Beyond Developmentalism and Market Fundamentalism in Brazil: Inclusionary State Activism without Statism

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The attention recently paid to the growth trajectories and ability to weather the global recession of various developing countries has recast the debate originating in the 1990s about the supposed generalized decline of the state. In post-2000 Latin America, many governments that have come to power skeptical about the recommendations of the mainstream economic thinking of the nineties have broadened the scope and scale of state intervention and altered the direction of public policy. This political reaction against the more orthodox, economic orientations that prevailed among policymakers and dominated the reform agenda of the continent has stimulated and deepened a debate about the course, prospects and “state of the state.”

This essay takes as it point of departure the notion that an incipient new development model is taking shape in several South American countries, to a greater or lesser extent. This model recovers the state as a focal point, but in a manner quite distinct from the heavy-handed, often dirigiste role of the developmentalist state of what some have insightfully termed the period of the “state-centered matrix.” (Cavarozzi 1992, Garretón et. al 2003). The visible outlines of this new model, though incipient, suggest its compatibility with political democracy and open economies. The positive performance of these countries, with respect to economic growth and poverty reduction, permits and indeed requires a rethinking of the on the state and development — under which state intervention in economic and social policy was cast as essentially defensive, and treated as one of the principal obstacles to growth, competitiveness, social equity, and even democratic consolidation.

One of the chief laboratories for this rebirth of state activism, of a new type, is to be found in contemporary Brazil, we argue. In the economic realm, the Growth Acceleration Program (Programa de Aceleração do Crescimento, or PAC) of 2007 and the two different versions of a national industrial policy and national
science and technology plan, respectively (2004, 2007 and 2008), put into place by the government of Luiz Inácio Lula da Silva, are based on heavy investment in infrastructure, science, technology and innovation.

Such policies are based on selection of priority areas for public investment, subsidized (but largely conditions-based) credit, incentives for exporting firms, and stimulus for the creation of large, globally competitive national conglomerates including special lines of support for the internationalization of Brazilian firms. Deemed undesirable and market-distorting during the 1990s, such policies had been practically banished from the arsenal of state policy in Brazil as in many other countries. Yet they have made a comeback — albeit in the form of what Schrank and Kurtz (2005) term “open economy industrial policy” — amidst both a political system and an economic environment that are incomparably more open, decentralized and competitive than any that existed during the developmentalist era in Brazil (whose heyday was the 1940s to 1970s). These reforms both build upon the edifice of the other noted economic reforms of the post-1990 and post-1994 periods — macroeconomic stabilization and adjustment, privatization, commercial opening and a more aggressive commercial policy, de facto Central Bank autonomy, and the like — but also take these reforms in a new direction that makes them more than just an instance of “reform continuity.” The election of Lula and more importantly the policy trajectory under his two terms have marked a watershed in terms of re-orienting Brazil toward what we term a “recapturing of stateness”, conceived as a redeployment of state capacities to address new activities — e.g. investing in market supporting — and missions — investing in social policies.

The new state activism differs at least in three important ways from its dirigiste, developmentalist predecessor. The first concerns the new decentralized political structures that play a significant role in the making and implementation of economic and social policies. Since the new Constitution of 1988 and more generally under democratization, states and cities were fiscally empowered and became politically relevant to regional development. Their regional power requires permanent (re)negotiation with federal authorities, limiting unilateral
central state action and also—in developments beyond the scope of this essay—involving the emergence of greater regional and local prominence in terms of innovation in the realms of industrial policy (Montero 1997) and various aspects of social policy such as health care. The second novelty vis-à-vis desenvolvimentismo is in the relationship to the private sector. Instead of seeking to impose specific competitive strategies on firms, state initiatives are geared toward providing an enabling environment: emphasis on innovation and technology, and high-level, ongoing dialogue with firms and associations, in order to expand the options available to companies. State actions are more market-adjusting than market-dominating.

The third singularity vis-à-vis the old developmentalism concerns traditional social exclusion. Over the course of several decades, the statist model shifted resources from consumption to investment, limiting real wages and social spending and directing social spending in clientelistic fashion toward more organized segments of society with an eye toward political stability and control. Recent state intervention manifests a strategic shift. Attention has begun to be paid to the necessities of the least well off without undermining economic performance or fiscal solvency. Thus, in the social arena, Brazil has witnessed some important reforms over the past decade and a half to reform basic social services and benefits in the area of public health, education, and social security as well as an unprecedented expansion of social benefits targeted at the poorest citizens.

