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Source: *Latin American Politics and Society*, Spring 2015, Vol. 57, No. 1 (Spring 2015), pp. 75-98

Published by: Distributed by Cambridge University Press on behalf of the Center for Latin American Studies at the University of Miami

Stable URL: https://www.jstor.org/stable/24765956

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Mona Lyne

ABSTRACT

Import substitution industrialization was the postwar development policy of choice in Latin America, and the diagnosis of its weaknesses heavily influenced subsequent policy recommendations. Yet few attempts have been made to test the predominant sectorally based explanation of ISI's failings against alternatives. This article develops a model of direct (clientelistic) linkages between politicians and their supporters and tests it against the standard sectoral model based on indirect linkages. Examining three features of process (economic sector influence, legislative voting, and exchange rate policy) and analyzing the distributional implications of the overall policy in Brazil, this article demonstrates that a clientelist model provides a more complete and coherent account of the empirical record. By demonstrating that variation in linkage type alters the political constraints on policy choice, the analysis also provides new insight into enduring puzzles, including the better performance in East Asia.

The postwar import substitution industrialization (ISI) programs adopted across the developing world received intense scholarly attention, yet researchers relied almost exclusively on one theory to analyze the programs' politics. In the prominent case of Brazil and most Latin American countries, scholars examining the persistent inward orientation, the choice of specific policy instruments, and the policy's disappointing results have all relied on some version of a sectoral interest group model of politics built on indirect constituent-politician linkages in interpreting results (Kaufman 1990; Sachs 1985; Frieden 1991).[1]

Yet this analysis leaves poorly explained the highly consequential variation in outcomes across countries employing ISI. East Asia's use of a less distortionary primary ISI program and subsequent shift to export promotion led to markedly superior results in comparison to Latin America. Yet the near-exclusive reliance on a sectoral model yields only prescience and discipline as explanations for why some East Asian countries avoided a number of the pitfalls of ISI in Latin America and were able to make the shift to export orientation.

Recent work examining variation in exchange relationships between politicians and constituents provides a basis for rethinking the politics of ISI policy (Kitschelt

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DOI: 10.1111/j.1548–2456.2015.00257.x

and Wilkinson 2007). The present study tests the standard sectoral model based on indirect constituent-politician linkages against an alternative clientelist model based on direct exchange links to explain process and outcome in post–World War II ISI policy in Brazil. It analyzes three aspects of process: the relative strength of inward- and outward-oriented sectors, the legislative voting behavior of the major parties adopting the program, and one critical choice of policy instruments—the decision to use overvalued exchange rates to transfer resources from exporters to import-substituting industrialists. It also revisits the distributional implications of ISI and moves beyond the prevailing practice of examining only one component of exchange rate policy; it analyzes the overall effect of the comprehensive package of exchange rate policies, as well as credit and price support programs.

This more general analysis demonstrates that the distributive impact was far more intrasectoral than intersectoral, and it was far less damaging to the income of selected exporters and far more damaging to the income of selected importers than previously recognized. With both process and outcome, it finds that a clientelist model based on direct linkages between politicians and constituents provides a more complete and coherent account of the ISI policy program in Brazil than a sectoral interest group model built on the assumption of indirect links.

This study argues that just as with the ISI policy examined here, further development of alternative models of politician-constituent linkages holds much promise for illuminating heretofore poorly understood political constraints on behavior and choice in a wide range of countries. Instead of a voluntarist explanation for East Asia's superior outcomes, this article demonstrates how the politics of direct clientelist linkages precluded better development results in Latin America. An analysis of the implications of direct exchange linkages can afford new insight into choices that existing models largely relegate to leadership mistakes or failure. With better models of the implications of variation in linkage, apparently misguided or irrational policies will be reinterpreted as resulting from political constraints that currently are poorly understood.

ISI Policy and Institutions in Brazil, 1945–1964

A brief review Brazil's import substitution policy from 1945 to 1964 provides context for the analysis. The policy consisted of exchange controls, various protectionist mechanisms, credit policy, and other incentives. From 1945 to 1953, 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; the other half was distributed at officials' discretion 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 rapidly increasing under the earlier licensing system. Tariffs were not an important instrument of policy until 1957; the most important protectionist instrument was a system of quantitative

restrictions known as similarity analysis. By registering their products with the government, domestic producers obtained a market reserve that eliminated international competitors. Another important incentive was the concession of long-term loans at negative real interest rates.

Institutionally, from 1945 to 1964, Brazil was a democracy structured by presidentialism, bicameralism, federalism, and open-list proportional representation and 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). While the PSD's strength diminished from roughly 50 to 30 percent of the seats in the Chamber of Deputies over the period, the PTB increased its share from 8 percent to 30 percent, and the UDN hovered in the mid- to low 20s throughout the period. The three small parties were the PSP (Progressive Social Party), the PR (Republican Party), and the PDC (Christian Democratic Party). The period saw four elected presidents, only two of whom served out their entire term. In 1964, this democratic regime was overturned by a military coup.

Indirect Versus Direct Exchange Linkages

The sectoral interest group model encompasses a great variety of theories of policy-making; here we focus on the version adopted by most political economists analyzing ISI. Political economists who employed a version of this model to explain ISI policy developed a theory of rent seeking on the basis of sectoral groups' position in the economy. Exporters are assumed to prefer more neutral policies in order to maintain their competitiveness in international markets, including macroeconomic stability, neutral or undervalued exchange rates, and minimal protection. Inward-oriented producers, such as import-competing industries, favor policies that expand the domestic market and exclude international competitors. From this point of view, the dramatic shift to inward-oriented policies that characterized explicit ISI programs resulted from the ascendance of inward-oriented sectors, but as we will see, no such shift took place in Brazil.

