

**WHY THE WASHINGTON CONSENSUS MISDIAGNOSED ECONOMIC
REFORM IN DEVELOPING COUNTRIES: NOT RENT-SEEKING BUT
CLIENTELISM**

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ABSTRACT: To date scholars have relied almost exclusively on interest group models for analyzing ISI policy and its demise (Kaufman 1990; Sachs 1985; Bates and Krueger 1992). The paper first demonstrates that interest group theory cannot explain some of the most important features of ISI, including the initiation of the policy, the pattern of legislative politics implementing the policy, nor the choice for extremely distortionary policy tools among the range available *within* ISI. It then presents an alternative model of politics which builds on earlier work on clientelism, and demonstrates that a clientelist model can resolve these anomalies for interest group theory. Finally, a detailed examination of the policy itself further corroborates the clientelist alternative. The results have important implications not only for our understanding of development policy, but also prescriptions for reform. The results support area specialists' contention that reform is not simply a matter of reducing the size of the state to prevent rent-seeking, but one of restructuring citizen-politician links and state structures more generally.

“The discussion which held sway at a certain point, whether the state should be large or small, is futile and useless. The state must be competent, and of the necessary size to be competent, and it must be transparent.”¹

“Rather than proceed to dismantle the state apparatus, inspired by neoliberalism, we have reconstructed the Brazilian state such that it can ...act effectively.”²

--- Fernando Henrique Cardoso, address to the nation introducing his legislative agenda for the final two years of his second term as president of Brazil.

With the final denouement of the post-War import substitution industrialization (ISI) programs in the 1980's and 1990's in Latin America, there was considerable disagreement over the appropriate policy remedies for renewing growth. International Financial Institutions (IFIs) and the US government promoted what has been labeled a neo-liberal reform program (Williamson 2000). Preeminent in this prescription is a reduction in the size of government, primarily by curtailing its capacity to intervene in the economy. Privatization of state-owned enterprise, deregulation and liberalization are said to be the formula for future success. The quotes from Cardoso cited above reflect a different approach. Many Latin American scholars and policymakers see the problem not as one of simply reducing the size of the state, but far more critically as one of increasing the effectiveness of state action.

Although the popular literature has tended to cast this conflict as an ideological difference, these views reflect deeper underlying theories regarding what debilitated ISI, and thus what kinds of reforms are necessary for correcting its ills. The North American diagnosis follows from an interest group theory of government policymaking—the

¹ Free translation of the quote "A discussão que houve em certo momento, se o Estado deveria ser grande ou pequeno, é de balde, é inútil. O Estado tem de ser competente, no tamanho que seja necessário para ser competente, e tem de ser transparente." Quoted in Estado de Sao Paulo, 3/14/01.

² Free translation of "Ao invés de proceder ao desmonte do aparelho estatal sob inspiração dita 'neoliberal', remontamos o Estado brasileiro, para que ele voltasse a atuar com competência." Quoted in Estado de Sao Paulo, 3/6/01.

necessary changes require eliminating the interstices in which rent-seekers esconced themselves in the state. The alternative view articulated by Cardoso has its roots in a long area studies literature which argued that the relationships between parties, interest groups and government were fundamentally distinct in Latin America and North America. According to this view, politics in post-War Latin America was not animated by the pulling and hauling of categoric interest groups striving to influence the direction of national policy in their favor, but instead by a direct exchange relationship between politicians and their supporters that was labeled clientelism.³

By making the underlying theories informing these two views explicit, we can test them and assess which can best account for important features of ISI policy. With some simple deductions from a model linking politicians and supporters through direct quid pro quo exchange, we can develop a theory of clientelist politics that can be tested directly against an interest group model. In this paper I develop such a clientelist model and test it against interest group theory in explaining policy choice and political behavior in Brazil during the heyday of ISI.

After a brief review of ISI policy and the political players in Brazil from 1945-64, I test the interest group model in explaining the shift to inward-oriented policy, legislative voting in the policy adoption, and the choice for overvalued exchange rates as the mechanism for transferring resources from the agricultural to the industrial sector. Each of these outcomes presents an anomaly for interest group theory. I proceed to develop the clientelist alternative, deducing how a direct link between politicians and their supporters alters the calculus of policy shift, credit-claiming problems and thus legislative

³ For the earlier clientelist literature see Scott 1969 1972; Schmidt 1977; Strickon and Greenfield 1972. More recent work includes Kitchelt (2000), Mainwaring (1999), and Stokes and Medina (2002).

voting behavior, and the utility of overvalued exchange rates. I demonstrate that this clientelist alternative resolves each of these puzzling anomalies for interest group theory. Finally, I provide a new and detailed examination of ISI policy itself, and demonstrate that on close examination, ISI policy choices are more consistent with clientelist rather than interest group politics.

In conclusion I argue that it is seriously misleading to view the policy distortions in developing countries as simply extreme cases of rent-seeking, which require only concentrated doses of the standard remedy to correct. Rent-seeking and clientelism spring from distinct accountability problems, with dramatically different implications for the appropriate remedy. Policies that create rents, as conventionally defined, provide advantages to a few producers, and are typically paired with policies that force most producers to face market competition most of the time. The efficiency losses associated with rent-seeking thus typically fly under the radar of rationally ignorant voters.

Clientelism, in comparison, is more akin to mercantilism, in which politicians distribute the vast majority of production rights directly, with much more dramatic effects on economic efficiency. In short, whereas rent-seeking stems from the cognitive and attention limitations of rational voters, clientelism stems from more dramatic failures of democratic accountability, which are not due to voter ignorance but varying forms of voter vulnerability. I conclude that a more sophisticated understanding of the policy failures in developing countries requires that scholars and policymakers focus more attention on the failings of democratic accountability that occur under clientelism. If it is dramatic failures of accountability that lead to the typically disappointing outcomes in

developing countries, then as Cardoso states, it is the transparency and efficacy of the state that is key, rather than its size.

ISI Policy in Brazil

Import substitution policy consisted of the use of exchange controls, various protectionist mechanisms including tariffs and a quantitative control system known as similarity analysis, credit policy, and other incentives. From 1945-53, exchange controls were directly administered through licensing and overvalued rates were maintained. In 1953 a system of exchange auctions was instituted to distribute roughly half of foreign exchange, while the other half continued to be distributed at the discretion of government officials at highly subsidized rates. By allowing the rate to reflect demand in the auction system, the reform of 1953 reduced the overall overvaluation that had been increasing rapidly under the earlier licensing system. Tariffs were not an important instrument of policy until 1957, when specific rates were replaced by a system of ad valorem rates. The most important protectionist instrument throughout the period 1945-64 was a system of quantitative restriction known as similarity analysis. Similarity analysis was an extreme form of quantitative restriction that created a market reserve for domestic producers: firms that registered their products with the appropriate agency could be assured that no further imports of that product would be allowed. Another important incentive was the concession of long term loans at negative real interest rates. Finally, starting in 1953, there were various incentives for foreign direct investment, primarily through favorable exchange rates for imports and remittance of profits.

The Political Players in Brazil, 1945-64

Before examining legislative and policy outcomes, some brief background on the Brazilian party system is in order. Brazil was under democratic rule between 1945 and 1964, and since 1989. The vast majority of institutional rules are constant across the two periods, including presidentialism, bicameralism (a Chamber of Deputies and a Senate), federalism, and open-list proportional representation. The period of 1945-64 was characterized by a multiparty legislature. The three largest parties were the PSD (Social Democratic Party), the UDN (National Democratic Union), and the PTB (Brazilian Labor Party), and the three small parties were the PSP (the Progressive Social Party), the PR (the Republican Party) and the PDC (the Christian Democratic Party).

TABLE 1: SEAT SHARES PER PARTY (%) IN THE CHAMBER OF DEPUTIES (1946-1963)
LEFT -----RIGHT

YEAR	PTB	PSP	PR	PSD	PDC	UDN
1946	7.7	0.7	2.4	52.8	0.7	26.9
1951	16.8	7.9	5.8	36.8	0.6	26.6
1955	17.2	9.8	5.8	35.0	0.6	22.7
1959	20.2	7.7	5.2	35.3	2.1	21.5
1963	28.4	5.1	1.0	28.8	4.9	22.2

Source: Hippólito (1985: 58).

Table 1 shows the evolution of seat shares for the major parties throughout the period. In 1964, this democratic regime was overturned by a military coup.