We wish to underline three characteristics of these social policy reforms that are important within wider debates about not only the state but also about the reorientation of public policies. First, like the reforms in industrial and science and technology policy, these new social policies have been forged through the negotiation, conflicts, and “rough and tumble” of democratic politics. Second, they have entailed recapturing and reorienting the traditional role of the public sector in providing social protection, rather than emphasizing the market-based, privatizing solutions common in many social policy reforms in other countries of the region in the 1990s and early 2000s. Yet, third, the emphasis on the state’s
role in providing social protection has been characterized by important, albeit still incomplete, efforts to overcome the historic “dualism” of Brazil’s “segmented welfare state,” which was marked perversely by benefits mostly for the most organized and well connected among the country’s middle and working classes.

The two stages of social security reform carried out by the governments of Fernando Henrique Cardoso and Lula began to rein in some of the excesses of the inefficient, costly system of the *previdencia social*. At the same time, they made it possible to then expand in the 2000s the coverage of the system to include both retired non-contributory rural poor as well as new contributors brought in through formal-sector job creation.

In the same vein, the transformation, expansion, and consolidation of what started as the *Bolsa Escola*, Program to Eliminate Child Labor, and other smaller-scale initiatives under Cardoso into the massive *Bolsa Família* cash-transfer schemes — more generous and broader and scope than its counterparts elsewhere in the region — also extended conditional cash stipends to 11 million impoverished families. The program that has been hailed for its effective targeting and low level of resource leakage.

It seems that a new model of state activism has emerged entailing a virtuous circle of economic growth with reduction in poverty and inequality and improvement in basic social indicators — in short, a period of inclusionary development. Though growth was temporarily slowed, it is now clear that this virtuous circle was not interrupted by the global economic recession that started in 2008: not only economic and social policy more broadly but also in particular formal-sector job creation and low inflation have contributed to this emerging new pattern of development. A central argument of this essay emphasizes the new synergies that have emerged, to some extent by design and to some extent by virtuous accident, across economic and social policy — traditionally two very distinct spheres of public policy in Brazil in terms of aims and institutions.
What do these changes in policy mean in terms of the evolution of the Brazilian state?

A superficial, mechanistic view holds that the pendulum has now swung back in the opposite direction, and that the country (as well as perhaps others) is experiencing a revival of developmentalism (or even populism). Quite to the contrary, our analysis here seeks to explain and elucidate two complementary movements in Brazilian public policy and state action. On the one hand, we demonstrate the rise of a more business- and market-friendly environment amidst a strengthening of state intervention in economic and social life — in short, policies that suggest a more activist, and enabling, state. On the other hand, we underline that state intervention in support of a more business-and market-friendly political economy is accompanied by — and also takes the form of — a significant expansion of social protection and efforts to combat not only poverty and inequality. That is to say, the opening of the economy has not represented an eclipse of the state, nor has the widening of state activism provoked a collapse of the market or a retreat toward a closed economy. And for the first time in Brazil’s history, this combination, at least in its initial form, appears virtuous with respect to reduction of poverty and, in particular, of income inequality.

The paper is organized as follows: First, we review briefly recent debates on the state regarding the impact of globalization and apparent decline of market fundamentalism as well as recent efforts to characterize these patterns and search for alternative analytical categories. Second, we examine how some state capacities have been rebuilt and reoriented. Third, we explore the rise and evolution since the early 1990s of new public policies and state capacities in the areas of foreign trade, competitiveness policy (in terms of industrial, and science and technology policy) and social policy. In the conclusion, we reaffirm that the recent evolution of Brazil is not adequately captured by the most frequently used labels, be they “social-democratic”, “developmentalist,” “neo-developmentalist, ”social developmentalist,” or even a “disguised neo-liberalism”. More than 25 years after the end of the military regime, Brazil is a
democratic country still searching for a lodestone to guide its growth and sustain its development. That is to say, the process now underway in Brazil is far from complete or consolidated. It also seem to lack a clear or succinctly expressed ideological or philosophical rationale, relying instead and to a surprising degree on pragmatism. But the new inclusionary state activism without statism\footnote{For more on declining statism see: Levy Ed. (2006).} we analyze is a key piece in understanding the puzzle of Brazil and perhaps more broadly Latin American development.