This approach derived sectoral preferences exogenously, but there was no explicit modeling of the role of rents in politicians' overall calculus. Little attention was paid to any countervailing forces, particularly how the general electorate would react to the economic effects of excessive rents. There was no consideration of whether constituents might reject the policy package based on the degree to which sectoral policy distorted overall outcomes, and thus no modelling of how electoral politics might militate against the unlimited provision of rents to favored groups. In effect, rents were assumed always to redound to politicians' benefit, in the form of campaign contributions or other types of support from the favored group (Krueger 1974; Buchanan et al. 1980). This model was also commonly employed post hoc to explain the policy outcome, rather than used to derive expectations for policy a priori.

With the work generalizing exchange relationships, we can develop distinct expectations that give us leverage to test alternative theories of ISI policy (Kitschelt

Table 1. Indirect versus Direct Linkages and Policymaking

Implications	Indirect Links	Direct Links
Credit claiming	Credit claiming via intangibles such as party reputation.	Credit claiming via direct political exchange.
Legislative voting	Exhibits interparty difference or government-opposition difference necessary to credit claiming.	Patterns of party voting not related to credit claiming. Legislative voting primarily a conduit to resources for direct exchange.
Policy change	Group strength sufficient to alter patterns of party voting in their favor.	First mover advantage in expanding direct exchange networks.
How general interests constrain development policy	Electoral response to overall outcomes constrains sectoral policy. Large distortions in overall economy will create an electoral liability.	No electoral constraints on sectoral policy. Major constraint on development policy is accommodation of existing direct exchange networks.
Policy impact	Nontargeted. All in sector benefit.	Targeted to specific firms.

and Wilkinson 2007). Sectoral arguments, including those of the rent-seeking variety, are based on an indirect link between politicians and sectoral groups.[2] Clientelist models are built around a direct link between politicians and their supporters. Table 1 summarizes the expectations for the two types of linkages. The first difference in expectations relates to how politicians claim credit with their constituents. With an indirect link, constituents must rely on party behavior and a party reputation to determine which party's policies are closest to their preferences. When linkages are direct, however, constituents evaluate politicians based on receipt of their direct benefit.

These differences, in turn, have implications for legislative behavior. When supporters are evaluating parties based on their reputation for adopting a given set of policies, parties must maintain a voting record that allows them to communicate those policy positions. This typically means government-opposition difference in voting patterns on major policy issues. With direct ties, however, a discernable pattern of policy voting is not necessary for constituents to evaluate their representatives; they vote on the basis of receiving a direct benefit. Under these conditions, legislative voting is often a vehicle for obtaining resources for forging direct exchange networks, and can lead to bandwagon effects in legislative voting.[3]

With regard to policy change, indirect links suggest that parties will implement major shifts in policy when a new sector achieves at least parity in the political arena. Such a shift in interests will lead to a shift in the legislative voting used to generate policy reputations. Direct links, which characterize clientelism, suggest that politi-

cians will compete to co-opt any new interests that hold out the promise of new direct exchange networks of political support. When links between politicians and their supporters are forged through direct exchange, the emergence of any new interest represents a political opportunity in which first movers will have an extreme advantage. Moreover, politicians do not need to weigh how new policies that benefit an emerging group will affect overall outcomes; they need only to ensure that the new policies do not disrupt existing direct exchange networks. Since neither sectoral nor other groups nor the general public takes overall outcomes into account in their voting choices in clientelist systems, politicians can actually disregard the effects of any new rents on overall economic results.

Thus, instead of a new policy resulting from a significant change in the strength and clout of a given group relative to others, as we would expect in the classic sectoral model, in clientelist systems, politicians will compete to co-opt new interests with any policy that will not disrupt existing direct exchange networks. Furthermore, the policy impact will be distinct, based on the type of linkage. With indirect exchange, all firms in a given sector benefit from the policy, such as a regulatory statute or a tariff. With direct exchange linkages, in contrast, the actual policy will be targeted to a specific firm, and what firms receive is mutually exclusive, even within the sector.

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

Existing analyses of ISI typically focus on the distributional implications of alternative policies to explain policy choice. The results of the policy are taken as prima facie proof of the politics of ISI, and great emphasis is placed on the distributional result of one facet of what was a much larger package—the transfer of resources from exporters to importers through overvalued exchange rates. In the case of ISI, the literature clearly demonstrated that postwar inward-oriented policies represented a new balance of interests that were favored by government policy.[4] At the same time, there have been relatively few empirical tests of the conclusions regarding either the policy's economic impact or the politics purportedly behind the policies. The use of overvalued exchange rates was commonly taken as sufficient evidence for an inward-oriented coalition sufficiently powerful to win policies that bestowed very high rents.[5]

Sectoral explanations of ISI, however, are plagued by a contradiction. While the argument posits that inward-oriented interest groups were able to extract policies that served their interests to the detriment of others, industrial entrepreneurs were politically weak during this period in Latin America. A careful examination of the evidence reveals that an inward-oriented coalition was neither a dominant economic nor political player during the ISI period. Indeed, it has often been argued that the sector's weakness was what necessitated state intervention to promote industrial development in the first place (Haggard 1990; Pinto 1965; Schmitter 1971; Jaguaribe 1958).

