist period, government deficits were financed, as discussed in chapter 5, by emission of paper money, hence inflation. After 1964, the government deficits began to be financed through the sale of indexed treasury securities (internal public debt) and increased tax and revenues. But, as deficits turned into surpluses throughout the 1970s, why did the internal public debt grow? Why have reductions in public investments, in the context of the crisis of the 1980s, not led to a reduction in the government deficit?

Gazeta Mercantil provides the answer:

The major function of the public internal debt of a country is to cover government deficits through the sale of treasury bonds in the financial markets. The experience of Brazil, however, challenges this basic rule. Brazil must be the only country in the world that accumulated a massive internal debt in a period of continuous budget surpluses. From Cr\$3,5 billion in 1968, the internal debt grew to Cr\$272 billion (US\$16 billion) by 1978, despite the fact that the government did not need these additional resources to finance expenditures which were much lower than total revenues.

In Brazil, paradoxically, the function of the bonds of the public debt is not to finance the public debt which does not exist, but to perform the role of regulator of financial markets and facilitate the conduction of the monetary policy of the Central Bank. This means that the external debt is one of the most important factors behind the emergence of an unnecessary internal public debt...The continuous inflows of foreign loans -"external savings" - means that the Central Bank receives this foreign currency and converts it into cruzeiros at the daily rate. When the volume of the inflows is very high, the Central Bank also places a high volume of cruzeiros in the domestic market. However, the Bank is immediately led to withdraw part of this money in circulation in order to avoid an excess of liquidity (inflation) through the sales of treasury bonds in the "open market", at one of the highest rates of interest in the world. Therefore, the external debt has created an internal debt through a vicious circle: the need to attract foreign exchange to maintain the equilibrium of the balance of payments leads the government to provide all kinds of incentives to inflows of foreign loans, which, when converted into cruzeiros, disturbs the domestic financial equilibrium.²⁸

This vicious circle was inaugurated precisely with the domestic reforms between 1964 and 1967 to promote "market capitalism". The restructuring

of the financial system , the establishment of private investment banks and financial markets, for example, was aimed primarily at facilitating the free flows of loan capital from the bourgeoining Euromarkets to some sectors of private national industry (see discussion below). As Davidoff Cruz argues: "The policies implemented during the second half of the 1960s reflected a progressive adaptation of the domestic financial mechanisms to the transformations at the international level."²⁹

But the financial reforms and the deliberate policy of external indebtedness that was being formulated also accelerated the oligopolistic tendencies of the economy by reinforcing the hegemony of the large, modern industrial enterprises and financial conglomerates , which generally included a commercial bank, an investment bank, a consumer finance firm and a real estate firm, that had much easier access to the Euromarkets.³⁰ And it is here that we see how the national bourgeoisie, particularly the small and medium-sized entrepreneur, was punished by the liberalism of those it had supported: national private firms were eliminated not because of production inefficiency as the "free-marketers" of the military regime claimed, but as a direct result of the government credit policy which favored foreign firms and state enterprises.

SUMOC Instruction 289 and Law 4131: the mechanisms of denationalization and foreign indebtedness

To circumvent the domestic policy of credit restriction and attract foreign capital, SUMOC Instruction 289 of January 1965 allowed a direct credit line between the parent and the local TNC subsidiary. In addition, Law 4131, which was to become the major instrument to stimulate the entry of long-term foreign loans in the 1970s, allowed domestic firms to borrow directly from foreign banks. Ironically, Law 4131 was originally designed to restrict profit remittance by TNCs in September 1962 (see chapter 6). In August 1964, the provision of profit restriction was revoked and reinvested profits could once again be calculated in the "capital base" figure on which allowable profit remittances

were figured. The 10 percent limit for remittances was also increased to 12 percent. But Law 4131 not only served to stimulate foreign direct investment; it was the single most important mechanism through which large enterprises in Brazil borrowed directly (without the intermediation of domestic financial institutions) from the Euromarkets in the 1970s (see chapter 9).

But Law 4131 tended to favor TNCs and state enterprises over national private firms because the former had preferential access to the Euromarkets due to the size and creditworthiness of the ultimate guarantor of the loan (the parent firm in the case of the local TNC and the Brazilian government for state enterprises), which strongly contributed to the monopolization of the economy. Thus, unable to obtain either domestic or foreign credit, many national private firms were forced to either declare bankruptcy and enter into receivership or sell out to foreign competitors. Before we discuss the detrimental impact of Instruction 289 and Law 4131 on national private firms, something has to be said at this point about state enterprises and local subsidiaries of TNCs borrowing in the Euromarkets under Law 4131.

With respect to state enterprises, the ideology of economic liberalism of Campos and Castello Branco was also reflected in their attempt at "privatization." The Truck Manufacturing Company, Fabrica Nacional de Motores, was sold to Alfa-Romeo of Italy and equity in Cosigua, the steel company owned by the state of Guanabara was allowed to be purchased by Thyssen Steel.³¹ Even the previous prohibition of foreign investment in Brazil's iron-ore deposits was reversed and the government approved controversial concessions to Hanna Corporations to mine and export iron ore.³² In the case of oil, nationalist sentiment in Brazil, and particularly in the armed forces, was so strong that Castello Branco was forced to leave the issue open for future considerations. The use of Law 4131 to support state enterprises at a time of domestic deflation, however, was an early sign that liberal economics were inconsistent with the

traditional nationalist ideology within the military since only foreign firms had, of course, the resources to purchase state enterprises (in light of this it is interesting to observe recent privatization attempts by the Sarney administration and the extent to which they will be successful).

Privatization also ran counter to the military's strategy of increasing political and economic centralization. According to Peter Evans:

To abolish them [state enterprises] would have meant diminished central control over the economy, which would have run directly counter to the government's strategy. Despite the pro-laissez-faire conviction of many of the military's early supporters, the major impact of the military's takeover was a centralization of economic power...Instead of diminishing under the military, the number of state enterprises increased more rapidly than in any previous era.³³

But the primary objective of the post-64 regime, to make market capitalism work, was, paradoxically, a major factor for the expansion of both the indirect form of state intervention (i.e., control of fiscal, monetary, financial, wage and credit policies) to "perfect the market" and the direct form of state intervention (state enterprises) to provide important inputs to the private sector at subsidized prices. As Anglade observes:

Every survey carried out in the 1970s confirms that the development of the entrepreneurial role of the state was not the result of planned action, but that it corresponded instead to the ad hoc requirements of private capital in a process of expansion of market capitalism...Evidence suggests...that, during the 1970s, rather than working against private capital accumulation, the entrepreneurial action of the state was perfectly congruent with the objective of its 'indirect' form of intervention in capital accumulation, which was to make market capitalism work.³⁴

Whatever motives may have been behind the proliferation of state enterprises, and the hypothesis of "making market capitalism work" seems very plausible in light of the data produced by this study since the 1930s, there is no doubt that they served as the most important channels for the inflows of foreign loans after 1973, when the private sector was no longer able to sustain a process of indebted capital accumulation (see chapter 9).

Law 4131 was, therefore, the major mechanism through which state enterprises borrowed heavily directly from the Euromarkets. As a result, their foreign debt in 1981 accounted for \$33.2 billion, nearly half of the country's total foreign debt of \$61.4 billion in that year and over two-thirds of the state sector foreign debt, the remainder of which was owed by public financial institutions, such as the BNDE (see chapter 9).

With respect to local subsidiaries of TNCs borrowing in the Euromarkets under Law 4131 (after SUMOC Instruction 289 was revoked in 1972), something has also to be said at this stage. Borrowing abroad was often more attractive than direct investment by the home office because the Brazilian government controls interest payments less than profit remittances. In fact, it is well known that the fiscal policy of the technocracy favored interest payments over profit remittances and dividends. Thus, while profits were taxed and could be remitted abroad only at the rate of 12 percent (already an improvement over the 10 percent decreed by the populists) of the capital invested per year, the payments made by the subsidiaries to the parent company on the amortization and interests of the loans were not taxed.³⁵ As John Wells observed in 1973:

The financing of TNCs investment through foreign loans facilitates a faster repatriation of the initial capital invested, in addition to profit remittance. With Brazilian financial institutions operating in strict understanding with TNCs, the availability of easy credit from the Euromarkets probably facilitates the expansion of foreign control over the national economy.³⁶

There were, however, also other important facts that can not be ignored regarding TNCs' investments in Brazil through loans rather than risk capital throughout the 1970s (see chapters 8 and 9 for data on the borrowing of foreign firms). According to a document presented to FIESP (Federation of Industries of São Paulo) in 1981 by a group of directors of foreign firms, the preference for loans was explained in terms of both assuring the parent of a fixed income independent of productive results by the subsidiary

and of less vulnerability to government control of profit repatriation and dividends: "Foreign loans provide a pre-established return - independent of the economic results obtained in productive activities... Loan contracts are generally established according to internationally accepted norms, whose stability provides more security to the foreign investor."³⁷ In this way, between 1972 and 1980 \$15 billion was borrowed by foreign firms under Law 4131.³⁸ But the process began much earlier under SUMOC Instruction 289 of 1965 which strengthened the credit position of TNCs vis-a-vis national private industries.

Table 7.7 shows that in 1966 44.2 percent of all foreign loans (currency loans and import financing) were contracted by TNCs and 46.4 percent by state enterprises. Significantly, in the same year, 69.1 percent of the loans were contracted with private nonfinancial institutions, indicating that it was credit extended by the parent corporation to their subsidiaries in Brazil. In fact, 32 percent of the currency loans for working capital of firms in 1966 was obtained through SUMOC Instruction 289, the mechanism which allowed a direct credit line between the parent and the local subsidiary. The advantages of foreign corporations over national private firms in having access to foreign credit at a time when domestic credit was restricted is illustrated with the following data: the currency loans under Instruction 289 totalled Cr\$1.12 billion, at the exchange rate prevailing in 1966, representing an amount equivalent to 14 percent of the total loans to the private sector in that year.³⁹

Thus, SUMOC Instruction 289 was the major instrument to enforce the laissez-faire conviction of Campos and Bulhões: many local private firms, particularly small and medium-sized enterprises, unable to obtain credit and also faced with an end to protection from imports, were forced to declare bankruptcy or enter into receivership and sell out to foreign competitors.⁴⁰

Table 7.7 Brazil: Currency Loans and Import Financing, 1966, 68, 71
(in percentages)

	1966	1968	1971
I Debtor			
1. Foreign enterprises	44.2	76.3	60.0
2. Public enterprises	46.4	6.3	3.9
3. Private national	6.5	13.1	20.9
4. Indeterminate	2.9	4.3	15.2
5. Total	100.0	100.0	100.0
II Objective of the loans			
1. Currency loans	49.6	85.2	78.9
1.1 Working capital	46.5	84.1	70.9
1.2 Fixed capital	0.4	0.8	4.3
1.3 Working and fixed capital	0.0	0.3	3.7
2. Import financing	53.1	14.8	21.1
2.1 Capital goods	51.5	14.8	13.8
2.2 Intermediate goods	0.2	0.0	0.1
2.3 Capital and intermediate goods	1.4	0.0	7.2
3. Total	100.0	100.0	100.0
III Nature of the creditor			
1. International financial agencies	1.6	1.9	0.0
2. Private banks (Euromarket)	29.3	44.0	64.8
3. Private non-financial corporations (TNC parent)	69.1	54.1	35.2
4. Total	100.0	100.0	100.0
IV Entry mechanisms			
1. Import financing	53.3	11.8	21.1
2. Currency loans	46.7	85.2	78.9
2.1 Law 4131	14.7	26.6	60.7
2.2 Instruction 289	32.0	58.6	18.2
3. Total	100.0	100.0	100.0

Source: Lara Resende, "A politica brasileira de estabilizaçao",
op.cit., p. 794, Table 14.

Table 7.8 presents data on acquisition as a mode of entry in Brazil by U.S. TNCs as opposed to formation or reorganization. The Table shows that the percentage of new U.S. manufacturing affiliates established by acquisition went from less than 10 percent prior to 1950 to just over 60 percent in the early 1970s.

This denationalization of Brazilian industry was a clear result not of inefficiency in production, but of the government credit policy which favored foreign firms. Yet the ideologues of the regime justified their action in terms of "modernization of habits and attitudes" of the Brazilian entrepreneur and "economic rationality." As Roberto Campos argued in 1965:

The economic situation is really difficult, but there is one compensation. The most important thing now is to change the attitude of the industrial leaders, to make them become concerned with costs and increasing productivity. The time has passed when it was enough merely to sell and to make big profits. Now they either change their attitudes and begin to compete effectively in a free market or they will not survive.⁴¹

Paulo Egidio, the then Minister of Industry and Commerce also argued that:

Some companies actually have shut their doors and others in the near future will be obligated to cease activities. If we examine the cases individually, we will see that the majority of the companies were obligated to close their doors owing to managerial incapacity or inability to adjust to the economic conditions required by the country.

Those responsible for the government's financial and economic policy have been worried by the industrialists, who, satisfied with profits obtained principally because of exchange and tariff protections, were not interested in improving their productive activities. Free from any competition in the domestic market and producing for a not very changing demand, they were not motivated to produce more or to improve quality and decrease costs.

The transfer of merchandise from the special category (in which the requirements were greater for importation) was one of the means adopted to create this necessary change in the businessman's mentality. It is planned that the competition of foreign merchandise, or at least the possible competition, will force a lowering of domestic prices, which are much higher than necessary, and will encourage industries to improve methods of production and attain higher levels of productivity.⁴²

Table 7.8 Acquisition as a mode of entry into Brazil: percentage of new U.S. manufacturing affiliates established by acquisition (rather than formation or reorganization)

Date_of Formation	Percentage of New Affiliates Established by Acquisition	Total Number of Newly Established Affiliates
Prior to 1945	0	28
1946-1950	9	11
1951-1955	22	22
1956-1960	33	36
1961-1965	38	16
1966-1970	52	46
1971-1973	61	18
Total, all periods	33	177

Sources: Peter Evans and Gary Gereffi, "Foreign Investment and Dependent Development: Comparing Brazil and Mexico", in Sylvia Ann Hewlett and Richard S. Weinert (eds.), Brazil and Mexico: Patterns in Late Development (Philadelphia: ISHI, 1982), p. 141, Table 5.

Table 7.9 Bankruptcies and Receiverships in Rio and São Paulo (by industrial activity)

	1962	1963	1964	1965	1966	1967
Apparel	67	69	63	117	252	297
Food	66	40	51	85	159	223
Import/Export	26	24	31	37	62	57
Furniture/decorations	24	23	29	-	72	95
Chemicals/pharmaceuticals	20	39	27	-	58	115
Metal fabrication	36	9	25	52	52	70
Construction material	13	25	24	33	60	62
Domestic appliances	13	18	23	35	60	-
Transport equipment	11	17	23	-	22	49
Printing and publishing	11	8	15	-	31	46
Civil construction	25	26	14	25	48	36

Source: Lara Resende, "A politica brasileira de estabilizacao", op.cit., p. 793, Table 13.

Table 7.9 further shows the detrimental impact of "economic rationality" on the traditional sectors of the economy where small and medium-sized industries predominate, such as apparel and food. The number of bankruptcies and receiverships in those sectors in Sao Paulo and Rio de Janeiro tripled between 1964 and 1966. The construction industry was also clearly a victim of the fiscal policy which reduced substantially government expenditures with public works in the period. It is important to note that the construction industry is a sector that intensively absorbs unskilled labor and whose paralysis had, therefore, a serious negative social impact. Although the military regime created the National Housing Bank (largely financed by workers' forced savings through the FGTS), supposedly to stimulate the construction industry and employment as well as to provide popular housing, in its earliest phase the Bank's major role was to finance federal cash deficit by purchase of government bonds.⁴³ Later, the Bank's funds were channeled to luxury residential construction and to the BNDE which supplied investment credit, highly subsidized, to private national enterprises, the capital goods industry after 1974 (see chapter 9).

Finally, Table 7.10 shows the stagnation of Brazil's national industry in general, and the construction industry in particular, between 1963 and 1965, thus also revealing the negative impact of Goulart's stabilization on the economy (see also Tables 6.14 and 6.15 above). But what distinguished the post-64 orthodox policies from Goulart's, was, of course, the radically different political context which enabled the technocrats to maintain the "rational" policies for an extended period. But the result was that the contraction of industrial growth and of the economy in general that began in 1963 with the populists was reinforced by the orthodoxy of the post-64 technocracy and that the broad alliance that supported the implantation of the military regime did not take long to disintegrate.⁴⁴ When that happened, the response was a tightening of authoritarian control.

Table 7.10 Brazil: Real Industrial Growth Rates, 1959-1965

	1959	1960	1961	1962	1963	1964	1965
Nonmetallic minerals	2.5	14.5	6.8	4.0	-0.1	5.8	-9.5
Metal fabrication	18.1	11.3	9.3	20.4	3.4	6.0	-3.8
Machinery	13.2	27.4	24.2	10.7	2.6	1.4	-12.1
Electrical machinery	13.2	27.3	24.2	10.7	-3.9	9.4	10.6
Transport equipment	35.7	28.4	2.7	24.9	-10.7	3.4	-0.7
Furniture	7.6	11.6	11.1	18.3	2.5	2.9	-20.9
Paper and paper products	5.6	7.8	5.8	11.6	7.8	6.5	-2.3
Rubber	20.0	22.4	4.8	16.1	0.9	6.6	-5.9
Leather products	-1.3	-6.4	1.7	-0.6	-7.2	10.0	29.7
Chemicals	7.5	15.5	21.3	23.2	3.6	9.9	-3.7
Textile	7.3	7.8	7.4	4.3	-2.7	4.4	16.1
Apparel and footwear	-	-	-	-	0.8	12.1	-10.9
Food	2.7	5.6	7.0	5.6	-0.8	1.4	-4.8
Beverages	0.0	-1.0	16.2	-2.6	2.0	-10.5	8.6
Tobacco	7.0	2.8	11.2	9.6	0.5	-1.3	-4.7
Total of manufacturing Industries	12.8	10.6	11.1	8.2	-0.3	5.1	-4.7
Civil construction	0.6	-4.0	9.7	0.6	1.3	2.3	-24.0
Public services	7.0	9.2	6.8	11.3	2.6	7.2	4.1
TOTAL	11.9	9.6	10.6	7.8	0.2	5.2	-4.7

Source: Lara Resende, "A politica brasileira de estabilizaco", p. 796, Table 16.

Opposition to stabilization and an authoritarian response

Although Castello Branco suspended the democratic political process in April 1964, he retained some of the forms of electoral democracy and gubernatorial elections were scheduled for October 1965. The elections were precisely the channel through which both popular opposition to the regime and the industrial sector's dissatisfaction with the economic and financial policies were voiced: populist politicians associated with former president Kubitschek won several key governorships. But the electoral defeat of the military regime was met with a Second Institutional Act that closed the political system even further in order to eliminate any organized resistance to the stabilization program.

All political parties were abolished and a new two-party system was instituted where the predominance of the official party Aliança Renovadora Nacional (ARENA) over the opposition Movimento Democrático Brasileiro (MDB) had to be guaranteed by periodic purges and manipulation by the executive.⁴⁵ Furthermore, the elections of 1966 were made indirect, with the president and vice-president to be chosen by congress and a new wave of purges dismissed elected officials and suspended the political rights of many public figures. Without doubt, the blatant attacks on any semblance of democratic politics after 1964 were the major weapon of the regime to ignore public opinion and to sustain a stabilization program which hurt economically many of its allies. As Skidmore observed:

The immediate justification [for the Second Institutional Act] was the need to continue an anti-inflation and economic development program that was acknowledged to be unpopular but nonetheless essential. It was the one issue on which Castello Branco demanded a commitment from General Costa e Silva, the consensus candidate of the military and therefore the certain successor.⁴⁶

There is no doubt that the gradual tightening of authoritarian control between 1964 and 1967 was directly linked with the need to eliminate domestic pressure from the groups most severely hit by the deflationary and free market policies: the industrial worker and entrepreneur. In fact, it could be argued that the state was never again to be so autonomous with respect to civil society, and particularly to important sectors of the dominant class, such was the case of the national industrial bourgeoisie. But with respect to international financial centers, I suspect it was not so as the domestic economic and political decisions were clearly subordinated to the needs of the external adjustment. Before we examine the policies of Costa e Silva and the extent to which they departed from the more orthodox Caspary-Castello Branco program, attention should now be focused on the external accounts of Brazil, whose equilibrium, after all, was the major concern of the technocrats and foreign

creditors. The examination of the BOP will show that the stabilization measures and the "structural reforms" adopted were not meant to put it on a stable footing. Rather, they only served to perpetuate the financial dependency of the economy on inflows of foreign loans to finance current account deficits that soon began to accumulate as a result of the liberalization of trade and foreign investment the reforms were intended to promote in the first place.

Stabilization and the balance of payments

While the impact of the orthodox package on the domestic social context was highly negative, this can not be said with respect to the external front. In fact, the successful results in the BOP between 1964 and 1966 were only possible with the stagnation of the domestic economy (see Table 6.15 above). The sharp contraction of all imports and of domestic demand in general facilitated the accumulation of trade surpluses to service the foreign debt. Column 1 of Table 7.11 below clearly shows that the value of imports in 1965 was similar to 1950, the lowest of the two decades. Column 4 indicates that exports reached record levels in 1965 and 1966 and column 5, the trade balance, explains the surplus in the traditionally deficitary current account in 1964, 1965 and 1966 (note that in 1963 the deficit on current account had already been drastically reduced as a result of Goulart's stabilization). The surplus on current account, column 7, and in the overall BOP, column 12, financed not only the service account (interest, profit repatriation, dividends, travel and transportation), shown in column 6, but even restored the reserves, column 13. Thus, it is clear that the attainment of surpluses in the trade balance and in the overall BOP was only possible with the industrial recession that gripped the economy in 1964-67.

Table 7.11 also reveals another important feature of the stabilization period: the balance of the capital account in column 11, where net inflows of

capital (gross inflows minus amortization) are recorded, was quite low and even negative in 1963 and 1965. This, combined with the surpluses on current account in 1964, 1965 and 1966, means that the outflow of capital from Brazil exceeded new inflows in those years (this has already been indicated in Table 6.12 above). The outflow is clear when we compare the stabilization period with the preceding and succeeding current account deficits and high levels of net capital inflows to cover the deficits. But why was there capital outflow if column 9 indicates substantial inflows of foreign loans, mainly USAID loans, after the coup d'etat? It is clear that even though Brazil ranked behind only India, Pakistan and South Vietnam in net official aid receipts between 1964 and 1967,⁴⁷ the new inflows went not to finance required imports and stimulate development, but to debt repayment.⁴⁸ Column 10 of Table 7.11 shows that after 1964 the amortization of the foreign debt was indeed quite high for a regime which supposedly counted with unconditional support from the U.S. and international financial agencies (again, Table 6.12 above has already shown this to be the case.

Furthermore, as we have already discussed in chapter 6, the military regime was also rewarded by the Hague Club with a substantive rescheduling of debt service obligations on suppliers' credits. But it should be clear by now that both the rescheduling and new inflows were more a means of postponing the debt problem than of solving it. As Table 6.11 above indicates, the 1964 rescheduling did not correct the highly unfavorable repayment structure of Brazil's debt: the effective maturity period of Brazil's outstanding external debt was shortened from 7.8 years between 1957 and 1961 to 6.6 years between 1962 and 1966 and the rate of interest climbed to 5 percent from 3 percent. In fact, the increased cost of external financing in the latter years must be attributed to the rescheduling operations of 1961 and 1964. Finally, Table 7.12 shows that between 1964 and 1967 the foreign debt even

increased from the \$3.2 billion in 1963 as the new inflows only added to existing debt. This leads us to believe with John Donnelly that the primary objective of international finance in assisting the military regime was indeed "...to bail out Brazil with strictly short-term relief so as to permit uninterrupted debt servicing."⁴⁹

But this short-term debt relief was being extended subject to "positive" results of the orthodox stabilization program on the domestic front. And the foreign creditors, particularly the U.S., had considerable control over national economic policy-making, showing the extent to which financial dependency undermined the autonomy of the state. As Fishlow observes:

Because they were general in character, designed to finance the foreign exchange requirements of the government's policies, and because they were disbursed only after quarterly reviews, these loans necessarily involved close association between American and Brazilian policy makers. Furthermore, because advances from the IMF were involved, the program loan negotiations and reviews went beyond American participation. The foreign influence was fully on the side of orthodoxy.

In effect, by closing down the internal political process and giving virtual carte blanche to Campos and Bulhões, the military government had also opted for magnifying the external influence upon domestic economic policy. It is difficult to evaluate how significant external pressures were in shaping decisions. They were probably greater than most Brazilian officials would like to admit, while considerably less than the foreigners believed... Yet in 1967 and early 1968 foreign influence was almost unanimously aligned against the experimental departure from the orthodoxy of the Castello

Branco years. Disbursement of the program loans was considerably delayed for the first time, and prolonged negotiations were required to satisfy AID officials that the new policies continued the previous emphasis upon stabilization. ⁵⁰

Furthermore, Skidmore, in his most recent work, The Politics of Military Rule in Brazil, 1964-1985, reports that USAID provided over 80 percent of the net inflow of long-term capital to Brazil between 1964 and 1967 (\$488 million), but that this financial assistance eroded considerably the autonomy of the technocrats. He explains:

USAID program loans...required the Brazilian government to present USAID officials with quarterly reports on macroeconomic performance, whereas for project loans USAID was entitled only to reports on the projects themselves. As each quarterly report came in, the US embassy closely inspected the government's total economic performance. This process turned the US into a kind of unilateral IMF, overseeing every aspect of Brazilian economic policy...When a new US Ambassador arrived in Brazil in 1966, he was dismayed to find that "in almost every Brazilian office involved in administering unpopular tax, wage, or price decisions, there was the ubiquitous American adviser." 51

Significantly, the foreign-imposed stabilization program did not restore the equilibrium of the BOP. Rather, it served only to perpetuate the dependency of Brazil on foreign loans. Table 7.11 reveals that already in 1967 the current account of the BOP was back again in deficit, \$237 million. In 1968 the deficit climbed to \$508 million and in 1970 to \$562 million, the largest deficit of the two decades. The counterpart of the current account deficits (which continued growing from \$1.3 billion in 1971 to the frightening \$12.8 billion in 1980, as Table 8.2 below shows) was, of course, the dependency on foreign loans to finance the deficits and the rapid build-up of foreign debt (see Table 7.12) leading to more deficits in a snow ball process throughout the 1970s and culminating in the worst financial crisis in the history of the country. It should be noted at this stage, however, that for the very first time the trade account began accumulating deficits as industrial imports soared even higher than the export boom promoted by the technocrats to buoy foreign confidence in Brazil's creditworthiness. Table 7.11 already indicates the growing imports between 1967 and 1970, as the trade liberalization measures of the stabilization period (i.e., relaxation of foreign exchange and import controls) were allowed to continue until 1975. In 1971 and 1972 the trade deficit was \$343 and \$241 million respectively, but between 1974 and 1981, the trade account was also consistently in deficit as Table 8.2 below shows, resulting in the need to borrow more and more to pay interest on the foreign debt. Nevertheless, as we will make clear, the real problem of the BOP in the

Table 7.11 Brazil: Balance of Payments , 1950-1970
(in millions of dollars, FOB)

Years	Imports	Exports		Trade Balance (5)	Services (6)	Current Account Balance (7)	Direct Invest- ment (8)	Loans (9)	Amorti- zations (10)	Capital Account Balance (11)	BOP Balance (12)	Reserves (13)	
	(1)	coffee (2)	others (3)										total (4)
1950	942	865	470	1.335	393	-283	140	3	28	-85	-65	52	
1951	1.725	1.059	710	1.769	44	-469	-403	-4	38	-27	-11	-291	
1952	1.720	1.045	373	1.118	-302	-336	-624	9	35	-33	35	-615	
1953	1.275	1.070	449	1.539	394	-355	55	22	44	-46	59	16	
1954	1.415	948	614	1.562	147	-338	-195	11	109	-134	-18	-203	
1955	1.104	844	579	1.423	319	-308	2	43	84	-140	3	17	
1956	1.016	0.030	452	1.482	436	-369	57	89	231	-187	151	194	
1957	1.285	846	516	1.392	107	-358	-264	143	319	-242	255	-180	
1958	1.179	688	555	1.243	64	-309	-248	110	373	-324	184	-253	
1959	1.210	744	538	1.282	72	-373	-311	124	439	-377	182	-154	367
1960	1.293	713	557	1.270	-23	-459	-478	99	318	-417	58	-410	345
1961	2.292	710	695	1.405	113	-350	-222	108	579	-327	288	115	470
1962	1.304	643	572	1.215	-89	-339	-398	69	325	-310	181	-346	285
1963	1.294	747	659	1.406	112	-209	-114	30	250	-364	-54	-244	219
1964	1.086	770	760	1.430	344	-259	140	28	221	-277	82	4	245
1965	941	707	889	1.596	655	-362	368	70	363	-304	-6	331	484
1966	1.303	774	967	1.741	438	-463	54	74	508	-350	124	153	425
1967	1.441	733	921	1.654	213	-527	-237	76	530	-444	27	-245	199
1968	1.855	797	1.084	1.881	26	-556	-508	63	583	-484	541	32	257
1969	1.993	846	1.465	2.311	318	-549	-281	189	1.201	-493	871	549	656
1970	2.507	702	1.837	2.739	232	-696	-562	146	1.510	-672	1.105	545	1.187

Source: Lara Resende, "A politica brasileira de estabilizaco", op.cit., p. 760, Table 2.

Note: For 1950-68 services include interest on foreign debt, profit repatriation and dividends. For 1969-70 services do not include profit repatriation and dividends. In 1970 profit repatriation and dividends was \$119 million, see Paulo Nogueira Batista Jr., Mito e realidade na divida externa brasileira (Rio: Paz e Terra, 1983), p. 111, Table 3.

Table 7.12 Brazil: Evolution of the Gross External Debt and International Reserves, 1960-1984
(In billion of US dollars)

Year	Gross External Long-Term Debt	International Reserves
1960	3.1	0.3
1961	3.1	0.5
1962	3.2	0.3
1963	3.2	0.2
1964	3.1	0.2
1965	3.5	0.5
1966	3.7	0.4
1967	3.4	0.2
1968	3.8	0.3
1969	4.4	0.7
1970	5.3	1.2
1971	6.6	1.7
1972	9.5	4.2
1973	12.6	6.4
1974	17.2	5.3
1975	21.2	4.0
1976	26.0	6.6
1977	32.0	7.3
1978	43.5	11.9
1979	49.9	9.7
1980	53.9	6.9
1981	61.4	7.5
1982	83.2	3.9
1983	91.6	4.6
1984	102.4	11.9

Sources: Paulo Davidoff Cruz, Divida externa e politica economica: a experiencia brasileira nos anos setenta (Sao Paulo: Editora Brasiliense, 1984)
For 1982-84, Central Bank of Brazil, Brazil : Economic Program, Vol. 3 of May 1984 and Vol. 6 of February 1985.

1970s and 1980s was - and has always been - the traditional service burden (interest and amortization payments) of the massive foreign debt accumulated during the period.

All of this reveals the contradictions of the stabilization between 1964 and 1967: measures were taken not to put the BOP on a stable footing, but again, as Prado noted with respect to the 1898 financial crisis and stabilization imposed by the British investment banks (see chapter 2), "...to make Brazil a stable place for the export of loan capital which would find in the country the most advantageous opportunities."⁵² As the French say, "plus ca change c'est la meme chose."

It is indeed ironic, however, that the IMF and the US were displeased with the "independent" course of action of Costa e Silva in 1967 when orthodox stabilization was put to an end and aid was suspended. Although the second military president began evading external finance with "strings attached" from traditional official credit sources of foreign governments and international aid agencies, his resort to the much larger and easier credits of the Euromarkets, but at floating interest rates (see chapter 9), was nothing but the faithful execution of the free market reforms favored by the international lending agencies themselves and whose results were already evident by 1967: increasing inflows of private financial capital.⁵³

Nevertheless, it could also be argued that Brazil's resort to the new international financial markets (as well that of many developing countries well before the oil crisis of 1973) irritated the Americans as it was a clear demonstration of the weakening of the monopolistic position exercised by their financial institutions and bilateral aid programs since the postwar period and hence of their power over political and economic decisions in debtor countries. Furthermore, the Transnational Banks operating in the Euromarkets emerged as an important rival to the IMF as a source of BOP

financing without conditionality, another evidence of the weakening of the postwar financial agreements at Bretton Woods when the IMF was established as the main source of external financing for BOP deficits (see introduction to Part Four).

But it is also indeed ironic that the Brazilian authorities believed that they were free from external constraints on national economic policy making and that the interests of TNBs were consistent with long-term local capital accumulation. As it turned out to be, neither the U.S. nor the IMF had reasons to despair. Not only did Brazil's and other developing countries' massive borrowing in the Euromarkets in the mid 1970s benefit developed countries by maintaining a steady level of imports at a time of world recession, but the IMF remerged from the sidelines with the most important role in the debt crisis of the 1980s as the supervisor of devastating austerity programs in debtor countries on behalf of TNBs to ensure their short-term profitability (see chapter 9). And most TNBs exposed in Latin America were from the U.S. What has to be made clear first, however, is that the change in development strategy after 1967 in Brazil was not only the product of transformations at the international level, but was also very much the product of internal pressure on the regime.

The incorporation of the national bourgeoisie and the
financial internationalization of Brazil

Even within an increasingly authoritarian context the political opposition of the national bourgeoisie to the stabilization program continued as in the period prior to the coup. The departure from the more orthodox policies of Campos-Castello Branco after 1967 was a direct consequence of the growing conflict within the military itself over the desirability of continued economic austerity as well as between the military and dissatisfied civilian groups, particularly the national bourgeoisie.⁵⁴ In fact, the

mobilization of the industrialists against the economic liberalism and internationalism of Castello Branco and the class's exclusion from the power bloc was undoubtedly a major reason for the new "nationalist" outlook of General Costa e Silva, the second military president.⁵⁵ Another was the accomplishment of the technocracy in the external front: foreign loan capital began to enter in sustained fashion. As Costa e Silva stated in 1967: "we are proud of Brazil's new international standing."⁵⁶

But if the policy orientation of Costa e Silva (1967-69) and Medici (1969-74) differed from Castello Branco's, it was not in the priority of making "market capitalism" work. It was in the emphasis now placed on maximizing local capital accumulation rather than global profit maximization by international finance. In my view, it is only in this sense that we can argue that the successors of Castello Branco abandoned his internationalism and embarked on a policy of "nationalism."⁵⁷

The opposition of the Brazilian industrial bourgeoisie had centered on Law 4131 and Instruction 289 which provided direct access to foreign credit only to subsidiaries of TNCs and state enterprises while domestic credit was restricted, a deliberate policy of Campos to eliminate "inefficient" national industries.⁵⁸ In March 1967 Costa e Silva appointed as Minister of Finance Antonio Delfim Netto, a spokesman of the São Paulo industrialists, who had publicly criticized Campos' diagnosis of inflation as "demand-pulled."⁵⁹ Attributing Brazil's inflation as "cost pushed", Delfim began meeting the demands of the private sector for easier credit - against the advice of the IMF, hence the suspension of aid - by requiring that all public and private domestic financial institutions channeled 50 percent of their loans to national enterprises.⁶⁰

But it was the introduction by the government in August 1967 of Resolution 63 of the newly created Central Bank that would "selectively"

incorporate the national bourgeoisie as a "junior partner" into the new alliance of the state sector and international finance by using the domestic banking system that had been structured in a way to facilitate the entry of foreign loans.⁶¹ Thus, although Delfim rejected Campos' views on inflation, he accepted Campos' traditional developmentalist proposition that the Brazilian economy, given its underdeveloped stage, required continuous inflows of "foreign savings" to achieve rapid and self-sustaining growth. Indeed, this proposition became the central point of the new minister's defense of the regime's deliberate policy of external indebtedness as the instrument of long-term development (see chapter 8).⁶²

Resolution 63 allowed domestic financial institutions - private and public commercial banks, public development banks (such as the BNDE and its supplementary network of state and regional development banks) and newly established private investment banks - to borrow in the Eurocurrency markets for "repassing" to national industry.⁶³ This financial intermediation that grew tremendously in the 1970s with generous government incentives is known as the famous "repass operations" (*captações para repasse*) through which the domestic banks borrowed abroad and "repassed" the cruzeiro equivalent to the private (local) firm. But with the exception of the state-owned BNDE, whose credit was long-term and highly subsidized by the government, the private investment and commercial banks, particularly branches of foreign commercial banks, were allowed to borrow abroad at long-term and repass domestically at medium- and short-term for working capital of private firms. And this credit was, of course, not subsidized by the government.

Furthermore, to this attractive condition, the government added additional incentives to induce financial institutions to borrow abroad for the repass operations: (1) the final borrower had to absorb the exchange risk, i.e., a cruzeiro devaluation would hit directly the industrial sector, not

the financial sector and although Delfim introduced the system of mini-devaluation in 1968 to reduce the risk and encourage private firms to borrow abroad, they were severely hit with the ~~mini~~devaluation in 1979 and 1983 (see chapter 9),⁶⁴ and (2) after 1973, when the government's foreign exchange needs to cover BOP deficits became the priority, the unused resources borrowed under Resolution 63 were to be automatically deposited with the Central Bank which assumed both the exchange risk and all obligations to the foreign creditors (see chapter 9).

The other side of the coin, that is, the inducement to private firms to use the facilities of Resolution 63 and accept credit denominated in foreign currency rather than cruzeiros was the deliberate policy of the government to keep domestic interest rates always higher than the ones prevailing in the international financial markets which, given the availability of resources, were quite low until 1978. As we will see in chapter 9, this policy was used and abused throughout the 1970s and early 1980s to force private domestic firms to borrow abroad and supply the Central Bank with foreign exchange to cover BOP deficits.