**Globalization, States, and Development**

If much of the decade of the nineties was marked by considerable preoccupation about globalization-induced “convergence” toward a narrow market fundamentalist-oriented state, the past decade has been marked by empirical and theoretical refutations of such determinism as applied to both advanced and developing countries\footnote{Restricting the focus to studies centering mostly on the global South, we can cite Weiss ed. (2004), Boyd & Ngo (2006) regarding states in general and, with regard to social welfare polices in particular, Glatzer and Rueschemeyer, eds. (2004) and Haggard and Kaufman (2008).} as well as discussions about varieties of capitalism and public policies in the North (Hall and Soskice, eds. 2001, Levy 2000, 2006), and alternatives or successors to neoliberal versions of capitalism for Latin America and the global South (e.g., Huber ed. 2002). The sense of a palpable decline of economic orthodoxy is widespread, in part given the backlash generated against those policies at the national and international levels. Within that general intellectual and policy milieu, some scholars (e.g., Weiss ed. 2004, Weiss forthcoming, Levy 2006), have begun to explore creatively how states seemingly are carving out new roles and development strategies that are both post-neoliberal and post-developmental state. Meanwhile, some analysts in Brazil (Bresser-Pereira 2004, 2006; Sicsú and Renaut eds., 2004), reflecting the hold that developmentalist thinking still has in certain intellectual quarters, have begun to discuss — in part as proposed doctrine and in part as description of emerging empirical reality — a “new developmentalism” [“novo desenvolvimentismo”] with roots in the “old developmentalism.” For his part, the current Finance Minister, Guido Mantega,
spoke in September 2007 of a “social-developmentalism” [“social-desenvolvimentismo”] that he believed was emerging under Lula.4

The problem with attempts to revive or re-orient the developmental state concept is that it conflates very distinct experiences, across both time periods and countries. By associating state behavior narrowly with economic performance, especially GDP growth, it tends to obscure the real debate that needs to occur about recent transformations. It reduces the diverse dimensions of state action and capacity, their roots in society and in institutional relations, to the simple movement of the economy, in particular the macroeconomy. Thus, the new profile of the state would be defined narrowly by its capacity (in reality, its success) in making the economy deliver better performance.

The debt and oil crises, which contributed to the erosion and collapse of the economy of Latin American and general and Brazil in particular, were the first great blow to the developmentalist edifice constructed over the 1940s, 1950s and 1960s and still operating albeit with greater difficulties in the 1970s.

Brazil has reaped mixed results from the developmental state-centered approach. Import Substitution Industrialization (ISI) succeeded in establishing a diversified and integrated industrial base, and promoting accelerated economic growth. Socially, however, the country evolved in a very perverse way, producing and reproducing inter-regional and inter-group income inequalities.

With a certain irony, Hirschman pointed out the supposed paradox caused by the development model: “Industrialization was expected to change the social order and all it did was to supply manufactures!”(1971: 32). Even then, it produced manufacturing with low capacity for technological innovation, and dependent on protection.

In these circumstances, growing productivity would face enormous obstacles to its long-term sustainability. At the end of the 1970s, this model based on a

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closed economy gave clear signs of being eroded and challenged by the debt and oil crisis that ravaged Latin America, and particularly Brazil.

The reactions of policymakers and business were not directed at questioning the technology trap that marked the closed industrial policy matrix. Comparing different modalities and eras of industrial policy, Schrank and Kurtz emphasize that “while tariffs and import controls are designed to foster the growth of infant industries, their offspring tend to prefer the comfort of mother’s bosom to the harsh realities of the international economy—and therefore tend to grow into troubled, costly, and demanding adolescents. They are economically feeble. They are politically powerful. And they are therefore likely to lobby the state for additional support rather than to specialize, invest, and accumulate”. (2005: 683).

Despite the new international scenario, with the formation of new global value chains and increased knowledge flows, Brazil’s effort to break out of the vicious circle was timid, in addition to late.

The debate about changes within state institutions was traumatic. After successful decades based the growth-based-on-investment model, developed under a closed economy, it was difficult to conceive of any substantive alteration in direction. In addition, habits, part of the “rules of the game” (North 1990: 6) and of organizations, molded for a protected environment, lacked flexibility to readjust to the changes necessary to support a new growth cycle.