Table 2. Sectoral Contribution to GDP
(Percent)

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
Other	48.7	50.1	50.5	45.6	43.7

Source: Schmitter 1971, 27

This study assesses the relative strength of agroexporting and industrial interests in Brazil from 1945 to 1964 with three different measures of power. First, it examines each sector's contribution to GDP and the concentration of assets within the sector. This provides a measure of the relative size of the sectors and the degree of ownership concentration, in order to evaluate collective action potential. Second, it examines how well the different sectors are represented in political parties and interest groups. Third, the analysis examines how well the sectors' economic power is translated into political institutional resources in Congress and the executive bureaucracy.

Beginning with economic resources, we can see from table 2 that industry and mining come to exceed agriculture slightly in contribution to gross domestic product only in 1951, and clearly surpass agriculture only in 1960.

A sector characterized by many atomized units will have difficulty organizing effectively to influence policymakers. The degree of concentration in the agricultural sector is well documented: the agricultural censuses of 1940 and 1950 indicate that roughly 10 percent of landowners controlled 80 percent of the agricultural land (Kahil 1973, 36). Moreover, the survey of Brazilian agrarian structure taken by the Agrarian Reform Institute (IBRA) in 1965 found that 2.8 percent of agricultural property owners accounted for 50 percent of total agricultural land area (Chacel 1969, 105). Heavy concentration in industrial ownership, in contrast, did not emerge until the end of the period.

Industrial production in the postwar period in Brazil can be divided roughly into three different groups. The most atomized sector, textiles, consisted of many small family firms, and accounted for 19 percent of total industrial production in 1949 and 13.4 percent in 1961. The food sector, which exhibited intermediate levels of industry concentration, was responsible for 32.5 percent of total manufacturing in 1949, reduced to 20.5 percent by 1961 (ECLAC 1964). Consumer durables and inputs, which accounted for roughly 15 percent of total production in 1949, grew to 28.1 percent of total production by 1961 (ECLAC 1964). The two latter sectors were highly concentrated, with an average of 85 percent of output produced by the three largest firms (ECLAC 1964, 54). Therefore, the industrial sector clearly did not greatly overshadow the agricultural sector in GDP terms during the period, and while collective action potential in industry probably increased over time, it was clearly less concentrated than agriculture, even by 1961.

With regard to influence in political parties and interest groups, it is noteworthy that no political party championing industrial interests existed during the period. Of the three largest 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 1973; Pinto 1965).[6] In contrast, the UDN did publicly champion agricultural interests, especially in the areas of exchange rate policy.

In the case of interest groups, there is also no evidence for an important advantage for industry. Before 1930, interest group formation was primarily a spontaneous process; the available evidence points to rural associations, which were effective in influencing public policy, and industrial associations, which were largely ineffective. The National Society of Agriculture (SNA) was formed in 1897 and, beginning in 1906, had great influence in staffing the Ministry of Agriculture. The Brazilian Rural Society (SRB), formed before the turn of the twentieth century, was instrumental in creating the Coffee Institute of São Paulo, which undertook the early coffee price support programs sponsored by the State of São Paulo. This state-level policy was the precursor of the federal price support programs that 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 when the policy also coincided with agricultural interests, particularly as a byproduct of exchange controls used to address payment imbalances (Luz 1960; Macario 1964, 61–62). A tariff with explicit protective intent, the primary demand of these groups, was not adopted until 1957.

The distribution of power in Congress similarly points to a much more influential agricultural sector. Brazil had a bicameral legislature, with seats in the lower chamber assigned by population and in the Senate by state. Statewide electoral districts were allocated seats based on a formula of one representative per 150,000 inhabitants, up to 20 seats, and then one additional representative for each additional 250,000 inhabitants with a minimum of 7 representatives per state. This result was significant overrepresentation of rural areas and underrepresentation of urban areas. In 1962, from a total of 409 deputies in the lower chamber, São Paulo had 27 fewer deputies than an exactly proportional system would assign; Minas Gerais had 17, Bahia 8, Rio Grande do Sul 7, Paraná 3, Pernambuco 3, and Rio de Janeiro 2. Those states that were overrepresented received 18 deputies above a proportional allocation (Soares 1973, 5–23).

Comparing this to the distribution of workers by state and occupation, it becomes clear that this malapportionment of seats discriminated against urban

industrial interests. Of the ten states with the highest ratios of agricultural to mining and manufacturing workers, only one was underrepresented in the Chamber of Deputies in 1962. Of the ten states with the lowest ratios, four were underrepresented. Clearly, the malapportionment systematically reduced the representation of those states with the largest industrial sectors relative to agriculture (Schmitter 1971, 26). The distribution of legislative power versus industrial output demonstrates the same pattern: as percentage of manufacturing value added increases, so does underrepresentation in the lower house. Of Brazil's five regions, the Northeast, the East, and the South contained 7, 31, and 61 percent of manufacturing valued added, respectively, and had 14, 60, and 75 percent of their states underrepresented in the Chamber of Deputies (Bergsman 1970,163).