The domestic sector that would ultimately benefit the most from the institutionalization of foreign borrowing or the financial internationalization of Brazil was not the industrial, but the financial. But, in the euphoria of the late 1960s, the indirect access of the large private national enterprises to foreign credit led some to believe that there occurred a "democratic opening" (abertura democratica) with Costa e Silva as "the regime admitted into its ranks parts of the once assertive national(local) bourgeoisie."⁶⁵ In fact, it could be argued that this financial liberalization was the culmination of the policy of the post-64 military regime to make the private sector (after eliminating the "inefficient" enterprises) the "engine of growth", since the build-up of foreign debt began, between 1968 and 1973, in the private

not in the public sector (see Table 8.3 below). But Resolution 63 represented, above all, another concrete form of articulation between the domestic financial system and international finance as well as the instrument through which foreign commercial banks expanded their operations in the Brazilian market.⁶⁶

There occurred a kind of internal division of labor in the mechanisms of foreign borrowing after 1967. Law 4131 would be used mostly by state enterprises and subsidiaries of TNCs to borrow directly from the Euromarkets (Instruction 289 was abolished in 1972 as the government encouraged foreign firms to use the facilities of Law 4131).⁶⁷ Resolution 63 would be used by large national enterprises through the intermediation of the domestic banking system. As we will see in chapter 9 however, after 1979 the government disturbed this neat division of labor and began allowing state enterprises to borrow also under Resolution 63 in order to obtain the foreign loans badly needed to close the BOP. Thus, Resolution 63 and Law 4131, designed by the technocrats, were the two single most important mechanisms through which massive foreign loans from the new international financial markets would enter Brazil in the 1970s.

For some sectors of the Brazilian bourgeoisie, therefore, austerity had ended with the new credit policy, but for the majority of the working class it had hardly began. The wage policy of the short-term stabilization period became very useful to the post-67 long-term growth strategy of the technocrats based on the neo-classical economic doctrine that income concentration is an inevitable and necessary consequence of economic development (see chapter 8). But the economic "miracle" (1968-73), triggered primarily by the elimination of excess capacity of the recession years and an expansionist credit policy to both the domestic producer and consumer of luxury durable goods, was also characterized by the "perfection" of the model of capital accumulation that began in 1955 and institutionalized between 1964 and 1967:

the full integration of the Brazilian economy into the international financial system. If there was any innovation to Kubitschek's development strategy during the "miracle", it could only have been the much larger scale of reliance on foreign loan capital regarded - again - by the external and internal ideologues of developmentalism as the instrument of long-term development, as measured by short-run, high rates of GDP, regardless of its composition.

In summary, the empirical evidence presented in chapter 7 shows the extent to which the contradictions inherent in dependency situation are ultimately resolved in favor of global profit maximization rather than local capital accumulation: Brazil had to choke off its growth of a decade in order to transfer available resources abroad as debt payments. But, more than confirming this major proposition of the dependency approach regarding the developmental outcomes implied by dependency situations, the historical-structural analysis showed how dependency relations are maintained through concrete interaction of domestic social groups and classes whose values and interests coincide with those of the foreigners they support. As we demonstrated, the major feature of the period 1964-67 was not so much the emphasis given by the military regime to orthodox stabilization measures to repay the "populist debt", but the new regime's political choice of a growth strategy based on the reincorporation of international financial interests in the internal developmentalist alliance of the state and the internationalized sectors of the industrial and banking bourgeoisie. In chapters 8 and 9 the focus is again on the developmental outcomes of this new concrete alliance and the extent to which state autonomy increased in ensuring the priority of long-term capital accumulation over short-term global profit maximization by international finance.

NOTES

1. Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton: Princeton University Press, 1979), p. 210.

2. The latter point is best illustrated with the corporative labor system of the Estado Novo (1937-45) discussed in chapter 4, which was used effectively by the post-64 regime. Thus, while Vargas' populist legacy of the 1950s and early 1960s was a target of the new rulers, his earlier institutional innovations were very useful to Castello Branco's policy of control and repression of the working class during the stabilization period (and, of course, beyond that). It is interesting that the late Tancredo Neves, a veteran politician and opposition leader, whose death in April 1985 prevented him from assuming the presidency of Brazil, called the 1964 coup "The Estado Novo of the UDN". Quoted in Thomas Skidmore, The Politics of Military Rule in Brazil, 1964-85 (New York: Oxford University Press, 1988), p. 158.

3. As we saw in chapter 6, the internationalization of the economy had already begun by 1956. The coup d'etat did not represent any break with the development model of Kubitschek, but served, on the contrary, to remove the "obstacles" that were jeopardizing its consolidation (i.e., protection from imports and subsidies to national industry and the populist inability to impose effective stabilization, hence the contraction of foreign capital inflows in the early 1960s). For an analysis of the interrelationship of national security and national development in the military's doctrine of national security, see Alfred Stepan, The Military in Politics: Changing Patterns in Brazil (Princeton: Princeton University Press, 1971), pp. 172-187. For a discussion of internationalism and interdependence as the basic ideology of the Castello Branco regime see also Octavio Ianni, Crisis in Brazil (New York: Columbia University Press, 1970), pp. 148-181.

Interdependence, as the military interpreted it, is clearly spelled out in the Government Economic Action Program (Programa de Acao do Governo or PAEG) of November 1964. It says that one of the objectives of the "revolutionary government" was to "pursue a policy of stimulus to foreign capital and of active technical and financial cooperation with international agencies, other governments, and in particular, with the multilateral system of the Alliance for Progress, in order to accelerate the rate of economic development." The full text is contained in Andre Lara Resende, "A politica brasileira de estabilizaçao: 1963/68", Pesquisa e Planejamento Economico, Vol. 12, Dezembro 1982, No. 3.

4. Ianni, Crisis in Brazil, pp. 180-81.

5. The right-wing military coup of 1964 represented a clear victory for the UDN forces. It was precisely the type of policies favored by them that came to be implemented after 1964, totally free from internal constraints. In fact, Skidmore observes that the Castello Branco government "relied upon the old-line moderate-to-conservative civilian politicians, primarily from the former UDN - the antipopulist party par excellence that had failed to generate any wide popular appeal between 1946 and 1964." See

Skidmore, "Politics and Economic Policy-Making in Authoritarian Brazil, 1937-1971", in Alfred Stepan (ed.), Authoritarian Brazil (New Haven: Yale University Press, 1973), p. 9. Also see Skidmore, The Politics of Military Rule in Brazil, pp. 21-23, 39-41 for a discussion of the UDN-military alliance and the clear pro UDN bent of Castello Branco.

6. See Roberto Campos, A Moeda, o Governo e o Tempo (Rio: Apec Editora, 1964).

7. In addition to Campos and Bulhões, the economist ideologues of the military regime most representative of developmentalism were Gudin and Simonsen. See Eugenio Gudin, Analises de problemas brasileiros (Rio: Agir, 1965) and Mario Henrique Simonsen, Brasil 2001 (Rio: Apec, 1969) and Brasil 2002 (Rio: Apec, 1972). The latter work is a defense of the regime's policy of foreign indebtedness and income concentration. See also Simonsen and Roberto Campos, A nova economia brasileira (Rio: Livraria Jose Olimpio Editora, 1974).

8. Campos was unquestionably the architect of the stabilization program contained in the already mentioned Government Economic Action Program of November 1964. But as Teresa Hayter further states, "there was a 'basic identity of views' between the three international agencies and the Brazilian government." See Hayter, Aid as Imperialism (London: Penguin Books, 1971), p. 139. For a thorough analysis of the Program and an interesting comparison with Goulart's Three Year Plan, see Lara Resende, "A politica brasileira de estabilização". On the role of the technocrats and how the "revolutionary" government gave the command of the national economy to them, see João Paulo de Almeida Magalhães, A economia e a abertura politica (Rio: Livros Technicos e cientificos Editora, S.A., 1981), pp. 16-22. It is worth noting, however, the following comments by Alfred Stepan in The Military in Politics (p. 218):

It is often erroneously assumed that the military had no economic ideas, and for this reason gave Campos carte blanche. A more correct interpretation is that Campos had been a frequent lecturer at the ESG (Escola Superior de Guerra or Superior War College) for ten years before the coup; the staff of the ESG liked his ideas and incorporated them into much of the ESG philosophy.

9. Skidmore, The Politics of Military Rule, p. 20.

10. Ibid., pp. 23-27.

11. Almeida Magalhães, A economia e a abertura politica, p. 18.

12. The belief that Brazil's inflationary process was caused by excess demand has been highly disputed by many well known economists. We have already mentioned Raouf Kahil in chapter 6, but Albert Fishlow and Bresser Pereira are also among those who have argued convincingly that inflation was caused by costs, rather than by demand. Even Delfim Netto, the Finance Minister of the Costa e Silva and Medici administrations, clearly recognized this fact in 1967 when in a clear criticism of Campos' policies he argued that:

The current Brazilian inflation cannot be understood in terms of theoretical schemes of pure demand-pulled inflation or pure cost-pushed inflation. Experience has shown that these two tensions alternate in predominance over the economy. In fact, the autonomous pressure of costs has always been present in the inflationary process, yet was often obscured by the importance of the effects resulting from demand. These tensions are increased by the very nature of the fight against inflation (quoted in Bresser Pereira, Development and Crisis in Brazil, p. 137).

Furthermore, even the conservative economist Eugenio Gudín changed his position radically when he argued in 1969 that budget deficits, not wages, were the cause of the inflationary process in Brazil in the 1950s and early 1960s. Thus, he said:

The main cause [of inflation] was the excess of federal expenditures over receipts...It may also be said of wages that they rose with the increases in the cost of living resulting from federal deficits. Except for the 1954 wage push (forced by Goulart under the Vargas administration) discrepancies in the adjustment of minimum wages were not important.

See Gudín, "The Chief Characteristics of the Postwar Economic Development of Brazil", in Howard Ellis (ed.), The Economy of Brazil (Berkeley: University of California Press, 1969), p. 17.

13. Quoted in Ianni, Crisis in Brazil, p. 189.

14. IPEA, Brazil, 14 anos de revolução (Brasília, 1978), p. 12.

15. DIEESE, "Dez anos de política salarial", Estudos Socio-econômicos I, No. 3 (São Paulo: August 1975), pp. 64-65.

16. For an explanation of the official readjustment formula, see Lara Resende, "A política de estabilização."

17. Quoted in Lara Resende, p. 802. It should be noted at this point that the government of Geisel corrected some of the more extreme distortions that resulted from the application of the "formula", with the goal of granting higher wage readjustments. The practical effect of this policy on the level of real wages, however, ended up being offset by the acceleration of inflation (see chapter 9).

18. See Paul Singer, A crise do "milagre" (Rio: Paz e Terra, 1982), pp. 78-80.

19. *Ibid.*, pp. 110-111.

20. Lara Resende, "A política brasileira de estabilização", p. 795.

21. The most comprehensive national study of malnutrition and its direct relation to family income in Brazil is the Estudo Nacional de Despesa Familiar (ENDEF) undertaken by the Instituto Brasileiro de Geografia e Estatística (IBGE) during 1974-75. The appalling results were not published

until 1978 and in 1979 the military government discouraged attempts at further research. Finally, in 1981 the department of the IBGE in charge of the ENDEF was eliminated. An analysis of the ENDEF is found in Francisco Viacava et al, A desnutrição no Brasil (Petropolis: Editora Vozes Ltda., 1983).

22. In 1964 the cruzeiro was devalued 5 times. Two devaluations under Goulart and three under the military regime. The value of the cruzeiro was reduced by 204 percent against the dollar. In 1965, a further devaluation reduced the cruzeiro's value another 21 percent. In early 1965 the IMF granted Brazil a \$126 million "standby" agreement indicating its satisfaction with the regime's devaluation policy to promote exports and hence obtain the foreign exchange necessary to pay the foreign creditors.

23. See, for example, Christian Anglade, "The State and Capital Accumulation in Contemporary Brazil", pp. 93-95.

24. O'Donnell revised much of his early argument on the rise of the BA regime in "Reflections on the Patterns of Change in the BA State", Latin American Research Review, Vol. 13, No. 1, 1978, p. 8.

25. "Some Reflections on Post-1964 Brazilian Economic Policy", in Alfred Stepan (ed.), Authoritarian Brazil, p. 80.

26. Indexing, viewed initially as a transitional mechanism to facilitate disinflation and promote the growth of credit and capital markets, and hence of the private sector, only strengthened the dominant role of the government in the domestic financial system. Furthermore, indexing became in the 1970s and 1980s an integral part of the inflationary spiral as the savings propensities of Brazil's affluent classes were too low to sustain a noninflationary fast-growth strategy. For a discussion of indexing, see David Felix, "On Financial Blow-ups and Authoritarian Regimes in Latin America", in Jonathan Hartlyn and Samuel A. Morley (eds.), Latin American Political Economy: Financial Crisis and Political Change (Boulder, Colorado: Westview Press, 1986), pp. 107-116.

27. See Felix, "On Financial Blow-ups", p. 110.

28. Balanco Anual, Setembro de 1978, pp. 29-30.

29. Divida externa e politica economica (São Paulo: Editora Brasiliense, 1984), p. 108.

30. The oligopolization of the economy was clearly a source of inflation as the market power enjoyed by the large firms allowed them to pass on the higher costs of production, due to falling demand, in terms of higher prices. Delfim Netto, of course, recognized this and embarked on a policy of strict price control after 1967. Thus, Fishlow is quite correct in arguing that the Castello Branco government,

...was committed to the establishment of a functioning free market system in Brazil, perhaps even more than to the struggle against inflation...Indeed, in the battle against inflation, which was slower and less successful than planned, the government persisted

in orthodox policies - although their inefficiencies were painfully apparent by 1966 - partly in order to change the system.

See Fishlow, "Some Reflections on Post-1964 Brazilian economic Policy", p. 80.

Furthermore, this kind of resource allocation, that is, large private and public firms with access to easy foreign credit, hence the oligopolization of the economy, was attributed to the "market mechanism", not to state policy. As John Wells argues, "in Algeria and Mexico, state banks allocate external credit according to some defined criteria; in Brazil the authorities do not even want to define these criteria, preferring, instead, to let the "market" allocate the foreign resources." See Wells, "Euro-dolares, divida externa e o milagre brasileiro", Estudos CEBRAP 6, Outubro-Novembro-Dezembro 1973, p. 28.

31. Peter Evans, Dependent Development, p. 217.

32. See Skidmore, The Politics of Military Rule, p. 59.

33. Evans, Dependent Development, p. 218.

34. "The State and Capital Accumulation in Contemporary Brazil", pp. 87, 89.

35. See Davidoff Cruz, Divida Externa, p. 110; Paulo Nogueira Batista Jr., Mito e realidade na divida externa brasileira (Rio de Janeiro: Paz e Terra, 1983), Segunda Edicao, pp. 110-111 and Anglade, "The State and Capital Accumulation", pp. 93-94.

36. "Euro-dolares, divida externa e o milagre brasileiro", p. 3.

37. Quoted in Paulo Nogueira Batista, Mito e realidade na divida externa brasileira, p. 113.

38. See Jeffry A. Frieden, "The Brazilian Borrowing Experience: From Miracle to Debacle and Back", Latin American REsearch Review, Vol. XXII, No. 1, 1987, p. 113.

39. Lara Resende, "A politica brasileira de estabilizaçao", p. 792.

40. On denationalization of Brazilian industry see Celso Furtado, Um projeto para o Brasil (Rio: Editora Saga, 1968).

41. Quoted in Bresser Pereira, Development and Crisis in Brazil, p. 118.

42. Quoted in Ianni, Crisis in Brazil, pp. 177-78.

43. See Fishlow, "Some Reflections on Post-1964 Brazilian Economic Policy", p. 98.

44. It is interesting to note that even Carlos Lacerda, the UDN spokesman and staunch supporter of the military coup showed his dissatisfaction with the policies of the regime in his daily Tribuna da Imprensa. He charged that the military had betrayed the revolution and

launched a full-scale attack on the entire stabilization program. In 1966, Lacerda launched the Frente Ampla (Broad Front) movement against the military regime, allying himself with the two populist politicians he hated the most: Kubitschek and Goulart. Lacerda's goals, incredible as it may sound for an UDN politician, were: a return to nationalism and independence in foreign relations; economic policy must no longer be hostage to the IMF; higher wages would build stronger internal demand, reduce unemployment, and thereby increase Brazil's control over its economic policy. See Stepan, The Military in Politics, p. 221 and Skidmore, The Politics of Military Rule, pp. 41, 54.

Furthermore, within the army itself, attacks against the economic austerity became frequent as the charges of the commanding officer of the Fourth Army, General Justino Alves Bastos, illustrate: "The poor people have never been so poor." As Stepan reported: "Civilians who disagreed with the government lionized the military dissenters as the 'loyal opposition' and attempted to play them off against the government." The Military in Politics, pp. 227-228.

45. The largest single previous party affiliation among ARENA was UDN, with almost as many from the PSD, whereas in the MDB the largest was PTB and the next large the PSD. See Skidmore, The Politics of Military Rule, p. 48.

46. Skidmore, Politics in Brazil, p. 320.

47. See Fishlow, "Some Reflections on Post-1964 Brazilian Economic Policy", p. 82 and Lara Resende, "A politica brasileira de estabilizacao", pp. 782-783.

48. It should be noted that USAID's money came in the form of "program loans" not of "project loans"- for schools, construction, health programs, literacy campaigns, etc. This is a clear indication that USAID "program loans" were financing debt payments to the Hague Club creditors. This issue is dealt with by Fishlow, "Some Reflections", p. 83; Payer, The Debt Trap, p. 159 and Skidmore, The Politics of Military Rule, pp. 39, 60. The latter duly acknowledges the capital outflow from Brazil between 1964-67: "For the Castello Branco presidency (1964-67), both the World Bank and the Eximbank took more capital out of Brazil than they put in." (p. 38). He further says that USAID loans "...were used largely to pay foreign creditors rather than finance imports." (p. 60)

49. "External Debt and Long-Term Servicing Capacity", in H. Jon Rosenbaum and William G. Tyler (eds.), Contemporary Brazil: Issues in Economic and Political Development (New York: Praeger Publishers, 1972), p. 108.

50. "Some Reflections on Post-1964 Brazilian Economic Policy", p. 83.

51. p. 30, emphasis in original.

52. Caio Prado Junior, Historia Economica del Brasil (Buenos Aires: Editorial Futuro, 1960), p. 253.

53. Private direct foreign investment did not recover its level of the late 1950s and early 1960s until 1969. It is obvious that even though the IMF gave its "seal of approval" on Brazil's economic policies to foreign investors, these were concerned only with profits which would not be generated in an economy in recession such as Brazil between 1964-67.

54. A thorough analysis of the military succession in 1967 is Stepan, The Military in Politics. He clearly shows that it was discontent over the economic stabilization and the "liberal internationalism" of Castello Branco, both within the military and between it and civilians, which led Costa e Silva to reject the policies of the first military president. But as he argues:

Costa e Silva certainly did not represent the authoritarian nationalists within the military, but he did represent a bridge between them and the Castello Branco government's liberal internationalism. His rise to power involved a break with the first government, and the tone of his government ("humanism" as opposed to "austerity", "nationalism" as opposed to "internationalism") emphasized precisely those points deemphasized by the Castello Branco government...Officers strongly identified with the first government fell into disfavor and openly complained against the policies of the second. Handling of the succession brought about serious discontinuities of policy as well as serious disputes within the military (p. 252).

55. See Cardoso, "Associated-Dependent Development: Theoretical and Practical Implications", in Alfred Stepan (ed.), Authoritarian Brazil pp. 168-169; Fishlow, "Some Reflections", pp. 82-83, Stepan, The Military in Politics, p. 236 and Bresser Pereira, Development and Crisis in Brazil, p. 134.

56. Quoted in Hayter, Aid as Imperialism, p. 136.

57. See also Peter Evans, Dependent Development, p. 49.

58. Conjuntura Economica 31 (11), Novembro de 1977, p. 174.

59. The new economic orientation of the Costa e Silva government and its criticism of Castello Branco's economic policy is contained in Diretrizes do Governo: Programa Estrategico de Desenvolvimento (Brasilia: Ministry of Planning and Economic Coordination, July 1967).

60. Lara Resende, "A politica brasileira de estabilizaçãõ", p. 793.

61. A thorough analysis of the various sectors of the Brazilian bourgeoisie and particularly the internationalized ones, that is, associated with TNCs, is Evans, Dependent Development. Resolution 63, at least in its initial phase, was aimed at strengthening this modern, internationalized sector, which formed with state and foreign capital the "triple alliance" of the "miracle" years.

62. See Davidoff Cruz, Divida reterna, p. 29. Nevertheless, Campos was "distressed" with Costa e Silva and Delfim's expansionist credit policies

and fearful that the new government would prematurely redistribute income and also embark on a policy of economic nationalism. See Campos, Temas e Sistemas (Rio: apec, 1969), p. 159. It is also interesting to note that the constitution of 1967, approved before Costa e Silva took office, strengthened the executive's control over public expenditure, a measure strongly advocated by Campos to deprive congress of control over appropriations, and a 10-year economic plan was formulated by Campos to ensure continuity in economic policy. It was clear, therefore, that Campos-Castello Branco were attempting to limit Costa e Silva's freedom of action on economic policy making.

63. As chapter 3 showed, in the 1920s, the government of Washington Luis also resorted to similar financial arrangements to provide credit for coffee planters in a fast deteriorating world economy. It was the inflows of loans to the stabilization fund that guaranteed domestic liquidity and BOP equilibrium. When foreign loans were interrupted after 1929, the dependent economy suffered a major financial crisis. It would again in the 1980s as a result of the financial internationalization of the economy (see chapter 9).

64. The strategy of minidevaluations or "crawling peg" was intended to keep the exchange rate at a "realistic" level. Recalling chapter 5, where we provided the IMF's exchange rate preferences, the "floating" or "crawling peg" exchange rates are rated as second best among the 6 items. Thus, Brazil moved from item 3, simple multiple exchange rates, to the crawling peg. The strategy caused the cruzeiro-dollar rate to lag moderately behind the domestic inflation and indexing rates. It helped the export promotion drive of the regime and buoyed foreign confidence in Brazil's creditworthiness, and also cheapened the cost of foreign credit relative to domestic credit, thus encouraging public and private banks and firms to borrow abroad. But as Payer notes: "This device is, in fact (though it is seldom mentioned by the press agents of the Brazilian miracle) an admission that inflation has not been fully conquered in Brazil... Brazilians have long know how to use compensating mechanisms to enable them to live with inflation; the exchange rate is simply one of the most recent of these." See The Debt Trap, p. 163.

65. Cardoso, "Associated-Dependent Development: Theoretical and Practical Implications", p. 169.

66. On the last point see Davidoff Cruz, Divida externa, pp. 123-25.

67. See Comunicado FIRCE (Fiscalização e Registro de Capitais Estrangeiros do Banco Central do Brasil) of January 9, 1972.

CHAPTER 8

MIRACLE OR MIRAGE: BRAZIL'S ROAD TO CRISIS, 1968-74

The official and theoretical discourse of the technocrats, that both income concentration and acceleration of foreign indebtedness during the "miracle" years were necessary for the transition of the Brazilian economy to a more developed stage and for the country to "catch-up" with the developed industrial societies,¹ is difficult to sustain in light of the evidence. What the evidence we will now present does show is that, in practice:

(1) The build-up of a foreign debt, whose nature was predominantly financial and not productive, was determined more by the technocrats' intended integration of Brazil's economy into the world financial system than by this developing country's real need of "external savings" and foreign exchange during an "expansive cycle". Indeed, the inflows of loans were running at rates over and above those required to finance Brazil's traditional current account deficit and domestic investments. The bulk of the loans between 1967 and 1973 served, instead, to accumulate foreign reserves well beyond import requirements.

(2) Neither foreign loans nor income concentration really contributed to the expansion of Brazil's productive forces and in this way to the country's "catching-up" with the developed industrial countries. The squeeze of the popular sectors and the availability of foreign loans provided resources not for the development of the highly technological capital goods industry, but, on the contrary, for the increasing imports of those goods, which retarded considerably the domestic industry and, hence, perpetuated the external dependence of the country. The growth strategy adopted also served only to produce a consumption orgy of so-called modern durable goods by the more affluent classes and the financing of the consumption of those goods by the better paid sectors of the middle and working class.²

The analysis that follows, therefore, shows the myth of the developmentalist thesis, adopted by the military regime, that foreign capital

and income concentration are crucial for the transition and "replication" process of developing countries and that they were crucial, indeed, but for Brazil's road to crisis.

The "policy of foreign indebtedness" and the
financial nature of the loans

Delfim Netto, considered the "father" of the "miracle" and one of the promoters of foreign indebtedness after 1967, made the following statement to the National Congress in 1973:

It is often said that the foreign indebtedness of Brazil is a retardation bomb, onerous inheritance to future generations. This is one of the repeated unsound criticisms...If, on the one hand, the indicators of global indebtedness rose from 1967 to 1972, on the other, all indicators of the external front improved substantially...Therefore, there is no evidence of retardation bomb or of irresponsibility in the Brazilian policy of foreign indebtedness ("politica do endividamento externo").³

A "retardation bomb" the foreign debt would certainly be, but in the euphoria of the late 1960s and early 1970s, when international commerce was growing at an annual average rate of 20 percent, Brazilian exports at 25 percent,⁴ and GDP at 11.3 percent on the average between 1967 and 1973 (see Table 8.1 below), Delfim's critics were really at a disadvantage. It appeared that the "policy of foreign indebtedness" of the technocracy was sound and that foreign loans were indeed condition sine qua non for the high rates of GDP, the major concern of the technocrats. But of what consisted the "policy of foreign indebtedness"?

The so-called "policy of foreign indebtedness" adopted in 1967 consisted of "administering" or "managing" the growth of the foreign debt through improving its profile (restriction of short-term operations), promoting exports to buoy the confidence of international finance in the country's creditworthiness, and maintaining "appropriate levels" of foreign reserves.⁵ The question was, therefore, not how to limit the foreign debt, but how to administer it. And the measures taken to administer the foreign debt would

apparently reduce the vulnerability of the economy to a sudden contraction of foreign loans and make viable the growth cum debt strategy which, in the opinion of the technocrats, was absolutely necessary for the transition of the Brazilian economy to a more developed stage.⁶

The evidence is overwhelmingly against the claims of the government authorities that the acceleration of foreign indebtedness during the "miracle" was necessary for the expansion of Brazil's productive forces and, hence, for "catching-up" with the more advanced countries. The predominantly financial nature of the inflows of foreign loans is clearly indicated in Table 8.2 below: 70 percent of the loans was used to build up foreign reserves over and above the required level to finance imports. While the gross foreign debt grew from \$3.3 billion in 1967, 10 percent of GDP, to \$12.6 billion in 1973, 17 percent of GDP (column 9), international reserves rose from \$257 million to \$6.4 billion (column 19). The reserves were, in turn, reinvested in the Euromarkets, although there was, of course, a considerable margin between the interest rates Transnational Banks (TNBs) charged for deposits and their rates for lending. As such, the major role of foreign loans during the "miracle" was to create a purchasing power that was not used in the period and that returned to the international circuit. This basically refutes the claims of the developmentalists that "external savings" were an absolute necessity for productive investments in an economy still in its underdeveloped stage.⁷

The financial nature of Brazil's foreign indebtedness can also be seen through the current account balance in column 6 of Table 8.2. Again, inflows of loans were running at rates over and above the traditional current account deficit showing that the growth of the foreign debt can not be justified as the result of a developing country in great need of foreign exchange to close the BOP. It is indeed ironic that for the very first time in the history of Brazil the excessive foreign loans were not really required

to maintain the equilibrium of the BOP, the traditional role of international finance in the country. One could argue, however, that the capacity to import of Brazil was never so high and that the "miracle" years marked the very first time in the postwar period that Brazil was not constrained by foreign exchange scarcity (see discussion below).

Furthermore, the claim of the technocrats, such as Langoni, that the loans to finance the current account deficit represented real resource transfers for productive investments in unwarranted.⁸ If we take the year 1972 as an example we will see that Brazil had indeed a trade deficit of \$241 million (column 3 of Table 8.2) as a result of excessive imports of capital goods to expand the production of luxury consumer goods and which retarded considerably the domestic industry of capital goods (see discussion below). The major cause of the deficit in the current account in that year (as well as in subsequent years, with the exception of 1974), however, was not the trade deficit, but the traditional service deficit (columns 4, 5 and 6 of Table 8.2) which amounted to \$1.2 billion, a "contribution" of profits and dividends by foreign firms of \$164 million; net interest on the foreign debt of \$359 million; transportation, freight, insurance and tourism of \$730 million. As John Wells commented in 1973, refuting the repeated arguments of the Brazilian authorities that foreign loans to Brazil were essential for the country's development: "Only with a very refined intellectual exercise can we interpret these payments as real resource transfers to Brazil and as a contribution to the expansion of the productive capacity of the economy."⁹

It is indeed impossible to explain the acceleration of foreign indebtedness during the "miracle" as primarily the result of the "foreign exchange gap" or even the "savings gap". In fact, with respect to the latter, the regime could claim some credit for the rise, although very modest, in domestic private savings, from 21.1 percent of GDP on average between 1960 and

Table 8.1 Brazil: Real Annual Growth Rates of GDP and Per Capita GDP (%)
(between 1967 and 1984)

Years	GDP	Per Capita GDP
1967	4.8	1.8
1968	11.2	6.3
1969	10.0	5.9
1970	8.3	6.2
1971	12.0	9.3
1972	11.1	8.4
1973	13.6	10.8
1974	9.7	7.1
1975	5.4	2.7
1976	9.7	7.1
1977	5.7	3.2
1978	5.0	2.5
1979	6.4	3.8
1980	7.2	4.6
1981	-1.6	-4.0
1982	0.9	-1.5
1983	-3.2	-5.5
1984	4.4	1.8

Sources: For the years 1967 to 1969, Luiz Bresser Pereira, Development and Crisis in Brazil, 1930-1983 (Boulder, Col.: Westview Press, 1984), p. 168, Table 8.3. For the years 1970 to 1984, Brazil Economic Program: Internal and External Adjustment (Brasilia: Banco Central do Brasil, February 1985), volume 6, p. 65.

1964 to 23.8 percent between 1970 and 1974. According to Anglade, this rise in domestic savings,

...combined with a stricter control over government current expenditures and with improved tax and social security revenues, which increased the government current savings (from 2.7% of GNP in 1970 to 4.6% in 1973), this helped to maintain the contribution of domestic savings to the financing of investment at 88.8 percent on average between 1970 and 1974. 10

After all, the "reformist" regime was hailed for its efforts at mobilizing domestic savings through the restructuring of the domestic banking system and capital markets by many observers, not to mention the concentration of income that took place (see discussion below). That foreign inflows of foreign loans for domestic investment were indeed superfluous is recognized

Table 8.2 Brazil: Balance of Payments and the External Debt, 1967-81
(in millions of \$)

Year	Exports (1)	Imports (2)	Trade Balance (3)	Net Services ¹ (4)	Profits and Dividends (5)	Interest (6)	Current Account Balance (7)	Loan Capital Inflows ² (8)	Amorti- zations ³ (9)	Gross debt (10)	Foreign Reserves (11)
1967	1,654	1,411	243	-270		-184	-237	360	-444	3,372	199
1968	1,881	1,855	26	-328		-144	-508	553	-484	3,780	257
1969	2,311	1,993	318	-367	-81	-182	-281	1,023	-493	4,403	656
1970	2,739	2,507	232	-462	-119	-234	-562	1,433	-672	5,295	1,187
1971	2,904	3,247	- 343	-560	-121	-302	-1,307	2,037	-850	6,622	1,723
1972	3,991	4,232	- 241	-730	-164	-359	-1,489	4,299	-1,202	9,521	4,183
1973	6,199	6,192	7	-1,010	-199	-514	-1,688	4,495	-1,673	12,572	6,415
1974	7,951	12,641	-4,690	-1,532	-250	-652	-7,122	7,455	-1,920	17,166	5,269
1975	8,670	12,210	-3,540	-1,429	-237	-1,498	-6,700	7,672	-2,185	21,171	4,040
1976	10,128	12,383	-2,255	-1,574	-383	-1,809	-6,013	9,104	-3,009	25,985	6,644
1977	12,120	12,023	97	-1,576	-458	-2,103	-4,037	8,861	-4,135	32,037	7,256
1978	12,659	13,683	-1,024	-1,720	-564	-2,695	-5,927	15,641	-5,439	43,511	11,895
1979	15,244	18,084	-2,839	-2,378	-740	-4,185	-10,742	12,594	-6,541	49,904	9,689
1980	20,132	22,955	-2,823	-3,120	-544	-6,311	-12,807	14,879	-6,705	53,847	6,913
1981	23,293	22,091	1,213	-2,837	-587	-9,179	-11,717	18,882	-7,514	61,411	7,507

¹Net services include transportation, freight, insurance, tourism.

²Medium-and long-term loans (currency loans and import financing)

³Amortization on medium- and long-term loans

Sources: Luiz Bresser Pereira, Development and Crisis in Brazil, p. 171, Table 8.4; Paulo Nogueira Batis Jr., Mito e Realidade na Dívida Externa Brasileira (Rio: Paz e Terra, 1983), Segunda Edição, p. 102, Quadro III and p. 111, Tabela 3 and Anthony Phillip et al., "Endividamento Externo balanço de pagamentos e crescimento econômico no Brasil, 1965-78", Fundação João Pinheiro 13 (1/2) Jan/Feb 1983, p. 8, Quadro 2.

even by government authorities. In 1973, João Paulo dos Reis Velloso, the then Planning Minister, made the following observation:

The opportunities for investment in an economy growing at accelerated rates has generated a correspondent demand for financing. But given the availability of resources in the international capital markets, the inflows of currency loans have run over and above our need of short- and long-term financing.¹¹

We are thus led to conclude that the explanation for the build-up of an excessive foreign debt between 1968 and 1973 is found in the intended financial internationalization of Brazil: the growing demand of the private sector for credit in cruzeiros was simply met with the resources of the Euromarkets to substitute for more expensive domestic credit lines (as discussed in chapter 7, the government induced the private sector to resort to foreign loans by maintaining domestic interest rates higher than the rates prevailing in the Euromarkets), regardless of the country's real need for either foreign exchange to finance the BOP or "external savings" to finance domestic investment. But as Paulo Davidoff Cruz explains, traditional BOP concerns were clearly behind the financial internationalization of the economy. He argues that:

As a result of the financial transformation [of the second half of the 1960s], the public and private sectors began to satisfy part of their increasing needs for credit in cruzeiros through operations that involved the simultaneous inflows of foreign loans. Since then, the movements of expansion or contraction in the internal demand for credit in cruzeiros brought, implicit in themselves, movements of expansion and contraction in the demand for credit in foreign currency. Given the premise of the government authorities that the Brazilian economy required the contribution of "foreign savings" in order to grow, it was established, apparently, an automatic mechanism of adjustment in the BOP: as the demand for credit in cruzeiros accelerated, there would be an automatic increase in the inflows of foreign loans.¹²

It should be emphasized at this point that the Euroloans to Brazil (and elsewhere in the developing world) were not earmarked for specific projects as was the case with loans from international lending organizations. The Euroloans were, in essence, from the perspective of the lenders, compensatory finance for BOP deficits.¹³

That the build-up of foreign debt began in the private sector and that the major borrowers under Law 4131 were the subsidiaries of TNCs is clearly revealed in Table 8.3. While the public sector was responsible for 24.9 percent of the long-term currency loans in 1972, 39.7 percent in 1973 and 35.3 percent in 1974, the private sector accounted for 75.1 percent, 50.3 percent and 64.7 percent, respectively, with foreign firms leading the way with 47.8 percent, 30.2 percent and 42.8 percent of the total loans to the private sector during those years. As to private national firms, their foreign borrowing under Law 4131 represented only 27.3 percent, 23.0 percent and 13.9 percent. As we have already discussed in chapter 7, however, large national private firms' access to the Euromarkets was made indirect, through the financial intermediation of domestic institutions under Resolution 63. Table 8.4 thus gives an idea of the "repass operations" between 1972 and 1974 when private national commercial banks and foreign investment banks were responsible in large part for the annual inflows of long-term loans for domestic lending at medium- and short-term to the "elite" national firms.

Foreign loans and inflation

By 1972 the "competence" of the technocrats in attracting foreign loans was such that reserves reached \$3.5 billion. Paradoxically, the very success of the "policy of debt administration" gave rise to a fear of the inflationary impact of the inflows of loans on the country's money supply. Thus, the government attempted - for the very first time in the history of Brazil - to reduce the inflows of loans! In October, the National Monetary Council required 25 percent of incoming loans to be put on deposit with the Central Bank (Resolution 236 and Circular 190). In addition, a minimum time period of six years for the amortization of loans was established, indicating that the Brazilian government was indeed in a position to dictate to foreign lenders the conditions under which it accepted loans.

Table 8.3 Currency Loans under Law 4131
Gross Annual Inflows to the Private Sector,
1972-74 (In millions of US\$)

Borrower	1972		1973		1974	
	\$	%	\$	%	\$	%
PRIVATE SECTOR	1,874.4	75.1	1,718.3	60.3	2,011.5	64.7
National	680.6	27.3	655.6	23.0	431.8	13.9
External ¹	1,193.8	47.8	1,062.7	37.3	1,579.7	50.8
International firms	1,004.0	40.2	860.5	30.2	1,330.9	42.8
Foreign firms	47.5	1.9	68.4	2.4	121.3	3.9
Conglomerates	37.5	1.5	19.8	0.7	52.9	1.7
Joint-ventures	104.8	4.2	114.0	4.0	74.6	2.4
PUBLIC SECTOR	623.1	24.9	1,130.9	39.7	1,098.0	35/3
TOTAL	2,497.5	100.0	2,849.2	100.0	3,109.5	100.0

1

According to the classification of the author, the external sector consists of: (1) international firms which are the subsidiaries of TNCs; (2) foreign firms which are distinct from TNCs in that the former do not necessarily have investments in at least six countries and are not included in the Fortune 500, but have, as in the case of TNCs, at least 20 percent of their capital owned by the parent corporation; (3) conglomerates which are firms affiliated with financial conglomerates whose capital, at least 25 percent of which is owned by a commercial bank or financial group with headquarters abroad and (4) joint ventures, associations of foreign and national (private or public) firms.

Source: Paulo Davidoff Cruz, Divida Externa e Politica Economica (São Paulo: Brasiliense, 1984), p. 100, Tabela 5.