There were four elected presidents during the period, only two of which served out their entire term. Dutra was elected in 1945 on an alliance between the PSD and the PTB. Vargas was elected in 1950 on an alliance between the PTB and a regional party predominant in São Paulo, the PSP. Vargas committed suicide in 1954 on news that he would soon be overthrown by a military coup. Kubitschek was elected in 1955 through another alliance between the PTB and the PSD. Janio Quadros was elected in 1960 on an essentially non-aligned platform, but with support from the UDN. He resigned after nine

months in office. The vice-president, Joao Goulart, was from the PTB and assumed office in 1961 after Quadros' resignation. He was overthrown by a military coup in 1964.

Democratic politics would not return to Brazil until 1985.

THE INTEREST GROUP MODEL

Briefly put, interest group models derive preferences exogenously based on the sector's position in the economy. According to this view, exporters prefer more neutral and efficient policies in order to maintain their competitiveness in international markets, including macroeconomic stability, neutral or undervalued exchange rates, and minimal protection. Producers oriented primarily toward the internal market, such as import-competing industries, favor policies which promote the expansion of the domestic market and protection from international competitors. In practice, under ISI in Latin America, this meant high and variable protection, multiple and overvalued exchange rates for importing inputs and machinery, cheap credit, and a range of fiscal incentives. How well does such an interest group model explain the switch to policies that heavily favored inward-oriented interests at the time of initiation of ISI? As I will show, interest group strength runs exactly counter to what we would expect based on the theory:

agroexporting interests are dominant during the turn inward.

A long line of distinguished economists and political economists have sought to explain the politics behind the ISI choices, typically by focusing on the distributional implications of different policy choices.⁴ This literature did an excellent job of demonstrating that the inward-oriented policies of the post-War were heavily biased in

⁴ These include Bhagwati (1978), Kreuger (1974 1978), Little (1970), Sachs (1985) and Kaufman (1990).

favor of import-competing interests, but there has been little serious effort to empirically test these models. All too often, the simple demonstration of the distributional consequences of policy is taken as sufficient evidence both for the presence of the inward-oriented coalition and its success and achieving policies that served its interests.⁵ Moreover, when sectoral strength is actually measured, the analysis typically ends here, without any attempt to determine how sectoral strength is translated into policy influence.⁶ In this section I will show that the data do not support an interest group explanation of the initiation of ISI: measures of group size, collective action potential and political influence all point to a relatively weak inward-oriented industrial sector at the time when most ISI policies were adopted.

The Turn Inward: Interest Group Size, Collective Action Potential, and Political Influence

The interest group or rent-seeking theory of the failures of ISI hypothesizes that inward-oriented interest groups came to dominate public policy and were able to extract policies that served their interests, to the detriment of exporters and the public. Yet here is little data to support the view that an inward-oriented coalition was a dominant economic player, or that it enjoyed overweening political influence when ISI policies were adopted.

In order to assess the relative strength of agro-exporting and industrial interests in Brazil during the period from 1945-64, it is useful to examine three different measures of power. First, we can examine the structure and distribution of economic power by examining each sector's contribution to GDP and the concentration of assets within the

⁵ Kreuger (1974 1978), Sachs (1985) and Kaufman (1990) are most explicit in drawing this connection.

⁶ Frieden (1991) provides the most sophisticated and comprehensive a-priori measures of group strength.

sector. This will help us determine the relative size of the sectors, and whether one or the other is more characterized by many atomistic units, which would create the well-known barriers to collective action. Second, we can examine how well the different sector's interests are represented in political parties and interest groups. And third, we can examine how well their respective economic power is translated into political institutional resources in Congress and in the executive bureaucracy.

Beginning with the structure and distribution of economic resources, we can see from the following table that industry and mining come to slightly exceed agriculture in contribution to gross domestic product only in 1951, and only clearly surpass agriculture in 1960. Thus, in the period under study, from 1945 to the early 1960's, it would be difficult to argue that the industrial sector greatly overshadowed the agricultural sector.

**TABLE 2: SECTORAL CONTRIBUTION TO GDP
(Percentages)**

Sector	1939	1947	1951	1960	1963
Agriculture	33.3	27.7	24.5	21.4	21.0
Mining and Manufacturing	18.0	22.2	25.0	34.0	35.3
Others	48.7	50.1	50.5	45.6	43.7

Source: Schmitter 1971:27.

From this data alone, then, it is difficult to argue for a significant advantage for industry during the period in which ISI policy became institutionalized. As the literature on collective action has established, however, if a sector is characterized by many atomized units, this inhibits the ability to organize to influence policymakers. Data from the agricultural censuses of 1940 and 1950 indicate that roughly 10 percent of landowners controlled 80 percent of the agricultural land (Kahil 1973:36). The survey of Brazilian agrarian structure taken by the Agrarian Reform Institute (IBRA) in 1965 provides the best and most complete data for the period which corroborates the highly

concentrated ownership of land verified in the earlier surveys. IBRA found that 2.8 percent of agricultural property owners account for fifty percent of total agricultural land area (Chacel 1969:105). Clearly agriculture was not a sector characterized by barriers to collective action based on an atomized production structure at any point during the period. How does this compare with concentration in industry?

Industrial production was characterized by very concentrated ownership as well, but in comparison to agriculture, concentration in industrial ownership probably did increase markedly over the period. Data on industrial concentration in selected industries in 1963 can be seen below. In short, ISI policy did create a fairly concentrated industrial sector by the *end* of the period.

TABLE 3: INDUSTRIAL CONCENTRATION IN BRAZILIAN FIRMS, 1963

Branch of Activity	Number of Firms	Proportion of Output Produced by Three Largest Firms
Metal structures	8	78
Agricultural implements	9	97
Ploughs	17	76
Electric Motors	9	86
Refrigerators	8	91
Washing machines	6	82
Scales	19	74
Elevators	6	99

Source: ECLA 1964:54.

In 1949, these firms accounted for 15% of total production in very rough terms. This grew to 28.1% of total production by 1961. The textile sector, which was much more atomized, consisting mainly of many small family firms, accounted for 19% of total production in 1949, and 13.4 % in 1961. The food sector, which was intermediate between these consumer durable firms and textiles in terms of industry concentration,

was responsible for 32.5% of total manufacturing in 1949, and was reduced to 20.5 by 1961(ECLA 1964). These data indicate that collective action potential in industry likely increased over time during the period, but that it was unlikely to match that of agriculture at the time the ISI program was begun.

What about the balance of power reflected in existing political parties and interest groups? First, it is noteworthy that no political party championing industrial interests existed during the period. Of the three main political parties, the UDN represented primarily rural interests, the PSD was an amalgam of rural and industrial upper class interests, and the PTB was a hybrid of urban middle and working class interests (Soares 1971; Pinto 1965).⁷ In the case of interest groups, there is also no evidence for an important advantage for industry. Before Vargas' active policy of creating and sanctioning official corporatist interest associations initiated in 1930, the organization of interest groups was primarily a spontaneous process. The available evidence up to 1930 points to rural associations which were effective in influencing public policy, and industrial associations that were largely ineffective. The National Society of Agriculture (SNA) was formed in 1897, and beginning in 1906, had a continuing strong hand in staffing the Ministry of Agriculture. The Brazilian Rural Society (SRB) was also formed before the turn of the century and was instrumental in creating the Coffee Institute of São Paulo, which undertook the early coffee price support programs sponsored by the state of

⁷ As is well-established in the specialized literature, these are very broad characterizations which often indicated little about the kinds of alliances the party would make or the policies its members would support. The point to be underscored here is that despite the formation of many new parties during the period, there was no party that championed industrial entrepreneurs' interests as an important part of their platform. This is quite odd if industrial interests were in fact strong enough to impose their agenda on public policy to the detriment of both agricultural and diffuse interests.

São Paulo. This state-level policy was the precursor to the federal price support programs which were initiated in 1930 (Schmitter 1971).

The first national industrial association, the Industrial Center of Brazil (CIB), was created in 1902, and the Industrial Center of São Paulo (CIESP) was created in 1928. These groups devoted considerable effort to obtaining a national protective tariff. Their activities included frequent contacts with the Ministry of Finance, congressional lobbying, and public relations campaigns carried out in the press and through association meetings and conferences (Schmitter 1971:144-47). These efforts were minimally successful as the tariff continued to be defined in fiscal terms, and industrialists received protection only where the policy also coincided with agricultural interests, such as in the case of protection stemming from undervalued exchange rates (Luz 1960). Even after industrialization began to pick up speed after 1930, much of the protection it received was a by-product of exchange controls adopted primarily for balance of payments reasons (Macario 1964:61-2). A tariff with explicit protective intent, the primary demand of these groups, was not adopted until 1957.