The scholarly literature emphasizes the executive bureaucracy's role in policy decisions (Jaguaribe 1958; Schmitter 1971; Cardoso 1973), and some scholars argue that the legislature's role was minimal. Yet all major changes in foreign trade policy had to be approved by Congress. These included both organizational changes, such as the creation of two foreign trade bureaus, the Conselho Política de Aduaneira (CPA) and the Carteira de Comércio Exterior (CACEX), and the successive modifications of exchange control and tariff systems. This legislation created the guidelines for the organization and functioning of each of these import 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 90 days up to 2 years. Legislation that established the executive agencies with authority over foreign trade provided for the direct participation of peak association members from industry, commerce, and agriculture (Lei No. 2145, 12.29.53 and Lei No. 3244, 8.14.57). SUMOC (*Superintêndencia de Moeda e do Crédito*), which was responsible for the foreign exchange distribution systems, was under the Ministry of Finance, and also included participation by private sector representatives designated by the president (Huddle 1972). In addition, legislative approval was required for many of the decisions that implemented industrial policy, including decisions governing short-term investments, executive concession of special credits, and the levying of (or exemption from) taxes (Lafer 1970).

In sum, the industrial sector never surpassed agriculture in terms of sectoral size, and had considerably less favorable conditions in organizing for collective action. By any measure of institutional power, including representation in political party platforms, interest groups, Congress, and executive councils, agriculture either equaled or exceeded the influence of industry. These findings cast considerable doubt on the notion that the industrial sector had economic and political power sufficient to shift policy away from one that heavily favored agricultural interests.

Policy Promulgation: Sectoral Groups and Legislative Behavior

Even when scholars endeavor to develop a priori measures of sectoral strength, ascertaining whether their influence was key to a policy's adoption remains problematic. Tracing the kind of diffuse influence posited by sectoral models is notoriously difficult. The implications of direct and indirect exchange provide an alternative means for theory testing. The sectoral model of the policy process, in which politicians and sectoral interests are linked indirectly and signal their policy positions through the legislation they promulgate, has clear implications for political party and legislative behavior.

According to the logic, distinct interests with opposing policy positions square off against one another in the political arena. In postwar developing countries, the overwhelmingly dominant policy priority was economic development. Therefore, we should expect legislative behavior to reflect a clash of views on how to promote economic development. The sectoral 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 sectoral clash of interests model is correct, then political parties representing these opposing interests must build a public record that allows them to credibly claim to represent said interests.[7] Parties create such a public record by 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 implies that majorities of parties representing these two positions should oppose each other on legislative votes regarding development policy.

Table 3 summarizes voting patterns on all the bills implementing the economic development program that dominated the executive's legislative agenda in Brazil throughout the period 1945–64. This includes all the major national development programs, 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. It also includes all bills providing special credits to the executive, which were indispensable to the implementation of economic development programs such as Getúlio Vargas's import substitution program and Kubitschek's program of secondary import substitution, dubbed the Target Plan.

Grand coalitions are coalitions in which no party majority opposed the bill. 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 on average over the period.

Table 3. Party Voting on Executive Economic Development Legislation

Content of Bill	Number of Bills	Grand Coalition	All Four Major Parties	All Three Major Parties
Economic development (all bills)	35	19 (54%)	21 (60%)	21 (60%)
Economic development (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: Roll-call data provided by Octavio Amorim Neto and Fabiano Guilherme dos Santos.

On 53 percent of all bills, there is no difference in any of the parties' voting record. If we examine just those bills passed, those most likely to be the vehicle for credit claiming, there is no difference between any of the parties on 65 percent of the bills. Furthermore, on the bills with the highest credit-claiming profile, which established the major development programs, there is no way to differentiate between any of the parties on 63 percent of these bills. Using the slightly less demanding criterion of the three major parties, which controlled over 81 percent of the legislature throughout the period, we see that there is no distinction in party voting in 68 percent of all bills considered, no distinction in 80 percent of all bills passed, and no distinction in 75 percent of the high-profile development bills passed.

Clearly, these data are not consistent with a struggle between inward- and outward-oriented interests as represented by the voting patterns of distinct parties. How would economic sectors opposing government programs determine which parties to support in order to further their policy goals?[8] In sum, legislative voting during this period did not exhibit any clear set of positions or clash of interests regarding emphasis on inward- versus outward-oriented development policy; instead, 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. These data clearly do not support an indirect link between economic sectors and politicians claiming credit for development policy.

Critical Distortions of ISI Policy: Overvalued Exchange Rates

Scholars both favoring and opposing the inward-oriented model agreed that ISI policy as implemented had important flaws. Among the most 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 (Bhagwati 1978; Little et al. 1970). Exchange controls and varying rates were used to block imports being substituted while subsidizing inputs and capital goods necessary to industrial production. Overvalued rates transfer income from exporters to import-competing industries by making crucial imports cheaper for industrialists and reducing exporters' earnings in national currency. Most economists, especially those sympathetic to state-directed development, do not decry so much the attempt to shift income, but rather how the shift was achieved (Pinto 1965; Bergsman 1970; Macario 1965). Economists almost universally recommended the much less distortionary tax and subsidy as the best mechanism for transferring resources between sectors (Bhagwati 1978; Little et al. 1970; Bergsman 1970; Macario 1965). Why policymakers maintained the highly distortionary exchange rate transfer has not been well explained.

This was a major source of subsidy to IS industries in Brazil. From 1947 to 1952, the subsidy was roughly 10 to 20 percent of the value added in industry, and from 1953 to 1957, Gudin (1969, 11–12) estimates that nearly half the cost of imports of equipment and machinery was subsidized. How well can a sectoral model account for this choice? The data presented above clearly establish the continued dominance of agricultural interests. But this makes it difficult to explain the choice for the exchange rate transfer with a sectoral model. Indeed, Sachs (1985) has argued that the continued strength of agriculture in East Asia led those governments to opt for more neutral exchange and trade regimes, which were the linchpins of their successful development policy. Why did the strength of the agricultural sector in Latin America not result in a similar choice?