Table 8.4 Currency Loans under Resolution 63
Gross Annual Inflows to the "repassing"
agents, 1972-74
(in millions of US\$)

Agents	1972		1973		1974	
	Value	%	Value	%	Value	%
Commercial Banks	688.2	46.9	566.7	53.0	1,157.5	72.0
Public	159.4	10.9	149.0	13.9	669.0	41.6
Private	528.8	36.0	417.7	39.1	488.5	30.4
National	403.1	27.5	339.0	31.7	381.3	23.7
Foreign	125.7	8.5	78.7	7.4	107.2	6.7
Investment Banks	763.6	52.1	496.7	46.4	427.9	26.6
National	283.2	19.3	154.6	14.4	95.2	5.9
External	480.4	32.8	342.1	32.0	332.7	20.7
Foreign	381.6	26.0	306.0	28.6	202.1	12.6
With participation	98.8	6.8	36.1	3.4	130.6	8.1
Development Bank (BNDE)	13.4	1.0	6.1	0.6	22.6	1.4
TOTAL	1,465.2	100.0	1,069.5	100.0	1,608.0	100.0

Source: Same as Table 8.3 above, p. 127, Tabela 13.

These restrictive measures were not effective, however, and by December 1972 the foreign reserves had reached \$4 billion (see Table 8.2 above). Thus, in order to avoid excessive liquidity in the economy, the Central Bank began launching massive indexed treasury bonds in the "open market" at very high rates of interest. This means that the foreign debt was determining the growth of the internal public debt. We have already explained the mechanism and here we may only recall that when the volume of the inflows of foreign loans is very high and the Central Bank also places a high volume of cruzeiros in the domestic market, the Bank is immediately led to withdraw part of the money in circulation through the sales of treasury

bonds in order to avoid inflation. Therefore, the growth of the internal public debt of Brazil was not being determined by government deficits, which were nonexistent at the time (recall the discussion on the efficiency of the technocrats in eliminating the populist deficits in chapter 7), but by the need of the financial authorities to conduct monetary policy in view of excessive inflows of foreign loans from the Euromarkets.¹⁴

When the reserves reached the unprecedented amount of \$6 billion in July 1973, however, the government attempted further restrictive measures to stop the inflows of foreign loans that were by now in clear conflict with domestic monetary policy (inflation jumped from an annual rate of 17.4 percent in 1972 to 20.5 percent in 1973, as Table 8.5 below indicates). In August, a new compulsory deposit with the Central Bank, now at 40 percent of incoming loans, was established (Resolution 265 and Circular 218) and the minimum time period of amortization was 10 years. In this way the inflows of foreign loans were drastically reduced. But only until February 1974, however, when the government, in a reversal of policy, suspended the 40 percent deposit and announced new measures to facilitate and stimulate the entry of foreign loans now indeed required to finance the deficit of the BOP in the context of a drastic deterioration in international conditions (see chapter 9).

The need to borrow massive amounts of new money in 1974 also forced the government to lower the minimum acceptable maturities on the loans in September from 10 years to 5 years and establish the period of six months for the initiation of principal payments, thus bringing about a deterioration in the maturity structure of the foreign debt.¹⁵ This, combined with the loss of foreign reserves in 1974, put in check the "policy of foreign indebtedness or debt administration" of the technocrats.

In fact, the year 1974 marks the beginning of the unfolding of the political and economic contradictions generated by the Brazilian "model" of

Table 8.5 Annual Inflation in Brazil
(percentages)

Year	Price Increase	Year	Price Increase
1962	54.8	1970	18.2
1963	78.0	1971	17.3
1964	87.8	1972	17.4
1965	55.4	1973	20.5
1966	38.6	1974	31.5
1967	28.8	1975	32.7
1968	27.8	1976	41.3
1969	20.3		

Source: Jose Serra, "Three Mistaken Theses regarding the Connection between Industrialization and Authoritarian Regimes", in David Collier (ed.), The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979), p. 119, Table 3.

capital accumulation and the transformation of the "policy of foreign indebtedness" into "debt administration of policy", that is, the expansion of the foreign debt was no longer a voluntary process, but the product of the very contradictions it generated: the foreign debt continued to grow to meet the massive credit costs of the debt itself. But before examining this key period (1974-79) in the relationship of international finance and Brazil's political forces, which is the subject of chapter 9, we still have to answer a major question: in addition to foreign indebtedness, what were the major features of the "model"?

In attempting to answer, we will first look at the political context which made possible the pursuance of a "model" which excluded the majority of the population from the benefits of growth and then will proceed to explain the nature of this growth. We will thus be better able to ascertain the extent to which foreign loans and income concentration contributed to the expansion

of the country's productive forces and to speed up the "replication" process, as claimed by the internal and external ideologues of developmentalism.

Authoritarianism and repression: the political face
of orthodox economic doctrine

I have argued above that the growing authoritarianism of the military regime between 1964 and 1967 was the direct result of the unpopular stabilization measures that had to be carried out to restore Brazil's international credit-worthiness. I have also discussed the extent to which the mobilization of the national industrial bourgeoisie against Campos-Castello Branco policies had a direct bearing on the new expansionist growth strategy after 1967 and explained how Delfim Netto, the influential Finance Minister of the Costa e Silva government, engineered the "opening-up" of the political system to include some sectors of the bourgeoisie.

It was during this so-called "humanization of the revolution" that the popular sectors believed that their voice could also be heard. But what the working class did not know was that the new growth model was to be based precisely on the continuation of the wage and labor policy they wished to resist.

The question to be posited here is not, therefore, whether there was a causal link between an authoritarian repressive regime in Brazil and economic growth, as many observers of the "miracle" did.¹⁶ Although economic success was presented by the military regime as well as its domestic and foreign allies, as a justification of authoritarianism,¹⁷ our discussion of the populist period (chapters 5 and 6) has already shown that Brazil achieved high rates of growth under a relatively democratic regime. The issue is, rather, whether there was a link between authoritarianism and repression and economic doctrine during the "miracle", as there was during the stabilization period. While it is true that widespread civilian criticism

of the regime, particularly massive student demonstrations, anti-government speeches in congress and attacks by the Church, contributed to the authoritarian crackdown in 1968, it is nonetheless undeniable that the "reactivation" of the doctrine of national security in that year to guarantee the stability necessary for economic growth was also the direct result of the threat labor groups posed to the technocrats' "grand plan" for the economy.

The basic element of Delfim's developmentalist growth strategy consisted of maintaining the wage policy of the stabilization years now under the guise of Kuznet's hypothesis of the inverted U curve. As discussed in chapter 1, the argument, based on the experience of the now developed countries of Europe and North America, suggests that as economies develop, relative income inequalities first grow, and then later diminish. But, most important, liberals (as well as Marxists in their own terms) have generalized this process as inevitable and necessary for the replication in developing countries of the growth path of the advanced countries and have argued that market forces should not be disturbed by premature redistributive measures which would only slow economic growth, measured in terms of GNP and GNP per capita.¹⁸

Costa e Silva and Medici policy-makers (Delfim continued in his position during the Medici administration, between 1969 and 1974) made sure that Brazil would provide empirical evidence for Kuznets' theory, at least as the concentration phase of the grow process went. As Delfim argued in 1972:

Crescer é concentrar (to grow is to concentrate income). To try to share the wealth or divide the cake will reduce the economy's momentum and result only in dividing the misery. Eventually, the new wealth will trickle down.¹⁹

In 1968 the Costa e Silva government began putting into practice the "grow first distribute later" theory. The first measure was to make permanent Campos and Bulhões wage law of 1965. The law, which had a devastating impact on the lives of the unskilled workers, as we have already

discussed in chapter 7, had only a three-year life, and the government now needed a permanent control over the minimum wage. The manipulated congress readily agreed to the request of the government.²⁰ What Delfim and his team of developmentalists did was, of course, to adapt the wage policy of the short-term stabilization period for a long-term well calculated growth strategy. This measure, combined with the government controlled corporatist structure of labor relations which remained intact after 1967, meant that the "revolution" was being "humanized" only for the capitalist classes of Brazil.

When workers mobilized to escape these controls and to reverse the deterioration in their living standards in the Spring of 1968, their resistance was met with violent police and army repression which "...intimidated and demoralized for several years both the rank and file who wished to resist and the potential leaders who could have organized such resistance."²¹

In December 1968, Institutional Act no. 5, the famous AI 5, was issued and with it the rule of law in Brazil ended. Stability, defined by the doctrine of national security as the absence of opposition or criticism of government policies, was ensured by a crackdown on the press, the congress, the judiciary and universities. The president received dictatorial powers that enabled him to enact laws, put people in prison, suspend political rights and cancel the mandates of representatives, establish censorship of the press and exclude professors from universities. But, above all, stability was ensured by the systematic repression and depoliticization of the working and lower classes, or if you will, by the systematic repression of "social mobilization and participation", to use Huntington's terms, to counter the inegalitarian consequences of the developmentalist growth model chosen by the technocrats.²²

These repressive and authoritarian measures against basic human rights and political liberties of the AI 5 under Costa e Silva were

institutionalized in the 1969 constitution promulgated by General Garrastazu Medici on October 17, eight days before the rubber-stamp congress met to elect him the new president of Brazil (the congress was then quickly sent back into recess). The 1969 constitution which drastically increased the power of the executive, clearly reflected the military demands for more and more arbitrary power as well for the strengthening of the national security law and an increased maximum length for a state of siege.²³ The AI 5 was finally annulled in 1978, but the 1969 constitution remained in force until 1988.

Therefore, political repression of the working and lower classes made possible the pursuance of a deliberate policy of income concentration by the Medici government that even Robert S. McNamara, President of the World Bank, felt was "excessive." At a United Nations Conference on Trade and Development in 1972, McNamara "singled out Brazil for having neglected the welfare of its poor in its drive for growth."²⁴ In fact, the year 1972, when GDP growth reached 11.1 percent (see Table 8.1 above), was the year with the highest concentration of income among the middle and upper classes (see Table 8.6 below). But as Delfim Netto stated in an interview to Le Monde in that year:

Of course we have a neo-capitalist economy - no denying it - with all of its errors and all its faults. It is an unstable economy and, what is more serious, no mechanism is provided for redistribution of national income. But I would like to know in which capitalist country things are any different.²⁵

I suspect, however, that Delfim was quite aware that "things" were different in his "neo-capitalist" country: the systematic absence of freedom of expression and association prevented organized groups, such as the case of labor unions, to fight to maintain their share of the growing economic pie. I also suspect that being a student of Kuznets, Delfim knew that the late Nobel laureate economist emphasized in his Economic Growth and Income Inequality that:

In democratic societies the growing political power of the urban lower-income groups led to a variety of protective and supporting legislation, much of it aimed to counteract the worst effects of rapid industrialization and urbanization and to support the claims of the broad masses for more adequate shares of the growing income of the country.²⁶

Furthermore, Kuznets stated that:

There is danger in simple analogies; in arguing that because an unequal distribution of income in Western Europe in the past led to accumulation of savings and financing of basic capital formation, the preservation or accentuation of present income inequalities in the underdeveloped countries is necessary to secure the same result. Even disregarding the implications for the lower-income groups, we may find that in at least some of these countries today, the consumption propensities of upper-income groups are far higher and savings propensities far lower than were those of the more puritanical upper-income groups of the presently developed countries.²⁷

That "simple analogies" are indeed dangerous and that Brazil was not, by any stretch of the imagination, replicating the pattern of the old developed countries during the "miracle" is supported by empirical evidence. What the evidence suggests is that reliance on internal income concentration and external flows of loans - the two major prescriptions of the developmentalist approach for the "replication process" - served more to increase short-term conspicuous consumption of so-called "modern" status goods by the more affluent classes of society and the dependence of Brazil on capital goods imports from the now modern capitalist industrial countries than to lead Brazil in the direction of the long-term self-sustaining and automatic growth experienced by the already developed societies. But, above all, the mere existence of the more advanced nations themselves made the replication process untenable.

Table 8.6 Brazil: Distribution of Income among the Economically Active Population (percentage)

	1960	1970	1972	1976	1980
Poorest 20%	3.9	3.4	2.2	3.2	2.8
Poorest 50%	17.4	14.9	11.3	13.5	12.6
Richest 10%	39.6	46.7	52.6	50.4	50.9
Richest 5%	28.3	34.1	39.8	37.9	37.9
Richest 1%	11.9	14.7	19.1	17.4	16.9

Source: Luiz Bresser Pereira, Development and Crisis in Brazil, p. 184, Table 8.8

The indebted "miracle" in the context of the international division of labor

Cardoso and Faletto were on solid ground when they stated that:

"From the economic point of view a system is dependent when the acceleration and expansion of capital cannot find its essential dynamic component inside the system."²⁸ The dependencistas were in fact attempting to show that the most important sector of an economy- the highly technological capital goods industry - was being retarded in Latin American countries by their very political insertion into the new international division of labor under the auspices of the legendary "law" of comparative advantage. The new international division of labor thus maintains the dependence of Latin America on the developed industrial countries for essential imports and financing, and exacerbates the vulnerability of the Latin economies to external shocks. This was precisely the case with Brazil after 1973.

Tables 8.7 and 8.8 below show that while the domestic industry of capital goods in Brazil grew 18.1 annually between 1967 and 1973 (between 1962 and 1967 it stagnated at -2.6 percent), capital goods imports rose from 20.5 percent between 1966 and 1969 to 23.0 percent between 1969 and 1973 and 47.5 percent in 1974. In 1974 domestic production grew only 13.6 percent.²⁹

This leads Serra to conclude that:

A large part of the powerful accelerating effects which derived from the higher rates of investment and from the decrease in the margins of idle capacity were channeled outside the country. Apart from wasting part of the already installed capacity for accumulation, this had the effect of limiting the expansion of the capital goods sector and increasing its relative technological backwardness.³⁰

Furthermore, while Brazil was importing producer goods to expand the consumer durable industry (Table 8.7 also shows the high rates of growth of the industry during the "miracle", 23.6 percent annually), Table 8.9 shows that the export boom of the period consisted primarily, as in the past, of primary products and also some nondurables such as shoes, orange juice and textiles which competed more easily in the international market according to the "law" of comparative advantage.

To promote exports of primary products, the technocrats of the military regime embarked on a policy of subsidies for export crops, thus encouraging the larger producers to switch away from home foodstuffs like rice and beans into export crops like soybeans. Aside from the shame that Brazil had to start importing foodstuffs in the 1970s, staples which the country had been self-sufficient before the "miracle", this explains malnutrition among the lower classes whose basic diet consists precisely of rice and beans. As Anglade correctly observes:

The causes for such neglect [of foodstuff production for the home market] came from the government obsession for exports but also... from its lack of concern for the social inequalities which its policies were accentuating. This was due to the belief that, since the lower paid do not save, a further deterioration in their standards of living is 'economically' irrelevant.³¹

After 1972 Brazil began diversifying export of manufactured goods to include electrical equipment, office supplies and particularly automobiles, with TNCs playing a major role. And as in the case with primary products, the technocracy also provided generous subsidies to the foreign firms engaged in the export of manufactured goods, such as the special export program, BEFIEEX

(Export Fiscal Benefit). For most of the product exported, the subsidies amounted to between 30 percent and 50 percent of their value, thus putting a considerable drain on government resources.³² However, although exports of manufactured goods increased several times over, imports of capital goods increased in an even faster pace, resulting in trade deficits and massive foreign indebtedness throughout the 1970s, as Table 8.2 above indicates.

Commenting on the strategy of the "miracle", Brazilian economist Paul Singer noted that:

In this change of strategy, Brazil yielded to the admonitions of the liberal economists of international financial centers who have always condemned ISI...In this way, the old colonial rancidity is maintained...In the case of manufacturing goods that Brazil is beginning to export, their production is in the hands of the subsidiaries of the buyers which have the immense advantage of substituting imports whenever it is convenient for them to do so. This possibility is obviously not open to Brazil and other countries in the same stage of development since they specialize in the production of some industrial products for which there is external demand and stop substituting essential imports - above all, the know-how technological and capital goods - thus becoming totally dependent on foreign supply. In this sense, the obvious retardation of our capital goods industry which absolutely did not accompany the industrial boom of the last six years represents what we call the reversal of the process of ISI which was at the heart of our development until 1964.³³

In this sense it is not difficult to see that the assertions made by the Brazilian authorities that the country, with its policy of foreign indebtedness, was just following the path of the U.S. in the nineteenth century and Japan in the twentieth were unsound.³⁴ While these countries borrowed to develop and expand domestic production of capital goods and create new technologies, Brazil borrowed to import those goods to expand an already developed consumer durables sector mostly controlled by foreigners. The U.S. and Japan invested in long-term development, Brazil invested in short-term conspicuous consumption of a wealthy minority. In short, foreign indebtedness, concentration of income and the retardation of the domestic industry of capital goods were the major contradictions of Brazil's "model"

Table 8.7 Industrial Output and Accumulation, 1955-1980
(annual growth rates)

Period	Investment in Manufacturing	Non- durable Consumer Goods	Durable Consumer Goods	Capital Goods	Inter- mediary Goods	Total
1955-62	17.4	6.6	23.9	26.4	12.1	9.8
1962-67	-3.5	0.0	4.1	-2.6	5.9	2.6
1967-73	26.5	9.4	23.6	18.1	13.5	12.7
1973-80	0.1	4.4	9.3	7.4	8.3	7.6

Source: Jose Serra, "Ciclos e mudançãs estruturais na economia brasileira do após-guerra", Revista de Economia Política, No. 2 (Abril-Junho 1982).

Table 8.8 Imports of Capital Goods: Annual Real Growth Rates
(1970 cruzeiros)

1966-1969	20.5
1969-1973	23.0
1974	47.5
1975	5.0
1976	-17.4

Source: Jose Serra, "Three Mistaken Theses regarding the Connection between Industrialization and Authoritarian Regimes", in David Collier (ed.), The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979), p. 122, Table 6.

Table 8.9 Brazilian Exports, 1964-76
(in millions of US dollars - annual percentage change)

Years	Primary Products		Manufactured Products		Total	
	Value	Change	Value	Change	Value	Change
1964	1,340.5		89.3		1,429.8	
1965	1,466.5	9.4	129.0	44.5	1,595.5	11.6
1966	1,598.6	9.0	142.5	10.5	1,741.4	9.1
1967	1,490.2	-6.8	163.8	14.9	1,654.0	-5.0
1968	1,706.3	14.5	175.0	6.8	1,881.3	13.7
1969	2,066.5	21.1	244.7	39.8	2,311.2	22.9
1970	2,373.2	14.8	365.7	49.4	2,738.9	18.5
1971	2,381.0	0.3	522.9	43.0	2,903.9	6.0
1972	3,160.9	32.8	830.3	58.8	3,991.2	37.4
1973	4,864.8	53.9	1,334.4	60.7	6,199.2	55.3
1974	5,804.5	19.3	2,146.7	60.9	7,951.2	28.3
1975	6,165.1	6.2	2,504.8	16.7	8,669.9	9.0
1976	7,579.8	22.9	2,550.6	1.8	10,130.4	16.8

Source: Same as Table 8.8 above, p. 135, Table 10.

of capital accumulation during the "miracle". As Peter Evans observes:

There is more than a coincidental connection between the failure of industrialization to speak to the needs of Brazil's population and the fact that it has also left Brazil dependent on foreign goods in ways that are as vexing as the dependence of the classic model.³⁵

It is, therefore, within the context of the new international division of labor that we can better understand the integration of the Brazilian economy into the world financial system: not only were the inflows of foreign loans during the "miracle", superfluous, serving, as we saw, for the accumulation of reserves, but they also increased Brazil's capacity to import, thus facilitating the rapid growth of capital and intermediate goods imports (raw materials, such as iron and steel, aluminum and fertilizers) to the detriment of the domestic industry of those goods. This is clearly revealed in Table 8.10 showing the value and structure of Brazil's imports between 1967 and 1973.

According to Brazilian economists Regis Bonelli and Pedro S. Malan, import capacity grew by 150 percent between 1967 and 1973 (16.5 percent annually), while actual imports grew at an average rate of nearly 27 percent. In 1967 capital goods imports totalled some \$460 million, and raw materials imports some \$590 million. In 1974 (the end of the "boom"), their value had increased to \$3.1 billion and \$5.7 billion respectively. As they observe:

This performance contrasts sharply with that observed throughout almost the entire previous period of ISI. During this process the import coefficient showed a secular downward trend. Growth of import capacity and the simultaneous increase in the rate of capital formation was also favorable to the purchase of capital goods abroad.³⁶

The dependence of Brazil on imports was dramatic, however. As imports grew at an annual rate of 27 percent between 1967 and 1973, in rough terms this meant that every one percent of GDP growth required a 2 percent in import volume, making the Brazilian "miracle" more an import than export-led growth.³⁷

This import-intensive industrialization was sanctioned by the developmentalist ideology of free trade of the regime which openly stimulated TNC's imports of machinery, equipment and technology with a policy of liberalization of import restrictions and fiscal incentives.³⁸ At the same time, the not-so-genuine high-mass consumption ideology of the regime promoted the domestic consumption of the modern durable goods produced by the foreign corporations. As Felix remarks "Brazil's authoritarian regime was not imposing a form of right-wing Stalinism but facilitating right-wing consumerism."³⁹

Therefore, the costly ISI of the 1950s and early 1960s (see chapters 5 and 6), when, in addition to the development of the luxury consumer goods sector, the domestic production of capital and intermediate goods also advanced considerably at annual rates of growth of 26.4 percent and 12.1 percent

Table 8.10 Value and Structure of Brazilian Imports (FOB), 1967-1983

Year	Value of Imports (\$million)	Structure (%)			
		Capital Goods	Raw Materials	Consumer Goods	Petroleum Products
1967	1,441	31.9	41.2	15.0	11.9
1968	1,855	33.7	41.6	13.8	10.9
1969	1,993	37.0	38.4	14.0	11.6
1970	2,507	37.7	37.0	14.4	10.9
1971	3,245	41.3	40.5	7.9	10.3
1972	4,235	41.0	38.1	10.9	10.0
1973	6,192	34.6	42.1	11.6	11.7
1974	12,641	24.8	45.2	7.6	22.4
1975	12,210	32.3	35.6	6.8	25.3
1976	12,347	28.7	33.7	6.4	31.2
1977	12,023	25.8	32.5	7.8	33.9
1978	13,639	25.8	33.1	8.2	32.9
1979	18,084	20.9	32.9	8.7	37.5
1980	22,955	19.1	39.7	5.7	44.4
1981	22,091	18.2	26.0	4.5	51.3
1982	19,397	16.9	24.0	5.2	53.9
1983	15,383	12.2	23.9	3.9	56.0
1984	13,916	15.5	29.1	6.1	49.3
1985	13,189	18.2	31.1	7.0	43.7
1986	13,300	21.1	35.3	13.5	30.0

Source: Regis Bonelli and Pedro S. Malan "Industrialization, Economic Growth and Balance of Payments", in John D. Wirth and Edson de Oliveira Nunes (eds.), State and Society in Brazil: Continuity and Change (Boulder, Col.: Westview Press, 1987), p. 18, Table 1.3

respectively (see Table 8.7 above), was reversed by the orthodox developmentalism of the technocrats, to whom maximizing the growth rate of GNP in the short-run, regardless of its composition, was synonymous with development. But this strategy, made possible by the huge transfer of financial capital between 1968 and 1973, only served to increase the dependence of Brazil on imports of capital goods and technology and retarded the preparation of scientists, technicians and skilled workers that are crucial for the long-term self-sustaining growth experienced by the advanced capitalist countries.⁴⁰ Commenting on the growth strategy during the "miracle", John Wells observed that:

An alternative strategy could consist of moderating the rhythm of expansion of private consumption and directing resources to the expansion of the already significant capital goods industry. This change in the structure of production would require a small reduction in the global rate of GNP growth. Instead of continuing to grow at 10 or 11 percent annually, a rate of 7 or 8 percent, combined with a reduction in private consumption of durable goods would help reduce the dependence of the economy on imports and would make possible stable long-term growth.⁴¹

Priority, however, was given to satisfying both the growing domestic demand of the middle and upper classes for import-intensive luxury consumer goods in order to modernize the way of life of a minority and legitimize authoritarian rule, and the external demand for primary and some manufactured goods of low wages and low technological content in order to obtain foreign exchange to service a growing foreign debt, with the consequent neglect of local production of capital and intermediate goods.⁴² As Serra argues in a critique of O'Donnell 's thesis that posits a link between Brazil's BA regime and "deepening":

In fact, the regime did not exhibit any special orientation toward deepening. On the contrary, one could even say, stretching the terms slightly, that: (a) during the decade, instead of deepening, the economy was "undeepened," at least in relative terms; (b) the concern with deepening and the attempt to achieve it did not appear at the beginning of the regime, but ten years later, as a result of the very problems and contradictions generated from pursuing the development strategy that was initially adopted; (c) these recent attempts to achieve deepening have been among the principal factors that contributed to the recent "destabilization" of the regime. ⁴³

In chapter 9 we will discuss precisely the immediate consequences of the contradictions of Brazil's "miraculous" model of development: massive foreign indebtedness to sustain, in the midst of a world recession, a politically motivated, but ill-fated, state-led ISI program (1975-76) in the neglected capital and intermediate goods sector which only served to increase the disequilibrium of the economy to a great extent and thus exacerbate its external vulnerability. Aside from the fact that the emphasis now placed on the capital goods industry was an open admission of the

government to the flaws of the "miracle", direct state intervention in the economy to maintain high growth rates through "deepening" was the result not only of the slowdown of the private sector and overall industrial growth in 1974 and 1975. State intervention was also the direct result of the import bill in 1974 which more than doubled over the previous years, rising from \$6.2 billion to \$12.6 billion (Table 8.2 above), more the consequence of capital goods than oil, as Tables 8.10 above and 8.11 below show.

In 1974, the trade balance registered a deficit of \$4.6 billion, the largest in the history of the country. This, combined with the already growing service account deficit of \$2.9 billion, resulted in a current account deficit of \$7.1 billion which amounted to about 7.5 percent of the GDP.⁴⁴ The deficit was financed, as Table 8.2 above further shows, with new inflows of foreign loans from the Euromarkets which totalled \$7.4 billion, an amount equal to the total new debt Brazil had accumulated from the beginning of the nineteenth century to the year 1972. The inflows of loans, however, were not enough to finance the overall BOP deficit (as Table 8.2 indicates, amortization on the debt amounted to \$1.9 billion) and the government had to draw down the foreign exchange reserves by nearly \$1 billion.

Table 8,11 Brazilian imports (FOB), 1973-74
(US millions)

Import Category	1973	1974	1973/74 (increase)
Petroleum	711	2,760	288%
Iron and Steel	493	1,535	211%
Machinery and equipment	2,143	3,108	45%
Nonferrous metals	288	593	106%
Fertilizer	139	403	191%
Organic chemicals	372	635	71%
Subtotal	4,146	9,034	117%
Other	2,046	3,497	71%
Total	6,192	12,531	102%

Source: Banco Central do Brasil, Relatorio Anual 1974, March 1975, p. 212.

While the rise in oil prices in 1973/74 per se was not the major source of the BOP disequilibrium of Brazil in those years, and hence, of the country's acceleration of foreign indebtedness and future problems, the consequences of the first oil shock- world recession and the sharp deterioration of the country's terms of trade - clearly exposed the extreme vulnerability of the "export-import miracle" to external shocks. As Table 8.11 shows, while expenditure for oil imports indeed increased in 1974 from 1973, expenditures for intermediate and capital goods imports registered extraordinary increases, also as a result of higher prices. At the same time, the slump in world trade and the strong price fluctuations in international commodity markets directly affected the value of Brazil's exports, as Tables 8.2 and 8.9 above indicate. But, as Brazilian economist Pedro Sampaio Malan strongly argues:

What must be pointed out is that the spectacular rise in oil prices, far more than creating a problem of balance of payments adjustment in the short and medium term, called into question the basis of a 'model' of capital formation largely aimed at reproducing consumption patterns of economies where per capita income is several times higher than in Brazil, which have a different social infrastructure and a different level of state property, and - above all- which do not have the enormous social flaws that make pariahs of almost 30 million Brazilians. 45

In summary, our discussion of the "miracle" years has indicated that far from replicating the automatic, unilinear evolutionary growth experienced by the now modern, capitalist industrial countries, Brazil's economic growth based on external reliance on flows of financial capital and internal political repression and economic exclusion of the majority of the population was just a mirage that lasted as long as the international economy was favorable. But the contradictions of the "miracle", with their negative effects not only for the Brazilian wage earner, but also for state autonomy over the process of domestic capital accumulation, were real enough as we will see in the subsequent and final chapter of this study. We may conclude

chapter 8 with the perceptive insight of Peter Evans into the nature of dependent development:

Brazil in the seventies had not escaped the problems associated with dependence. On the contrary, it illustrated beautifully the extent to which disarticulation (epitomized by the growing need for imported capital and intermediary goods) and exclusion (exemplified by the changes in income distribution between 1960 and 1970) could persist despite dependent development. It showed the tremendous amount of growth and structural change that could be fostered by the new system. But it showed equally well that the contradictions created by dependent development are at least as severe as those which confronted the country during the period of classic dependence. 46

NOTES

1. See, for example, Mario Henrique Simonsen, Brasil 2001 (Rio: Apec, 1969) and Brasil 2002 (Rio: Apec, 1972).

2. This point is, of course, emphasized by, among others, Celso Furtado, "The Concept of External Dependence in the Study of Underdevelopment", in Charles K. Wilber (ed.), The Political Economy of Development and Underdevelopment (New York: Random House, 1973), pp. 118-123; Pedro Sampaio Malan, "The Brazilian Economy: Options for the Eighties", CEPAL Review, August 1979, pp. 91-101; Fernando Henrique Cardoso, "Associated-Dependent Development: Theoretical and Practical Implications", in Alfred Stepan (ed.), Authoritarian Brazil (New Haven: Yale University Press, 1973); Jose Serra, "Three Mistaken Theses regarding the Connection between Industrialization and Authoritarian Regimes", in David Collier (ed.), The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979), pp. 99-163 and Peter Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton: Princeton University Press, 1979).

3. Quoted in Paulo Davidoff Cruz, Divida externa e politica economica: a experiencia brasileira nos anos setenta (São Paulo: Editora Brasiliense, 1984), p. 37 (my emphasis).

4. Pedro Malan, "The Brazilian Economy: Options for the Eighties", p. 93. The exceptionally favorable condition of external demand during this period should be contrasted with the decade of the 1950s when world exports grew at only 1.8 percent per year (see Serra, "Three Mistaken Theses", p. 153), since it is sometimes argued that export promotion could not have been carried out by democratic governments. This is the argument developed by Thomas Skidmore, "Politics and Economic Policy-Making in Authoritarian Brazil, 1937-1971", in Alfred Stepan (ed.), Authoritarian Brazil, pp. 24-25. Without doubt, the post 1964 military regime adopted an aggressive export policy consisting of fiscal incentives, subsidies and mini-devaluations which contributed to the brilliant performance of exports between 1967-73. However, the favorable situation in the international market certainly played a fundamental role in the expansion of exports. This weakens considerably the hypothesis that posits a link between export promotion and authoritarian regimes. A good analysis of the extent to which the extraordinary performance of the Brazilian economy depended on the unusual growth of the world economy from the late 1960s until 1973 is Malan.

5. A thorough analysis of the "policy of foreign indebtedness" is Davidoff Cruz, Divida externa, pp. 28-92.

6. This position is best articulated by Mario Henrique Simonsen, Brasil 2001 and Brasil 2002 and Paulo H. Lira, "Endividamento externo e crescimento", Jornal do Brasil, March 31, 1972. It is interesting that Lira clearly acknowledges the role of the contraction of foreign loans in the paralysis of economic activities in the early 1960s (see chapter 6), apparently because the populists did not have a "policy of debt management."

7. See John Wells, "O mercado de euro-dolares, divida externa e o milagre brasileiro", Estudos CEBRAP 6, Out. Nov. Dez. 1973 and Davidoff Cruz, Divida externa.

8. See Carlos Geraldo Langoni, A crise do desenvolvimento: uma estratégia para o futuro (Rio: Jose Olympio Editora, 1985), p. 8.

9. Wells, "O mercado de euro-dolares, divida externa e o milagre brasileiro", p. 25.

10. Christian Anglade, "The State and Capital Accumulation in Contemporary Brazil", in Anglade and Fortin (eds.), The State and Capital Accumulation in Latin America (Pittsburgh: University of Pittsburgh Press, 1985), p. 69. Jose Serra is highly critical of the investment performance of the military regime. He provides data that show that only in 1972 did the rate of investment surpass the levels reached during the populist years (1958-63) and that in 1971 the rate of industrial investment was still below that of 1962. See "Three Mistaken Theses", p. 158.

11. Quoted in Davidoff Cruz, Divida Externa, p. 34.

12. Divida externa, pp. 108-109.

13. See John Wells, "O mercado de euro-dolares, divida externa e o milagre brasileiro", p. 14 and the World Bank, World Development Report 1985, p. 110.

14. See Gazeta Mercantil, Balanço Anual, September 1978, pp. 29-30.

15. See Davidoff Cruz, Divida externa, p. 41.

16. O'Donnell is, of course, the major proponent of such link. But Riordan Roett, among others, established the connection between authoritarian regime in Brazil and economic growth, see "A Praetorian Army in Politics: The Changing Role of the Brazilian Military", in Riordan Roett (ed.), Brazil in the Sixties (Nashville: Vanderbilt University Press, 1972). On page 40 he states that:

What have been the accomplishments of the military regime since 1964? Certainly they have succeeded in great measure in further centralizing the central government. Decision making is more efficient, resources are allocated more rationally, and economic growth goals are no longer subverted by the turmoil of the civilian political process. It is the economic record of the regime that stands as its one positive accomplishment.

17. In 1969, William Ellis, Aid Mission Director in Brazil, made the following statement in his testimony to the hearings before the Subcommittee on Inter-American Affairs of the Committee on Foreign Affairs:

In terms of general economic policies, I would say if anything there has been a net improvement. The finance minister can now do by decree things that before had to go through congress; they have been passing out decrees left and right, and most of them are to the good. Most of them are very much oriented to strengthening the private sector (quoted in Payer, The Debt Trap, p. 160).

18. Kuznets' hypothesis was extended to Brazil by Chicago Ph.D. Carlos Geraldo Langoni in his Distribuição de renda e crescimento economico

no Brasil (Rio: Expressão e Cultura, 1973). Langoni argues that "increasing inequality is an inevitable consequence of economic development which will automatically correct itself as a country develops" so that "the cure is not redistributive policies, but the promotion of accelerated growth." The concentration phase, however, is "independent of the prevailing institutional environment" (pp. 81-121, espe. p. 110). But economist Adroaldo da Silva, also a Chicago Ph.D., stated in Veja (April 5, 1972), pp. 3-6, that the income concentrating policies were a direct result of the concentration of political power since 1964. This theme is developed in Edmar Bacha and Roberto Mangabeira Unger, Participação, salario e voto: um projeto de democracia para o Brasil (Rio: Paz e Terra, 1978) and Pedro Malan, "The Brazilian Economy: Options for the Eighties". A good defense of the regime's policy of income concentration is Simonsen, Brasil 2002, op.cit. Roberto Campos was, of course, a tireless proponent of the doctrine of growth before redistribution and he argued that such had been the "secret" of prosperity in the U.S. and Europe. See his Temas e sistemas (Rio: Apec, 1969).

19. Interview in Veja, June 7, 1972.

20. See Thomas Skidmore, The Politics of Military Rule in Brazil, 1964-85 (New York: Oxford University Press, 1988), p. 80.

21. Kenneth Paul Erickson and Kevin J. Middlebrook, "The State and Organized Labor in Brazil and Mexico", in Sylvia Ann Hewlett and Richard S. Weinert (eds.), Brazil and Mexico: Patterns in Late Development (Philadelphia: ISHI, 1982), p. 246. For a detailed account of the metal-workers' strikes in Belo Horizonte and Sao Paulo in 1968 and police brutality, including torture, see Skidmore, The Politics of Military Rule, pp. 76-79.

22. As discussed in chapter 1, modernization theory was an essential part of the ideological arsenal of the military regime. In this connection, it is interesting to note that it was the ideas of Samuel Huntington that permeated the so-called "political decompression" of the Geisel years (1974-79), when the political scientist became a consultant to the Brazilian government. But, according to Skidmore, Huntington was also a consultant to the Medici government (1969-1973) and in 1972 held extensive talks with Leitão de Abreu, head of the Civilian Presidential Staff, and Delfim Netto. The ministers apparently took the initiative to discuss how the repression might be phased out and in a paper entitled "Approaches to Political Decompression", Huntington wrote in 1973 that "the relaxation of controls in any authoritarian political system can often have an explosive effect in which the process gets out of the control of those who initiated it..." According to Skidmore, Huntington

... further argued that such regimes should give first priority to institutionalization, and he suggested that the Brazilian government study carefully the Mexican one-party system of managing an orderly presidential succession. Huntington stressed also the weakness of Brazilian political parties, pointing to Mexico's PRI as the model of an effective party. And he concluded by recommending Mexico and Turkey as examples of comparable Third World countries that had successfully institutionalized their political systems (The Politics of Military Rule, p. 165).

23. These features of the constitution were aimed at the guerrillas. The urban guerrillas emerged in the mid-1960s to attempt to destabilize the military regime through armed struggle and were very much encouraged by the worker and student protests in 1968. But by the beginning of 1972 the guerrillas had been completely defeated by the systematic use of torture under the Medici government. Nevertheless, the guerrilla furnished the pretext for the authoritarian crackdown in 1968. For an analysis of the guerrillas and the military and police's use of torture, see Skidmore, The Politics of Military Rule, pp. 125-135.

24. Skidmore, p. 143. This point is also emphasized by Payer, The Debt Trap, p. 160.

25. Quoted in Payer, p. 161.

26. Reprinted in Mitchell A. Seligson (ed.), The Gap Between Rich and Poor: Contending Perspectives on the Political Economy of Development (Boulder, Colorado: Westview Press, 1984), pp. 28-29.

27. Ibid., p. 36, my emphasis.

28. Dependency and Development in Latin America, p. xx.

29. Serra, "Three Mistaken Theses", p. 121.

30. Ibid., p. 125.

31. "The State and Capital Accumulation in Contemporary Brazil", p. 78.