The search for a new development model had an additional hurdle, as Brazil was living the drama of institutional aging, and institutional accretion, as new “layers” of institutions were laid on existing layers. Appropriate structures for the early stages of development became inadequate to act and organize an economy that had matured and diversified, but without the incentives for advancement. Understanding this process of growing obsoleteness and incoherence, its characteristics and subtleties, was and remains key to the design of new policies.

The response of policymakers and of business, however, were only defensive and did not reflect an appreciation of these problems, which contributed to the
survival of developmentalist institutions, despite their inefficiency. In the interim period of the 1980s, in the middle of a severe crisis, the questions that plagued policymakers were: What to adapt? What to abandon? What needs to be constructed? The alternatives assumed a corporate universe that was more agile and competitive, based on liberalized financial markets, as well as the need for processes of allocating investment via the market and without price control mechanisms. In addition to being difficult, the choices were contradictory. To what extent could that transition be made without the complete degradation of the state? Even more so with the external debt crisis, oil shocks, and severe fiscal funding and liquidity constraints?

The Brazilian state, an example of successful industrialization, had trouble formulating different policies designed for an open economic environment in which it could no longer control the allocation of investment, trade or finance.

In many ways, this search for a new paradigm, which started at the end of the 1970s, still maintains its relevance today.

The first experiment

The first trial surfaced only with Fernando Collor de Mello, the president elected by the Brazilian people after 25 years of authoritarianism, in 1989. The underlying diagnosis pointed to the opening of the economy, but in many senses, the state has been designated as the culprit of economic stagnation. The destruction of the developmental model was the main political and institutional goal of the Collor de Mello government, a goal which — after the interim government of Itamar Franco (1992-94) — was recaptured and pursued vigorously by the government of Fernando Henrique Cardoso (1995-2002). Via liberalization and privatization, the old state was dismantled and reduced in power. Simultaneously, new institutional instruments and regulatory changes have been gradually introduced.

The state was seen by governing and policy elites as the biggest obstacle to development. Its regulatory rigidity, direct ownership of companies, and protectionist bias, had to be dismantled or at least substantially diminished to give space to markets, private investment and companies. Developmental
Interventions were considered outdated and harmful to the country. High levels of inefficiency and persistent economic and technological backwardness were attributed to anticompetitive public policies (Suzigan and Furtado 2006). Consequently, policy debate tended to establish development on a dichotomy between an inward-oriented model, based on protection and the state, to an outward-oriented model, based on a free-market approach. There was no place for any different kind of industrial policy, based on innovation and compatible with an open economy.

The rigid conduct of macroeconomic policy discouraged more active measures aimed at generating a high level of competitiveness of the economy, and the motto announced by then-Minister of Finance, Pedro Malan of - "The best industrial policy is no industrial policy" - remained a hallmark of the entire era. The opening up of the economy and liberalization were designed to be the main stimulus to efficiency and technology, through less protectionism and greater competition.

However, amidst the economically orthodoxy recommendations, the word efficiency was drained of its relationship with technology. Public projects were re-oriented narrowly towards infrastructure investment and formation of human resources as a means of raising the technology standard (Arbix 2007). Openness and competition were presented as the best remedy against decades of protectionism, and the way to push enterprises to meet innovation challenges.

The results manifest over the decade of the 1990s, however, were not cause for optimism.

The distance that separated Brazil from the most sensitive and technological practices — especially those derived from advances in microelectronics, information technology and communication — increased dramatically in the late 90's.

Under pressure to revive its S&T institutions, which had been adversely affected by the fiscal constraints over the decade, the Cardoso government only paid greater attention to the debate on innovation and technology toward the end of
its second term. This was the period of Sector Funds creation, focusing on financing of innovation. For its institutional boldness, it is possible that the approval of Sector Funds in Congress will come to be recognized as the major achievement in the second term of the Cardoso government, exactly because it responding positively to Brazil’s institutional deficit.

Although the decision was very positive, there was no break with the past S&T policy bias, as funding processes were primarily oriented to public universities and research institutes. The linear model of Science, Technology and Innovation, which was pervasive during the developmental period, was still working inside Brazilian institutions.

The structural changes promoted during the course of the 1990s took place within a process of global integration, marked particularly by the newly founded World Trade Organization (WTO) and international financial liberalization. In terms of the structural characteristics of the national state, these global changes produced a point of no return, in Brazil as elsewhere, and established some conditions for future state development. The transformations were inspired in the most orthodox pro-market models or prescriptions, which were based on the idea of an inert state, responsible for setting basic rules and broad regulations for private markets, and notably reactive in character.