Hirschman (1968) attempts to reconcile the continuing strength of Latin American agroexporters with the choice for exchange controls with an argument about the opacity of the policy. According to Hirschman, agroexporters remained a powerful player and opposed a direct tax, and thus state leaders utilized the less direct yet more distortionary option of overvalued exchange rates. But why wouldn't powerful agroexporters oppose the exchange controls that also reduced their income, albeit in a more indirect fashion? Hirschman argues that exporters did not clearly perceive the effects of the overvalued exchange rates (1968, 117–18). Given the magnitude of the subsidies, ignorance of the policy's effects seems implausible. Moreover, Hirschman provides no evidence to support the argument, and available evidence contradicts his view.

Legislation adopted in October 1953 to implement the exchange auctions provides direct evidence that agroexporters recognized 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 premiums 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 that the legislation providing export "bonuses" was "resolving the problems of the so-called 'difficult exports' 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 opposition to the exchange confiscation one of its principal themes of congressional action (Benevides 1981,103). The fact that the congress, with its overrepresentation of rural interests, passed the legislation, along with the public recognition of its intent to attend to coffee producers' complaints about exchange confiscation, makes it difficult to accept Hirschman's argument.[9] In sum, the continued strength of agriculture, combined with an inward shift in policy, is difficult to reconcile with a model based on indirect linkages between elected officials and economic sectors.

An Alternative Model: Direct Exchange Linkages

Clientelism is characterized by direct, quid pro quo exchanges between politicians and their constituents (Kitschelt 2000; Stokes 2005; Lyne 2008). This is in contrast to an indirect link, in which favorable regulatory decisions, or tariffs, for example, apply to a favored sector and not an individual firm. With indirect links, which characterize sectoral models, supporters must evaluate politicians based on intangibles, such as policy reputations established through voting patterns and party affiliation. Under clientelism, firms evaluate their politicians based on those direct exchanges (Kitschelt 2000).

These distinct linkages have two key consequences for competition among politicians and mode of policy change. With an indirect link, all constituents can benefit from a given policy. For example, all firms in a sector receive a benefit from a favorable regulatory decision for that sector. Two politicians whose party votes to adopt such a regulation can both claim credit for the policy with their respective business supporters. In other words, when linkages are indirect, benefits legislators provide to their constituents are not mutually exclusive at the individual level.

Direct links between politicians and supporters, by contrast, also mean mutually exclusive benefits. Direct links are in fact designed to discriminate on an individual basis in terms of who receives benefits. For example, what one firm receives in terms of access to overvalued foreign exchange in return for the votes of its employees or a campaign contribution, another firm does not.

If politicians are linked to their supporters through the direct delivery of excludable benefits, then all goods provision to constituents is mutually exclusive. In the absence of agreements regarding how to divide and distribute resources among themselves, all benefits provision pits legislators directly against one another to gain constituent support. This mutual exclusivity of support provides critical insight into the choice of distortionary, overvalued exchange rates as a means to transfer resources from agriculture to industry.

A second key difference relates to incumbent advantage. Although incumbents in all systems have advantages over challengers, clientelist systems are characterized by inordinate incumbent advantage due to the nature of the political currency. With indirect exchange, the key currency is a public reputation for supporting a given policy package through legislative voting records, such as a development plan with a given orientation (inward or outward). Politicians must join parties that use the powers and resources at their disposal to create a reputation for supporting such a plan. In the case of direct exchange, incumbency and control of resources conferred by the position are the direct currency used to win support. Although it is not possible to monopolize development ideas or regulatory rules, incumbent status does often confer a near-monopoly on resources for direct distribution to supporters. The result is that first movers in incorporating new clients with direct benefits are extremely difficult to defeat.

Adoption of ISI Policy: Not Inward Shift but Diversification of Direct Benefits

We can now resolve the puzzle of ISI's adoption and extension despite the limited political and economic influence of inward-oriented groups. Inward-oriented interests clearly did not possess the legislative or interest group influence sufficient to promulgate a major policy shift in their favor. A clientelist model, however, predicts a distinct mode of policy change.

Given the extreme incumbency advantage, politicians will compete fiercely to be first movers, based on the emergence of a group with enough clout to force existing power groups to cede some portion of available resources (Anderson 1967; Kenworthy 1970). The shift to ISI reflected competition to incorporate new interests that were sufficiently influential to challenge longstanding policy, which favored commodity-exporting interests almost exclusively. The literature is nearly unanimous in the view that precisely due to the success of exporting, new manufacturing and middle-class groups emerged that, by the mid-twentieth century, could no longer be excluded from the political arena (Jaguaribe 1958; Soares 1973; Schmitter 1971). Political entrepreneurs who incorporated new industrial firms and the emerging industrial working class into the clientelist distribution first, while not threatening the excludable benefits enjoyed by exporters, would see significant advantages at the polls. This change was not driven by a powerful new sector that tipped the balance of interests—agroexporters remained dominant—but instead resulted from the first mover advantage that characterizes clientelist competition.

Legislative Voting on ISI: Not Public Reputation but Access to Resources

As we have seen, the pattern of legislative voting under ISI was not consistent with credit-claiming imperatives based on indirect links between politicians and their supporters. At least on the basis of legislative voting records, no party could credibly claim to support any position other than the government's position. These patterns resulted from the distinct credit-claiming imperatives that characterize direct exchange.