32. For a questioning of the advantage for Brazil of the BEFIEEX, see Peter Evans and Gary Gereffi, "Foreign Investment and Dependent Development: Comparing Brazil and Mexico", in Sylvia Ann Hewlett and Richard S. Weinert (eds.), Brazil and Mexico: Patterns in Late Development, pp. 111-168.

33. A crise do "milagre": interpretação crítica da economia brasileira (Rio: Paz e Terra, 1982), Sexta Edição, p. 115.

34. See John Wells, "O mercado de euro-dolares, dívida externa e o milagre brasileiro", p. 24.

35. Dependent Development, p. 98.

36. Regis Bonelli and Pedro S. Malan, "Industrialization, Economic Growth and Balance of Payments: Brazil, 1970-1984", in John Wirth and Edson de Oliveira Nunes (eds.), State and Society in Brazil: Continuity and Change (Boulder, Colorado: Westview Press, 1987), p. 19.

37. Gazeta Mercantil, Balanço Anual, September 1978, p. 28. See also "A era Delfim: em 20 anos, do "milagre a crise", Folha de São Paulo, 27 de Janeiro, 1985, p. 31.

38. See Paul Singer, A crise do "milagre", pp. 93-94; Serra, "Three

Mistaken Theses", pp. 132-33; John Wells, "O mercado de euro-dolares, divida externa e o milagre brasileiro", p. 230 and Davidoff Cruz, Divida Externa, p. 15.

39. David Felix, "On Financial Blowups and Authoritarian Regimes", in Jonathan Hartlyn and Samuel A. Morley (eds.), Latin American Political Economy: Financial Crisis and Political Change (Westview Press, 1986), p. 110.

40. The neglect of the Brazilian government of the preparation of scientists, etc...is emphasized by, among others, Paul Singer, A crise do "milagre", p. 118.

41. "O mercado de euro-dolares, divida externa e o milagre brasileiro", p. 30.

42. It should be noted that the domestic production of intermediate goods - steel, aluminum and fertilizers - fell notably behind in relative terms, as indicated in Table 8.7 and by the beginning of the 1970s Brazil had to import these products. Between 1968 and 1973 capital goods represented 37 percent of total imports; raw materials, 40 percent; consumer goods, 12 percent, and petroleum, 11 percent. The unbalanced growth of the miracle is analyzed by Thirlwell et al., "Endividamento externo, balanço de pagamentos e crescimento economico no Brasil, 1965-1978", Fundacao Joao Pinheiro Belo Horizonte 13 (1/2) Jan/Fev. 1983.

43. "Three Mistaken Theses", p. 118.

44. Bonelli and Malan, "Industrialization, Economic Growth and Balance of Payments: Brazil, 1970-1984", p. 23.

45. Malan, "The Brazilian Economy: Options for the Eighties", p. 97.

46. Dependent Development, p. 99.

CHAPTER 9

CONTRADICTIONS AND CRISIS OF DEPENDENT DEVELOPMENT, 1974-84

After massive trade deficits in 1974 exposed the vulnerability of the unbalanced growth pattern of the "miracle", the Brazilian technocracy began to justify foreign indebtedness as the logical instrument to move Brazil into the status of developed country before the end of the decade. Foreign loans would promote a short period of transition to a growth pattern with equilibrium and thus eliminate the structural dependence of the economy on imports of capital and intermediate goods.

As such, in September 1974, in the midst of a world recession, the government of General Ernesto Geisel launched a state-sponsored ISI program in the neglected area of heavy industry, the so-called Second National Development Plan (hitherto referred to as PDN II). The short-lived plan (1975-76), aimed at reducing the BOP deficit and, at the same time, maintaining economic expansion by stimulating the national private capital goods industry through orders from state enterprises engaged in massive debt-led investments in infrastructure (huge projects in hydroelectric and nuclear energy, transportation and telecommunications) and export-oriented basic input industries (especially petrochemical, mining and metalurgical industries), often joint ventures with local and foreign capital. The PND II was, in effect, the means through which the government attempted to "adjust" Brazil to the first petroleum shock.

The availability of foreign finance constituted, without doubt, a powerful stimulus for the adoption of an expansionist policy during the world crisis. But the choice of sustaining high growth rates at any price was motivated, above all, by the absolute political necessity of the government to maintain the illusion of the continuation of the "miracle" and bring about a gradual and highly controlled liberalization process.

There is, however, a certain irony in the ill-fated economic strategy chosen by the Geisel government. Although the PND II was a very realistic assessment of the problems of the economy, a change in the structure of production of the country in the context of a worldwide crisis which adversely affected Brazil's exports not only exacerbated the external vulnerability of the economy and postponed the moment when the burden of the foreign debt would have to be confronted, but it also upset the internal balance of political alliance which sustained the regime.

As this chapter shows, the PND II was an interesting nationalist attempt by the government to reverse the international division of labor, an attempt that was thwarted by Brazil's very concrete situation of dependency. This fact can be evidenced in (1) the opposition to the PND II of the internationalized - and directly international - sectors of the bourgeoisie engaged in the manufacturing of durable consumer goods and the importation of equipment, and their technocrat allies, in and out of the government, who favored the liberal growth pattern of the "miracle", and (2) the condition set by international creditors to release currency loans to state enterprises, that is, their foreign borrowing became subject to the acceptance of capital goods from foreign suppliers. The latter delivered a heavy blow to the autonomy of the state which could no longer sustain the national sector of capital goods, exposing the limitations on local control over crucial policy decisions for development. After 1976, the local manufacturers of heavy machinery, whose

raised expectations the government could not fulfil, formed the nucleus of entrepreneurial opposition first to economic policy and then to the regime itself.

The Geisel government (1974-79) is thus the key period for an analysis of the political and economic contradictions of dependent development. Afterwards, the crisis of this model of capital accumulation and of the regime itself simply followed the pattern of the past, as government decisions became completely subordinated to the constraints imposed by the foreign debt. In the most contradictory way, the foreign debt continued to grow not to finance further economic expansion (GDP growth was sustained until 1980, but inflation accelerated to levels never experienced in the country), but to meet the massive costs of the debt itself. In other words, once the product of authoritarian voluntarism, the expansion of foreign indebtedness became determined by the contradictions the "policy of foreign indebtedness" of the technocracy had engendered since the beginning.

In the process, the alliance of the state and international finance became even stronger as state enterprises continued to be used by the Figueiredo government as the instruments to perform the role of debt rollover, that is, they kept on borrowing more and more money just to pay the huge interest bill. In 1982, however, when the foreign partner withdrew from the alliance, essentially refusing to continue financing Brazil's interest payments, local capital accumulation collapsed as the resources and foreign exchange to service the foreign debt had to come primarily from within the country through drastic orthodox stabilization measures imposed by the creditors and their front organization, the IMF. Economy and society were thrown in the worst financial crisis in the history of the country, a crisis which became the ultimate determinant of the breakdown of military rule and from which the country is yet to recover.

This final chapter examines the latest in a series of contradictions and crisis of the developmentalist growth model based on extreme reliance on external flows of financial capital historically adopted in Brazil. As in the past, foreign indebtedness, justified by the internal and external ideologues of developmentalism as the necessary instrument of long-term economic prosperity and BOP equilibrium turned into the major source of financial and economic turmoil, and also of political instability as the continuing trade off between huge foreign debt payments and improvement of living standards threatens the country's difficult transition to democracy.

Economic nationalism political liberalization and financial dependency:
The myth of state autonomy, 1974-1979

During the first years of the Geisel government the state attempted to use foreign loans in the most interesting way: to support, by means of BOP financing, the simultaneous strategy of economic nationalism embodied in the PND II and the initiation of a "slow, gradual and stable" political liberalization process (first called *distensao*, or loosening, then *abertura*, or opening) aimed at institutionalizing the military regime.¹ In fact, international finance was now being boldly called upon by its domestic partner not merely to help maintain ordinary economic growth during a world crisis and hence the legitimacy of a regime that depended on economic success, but significantly, to upset the very foundations of the postwar international division of labor it was intended to preserve. The net foreign debt grew from \$6 billion at the end of 1973 (gross debt \$12.5 billion, 15.4 percent of GDP) to \$32 billion (gross debt \$43.5 billion, 22.5 percent of GDP) in 1978 (see Table 9.2 below). Yet, average annual real growth in manufacturing production of capital goods fell from 18.3 percent between 1968-74 to 6 percent between 1975-78 (see Table 9.16 below). The discussion that follows shows the extent to which the government overestimated the autonomy of the state, evident during the "miracle" years, vis-a-vis external, but also internal, constraints in carrying out its development project.

As we saw in chapters 7 and 8, economic liberalism in Brazil between 1964 and 1973 was accompanied by political authoritarianism and repression. Here we attempt to show the inverse hypothesis during the first years of the Geisel government, that is, the connection between economic nationalism and the initiation of political liberalization.² Thus, although the "relaxation of repression" and the reopening of some formal channels of

participation began to be debated within the Medici government at the pinnacle of the "miracle",³ the new political course was initiated by the Geisel government in the context of increasing economic difficulties manifested not so much in the slowdown of overall growth rates in 1974 (it can be considered a slowdown only in comparison to the expansion before 1974 as GDP growth rate fell from 13.6 percent in 1973 to 9.7 percent in 1974, as indicated in Table 8.1 above), but in the return of the two traditional Brazilian problems: the acceleration of inflation and, particularly, the deterioration of the BOP. That the new president opted for a policy of nationalism to respond to economic imbalances and political pressures is revealed in two early measures taken by his government:

(1) The composition of Geisel's ministry included, alongside the liberal Mario Henrique Simonsen, the staunch nationalist Severo Fagundes Gomes, who favored the protection of Brazilian industry against denationalization and an alternative form of development, less subjected to the international division of labor under the control of TNCs;

(2) The PND II, the ambitious ISI Program aimed at eliminating Brazil's external dependence on capital and intermediary goods by stimulating local private producers through orders from state enterprises engaged in infrastructural and basic inputs projects as well as strengthening the internal market through a reduction in social disparities (Gomes was, of course, one of the most prominent protagonists of the new economic policy), was launched two months before the relatively free congressional elections of November 1974 and the gradual suspension of press censorship (in January 1975 the government removed prior censorship from O Estado de São Paulo and O Jornal da Tarde).

While those measures can not be considered conclusive evidence of a close connection between economic nationalism and the political opening engineered by the government, they do indicate the desire of Geisel to appease the opposition - and incidentally the national bourgeoisie - whose attacks on the regime had centered precisely on the increasing denationalization of the economy, in addition, of course, to the inequality in the distribution of income.

With respect to income inequality, in November 1974 the government

made changes in the wage policy, correcting some of the extreme distortions that resulted from the application of the so-called "readjustment formula" inaugurated in 1965 (see chapter 7). Table 9.1 below shows the increase in the acquisitive power of the real minimum and average wages after 1974 and a certain deconcentration of income did take place in 1976 (see Table 8.6 above). Nevertheless, the practical effect of the new wage policy on the level of real wages ended up by being offset by the acceleration of inflation (see Table 9.3 below) and by the introduction, in July 1976, of a so-called "terms of trade" factor designed to "reflect changes in the terms of trade between industrial product prices, on the one hand, and prices of agricultural products and imported raw materials, on the other."⁴ (The wage increases after 1979 are discussed below).

With respect to the denationalization of the economy, the government also took concrete action. In fact, a major political aspect of the PND II was to restrict the domestic activities of TNCs and strengthen local control.⁵ The Plan contemplated new foreign direct investment only in joint-ventures with Brazilian partners, particularly in state-led export-oriented basic input industries (i.e., petrochemical and metalurgical industries) as a means of transferring technology into local hands and of assuring local control. Significantly, the first overt step to protect Brazil's infant computer industry was taken in 1977 when the government refused to allow IBM and other TNCs to manufacture computers in Brazil. Furthermore, consistent with the new economic policy of expanding the local capital goods manufacturing sector, the PND II openly discriminated against foreign corporations whenever state enterprises handed out orders for heavy machinery.

In addition to those measures, TNCs' access to local credit was narrowed through the transference, and hence centralization, of compulsory workers' savings programs - the Programa de Integração Social (PIS) for the

Table 9.1 Wages and Productivity, 1970-1981

Year	Real Minimum Wage Index	Real Average Wage Index	Productivity Index (GDP per capita)
1970	100.0	100.0	100.0
1971	95.7	103.2	109.3
1972	93.9	107.4	118.5
1973	86.1	112.7	131.8
1974	79.0	112.7	140.8
1975	82.5	121.5	145.1
1976	82.0	127.2	155.2
1977	85.4	135.8	159.8
1978	88.0	147.2	163.4
1979	90.4	154.0	170.1
1980	93.4	149.4	179.0
1981	95.5	161.3	171.4

Note: The minimum wage index includes the thirteenth month's wage that was instituted in 1962. The average real wage corresponds to the average wage of Sao Paulo unions until 1974. All indexes were deflated by the DIEESE's cost of living increase.

Source: Luiz Bresser Pereira, Development and Crisis in Brazil, 1930-1983 (Boulder, Colorado: Westview Press, 1984), p. 183, Table 8.7

private sector and the Programa de Formação do Patrimônio do Servidor Público (PASEG) - from the Federal Savings Bank (Caixa Econômica Federal) and Banco do Brasil to the National Development Bank (BNDE), whose heavily subsidized credits are limited primarily to locally owned firms, thus placing the funds beyond the reach of foreign corporations. Three subsidiaries of the BNDE - IBRASA, EMBRAMEC and FIBASA - were then created in 1974 with the resources provided by workers' savings to strengthen small and medium-sized national manufacturers against competition from TNCs and provide long-term subsidized credit to local producers of capital goods.⁶ The FGTS, the largest of the social security funds, was also transferred from the BNH to the BNDE and used to supply investment credit to the capital goods sector. Finally, state agencies (the Foreign Trade Department of the Banco do Brasil,

CACEX, the Economic Development Council, CDE, and the Industrial Development Council, CDI) began to closely scrutinize TNCs' repatriation of profits, import authorization, tax credits and exemptions, price fixing, etc.

In a study of Brazil's attitude towards foreign capital, Business International, a New York-based risk analysis firm, traced economic nationalism to Geisel's political liberalization and warned its multinational clients that

Brazil's foreign investment climate is changing subtly. After welcoming international firms almost unconditionally in the first decade after the 1964 military takeover, the government more recently has become more selective about the type of foreign direct investment it would like to see enter the country. Major multinational manufacturing firms have recently been barred either wholly or in part, from a few sectors. To some extent, the shift can be traced to a freer political climate, which allows Brazilian-owned companies and other groups that champion nationalist solutions to speak out more forcefully in their own interests.⁷

The official rhetoric also drastically changed in the first years of the Geisel government. In June 1974, Severo Gomes, the nationalist Minister of Industry and Commerce, publicly warned foreign investors regarding the new economic policy of the Brazilian government:

The government will decide, consistent with the national interest, the convenience and the opportunity of each and every transfer of control from Brazilian enterprises to foreign capital. The government is well aware of the competitive edge of better equipped foreign corporations and the danger they represent to national firms. Therefore, we will defend our industry because we do not see the purpose of approving the projects of multinationals when⁸ our factories are able to manufacture the same products they do.

A year later, in July 1975, Severo Gomes demonstrated the seriousness of his intentions: he prevented Philips from acquiring Consul, a Brazilian electrical appliances manufacturing company. In the meantime, the Minister proudly continued to "show off" the new Brazilian nationalism even abroad. At a Conference of the United Nations Industrial Development Organization (UNIDO) in Lima, in March 1975, in a speech apparently approved by the

powerful General Golbery do Couto e Silva, the head of the Presidential Civilian Staff and the man behind the strategy of liberalization, Severo Gomes exposed the "system of trade, financial and technological dependence that inhibits and conditions national efforts at industrial development" and the "promotion by developed countries of so-called interdependence between nations."⁹ He said that:

In fact, there are two forms of interdependence. The first, which actually rules the relations between center and peripheral economies, is based on the institutionalization of inequality and is the instrument of dependence. The second presupposes equality and shows the way of independence.¹⁰

What appears to be a clear connection between economic nationalism and political liberalization, however, is revealed precisely in the absence of really deflationary stabilization policies, IMF style, to adjust to the massive BOP disequilibrium during the Geisel government. Although Finance Minister Simonsen did use orthodox fiscal and monetary policies (i.e., restriction of money supply and domestic credit), the government was apparently unwilling to impose a really severe credit and wage squeeze for fear of the political consequences. As we will discuss soon, the orthodox measures were aimed less to fight inflation than to force private and public firms to resort to foreign credit for the traditional temporary relief of BOP problems.

It was the ready access to unconditional private bank loans that allowed the government to postpone stabilization and launch its strategy of "liberalization of authoritarian rule" within the context of economic nationalism expressed in the ISI program of capital goods. Thus, while the major source of funds for the local private producers of capital goods was the heavy subsidized credits of the BNDE, which often supplemented its domestic funds with foreign loans and guaranteed foreign borrowing by national firms, the state enterprises were induced by the government to

resort to the floating rate credits of the Euromarkets to finance, in large part, their investment projects in infrastructure and basic input industries - characterized by long maturation and low economic return - which, according to the PND II, were to provide the local suppliers of capital goods with orders for their expansion. In fact, currency loans to the public sector under Law 4131 were the major form of capital inflows to Brazil in the second half of the 1970s (see Table 9.5 below).

It should be recalled from our discussion in chapter 7 that Law 4131 was the single most important mechanism through which large enterprises in Brazil borrowed directly (without the intermediation of domestic financial institutions) from the Eurocurrency markets. And borrowing under Law 4131 continued to follow the logic of the financial internationalization of the economy promoted by the regime: the demand of the public, but also the private, sectors for less expensive credit in cruzeiros was met through operations that involved the simultaneous entry of foreign loans with the obvious advantage of providing foreign exchange for BOP purposes (see discussion below).

Foreign loans indeed preserved the financial equilibrium of the economy in the midst of a world recession and allowed it to grow at levels close to the historical norm (see Tables 8.1 above and 9.3 below), thus performing a crucial role in sustaining the authoritarian regime.¹¹ Yet they did not necessarily advance the long-term political and economic goals of the Geisel government. As we will discuss shortly, on the one hand, the inflows of loans rapidly became the very cause of the deficit it financed; on the other, the major domestic borrowers, the state enterprises, became extremely vulnerable to the pressure from foreign creditors to purchase capital goods from their countries as a precondition to the release of currency loans to finance the BOP deficit. The inability of the

government to implement the PND II explains much of the dissatisfaction of the local producers who were encouraged by the government to expand investment and then found they could no longer rely on domestic demand for their equipment. After 1976, the national sector of capital goods, which briefly became the "vanguard" of the bourgeoisie, formed the nucleus of entrepreneurial opposition first to economic policy and then to the authoritarian regime itself.¹² But the erosion of the regime's social support among the dominant classes began with the very launching of the nationalist challenge of the PND II.

The internal constraints on state autonomy

If nationalism was indeed a "rediscovered" expedient of the Geisel government, or something more sincere than that, to rally support for the regime, the chances of its success were, of course, small given the degree of internationalization of the Brazilian economy promoted by the regime itself. What nationalism, embodied in the PND II, did was to unsettle the system of alliances that supported authoritarianism. As Mendonça argues, "Politically, the flaw of the PND II was the establishment of a strategy that proposed a radical change in the economy but lacked the support of crucial social sectors."¹³

In fact, the first real challenge to the new economic policy came not so much from the government's defeat in the November elections, but from the strong political opposition of the internationalized - and directly international - industrial sectors involved in the manufacture of durable consumer goods and importation of capital goods and their liberal technocrat allies.¹⁴ Their opposition to the PND II was expressed in the campaign against "estatização" (statism), i.e., against the expansion of state enterprises which, in their opinion, were competing with the private sector. And the often overlooked leading "visible" actors of the campaign were

precisely the traditional ideologues of developmentalism and advocates of export-led growth, foreign indebtedness and foreign direct investment as the solution to BOP problems. Prominent among them were Finance Minister Mario Henrique Simonsen and former finance and planning ministers, like Roberto Campos, Delfim Netto, Eugenio Gudin - the father of neo-classical orthodoxy in Brazil - and Octavio Gouveia de Bulhões, the president of the editorial council of Visao, the main voice of the campaign.¹⁵

To those economists, traditional promoters of the liberal doctrine of comparative advantage and hence of the international division of labor, state-sponsored ISI in capital goods was not desirable. As such, the campaign against state enterprises, organized by the above mentioned technocrats, was, in fact, a campaign against the proposed change in the structure of production of Brazil. As Wells notes, "This is an interesting example of the way in which a more self-reliant solution to the problems of external equilibrium has been partially thwarted by a coalition of private and international interest groups."¹⁶

It is not surprising, therefore, that the leading industrialists in the capital and intermediate goods, the sector which would benefit the most from the PND II, kept a low profile in the campaign against statism, such as the Matarazzo family, Jose Ermirio de Moraes of the Votorantim Group, Paulo Villares, Claudio Bardella, Azevedo Antunes and Helio Beltrão of the Ultra Group.¹⁷ This was an indication that the expansion of state enterprises was not perceived by those groups as competing with the private sector, the central argument of the campaign, but on the contrary, as stimulating it.

In effect, the PND II was a concrete evidence of the supporting role of the Brazilian entrepreneurial state in a process of private capital accumulation. The very expansion of public firms in infrastructural and

basic industries, in addition to offering cheap services and inputs to the private sector (see Table 9.7 below), was primarily intended to provide domestic demand for the private domestic industry of capital goods. The Plan, however, divided the industrial bourgeoisie into two factions: the manufacturers of capital goods, whose chances of expansion depended on the autonomy of state enterprises, and those involved in the consumer goods sector, who counted with the unconditional support of economists of "international prestige."

It is interesting, however, that while there was a congruence of interests between the industrialists in the consumer goods sector and the liberal neo-classical technocrats in denouncing the statist PND II, different reasons were behind each sector's opposition to Geisel's new development strategy. The internationalized sectors of the bourgeoisie began protesting the obvious discrimination of economic policy - investment, import, credit and subsidy policies - in favor of state enterprises and the private capital goods sector. In fact, consistent with the priority of the PND II, the assistance given to the basic sectors by the CDI between 1973 and 1977 increased from 5 percent to 18 percent of the total investment, while to the consumer goods sector it decreased from 5.5 percent to 2.6 percent.¹⁸ As Bresser Pereira notes, "The 1975 campaign against state control clearly expressed a protest against the favoritism that would certainly be a part of the big Second National Development Program projects."¹⁹ Similarly, Luiz Celso Martone made the following comments regarding the PND II:

This large scale anti-cyclical policy (in reaction to the first petroleum shock) developed industries characterized by long maturation periods, high capital intensity, and high import coefficients, at least in the initial phase, and directly competed or provoked competition, for precisely those resources that were scarcest in that period --foreign currency, fiscal capital, qualified labor, etc.²⁰

Furthermore, the industrialists lost important channels through which they articulated with the regime. After 1974, the National Monetary Council (Conselho Monetario Nacional or CMN), one of the "bureaucratic rings" of articulation between the regime and the private sector during the Medici government, lost influence in favor of the Economic Development Council (Conselho de Desenvolvimento Economico or CDE) which was directly linked to the presidency.²¹ In order to appreciate the loss to the bourgeoisie one should only recall that the CMN's most important function, in terms of its effects on the private sector, is the drawing up of the monetary budget, the document which is the basis for monetary and credit expansion throughout the year. Among the members of the CMN are eight members drawn from the private sector, hence the Council's importance as an instrument of pressure of industrialists (but also of financiers). Thus, by centralizing the decision making process in the CDE, whose priority was now the capital goods sector, Geisel eliminated the influence of the internationalized sectors of the bourgeoisie on credit policy.

Finally, the PND II emphasized the creation of industries, particularly petrochemical industries, in other regions of Brazil, thus threatening to put an end to the traditional monopoly of the Center-South as the dynamic center of capital accumulation in the country. According to Cardoso, "With its policy of 'regional balances'...the government instilled an even deeper feeling of insecurity in the São Paulo business community."²²

On the other hand, the major reason behind the opposition of the developmentalist ideologues to the ambitious PND II, which forecast \$43 billion investment for the ISI Program in the capital goods sector,²³ was their traditional concern with the reaction of international creditors to the acceleration of domestic inflation (see Table 9.3 below) and, above all, the deterioration of the country's external accounts and the loss of

foreign exchange reserves in 1974 and 1975. Furthermore, in September 1974 the government was forced to lower the minimum acceptable maturities on foreign loans from 10 years to 5 years as a result of the need to borrow massive amounts of new money to finance the BOP deficit, thus bringing about a deterioration in the maturity structure of the foreign debt.²⁴

As Table 9.2 below shows, between 1974 and 1975 the inflows of foreign loans, although significant, were not enough to finance the overall BOP which was being pressured not only by the unfavorable trade account during the world crisis (column 3) as the terms of trade deteriorated (the price index for Brazilian exports in relation to imports fell from 107.9 in 1973 to 88.3 and 85.5 in 1974 and 1975 respectively²⁵), but also by the increasing capital outflow in the form of interest and amortization payments on the foreign debt (columns 6 and 9) in addition to the growing profit remittance and dividends by TNCs (column 5). Therefore, the government had to "burn" \$2 billion of foreign reserves between 1973 and 1975 (see Table 8.2 above) which, in the view of the debt managers, seriously damaged Brazil's credibility abroad, not to mention their "policy of foreign indebtedness" whose success depended precisely on the maintenance of "appropriate levels" of foreign reserves and a good profile of the foreign debt (see discussion in chapter 8).

It appears, however, that the relatively low levels of currency loans in 1974 and 1975 had to do less with the policies of the Brazilian government than with the unstable international conditions.²⁶ Nevertheless, the traditional concern of finance and planning ministers in Brazil to adopt "sound" economic policy to please orthodox international creditors, and hence guarantee the uninterrupted inflows of loan capital to finance BOP deficits, explains their demands for the implementation of austerity measures (i.e., restriction of credit, money supply and public expenditures)

as well as the promotion of exports and further incentives to foreign direct investment in order to boost foreign exchange reserves and thus maintain Brazil's international creditworthiness. As Augusto Jefferson, the then assistant to Finance Minister Simonsen, stated in 1975, referring to the stabilization program of Castello Branco, "We should bury the PND II with an emergency plan, in the style of the PAEG."²⁷

Simonsen himself stated his conviction in 1976: "A monetarist policy, designed to contract domestic demand, is the key instrument to fight inflation and adjust the BOP."²⁸ ISI, the solution of the PND II to BOP problems, was, therefore, anathema to the orthodox thought of such key figure as the Finance Minister, who considered the experiences of the 1950s and early 1960s as "leading to the waste rather than the savings, of foreign exchange."²⁹

Export-led growth and further reliance on foreign loans within the context of the international division of labor was his strategy to deal with Brazil's external disequilibrium because, for Simonsen, as well as for all post-1964 technocrats, the problem of the country's BOP deficits was the trade account. Export promotion was precisely the course of action followed by the Geisel government and ISI subsidies favoring national firms were quickly replaced by export subsidies favoring foreign firms.

Simonsen's aggressive export policy consisted of massive subsidies (some of which had been in existence since the "miracle") whose major beneficiaries were foreign firms engaged in manufacturing exports.³⁰ The subsidies ranged from exemptions from payment of IPI (Imposto sobre Produtos Industrializados), a federal value added tax, and of ICM (Imposto sobre Circulação de Mercadorias), a state tax on exports, to tax credits for the purchase of inputs used in manufacturing exports (import subsidies) and credit incentives offered by the government's Special Export Program BEFIEX, and the Foreign Trade Department of the Banco do Brasil, CACEX. For most

Table 9.2 Brazil: Balance of Payments and the External Debt, 1974-1978
(in millions of \$)

Year	Exports (1)	Imports (2)	Trade Balance (3)	Net Services ^a (4)	Profits and Dividends (5)	Interest (6)	Current Account Balance (7)	Gross Loan Capital Inflows ^b (8)	Amorti- zations ^c (9)	Gross Debt (10)	Reserves (11)
1974	7,951	12,641	-4,690	-1,532	-250	-652	-7,122	7,455	-1,920	17,166	5,269
1975	8,670	12,210	-3,540	-1,429	-237	-1,498	-6,700	7,672	-2,185	21,171	4,040
1976	10,128	12,383	-2,255	-1,574	-383	-1,809	-6,013	9,104	-3,009	25,985	6,644
1977	12,120	12,023	97	-1,576	-458	-2,103	-4,037	8,861	-4,135	32,037	7,256
1978	12,659	13,683	-1,024	-1,720	-564	-2,695	-5,927	15,641	-5,439	43,511	11,895

^a Net services include transportation, insurance, freight and travel.

^b Medium- and long-term loans (currency loans and import financing)

^c Amortization of medium- and long-term loans

Sources: Bresser Pereira, Development and Crisis in Brazil, p. 171, Table 8.4; Paulo Nogueira Batista Jr., Mito e Realidade na dívida externa brasileira, p. 102, Quadro III and p. 111, Tabela 3; Thirlwall et al., "Endividamento externo, balanço de pagamentos e crescimento econômico no Brasil, 1965-1978", p. 8, Quadro 2.

Table 9.3 Brazil: Real Rate of Change of Selected Macroeconomic Indicators and Rate of Inflation, 1974-78 (in percentage)

Year	Money Supply	Government Expenditure	Rate of Exchange	Growth In GDP	Growth in Industrial GDP	Inflation
1974	.8	3.0	4.3	9.5	9.1	34.6
1975	10.3	1.0	.7	5.6	5.6	29.4
1976	-6.1	18.8	-2.7	9.7	12.5	46.2
1977	- .9	5.0	2.6	5.4	3.9	38.8
1978	1.0	1.0	- .5	4.8	7.4	40.8

Source: Bolivar Lamounier and Alkimar R. Moura, "Economic Policy and Political Opening in Brazil", in Jonathan hartlyn and Samuel A. Morley (eds.), Latin American Political Economy: Financial Crisis and Political Change (Boulder, Colorado: Westview Press, 1984), p. 169, Table 7.2.

of the products exported, these subsidies amounted to between 30 and 50 percent of their value and were, in fact, a drain on government's resources.

Although exports increased, imports of capital goods increased faster and although there was a modest trade surplus in 1977 (the first since 1973), trade deficits continued to plague Brazil until the government was forced to drastically contract imports in the early 1980s (see discussion below). Furthermore, the subsidies provoked strong reaction in the US and the EEC which, in 1978, started imposing non-tariff barriers and voluntary curbs on Brazilian exports.

Simonsen also used some unorthodox import controls after realizing that Brazil was not really "an island of prosperity in an uncertain sea" (the slogan of the technocrats during the import orgy of 1974) in an attempt to reduce the trade deficit. But, without doubt, export subsidies were the major feature of his policy of achieving external equilibrium. And the decision of the Geisel government to resort to the subsidies over devaluation

of the cruzeiro (which was considered overvalued) to make exports more competitive was conditioned by the constraints imposed by the country's foreign debt: a large devaluation would have meant (as it did in 1979 and, particularly, 1983) a heavy burden on firms which were being induced by the government itself to borrow abroad for BOP purposes (see discussion below).³¹ The obvious contradictions that the "policy of foreign indebtedness" of the technocrats were generating is best summarized by Wells:

...the extremely high level of foreign indebtedness has imposed additional constraints on government policy-making - impinging on the government's ability to balance the commodity account and thus making for further dependence on foreign loans.³²

As Tables 9.2 above and 9.18 below clearly show, the real problem of the current account deficit of the BOP, however, was not the trade account that the export-led growth was supposed to correct, but the constantly deteriorating service account which resulted from the ever-growing interest payments on the foreign debt, in addition to amortization. In 1974, debt service (interest and amortization) absorbed 33 percent of export earnings; by 1977 it increased to 50 percent and to 64 and 70 percent in 1978 and 1979 respectively. By 1982 debt service reached 97 percent of Brazil's export earnings.³³ But, as Anglade notes, for those interests who were behind the adoption of the policies of the "miracle",

...the expansion of the export policy had the advantage that it required changes neither in the distribution of personal income nor in the process of capital accumulation. The most interested party in the latter were the foreign firms but, since it was politically difficult for them to oppose too openly the proposed changes, they orchestrated the 'anti-statism' campaign through some of their powerful local supporters. Helped by the poor results obtained by the government in the 1976 elections and by the new inflation record of that year (46.3%), they won the battle in the government. Minister Severo Gomes resigned and the plan was abandoned.³⁴

In fact, it was more within the government itself than in civil society that the most efficient pressure group against the PND II was

organized around Finance Minister Simonsen. The increasing ideological conflict between the liberal Simonsen and the nationalist Severo Gomes began to be resolved in favor of the former with his first victory in October 1975 on the issue of foreign investment in the "untouchable" oil monopoly Petrobras, the ultimate symbol of nationalism in Brazil.³⁵ With the argument that Brazil required immediate foreign exchange for BOP financing and that the country's credit standing in the Euromarkets was weakening, a view strongly shared by Roberto Campos who was then the Ambassador in London, Simonsen apparently convinced President Geisel to set aside nationalist policies and let foreign oil companies engage in exploration for oil on a contract basis.³⁶

According to The Economist, Geisel's decision was an attempt to "show the international financial community that Brazil welcomes foreign currency, loans and capital investment."³⁷ Indeed, the need to pay heed to foreign creditors appears to have been behind the controversial decision. As Simonsen himself stated to the press:

The situation is the following: international creditors are extremely cold citizens. We know exactly how they analyze balance of payments. They look at a country's total debt, the level of reserves, the projections for future indebtedness and the ratio of debt service payments to export earnings. There are various indicators of creditworthiness. If you are within them, you have credit, if you aren't, you don't. The fundamental problem is that Brazil needs to capture abroad between \$4 and \$5 billion annually in order to maintain its financial stability. Our action [on oil exploration] was therefore preventive so as to avoid a financial crisis in 1977 or 1978.³⁸

But, as Severo Gomes observed a few days later:

The balance of payments will not improve with new inflows of foreign direct investment and soon our foreign debt will reach \$42 billion. I think Mario [Simonsen] knows that but he can not admit publicly as it would clearly conflict with his ideology. To admit that the classical model of capital import is not appropriate to the deteriorating financial situation of Brazil is a kind of intellectual suicide for him.³⁹

The cornerstone of Simonsen's strategy to deal with the BOP, consistent with his developmentalist beliefs, was precisely further reliance on foreign loans.⁴⁰ And it was with the government's change of economic policy after 1976 that the influential Finance Minister accomplished his objectives and the PND II suffered a fatal blow. The priority of the Brazilian technocracy was no longer to move Brazil into the status of developed country before the end of the decade with the ISI program in capital goods, but to adjust the BOP and salvage the "policy of foreign indebtedness" by expanding the foreign debt itself. As such, the government began to impose restrictive monetary and fiscal policies which, while reducing government expenditures in 1977 to levels well below 1976 (see Table 9.3 above) and hence the viability of the PND II, was, in fact, intended less to fight inflation than to induce private and public firms to borrow abroad to substitute for more expensive domestic credit lines and simultaneously bring foreign exchange to finance the current account deficit, rebuild reserves and improve the profile of the foreign debt in order to maintain a good image abroad. In turn, the foreign borrowing of state enterprises became increasingly conditioned to their purchase of capital goods from foreign suppliers, thus leaving the government even less room for maneuver in sustaining the local industry. The goals of the PND I became untenable. And here lies the key to an understanding of two simultaneous processes that occurred in Brazil in the second half of the 1970s: massive build-up of a foreign debt to finance BOP deficits which were themselves mostly caused by the service costs of that debt (see Table 9.10 below) and the open political opposition of the bourgeoisie, now centered in the heavy machinery sector, first to statism and then to authoritarianism.⁴¹ The contradictions of financial dependence are now the focus of our analysis.

The political and economic contradictions of financial dependency

Central to the state-sponsored ISI program in capital goods was the assumption of a coincidence of interests between international finance and national development. Foreign loans were to contribute to the long-term development of national production of machinery and equipment by sustaining the investments of state enterprises which in turn would provide the local suppliers with orders for their expansion. This assumption still permeates the work of some scholars such as Jeffrey Frieden, who asserts that debt-financed state enterprises in Brazil provided the national capital goods industry with "a seemingly inexhaustible source of orders from the late 1960s to 1980."⁴² Contrary to Frieden's assertion, however, the heavy equipment for the projects of the Brazilian public firms came more from center countries than from local industries. From 1975 orders from state enterprises to domestic suppliers declined from index number 135 (1972=100) to 97 in 1978, leading to overcapacity in the local capital goods manufacturing sector.⁴³

To begin with, one should only recall that the PND II and its ISI program was launched during the world recession of 1974-75 and that the initial stages of such development strategies are usually characterized by high levels of imports. By sustaining the import-intensive investment projects of state enterprises in the midst of a world crisis, the currency loans from the Euromarkets were ultimately contributing not to the development of the domestic capital goods industry, but to the expansion of foreign suppliers of those goods (see Table 8.10 above and Tables 9.14 and 9.15 below). In this sense, it can be surely argued that indebted ISI in Brazil, and similar expansionist policies elsewhere in the developing world, was perfectly consistent with the interests of private international financial markets and, particularly, the governments of center countries. The Euro-

markets, deprived of loan demand in industrial countries as a result of the recession, were searching for new outlets for their enhanced liquidity as a result of OPEC surpluses; the governments of industrial countries, were, of course, searching for markets for their exports of capital and intermediate goods in order to mitigate the recessionary effects of the oil crisis on their economies. According to such a reliable source as the World Financial Markets of the Morgan Guaranty Trust Company of New York, bank lending to LDCs in the aftermath of the first oil shock

...was encouraged by governments of industrial countries. They were concerned that the OPEC current account surplus, which jumped from \$7 billion in 1973 to \$68 billion in 1974, would continue indefinitely at very high levels because of perceived limits on OPEC's "absorptive capacity." Banks, in which OPEC members placed a large portion of their surplus, were encouraged to recycle these funds to mitigate the higher oil prices' recessionary impact on the world economy.