What can be said about the distribution of power within congress? Brazil had a bicameral legislature with seats in the lower chamber assigned by population and in the senate by state. Electoral districts for the lower chamber were state-wide, and the number of seats per state was determined by Article 58 of the 1946 Constitution, which gave one representative for every 150,000 inhabitants, up to 20 seats, and then one additional representative for each additional 250,000 inhabitants. There was also a minimum of seven representatives per state. The results of this formula can be seen in the table below.

**TABLE 4: PERCENTAGE OF TOTAL POPULATION
AND PERCENTAGE OF LEGISLATIVE SEATS BY STATE**

State	1945		1950		1954		1958		1962	
	% Pop.	% Rep.	% Pop.	% Rep.	% Pop.	% Rep.	% Pop.	% Rep.	% Pop.	% Rep.
Amazonas	1.0	1.7	1.0	2.3	1.0	2.1	1.0	2.1	1.0	1.7
Pará	2.2	3.1	2.2	3.0	2.1	2.8	2.1	2.8	2.1	2.4
Acre	0.2	0.7	0.2	0.7	0.2	0.6	0.2	0.6	0.2	1.7
Maranhão	3.0	3.1	3.0	3.0	3.1	3.1	3.1	3.1	3.6	3.9
Piauí	2.0	2.4	2.0	2.3	2.0	2.1	2.0	2.1	1.7	2.0
Ceará	5.1	5.9	5.2	5.6	5.2	5.5	5.3	5.5	4.6	5.1
Rio Grande do Norte	1.9	2.4	1.0	2.3	1.9	2.1	1.9	2.1	1.6	1.7
Paraíba	3.4	3.5	3.3	3.3	3.2	3.4	3.2	3.4	2.8	3.2
Pernambuco	6.5	6.6	6.5	6.2	6.5	6.7	6.5	6.7	5.7	5.9
Bahia	9.4	8.4	9.3	8.2	9.2	8.3	9.1	8.3	8.3	7.6
Alagoas	2.2	3.1	2.1	3.0	2.0	2.8	1.9	2.8	1.7	2.2
Sergipe	1.3	1.7	1.2	2.3	1.2	2.1	1.2	2.1	1.0	1.7
Espírito Santo	1.7	2.4	1.8	2.3	1.6	2.1	1.5	2.1	1.7	2.0
Minas Gerais	15.6	12.2	15.0	12.5	14.3	12.0	13.8	12.0	13.6	11.7
Rio de Janeiro	8.9	11.9	9.0	11.2	9.0	10.4	9.2	10.4	9.5	10.3
São Paulo	17.6	12.2	17.6	13.2	17.7	13.5	17.7	13.5	18.4	14.4
Paraná	3.5	3.1	4.1	3.0	4.6	4.3	5.3	4.3	6.5	6.1
Santa Catarina	2.9	3.1	3.0	3.0	3.1	3.1	3.1	3.1	3.0	3.4
Rio Grande do Sul	8.0	7.7	8.0	7.2	8.0	7.4	8.0	7.4	7.6	7.1
Mato Grosso	1.0	1.7	1.0	2.3	1.0	2.1	1.0	2.1	1.3	2.0
Goias	2.2	2.4	2.3	2.3	2.5	2.4	2.6	2.4	3.0	3.2

Source: Santos 1987:58-61.

The shaded states are those that were consistently under-represented by this formula. In terms of actual numbers of seats, this formula meant that in 1962, out of a total of 409 deputies in the lower chamber, São Paulo had 27 fewer deputies than an exactly proportional system would assign, Minas Gerais, 17, Bahia, 8, Rio Grande do Sul, 7, Parana, 3, Pernambuco, 3, and Rio de Janeiro, 2.⁸ Among those states that were over-represented, they received 18 deputies above the number that would have been awarded in a proportional system (Soares 1971:5-23). When we compare this to the distribution of workers by state and occupation, it becomes clear that this malapportionment of seats discriminated against urban industrial interests.

⁸ This includes the old capital of Rio de Janeiro and the state of Guanabara.

**TABLE 5: RATIO OF AGRICULTURAL WORKERS
TO WORKERS IN MINING AND MANUFACTURING⁹**

State	Under-represented?	1950	1960
Piauí-NE	No	108.4	98.6
Goiás-CW	No	96.4	71.4
Maranhão-NE	No	43.7	76.7
Bahia-E	Yes	38.6	43.5
Espírito Santo-E	No	35.9	28.6
Rio Grande do Norte-NE	No	30.5	33.2
Mato Grosso-CW	No	26.9	22.6
Ceará-NE	No	26.7	42.5
Amazonas-N	No	24.5	33.8
Pará-N	No	22.2	27.9
Paraíba-NE	No	19.5	32.0
Minas Gerais-E	Yes	17.4	15.9
Paraná-S	Yes	15.4	18.9
Alagoas-NE	No	12.0	18.6
Pernambuco-NE	Yes	10.7	17.6
Santa Catarina-S	No	10.6	9.9
Rio Grande do Sul-S	Yes	10.3	9.7
Sergipe-E	No	10.0	17.7
Rio de Janeiro-E	Yes	3.5	2.2
São Paulo-S	Yes	2.9	2.0

Source: Schmitter 1971:26.

The states are arranged in descending order of the ratio of agricultural to mining and manufacturing workers as of the year 1950. By examining which states were under-represented (shaded), this data gives a sense of how the malapportionment altered the preponderance of interests represented in the legislature. Of the nine states with the lowest ratio of agricultural to mining and manufacturing workers, six were under-represented in congress. Of the eleven states with the highest ratio, only one was under-

⁹ To the extent that mining workers should in fact be grouped with agricultural workers based on their links to exporting activity, these numbers would underestimate the discrimination against urban, industrial, inward-oriented interests.

represented. Clearly, the malapportionment systematically reduced the representation of those states with the largest industrial sectors relative to agriculture. An examination of the distribution of urban population by region as seen in the table below gives the same picture of an underrepresentation of urban interests. Those regions with the greatest percentage of the urban population are also those with the greatest number of under-represented states.

TABLE 6: DISTRIBUTION OF URBAN POPULATION BY REGION¹⁰
(Regional Total as % of National Total)

Region	% of States in Region Under-Represented in Lower House ¹¹	1940	1960
North	0	3.7	3.1
Northeast	14	20.4	18.4
East	60	34.3	34.2
South	75	41.2	42.3
Center-West	0	.4	2.0

Source: Villela and Suzigan 1977:239

Finally, in the unlikely chance that the distribution of manufacturing and mining workers or urban population does not reflect the distribution of industrial output, an examination of manufacturing value-added by region provides one more measure of how the malapportionment in congress affected interest representation.

¹⁰ Percent of states in region under-represented calculated from table above with states assigned to regions as designated in the table on representation. Note that São Paulo has its own category, but in the table below it is assigned to the Southern region.

¹¹ Although the degree of over and under-representation changed over the period, no state switched status from over to under-represented.

**TABLE 7: DISTRIBUTION OF MANUFACTURING
VALUE-ADDED BY REGION
(Regional Total as % of National Total)**

Region	1949	1959	% of States in Region Under- Represented in Lower House
North	1	1	0
Northeast	5	7	14
East	26	31	60
South	67	61	75
Center-West	1	1	0

Source: Bergsman 1970:163

As with the other measures, this one also indicates a systematic relationship: as percentage of manufacturing value added increases, so does under-representation in the lower house.