In direct exchange, politicians signal ability and willingness to deliver by demonstrating access to resources and delivering excludable goods, rather than through voting records. Differentiation in voting records across parties is unnecessary, and legislators' votes will be directed toward securing access to resources distributed through the legislature. As long as most decisions regarding the distribution of government resources take place in the legislative arena, we should expect low interparty divisiveness, because legislators or parties will be eager to join any legislative deals that can provide them with direct benefits. In clientelist systems, supporters are not evaluating a party's public record on legislation, and under these conditions, any legislative vote that secures direct benefits for distribution is pure electoral gain.

The Distortionary Exchange Rate Transfer: Not Bad Economics but Good Clientelist Politics

A clientelist model of politics can also illuminate the logic behind the apparently puzzling choice for overvalued exchange rates for transferring resources between sectors. Under clientelism, incumbency and the associated resources are the direct currency of politics. Thus, control of fungible resources confers much more formidable political weapons in clientelist systems than in systems of indirect exchange. In a clientelist system, fungible resources can be used to outbid existing quid pro quo bargains and directly reconfigure clientelist networks. The direct tax as a mechanism for transferring resources between sectors, almost universally recommended by economists, would have placed just such a formidable weapon in the hands of the executive, providing a means to challenge agroexporters directly for supporters' loyalty.

Agricultural elites in Brazil had good reason to fear attempts to outbid them. The source of these elites' political power was their control of the votes of low-income rural populations (Leal 1977). Getúlio Vargas had effectively wielded federal funds to erode state-level elites' control over state-based clienteles during his authoritarian rule (1930–1945) (Skidmore 1967). A direct tax on exporters would have further empowered presidents to outbid local agricultural elites. The use of overvalued exchange rates, in comparison, much more carefully restricted the application of the resources created.

Preferential access to subsidized foreign exchange could be used to incorporate industrialists into the clientelist system and return income to favored exporters, but not to remake existing clientelist bargains more generally. Here we have the answer

to why politicians ignored near-universal policy advice: the still-dominant commodity exporters would have opposed a switch from the exchange rate transfer to a direct tax and subsidy. Exchange rate manipulation did not carry the same risk, and therefore was an effective tool for reconciling agricultural interests to policies incorporating industrial interests into a system of direct exchange.

In this way, the adoption of inward-oriented policy 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 into a clientelist system. The puzzling pattern of legislative voting observed makes sense once we understand how credit-claiming problems differ under politics of direct and indirect exchange. Once urban industrial interests could no longer be excluded, all politicians had an interest in gaining access to resources and forging new direct ties to these groups, and therefore politicians from all parties voted to provide benefits to inward-oriented interests.

A Comprehensive Analysis of Policy Choice

Whereas previous analyses typically examine only one aspect of exchange rate policy, this study provides a more general analysis of exchange rate programs, as well as price support and credit policy. Previous analyses of the distributional impact of ISI have placed great emphasis on a simplified measure of the intersectoral transfer via overvalued exchange rates, and typically have failed to examine how other policies qualified the effects of the exchange rate transfer. Most analyses of exchange rate policy have assumed that the overvalued exchange rate implicit tax on exporters gave a full picture of how policy affected differing sectors. The implicit tax on exports was calculated by comparing exporters' income at the official rate with their hypothetical income at a purchasing power parity rate (Krueger 1974; Little et al. 1970; Malan et al. 1977; Fishlow 1985; Huddle 1972).[10]

When the overall policies are examined more carefully, however, three aspects more consistent with a model of direct exchange become clear. First, the net effect of overall policy was not so much to transfer resources from the exporting sector to the import-competing sector, but rather to compensate selected exporters for the overvalued rate with a variety of other measures. Similarly, policies favored some import-competing firms and penalized others, depending on who had access to subsidized foreign exchange and credit (Huddle 1972). Second, with the possible exception of price support programs, all of these compensation measures were administered on a discretionary basis at the level of the firm. Furthermore, the policy created immense distortions in the overall economy and extracted most of the subsidies provided from the population as a whole.

Exchange Rate Policy

Examining how overall exchange rate policies affected exporters, the first observation is that not all foreign exchange had to be sold at the overvalued official rate. Therefore, an assumption that exporters sold all their exchange at the official rate considerably overstates the value of the transfer. From 1945 to 1953, coffee exporters were required to sell only half of their foreign exchange at the overvalued rate (Kafka 1956, 309). Second, for exporters other than coffee, a program of "linked operations" allowed exporters of noncompetitive products (i.e., all except coffee) to sell the foreign exchange they earned to importers at a premium in comparison to the official rate. These linked operations were quickly seized on, and in 1950 they were responsible for 20 percent of exchange transactions. The system's popularity greatly reduced the government's ability to control imports, and the system was discontinued in 1952 (Doellinger et al. 1977, 21).