The rapid increase in loans to LDCs proved highly successful in terms of moderating the adverse consequences of higher oil prices for world economic growth. Economic expansion among the major LDC borrowers was sustained at 5½% annual rate in 1974-75 because financing was available for their growing imports. This, in turn, helped growth in industrial countries, which were able to continue expanding their exports to developing countries. For example, U.S. exports to those countries increased over the period, at an annual rate of about 30% - nearly twice as fast as the growth of U.S. exports to industrial countries. By the second half of 1975, a strong recovery was under way in the United States, and recovery in other industrial countries followed. The 1974-75 recession in industrial countries, was, thus, relatively short-lived. OECD real GNP growth averaged over 3½% annually in the remainder of the 1970s.⁴⁴

Furthermore, as Darrell Delamaide reports in his work Debt Shock,

In the wake of the oil shock...another way of adjusting for industrial countries was to increase their exports to the developing countries. The poor countries were able to continue buying things from the rich countries thanks to the credits so helpfully supplied by the Western banks. By continuing their economic growth, financed by bank credit, the developing countries took upon themselves the burden of the payments deficit. The developed countries transferred their deficits to the developing countries.

In the end, the developing countries had to finance not only the shortfall from oil imports, but also from their trade with industrial countries. They had to borrow to cover their own deficits, and then

borrow more to take over the industrial countries' deficits. The industrial countries, in short, "recycled" their deficits to the developing countries. This economic recycling is as important as, and more sinister than, simple financial recycling. The press has largely ignored why the plight of developing countries now is not due simply to mistakes on their part and why industrial countries are obliged in justice to find a solution to the debt problem.⁴⁵

After 1976, however, it was the vulnerability of the Brazilian economy to the pressure from foreign creditors, but also the logic of joint ventures with TNCs, that determined the acquisition by state enterprises of foreign capital goods, thus undermining the autonomy of the state in carrying out the major goals of the PND II. In order to show how this situation came about we will have first to examine the contradictions generated by the Brazilian "policy of foreign indebtedness", which soon turned into "debt determination of policy", that is, the foreign debt became the major determinant of short-term economic policy and of long-term development strategy.⁴⁶

The external determinants of domestic economic policy-making

The deterioration of the BOP and the loss of foreign reserves between 1974 and the first semester of 1976 were the major factors that led the government to begin the implementation of restrictive monetary and fiscal policies. Austerity was intended to contract domestic demand as a means of generating trade surpluses and, particularly, to raise the cost of domestic credit as a means of inducing private firms to borrow abroad under Law 4131 and Resolution 63, the "repass operation" (see chapter 7) so as to supply the Central Bank with foreign exchange for BOP purposes. Thus, in April and July 1976, commercial bank reserve requirements were raised progressively from 27 to 35 percent of demand deposits. Central Bank rediscount rates were raised from 22 percent (March 1976) to 28 percent (May). In addition, the Central Bank fixed lending rates on many investments

and commercial bank operations. Curbs were also placed on installment and real estate credit. Those measures were complemented in 1977 with the freeing of interest rates throughout the whole financial system, the further increase of commercial banks' compulsory deposits from 35 to 40 percent and of Central Bank discount rates.

Simultaneously with the tightening of domestic credit, whose ultimate beneficiary was, of course, the financial sector, the government announced new measures to facilitate and stimulate the foreign borrowing of the private industrial sector. Already in November 1973 the "repass operations" of Central Bank Resolution 63 were exempted from payment of IOF (Imposto sobre Operacoes Financeiras), a federal tax on financial operations, reducing by 2/3 percent the final cost of the loans. In addition, the Central Bank assumed the exchange risk (that is, since Brazilian debtors had obtained dollar loans, more cruzeiros would be required to repay the same amount of dollar debt in the event of a sharp devaluation of the cruzeiro) and all obligations to the foreign creditors (both interest payments and spreads), which also reduced the final cost of the loans to companies by reducing the repass fee (generally 3-5 percent) charged by the intermediary agents. Again, the real domestic beneficiary of such measure was the financial sector which became completely free from the exchange risk: when the loan was "repassed", the final borrower (private firms) assumed the risk; in the absence of a final borrower, the Central Bank assumed the risk.

In July 1977, the government extended the same facilities to the direct long-term foreign borrowing of private companies under Law 4131. Resolution 432 allowed the borrowers to deposit foreign currency with the Central Bank for a period of 30 days, during which the Bank assumed the exchange risk, the obligations to the foreign creditors and the withholding taxes incurred by the borrowers. As Davidoff Cruz observes, "This measure

practically constituted a remunerative checking account for private firms which borrowed abroad."⁴⁷ In 1977 the deposits of foreign currency in the Central Bank was \$3 billion; by 1981, it was \$11 billion.⁴⁸ The Central Bank became, in effect, the borrower of last resort.

As Table 9.4 indicates, the beneficiaries of the cost and hedging possibilities of Central Bank Resolution 432 (and which were very useful to cushion the effects of the 1979 and 1983 maxidevaluations of the cruzeiro) were the foreign firms, by far the largest private borrowers under Law 4131, clearly showing that the bulk of their investments in Brazil in the 1970s was through loans rather than risk capital (see discussion in chapter 7).

Table 9.4 also indicates, however, that in spite of the official incentives, the foreign borrowing of the private sector, particularly national firms, after 1976, did not show spectacular growth as compared to the years 1972, 1973 and 1974 when the sector was responsible for 75.1, 60.3 and 64.7 percent, respectively, of the country's total foreign debt (see Table 8.3 above). This relative slow down of private sector foreign borrowing was, of course, the direct result of the overall slowdown of economic growth after 1974 and in the final analysis determined the progressive "statization" of the Brazilian foreign debt, that is, the massive foreign borrowing by state enterprises. Tables 9.4 and 9.5 below show that the bulk of foreign loans was contracted by the public sector in the second half of the 1970s. From 50.4 percent of the total foreign borrowing in 1975, the public sector's share rose to 76.8 percent in 1979. It was the government using state enterprises, particularly those in energy and metalurgical activities (but also transportation until 1978) as instruments to capture the foreign loans needed to finance BOP deficits. By approving their investment programs, in spite of the official restrictive monetary policy and simultaneously restricting their access to domestic credit and

holding down their prices and tariffs needed for self-financing, the government forced the state enterprises to borrow abroad under Law 4131 in order to bring foreign exchange into Brazil. And as the government was the ultimate guarantor of the loans, the state enterprises quickly became the "darling" of the international financial markets. The alliance of the state and international finance was never so obvious.

Thus, after 1975, with inflation accelerating, the CDE adopted the measure of slower readjustment of public utility rates, reversing the orthodox policy of "realistic tariffs" of the Campos-Castello Branco's stabilization and which had been in force until 1974, performing an important role in the self-financing of state enterprises. The sector most affected by the new policy of lower tariffs was electric energy. Table 9.6 shows that while the self-financing of the sector (and treasury transfers) declined progressively after 1975, its external financing rose. In fact, Table 9.5 indicates that after 1977 the energy sector became by far the major borrower in the Eurocurrency markets. In 1977, the sector's foreign borrowing was 12.2 percent of the total public and private debt; by 1980, it reached 25.1 percent and by 1981, 26.5 percent. Eletrobras, the state-run holding company for all hydroelectric power activities was the responsible for an outstanding debt of \$7 billion in December 1981.⁴⁹ As Mario Bhering, President of Eletrobras in the Sarney administration puts it, the foreign loans were used

to form the Figueiredo government's famous financial packages...to capture money in Europe, mainly, and Japan, buying a certain amount of equipment and borrowing a parallel amount. The result was that the sector accumulated a debt bigger than was required and bought equipment at the wrong time.⁵⁰

Furthermore, the low levels of direct profitability of state enterprises in general as a result of low prices of their industrial output set by the government (basically subsidies to the private sector) was a

Table 9.4 Currency Loans Under Law 4131, Gross Annual Inflows to the Private Sector, 1975-1981 (In millions of US\$)

Borrower	1975		1976		1977		1978	
	\$	%	\$	%	\$	%	\$	%
PRIVATE SECTOR	1,872.1	49.6	1,872.7	48.9	2,356.9	48.5	3,511.5	39.8
National ¹	234.8	6.2	139.5	3.6	292.6	6.0	465.5	5.3
External ¹	1,637.3	43.4	1,733.2	45.3	2,064.3	42.5	3,046.0	34.5
International firms	1,384.7	36.7	1,511.3	39.5	1,695.2	34.9	2,357.3	26.7
Foreign firms	75.5	2.0	49.7	1.3	63.1	1.3	53.0	0.6
Conglomerates	109.4	2.9	53.6	1.4	97.1	2.0	282.5	3.2
Joint Ventures	67.7	1.8	118.6	3.1	208.9	4.3	353.2	4.0
PUBLIC SECTOR	1,900.9	50.4	1,953.3	51.1	2,500.5	51.5	5,317.4	60.2
Total	3,773.0	100.0	3,826.0	100.0	4,857.4	100.0	8,828.9	100.0

Borrower	1979		1980		1981	
	\$	%	\$	%	\$	%
PRIVATE SECTOR	2,007.4	23.2	1,124.1	23.4	2,311.1	30.4
National ¹	554.1	6.4	176.2	3.7	427.7	5.6
External ¹	1,453.3	16.8	947.9	19.7	1,883.4	24.8
International firms	1,228.3	14.2	500.4	10.4	1,459.9	19.2
Foreign firms	8.7	0.1	43.3	0.9	61.3	0.8
Conglomerates	138.4	1.6	120.3	2.5	164.1	2.2
Joint Ventures	77.9	0.9	283.9	5.9	198.1	2.6
PUBLIC SECTOR	6,642.9	76.8	3,687.0	76.6	5,285.5	69.6
Total	8,650.3	100.0	4,811.1	100.0	7,596.6	100.0

Source: Paulo Davidoff Cruz, Divida externa e politica economica: a experiencia brasileira nos anos setenta (São Paulo: Editora Brasiliense, 1984), p. 100, Tabela 5.

¹ See classification in Table 8.3 above showing the foreign borrowing of the private sector between 1972 and 1974.

Table 9.5 Currency Loans under Law 4131, Gross Annual Inflows to the Public Sector, 1975-1981 (In millions of US\$)

Borrower	1975		1976		1977		1978	
	\$	%	\$	%	\$	%	\$	%
PUBLIC SECTOR	1,900.9	50.4	1,953.3	51.5	2,500.5	51.5	5,317.4	60.2
Energy	180.0	4.8	187.1	4.9	591.4	12.2	1,368.3	15.5
Metalurgy	72.0	1.9	128.5	3.4	610.7	12.6	610.0	6.9
Petrochemical	129.9	3.4	0.0	0.0	136.0	2.8	151.5	1.7
Transportation	531.0	14.1	475.7	12.4	603.2	12.4	1,096.8	12.4
Telecommunications	267.7	7.1	262.2	6.8	10.0	0.2	267.0	3.0
Financial								
Intermediation (BNDE)	141.2	3.7	282.0	7.4	427.7	8.8	717.8	8.1
Public administration	459.0	12.2	515.9	13.5	50.0	1.0	580.0	6.6
Other	120.1	3.2	101.9	2.7	71.5	1.5	526.0	6.0
PRIVATE SECTOR	1,872.1	49.6	1,872.7	48.9	2,356.9	48.5	3,511.5	39.8
Total	3,773.0	100.0	2,826.0	100.0	4,857.4	100.0	8,828.9	100.0

Borrower	1979		1980		1981	
	\$	%	\$	%	\$	%
PUBLIC SECTOR	6,642.9	76.8	3,687.0	76.6	5,285.5	69.6
Energy	1,599.1	18.5	1,207.7	25.1	2,009.5	26.5
Metalurgy	913.0	10.6	378.2	7.9	317.0	4.2
Petrochemical	133.9	1.5	250.0	5.2	522.0	6.9
Transportation	560.0	6.5	113.9	2.4	994.4	13.1
Telecommunications	309.0	3.6	229.0	4.8	15.0	0.2
Financial						
Intermediation (BNDE)	710.0	8.2	535.5	11.1	429.3	5.7
Public administration	1,749.7	20.2	822.6	17.1	657.1	8.6
Other	668.2	7.7	150.1	3.0	341.3	4.4
PRIVATE SECTOR	2,007.4	23.2	1,124.1	23.4	2,311.1	30.4
Total	8,650.3	100.0	4,811.1	100.0	7,596.6	100.0

Source: Same as Table 9.4 above, p. 96, Tabela 4.

Table 9.6 Electric Energy Sector: Source of Resources, 1972-1980
(percentage)

Source of resources	1972	1973	1974	1975	1976	1977	1978	1979	1980
Internal	64.0	65.2	62.4	59.2	52.0	45.7	40.1	32.0	32.6
Self-financing	42.2	46.4	42.5	35.9	43.2	34.5	28.1	28.9	26.7
Treasury transfers	21.2	20.3	19.7	21.7	14.7	10.5	10.3	6.0	6.1
Other	0.6	(1.5)	0.2	1.6	3.1	0.7	1.7	(2.9)	(0.2)
Financing	36.0	34.8	37.6	40.8	48.0	54.3	59.9	68.0	67.4
Compulsory loans	8.9	9.4	8.4	7.2	7.7	6.4	6.5	5.9	8.6 ¹
Domestic financial institutions	4.1	6.5	10.0	13.3	22.8	17.3	20.5	30.1	32.8
Foreign financial institutions	23.0	18.9	19.2	20.3	17.5	30.6	32.9	32.0	26.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

¹

Includes contributions and sale of stock

Source: Same as Tables 9.4 and 9.5 above, p. 122, Tabela 12.

further encouragement for their foreign borrowing to sustain the high levels of investments approved by the government. Table 9.7 gives evidence for 1976 when the prices of public firms were set well below inflation rates, indicating the disproportion between their assets and revenues from sales as compared to private, particularly, foreign firms. This situation was particularly aggravated after 1979 when the government, in need of ever larger amounts of foreign exchange to service the foreign debt, aggressively induced the public firms to borrow abroad through their artificially low domestic prices. In 1980, for example, the public steel company Siderbras (and its subsidiaries, Cosipa, Açominas, Tubarão e Vibasa) was allowed to increase the price of its steel only by 60 percent while inflation was running at about 110 percent. As Camilo Pena, the Minister of Industry and Commerce in the Figueireto administration lamented:

The drastic financial situation of Siderbras today is the result of the consistent low prices of its products imposed by the CIP and the consequent resort of the firm to foreign loans, compelled by the government, to help Brazil's external accounts. Siderbras became the victim of two maxidevaluations and the increase in international interest rates.⁵¹

All of this refutes both the central argument of the anti-statist campaign that state enterprises were competing with the private sector and the contention of some scholars that a process of "state capitalism" was taking place in Brazil in the mid 1970s.⁵² What was clearly taking place was the constraints of the foreign debt on the autonomy of the state to raise public savings by the full pricing of goods and services of public firms and which had been a key factor in slowing down inflation and reducing the government's deficit between 1965 and 1973. As discussed, the slower readjustment of public utility rates, and hence the decline of the self-financing of state enterprises, was designed by the government to force them to rely on foreign loans to finance their investment and simultaneously

Table 9.7 Brazil: Distribution of Assets and Profits among firms, 1976

Net Capital Assets	Public Firms %	Private Domestic Firms (%)	Private Foreign Firms (%)
Net capital assets	52.2	27.7	20.1
Revenues from sales	24.3	37.4	38.3

Sources: Joao Paulo de Almeida Magalhaes, Modelos Alternativos de desenvolvimento (Rio: Paz e Terra, 1979), p. 121.

bring foreign exchange to cover BOP deficits caused by the service of the foreign debt itself.⁵³

In addition to holding down the prices and tariffs of state enterprises, the government also restricted their access to domestic credit, thus leaving the firms with no other alternative but to resort to foreign sources. In September 1977, Central Bank Resolution 445 limited to 8 percent the total cruzeiro lending of investment banks to public firms, and, still in the same month, a presidential resolution prohibited all ministries to borrow in the domestic financial system to finance the investment programs of their subordinated enterprises without the previous authorization of the Secretariat of Planning (and in 1979 of the CMN). In December 1978, further measures were taken to restrict the domestic borrowing of state companies, but also of foreign firms: 50 percent of the total lending of commercial banks were to be channeled to private national firms, thus leaving 50 percent to be shared between public and foreign firms. In July 1980, the government increased from 50 percent to 60 percent the portion of available loan funds to private Brazilian firms thus reducing even more the amount of funds domestic banks could offer to state companies and foreign firms. Given the slowdown of foreign firms borrowing in 1980 under Law 4131 (Table 9.4) those firms must have had preference over state enterprises in borrowing domestically in that year, thus forcing the latter

to resort to the international financial markets.

In fact, faced with a simultaneous foreign exchange squeeze in 1980 and 1981 and a provoked domestic recession to please foreign creditors and generate trade surpluses, but which contradictorily offset official stimulus to private sector foreign borrowing (again, the same monetary mechanisms used in 1976-77, that is, restriction of domestic credit and freeing of interest rates), the government launched the state enterprises in a truly desperate "loan hunt" operation and disturbed the neat "division of labor" established in 1967. State enterprises began to use the "repass operations" facility of Resolution 63 previously used only by private national firms without direct access to foreign loans under Law 4131. Thus, Table 9.5 (gross annual inflows of currency loans under Law 4131 to the public sector) does not in itself indicate the magnitude of the foreign borrowing by state enterprises between 1980 and 1981. Table 9.8, showing annual inflows of loans both under Law 4131 and Resolution 63 between 1975 and 1981, reveals that the "repass operations" were accelerated between 1980 and 1981, when 42.1 and 41.8 percent, respectively, of the total foreign loans were contracted by financial intermediaries. The final borrowers, given the recession and the paralysis of domestic investment in the private sector, were the state enterprises, particularly those in the metalurgical sector. In 1981, for example, they contracted \$1 billion, or 20 percent of the total of the "repass operations of Resolution 63 in that year.⁵⁴ Nevertheless, the Central Bank ended up with a massive volume of deposits in those years assuming all financial obligations to foreign creditors, in addition to the exchange risk. Commenting on the foreign borrowing of state enterprises, Brazilian economist Persio Arida correctly observes that,

Critics point out the fact that 60 or 65 percent of Brazil's foreign debt belongs to state enterprises to "clear" the private sector. Statization was the great responsible for the massive

Table 9.8 Gross Annual Inflows of Currency Loans under Law 4131 and Resolution 63, 1975-1981
(in millions of US\$)

	1975		1976		1977		1978	
	\$	%	\$	%	\$	%	\$	%
Law 4131	3,773.0	80.3	3,826.0	70.9	4,857.4	78.6	8,828.9	74.3
Resolution 63	928.3	19.7	1,572.5	29.1	1,321.4	21.4	3,053.8	25.7
Total	4,701.3	100.0	5,398.5	100.0	6,178.8	100.0	11,882.7	100.0

	1979		1980		1981	
	\$	%	\$	%	\$	%
Law 4131	8,650.3	84.6	4,811.1	57.9	7,596.6	58.2
Resolution 63	1,574.5	15.4	3,500.9	42.1	5,467.1	41.8
Total	10,224.8	100.0	8,312.0	100.0	13,063.7	100.0

Source: Davidoff Cruz, Divida externa, op.cit., p. 140, Tabela 20.

foreign debt as the state bureaucracy, characterized by the absence of rationality which prevails in private enterprise, contracted massive loans to finance white elephant projects. The critique is unfounded. There is no doubt as to the irrationality of state enterprises in their use of foreign loans; but the decision to launch the public firms in the international financial markets was not the result of isolated action of each firm. The source of the problem is not the existence of the public firms, but the government's policy of maintaining the equilibrium of the balance of payments, year after year, through an insane process of foreign borrowing...It is said that a process is "autotelico" when there is no purpose. Borrow just to borrow, this is the "autotelia" responsible in great part for the current situation.⁵⁵

Table 9.2 above provides evidence for the successful result of the government's measures to induce the public firms to borrow abroad for BOP purposes. By 1978, while the financing of public investment programs became totally dependent on foreign resources, Brazil's foreign exchange reserves rapidly increased, reaching levels never seen before: \$7.2 billion in 1977 and \$11.8 billion in 1978. Furthermore, the profile of the foreign debt improved as the government was able to raise the minimum acceptable maturities on foreign loans from 5 to 8 years and the grace period from 6 to 36 months (see discussion in chapter 8), although at the expense of higher spreads (Table 9.11 below) and the postponement to the 1980s of all obligations with amortization. The current account deficit even declined from \$7.1 billion in 1974 (7.5 percent of GDP) to \$4.0 billion in 1977 (2.8 percent of GDP) as a result of a small trade surplus (\$97 million). As Bonelli and Malan point out: "By 1978 it seemed to the most optimistic observer that the effects of the first oil shock on the balance of payments had been completely absorbed."⁵⁶

As Tables 9.2 and 9.18 show, however, the trade account went quickly back into deficit after 1978 as a result of an increasing deterioration in the terms of trade after the Second Oil Shock and the subsequent world recession of the early 1980s. The price index for Brazil's exports in relation to imports fell from 112.7 to 65.1 percent between 1977 and 1981.⁵⁷

The real problem of the BOP, however, was not in the trade account as the technocrats claimed, hence their emphasis on the export drive as a panacea to the problems of the BOP, but elsewhere, in the services account, as a result of a dangerous build-up of interest payments on the foreign debt. Tables 9.2 and 9.18 further show that in 1978, the current account deficit again rose to \$5.9 billion and in 1979 to \$10.7 billion and net interest payments represented nearly half of the deficit. The dramatic increase in interest rates between the end of 1979 and 1981 finally exposed the real problem of the BOP and the vulnerability of the Brazilian economy to fluctuations in the international financial markets, generated by the model of growth based on extreme reliance on foreign loans promoted by the ideologues of developmentalism. Thus, between 1979 and 1984 the accumulated deficit in the current account was \$58.1 billion and \$52.3 billion of it represented expenditures with interest payments, showing the strict financial nature of the foreign debt, completely divorced from productive activities in Brazil, and that the export drive was not able to eliminate.

In the meantime, many interpretations of the Geisel government stress the failure and contradictions of its monetary policy in reducing the rate of inflation.⁵⁸ The so-called contradictory "stop and go" policy, that is, the alternation between expansion and contraction of economic activities between 1974 and 1978 (see Table 9.3 above), however, was less the direct result of the concern of Brazilian policy makers with the acceleration of inflation than with the deterioration of the BOP. To begin with, there was no external pressure for a really deflationary policy, IMF style, and in addition, the government did not want to jeopardize its political efforts to institutionalize military rule with a real credit and wage squeeze. But at the same time, the political liberalization itself had unleashed the traditional opposition forces against precisely such a course of action. As

economist Werner Baer argues,

In evaluating the economic policy actions of the Geisel and early Figueiredo periods in political terms, it is clear that the gradual deauthoritarianization of Brazil explains much of what happened. The political opening was perceived as requiring a good economic performance in terms of growth and the avoidance of a confrontation in the fight for shares among various socioeconomic groups or between the government and specific economic sectors. The resulting inflation was tolerable, as most savings were protected by an indexing system. The increased foreign indebtedness was also tolerable as long as the export-incentive system made possible an overvaluation of the cruzeiro, which protected economic groups with large foreign debts. 59

In fact, the priority of the Geisel government was not the stabilization of prices, but the BOP. As Finance Minister Simonsen, the man behind the policy, stated in January 1977, "The recuperation of foreign reserves to the level prior to the oil crisis was the result of our monetary policy as well as the good performance of our exports in the second semester of 1976."⁶⁰ Furthermore, in July 1977, with foreign reserves rising rapidly, the Finance Minister stated: "Inflation is bad, but the external impasse would be deadly. As such, as long as the BOP did not show improvement, it was natural that the government concentrated its efforts in solving the external equation. Today, with favorable prospects in the BOP we can begin directing our energy towards the combat of inflation."⁶¹

The contradictions in policy-making were, in effect, less in the failure to fight inflation than on the success to improve the BOP through the expansion of the foreign debt itself: the more the inflows of loans to finance the BOP deficits in the short-term, the larger the deficit, for foreign loans were the very cause of the structural deficit they financed. At the same time, the more the inflows and hence liquidity in the economy, the stronger the inflationary process. Attempts by the government to neutralize the effects of inflows of loans in the economy (as Table 9.2 shows,

in 1976 gross loan capital inflows reached \$9.1 billion and in 1977 and 1978, \$8.8 and \$15.6 billion respectively) only served to exacerbate inflation. The launching by the Central Bank of massive indexed treasury bonds in the open market between 1976 and 1978 at very high rates of interest accelerated the internal public debt (Table 9.9 below) and hence the government deficit and the inflationary process (see discussion in chapter 7).

In the meantime, domestic investment and savings were falling. Gross domestic investment as a percentage of GDP fell from 25.7 percent in 1975 to 24.2 percent in 1976, 22.6 percent in 1977, 22.0 percent in 1978 and 21.5 percent in 1979.⁶² Gross national savings as a percentage of GDP declined from 24.2 percent in 1976 to 19.8 percent in 1977, 18.3 percent in 1978 and 16.6 percent in 1979.⁶³ It was the financial policy of the government, a policy that was being shaped by the foreign debt, that was discouraging long-term productive investments in the country while promoting a boom in short-term financial activity. Gazeta Mercantil, in its 1978 annual balance, explains the negative consequences for the economy of the vicious circle produced by the foreign debt:

The Central Bank was paying the highest interest rates in the domestic market for its bonds. It initiated in this way the most profitable and safest financial speculation in the history of the country. The vehicle manufacturer profited much more with treasury bond transactions than manufacturing and selling cars, his supposed function in the economy. The airlines profited much more in the "open market" than in their own business. The banks preferred to negotiate with bonds than in lending money to companies. In part, they were induced to do so. With the "open market", the government created a sterile market where nothing is produced, besides paper, and that concentrated the resources of the economy in speculative activities. The "open market" turned into a gigantic lottery where the bettor always wins.⁶⁴

What was happening in Brazil was the transformation of the voluntary "policy of foreign indebtedness" of the technocrats into "debt determination of policy" and over which they were losing control. In other words, the

Table 9.9 Evolution of the Public Internal Debt, 1976-1979
(In billions of Cr\$)

Year	January	March	May	July	September	November
1976	167.7	162.4	174.5	192.5	192.5	192.5
1977	187.6	192.2	190.4	197.3	203.6	209.5
1978	213.3	214.2	212.7	209.5	213.9	223.3
1979	216.2	199.9	200.7	210.8	203.4	193.7

Source: L. Coutinho, "Politica Economica: 1974-1980", Revista de Economia Politica 1 (1), 1981, p. 100.

foreign debt was rapidly becoming the major determinant of short-term economic policy and also of long-term development strategy. "Afterwards", Anglade correctly notes, "the crisis [of the model of capital accumulation] simply unfolded 'naturally', fed by contradictions which could no longer be controlled.⁶⁵ Again, quoting Gazeta Mercantil, which echoes the words of Getulio Vargas' Finance Minister Oswaldo Aranha in the 1930s (see chapter 4):

Initially, the fathers of the foreign debt argued that "external savings" were being used in projects that would save foreign exchange and create new jobs in the future. In reality, what the foreign loans have promoted in Brazil is the need to contract new loans to service old ones.⁶⁶

As Table 9.10 shows, the bulk of the inflows of loans between 1973 and 1981 was indeed used to service old ones. From 58.4 percent in 1973, debt service (interest and amortization) absorbed 94.4 percent of the inflows of foreign loans in 1979, 95.2 percent in 1980 and 94.4 percent in 1981. In other words, between 1979 and 1981 Brazil's foreign borrowing was almost entirely used up by the servicing of the loans it raised in the 1970s. After 1982 Brazil became a capital exporter as interest payments exceeded new inflows (see Table 9.13).

Table 9.10 Brazil: Foreign Loans and Debt Service, 1973-1981
(in millions of US\$)

Year	Interest ¹ (1)	Amorti- zations ² (2)	Debt Service (3=1+2)	Gross Inflows Foreign Loans ³ (4)	Net Inflows Foreign Loans (5=4-2)	Debt Service/ Foreign Loans (%) (6=3:4)
1973	840	1,673	2,513	4,304	2,631	58.4
1974	1,370	1,920	3,290	7,455	5,535	44.1
1975	1,863	2,185	4,048	7,672	5,487	52.8
1976	2,091	3,009	4,100	9,104	6,095	56.0
1977	2,462	4,135	6,597	8,861	4,726	74.4
1978	3,344	5,439	8,783	15,641	10,202	56.2
1979	5,348	6,541	11,889	12,594	6,053	94.4
1980	7,457	6,705	14,162	14,879	8,174	95.2
1981	10,305	7,514	17,819	18,882	11,368	94.4

¹ Gross Interest

² Amortization of currency loans and import financing, medium and long-term.

³ Gross currency loans and import financing, medium-and long-term.

Source: Paulo Nogueira Batista Jr., Mito e realidade na dívida externa brasileira (Rio de Janeiro: Paz e Terra, 1983), p. 102, Quadro III.

International finance and profit maximization strategies

In the meantime, Transnational Banks operating in the Euromarkets with their role in BOP financing enhanced in the 1970s, a role once reserved exclusively for official institutions such as the IMF, were quickly developing mechanisms for profitable lending to deficit-ridden Third World countries.⁶⁷ One such innovation in lending techniques to deal with "sovereign risk" was the syndicated loan. Commercial banks formed syndicates to spread a loan among several institutions and thus minimize the risk on the credit itself. Thus, a TNB could make a \$10 million loan to a developing country by getting four other banks to participate in the credit so that each of them lent only \$2 million. If the country defaulted, the

bank would lose only \$2 million instead of \$10 million. In reality, however, most syndicated loans were arranged by a core of 25 to 50 large commercial banks based in the industrial countries and up to 3,000 others, mostly regional banks, joined in from time to time.⁶⁸

Commercial banks, however, ensured that sovereign defaults would be difficult, if not impossible, to occur through their introduction of a cross-default clause covering publicly guaranteed debt. The clause specified that the loan would be considered to be in default if the borrower defaulted on any other loan. As the World Bank notes, the cross default clause

...strengthened the guarantee on sovereign loans and blurred the difference in risk between individual borrowers and projects within a developing country. Hence, banks paid less attention to the viability of the particular projects they financed, and more to the macroeconomic conditions in borrowing countries. Furthermore, if a developing country borrower defaulted, cross-default clauses would ensure that all bank lenders would be affected. As a result, a borrower confronted with debt-servicing difficulties had a strong incentive to reschedule its lending rather than default on a loan.⁶⁹

What proved to be the most vulnerable element in debt servicing for developing country borrowers was the floating interest rates of the Eurocurrency loans. To minimize the interest risk on long-maturity loans (generally 7 to 12 years), commercial banks rolled over the loans every three or six months on the basis of what it cost them to obtain funds in the London Interbank Offered Rate, the famous LIBOR, thus shifting the interest rates risk onto the borrowers.

The vulnerability of the Brazilian economy to increases in interest rates grew considerably due to the fact that 70 percent of the \$43.5 billion foreign debt by 1978 had been contracted with floating interest rates. By 1983, 80 percent of the \$91.6 billion foreign debt was at floating rates. Each percentage point rise in the LIBOR meant that the country owed by 1978

an extra \$300 million a year in interest payments to its foreign creditors. In 1979, with a foreign debt of \$50 billion, the increase in the LIBOR (plus the spread) from 8 percent to 13 percent represented an additional payment of some \$1.5 billion.⁷⁰ (Table 9.12 shows the increase in international interest rates after 1979).

Although until 1978 the lending rate fixed by LIBOR was basically around 8 percent, the borrowers had to pay commission fees and spreads, the so-called margins above the banks' funding costs, that is, above the LIBOR, and which were, in effect, the terms of the loans and the profits of the banks (see Table 9.11 for the spreads Brazil was paying). As Darrell Delamaide observes, "Details of individual projects were sketchy, the terms were not: margin 1/2 to 5/8, commitment fee 3/8 (to pay the Bank for keeping the money ready), participation fee 3/16 for amounts above \$5 million."⁷¹

Brazil played well the rules of the game. The debt managers quickly developed a "policy of spreads" alongside their "policy of foreign indebtedness" to maintain a good image abroad. The policy consisted of paying higher margins of 2 points or beyond above LIBOR than most developing country debtors in order to guarantee the large amounts of new money the country needed each year and long maturity for the loans (see Table 9.11).⁷² As John Carioba, the representative in Brazil of Manufacturers Hanover, stated in March 1978: "In my opinion, the policy of the Brazilian government to pay higher spreads than most debtors is very interesting: we are always ready to send money in this direction."⁷³

As Table 9.11 shows, the spreads that Brazil was offering to commercial banks after 1979 were particularly high at a time of ample liquidity in the international financial markets (the second recycling of petrodollars).⁷⁴ A factor that determined the increase in the spread

was the country's need to offer creditors the possibility to choose between LIBOR and the higher US Prime rate (see Table 9.12) to ensure the massive inflows of loans required to rollover the debt, that is, to finance the service payments of the debt itself. In other words, the creditors began to have the right to opt for the interest rate that was more favorable to their profitability as a result of the deteriorating financial situation of the country, and hence, its creditworthiness. As Table 9.2 above and 9.18 below show, in 1979 the current account deficit doubled, from \$5.9 billion in 1978 to \$10.7 billion, and in 1980, it rose to \$12.8 billion, reflecting the rise in international interest rates. Simultaneously, the foreign reserves declined from \$11.8 billion in 1978 to \$6.9 billion in 1980 as new inflows were not enough to close the overall BOP. As Nogueira Batists observes, "In fact, our negotiating position became extremely difficult and commercial banks took advantage of it in order to increase the profitability of their operations in Brazil."⁷⁵

In March 1981, Business Week revealed this new source of profit to international banks, showing that the case of Brazil was not an isolated one:

Banks operating in the syndication market in London are quietly pricing their loans on the basis of the prime rates in the U.S. and Canada to increase their profits on international loans by as much as 40 percent. By pegging their loans to the North American rates instead of the London interbank offered rate (LIBOR), the banks can achieve a higher return, while their customers - mostly sovereign governments - can please their local politicians with what appears to be a lower rate.⁷⁶

While contributing to banks' profitability, however, the willingness of the Brazilian debt managers to pay a premium for foreign loans to rollover the debt did not save the country from the same fate as other debtors with lower credit rating when successive external shocks occurred between 1979 and 1982: the second oil shock, the explosion in international interest rates as a result of the change in U.S. monetary policy, the world recession with

the consequent decline in commodity prices, and, most important, the sudden contraction in international financial markets which ended the debt rollover game. The vulnerability of Brazil to a blowout in rollover lending is best put by Burtle and Young in an International Report of The Bankers:

What created a crisis [in Brazil] was a sudden holding back of funds that in the previous years were gladly rolled over by bankers who wanted the higher interest rates and low management cost of large-scale lending to Brazil...The Brazilian balance of payments has been pushed into deficit mainly by a failure of rollover financing by foreign banks.⁷⁷

Ironically, in early November 1982, just a few weeks before Brazil was forced to go to the IMF, and a few days before the November 15 direct elections for state governors (the first since 1965), a politically inspired Carlos Geraldo Langoni, the governor of the Central Bank, declared to Euromoney: "The profile of our external debt is another big difference between Brazil and some of its fellow sufferers. The strategy of accepting higher spreads for longer maturities has worked."⁷⁸

Commercial banks' profitability, however, did not come to a halt with the ensuing debt crisis of 1982 and beyond. On the contrary, the rescheduling and refinancing operations that followed became extremely profitable as spreads and fees were drastically raised. For Brazil, the terms of renegotiated debt in 1983 were: spread of 2.125 percent over LIBOR, 1.50 percent refinancing fee and 0.50 commitment fee; for new loans the terms were: 2.125 percent over LIBOR, 1.50 percent front-end fee and 1.0 percent commitment fee.⁷⁹ Those percentages meant that banks' profits from front-end fees and commissions amounted in 1983 to between \$65 and \$100 million for their "trouble" in arranging new loans.⁸⁰

The new lending to Brazil and other debtors after 1982, however, in addition to being conditioned to IMF stabilization measures, that is, the traditional compulsory economic adjustment to generate trade surpluses and

keep on servicing the debt, fell far below the greater debt servicing requirements, resulting in net transfer of resources to the creditors. And the creditors have maintained this perverse situation by preventing Brazil and other Latin American debtors from coordinating policies to obtain realistic repayment terms through "divide and conquer" strategies of promises and threats on such matters as access to loans or export markets according to debtors' ability and willingness to implement tough austerity measures and market-oriented "structural reforms" aimed - again - at opening up their economies to trade and foreign investment. But while Latin America has not succeeded in forming a debtor's bloc after almost seven years of economic crisis in the region, commercial creditors have formed powerful negotiating cartels of their own, called advisory committees to deal on a case-by-case basis with debtor countries, thus successfully imposing all the burden of the adjustment process on Latin America debtors.

Table 9.13 below shows that between 1982 and 1984 Brazil transferred abroad \$17.4 billion, 2.5 percent of GNP, to commercial banks in industrialized countries. Between 1983 and 1987, Brazil transferred \$39 billion to the rich countries, making it the world's largest capital exporter after Japan, as new "voluntary" lending by commercial banks virtually ceased.⁸¹ Finally, in 1988, six years after the debt crisis began, with a foreign debt of \$115.9 billion, Brazil paid \$15.8 billion in debt servicing to its foreign creditors, while receiving only \$6 billion in new loans, thus transferring abroad \$9.2 billion.⁸² Thus, we see the consequences for Brazil of the growth strategy based on the developmentalist assumption that there are no conflicts between the interests of international capital and national development. But even before the debt crisis - and the larger developmental crisis - and the transformation of Brazil into capital exporter, the interests of international finance were clearly not consistent with the developmental goals of the Geisel Government.

Table 9.11 Brazil: Nominal Spreads (currency loans), 1974-1981

Year	Nominal Spread (average in %)
1974	1.1
1975	1.7
1976	1.9
1977	2.0
1978	1.7
1979	1.0
1980 March	1.0
September	2.0
1981 March	2.3
June	2.3

Note: Those are spreads officially reported and do not specify whether they are related to LIBOR or Prime Rate, which are revealed only in the loan contract.

Source: Paulo Nogueira Batista Jr., Mito e realidade na dívida externa brasileira, op.cit., p. 118, Tabela 1.