What about the specific policy arenas governing foreign trade and industrial policy? Policy authority in this period in Brazil was shared between the legislature, and executive agencies which allowed formal participation of interest associations. All major changes in foreign trade policy had to be approved by Congress. This included both organizational changes, such as the creation of CACEX (Lei 2.145, 12.29.53) A BUREAU WITH AUTHORITY TO and the CPA (Lei 3.244, 2.2.45), WHICH HANDLED XXX and the successive modifications of exchange control and tariff systems from licensing (Lei 262, 2.23.48) to auctions (Lei 1.807, 1.7.53), to the creation of the new tariff system in 1957 (Lei 3.244, 8.14.57). This legislation created the guidelines for the organization and functioning of each of these control systems, including the designation of imports and exports to categories, the disposition of the funds obtained from the auctions, and the general guidelines for tariff levels. Smaller incremental adjustments were carried out by the executive bureaucracy through Decreto Leis, authorized through a continuing delegation from congress to the executive. These

delegations varied from ninety days to up to two years. Legislation which established each of these executive agencies provide for the direct participation of one member from the peak associations of industry, commerce, and agriculture in the case of CACEX (Lei No. 2145, 12.29.53), and two members from each peak association in the case of the CPA (Lei No. 3244, 8.14.57). SUMOC, which was responsible for setting exchange rates and approving any changes of product categories in the exchange auctions was under the Ministry of Finance, and changes to its structure and functioning was under its jurisdiction. The governing council of SUMOC which made decisions on exchange rates and category changes also included participation by private sector representatives designated by the president (Huddle 1972c:503). Finally, legislative approval was required for many of the nuts and bolts decisions that implemented industrialization policy, including decisions governing short-term investments, executive concession of special credits, and the levying of (or exemption from) taxes (Santos 1986:89; Carvalho 1977; Lafer 1970).

In sum, the data indicate a growing industrial sector, but not one that was likely to have been as effective in organizing for collective action as agriculture. When we look at how this distribution of economic power is reflected in political institutional power we see a pattern in which the long predominance of agriculture is sustained. By any measure of representation in political party platforms, interest groups, representation in congress, and representation on executive councils governing foreign economic policy, agriculture either equals or exceeds the influence of industry. In particular, agricultural interests were considerably over-represented in the congress, and the congress retained very tight control over design and implementation of industrialization policy. In short, this data

casts considerable doubt on the proposition that industry had political power sufficient to alter the status quo: longstanding policy that heavily favored agricultural interests. Thus, we must look beyond the interest group model to explain this change in policy.

It is worth noting that these findings are consonant with the overwhelming conclusion in the literature that industrial entrepreneurs were very weak politically during this period in Latin America. Indeed, it is argued that the weakness of this sector was what necessitated state intervention to promote industrial development in the first place. The overwhelming bulk of the literature on Latin America argues for the weakness of the inward-oriented industrial coalition (Haggard 1990, Pinto 1965).

Policy Promulgation: Interest Groups and Legislative Behavior

Even when scholars endeavor to develop a priori measures of group strength, ascertaining whether their influence was key to the selection of the policies in question remains problematic. Tracing the kind of diffuse influence posited by these models is notoriously difficult. I argue that there is another way to test this theory with systematic evidence. The interest group model of the policy process, in which politicians appeal to well-defined group interests through the policies they promulgate, has clear implications for political party and legislative behavior.

The logic underlying the model is that distinct interests with fundamentally opposed views on a particular policy square off against one another in the political arena. In the case of developing countries in the post-War, the overwhelmingly dominant policy priority was economic development. Thus, we should expect legislative behavior to reflect a clash of views regarding how to promote economic development. The interest group model argues that one coalition, consisting primarily of export producers and

commercial interests favored the earlier policies of free trade, neutral or undervalued exchange rates, and few controls on foreign direct investment. A second coalition, which according to this view, triumphed during the period of import substitution, favored policies supporting domestic production behind high tariffs, foreign exchange controls, and nationalization of key industries.

If this model of the policy process is correct, then political parties representing the interests of these opposing groups must build a public record which allows them to credibly claim to represent the interests of these competing economic sectors.¹² One of the principal ways parties create such a public record, which allows their supporters to differentiate them from their competitors, is through voting consistently in favor of legislation pursuing a particular policy goal while their competitors vote against said legislation. In other words, this model of the policy process leads us to expect that majorities of parties representing these two positions should oppose each other on legislative votes concerning development policy.

The table below summarizes voting patterns on all the bills implementing the economic development program that dominated the executive's legislative agenda in Brazil throughout the period from 1945-64. All of the major national development programs of the period are included, such as the creation of Petrobras (the national petroleum monopoly), Electrobras (the national electricity monopoly), BNDES (the National Development Bank), SUDENE (the Northeast Development Agency), the National Coffee Institute and the National Coal Institute. I have also included all the bills providing special credits to the executive, which were indispensable to the

¹² The "public record" of the party "consists of actions, beliefs, and outcomes commonly attributed to the party as a whole. For example, issue positions adhered to by substantial majorities of the party--especially if opposed by majorities of the other party--become part of its public record" (Cox and McCubbins 1993: 110).

implementation of economic development programs such as Vargas' import substitution program and Kubitschek's program of secondary import substitution, dubbed the "Target Plan".

TABLE 8
PARTY VOTING ON EXECUTIVE
ECONOMIC DEVELOPMENT LEGISLATION

Content of Bill	Number of Bills	Grand Coalition	All Four Major Parties	All Three Major Parties
Economic Develop. (All Bills)	35	19 (54%)	21 (60%)	21 (60%)
Economic Develop. (Bills Passed)	16	10 (63%)	12 (75%)	12 (75%)
Executive Credits (All Bills)	40	22 (55%)	26 (65%)	30 (75%)
Executive Credits (Bills Passed)	32	22 (69%)	24 (75%)	27 (82%)
Total Bills	75	40 (53%)	47 (63%)	51 (68%)
Total Bills Passed	49	32 (65%)	36 (73%)	39 (80%)

Source: Database on roll call voting provided by Octavio Amorim Neto and Fabiano Guilherme dos Santos.

Grand Coalitions are coalitions in which no party majority opposed the bill.¹³ The All Four Major Parties category designates bills in which majorities of all four of the largest parties (PSD, UDN, PTB, PSP), which controlled 86 percent of the seats in the legislature, on average over the period, voted the same way on a bill. The All Three Major Parties category corresponds to the same for the three largest parties (PSD, UDN, PTB), which controlled 81 percent of the seats in the legislature, on average, over the period.

As can be seen from the table, taking even the most conservative reading of the data, on 55 percent of all bills, there was no difference between *any* of the parties in how

¹³ On one of these bills, the PDC did not vote, which is the only case in this category in which *majorities of all of the six parties* listed in Table 1 above did not vote the same way on a bill.

they voted. If we examine just those bills passed, the most likely to be the vehicle for credit-claiming, we see that there was no difference between any of the parties on 65 percent of the bills. Finally, if we consider the bills which established the major economic development programs of the period, and thus with the highest profile in terms of credit-claiming, we see that there was no way to differentiate between any of the parties on 63 percent of these bills. If we employ a slightly less demanding criteria, and look at the three major parties which controlled over 80 percent of the legislature throughout the period, we see that there is no distinction in party voting in 72 percent of all bills considered, no distinction in party voting in 84 percent of all bills passed, and no distinction in party voting in 88 percent of the bills passed related to economic development programs.

Clearly this data is not consistent with a struggle between inward and outward oriented interests as represented by the voting patterns of distinct parties. How could any party claim to represent other than the government position if all parties voted the same way on 88 percent of the bills establishing these programs? If voting which pits majorities of one party against another is one of the key means by which parties create a public record, how could any party claim to represent outward-oriented interests? How would economic interests opposing government programs determine which parties to support in order to further their policy goals?¹⁴ In sum, legislative voting during this period did not exhibit any clear set of positions or clash of interests regarding emphasis

¹⁴ Some observers may cite the institutionalist literature on Brazil which argues that legislators are overwhelmingly concerned with developing a personal reputation to the detriment of national policy. The importance Brazilian legislators place on their personal reputations is undeniable. At the same time, no individual legislator in any political system can claim credit for a national program without recourse to a political party or coalition with a voting record that demonstrates support for such a program. As Fiorina and Noll (1979) have argued, claims by individual legislators to deliver programs are not credible because their adoption requires majority support in the legislature. See section XX below for a more in-depth discussion of this issue.

on inward versus outward-oriented development policy. Rather than one set of parties supporting inward-oriented policies and another set supporting outward-oriented policies, all parties voted consistently to support inward-oriented policies throughout the period.

These results raise quite a paradox: although agricultural interests were clearly more politically powerful than industrial interests, policies promoting inward-looking development gained near universal support in the legislature. This data clearly does not support an interest group model of policy.