A second factor qualifying the prevailing conception of the intersectoral transfer was that Brazil was a near-monopoly supplier of coffee, and price elasticity of demand was low. Thus, a considerable portion of the 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 contributed significantly to an increase in coffee prices of 588 percent from 1945 to 1954 (Baer 1965, 302). 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 1945–53, meant that coffee exporters were taxed at roughly one-fourth the overall coffee income over the period. But with a 588 percent increase in price, government intervention resulted in a considerable net gain for coffee, even if all coffee exports had been subject to the implicit tax. As many analysts have noted, the coffee sector did not suffer an absolute decline in its income during this period (Lessa 1964).[11]

In 1953 the auction system was adopted, including five categories of minimum price with ascending overvaluation, and imports were allocated to each of the categories. The system greatly favored domestic producers whose imports were in the subsidized categories, while it penalized those whose imports were in the overvalued categories. The categorization of imports was determined by SUMOC on a firm-by-firm basis (Malan et al. 1977). Those whose final goods (typically those producing more sophisticated goods as time wore on) were in the very high priced categories and whose imports were in the very low priced categories enjoyed a double subsidy. As Bergsman (1970) notes, this system gave the firms that least needed it—what he calls the "Daddy firms" (firms in which Brazil had a comparative advantage)—the most protection. Those whose final goods were not in the high-priced categories (typically those producing more sophisticated goods) and whose imports were in the high-priced categories faced the lowest levels of protection. In other words, there was a clear transfer from favored domestic producers to disfavored domestic producers.

This reform also included a new system of devaluation for exporters. Exporters were now required to sell all of their foreign exchange earnings to official banks at

the official rate, but the premiums captured in auctioning foreign exchange were required to be returned to exporters to provide "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 adapted over time to changing circumstances, including increasing the categories from two to four and regularly increasing the bonuses to keep up with the rapidly rising free market rate. From November 1953 through February 1955, coffee received a readjustment of its exchange rate of 101 percent, while inflation over the same period was no more than 33 percent (Netto and Pinto 1973, 290).

Through these bonus systems, Huddle (1972) calculates that roughly 1 billion dollars of the difference between the import and export rate was returned to coffee, and 1.5 billion dollars to all other exports. According to Bergsman, this system of bonuses served to protect exporters from any further loss through overvalued rates: "Since 1952, the export exchange rate has kept up with the Brazilian inflation" (1970, 47). Kafka has actually 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 were maintained until all multiple rates were abolished in 1961.

Yet another factor, the ability to evade the law, must be considered to fully assess how exchange rate policy affected exporters.[12] Analysts have noted that the largest supply source of dollars to the free market from 1954 on was the underinvoicing of coffee exports (Gudin 1956, 503; Kafka 1956). The average rate in the free market was higher than the official exchange rate, and thus it was profitable to underinvoice exports and sell the difference on the free market. With the floating free rate, again, those coffee exporters that could convert their foreign exchange through this mechanism did not suffer the full brunt of the income loss 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 disfavored domestic producers and exporters and the taxpayers (through publicly funded price supports) in order to provide benefits to both 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 who bore the brunt of policies that served both domestic producers and exporters. After 1953, the exchange rate tax was more than compensated for through the bonus schemes funded from the auction premiums. 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 premiums. This pattern of selective benefits distributed at the level of the firm is not consistent with a transfer from an efficient export sector to an inefficient import sector, but it fits the predictions of clientelist politics quite well.

Table 4. Bank of Brazil Real Loans to Agriculture and Industry and Percent of All Bank of Brazil Loans (in billions of cruzeiros at 1939 prices)

	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	1.30	25.6
1951	1.41	32.7	2.20	29.4
1952	1.71	32.7	3.35	33.3

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

Price Support Programs and Credit Policy

Coffee price supports were initiated by the State of São Paulo and were transferred to the federal government in the early 1930s. Their costs 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 percent of GNP. This was a policy inspired by the coffee interests, and 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, 146–47)

Once the national government took over coffee price support, the costs for 1954–62 fluctuated between one-half percent and 2 percent of GDP per year (Lessa 1964, 183). Intermittent price support programs were created for other exports as well. The Export-Import Department of the Bank of Brazil would at times buy a given export at above-market prices and export at a loss (Gudin 1956, 507–8). This was done for cacao and coffee at various times throughout the period (Doellinger et al. 1974, 46). In 1952 the Bank of Brazil bought the entire cotton crop, the second most important export behind coffee (Sochaczewski 1993, 89). Credit policies provided another subsidy to agriculture, as can be seen in table 4.

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 percent of all loans of the bank (Malan et al. 1977, 250). From 1955 to 1960, the subperiod of the most intense industrialization drive, loans to industry

Table 5. Bank of Brazil Total Real Loans to Agriculture (in billions of cruzeiros at 1953 prices)

	Loans to Agriculture	As 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

Note: End-of-year balances deflated by the official general price index.
Source: Smith 1969, 240.

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 table 5.

All these loans were given at highly negative real interest rates. Nominal rates charged, including commissions, have never exceeded 19 percent per year, while inflation reached 40 to 50 percent by the late 1950s (Smith 1969, 239–40).

The other major source of official loans was the National Development Bank (BNDE), whose credit was also conferred at negative real interest rates (Sochaczewski 1993, 114). The BNDE favored industry over agriculture, but given that this was a bank created expressly to foster industrialization, it is significant that roughly 5 percent of agriculture's loans came from this source (Bergsman 1970, 72). Considering credit policy overall, before 1952, the Bank of Brazil was by far the most important source of credit in Brazil. Except for 1951–52, loans to agriculture were generally more than double those to industry. And although the BNDE heavily favored industry, Bank of Brazil loans were on the order of ten times those from the BNDE, and heavily favored agriculture.

In sum, a more comprehensive look at overall policy supports the argument that ISI was not a program that shifted policy from one that favored efficient exporters preferring neutral macroeconomic policies to one that supported inefficient import substitution industries seeking rents. Instead, it was a program that provided subsidies to both favored domestic producers and favored exporters while extracting from disfavored sectors with both orientations, and from the general public.