Table 9.12 US Prime Rate and LIBOR, 1979-81
(annual percentages)

Period	Prime (1)	LIBOR (2)	(1) - (2)
1979	12.8	12.0	0.8
1980	15.4	14.2	1.2
1981	19.4	17.2	2.2
January	20.1	16.9	3.2
February	19.4	17.0	2.4
March	17.8	15.3	2.5
April	17.3	15.9	1.4
May	19.7	18.4	1.3
June	19.9	17.2	2.7
July	20.4	18.2	2.2
August	20.5	18.9	1.6

Note: An explanation for the U.S. Prime Rate to be always higher than LIBOR is that in the U.S., when banks lend to preferential clients (corporations), it is common use to allow a deduction in relation to the prevailing prime rate.

Source: Same as Table 9.11 above, p. 121, Tabela III.

Table 9.13 Brazil: Net Transfer of Resources, 1982-84
(In billions of US\$)

Year	Trade Account	Current Account	% of GDP	Net Capital inflows ¹	Interest Payments	Net capital Transfer
1982	0.8	-14.7	5.2	5.2	-11.3	-6.1
1983	6.3	- 7.6	3.0	2.8	- 9.5	-6.7
1984	13.1	- 0.5	0.25	6.0	-10.6	-4.6

¹

Net capital inflows are defined as currency loans and import financing minus amortization and direct investment.

Source: Carlos Geraldo Langoni, A crise do desenvolvimento: uma estratégia para o futuro (Rio de Janeiro: Jose Olympio Editora, 1985), p. 63, Tabela 2.3.

The external constraint on state autonomy and the
collapse of the "triple alliance"

This section shows how foreign loans did not advance the developmental goals of the Geisel government, contemplated in the PND II. As discussed above, the Plan envisaged foreign loans ultimately contributing to the long-term development of national production of capital goods by sustaining the investment of state enterprises which, in turn, would provide the local suppliers with orders for their expansion. Instead, the massive foreign borrowing of state enterprises under Law 4131 became increasingly conditioned to their purchase of capital goods abroad. Transnational Banks' loans expanded the entrepreneurial role of the state in the infrastructure and basic inputs industries in 1970s, but both as an outlet for profitable investment and as a market for foreign capital goods. After all, the financing function of commercial banks is - and has always been - the promotion of world trade, not development in Third World countries.⁸³ Commercial banks are not development agencies.

Furthermore, in the 1980s when most debt-financed export-oriented state industries, particularly those in the metalurgical sector, have come to maturation, the foreign exchange earnings the firms generate have been almost in their entirety reserved for debt payments. Thus, international bankers could indeed claim that in addition to promoting the growth of world trade, they also promoted productive investments in Brazil in the 1970s, whose returns in the 1980s, in the form of trade surpluses, are being directed towards their coffers.

Delamaide touches the heart of the matter when he comments on the nature of the syndicated loans to developing countries in the 1970s. He says that:

The bank putting together the syndication may have had a long relationship with the borrower, or may have a domestic manufacturing

customer who is delivering turbines or rail cars for the project to be financed by the loan. The decision turned not only on the credit rating of the borrower, but the chances for domestic customers to export something for the project, the overall relationship to the government in question, and subtle alignments among the banks.⁸⁴

In the specific case of Brazil, that the export of "turbines or rail cars" were linked to the export of loan capital is revealed by the close relation between import financing and currency loans to state enterprises between 1976 and 1981.⁸⁵ As Tables 9.5 above (currency loans to the public sector) and Table 9.14 below (import financing to the public sector) show, both forms of loans were concentrated in three major sectors of activities of the state enterprises: energy, metalurgy and transportation. Those sectors were precisely the ones that, according to the PND II, were instended to provide orders for the domestic capital goods industry, and were, instead, being supplied from abroad.

This situation, that began by 1976, was intensified after 1979 during the Figueiredo administration, when Brazil found itself in a foreign exchange squeeze. Thus, in order to obtain temporary debt service relief, the government was openly accepting financial packages, linking currency loans to suppliers and buyers' credits for the purchase of foreign capital goods, when Brazilian firms could have easily provided them.⁸⁶ This was particularly the case with the energy sector, the major borrower of currency loans under Law 4131 (see Table 9.5 above). Its share of the total imports to the public and private sectors rose from 30.1 percent between 1976 and 1977 to 38 percent between 1980 and 1981, as Table 9.14 indicates. Further evidence of the "linkage" is found in Table 9.15 showing the total outstanding foreign debt of Brazil between 1981 and 1983. Table 9.15 shows the predominance of suppliers' and buyers' credits in Brazil's import financing, indicating that the suppliers of currency loans,

foreign commercial banks, were also providing a large chunk of Brazil's improt financing.

Furthermore, while the PND II had estimated an increase of 70 percent in capital goods production for the period 1975-79,⁸⁷ Table 9.16 shows that the growth rate in manufacturing production fell from 18.3 percent between 1968 and 1974 to 6.0 percent between 1975-78 and 5.8 percent between 1978-80. Between 1981 and 1983, the years of stabilization and recession, the capital goods sector was the hardest hit as public investments contracted, stagnating at -16.7 percent. Production of intermediary goods (particularly steel and chemicals) also fell from 13.3 percent between 1968 and 1974 to 8.3 percent between 1975 and 1978 and between 1979 and 1980. Between 1981 and 1983 growth rates were negative at -4.5 percent. A simultaneous look at Tables 8.10 above (value and structure of Brazilian improt between 1967 and 1983) and Table 9.16 below (average annual real growth in manufacturing production, 1968-83) shows that while the growth rate in manufacturing production of those priority goods fell, improt continued expanding until 1980 when the government was forced to cut improt drastically in order to generate trade surpluses and service the foreign debt.

But the major evidence of the vulnerability of state enterprises to the pressure from foreign creditors to purchase capital goods abroad as a condition to the release of currency loans for their projects, and simultnaeously, foreign exchange for BOP, is found in specific, well publicized cases between 1976 and 1979 and which triggered the open political opposition of the domestic manufacturers to the government's economic policy, or better, to the government's evident inability to sustain the industry. The cases were: the Tucurui, Itaparica and Itaipu power plants, the nuclear energy sector, the steel railway, the Cosipa and CSN

Table 9.14 Brazil: Import Financing to the Public Sector, 1972-1981
(annual averages, in millions of US\$)

Sector	1972-73		1974-75		1976-77		1978-79		1980-81	
	\$	%	\$	%	\$	%	\$	%	\$	%
PUBLIC SECTOR	1,376.0	71.2	1,654.2	67.0	3,257.4	78.7	3,348.9	84.7	4,086.6	82.3
Energy	284.7	14.7	257.9	10.5	1,245.8	30.1	1,136.1	28.7	1,887.2	38.0
Metalurgy	425.5	22.0	172.2	7.0	710.9	17.2	1,015.2	25.7	202.1	4.0
Transportation	122.5	6.3	580.0	23.5	482.3	11.6	213.9	5.4	426.2	8.6
Petrochemical	53.4	2.8	99.4	4.0	168.4	4.1	229.7	5.8	407.7	8.2
Public administration	263.7	13.7	237.5	9.6	244.7	5.9	342.7	8.7	784.5	15.8
Financial intermediation	149.0	7.7	65.9	2.7	200.0	4.8	202.5	5.1	255.2	5.1
Others	77.2	4.0	241.3	9.7	205.3	5.0	208.8	5.3	123.7	2.6
PRIVATE SECTOR	553.3	28.8	813.5	33.0	883.5	21.3	603.3	15.3	881.1	17.7
TOTAL	1,931.3	100.0	2,467.7	100.0	4,140.9	100.0	3,952.2	100.0	4,967.7	100.0

Source: Paulo Davidoff Cruz, Divida externa, op.cit., p. 152, Tabela 24.

Table 9.15 Brazil: Total Outstanding Medium- and Long-term Loans,
1981-83 (US\$ million)

Item	Total Outstanding		
	Dec. 31.81	Dec. 31.82	Dec. 31.83
IMF Loans	-	544.0	2,647.8
IMPORT FINANCING	12,880.5	13,519.7	16,242.0
International Entities	3,582.9	3,847.1	4,323.6
World Bank	2,263.5	2,341.3	2,587.9
IADB	1,071.1	1,202.4	1,367.1
IFC	248.3	300.9	302.6
Other	-	2.5	66.0
Government Agencies	3,404.0	3,689.8	4,405.7
USAID - Project Loans	528.9	519.1	518.2
Wheat/Other Loans	510.5	838.5	1,168.0
Eximbank-USA	954.7	934.0	981.1
Eximbank- Japan	508.2	476.8	502.5
KFW	623.5	613.2	722.1
OPIC	2.3	2.0	1.3
PL 480 (USA Govt.)	57.2	50.5	43.7
Other	218.7	255.7	468.8
Other Financing Sources (suppliers' and buyers' credits)	5,893.6	5,982.8	7,512.7
Provided by:			
Foreign Commercial Banks	3,995.0	3,703.9	4,094.6
Brazilian Banks	174.0	157.7	142.2
Nonfinancial Inst.	1,724.6	2,121.2	3,275.9
CURRENCY LOANS	44,976.6	52,908.3	59,625.9
Resolution no. 63	13,456.2	16,145.3	15,115.0
From Foreign Commercial Banks	10,795.7	13,267.2	12,431.8
From Brazilian Banks	2,660.5	2,878.1	2,683.2
Law no. 4131	31,520.4	36,763.0	44,510.9
From Foreign Commercial Banks	26,223.0	30,903.1	38,079.1
From Brazilian Banks	3,200.0	3,927.0	4,530.0
From Nonbanks	2,097.4	1,932.9	1,901.8
PROGRAM LOANS (AID)	490.1	469.8	449.3
BONDS	2,895.7	2,609.7	2,226.2
OTHER LOANS	167.9	146.0	128.0
TOTAL MEDIUM AND LONG TERM DEBT	61,410.8	70,197.5	81,319.2

Source: Brazil: Economic Program, Internal and External Adjustment,
Central Bank of Brazil, Volume 3, May 1984, p. 56, Table 38.

Table 9.16 Average Annual Real Growth in Manufacturing Production
in Selected Periods by Category of Use, 1968-1983
(in annual percentages)

Category	1968-74	1975-78	1979-80	1981-83	1968-83
All sectors	12.9	6.7	7.0	-5.5	7.0
Intermediate goods	13.3	8.3	8.3	-4.5	7.8
Capital goods	18.3	6.0	5.8	-16.7	6.3
Durable Consumer Goods	22.5	6.0	9.2	-8.9	10.2
Non-Durable Consumer Goods	8.8	5.1	4.8	-1.9	5.3

Source: Regis Bonelli and Pedro S. Malan, "Industrialization, Economic Growth, and Balance of Payments: Brazil, 1970-1984", in John D. Wirth et al. (eds.), State and Society in Brazil: Continuity and Change (Boulder, Colorado: Westview Press, 1987), p. 17, Table 1.2

steel mills and, particularly, the Tubarão steel mill, the major borrower, within the metalurgy sector, in the Eurocurrency markets.⁸⁸

In the hydroelectric energy sector, 50 percent of the hydraulic turbines were obtained through suppliers' and buyers' credits. In February 1979, for example, a loan of \$612 million to Itaipu was conditioned to the acquisition of the equipment and raw material from Germany and Switzerland, the countries that were financing the project, when Brazilian firms could have provided the equipment.⁸⁹ In the steel sector, in 1976, the World Bank, whose participation represented only 10 percent of the foreign financing, required for the sector as a whole that contracts of purchase be awarded by an international call for tenders which practically eliminated local manufacturers as a result of foreign competition. This was particularly the case with the Cosipa and CSN steel mills, where Japanese and American equipment predominated.⁹⁰ The World Bank also made the following demands on the Brazilian government: (1) that eventual changes of ownership of

shares in steel enterprises would not be made without prior consultation with the Bank, (2) that any alteration of the price of steel would be submitted for evaluation and (3) that a substantial part of the coal necessary for the production of steel would be imported from the U.S.⁹¹

A similar situation occurred with the Tubarão steel mill in May 1976. Out of the estimated \$1.2 billion cost of equipment, only 30 percent was to be produced locally, while the rest, \$800 million, was to be imported, when again Brazilian firms could have provided the equipment perfectly well. The conditions were also laid down by international financial institutions,⁹² but the very nature of the project, a joint venture of the state enterprise Siderbras with the Japanese firm Kawasaki and the Italian firm Finsider, also meant that the supply of capital goods would come from abroad as this is often a condition for the participation of foreign firms. Furthermore, even though the state assumed all the financial risks in this joint venture, the foreign partners obtained a veto power on the decisions of the Board of Directors.⁹³ Similarly, in the famous nuclear agreement with Germany, the bulk of the equipment for the project was imported as the Germans were the major creditors of the state holding Nuclebras and as the Brazilian government gave them vast controlling powers.⁹⁴

The industrialists in the national heavy equipment sector began denouncing the Tubarão and the other deals of the government with foreign financial and industrial interests in speeches, interviews, seminars and business journals and soon joined forces with those associated with the campaign against state intervention in the economy promoted by Visão (see discussion above).⁹⁵ Contrary to Evans' assertion that there was "an obvious contradiction in the demands of the local bourgeoisie" in the 1976-77 campaign as "the support of the state is an essential element in their defense against multinationals,"⁹⁶ the demands of the capital goods sector

was by then perfectly consistent with its meager part of the surplus in the "triple alliance". By praising the strong Brazilian state as well as the autonomy of state enterprises in advancing the goals of local capital, Evans was apparently neglecting the evident constraints on state autonomy imposed by the country's massive foreign debt and the inability of the government to look after the interests of the bourgeoisie. As soon as it became clear to the national manufacturers of heavy machinery that the government was unable to implement the PND II, the sector formed the nucleus of entrepreneurial opposition first to economic policy and then to the regime itself.⁹⁷

"What was taking place between 1976 and 1978, particularly in 1977", Bresser Pereira argues, "was the collapse of the alliance between the industrial bourgeoisie and the military technobureaucracy."⁹⁸ In fact, if 1976 marks the beginning of the bourgeoisie's open opposition to the government's economic policies, 1977 marks the beginning of that class' direct opposition to authoritarianism with public statements by business leaders demanding democracy and participation in the decision making process.⁹⁹

Claudio Bardella, an important representative of the capital goods sector and elected as leader of the private sector in the Forum of Gazeta Mercantil in 1977, declared: "We, the business community, like all other sectors of society, each according to its ability, have and wish to participate in the decision making process and so we have and wish to participate in the definition of the course that the country is to take."¹⁰⁰ Furthermore, Severo Gomes, the Minister of Industry and Commerce declared to Gazeta Mercantil in 1977: "What matters is that society can control the state and not vice versa, as is the case at the moment. And if this is to happen, there is only one way out - political correction. Democracy is the

only solution."¹⁰¹ Gomes was soon removed from his government post and elected in the Forum as a representative of the private industrial sector. Significantly, all the other entrepreneurs elected to the Forum in 1977 were involved in the capital and intermediary goods sectors: Jose Mindlin, Antonio Ermirio de Morais, Paulo Villares, Paulo Velhinho, Laerte Setubal and Jorge Gerdau.

In June 1978 those industrialists issued the "First Document of the entrepreneurs", which became known as the "Manifesto of the Eight."¹⁰² The entrepreneurs called for the active participation of the private national industrial sector in economic policy and for the priority of the government to the national capital goods industry as development should be based on heavy industry. they addressed themselves particularly to the unbalance of the "triple alliance":

We realize that the desired equilibrium among the three principal protagonists of the process of industrialization is far from being attained. National private entrepreneurs suffer from a disquieting fragility, public enterprise has escaped from the control of society and foreign enterprise has no clear or adequate norms of discipline.¹⁰³

Furthermore, the entrepreneurs criticized the financial system, the growing foreign indebtedness of the country, regional imbalances and the social policy of the government in the areas of health, housing, education and basic sanitation; called for a just incomes policy and for freedom of trade unions, and concluded that "There is only one regime that can provide for the full expression of interests and absorb tensions without channeling them into undesirable class conflict - the democratic regime."

But what the industrialists hoped to accomplish at that stage with their protest against the regime was primarily influence over economic policy making in order to advance their interests and not necessarily a change in regime. As Maxfield observes, "The industrialists' goal in opposing

authoritarian government was not regime change but change in the procedures and substance of economic policy making. Support for political opening was a means to that end."¹⁰⁴ And as Cardoso Aptly remarks:

...The interregnum in which "liberal" entrepreneurs appeared to represent themselves as an "autonomous social group" that should fight to obtain political power and control the state in civilian society was shortlived. More recently, in the face of strong and more general pressures for democracy from other sectors of society, industrial leaders began to talk again about a democracy "managed" by the state. The rebirth of the union movement and the outbreak of strikes (above all the metal workers' strikes), beginning in 1978, established the limits of society's generalized good conscience. When flames of wage claims began to singe the direct interests of enterprises, the enchantment of a consensus of liberal attitudes evaporated.¹⁰⁵

While the awakening of the labor movement between 1978 and 1980¹⁰⁶ was certainly an important factor in the bourgeoisie's conservative turn, it is nonetheless true that the new president who replaced Geisel in March 1979 made great efforts to please the business community. General João Baptista Figueiredo's most significant gesture towards the bourgeoisie, particularly the mobilized capital goods sector, was to replace Simonsen with that class' candidate: Delfim Netto, the father of the "miracle". Simonsen, identified with the collapse of the PND II and monetarist orthodoxy that benefited the financial sector at the expense of industrialists, had moved from the Treasury to the Planning Ministry in March and was already initiating a new monetary shock (particularly the reduction of credit to the private sector and cuts in public investments) to deal with the acceleration of inflation and the deterioration of the BOP. But the entrepreneurs put pressure on the new government to name the "less orthodox" Delfim Netto as Planning Minister and forced Simonsen to resign.¹⁰⁷

With politically inspired economic actions which resembled those of populist leaders, Delfim Netto quickly accelerated investments in the state enterprises to please the national capital goods industry (and, of

course, bring foreign exchange into Brazil, thus exacerbating the vulnerability of public firms to the pressure from foreign creditors to purchase heavy equipment abroad), increased credit to the private sector, controlled nominal interest rates and even modified the wage-indexing policy by making semiannual rather than annual adjustments and allowing a larger correction for inflation to compensate for previous losses in real wages (see Table 9.1 above).¹⁰⁸ With those impact measures, the Planning Minister was obviously imagining that he could repeat his success of 1967 as a simple matter of political choice in an attempt to maintain the illusion of the stability of the alliance that supported the military regime and reduce popular dissatisfaction.

But the external environment of the late 1970s was very different from that of the late 1960s, and the growth model adopted then had left the country extremely vulnerable to adverse international trends. Delfim could not, of course, repeat the "miracle". On the contrary, after trying to hide the existence of a deep financial crisis with a short-lived economic expansion (until the end of 1980) and borrowing his way around the drastic increase in international interest rates, thus accelerating the contradictions that his "policy of foreign indebtedness" had generated since the beginning, the Planning Minister was forced to plunge the economy into the worst recession in the history of the country to please foreign creditors with trade surpluses large enough to make interest payments on the foreign debt. With the end of the debt rollover game went also the growth of a decade. And as in the early 1960s, Brazil had again to choke off its own growth to meet the short-term economic gains of international financiers.

The most severely affected industrial sector with the virtual collapse of the Brazilian growth model between 1981 and 1983 was precisely the one Delfim Netto had desperately attempted to court: the capital goods

(as indicated in Table 9.16 above, the industry stagnated during those years at -16.7 as a result of the drastic reduction in the investments of state enterprises). And as during 1976-78, the alienated industrialists were again the first to openly attack the regime and defect to the opposition of the urban middle and working classes. The political alliance that supported authoritarianism had finally broken down, but at a very heavy economic cost to the country and a drastic reduction in the living standards of those who had received few, if any, of the benefits of indebted growth: the working and lower classes.

The crisis of dependent development, 1980-1984

By 1980 Brazil's authoritarian regime was in the same type of situation that preceded the overthrow of the populist civilian government of João Goulart: one of rising inflation, a deteriorating BOP, popular mobilization in defence of sector interests and pressure from foreign creditors for stabilization measures. In effect, the situation created by the technocrats of the military regime was much, much worse than the one they had inherited from the populists, in so far as inflation and foreign indebtedness reached levels beyond the imagination of the latter. By the same token, the drastic orthodox stabilization program the military regime imposed on Brazil between 1981 and 1984 to preserve its international creditworthiness resulted in output losses of a much greater magnitude than the stabilization of the mid 1960s (see chapter 7) and did not succeed, as in the earlier period, in recreating the conditions for new inflows of loans. The difference between the two periods is fundamental however. Whereas in the 1960s it was in the interest of international creditors to support the authoritarian regime's financial restructuring of Brazil with immediate and substantive relief from the crushing foreign debt repayment burden, in the 1980s, by contrast, further exposure to a high risk country

was incompatible with the logic of global profit makers. And it was precisely the withdrawal of international financiers from the developmentalist alliance formed in the mid 1960s by the military regime that precipitated the collapse of its growth model and, eventually, the breakdown of the regime itself. Let's examine more closely this process.¹⁰⁹

The politically inspired expansionist policy of Delfim Netto in 1980 succeeded in a GNP growth of 7.2 percent, as compared to 6.4 percent in 1979, but inflation jumped from 77.2 to 110.2 percent, a record for Brazil (see Table 9.17 below). The current account deficit of the BOP reached \$12.8 billion, half of it caused by the high interest costs of the \$53.8 billion foreign debt (20 percent of the GDP) at the end of 1980 (see Table 9.18 below). The situation was aggravated by the loss of almost \$3 billion of gross foreign reserves between 1979 and 1980, a rise in short-term debt in 1980 which reduced net foreign exchange reserves to only \$3.4 billion at the end of 1980 (see Table 9.19 below) and the suspension by foreign creditors of the automatic rollover of the foreign debt. Late in 1980, in a world tour and meetings with creditor bankers, Delfim was in fact warned that debt relief would not be available without major changes in economic policy, that is, without IMF style stabilization measures to generate trade surpluses.¹¹⁰

As Table 9.18 below shows, the trade account of the BOP registered large deficits in 1979 and 1980. Although in December 1979 the cruzeiro was devalued by 30 percent to promote exports, the maxidevaluation turned out to be completely neutralized by the decision to prefix the rates of exchange devaluation during 1980 in 40 percent and of the monetary correction in 45 percent, whereas inflation increased 110 percent (that is, the benefit of devaluation was fully eroded by inflation). But, as with Simonsen's choice of export subsidies over devaluation of the cruzeiro between

1976 and 1978, the decision to preestablish the indexation of the exchange rate was very much shaped by the constraints of the foreign debt: it was intended less to reduce inflationary expectations than to restore the confidence of private sector debtors by removing their fear of a new maxidevaluation that could make debt servicing more expensive and, simultaneously, to cheapen the cost of foreign credit relative to domestic credit -without raising domestic interest rates - thus encouraging firms to continue to borrow abroad and bring foreign exchange for BOP purposes.¹¹¹ As in 1977, however, domestic interest rates were drastically raised with the freeing of interest rates throughout the financial system in 1981.

In fact, as Bonelli and Malan argue, "The concern of Brazilian policy makers was with external problems, not with inflation...Since at least 1979 it was recognized that the basic limiting factor to the expansion of the Brazilian economy was the BOP crisis, and not the inflationary process."¹¹² But again, it was the foreign debt itself that was determining the most contradictory policies: discouraging the much needed exports to adjust the BOP and making for further reliance on foreign loans. In other words, the expansion of the foreign debt was the very product of the contradictions it generated since the beginning.

The result of trade deficits, combined with the loss of foreign reserves and the rise in short-term debt, was the rapid deterioration of Brazil's international creditworthiness that the technocrats had struggled so hard to preserve with their "policy of foreign indebtedness" since the late 1960s. At the end of 1980, however, they lost their battle and a "voluntary" adjustment plan was presented to foreign creditors as a condition for the traditional debt relief. The government was, in effect, desperately trying to avoid the IMF and until November 1982 the authorities

Table 9.17 Brazil: Inflation and Growth Rates (%), 1979-1984
Real Average Wage and Unemployment Rates (%), 1981-84

Years	Inflation Rate	GDP Real Growth Rates		Real Average Wage	Unemployment Rate*
		Total	Per Capita		
1979	77.2	6.4	3.8		
1980	110.2	7.2	4.6		
1981	95.2	-1.6	-4.0	12.6	8.0
1982	99.7	0.9	-1.5	4.0	6.3
1983	211.0	-3.2	-5.5	-2.2	6.7
1984	223.8	4.4	1.8	-6.0	7.2

* As percentage of the working force.

Source: Carlos Geraldo Langoni, A crise do desenvolvimento, op.cit., p. 21, Tabela 1.4 and p. 140, Tabela 4.5

Table 9.18 Brazil: Balance of Payments and the External Debt, 1979-1984
(in millions of US\$)

Year	Exports (1)	Imports (2)	Trade Balance (3)	Net Services (4)	Profits and Dividends (5)	Interest (6)	Current Account Balance (7)	Medium- & Long- Term Gross Loan Capital Inflows (8)	Amorti- zations (9)	Gross Debt (10)	Reserves (11)
1979	15,244	18,084	- 2,839	- 2,378	-740	- 4,185	-10,742	12,594	=6,541	49,904	9,689
1980	20,132	22,955	- 2,823	- 3,120	-544	- 6,311	-12,807	14,879	-6,705	53,847	6,913
1981	23,293	22,091	1,213	- 2,837	-587	- 9,179	-11,717	18,882	-7,514	61,411	7,507
1982	20,175	19,395	780	- 3,588	-586	-11,353	-14,755	12,515a	-8,215	70,198b	3,994
1983	21,899	15,429	6,470	- 2,307	-758	- 9,555	- 6,142	15,025	-10,239	81,319	4,563
1984	27,005	13,916	13,089	- 1,744	-796	-10,203	0,517	16,932	-7,816	91,091	11,995

a

Includes the rescue operations of the IMF, BIS, US Treasury and bridge loans from commercial banks. For 1983 and 1984 it includes the rescheduling and refinancing operations and a "jumbo" loan of \$6.5 billion in January 1984, another rescue operation.

b

Inclusion of non-registered debt (short-term debt) would increase the total to \$83.2 billion (1982), \$91.6 (1983) and \$102.4 (1984).

Sources: For 1979-1981, same as Tables 8.2 and 9.2 above.

For 1982-1983, Brazil: Economic Program, Internal and External Adjustment, Central Bank of Brazil, Volume 3, May 1984 and Volume 6, February 1985, various Tables.

For 1984, Bonelli and Malan, "Industrialization and Economic Growth: Current Policy, 1984-1986", in State and Society in Brazil, op.cit., p. 51, Table 2.2.

Table 9.19 Brazil: Gross Reserves, Monetary Authorities' Liabilities, and Net Reserves, December 1978 to March 1982
(In millions of US\$)

Period	Gross Reserves of Monetary Authorities	Short-term Liabilities of Monetary Authorities	Net Reserves	Ratio of Net Reserves/ Imports (%)
1978-December	11,894	1,613	10,281	71.1
1979-December	9,688	1,763	7,925	36.1
1980-March	7,951	2,883	5,068	23.1
June	6,574	3,147	3,427	14.9
September	6,488	3,329	3,159	13.1
December	6,913	3,413	3,500	15.4
1981-March	6,477	3,578	2,899	12.9
June	6,149	3,403	2,746	12.3
September	6,345	3,258	3,087	13.8
December	7,509	3,237	4,272	20.1
1982-January	7,284	3,308	3,476	16.5
February	7,080	4,769	2,311	11.7
March	7,082	4,577	2,505	13.0

Source: Paulo Nogueira Batista Jr., Mito e realidade na dívida externa brasileira, op.cit., p. 22, Tabela II.

continued to deny that any approach to the Fund or debt renegotiation was imminent, mindful of the political impact such a move would have on the country's direct elections for state governors that month. In fact, in May 1982 Delfim Netto admitted that the external collapse was inevitable and was quoted in Gazeta Mercantil as saying that "My major problem is to hold on until the November elections."¹¹³

But what the "voluntary" adjustment produced in Brazil between 1981 and mid 1982 was a recession without stabilization and a widespread dissatisfaction with the regime, particularly among the industrial bourgeoisie whose interests were being subordinated to those of foreign financiers. While the country began experiencing the deepest, most prolonged and most comprehensive drop in economic activities in its history (Table 9.16 above

shows the stagnation of national industry between 1981 and 1983 and Table 9.17, according to conservative calculations, indicates the drastic fall of GNP and GNP per capita growth rates, the high rates of unemployment and the squeeze in real wages), the BOP disequilibrium deteriorated even further. Table 9.18 shows that although Brazil's stagnation did produce trade surpluses, which were achieved despite a decline in the value of exports during the world recession and, consequently, at the cost of drastic cuts in imports, the current account deficit after falling slightly to \$11.7 billion in 1981 from \$12.8 billion in 1980, jumped to an unprecedented \$14.7 billion in 1982 (this figure is according to the Central Bank, but some observers have given the amount of \$16.2 billion¹¹⁴) as a result of \$11.3 billion in interest payments alone. Significantly, at the end of March 1982, six months before the Mexican moratorium, the so-called "Black September" that is often mentioned as the sign of an imminent debt crisis in Brazil, the net foreign exchange reserves of the country amounted to only \$2.5 billion, equivalent to no more than 1 month's imports, when the minimum recommended by the IMF is three months, thus leaving the government with no room for maneuver whatsoever with foreign creditors and placing the country in the most extreme vulnerable position vis-a-vis the international financial system (see Table 9.19). As Bresser Pereira observes, "...the recession did not resolve a thing. It only deepened the crisis, clearly showing that the government was paralyzed, unable to formulate a viable economic policy that could lead the country out of crisis."¹¹⁵

I would run the risk of being repetitive if I described the actions of the debt managers between 1981 and mid 1982. Suffice it to say here that they attempted by all possible means to reestablish the automatic rollover of the foreign debt with drastic orthodox policies that completely paralyzed domestic demand and investment to generate trade surpluses and

appease international creditors. The money supply was contracted, domestic credit was restricted (except, of course, the credit lines of Resolution 63, the "repass operations"), interest rates were liberated to attract more foreign loans, benefitting dramatically the domestic private financial sector, investments in the state enterprises and public expenditures in general were cut down and the preestablishment of price and exchange indexation were lifted. The only policy elements that did not comply with an IMF orthodox package were the maintenance of the politically sensitive wage law (until after the November elections, however) and continued subsidies to export sectors.

As Table 9.17 indicates, GNP and GNP per capita growth rates, the indexes of economic development used and abused by developmentalists in the 1970s as proof of the rationality of their growth models and as the basic criterion for the political legitimacy of the authoritarian regime, were negative, and for the first time since the Great Depression! This economic regression, resulting from the contradictions generated precisely by the developmentalist model adopted in Brazil, was, however, from the perspective of orthodox international creditors, proof of technocrat rationality and they quickly renew Brazil's credit.

In what was known as Delfim Netto's "strategy of debt rollover", a frantic borrowing spree took place in 1981 just to service the foreign debt. But the new loans were, of course, not a solution to the structural financial disequilibrium of the country; they were at most a sedative that brought temporary relief to the problem but at a price of making it fundamentally worse. As discussed above, given the domestic recession that was contradicting official stimulus for private sector foreign borrowing (i.e., high domestic interest rates and credit restriction), the government launched the state enterprises in a truly "loan hunt" adventure under both

Law 4131 and Resolution 63 (see Tables 9.15 and 9.8 above) to roll over the debt.¹¹⁶ The government thus disturbed the division of labor established in 1967 under which Resolution 63 was to be used only by private national firms without direct access to foreign loans under Law 4131, further indebting the public firms to unmanageable proportions and making them extremely vulnerable to foreign creditors conditioning the release of currency loans to finance the BOP deficit to the purchase of capital goods abroad. The result was the reactivation of the anti-estatização campaign in 1981-83 orchestrated by the local producers of heavy machinery who now openly attacked the regime's capitulation to foreign creditors, called for a debt moratorium and an immediate end to austerity measures.¹¹⁷

In the short-run, however, the concern of the government was essentially with the BOP and the strategy of debt rollover in 1981 was indeed successful. It resulted in a massive inflow of \$18.8 billion, 94.4 percent of which was used to service the foreign debt (hence the exhaustion of foreign reserves already in March 1982) that continued to grow from \$53.8 billion in 1980 to \$61.4 billion at the end of 1981 (see Table 9.18). But the government, in desperation, also resorted to short-term loans in 1981 and 1982 (see Table 9.19 indicating the short-term liabilities of monetary authorities), aggravating the financial situation of the country and exacerbating the already extreme vulnerability of the economy to a sudden contraction of foreign loans.

That was exactly what happened in September 1982, causing a virtual external strangulation of the economy. Brazil had become a high risk country for overexposed international financiers who had profited enormously from a decade of lending there and they suddenly withdrew from the alliance with the state established in the mid 1960s, thus ending the debt rollover game, essentially refusing to continue financing Brazil's massive interest

payments at a critical time when the world recession had caused a drastic deterioration in the country's terms of trade. An interruption of interest payments was avoided at the end of December 1982 only by the assemblage of an emergency financial assistance package, involving bridge loans and other rescue operations from the IMF, the Bank of International Settlements (BIS), the U.S. Federal Reserve System, U.S. Treasury and major private U.S. banks.¹¹⁸

The show of resolve on the part of foreign financial interests, however, was not aimed at reducing the burden of Brazil's foreign debt, but to enable the country to continue meeting interest payments, thus relieving commercial banks of the obligations, under U.S. banking regulations, of subtracting Brazilian interest more than 90 days in arrears from current profits and later writing off bad loans as capital losses. Furthermore, the rescue operations of 1982 were intended to force the government to submit national economic policy making to the dictates of the IMF, the representative of the international commercial lending institutions, and begin the painful and endless process of debt refinancing and rescheduling with private banks.

Debt rescheduling involves complex negotiations with hundreds of foreign creditors who offer debtor countries complicated packages of new loans, at very high spreads, to pay off interest on old ones and stretch-out maturities of existing loans. But the new loans always fell far below the greater debt service requirements and Brazil soon transformed itself into a net capital exporter to the industrialized world (see Table 9.31 above). Furthermore, while debt rescheduling packages maintain the short-term profitability of the creditors, they increase even further the amount of floating rate debt the country has to pay interest on the following years, perpetuate the vulnerability of the economy to fluctuations in international

financial markets and impose severe constraints on state autonomy as long- and short-term domestic economic management is subject to the vagaries and uncertainties of the international financial system, beyond the control of Brazil's policy-makers.

Table 9.18 shows that Brazil's medium- and long-term foreign debt rose from \$71.1 billion at the end of 1982 to \$81.2 billion (43 percent of GDP) in 1983 and \$91 billion (50 percent of GDP) in 1984 and continued to grow. Debt service absorbed 97 percent of export earnings in 1982, 90 percent in 1983 (including short-term debt, it was 117 percent in 1983) and 70 percent in 1984. In 1983, 80 percent of the foreign debt, that is, \$65 billion, was at floating interest rates and each percentage point rise in LIBOR meant that Brazil owed an extra \$700 million a year to its international creditors.¹¹⁹ The country was, thus, caught in a vicious spiral of indebtedness: it had to borrow more and on harder terms to pay its present debt, which in turn made it more difficult for Brazil to get out of the debt eventually.

But by then, when the full burden of the adjustment process finally fell on Brazil through compulsory IMF stabilization measures designed to generate megasurpluses in the trade balance to pay off foreign creditors, the country had already begun trading off debt service payments for economic growth and transformed itself into a net capital exporter to the industrialized world, a position that it has maintained through the decade of the 1980s, constituting the major obstacle to its development process. These are, in short, precisely the developmental outcomes to be expected resulting from the contradictions of the developmentalist growth model adopted in Brazil, or, in other words, from the "strategy" of dependent development. And the impact of these outcomes on civil society was profound.

The political and economic consequences of the
crisis of dependent development

In 1983, domestic economic policy making became completely subordinated to the constraints imposed by the foreign debt, and the military regime attempted by all possible means to preserve its international credit-worthiness in the hopes that normal inflows of loans would soon reemerge. But the compulsory IMF stabilization measures imposed in that year plunged the economy into a much deeper crisis than that which took place between 1981 and 1982, wiping out the shaky growth of a decade, shattering the authoritarian dream of moving Brazil into the status of developed country and shaking the self-confidence of Brazilians in the future of their country.

GDP and GDP per capita growth rates were negative and this time at -3.2 percent and -5.5 percent, respectively (see Table 9.17), bringing per capita income to the level of the mid 1970s (around \$1500). In social terms, the fall was dramatic given a population growth rate of 2.5 percent a year and an extremely unequal distribution of income. What better evidence could be given of the impact of the economic crisis on Brazilian society other than the fact that in 1983, even the top 1 percent of the population, which in 1977 earned more than the bottom 50 percent, had its income share reduced, thus earning as much as the poorest 50 percent? This unprecedented event in the country since the military coup in 1964 is revealed in Table 9.20 below. But, unfortunately, the worst economic and financial crisis in the history of Brazil was not able to disturb the 1 percent of the population which continued to own 41 percent of the country's land!