Critical Distortions of ISI Policy: Overvalued Exchange Rates

Scholars both favoring and opposing the inward-oriented development model agreed that ISI policy as implemented had important flaws. Among the most heavily criticized choices, including the use of overvalued and multiple exchange rates, capital intensive investment, and high and variable protection, overvalued exchange rates were considered the most distorting. Exchange controls and varying rates were used to block imports being substituted while subsidizing those needed to jump start industrial production: inputs and capital goods. Given the fact that overvalued rates reduce exporters' earnings in national currency, the overvalued exchange rates provided a mechanism for shifting income from the export to the import-competing sector. Most economists do not decry so much the attempt to shift income, but rather the means by which this shift was achieved. Scholars have long been puzzled by why policymakers would opt for this mechanism, given the extreme distortions in price signals created which reverberate throughout the economy. Why policymakers chose exchange controls over the much less distortionary tax and subsidy, which would limit the effects of the policy to the direct actors concerned, has not been well-explained.

This was a major source of subsidy to IS industries in Brazil: from 1947-52 analysts have calculated the subsidy to be between 10 and 20 percent of the value added in industry, and from 1953-57, Gudin (1969:11-12). estimates that nearly half the cost of imports of equipment and machinery was subsidized. How well can an interest group model account for this choice?

The data presented above clearly established the continued dominance of agricultural interests. But this makes it difficult to explain the choice for the exchange rate transfer with an interest group model of politics. Indeed, Sachs (1985) has argued that it was the continued strength of the agricultural sector during the phase of industrial promotion that led East Asian governments to opt for more neutral exchange and trade regimes that were the linchpin of their successful development policy. This raises the question of why the strength of the agricultural sector in Latin America did not lead to the same choice.

Hirschman (1985) attempts to reconcile the continuing strength of Latin American agro-exporters with the choice for exchange controls through an argument about the opacity of the policy. According to Hirschman, agro-exporters remained a powerful player and opposed a direct tax, and thus state leaders resorted to the less direct yet more distortionary option of overvalued exchange rates for achieving a transfer of resources between sectors. But if agro-exporters were strong, which helps explain the inability to tax them directly, why wouldn't they also oppose the exchange controls that also reduced their income, albeit in a more indirect fashion? Hirschman's response was that exporters (and other social groups) did not clearly perceive the effects of the overvalued exchange rate mechanism (1985:117-18). Given the magnitude of the subsidies conferred through

the exchange controls discussed above, ignorance of the policy's effects seems highly unlikely. Moreover, Hirschman does not provide any direct evidence to support this argument. And an examination of the available evidence directly contradicts his view.

Legislation adopted in October 1953 to implement the exchange auctions provides direct disconfirmation of the view that agroexporters failed to recognize the effect of exchange rate manipulation on their income. These bills altered the exchange rate regime from one of a fixed overvalued rate, to one of five categories of auctions, and required that auction premia be *returned to exporters in the form of higher export exchange rates*. The Finance Minister and the President of the National Monetary Council (CMN) publicly proclaimed the legislation providing export 'bonuses' as "resolving the problems of the so-called 'difficult exports' [those other than coffee that declined rapidly from 47-53, as discussed above] and attending to the aspirations of the coffee producers, *eliminating the exchange confiscation*" (Rio and Gomes 1955:339, emphasis added). In addition, the UDN made one of its principal themes of congressional action opposition to the exchange confiscation (Benevides 1981:103). Both the fact that the congress, with its over-representation of rural interests, passed the legislation, as well as the public recognition of its intent to attend to coffee producers' complaints about exchange confiscation make it difficult to accept Hirschman's view that government officials had found a way to extract from agro-exporters which eluded their perception.

In sum, though the data support Hirschman's assertion that agro-exporters remained a powerful player, it directly refutes the notion that they were unaware of the consequences of ISI policy choice. Rather, the analysis of sectoral power indicates that

any explanation of ISI policy choice must account not for what agro-exporters opposed, but for what they wanted, and how that shaped ISI policy choice.

AN ALTERNATIVE MODEL: CLIENTELISM

The previous sections have demonstrated that interest group theory shed little light on the shift to inward-oriented policy, the legislative process, the choice of extremely distortionary policy tools for implementing that policy, and the process of reform. In this section I argue that a clientelist model of politics can explain these patterns of political behavior and policy choice.

Clientelism is characterized by direct, quid pro quo links between supporters and their elected representatives (Kitschelt 2000; Stokes 2000). This is in contrast to an indirect link in which politicians supply some combination of national collective goods, pork, and rents in an attempt to sway voters' choices. Although much of the literature slurs over the difference between clientelism and "ordinary" localism, these two types of relationships between politicians and their supporters are distinct and have different implications for political behavior and policy outcome. Under clientelism, votes are monitored and benefits are distributed based on a quid pro quo with an individual voter or economic agent. "Ordinary" localism, rent-seeking, or pork barrel is non-excludable at the local or sectoral level and is typically supplied in combination with national collective goods.¹⁵

Citing Cain, Ferejohn and Fiorina (1987), Kitschelt argues that "Clientelism is ... not the same thing as ...the personal vote. The personal vote is the effect of a candidate's personal initiatives on his or her electoral success, net of aggregate partisan trends that

¹⁵ For the classic study of "ordinary" pork barrel see Ferejohn (1974). For a similarly seminal study of "ordinary" rent-seeking, see Buchanan et. al. (1980).

affect partisans as members of their parties” (2000:852, emphasis added). In other words, in the case of ordinary pork barrel, dams, hospitals and schools are typically distributed based on legislators’ influence rather than national social welfare considerations, but they are non-excludable locally targeted public goods in that district. Similarly, with ordinary rent-seeking, favorable regulatory decisions, or tariffs, for example, apply to a favored sector, and not an individual firm. Voters and interest groups typically weigh both local or sectoral *and* national concerns in deciding which politicians or parties to support. Under clientelism, in contrast, these goods are in fact made excludable at the level of the individual voter or firm and are exchanged *directly* for votes or other types of support (Kitschelt 2000).

This distinction between a direct or an indirect link between politicians and their supporters has dramatically different implications for political behavior and outcomes. The key consequence of this difference in the relationship between politicians and their supporters is that under clientelism the links between supporters and their elected representatives are direct and *mutually exclusive*. What one firm receives in terms of access to overvalued foreign exchange in return for the votes of his employees or a campaign contribution another firm cannot. The job one voter receives in return for his vote cannot benefit another voter. This is in contrast to an economic development policy that does not create jobs based on subsidies and distribute them directly but aims at increasing them through promoting efficiency through competition. Two politicians who vote to support an economic development program based on efficiency can in fact both claim credit for the jobs created.

The strategic implications of these differences in the link between voters and politicians have been seriously understudied. If politicians are linked to their supporters through the direct delivery of individually excludable benefits, then every politician is potentially pitted against every other politician in gaining constituent support. This is in contrast to an indirect link, which may involve some localism, but in which the party program serves as a collective good for all members of the party (Cox and McCubbins 1991). Under clientelism, legislators must develop credible agreements not to encroach on one another's bailiwicks in order to avoid the war of all against all that mutual exclusivity of support creates. As we will see, this potential war of all against all is crucial for understanding the choice for distortionary overvalued exchange rates as a means to transfer resources to industry.

Not Inward Shift but Diversification of Direct Benefits

We can now resolve the puzzle of how we got an ISI policy that apparently heavily favored import-competers despite their lack of economic dominance and limited political influence. The interest group model discussed in section XX above has implications for how policy change takes place. In the interest group model, in which politicians organize to provide broad collective goods coupled with policies that benefit their specific supporters, major changes in policy, as a shift from outward to inward-oriented development, occurs when a new group gains sufficient power to seize control of the legislative agenda. It is only when a party or coalition with a program gains the legislative seats sufficient to harness the legislative machinery that a major shift in policy takes place. This is why the shift to industrialization has proven so puzzling to analysts.

As the analysis above demonstrates, inward-oriented interests clearly did not possess the legislative or interest group influence sufficient to promulgate a major policy shift.