Conclusions

Politicians across the globe often adopt policies that provide benefits to a narrow group or sector. What has been little recognized is that the type of linkage affects the degree and type of sector-specific policy possible. In systems of indirect exchange, most constituents are choosing based on some weighting of overall outcomes and other more specific policies. Politicians must therefore consider how supporters will weigh and evaluate sectoral policy and overall outcomes. This is an important constraint on politicians' ability to serve special interests at the expense of the general public. In other words, in systems of indirect exchange, that component of the vote that turns on overall outcomes serves as a counterweight to economically distorting special interest politics.

In systems of direct exchange, in contrast, politicians' ability to favor special interests is less constrained, because voting choices turn on the conferral of a direct benefit and do not include a weighting of overall economic outcomes. If voters cannot sanction politicians for overall outcomes, then politicians can countenance much greater economic distortions with fewer political costs. The very high levels of inflation characteristic of most of the ISI programs in Latin America are a case in point. If voters were weighing sectoral policies as well as overall outcomes, policies that produced such very high and rapidly increasing levels of inflation would probably have become a serious political liability.

This provides a plausible explanation for the differences in ISI experience across Latin America and East Asia. If politicians in East Asia were linked to their supporters through indirect exchange, then a move to secondary ISI with the associated very large distortions in the overall economy would probably have had serious political costs. Indeed, it was secondary ISI's use of new subsidies to compensate for previous subsidies and to push industry into highly capital-intensive production that economists decried as both unnecessary and highly distortionary in its effects on the overall economy (Bergsman 1970; Rio and Gomes 1955). Similarly, if overall outcomes were one aspect of voting choice, as is the case with indirect linkages, export promotion and the attendant improvements in the overall economy would redound to politicians' benefit. In short, with indirect linkages, the secondary ISI policies would probably be politically costly, and export promotion and associated reforms would probably be politically beneficial.

Conversely, if politicians in Latin America were linked to their supporters through direct exchange, a theory that the monographic literature and the analysis presented here support, there would be little political cost to more ISI after the initial round. Direct exchange links mean that distortions to the overall economy are not reflected in voting choices. Political competitiveness requires maintaining and multiplying subsidies, which is precisely what secondary ISI historically did. By the same token, reforms to reduce distortions and produce better overall outcomes would not redound to policymakers' electoral benefit. This was precisely the kind of reform that was necessary to move from primary ISI to export promotion. Such a move required reducing subsidies, unifying exchange rates, and devaluing the currency, all policies that would diminish

politicians' ability to provide direct benefits and build direct exchange linkages. Paradoxically, with direct linkages, the many distortions associated with secondary ISI would have minimal political cost, and improvement in overall outcomes associated with export promotion, paradoxically, would provide little political benefit.

A careful examination of the policy process and a comprehensive look at policy choices in Brazil demonstrates that the most egregious policy distortions of ISI were not a case of aggravated sectoral politics driven by overweening inward-oriented sectors. Nor were they the simple result of excessive state intervention. The analysis presented here suggests that it was neither ignorance that drove Latin America to secondary ISI and all its attendant failures, nor insight that led East Asia to move to export promotion, with its superior results; it was politics that determined both. This analysis suggests that further development of models of direct exchange can shed important light on both political behavior and outcomes in developing countries that the extant literature continues to diagnose largely as "mistakes."

NOTES

1. Inward orientation refers to a development strategy based primarily on producing for the domestic market, and outward orientation to a strategy based primarily on exports.

2. Most political economists did not develop explicit models of links between politicians and their supporters. But the analysis was clearly based on a kind of classic interest group model run amok—some groups could demand and receive almost unlimited rents from their political sponsors.

3. This prediction varies depending on electoral law and internal party organization. If the party carries the reputation for distributing direct benefits and can withhold them from individual deputies, then party leaders will be able to enforce discipline that empirically looks very similar to programmatic politics.

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

5. In the general literature, Krueger (1974, 1978), Sachs (1985) and Kaufman (1990) draw this connection most explicitly. For Brazil, Huddle (1972), Kafka (1956), and Baer (1965) employ this type of analysis.

6. These are broad characterizations, which often indicate little about party alliances and policy positions. The key point is that no existing or new party championed industrial entrepreneurs' interests.

7. The "public record" "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).

8. Some observers may cite the institutionalist literature on Brazil, which argues that legislators are overwhelmingly concerned with developing a personal reputation. 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 many scholars have argued (Fiorina and Noll 1979; Arnold 1990; Cox and McCubbins 1993), claims by individual legislators to deliver programs are not credible because their adoption requires majority support in the legislature.

9. This does not mean to imply that export sectors "chose" the indirect transfer. Policymakers used exchange controls extensively to manage payment imbalances and naturally transitioned to using them for intersectoral resource transfers. More likely, I would argue, is that suggestions for policy optimization via moving from exchange rate transfer to tax and subsidy were strongly opposed by exporters.

10. See Malan et al. 1977; Fishlow 1985; and Huddle 1972 for analyses of Brazil.

11. Compensating exporters for ISI policy was not unique to Brazil. Chile heavily subsidized nitrate exports, Argentina maintained the volume of its exports through an agreement with Britain, and Bolivia obtained guarantees on tin exports from the United States. Thus, while export volume declined and the role of exchange rate policy changed, exporters' income did not necessarily decline.

12. A colloquial characterization of clientelist politics: "For my friends anything, for my enemies the law."

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