But leaving aside the irony, the decision of the government to place its foreign debt obligations ahead of any other consideration had disastrous consequences primarily for those who were forced to pay for the "miracle", the poorest 50 percent of the population who received in 1983 only 13.6

percent of the country's total income. Indeed, what the so-called "temporary liquidity crisis" brought to the fore was a much deeper development crisis in Brazil where 61.2 percent of the work force of 52.4 million in 1984 (total population in 1984 was 131.4 million) lived in a situation of extreme misery and strict poverty, receiving between one half and two times the minimum wage (in November 1984 the monthly minimum wage was Cr\$166.560, equivalent to \$79 at the official exchange rate) in a "model" economy considered by the developmentalist ideologues of the World Bank as the eighth in the capitalist world. The stabilization policies between 1981 and 1984 only served to reinforce this human tragedy in terms of extremely low wages amidst high inflation - 216 percent and 223 percent in 1983 and 1984, respectively - massive unemployment and drastic cuts in public welfare expenditures and subsidies.¹²⁰

According to DIEESE, in 1984 the minimum wage reached the lowest level of the last 33 years, suffering a real decline of 16 percent from 1980 and 1984. In November 1984, the minimum wage was fixed in Cr\$166.560, but if it had maintained the real value of 1940, when it was established by Vargas, it would have been Cr\$209.936, in 1984 cruzeiros. DIEESE observes that the minimum wage reached its highest level in 1959 when it was worth Cr\$446.561 in 1984 prices. Therefore, the data presented by DIEESE shows that the minimum wage declined 50 percent in relation to 1940. Furthermore, DIEESE reports that between February 1984 and February 1985 the Brazilian worker who earned 1 minimum wage spent at least Cr\$127.499 to buy the minimum required food basket in São Carlos (São Paulo state), Cr\$142.119 in Porto Alegre and Cr\$134.101 in São Paulo city and the monthly working hours necessary to eat increased from 190 hours and 59 minutes to 193 hours and 94 minutes.¹²¹

This disturbing living conditions of the majority of Brazilians was aggravated even more by the export drive of the government which openly neglected the production of basic staples for the poor in favor of export crops (i.e., soybeans and oranges) for the international market. But the consequences of all of this perversity came to haunt the armed forces in 1983 when the military had to fail 360 thousand eighteen year old boys, out of 770 thousand, in the physical exam in preparation for compulsory military services. The causes varied from malnutrition and being underweight to congenital deformities of the limbs and spinal column.¹²²

Table 9.21 below shows absolute poverty in Brazil, the result of the application in the country of the "grow first distribute later" neo-classical doctrine. In fact, if there was any income redistribution after the illusive growth of a decade it could only have been from Brazilians to foreigners in the form of interest payments and profit remittance. In the 1980s, Brazil has been sending abroad in the form of interest payments alone the equivalent of 5 percent of its national income and 24 percent of its internal savings, thus crippling investments at home and reducing even more the possibilities for badly needed improvement in living standards.¹²³

But the data on Table 9.21, taken from Brasil 2000, a study commissioned by President Jose Sarney in 1985, represent, in the view of Helio Jaguaribe, the sociologist in charge of the project, very conservative estimates based on personal income, rather than family income. The social picture is thus darker when we look at the situation of the Brazilian family. Thus, from a total of 31.075.602 families researched by the IBGE in its National Household Survey (Pesquisa Nacional por Amostra de Domicilios, PNAD) in 1984, 24.3 percent earn up to 1 minimum wage and 4.0 percent do not have income whatsoever, raising the rate of families in a situation of wretchedness to 28.3 percent. Strict poverty, corresponding to earnings

between 1 and 2 minimum wages, affects 24.3 percent of the total of the families. Therefore, more than half (52.6 percent) of Brazilian families was found to live in a state that varied from a situation of wretchedness (28.3 percent) to extreme poverty (24.3 percent).¹²⁴ This is the sad evidence of an accumulated "social debt" during two decades of the authoritarian developmentalist growth model.

The situation of extreme poverty of a sizable majority of the Brazilian population, which makes the country the worst case in the world of a chasm between rich and poor and between economic and social indicators, leads Jaguaribe to conclude that:

The evidence shows that Brazil is, realistically analyzed, a miserable country, more than poor or destitute. And this is, in large part, due to its extremes of progress and retardation and a perverse growth pattern. The problem of income in Brazil, therefore, does not consist only in a deconcentration at the top, but fundamentally in redeeming the destitute and miserable base of the Brazilian working force, men and women, the rural and urban illiterates whose children die from malnutrition or lack of immunization, while the adults have wretched health conditions as a result of precarious or nonexistent hygienic infrastructure in the urban periphery and in the impoverished rural areas.¹²⁵

Table 9.20 Brazil: Income Distribution, 1977, 1983

	1977 %	1983 %
Top 1%	14.8	13.3
Top 5%	35.1	33.0
Top 10%	48.2	46.2
Bottom 50%	13.8	13.6

Source: Helio Jaguaribe et al., Brasil 2000: para um novo pacto social (Rio de Janeiro: Paz e Terra, 1986), Terceira Edição, p. 63, Quadro 2.12.

Table 9.21 Distribution of the Economically Active Population (EAP) by the Three Lowest Classes as % of the Total EAP: Brazil and Regions, 1984*

	Brazil	North	North-east	South-east	South	Center West
Miserable (up to 1/2 Minimum Wage)	13.4	7.1	25.4	9.5	8.5	9.3
Destitute (1/2 to 1 Minimum Wage)	22.8	17.7	29.8	20.5	19.6	21.1
Strictly Poor (1 to 2 Minimum Wages)	25.0	27.0	23.4	24.4	27.7	29.3
	61.2	41.8	78.6	59.4	55.8	59.7

*EAP - 50.2 million people

- Obs. 1. Excluding rural population of the Northern region.
2. Excluding people "without income".

Source: Same as Table 9.20, p. 64, Quadro 2.13.

Even though the burden of the stabilization program was placed on the working and lower classes, thus accelerating social inequality and poverty and producing widespread popular dissatisfaction with the regime, the urban middle class, one of the major beneficiaries of two decades of authoritarianism, also paid a heavy price with the austerity measures. The middle groups, those earning from 15 to 50 times the minimum wage (about 5 percent of the working population) suffered a decline in real income of between 50 and 76 percent between 1980 and 1984, while those earning 5 times the minimum wage, the bulk of the working class (about 23.5 percent of the working population receive from 2 to 5 times the minimum wage and about 7.2 percent, 5 to 10 times, suffered a decline in income of 24 percent.¹²⁶ The middle class groups, i.e., government employees, doctors, teachers, etc... soon joined workers in strikes and demonstrations against a regime that was openly sacrificing their interests to those of foreigners.

But the industrial bourgeoisie, particularly the national producers of capital goods, was also severely affected by policy decisions absolutely subordinated to the needs of the external adjustment. The necessity for domestic resources to meet debt service payments forced the regime to drastically cut public investment, dealing a crushing blow to the national capital goods industry which depended heavily (80 percent) on the orders of state enterprises. Ironically, Business Latin America, the weekly report of Business International to managers of Latin American operations, warned its TNCs' customers that:

International companies can only read Brazil's 1983 spending plan for state enterprises, banks and social security system with deep concern and apprehension. This time around, the official pruning blade -having already cut away the fat - is slicing into the bone, and not without dire consequences for the already hamstrung Brazilian economy over the next 12 months. Firms dependent on Brazil's mammoth state sector, which accounts for a third of total economic output, will have to prepare for notably reduced orders from that front in the wake of investment curtailments and project cancellations. Foreign suppliers of Brazil's state-owned firms are going to be the most severely hit by the budget cuts.¹²⁷

There is no doubt that foreign corporations, the major suppliers of capital goods to state enterprises and the beneficiaries of the "financial packages" imposed on Brazil by foreign creditors discussed at length above, were "severely hit" by the stabilization measures in Brazil. However, for the national capital goods industry, the cuts in public investment meant disaster. As Table 9.16 above shows, between 1981 and 1983, national production of capital goods fell 16.7 percent, the sector most heavily affected by the crisis. In 1983 alone it fell 20 percent (in 1984 production levels were at less than half of those for 1978 and in 1985 idle capacity was above 50 percent), leading Brazilian economist Celso Furtado to denounce the deindustrialization of the country promoted by the IMF and foreign commercial creditors.¹²⁸

But as to the state enterprises themselves, those involved in infra-

structure and export-oriented basic input industries, forced to over-borrow in the 1970s, the rollover of their foreign debt swallowed everything that was still directed towards their investments. Thus, the contradiction: the projects of the public firms could not be completed as a result of massive interest payments on past loans raised to finance the projects. This was the case with most metalurgic industries and electric and nuclear energy power plants, whose projects were postponed or cancelled.¹²⁹

In the meantime, as industry stagnated, the domestic financial sector continued to reap high profits in the same way it did in the mid 1970s, with domestic interest rates as high as 40 percent in real terms. Furthermore, another 30 percent maxidevaluation in February 1983, a last ditch effort to convince foreign creditors that the government was doing all within its power to assure a sizable trade surplus in that year, drove companies with foreign debt obligations to the wall since more cruzeiros were required to repay the same amount of dollar debt. A massive wave of business collapses and bankruptcies among small and medium sized private firms followed suit (456 bankruptcies and receiverships in 1983, 263 in 1982 and 193 in 1981), although large companies such as the powerful Matarazzo Group also called in the receivers.¹³⁰ In fact, the situation of private Brazilian firms during the stabilization of the early 1980s was worse than the one prevailing in the mid 1960s: neither foreign nor domestic credit, but with a foreign debt, forced on them by the government's "policy of foreign indebtedness", impossible to pay. However, the ultimate loser was the state which was forced by foreign creditors to assume responsibility for all private sector debt, including TNCs', thus exacerbating even more the financial burden of state enterprises and undermining the autonomy of the Brazilian state.

The stagnation of the domestic market and of national industry, and the sharp drop of investment - gross capital formation fell from 21½ of GDP during 1980-82 to 16½ of GDP during 1983-85-¹³¹ produced excellent results in the external front. In 1983, the trade surplus reached \$6.4 billion and in 1984, \$13 billion, achieved at the expense of drastic cuts in imports, as Table 9.18, column 2, shows. The current account deficit fell from \$14.7 billion in 1982 to \$6.1 billion in 1983 and \$0.5 million in 1984, financed basically not with new loans but with the megasurpluses in the trade balance. Finally, gross reserves rose from \$4.5 billion in 1983 to \$11.9 billion in 1984, allowing the new civilian government (see discussion below) some short-term maneuverability in negotiations with foreign creditors. But although in the second half of 1984 the economy began to experience what proved to be just a temporary recovery, supported basically by the export sector and hence extremely vulnerable to the vagaries and uncertainties of external markets and economies of industrialized countries, Brazil's fundamental long-term problem has remained unchanged: massive net transfer of resources to foreign creditors in the form of interest payments.

Yet although the Figueiredo government had clearly subordinated national development to the interest of global profit makers, the IMF and commercial bank creditors continuously harrassed Brazil for not complying strictly with "Letters of Intent" to the Fund (eight letters between 1983 and early 1985). The creditors suspended and released installments of "standby" and "jumbo" rescue loans at will in order to keep Brazil on a short leash and force it to "restructure" the economy according to neo-classical textbooks, and even refused to extend a multiyear rescheduling package of principal payments at the end of 1984.¹³² If the stabilization program of the military regime appeared to be "soft" to foreign creditors,

this was not the case with the domestic political base of the regime, the industrial bourgeoisie.

The collapse of the authoritarian alliance

The same leading industrialists in the capital goods sector that had openly criticized the Geisel government between 1976 and 1978, started again, and more so than in the previous years. Antonio Ermirio de Moraes, Claudio Bradella and Paulo Villares began attacking the government for having sacrificed the capital goods industry to achieve BOP stability and please foreign creditors and for having encouraged national firms to expand production in the 1970s and then leaving them with large debts and without a market, at the mercy of foreign firms and financial conglomerates. They considered the February maxidevaluation "a betrayal of the Brazilian business community that was forced to borrow abroad."¹³³

In July 1983, those three industrialists were joined by the other five who had issued the famous "Manifesto of the Eight" in 1978 (see discussion above) and released another position paper calling for a radical renegotiation of the foreign debt and an end to the government's austerity measures. They stated that the nation's foundering economy and worn social fabric could not withstand the severe belt tightening that had been ordained by the IMF as a *qui pro quo* for financial bailout. They concluded that the shock treatment spelled doom for Brazilian private industry and called for an immediate renegotiation of debt repayments at less onerous rates.¹³⁴

The widespread dissatisfaction of the industrialists with the regime was first expressed in the direct elections of November 1982 for state governors, a third of the Senate, the entire Chamber of Deputies and all state legislatures. The industrial bourgeoisie, one of the most important pillars of the authoritarian alliance, sided openly with the PMDB

opposition which own easily the governorships of nine states, including the most important states of Brazil: São Paulo, Minas Gerais and Rio de Janeiro, although the government party, PDS, was able to maintain a majority in the congress (considering the two houses together) and in the electoral college that would choose the next president in January 1985.¹³⁵

But throughout 1984, in the nationwide campaign for "direct elections now", and early 1983, the role of the industrialists in the anti-government coalition of working and middle classes was crucial in dislodging the regime's civilian candidate in the indirect presidential elections, despite all attempts to manipulate the electoral system. President Figueiredo, whose ability to govern effectively had been severely undermined by the economic crisis, was not able to heal the rift in his cabinet, completely divided over economic policy, and in his own PDS party, losing even his vice-president, who formed with other dissidents, the Liberal Front Party. The newly established party then quickly allied itself with the PMDB under the banner of the Democratic Alliance to elect the compromise opposition president, Tancredo Neves. The "New Republic" was thus born out of a debt crisis that brought the collapse of the Brazilian "growth model" and of a regime whose alternatives were drastically reduced after the defection of its most important partner in the 20 year old authoritarian developmentalist alliance: international financiers.

But president elect Tancredo Neves, backed by the industrial bourgeoisie and the overwhelming majority of the Brazilian population, did not live long enough to take office. His running mate and successor, Jose Sarney, a long time UDN and PSD stalwart who was chosen to be in the Alliance's ticket in a deal to ensure a "smooth" transition to civilian rule, quickly frustrated the industrialists with his indecisions over economic policy and debt renegotiations, and the majority of Brazilians whose raised expectations

of better living standards he was not able to fulfil. The "New Republic" thus continues the same "Old Republic", beset with rampant social inequality and a foreign debt burden that constitutes a concrete restriction to the continuity of the country's development process and a threat to its difficult transition to democracy.

In summary, the empirical evidence presented in chapter 9 supports once more the major propositions of the dependency approach regarding the developmental outcomes resulting from concrete situations of dependency. Brazil's "strategy" of dependent development based on extreme reliance on foreign loans under the military regime, and more so than under the populist regime it overthrew, drastically restricted the autonomy of the state over the national economic system and over crucial policy decisions for local development since they conflicted with the global priorities of international financial capital. Furthermore, dependent development exacerbated to the utmost the vulnerability of the economy to external shocks, reinforced and accentuated social inequality and poverty, choked off the shaky growth of a decade to meet the short-term gains of foreign creditors and even transformed the country from a net importer of capital into a consistent net exporter to the developed world, an unprecedented event in the historical relationship of dependency between international finance and Brazilian political forces since the early nineteenth century! In short, the fundamental contradictions between international financial capital and national interests were never so obvious. But if the political and economic contradictions of dependent development were indeed the ultimate determinant of the breakdown of the authoritarian regime, thus dialectically increasing the chances for a more democratic political system, it does not follow that a change of regime represents a change of the role of the state. Although events are

still unfolding, there is ample evidence to suggest that the crisis of dependent development in the 1980s, unlike the crisis of classic dependence in the 1930s, has not been able to undermine the strong foundations of the concrete situation of dependency under which the dependent capitalist state continues to dominate Brazil.

NOTES

1. Political liberalization as a strategy for the institutionalization of the military regime - and not for its withdrawal from power - through the recovery of military prestige and support/legitimacy for the regime, which had been seriously undermined by the excesses of arbitrary action of the repressive policy and military apparatus during Medici, is discussed by Luciano Martins, "The 'Liberalization' of Authoritarian Rule in Brazil", in Guillermo O'Donnell, Philippe C. Schmitter and Lawrence Whitehead (eds.), Transitions from Authoritarian Rule, Latin America (Baltimore: The John Hopkins University Press, 1986), pp. 72-94; Bolivar Lamounier and Alkimar R. Moura, "Economic Policy and Political Opening in Brazil", in Jonathan Hartlyn and Samuel A. Morley (eds.), Latin American Political Economy (Boulder, Colorado: Westview Press, 1986), pp. 165-196 and Robert R. Kaufman, "Liberalization and Democracy in South America: Perspectives from the 1970s", in O'Donnell et al. (eds.), Transitions from Authoritarian Rule, Comparative Perspectives (Baltimore: The John Hopkins University Press, 1986), pp. 85-107. The political strategy of liberalization was openly defended by, among others, Roberto Campos in "Como administrar a transição", in Folha de São Paulo, 21 January 1979.

It is noteworthy, as already mentioned in chapter 8, that Samuel Huntington was a consultant to the Geisel Government. The political scientist held intensive talks in February 1974 with General Golbery do Couto e Silva, the head of the Civilian Presidential Staff and the man who actually set in motion the strategy of liberalization. Huntington argued for a gradual and highly controlled liberalization process to guarantee stability and order with a view to institutionalize the Brazilian military regime along the lines of the Mexico's PRI. See Skidmore, The Politics of Military Rule in Brazil, 1964-1985 (New York: Oxford University Press, 1988), pp. 167, 170. Whether Geisel and Golbery followed Huntington's advice of merely attempting to institutionalize the regime or their strategy consisted of something more liberalizing than that, the fact is that they had no intention whatsoever of allowing advances of the opposition. Thus, after the November 1974 MDB victory in legislative elections, the government simply resorted to electoral manipulations to ensure that its party, ARENA, maintained majority in the congress and in the federal senate. In the 1976 municipal elections, the so-called Falcão Law drastically restricted the opposition's access to television, and in 1977, with an eye to the 1978 gubernatorial elections which the constitution stipulated were to be direct, Geisel closed congress down and enacted major amendments to the 1969 constitution in the so-called "Pacote de Abril" (April Package), aimed at making ARENA unbeatable in future elections: all state governors and a third of the federal senators were selected indirectly in 1978 by state electoral colleges. Finally, the AI 5 (Institutional Act 5) which gave the president dictatorial powers to suspend civil rights, censor the press and close down congress was used and abused by Geisel until December 1978, when it was annulled in exchange for the election of General João Batista Figueiredo by the electoral college, thus guaranteeing six more years of military rule.

2. The emphasis of this analysis is therefore more on the connection between the nationalist growth pattern of the Geisel years, that is, the ISI program in capital and intermediate goods, and the introduction of some

measure of political opening than on the obvious relation between the maintenance of ordinary economic expansion at any price and abertura. The latter connection is clearly made by, among others, Werner Baer. The economist argues that:

...The gradual political reopening in the 1974-83 period helps explain the government's willingness to increase the country's foreign indebtedness and to tolerate the resurgence of inflation in order to maintain a rate of growth high enough to minimize the impact of the increasingly liberated and focal interest groups.

See Baer, "Political Determinants of Development", in Robert Wesson (ed.), Politics, Policies and Economic Development in Latin America (Stanford: Stanford University, 1984), p. 72.

The relationship between nationalism and liberalization is explicitly made by the Brazilian journalists Andre Gustavo Stumpf and Merval Pereira Filho, A segunda guerra: sucessão de Geisel (São Paulo: Editora Brasiliense, 1979), p. 58 and to a certain degree by Philippe Faucher, "The Paradise that Never Was: the Breakdown of the Brazilian Authoritarian Order", in Thomas C. Bruneau and Philippe Faucher (eds.), Authoritarian Capitalism: Brazil's Contemporary Economic and Political Development (Boulder, Colorado: Westview Press, 1981), pp. 11-39.

3. See Skidmore, The Politics of Military Rule, pp. 164-65.

4. John R. Wells, "Brazil and Post-1973 Crisis in the International Economy", in Rosemary Thorp and Lawrence Whitehead, Inflation and Stabilization in Latin America (London: Macmillan, 1979), p. 260.

5. A thorough analysis of Geisel's nationalist policy is contained in a confidential Briefing Memorandum, Business International Executive Services (New York: Business International, 1980). On the PND II see Davidoff Cruz, Divida externa e politica economica: a experiencia brasileira nos anos setenta (São Paulo: Editora Brasiliense, 1984); Faucher, "The Paradise that Never Was", Mendonça, Estado e economia no Brasil (Rio de Janeiro: Graal, 1986) and Fernando Henrique Cardoso, "Entrepreneurs and the Transition Process: The Brazilian Case", in Transitions from Authoritarian Rule, Comparative Perspectives, pp. 137-153.

6. IBRASA (Investimentos Brasileiros) is an investment company wholly owned by the BNDE and designed to supply local firms with additional capital needed to purchase equipment or to acquire technology. EMBRAMEC (Empresa Mecanica Brasileira) is a holding company to take minority equity position in local firms making capital goods. FIBASA (Financiamentos de Insumos Basicos) is a BNDE subsidiary that makes minority investment in Brazilian companies producing basic industrial materials, e.g., non-ferrous metals and fertilizers. There was another BNDE administered agency, FINAME, the Special Agency for Industrial Financing which provided credit lines to state enterprises in order to finance their acquisition of capital goods produced locally.

7. Business International Executive Services, pp. 22-23.

8. Quoted in Stumpf and Pereira Filho, A segunda guerra, p. 55.
9. Ibid., p. 56.
10. Ibid.
11. A discussion of the issue of foreign loans sustaining authoritarian regimes in Latin America in the 1970s is Paul W. Drake, "Debt and Democracy in Latin America, 1920 1980s", in Barbara Stallings and Robert Kaufman (eds.), Debt and Democracy in Latin America (Boulder, Colorado: Westview Press, 1989), pp. 39-58.
12. See Cardoso, "Entrepreneurs and the Transition Process", pp. 143-33, 148; Faucher, "The Paradise that Never Was", pp. 22-24 and Bresser Pereira, Development and Crisis in Brazil, pp. 196-97.
13. Estado e economia no Brasil, p. 88.
14. While the victory of the MDB indicated the growing public dissatisfaction with arbitrary power and the restrictions of democratic freedoms, it can not be said that the social bases of the regime were undermined by the results of the elections. On the electoral level, the government could manipulate future elections, as it did, to guarantee ARENA victory, but on the social level, the stability of the regime depended upon the stability of the alliance between the military technobureaucracy and the bourgeoisie. The nationalist PND II split the bourgeoisie into factions, seriously eroding the alliance, but it was only when the government could not achieve the goals of the Plan that the alliance collapsed.
15. The campaign against statism began with the 1974 choice of Eugenio Gudin as "man of the year" by Visão. See, for example, Visão of May 26, 1975 for attacks of the technocrats on the government's PND II. It should be noted that it is not at all clear whether there was a connection between the opposition to economic policy and to the regime itself in the early phase of the campaign (1974-75). This connection began to be explicit only after 1976 and it was the industrialists involved in the manufacturing of capital goods who called for regime change (see discussion below). Gazeta Mercantil, the major financial newspaper in Brazil, became the voice of this faction of the bourgeoisie through its "Forum", that is, debates on the political, social and economic situation of the country.
16. "Brazil and the Post-1973 Crisis in the International Economy", p. 246.
17. See Anglade, "The State and Capital Accumulation in Contemporary Brazil", p. 96; Cardoso, "Entrepreneurs and the Transition Process", p. 142 and Mendonca, Estado e economia, p. 89.
18. Faucher, "The Paradise that Never Was", p. 21.
19. Development and Crisis in Brasil, p. 197.
20. Quoted in Lamounier and Moura, "Economic Policy and Political Opening in Brazil", p. 194.

21. See Lamounier and Moura, "Economic Policy and Political Opening in Brazil", p. 185. See also Faucher, "The Paradise that Never Was", p. 20. On "bureaucratic rings" see Cardoso, Autoritarismo e democratização (Rio de Janeiro: Paz e Terra, 1975), pp. 201-9.
22. "Entrepreneurs and the Transition Process", p. 143.
23. Faucher, "The Paradise that Never Was", p. 21.
24. Davidoff Cruz, Divida externa, p. 41.
25. Bresser Pereira, Development and Crisis in Brazil", p. 173. Regis Bonelli and Pedro S. Malan give even lower figures: 95 in 1973, 78 and 76 in 1974 and 1975 respectively. See Bonelli and Malan, "Industrialization, Economic Growth and Balance of Payments: Brazil, 1970-1984", in John D. Wirth, Edson de Oliveria Nunes and Thomas E. Bogenschield (eds.), State and Society in Brazil: Continuity and Change (Boulder, Colorado: Westview Press, 1987), p. 28.
26. OPEC placements fluctuated significantly in the 1970s. Placements in eurocurrency bank deposits in 1975 were only \$8.7 billion as compared to \$22 billion in 1974 and \$11.2 and \$16.4 billion in 1976 and 1977 respectively. Apart from bank deposits. OPEC members favored placements in Treasury securities, other bonds and stocks in the U.S. Outside the U.S. and the eurocurrency markets, OPEC members purchased equity and property and provided increased private credits and ODA (Official Development Assistance) to developing countries. Following the Second Oil Shock, however, placements in bank deposits rose in 1979 to \$33.4 billion and in 1980 to \$43 billion. See World Development Report (Washington, DC: World Bank, 1985), p. 89.
27. Quoted in Stumpf and Pereira Filho, A segunda guerra, p. 57.
28. Mario Henrique Simonsen, "Aspectos atuais do desenvolvimento brasileiro", speech to the Senate Economic Commission in April 1976, as cited in Davidoff Cruz, Divida externa, p. 48.
29. Simonsen, Brasil 2001 (Rio: Apec, 1969), p. 290.
30. See Evans and Gereffi, "Foreign Investment and Dependent Development", pp. 146-153 and Anglade, "The State and Capital Accumulation in Contemporary Brazil", pp. 75, 92-95.
31. This interpretation is also found in Serra, "Three Mistaken Theses regarding the Connection between Industrialization and Authoritarian Regimes", in David Collier (ed.), The New Authoritarianism in Latin America (Princeton: Princeton University Press, 1979), pp. 161-2 and Baer, "Political Determinants of Development", p. 66. Some analyses of Latin America stress the overvalued exchange rates of the 1970s as a major factor for the region's debt problem of the 1980s. In this view, the policy of overvalued exchange rates was pursued to limit or bring down inflation without recession and resulted in the loss of competitiveness of exports, leading to large trade deficits and, of course, capital flight. But the major cause of the crisis of the 1980s and which this study has been attempting to demonstrate, is precisely the model of growth adopted in most countries of Latin America, a

model based on extreme reliance on foreign loans and the contradictions it engendered. Thus, it was the burden of the foreign debt service itself that shaped policy decisions in Brazil, Argentina, Chile, Mexico and Venezuela. It forced them to maintain overvalued exchange rates to protect the indebted private and public sectors, which, in turn, led them deeper into debt as a result of the decline in export earnings. Contradictions of this nature are hardly mentioned in some works. See, for example, Rudiger Dornbursch, "The Latin American Debt Problem: Anatomy and Solution", in Stallings and Kaufman, Debt and Democracy in Latin America, pp. 7-22. A good analysis of the role of foreign indebtedness in shaping economic policies in Latin America is Albert O. Hirschman, "The Political Economy of Latin American Development: Seven Exercises in Retrospection", in Latin American Research Review, Vol. XXII, No. 3, 1987, pp. 7-36. Hirschman points out that

Comparing the Mexican story with those of Argentina and Chile raises some intriguing questions. In all three cases, the readiness of the international banks to finance BOP deficits facilitated the surprisingly similar policies that were pursued. These policies consisted in maintaining overvalued exchange rates that boosted imports, penalized exports, and led to speculative capital outflows... In this sense, therefore, the Chilean and Argentinian policymakers, were rather less autonomous than they and their critics had believed. Rather than being sovereign shapers of their own misfortunes, they should probably be viewed as having fallen pitifully into a trap set for them by the international financial system (pp. 16-17, 18).

32. "Brazil and the Post-1973 Crisis in the International Economy", p. 247.

33. See Carlos Geraldo Langoni, A crise do desenvolvimento: uma estrategia para o futuro (Rio: Jose Olympio Editora, 1985), p. 9.

34. "The State and Capital Accumulation", pp. 95-6.

35. A thorough analysis of the conflicts between the two ministers is found in Stumpf and Pereira Filho, A segunda guerra: sucessão de Geisel. Their work includes a very interesting document prepared by Simonsen and presented to Geisel in September 1975 in defense of foreign capital in Brazil. See "Notas sobre o problema dos capitais estrangeiros no Brasil", pp. 63-76.

36. See Stumpf and Pereira Filho, A segunda guerra, pp. 49-63. For a discussion of oil policy in Brazil, see Kenneth P. Erickson, "State Entrepreneurship, Energy Policy and the Political Order in Brazil", in Thomas C. Bruneau and Philippe Faucher, Authoritarian Capitalism: Brazil's Contemporary Economic and Political Development (Boulder, Colorado: Westview Press, 1981), pp. 145-149. Erickson argues that although the first risk contracts did not necessarily erode the power of Petrobras, the expansion of multinationals in this strategic sector could have far reaching political implications for the state monopoly. It should be noted, however, that the 1988 constitution put an end to the risk contracts and the search and extraction of oil and gas returned to the state monopoly, but the constitution will honor the existing contracts with foreign companies,

including Texaco and Pecten. The latter was the only one, among 32 foreign and 11 private Brazilian companies to come up with a commercial strike, indicating that the controversial decision in 1975 was more a serious one politically, than economically.

37. Quarterly Review, 1975, No. 4 as cited in Evans, Dependent Development, p. 271.

38. In Stumpf and Pereira Filho, A segunda guerra, pp. 62-63.

39. Ibid.

40. A good analysis of neo-classical orthodoxy and its controversial prescription of foreign loans to temporarily solve BOP problems is Marcelo Diamand, "Overcoming Argentina's Stop-and-go Cycles", in Hartlyn and Morley, Latin American Political Economy: Financial Crisis and Political Change, pp. 129-164. Diamand neatly shows in the case of Argentina precisely what we have been attempting to demonstrate in Brazil: a vicious circle of BOP crisis, stabilization, further reliance on foreign loans to temporarily solve BOP problems until a new crisis in the BOP develops and it is more serious than the one the increase foreign borrowing originally attempted to avoid.

41. There is a misconception regarding Brazil's BOP deficits in the 1970s. It is often asserted that current account deficits in the country (and elsewhere in the developing world) result from residents "living beyond their means", that is, spending more than they earn or investing more than they save. This view is, of course, identified with the IMF. The causes of current account deficits and the consequent need to borrow abroad to finance the deficits, however, are not exhausted by higher investment, private consumption or even government deficits. As we have been showing throughout this study, BOP deficits in Brazil have been, for the most part, generated by the service account, by the service of foreign capital, both loans and foreign investment that ironically, are invited in to finance BOP deficits. This was particularly the case in the 1970s and has been in the 1980s. For a discussion of this issue see Persio Arida e Andre Lara Resende, "Recessao e juros: o Brasil nos primordios da decada de 1980", in Revista de Economia Politica, Vol.5, No. 1, Janeiro-Marco 1985, pp. 5-20.

42. See "The Brazilian Borrowing Experience: From Miracle to Debacle and Back", in Latin American Research Review, Vol. XXII, No. 1, 1987, p. 116. The major weakness of Frieden's work, supposedly intended to show the dynamics of Brazil's foreign debt build-up in the 1970s, is the absence of a single, basic information on the BOP. This allows him to argue that "the overwhelming majority of the borrowing went, directly or indirectly, to boost production of basic industrial products" (p. 96). The bulk of the credit, however, was used not to "boost production", but to meet BOP deficits which were themselves mostly caused by that credit. Any report of the Central Bank of Brazil shows that.

43. Faucher, "The Paradise that Never Was", p. 22.

44. February 1983, p. 3.

45. Debt Shock, The Full Story of the World Credit Crisis (Garden City, N.Y.: Doubleday and company, Inc., 1984), pp. 36-37.

46. For this analysis I rely on Davidoff Cruz, Divida externa; Balanço Anual of Gazeta Mercantil (September 1978) and Paulo Nogueira Batista Jr., Mito e realidade na divida externa brasileira. It should be noted that many of the features of Brazil's economic policy-making and, of course, the outcome of the policies, in the second half of the 1970s, could also be seen, in different degrees, in other Latin American countries, such as Argentina, Mexico and laissez-faire Chile, countries that chose a similar growth strategy of reliance on foreign loans. See, for example, Sylvia Maxfield, "National Business, Debt-led Growth and Political Transition in Latin America", in Stallings and Kaufman (eds.), Debt and Democracy in Latin America, pp. 75-90.

47. Divida externa, p. 58.

48. Paulo Nogueira Batista Jr., Mito e realidade na divida externa brasileira, p. 200.

49. Ibid.

50. Cited in The Economist, April 25, 1987, p. 20. A good example of equipment bought and not used was the case with the turbines at Xingo, the São Francisco hydroelectric project.

51. Interview in Veja, 19 November 1983, p. 121.

52. See Werner Baer, R. Newfarmer and T. Trebat., "On State Capitalism in Brazil: Some New Issues and Question", Inter-American Economic Affairs, Vol. 30, No. 3, 1976, pp. 69-91. For a critical presentation of the arguments on state capitalism in Brazil see Jonathan Fox, "Has Brazil Moved Toward State Capitalism?", in Latin American Perspectives 24, Winter 1984, pp. 64-86.

53. See Davidoff Cruz, Divida externa, pp. 120-21.

54. Ibid., p. 146.

55. "Austeridade, autotelia e autonomia", in Persio Arida (ed.), Divida externa, recessão e ajuste estrutural: o Brasil diante da crise (Rio: Paz e Terra, 1983), Third Edition, p. p. 193.

56. "Industrialization, Economic Growth, and Balance of Payments: Brazil, 1970-1984", p. 23.

57. Bresser Pereira, Development and Crisis in Brazil, p. 173. Bonelli and Malan's calculations are (1977=100) 86 in 1978, 65 in 1980, 55 in 1981 and 53 in 1983. See "Industrialization, Economic Growth, and Balance of Payments: Brazil, 1970-1983", p. 28.

58. Wells, "Brazil and the post-1973 Crisis", pp. 252-258 and Anglade, "The State and Capital Accumulation in Contemporary Brazil", pp. 75-81.

59. "Political Determinants of Development", pp. 65-66.
60. Mario Henrique Simonsen, "Politica monetaria, reservas cambiais e exportação: desempenho economico 1976 e diretrizes para 1977", cited in Davidoff Cruz, Divida externa, p. 56.
61. Simonsen, "Balanço de pagamentos e inflação", lecture at the Escola Superior de Guerra, cited in Davidoff Cruz, Divida externa, p. 57.
62. For the years 1975-78, Gazeta Mercantil, Balanço Anual, September 1978, p. 32. For 1979, Anglade, "State and Capital Accumulation", p. 92.
63. Anglade, Ibid.
64. p. 30. A thorough analysis of what became known in Brazil as "ciranda financeira" (financial ring around the rosy) is found in L. Coutinho, "politica economica: 1974-80", in Revista de Economia Politica, 1 (1), 1981.
65. "State and Capital Accumulation", p. 70.
66. Balanço Anual, September 1978, p. 28.
67. On the privatization of BOP financing in the 1970s see Charles Lipson, "The International Organization of Third World Debt", in International Organization, Vol. 35, 4, Autumn 1981, pp. 603-631 and Benjamin J. Cohen, "BOP Financing: Evolution of a Regime", International Organization, Vol. 36, no. 2, Spring 1982, pp. 457-478. An analysis of the anarchic nature of the international financial system, that is, the absence of central control over lending by commercial banks for BOP purposes is David Williams, "Opportunities and Constraints in International Lending", in Finance and Development, March 1983, pp. 24-27.
68. World Development Report 1985, p. 110.
69. Ibid., p. 114.
70. Bonelli and Malan, "Industrialization, Economic Growth and BOP", p. 23.
71. Debt Shock, p. 44.
72. It should be noted that the spread above LIBOR or prime rate reflected the specific conditions of a debtor country and the estimated risk for operations there. By offering to pay high spreads Brazil, already highly indebted by the mid 1970s, was attempting to minimize the risk to its creditors and thus guarantee uninterrupted inflows of loans.
73. Interview in Tendencia, p. 11.
74. But as Brazilian economist Paulo Nogueira Batista Jr. (the source of Table 9.11), explains, the nominal spreads were based on official reports which underestimated the very high spreads that Brazil was being forced to

offer to guarantee the inflow of foreign loans in 1981. As he points out: "Through specific clauses in loan contracts, Brazil has been forced to pay rates that exceed considerably the nominal spread indicated in this study." See Mito e realidade na divida externa brasileira, p. 118.

75. Ibid., p. 124. In a thorough analysis of the costs of Brazil's foreign debt, Paulo Nogueira Batista shows that most foreign loans with contracts stipulating the prime rate as the basic interest rate were those of state enterprises, particularly the energy sector (loans to Eletrobras and Itaipu) and the metalurgical sector (loans to the steel industry Siderbras). See Mito e realidade na divida externa, pp. 117-124.

76. "A New Peg for Eurolending", p. 73.

77. James Burtle and Jordan M. Young, "Brazil on the Brink", The Bankers Magazine (Boston), Vol. 166, No. 4, July-August 1983, p. 21.

78. In Alan Robinson, "Can Brazil Make it?", Euromoney, November 1982, p. 11.

79. Langoni, A crise do desenvolvimento, p. 50, Table 2.2

80. Norman Gail, "Games Bankers Play", Forbes, December 5, 1983, p. 184.

81. Eul-Soo Pang, "Debt, Adjustment and Democratic Cacophony in Brazil", in Stallings and Kaufman, Debt and Democracy in Latin America, p. 128. See also Sarah Bartlett, "A Vicious Circle Keeps Latin America in Debt", The New York Times, January 15, 1989, p. 85.

82. World Bank, Institute of International Finance and J. P. Morgan, as cited by The New York Times of January 25, 1989, p. E5. According to Folha de São Paulo, Brazil received around \$3.9 billion in new loans in 1988 and paid around \$15.4 billion in interest and amortization, thus transferring abroad \$11.5 billion, around 3.5 percent of GDP (GDP in 1988= \$320 billion). See Folha de São Paulo, March 19, 1989, p. 6 of Economic Report.

83. David Williams, "Opportunities and Constraints in International Lending", p. 25.

84. Debt Shock, p. 44.

85. Import financing is extended by official sources, such as international agencies (World Bank and the Inter-American Development Bank, IADB) and government agencies (Japan Eximbank, US Eximbank and AID, for example), and also by private sources such as suppliers' and buyers' credits. Suppliers' credits, as we know from chapter 6, are private trade credits extended by the exporting company, with the guarantee of their governments, to the foreign buyer. Buyer credits are private trade credits extended directly by commercial banks in the exporting country on behalf of the exporters. Table 9.14 shows the predominance of the latter in Brazil's import financing.