The relationship between emergence of new groups and policy change is quite distinct under clientelism. With clientelist competition a change in policy does not require sufficient electoral and legislative power to seize control of the legislative agenda. Rather, it simply requires the emergence of a group with enough clout to force existing power groups to cede some portion of available resources (Anderson 1967; Kenworthy DATE). Moreover, in clientelist systems, successful first movers gain a significant advantage. Clientelist politics creates a much more uneven playing field between incumbents and opposition than collective goods politics. It is much more difficult to compete with a politician or party which has established a reputation for access to and delivery of direct benefits than it is to compete with a politician with the best plan for a development policy with a given orientation (inward or outward). This is due to the fact that whereas it is not possible to have a monopoly on good development ideas, incumbent status does often confer a near monopoly on resources for distribution. The result of this altered competitive dynamic is that when new potential clients emerge, there is a strong incentive to beat one's competitors to the punch in incorporating new interests with new direct benefits.

Rather than reflecting the rise of a new dominant sector, the shift to ISI reflected the race to incorporate incipient industrial interests into clientelist politics. Early industrial firms evolved precisely due to the success of exporting (Jaguaribe DATE). Those political entrepreneurs who could devise policies to incorporate emerging industrial firms and the emerging working class while safeguarding the interests of

exporters would become the new winners. Agro-exporting interests continued to dominate in Brazil in the mid mid-20th century, but the very success of exporting created new industrial and middle and working class groups that were fertile ground for building new clientelist networks of support.

Legislative Voting

As discussed above, the pattern of legislative voting under ISI was not consistent with an interest group model of politics. As the data indicated, no party could credibly claim to support any position other than the government's. I argue that these patterns are a result of the fact that clientelist politics creates very different credit-claiming problems than interest group politics. These distinct credit-claiming problems in turn have distinct implications for party and legislative behavior. It is useful to first consider the imperatives of credit claiming when politicians deliver non-excludable benefits.

When electoral competition favors indirect links to voters, politicians win votes by delivering some mix of national, local and sectorally targeted non-excludable goods. By definition, non-excludable goods are not delivered directly to voters, but are available to all members of the relevant political unit or sector. Procuring such goods does not require any direct contact with supporters. Thus, the only way voters can be sure who to reward for general policies is if the party regularly takes positions in favor of, and votes for such policies, while other parties regularly oppose them (Cox and McCubbins 1993). Intra-party discipline in legislative voting is necessary for demonstrating issue position and for passing a legislative program, whereas inter-party difference in voting is necessary for claiming responsibility for passing certain types of legislation (Cooper et.

al. 1977). If all parties vote to pass the same legislation, no particular party will be able to credibly claim they are distinct from the others in securing certain policies.

Now let us consider how credit-claiming is altered when electoral competition revolves around the direct delivery of goods in quid pro quo exchanges. In this case, the tasks of demonstrating issue position and political responsibility are transformed into those of demonstrating access to political power and resources. Demonstrating this access and obtaining resources for delivering excludable goods is what makes claims in clientelist systems credible. This is the root of the absence of inter-party divisiveness in such systems. As long as the legislative arena is the primary locus of decisions regarding the distribution of most government resources, we should expect low inter-party divisiveness because legislators or parties will be eager to join any legislative deals that can provide them with direct benefits.¹⁶ By the same token, when goods are exchanged directly for votes, there is no need for parties to differentiate themselves in terms of issue position in the legislative arena. When voters cast their vote based on the receipt of a direct benefit, rather than based on issue position, principled legislative votes (the opposition voting against government legislation, for example) have no electoral value. In clientelist systems, voters are not looking to a party's public record on legislation to determine their vote, but instead to whether the party has delivered. Under these conditions, any legislative vote that increases a party's ability to deliver is pure electoral gain.

¹⁶ Rules which take decisions about resource distribution out of elected representatives' hands will alter this prediction. An example is Costa Rica, where the Constitution of 1949 created a range of autonomous administrative agencies, which in some cases designed, implemented and raised revenues for their own budgets, and in others were protected from legislative reductions in their budgets below a specified level. See Mijeski (1977:61-63).

The Distortionary Exchange Rate Transfer

A clientelist model of politics can also illuminate the logic behind the choice for overvalued exchange rates for transferring resources between sectors. Clientelism means votes are bought directly. This in turn implies that fungible resources are potentially more formidable political weapons than in the case in which resources must be turned into policy and outcomes that voters evaluate. In a clientelist system fungible resources can be used to outbid existing quid pro quo bargains and directly reconfigure clientelist networks of political support. A direct tax would have provided just such a fungible resource to the executive. There is considerable agreement in the literature regarding the role of the executive in adopting and implementing ISI policies in Latin America. Legislatures delegated to executives to create and distribute incentives to firms to substitute previously imported manufactured goods. The exchange rate regime adopted in Brazil, and much of Latin America, however, insured that the resources generated could not be used directly against agricultural elites. As discussed above, Brazil initially employed a unified overvalued rate, and the windfall was distributed by way of licenses to favored importers. This allowed the executive to provide resources to favored importers, but such import licenses were of little use in courting rural voters or urban squatters, for example, in an attempt to reconfigure longstanding clientelist networks.

This system ultimately required modification due to the increasingly overvalued rate. The auction system instituted in 1953 was designed to resolve some of this overvaluation problem. The funds generated from the auctions, however, were mandated by law to be returned to exporters in the form of the bonuses. Both the generation of resources through exchange rate manipulation, as well as the legislation mandating the

use of the auction funds *avoided the creation of fungible resources that the executive could spend as he saw fit.*

It is worth noting that during this period agricultural elites in Brazil had good reason to be suspicious about attempts to outbid them in their own base of support. The source of these elites' political power was their control of the votes of low income rural populations (Nunes Leal 1977). Their control over state-based clientele had recently been challenged and in some cases eroded by the incursions of Getulio Vargas, authoritarian leader from 1930-45, wielding federal funds (Skidmore 1967). A direct tax on exporters would have further empowered presidents of the period to outbid local agricultural elites directly for the loyalty of their voters. Overvalued exchange rates, in comparison, provided a much more restricted tool. In the form implemented, it could be used to subsidize and incorporate industrialists into the clientelist system, and return income to favored exporters, but not to remake existing clientelist bargains more generally. The exchange rate transfer, in other words, was a fairly safe policy for existing beneficiaries of clientelist politics because its application was fairly restricted. It thus proved an effective tool for reconciling agricultural interests to the policies designed to incorporate industrial and urban working class interests into the clientelist system.

Summarizing the previous three sections, an inward shift despite the weakness of industrialists, legislative voting almost unanimously in favor of the shift, and exchange rate manipulation are of a piece. Each of these anomalies can be understood as the outcome of a bargain between still prominent exporters and political entrepreneurs incorporating new interests in a clientelist system. The adoption of import substituting policies incorporated rapidly growing urban interests into the existing clientelist system.

The preference for the exchange rate transfer was a way for agroexporting interests to insure that political entrepreneurs restricted themselves to incorporating new interests rather than attempt to remake existing clientelist networks. Finally, the puzzling pattern of legislative voting observed makes sense once we understand the credit-claiming problems associated with clientelism. Once one group of politicians began to devote resources to incorporating new interests, it was in the interest of all politicians to obtain some of those resources and take part in forging new direct ties to supporters.

ISI was not Rent-Seeking but Clientelism: Intra rather than Inter-Sectoral Transfers

The previous three sections argued that we can explain a series of puzzling features of ISI policy if we discard the interest group model in favor of a clientelist model of politics. In this section, I re-examine ISI policy itself to ask, to what degree do the policy choices under ISI support the general argument presented here? In other words, to what extent do the actual ISI policy choices support the argument that ISI was a policy that incorporated incipient urban industrial interests into a clientelist system dominated by exporting groups, rather than one that transferred resources from an efficient export sector to an inefficient import-competing sector?

The interest group lens and the exogenous preferences it posits predisposed scholars to view ISI policy as one that transferred resources from an efficient, export-oriented sector to an inefficient, import competing sector. This view of course provided a neat explanation for the failures of ISI. As we have seen, however, this explanation has difficulty explaining much of the important empirical detail surrounding ISI as it was implemented. In this section I argue that this characterization of ISI policy was based on

a very superficial examination of exchange rate policy only. A more detailed examination of overall policy indicates that it *avored selected firms in both the import-competing and export sectors*.

Exchange Rate Policy

As this section will demonstrate, exporters in Brazil did not lose as a result of ISI policy. Moreover, the evidence indicates that the benefits from ISI policy were distributed to both exporters and import competitors on firm by firm basis. Previous studies of ISI policy placed great emphasis on a very stylized measure of the inter-sectoral transfer via overvalued exchange rates, and typically failed to examine how other policies qualified the effects of the exchange rate transfer.