86. See, for example, Conjuntura Economica, Vol. 36, No. 11, Novembro de 1982, p. 58.

87. Wells, "Brazil in the Post 1973 Crisis in the International Economy", p. 245.

88. See, for example, Visão, "A face oculta da estatizacão", 48 (13), 1976, pp. 73-86 and O Estado de São Paulo of 12 August 1978 and 29 September 1978. See also Faucher, "The Paradise that Never Was", pp. 22-25; Davidoff Cruz, Divida externa, pp. 161-165; Cardoso, "Entrepreneurs and the Transition Process", p. 144 and Persio Arida, "Austeridade, autotelia e autonomia", pp. 192-193.

89. Davidoff Cruz, Divida externa, p. 164.

90. Ibid., p. 161.

91. Faucher, "The Paradise that Never Was", p. 23.

92. Davidoff Cruz, Divida externa, p. 164.

93. For an analysis of the controlling power of foreign partners in joint ventures in Brazil, particularly Tubarão and the petrochemical complex of Camaraci, see Faucher, "The Paradise that Never Was", pp. 23-25. Faucher maintains that neither the state nor national capital could counter the demands of foreign capital as effectively as Evans claimed. Peter Evans indeed wrote very optimistically of the autonomy of the state and national capital vis-a-vis foreign firms in joint ventures, particularly in the petrochemical industry, in his "Collectivized Capitalism", in Authoritarian Capitalism, pp. 85-125. However, in later works, Evans' views on the advantages for Brazil of the "triple alliance" were considerably watered down. See, for example, Gary Gereffi and Peter Evans, "Transnational Corporations, Dependent Development and State Policy in Brazil and Mexico", Latin American Research Review, pp. 31-64 and Evans and Gereffi, "Foreign Investment and Dependent Development: Comparing Brazil and Mexico", in Brazil and Mexico, Patterns in Late Development, pp. 111-168.

94. Davidoff Cruz, Divida externa, p. 151; Faucher, "The Paradise that Never Was", p. 24 and Erickson, "State Entrepreneurship", pp. 15-51.

95. After 1976 the voices of the capital goods sector were the Forum of the Gazeta Mercantil and O Estado de São Paulo.

96. Dependent Development, p. 270.

97. Cardoso, "Entrepreneurs and the Transition Process", pp. 144, 148; Faucher, "The Paradise that Never Was", p. 25 and Bresser Pereira, Development and Crisis in Brazil, p. 197.

98. Development and Crisis in Brazil, p. 193.

99. That the bourgeoisie closed ranks to protest against the regime is revealed by the statement of the conservative business leader José Papa Jr., the president of the Federation of Commerce of the state of São Paulo, to Veja of February 7, 1977, p. 72. His position favoring democracy was endorsed by the major business associations (ANFAVEA, ABDIB, ABINEE) and even FIESP (Federation of Industries of the State of São Paulo), where liberal-minded industrialists succeeded in winning great influence

over the ultra conservative Teobaldo de Nigris, the long-time president of the Federation and a virtual yes-man for the military government. See Skidmore, Politics of Military Rule, p. 202. Furthermore, that the business community began to manifest itself even before the 1977 "April Package" and the regression of liberalization, indicates that dissatisfaction with economic policy was indeed the underlying cause of the demands for democracy. But the events of April 1977, when Geisel closed down congress and enacted a series of amendments to the Constitution, designed to block the opposition in the 1978 elections, was certainly an important fact in speeding up the withdrawal of the industrialists from the authoritarian political alliance as well as increasing the protests from other groups within civil society, such as the Bar Association, journalists, intellectuals, students and the Church. A thorough analysis of this period is Skidmore, The Politics of Military Rule, pp. 180-192.

100. Declaration made during the elections to the Forum in 1977, Gazeta Mercantil, September 13, 1977, cited by Cardoso, "Entrepreneurs and the Transition Process", p. 142.

101. Ibid.

102. See O Estado de São Paulo and Gazeta Mercantil of 27 June 1978. A discussion of the "Manifesto" is found in Cardoso, "Entrepreneurs", p. 145; Faucher, "The Paradise that Never Was", p. 26 and Bresser Pereira, Development and Crisis in Brazil, p. 193.

103. Ibid.

104. "National Business, Debt-led Growth, and Political Transition in Latin America", in Stallings and Kaufman (eds.), Debt and Democracy in Latin America, p. 82.

105. "Entrepreneurs and the Transition Process", pp. 148-49.

106. It is beyond the purpose to discuss the emergence of an independent labor movement in Brazil in the late 1970s challenging the corporatist mechanisms of labor control. It is clear, however, that the new unionism was very much the product of the realization of the working class that the alliance of the dominant classes was collapsing. Although Brazil's recession between 1981 and 1983 undercut much of the new unions' bargaining strength and the ongoing debt crisis has had a devastating impact on the working class, as the costs of adjustment have fallen on its shoulder, the Brazilian labor movement has achieved a greater measure of independence from immediate state control. For an analysis of the new labor movement see Erickson and Middlebrook, "The State and Organized Labor in Brazil and Mexico", in Brazil and Mexico, Patterns in Late Development, pp. 246-254. For an account of labor relations during the civilian government of Jose Sarney and the effects of the debt crisis on labor, see Ian Roxborough, "Organized Labor: A Major Victim of the Debt Crisis", in Debt and Democracy in Latin America, pp. 91-108.

107. Gazeta Mercantil, Balanço Anual, September 1979, p. 21. It is noteworthy that there was also dissatisfaction within the government with Simonsen's approach. Ministers, such as Mario Andreazza (Interior), Karlos Rischbieter (Finance), Eduardo Portella (Education), Cesar Cals (Mines and

Energy) and, of course, the outspoken Delfim Netto (Agriculture) publicly criticized the austerity measures that Simonsen was proposing. The fact of the matter was that the Figueiredo government feared the political consequences of deflationary measures on its liberalization program.

108. The highest wage increases went to the lower paid workers, those earning up to three times the minimum wage (up to 70 percent of the working force). Anglade argues that, in addition to angering the middle income groups with a reduction in wage differentials, the new wage law, which was soon offset by the dramatic acceleration of inflation in 1980 (110) percent, was in clear contradiction with the policy of economic expansion, as a reflation of the economy would have required wage increases for the higher paid workers. See "The State and Capital Accumulation", pp. 101-102.

109. For this analysis I rely on the thorough analysis of all aspects of the Figueiredo government in the special issue of Gazeta Mercantil of February 28, 1985, "Balanco do Governo Figueiredo e Perspectivas da Nova Republica", 30 pages, and Folha de São Paulo of January 27, 1985, "A Era Delfim: em 20 anos, do "milagre" a crise", pp. 29-31.

110. Burtle and Young, "Brazil on the Brink", p. 23; Gazeta Mercantil of February 28, 1985, "Balanco do governo Figueiredo", p. 3 and Folha de São Paulo of January 27, 1985, "A era Delfim", p. 30.

111. Davidoff Cruz, Divida externa, p. 81.

112. "Industrialization, Economic Growth and BOP", pp. 31-32.

113. Gazeta Mercantil of February 28, 1985, "Balanco do governo Figueiredo", p. 3.

114. Bonelli and Malan, "Industrialization, Economic Growth and BOP", p. 24, Table 1.6.

115. Development and Crisis in Brazil, p. 182.

116. A good analysis of Delfim Netto's strategy of debt rollover by using the state enterprises is Gilson Schwartz, "A historia das relações entre o Brasil e o FMI", Folha de São Paulo, 25 de Setembro de 1988, p. B6. See also Gazeta Mercantil, "Balanco do governo Figueiredo", 28 de Fevereiro de 1985.

117. Gazeta Mercantil, Balanco Anual, September 1983, p. 46; Business Latin America, August 17, 1983, pp. 257, 263-64 and various issues of Business Latin America throughout 1983.

118. For a full account of the operations of 1982 and 1983 see Nigel Adam, "How They Tried to Rescue Brazil", Euromoney, October 1983, pp. 76-87.

119. See Langoni, A crise do desenvolvimento, p. 9 and Brazil Economic Program, Central Bank of Brazil, Vol. 3, May 1984, p. 55.

120. In 1983 alone, unemployment in urban regions reached 13 million people, 25 percent of the economically active population (EAP). But it should be kept in mind that the EAP growth rates are 4 percent a year,

more than population growth! See Jaguaribe et al., Brasil 2000: para um novo pacto social (Rio: Paz e terra, 1986), Terceira Edição, p. 18.

121. See DIEESE reports in Folha de São Paulo of March 6, 1985, p. 13 and March 10, 1985, p. 38 and Gazeta Mercantil of February 1, 1985, p. 8.

122. See interview with Air Force General Waldir de Vasconcelos in Exame, November 14, 1984, pp. 50-52.

123. Dilson Funaro, the second Minister of Finance in the Sarney administration between December 1985 and April 1987. Speech at the Conference on Debt and World Trade, sponsored by Democrat Senator Bill Bradley, at the Waldorf Astoria Hotel in New York on December 5, 1986. Cited in The New York Times of December 6, 1986, p. 37.

124. Brasil 2000, p. 18.

125. Ibid., p. 66.

126. Folha de São Paulo, March 24, 1985, p. 3.

127. February 16, 1983, p. 52, my emphasis.

128. See Não, não a recessão e ao desemprego (Rio: Paz e Terra, 1983).

129. This fact was publicly admitted by Delfim Netto in an interview in Gazeta Mercantil of February 28, 1985, p. 4.

130. See "A armadilha da recessão", in Carta Economica, Corporação Bonfiglioli, São Paulo, Ano II, No. 7, January-February 1984, pp. 4-8. A good analysis of the effects of the 1981-83 economic crisis on Brazilian businesses is the special issue of Gazeta Mercantil of February 28, 1985, "Balanço do governo Figueiredo".

131. World Financial Markets, Morgan Guaranty Trust of New York, August 1986, p. 7.

132. So-called multiyear debt reschedulings such as accorded between Mexico and foreign creditors in 1985 do not, of course, make a dent into the debt problem, as the case of Mexico itself has showed. Although this type of rescheduling offers somewhat more reasonable terms, it binds the debtor to pay interest due in the coming years in its totality, in addition to large installments of principal. Furthermore, it subjects the debtor's economy to the supervision of the IMF throughout the life of the agreement and unrealistically assumes an ever growing international economy that could absorb debtor's exports without a shadow of protectionism.

133. Exame, March 9, 1983, pp. 16-20.

134. Cited in Business Latin America, August 17, 1983, pp. 257, 263-64.

135. In November 1979, in a clever move to divide the opposition

while retaining government forces within a single party, the Figueiredo government dissolved the two-party system and promoted the creation of multiple parties among the opposition. ARENA had regrouped as the PDS (Partido Democrático Social) and the MDB as the PMDB (Partido Movimento Democrático Brasileiro). Other opposition parties quickly emerged, such as the old PTB, the PDT (Partido Democrático Trabalhista) of Brizola, the PT (Partido dos Trabalhadores) of Lula, the leader of the São Paulo metalworkers, and the PP (Partido Popular) of Tancredo Neves. In May 1980, the worsening of economic perspectives led the government to postpone for two years the municipal elections planned for November 1980 for fear of big losses for its party. Ironically, the postponement favored the opposition which then had enough time to organize itself for November 1982 when, in addition to the municipal elections, direct elections were to be held for state governors for the first time since 1965.

CONCLUSION: BRASIL'S DILEMMA: DEPENDENCY, DEBT, AND DEMOCRACY

In this concluding chapter we return to the proposition stated in chapter 1 that the ongoing socio-economic crisis in Brazil can not be seen as the result of the military regime's deviation from "wise" economic policies, but rather as the consequence of the development choices made. As such, the advice given to the debtor country by the ideologues of developmentalism to continue unchanged along the same course, as a way out of the crisis, is theoretically unsound and in practice misleading.

Indeed, it is precisely the externally conditioned growth pattern formulated by the developmentalist approach for the supposedly rapid local replication of the capitalist development in the center and the concrete policies prescribed to achieve this goal - efficiently implemented in Brazil - that constitutes the major obstacle to the capitalist development of the country and, hence, to the establishment of a stable bourgeois democratic society. This is so because inherent in the growth model adopted there are fundamental contradictions between the interests of global profit makers and national development, the major thesis of the dependency approach that was supported by the empirical evidence presented in this case study.

But Brazil's development path was not simply determined by external constraints and opportunities, it was also the result of internal political choices. This study, therefore, contributed to further our understanding of concrete situations of dependency characterized, as Cardoso argues, "by the forms of articulation between the global economy and the local economy,

between international domination and local class domination in each dependent country."¹

As we showed, the interests of center countries and their financial sectors indeed articulate inside Brazil with the interests of local dominant classes and groups expressed in specific state action. And we also revealed precisely the instrument through which this articulation is manifested. The evidence suggests that the ideology of developmentalism, the product of dominant interests in center countries and accepted by Brazilian power groups as their own, has been historically the key through which dependency situations are maintained in Brazil. In short, the ideology of developmentalism has been a major instrument of imperialist penetration in Brazil and elsewhere in developing countries.

The delusion of developmentalism: the crisis of the 1980s reconstructed

Consideration of the stabilization program and particularly the "restructuring" of the Brazilian economy in the second half of the 1980s (chapter 7) provides powerful insights into how concrete situations of dependency are maintained, but also into how the development crisis of the 1980s came about. The developmentalist growth strategy offered and the free-market oriented policy reforms prescribed by international financial centers as the solution to the current crisis are, of course, the same that were effectively implemented in the 1960s by the Brazilian technocrats as a route to long-term prosperity and BOP equilibrium and that guided 20 years of military rule.²

As we demonstrated, the Castello Branco government (1964-67) distinguished itself not so much by the emphasis given to short-term orthodox stabilization measures to repay the "populist debt", but by the introduction of far-reaching "structural reforms" to promote the free international flows of trade and investment and facilitate the full

integration of the Brazilian economy into the international financial and productive system, the basic elements of developmentalist growth models.³ In fact, it was the financial internationalization of the economy and the institutionalization of channels through which massive flows of loans from the Eurocurrency markets would freely enter the country that constituted the major feature of the reforms between 1964 and 1967. Thus, the conflicting interests of international finance and Brazilian dominant classes evident in the last years of the populist regime analyzed in chapter 6 were reconciled through the powerful ideology of developmentalism which became the guiding principle of the military regime.

The experiences of Brazil in the 1960s and early 1970s clearly showed the extent to which stabilization programs and "structural reforms" prescribed by international financial centers are not meant to put the BOP on a stable footing, but rather, to qualify the debtor country for ever increasing amounts of foreign loans to finance current account deficits that soon begin again to accumulate as a result of the sweeping liberalization of trade and foreign investment regulations the reforms are intended to promote in the first place.

It was, therefore, within the context of the new international division of labor promoted by the developmentalist growth theories that we explained the financial internationalization of Brazil between 1968 and 1973, the "miracle" years. As chapter 8 showed, the acceleration of the foreign debt during those years and the promotion of export-oriented growth were intended to accumulate foreign reserves and maintain Brazil's international creditworthiness as well as to import capital goods from center countries to expand the already developed consumer durable goods sector under the control of transnational corporations. The process promoted a consumption orgy of foreign-designed modern status goods by the more

affluent classes and retarded considerably Brazil's capital goods industry and technological change, thus preventing the country from "catching-up" with the advanced capitalist nations. Yet the developmentalist technocrats of the authoritarian and repressive military regime justified external reliance on flows of financial capital as well as economic exclusion of the majority of the population from the benefits of the externally conditioned growth adopted in terms of replicating the automatic, unilinear evolutionary growth experienced by the now modern, capitalist industrial countries.

Ironically, while the Brazilian state allied with international financial and industrial interests to promote market capitalism and supposedly replicate the pattern of capitalist development in center countries, the early stages of capitalist development in those countries, when the basis of self-sustained and automatic economic growth were launched, were characterized by strong nationalist and mercantilist states which restricted imports directed at luxury consumption and puritanical upper classes who saved and accumulated capital to be used in productive investments to produce yet more wealth.⁴ Most important, the domestic control over the capital accumulation process and over the use of the economic surplus of society, which made possible dramatic technological change, was the key to power and control of development in the West.

A major delusion of the developmentalist approach is to offer growth strategies and policies to developing countries that were implemented in today's developed countries (but by no means in all) in their classical capitalism period of laissez-faire (between 1750 and 1914) after those countries had passed through their mercantilist or early capitalist stage (1500-1750). And at the end of the middle ages Western Europe stood about where many underdeveloped countries stand in the twentieth century! As

Dudley Dillard points out:

Opportunities for profitable private investment multiplied rapidly as mercantilist policies succeeded in providing the basic social overhead capital. Rather paradoxically, it was because the state had made such an important contribution to economic development that the ideology of laissez-faire could later crystallise. When that occurred, dedication to capital accumulation remained a basic principle of capitalism but the shift from public to private initiative marked the passage from the early stage of capitalism and the beginning of the next stage, the classical period.⁵

It is not surprising, however, that a theory based precisely on the historical stages of capitalist development in the West prescribes free-market oriented policies for the "replication process" in developing countries: the theory was primarily designed to promote the trade and investment interests of already developed countries which are, of course, best served by an open world economy, and not development in "transitional" societies. As Gunnar Myrdal observed three decades ago:

It would be difficult to find a single case where English classical economists actually recommended that Britain should make a sacrifice for the welfare of the rest of the world. When, for instance, they recommended free trade as a general policy, it was not on the ground that free trade would be to the good of the world but because it would be in the interest of their own country.⁶

As we saw in chapters 2 and 3 treating the period of classic dependence (1850-1930), the role of Brazil in the British-designed international division of labor as a supplier of agricultural exports and as a market for manufactured goods and an outlet for portfolio investment was made possible by local dominant classes who accepted as their own the classical liberal British free trade ideology. This doctrine of laissez-faire capitalism thus became the tool of the export-oriented coffee oligarchies and its practical policies promoted in the country a growth pattern heavily conditioned by the external environment and retarded its industrialization process for 100 years. As we showed, not only did this first version of the developmentalist theory make it extremely difficult the

emergency of an entrepreneurial class in Brazil, but the financial dependency it generated resulted in the transfer to Great Britain of a large part of the surplus of coffee exports in the form of debt service payments, drastically restricting the autonomy of the economic system and the possibilities of national development.

It was not until a nationalist and interventionist state emerged in the 1930s as a response to the crisis of the liberal international trading and financial system, and simultaneously of the reflex-type dependent Brazilian export economy, that an autonomous horizontal ISI strategy was promoted through the mobilization of domestic resources and the redirection of the economic surplus of society from massive debt service payments and into industrial investment. But as chapter 4 made it clear, the transformation of classic dependence into greater national autonomy was made possible by the redefinitions of interest among Brazil's dominant classes and groups. For the first time in Brazil the interests of the political elites clashed with those of foreigners and their liberal ideology.

Yet as we saw in chapters 5 and 6, treating the populist period, the interests of Brazil's dominant classes again converged with those of foreigners who were looking for new markets in the post-1945 period. The old doctrines reemerged with new clothes to suit the new international division of labor under the leadership of the U.S. and promoted in Brazil a vertical ISI based on extreme reliance on flows of foreign loans to finance the high levels of capital goods imports to feed the foreign controlled luxury consumer durable manufacturing sector. The replication of the consumption pattern in the center by a wealthy minority was thus initiated in Brazil in the 1950s. But as we showed, the debt-led growth achieved in the new situation of dependency drastically restricted the autonomy of the

state over the national economic system and over crucial policy decisions for development since they conflicted with the global priorities of international financial interests. The growth of a decade was ultimately choked off and the democratic system destroyed by the very contradictions of the financial dependency it engendered. Indeed, Brazil's productive forces were retarded by the very forces depicted by the ideologues of developmentalism as the agents of their expansion.

As chapter 6 demonstrated, the political consequence of financial dependency was the emergence of a right-wing authoritarian regime capable of imposing orthodox stabilization measures demanded by foreign creditors and thus recreate the conditions for new inflows of loans. Indeed, in the view of the new military rulers, the crisis of the growth model had resulted solely from inefficient populist policies, not from the development choices made. Hence, the need to "perfect" the model through the "structural reforms" recommended by the developmentalist approach. Thus, we showed that Brazil's internal structures and processes were transformed by the contradictions of financial dependency without losing their distinguishing dependent characteristics.

But even by the 1960s, Brazil was surely adopting prematurely the policies favored by the promoters of classical capitalism in developing countries. This was revealed when external shocks exposed the extreme vulnerability of the unbalanced liberal growth model, showing that the "miracle" was just a mirage that lasted as long as the international economy was favorable. In fact, the year 1974 marked the beginning of the unfolding of the contradictions generated by the "structural reforms" of the mid 1960s which excessively integrated the Brazilian economy into the international capitalist system and promoted a type of capital accumulation based on extreme reliance on flows of foreign loans. As in the past, Brazil's

financial dependency became the major determinant of short-term economic policy and also of long-term development strategy.

We examined in great detail how the attempt of the Geisel government (1974-79) to reverse the international division of labor and thus eliminate BOP deficits caused by the structural dependence of the economy on imports of capital goods was thwarted by Brazil's very concrete situation of dependency. Not only did liberal technocrats, in and out of the government, quickly ally with domestic and foreign industrial interests to oppose the nationalist state-led ISI program contemplated in the PND II, but international financiers conditioned the release of currency loans to state enterprises - the instruments of the government to rollover the foreign debt - to their acceptance of suppliers' credits from center countries, that is, capital goods from foreign suppliers. As we showed, this severe external constraint dealt a heavy blow to the autonomy of the state which could not sustain the national industry of capital goods, dependent as it was on orders from public firms. The inability of the state to carry out its development plan explained much of the dissatisfaction of the local producers of heavy machinery who formed the nucleus of entrepreneurial opposition first to economic policy and then to the regime itself.

By 1977, however, the cornerstone of the government's strategy to deal with massive BOP deficits was no longer the defiant ISI Program in capital goods, but the expansion of the foreign debt itself and the promotion of exports, along the lines of the traditional developmentalist prescription of reliance on foreign loans and export-led growth to solve "temporary" BOP problems. But the more the inflows of loans to finance the BOP deficit in the short-term, the larger the deficit, for foreign loans were the very cause of the structural deficit they financed.

At the same time, the foreign debt became the major determinant of the growth of the internal public debt as the Central Bank, in order to offset the monetary effects of the inflows of foreign loans that the government was attracting with all kinds of incentives, began launching massive indexed treasury bonds in the open market - the two major instruments of monetary policy introduced during the "structural reforms" period - at one of the highest rates of interest in the world. In this way, not only the government deficit and the inflationary process accelerated, but long-term productive investment was discouraged and short-term financial speculation promoted. The result of all of this was a dramatic fall in domestic investments and savings, the very basis of the automatic and self-sustaining growth path that the developmentalist approach claims to be promoting in developing countries.

Furthermore, the evergrowing need to obtain foreign exchange led the "debt managers" to virtually bankrupt state enterprises which were used and abused as the instruments to raise foreign loans to cover BOP deficits as well as national private firms which were induced to overborrow abroad through the financial internationalization of the economy - the heart of the "structural reforms" of the 1960s. Simultaneously, the developmentalist technocrats accelerated the rate of capital transfers abroad through profit repatriation and dividends of multinational corporations and massive interest payments on the foreign debt to such an extent that they soon became net transfers of resources to the already capital-rich countries. Finally, the technocrats increased the vulnerability of the economy to external shocks so much that when global interest rates rose and easy flows of loans were interrupted in the early 1980s, local capital accumulation collapsed.

Drastic stabilization measures imposed by foreign creditors to

guarantee debt service payments reinforced foreign control over national economic policy making, but also led to the breakup of the internal political alliance that supported the authoritarian regime. In this way, the contradictions of financial dependency transformed once more Brazil's internal structures and processes by opening up the possibilities for a more democratic political system, without, however, losing their distinguishing dependent characteristics. Yet the environment for the long-run maintenance of democracy in Brazil, even within the parameters of dependent development, is severely constrained by the incompatibility between massive debt obligations and badly needed improvement of living standards.

The empirical evidence presented in Part Five (chapters 7 to 9) showed, therefore, that the ongoing foreign debt and development crisis of the 1980s in Brazil had its origins two decades earlier in the choice of the Brazilian political elites to pursue a developmentalist growth model based on excessive integration of the economy into the global financial and productive system and consequently on extreme reliance on external flows of foreign capital, particularly flows of financial capital. In order to achieve this goal they efficiently imposed orthodox austerity measures and implemented free-market oriented policy reforms prescribed by international financial centers aimed at providing Brazil with the export-led growth it needed to repay the "populist debt" and buoy foreign confidence in Brazil's creditworthiness for new inflows of loans it needed to purchase capital goods from center countries. Indeed, the major feature of the debt-led growth of the 1970s in Brazil was that it promoted industrialized nations' exports through the sustained high levels of capital goods imports by state enterprises and, thus, the economic expansion of those countries in the wake of the oil shock.

Yet in the 1980s, the same ideologues of developmentalism, in and

around international financial institutions and domestic government agencies, who lauded the debt-financed expansionist policies in Brazil and elsewhere in the developing world for their contribution to an open world economy during the turbulent trading environment of the 1970s, view the debt and capital accumulation crisis as resulting solely from poorly implemented policies in the past and not, of course, from the externally conditioned growth model they prescribed in the first place. As such, they recommend the same old package of free-market "structural reforms" and stabilization measures aimed at opening debtors' economies to foreign trade and investment and at qualifying them for more inflows of foreign loans as the solution to what they choose to see as just a temporary setback in the long-term replication process.

The data suggests, to the contrary, that the technocrats of the military regime in Brazil did not deviate from "wise" economic policies. Rather, it was the fundamental contradictions between the interests of international financial capital and national development inherent in the growth model they chose that set the limits for the country's capital accumulation process, retarded its productive forces, undermined its political autonomy by restricting local development options, played havoc with its social fabric and transformed it into a net capital exporter to the center of the capitalist system in the form of interest payments on the massive foreign debt. Indeed, this trade off between economic growth and debt repayments - the logical consequence of foreign controlled development - constitutes the major obstacle to Brazil's long-term capitalist development and to the establishment of a stable bourgeois democratic society. In short, this study has shown that foreign controlled capitalist development had had adverse consequences for Brazil that exist over and above the negative aspects of capitalist development in general.

But while the crisis of dependent development has seriously challenged the theoretical assumption of developmentalism that there are no conflicts between the interests of international capital and local accumulation, the evidence from the "New Republic", four years after its inauguration, suggests that the crisis has not been able to undermine the strong foundations of the concrete situation of dependency under which developmentalism in practice continues to thrive in Brazil. There are many Brazilians who believe that popular tolerance have been overestimated by the dominant classes who continue to trade off improvement of living standards for global profit maximization. This may take the form of a nationalist regime bent on implementing the real structural reforms Brazil needs to achieve greater autonomy: mobilization of domestic resources through the curtailment of luxury consumption by the wealthy and redirection of the economic surplus of society from oppressive debt payments and into social welfare and industrial development, as Vargas did during the Estado Novo. The transformation of foreign controlled capitalist development in Brazil into an autonomous capitalist development, however, is only the beginning of the long popular struggle to achieve a more egalitarian society.

NOTES

1. As ideias e seu lugar (Petropolis: Editora Vozes Ltda., 1980), p. 71.

2. The proponents of the "new orthodoxy", the perspective headquartered at the World Bank and the IMF, and favored by the Reagan and Bush administrations, are carrying forward the same liberalizing, pro-market strains of the thinking of the 1960s and 1970s and advocating export-oriented growth to virtually all developing countries. This point is covered by John Lewis and Valeriana Kallab (eds.), Development Strategies Reconsidered (New Jersey: Transaction Books, 1986). This is a publication of the Overseas Development Council, Washington, D.C. Also see on the subject, Albert Hirschman, "The Political Economy of Latin American Development: Seven Exercises in Retrospection", in Latin American Research Review, Vol. XVII, No. 3, 1987, pp. 7-36. Hirschman concludes his work by saying that:

The Latin American perception is, then, that no good reason exists for their being lectured unilaterally. They are similarly unreceptive to the message of the lectures - unqualified praise for the free market and condemnation of the state. For one thing, the authoritarian rulers of Southern Cone countries have intensively and unsuccessfully experimented during the seventies with policies inspired by free-market doctrines, and these experiments are now associated in the minds of democratic Latin Americans with both ruthless military regimes and pitiful failure. Moreover, the recent painful contraction of the Latin American economies was brought about precisely by the untrammelled operation of the international free market in loanable funds in the years prior to the debt crisis of 1982. It is indeed remarkable, after almost thirty years of orderly and productive capital transfers organized under the auspices of governments and multinational institutions like the World Bank and the Inter-American Development Bank, that the suddenly unleashed energies of free enterprise in international finance have managed to produce international economic havoc in less than a decade (pp. 33-34).

3. This course of action is precisely the one taken by Mexico in order to qualify for debt relief. See The New York Times of May 16, 1989, p. A1.

4. A good analysis of early capitalism is Dudley Dillard, "Capitalism", in Charles K. Wilber (ed.), The Political Economy of Development and Underdevelopment (New York: Random House, Business Division, 1988), Fourth Edition, pp. 87-95.

5. Ibid., p. 91.

6. Economic Theory and Underdeveloped Countries (London: Gerald Duckworth, 1957), p. 146.

Capital flows

Components of capital flows. International movements of capital may come from either official or private sources. Official sources are (a) governments and governmental agencies (also called bilateral lenders) and (B) international organizations (called multilateral lenders). Private sources comprise (a) commercial suppliers and manufacturers, which provide export credits for the purchase of their goods, (b) commercial banks, which provide export credits or cash loans, (c) other private investors, who invest in foreign enterprises in which they seek a lasting interest (direct investment) or purchase stocks or bonds issued by foreign companies or governments (portfolio investment), and (d) charitable organizations, which provide financial aid, goods, and services as grants.

Concessional flows. International lending on terms more favorable to the borrower than those obtainable through normal market transactions.

Direct foreign investment. Investment made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise.

Portfolio investment. Transfers of capital which do not allow the authors of the transfers any control on the recipient enterprises or institutions. From the beginning of the nineteenth century until the Great Depression portfolio investments were mainly constituted by the bonds issued

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I have relied primarily on the definitions supplied by the World Bank in its 1985 World Development Report focusing on International Capital and Economic Development. I have also learned from Cheryl Payer's beginners' lesson on "How to read a balance-of-payments table" and her comprehensive study of foreign exchange crises in The Debt Trap: The IMF and the Third World (New York: Monthly Review Press, 1974).

on the European or United States stock markets by the federal, state, provincial and municipal governments of the Latin American countries. They also included a small number of bonds and shares issued by some private firms not controlled from abroad.

Equity financing. Investment that confers whole or partial ownership in an enterprise and entitles the investor to share in the profits from its operation. International equity financing flows may be included in either foreign direct or portfolio investment.

Export credits. Finance provided by lenders in a given country for exports of specific goods or services. Conventionally, one distinguishes between private and official export credits. Private export credits consist of (a) supplier credits, which are extended by the exporting company to the foreign buyer and often guaranteed by the exporter's government, and (b) buyer credits, which are extended by commercial banks in the exporting country on behalf of the exporters. Official export credits are extended by an agency of the exporting country's government. Between 1957 and 1961 private suppliers' credits accounted for 67 percent of Brazil's gross autonomous loans.

Grant. A current transfer of capital, goods, or services to a foreign country that results in no current or future obligation to make a like transfer from the recipient country to the donor.

Net flows of lending. Loan disbursements less amortization of principal.

Nonconcessional flows. Lending on or near terms prevailing in private financial markets.

Private nonguaranteed debt. Private nonguaranteed loans are external obligations of private debtors that are not guaranteed for repayment by a public entity of the debtor country.

Public and publicly guaranteed debt. Public loans are external obligations of public debtors, including national governments, their agencies, and autonomous public bodies. Publicly guaranteed loans are external obligations of private debtors that are guaranteed for repayment by a public entity of the debtor country.

Trade and finance

Balance of payments (BOP). A systematic record of the economic transactions between a nation's residents and nonresidents during a given period, usually one calendar or fiscal year. It covers the flows of real resources (including factor services, such as the services of labor and capital) across the boundaries of the domestic economy, changes in foreign assets and liabilities resulting from economic transactions, and transfer payments to and from the rest of the world. BOP accounts comprise two broad categories: the current account, which measures merchandise trade, factor and nonfactor service income, and transfer receipts and payments, and the capital account, which measures changes in domestic and foreign capital assets and liabilities.

The first category of the BOP account - the current account - deserves special attention since in addition to recording trade in merchandise exports and imports - the trade account - it is there that transfer receipts and payments are listed in the item investment income (factor income), that is, profits on direct investment and interest on international loans - the service account or invisibles. This item, which Cheryl Payer has properly termed investment payments, since the income goes to other countries, represents the big drain on the international reserves of less developed countries. According to Payer:

...Since investment itself is listed elsewhere, in the capital account, it might seem reasonable to include investment income (profits on direct investment and interest on international loans) in the capital account as well. The IMF has decreed, however, that the supply of capital is a service, and that profits and interest payments should be legitimized as a charge for this service. This has a practical significance: when a country accepts the obligations set by the IMF for maintaining the convertibility of its currency, it agrees to put no restrictions on current account payments. Placing investment income firmly in the "goods and services" section of the balance of payments ensures that restrictions on payments to foreign investors cannot legitimately be imposed under IMF rules, while its inclusion in the capital account would allow them.

The second category of the balance of payments account - the capital account - includes all items which will give rise to transfers of real resources in the future. Another way of saying the same thing is that this category indicates changes in the country's debtor or credit positions. With the exception of the 1980s when Brazil has become a net exporter of capital, a look at any balance of payments table of the country indicates that it was a net capital importer and that a net inflow of a certain amount on capital account indicates also that Brazil incurred debts to foreigners to that amount during the period.

Current account balance. A representation of the transactions that add to or subtract from an economy's stock of financial items. It is given as the sum of net exports of goods and nonfactor services (travel, transportation, insurance, tourism), net factor income (profits and dividends, technical assistance, interest and commissions), and net transfers. Official capital grants are excluded. The current account deficit provides a measure of the amount of money the nation must raise abroad, principally borrowing, to finance the economy.

Debt reorganization. Any change in the payment arrangements associated with an existing stock of debt mutually agreed upon by the borrower and the lender. In debt refinancing, new loans are negotiated to meet debt

service obligations on existing debt. In debt rescheduling, arrangements are agreed upon for postponing payments of principal or interest or otherwise changing the terms of repayment or of interest charges.

Debt Service. The sum of interest payments and repayments of principal on external debt. The debt service ratio is total debt service divided by exports of goods and services.

External debt. Debt that is owed to nonresidents. World Bank data cover external debt that has an original or extended maturity of one year or more and that is repayable in foreign currency, goods or services. Transactions with the International Monetary Fund are excluded. A distinction in medium- and long-term debt is made between private non-guaranteed debt and publicly guaranteed debt.

Interest rates. The nominal rate on a given loan is the percentage stipulated in the loan contract and may be expressed as a fixed rate, that is, an interest rate that is constant over the duration of the loan, or as a variable, or floating, rate, an interest rate that is recalculated at fixed intervals (such as every six months). Variable interest rates consist of a base rate (such as the six-month London interbank offered rate - LIBOR) plus a margin, or spread. Market, or world, rates reflect the terms of borrowing at any given time in private capital markets; market rates are usually differentiated as long-term rates - the current rates payable on financial instruments, such as bonds, having maturities of more than one year - and short-term rates - those on such instruments maturing in one year or less. The real interest rate is the nominal rate adjusted to account for changes in the price level (inflation).

Intermediation. The process whereby a private or official financial agency accepts funds from investors and onlends them to borrowers.

Maturity. For a loan, the date at which the final repayment of

principal is to be made. Short-term loans are those with original maturity of a year or less, e.g., trade credits; medium- and long-term loans are those with original or extended maturity of more than one year. If a large proportion of debt is held in short-term liabilities this leaves a country susceptible to a sudden reversal of capital flows, which causes a balance of payments crisis (the "hot money" phenomenon). Short-term compensatory loans became especially important in Brazil following a break with the IMF in 1959, when the Kubitschek government resorted to swap operations in 1959 and 1960 to generate needed foreign exchange. Short-term loans were also important between 1981 and 1982 when the Figueiredo government was confronted with a foreign exchange squeeze.

Reserves. A country's international reserves comprise its holdings of monetary gold and special drawing rights; its reserve position in the International Monetary Fund; its holdings of foreign exchange under the control of monetary authorities; its use of IMF credit; and its existing claims on nonresidents that are available to the central authorities. Reserves are also expressed in terms of the number of months of imports of goods and services they could pay for.

Spread. The difference between a reference rate used to price loans and the rate at which funds are lent to final borrowers. A widely used reference rate is the London interbank offered rate, or LIBOR - the rate at which banks participating in the London market are prepared to lend funds to the most creditworthy banks. Another is the U.S. prime rate.

Terms of trade. A measure of the relative level of export prices compared with import prices. Calculated as the ratio of a country's index of export unit value to the import unit value, this indicator shows changes over a base year in the level of export prices as a percentage of import prices.

Trade balance. The difference between merchandise exports FOB and merchandise imports FOB.

National Accounts

Gross domestic product. The total final output of goods and services produced by an economy, that is, by residents and nonresidents, regardless of the allocation to domestic and foreign claims. It is calculated without making deductions for depreciation.

Gross national product. The total domestic and foreign output claimed by residents. It comprises gross domestic product adjusted by net factor income from abroad. Factor income comprises receipts that residents receive from abroad for factor services (labor, investment, and interest) less similar payments made to nonresidents abroad. It is calculated without making deductions for depreciation.

Gross domestic product (GDP) thus differs from gross national product (GNP) by including "net factor income paid abroad" and inflows of factor income. GDP includes all transactions taking place on the national territory regardless of the citizenship of the actors. GNP includes only transactions among national citizens and excludes flows abroad or inflows from abroad. "Factor income paid abroad" is used by some researchers as a measure of dependence because it includes as one of its components the expatriated profits on foreign investment. GNP is considered a better measure of economic activity which is uncontaminated by the direct exchanges with foreign investors.

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