Most analyses of exchange rate policy were based on the assumption that an examination of the implicit tax on exporters based on the overvalued exchange rate gave a full picture of how policy affected different sectors. Analysts typically calculated the implicit tax on exports by comparing exporters' income at the official rate with their hypothetical income at a purchasing power parity rate.¹⁷ Yet when the overall policies governing exporters are examined more carefully, however, two points become clear. First, the net effect was not to transfer resources from the exporting sector to the import-competing sector, but rather to subsidize *selected* exporters with a variety of measures that compensated for the overvalued exchange rates, including bonus programs that returned the resources extracted through the exchange rate, subsidies on their inputs, credit policies, and price support programs. Second, with the possible exception of price

¹⁷ In the case of Brazil, for example, Malan et. al. (1977), Fishlow (1985) and Huddle (1972) carry out this type of analysis. With the inclusion of Werner Baer and Nathaniel Leff, these are undoubtedly among the most influential analysts of economic policy in Brazil during the period.

support programs, all of these policies which compensated exporters for the exchange rate transfer were administered on a discretionary basis at the level of the firm. At the same time, policies favored some import-competing firms and penalized others, depending on who had access to highly subsidized foreign exchange and credit. Let us examine the important components of the overall policy in turn.

Examining how overall exchange rate policies affected exporters, first, there were a variety of policies in place that limited the quantity of foreign exchange that was required to be sold at the overvalued official rate. Thus, a calculation of the transfer based on an assumption that all exporters sold their exchange at the official rate, the typical assumption, will overstate the value of the transfer. From 1945-53 Brazil employed a unified overvalued exchange rate (1945-53), but coffee exporters were required to sell only half of their foreign exchange to official banks at the overvalued rate. The rest could be sold at the free market rate (Kafka 1956:309). Thus only half of the coffee earnings were subject to the exchange rate tax.

Second, for exporters other than coffee, a separate means of obtaining a de facto devaluation was instituted from 1945-53. This was a program of “linked operations” which allowed exporters of non-competitive products (i.e. all except coffee) to sell the foreign exchange they earned to importers at a premium in comparison to the official rate of 18.5 cruzeiros to the dollar. Soon after the linked operations were introduced, they began to take place on a large scale, and in 1950, they were responsible for 20% of exchange transactions. The system had to be discontinued in 1952 due to the fact that its great popularity was seriously reducing the government’s ability to control imports (Doellinger, et. al. 1977:21). The great popularity of this system indicates that for non-

coffee exports as well, a considerable portion of their foreign exchange was sold at rates higher than the official overvalued rate. These data demonstrate that calculations of the implicit tax on exports which compares exporters' income at the official rate with their hypothetical income at a purchasing power parity rate will overstate the size of the transfer due to the fact that it understates exporters' earnings under the prevailing policy in any case in which some exports are not sold at the official rate. Thus, the tax on exporters was smaller than these analyses report.

A second very important factor qualifying the prevailing conception of the intersectoral transfer was the fact that in the case of coffee, Brazil was a near monopoly supplier and price elasticity of demand was low. Thus, a considerable portion of this tax on exporters could be transferred to foreign buyers (in the short term). And indeed it was, at the public's expense -- government sponsored coffee price support programs (to be discussed more fully below) contributed significantly to an increase in coffee prices of 588 percent from 1945 to 1954.¹⁸ In addition, the volume of coffee sold increased over the period. The requirement to sell half of their proceeds at the official rate which averaged one half the free market rate over the period from 1945-53 meant that coffee exporters were taxed at roughly one fourth the overall coffee income over the period through these controls. But with a 588% increase in price, the result of government intervention would have led to a considerable net gain for coffee *even if all coffee exports* had been subject to the implicit tax. In short, the net result for coffee exporters of a policy of overvaluation combined with price supports (financed by the government) was a considerable net gain, an outcome that is overlooked with an emphasis on exchange

¹⁸ Baer (1965: 302). Calculation made from prices on Santos 4 grade coffee quoted in New York.

rates alone. As many analysts have noted, the coffee sector was far from suffering an absolute decline in its income during this period (Lessa 1964).¹⁹

In 1953 a new exchange rate system was put in place. It consisted of auctions for foreign exchange, with five categories of minimum price with increasing overvaluation. Certain types of imports were allocated to each of the categories. This reform also included a new system of devaluation for exporters. Under the new rules exporters were required to sell all of their foreign exchange earnings to official banks at the official rate. But by law this system was required to use the premia captured in auctioning foreign exchange to provide export “bonuses”. The bonuses were to be calculated based on the difference between the official rate of 18.5 cruzeiros to the dollar and the average free market rate over the period. The system was designed not simply to compensate exporters but to provide enough subsidy so that all exporters could continue to sell on the international market, thus providing the least productive exporters with the highest bonuses: initially coffee received a 5 cruzeiro per dollar bonus above the official rate, and all other exports received a 10 cruzeiro per dollar bonus. The system was adapted over time to changing circumstances including increasing the number of categories from two to four and regular increases in the bonuses to keep up with the rapidly rising free market rate.

From November 1953 through February 1955, coffee received a re-adjustment of their exchange rate of 101%, while inflation over the same period was no more than 33%

¹⁹ Brazil’s position as a near monopoly supplier of coffee should not lead to the conclusion that it was a unique case in compensating exporters for ISI policy. Chile heavily subsidized nitrate exports during the same period, and Argentina obtained an agreement from Britain to maintain the volume of its exports during the initiation of ISI. Bolivia obtained guarantees on tin exports from the United States. Thus, while exports may have declined, and ISI may have changed the role of exchange rate policy, it should not be concluded that exporters’ income declined until overall policy is evaluated. Moreover, when producers’ income is determined directly based on the distribution of production rights, as under clientelism, we must rethink how we derive economic groups’ interests. Interest group models’ exogenously derived preferences based on position in the international economy can be seriously misleading.

(Netto and Pinto 1973:290). Through these bonus systems, Huddle (1972b) calculates that roughly 1 billion dollars of the difference between the import and export rate was returned to coffee, and 1.5 billion to all other exports. According to Bergsman, this system of bonuses served to protect exporters from any further extraction through overvalued rates: “Since 1952, the export exchange rate has kept up with the Brazilian inflation” (1970:47). Kafka has in fact argued that the exchange rate on exports “sustained approximately the same rate on exports that was enjoyed by the most privileged exporters before the reform [of 1953]... Though allowed a lower premium [than the other exports], coffee also fared better than under the system that was in force before the reform” (1956: 309). These export bonus programs, which created periodic devaluations of the export exchange rate, were maintained until the abolishing of all multiple rates in 1961. But beginning in 1959, they became increasingly irrelevant due to the fact that controls on exports were successively removed, and their exchange transactions were transferred to the free market. Initially freed exports included sugar and cotton, but by late 1959, almost all exports were freed, with the exception of coffee and cacao (von Doellinger 1977:38-40).

Finally, the ability to evade the law must be considered in a full evaluation of how exchange rate policy affected exporters. Analysts have noted that the largest source of supply of dollars to the free market from 1954 on was through under-invoicing of coffee exports (Gudin 1956:503; Kafka 1956). Because the average rate in the free market was higher than the export exchange rate, it was profitable to under-invoice exports and sell the difference in the free market. With the floating free rate, again, this means that those coffee exporters that could manage to convert their foreign exchange through this

mechanism did not suffer the full brunt of the loss of income from overvalued exchange rates.

To summarize, during the first period of exchange controls, the overall effect of overvalued exchange rates cum price support policies was extraction from the many (through publicly funded price supports, to be discussed in detail below) in order to provide benefits to favored importers *and* exporters. Because price support policies which were funded at the public's expense more than compensated exporters for the exchange rate transfer, it was in fact consumers that bore the brunt of policies that served both import competitors and exporters. After 1953, according to most analysts, the transfer due to overvalued exchange rates was more than compensated for through the bonus schemes which were funded by the resources that were captured from the auctions. In this period then, the overall effect of policy was to extract resources from disfavored importers, who paid a high premium on their imports, and transfer them to both favored importers who received subsidized exchange and favored exporters who received compensation from the premia.

Price Support Programs

Brazil had a coffee price support program that dated back to the turn of the century. Initially, this program was carried out by the state of São Paulo. But the very success of this program in maintaining high prices stimulated more coffee production, both within São Paulo and in other states. With the crisis of the 1930's, São Paulo coffee producers found that they required federal intervention on a permanent basis to ensure that the short-term gains from their price support program and long term possibilities were not undermined by producers in other states not subject to São Paulo controls. As a

consequence, in the early 1930's the federal government took over the coffee price support program.

The costs of the national coffee price support program were extraordinary. As Furtado notes: "A good idea of the strain involved [in maintaining coffee price supports] may be had by considering the value of coffee that had to be bought for stocking or destruction, which in some years exceeded 10% of GNP. This was a policy inspired by the coffee interests, or designed to appease them. The more the government bought coffee for stocking or destruction, and thus inflated the internal economy, the more the Brazilian currency depreciated in relation to foreign currencies; this process also favored coffee growers because the price of coffee continued to rise in depreciated national currency even while the world price was steadily falling" (Furtado 1965:146-7, discussing coffee price support policy in the 1930's).

Lessa notes that a significant source of the drain on foreign exchange reserves after 1945 was due to writing off the consolidated international debt contracted from 1900-1930 for coffee price support. In other words, national reserves were used to erase debt incurred by the state of São Paulo to support coffee prices.

Once the national government took over coffee price support, the costs for 1954-62 were estimated as shown below:

TABLE 9: COFFEE PRICE SUPPORT, 1954-62

Year	Value of Increase in Stocks	As a Percentage of GDP
1954	3.4	0.61
1955	5.9	0.85
1956	1.2	0.14
1957	11.4	1.07
1958	26.9	2.05
1959	49.6	2.77
1960	49.0	2.05
1961	31.9	0.91
1962	110.3	

Source: Lessa 1964:183.

In addition to the diffuse costs to the economy as a whole due to inflation, these policies also reduced Brazil's share of the world market. While the Brazilian government could control coffee production within Brazil, it could not control the world market. Although from 1930-39 Brazil controlled 56% of the world coffee market, in comparison to Colombia's 13 and Africa's 7, between 1946 and 1952, Brazil's share had been reduced to 52%, Colombia's had risen to 17, and Africa's to 14. By 1954, the relative shares had become an alarmingly low 38 percent for Brazil, 20 percent for Colombia, and 20 percent for Africa (Netto 1979:132).

Similar to this institutionalized price support program for coffee were intermittent price support programs for other exports. If a particular export was having trouble on the international market at the prevailing export rate, the Export-Import Department of the Bank of Brazil would sometimes simply buy the product from the exporters at a higher price and export at a loss (Gudin 1957:507-8). This was done for cacao and coffee at various times throughout the period (von Doellinger 1979:46). In 1952 the Bank of Brazil bought the entire cotton crop, the second most important export behind coffee (Sochaczewski 1980:89).

Credit Policy

In addition to the fact that exporters were compensated for the implicit exchange rate tax through publicly funded price supports and later bonuses from the auctions, credit policies were a source of another large subsidy to agriculture. In fact, if the BNDE (the National Development Bank) is excluded (to be examined below), loans to agriculture exceeded those to industry over the entire period (Smith 1969). The predominance of loans to agriculture from 1945-52 can be seen in the following table.

TABLE 10: BANK OF BRAZIL REAL LOANS TO AGRICULTURE AND INDUSTRY AND PERCENT OF ALL BANK OF BRAZIL LOANS

In billions of cruzeiros at 1939 prices

Year	Agriculture		Industry	
	Real Loans	Percent	Real Loans	Percent
1945	2.43	58.6	0.61	15.6
1946	1.75	52.9	0.59	17.4
1947	1.43	45.4	0.84	19.7
1948	1.23	39.9	0.97	22.7
1949	1.15	40.7	1.24	24.5
1950	1.23	42.0	1.3	25.6
1951	1.41	32.7	2.2	29.4
1952	1.71	32.7	3.35	33.3

Source: Malan, et. al. 1977:244, 248.

During the period 1939-52, the agricultural sector absorbed nearly three-fourths of the Bank of Brazil loans for agriculture and industry on average, and nearly 40% of all loans of the Bank (Malan, et. al. 1977: 250). This situation continued throughout the decade of the fifties. From 1955 to 1960, the sub-period of the most intense industrialization drive, loans to industry from the Bank of Brazil increased by 8.2 percent, whereas those to agriculture increased by 28.2 percent. The increase in total value of loans to agriculture from 1953 to 1964, can be seen in the following table:

**TABLE 11: TOTAL REAL LOANS TO AGRICULTURE
BY BANK OF BRAZIL**

(In billions of cruzeiros at 1953 prices)²⁰

Year	Loans to Agriculture	As a Percentage of Gross Agricultural Product
1953	11.9	9.6
1956	11.5	8.9
1960	14.7	10.1
1961	19.1	12.8
1962	21.0	11.6
1963	20.3	12.7

Source: Smith 1969:240.

All of these loans were given at highly negative real interest rates. Nominal rates charged by the Bank of Brazil, including commissions, have never exceeded 19 percent per year, while inflation reached 40-50 percent by the late 1950's (Smith, p. 239-40).

The other major source of official loans was through the National Development Bank (BNDE). Just as with Bank of Brazil loans, BNDE loans were characterized by low interest and deferred payments, which in the inflationary environment of postwar Brazil meant negative real rates of interest (Sochaczewski 1980:114). The value of these loans to industry and agriculture can be seen in the table below:

²⁰ End-of-year balances deflated by the official general price index published in *Conjuntura Economica*.

TABLE 12: TOTAL REAL LOANS TO AGRICULTURE AND INDUSTRY BY BNDE AND PERCENT OF ALL BNDE LOANS

(In billions of cruzeiros at 1953 prices)

Year	Agriculture		Manufacturing	
	Real Loans	Percent	Real Loans	Percent
1952-6	0.3	3%	1.1	11%
1957	0.2	5%	0.9	21%
1958	0.2	4%	2.5	47%
1959	0.1	3%	1.4	44%
1960	0.0	0%	2.8	85%
1961	0.1	2.4%	1.3	31%
1962	0.1	5.3%	0.4	21%
1963	0.1	3%	3.2	86%

Source: Bergsman 1970:72.

Bergsman estimates annual gross investment in manufacturing on the order of one billion dollars, and thus that the subsidy was around 3 percent of total investment in manufacturing and five percent of total investment in industry (1970:72).

What can be said about credit policy overall then? Before the establishment of the BNDE in 1952, the Bank of Brazil was by far the most important source of credit in Brazil. And as the data indicates, except for 1951-2, loans to agriculture were generally more than double those to industry. And although the BNDE heavily favored industry, as can be seen from this data, agriculture was much more heavily favored by credit policy overall. Bank of Brazil loans were on the order of ten times those from the BNDE, and heavily favored agriculture.

Most analysts have concluded that the expansion of the means of payment that was necessary to maintain credit policy was a significant contributor to the high inflation of the period (Malan, et. al. 1977; Kahil 1973). Thus, in this area as well, it can be seen

that policy served to provide benefits to favored import-competers *and* exporters, at the expense of the general public.

In sum, a more comprehensive look at overall policy supports the argument that ISI was not a program that shifted government favor from efficient exporters to inefficient import substitution industries.

Conclusion

The most egregious policy distortions of ISI were not a case of aggravated rent-seeking driven by overweening inward-oriented sectors. Instead, these distortions were driven by the logic of clientelist politics. It is not so much the inward or outward orientation of policy that constrains policymakers' ability to serve the few at the expense of the many, but the degree to which they must reconcile benefits for narrow constituencies (whether inward or outward oriented) with outcomes acceptable to the majority. The diffuse effects of conventional rent-seeking as modeled on advanced industrial democracies typically flies under the radar of the rationally ignorant voter. What takes place in developing countries is not just an aggravated case of conventional rent seeking. Clientelist politics means voters are relinquishing their ability to pass judgment on overall policy by trading their vote directly for an individualized benefit. This quid pro quo virtually eliminates the requirement to produce general outcomes acceptable to the majority. This is consistent with the fact that the recurrent crises and policy failures in these countries cannot be lost on anyone, rationally ignorant or otherwise. These conclusions imply that the policy failures in developing countries cannot be addressed with simple formulas based on reducing opportunities for rent-

seeking. Instead, scholars must focus more attention on the political mechanisms driving clientelism.

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