In fact, we argue, the state never did withdraw altogether, even though various of its foundational elements were irreversibly altered, and in due course new elements added, such that in its current form it bears little resemblance to either orthodox market fundamentalism or the old developmental state.

**Rebuilding and reorienting state capacity**

The contemporary Brazilian state has undergone an important ongoing evolution in its capacity, within the broad context of economic opening and political democratization. Even as old forms of state capacity have been undermined by market reforms and by economic opening, new forms of state capacity have emerged and taken shape.

In a non-linear and sometimes incoherent process, state capacity has been transformed and adapted, rather than simply declining, and it has taken on new
forms and substance that are not captured by the developmentalist or neoliberal paradigms.

Actually, the liberalization of the economy was paved with new state interventions, in a new economic and social environment.

Five sets of changes figured most saliently. Although they have left no developmentalist stone unturned, the post-centralist Brazilian state failed to shrink, and by some indicators, it has become bigger under the Cardoso and Lula administrations:

- First, the coercive capacity of the military-developmentalist state — one of the main attributes of the state in that era — has been weakened by democratization. At the same time, processes of a more socio-structural nature, like the emergence of powerful governors and mayors as significant political and economic players, expressed new trends toward decentralization and the emergence of newly empowered regional and local authorities.

- Second, Brazil would now progress economically and socially with the benefit of low inflation. For much of the developmentalist period, the Brazilian authorities spurred growth through a combination of lax monetary policy and deficit spending, with strong negative impact on competitiveness. In the 1990s, particularly after 1994, when wage indexation was abandoned and devaluations were no longer an option, the general strategy would be different, and based on a strong Real. Keynesian demand stimulus gave way to austerity budgets, and monetary policy was tightened, supported by massive doses of state intervention.

- The third major change was the abandonment of government efforts to steer private companies and industry. Firms would receive less government support, and also be subject to fewer governmental restrictions. Nevertheless, a new Automotive Regime (1995) and programs to foster the computer industry (1996) were approved as quasi-sectoral industrial policies.
Fourth, although state owned banks, at the federal and regional level, have been privatized, the deregulation of financial markets did not dismantle the backbone of Brazilian banking, which is still supported by four state-controlled banks — Banco do Brasil, Caixa Economica Federal, the Central Bank, and the National Development Bank (BNDES).

Fifth, numerous elements beyond the starting point of macroeconomic stabilization under the Real Plan have contributed to the process of restoring the state’s key capacity to tax, spend, and invest. It is well known that Brazil has one of the highest tax to GDP ratios in the developing world; scholars have also noted how crucial fiscal health and fiscal capacity are in terms of offering either a more permissive or a more restrictive environment for social policy (Haggard and Kaufman 2008). We wish to underline the country’s ability to maintain a large tax base through periodic, typically incremental tax reforms, even amidst persistent cycles of crisis, stabilization, and recovery and even through the late 1990s recession. State revenues have continued to rise during the whole pro-market, less interventionist and post-dirigiste cycle, reaching 35 percent of GDP in 2002, at the end of Fernando Henrique Cardoso’s term. Moreover, unlike the past, there was a sharp de facto renegotiation of the fiscal pact between federation and states, resulting in incremental tax and social security reforms, administrative reforms, and tight-fisted monetary policies, including primary fiscal surpluses.

If some practices and institutions inherited from developmentalism have been dismantled, the same cannot thus be said of the Brazilian state, whose spending, taxation, tightened monetary policy, state-controlled and regulated banking system, and new forms of intervention in the economy have remained strong in the post-statist period. These trends would be enlarged and reinforced after Lula’s inauguration in 2003.

The turn of the century
The Brazilian state under President Luiz Inácio Lula da Silva is much more proactive than it was during the 1990s. Industrial policies are back on the national agenda, and the idea of having a national development project gained momentum.

We will examine four key set of policies of the new market-friendly Brazilian state activism: (1) Trade policy (broadly conceived); (2) industrial policy and science, technology and innovation policy; (3) new role of financing institutions – BNDES and FINEP; and (4) social policies.

1. Trade policy is an area of renewed and transformed state capacity combined with a substantive political reorientation. While extensive protection has been left behind since the trade liberalization of the early 1990s (and indeed the WTO and other international trade commitments create further general constrains), the federal government has taken on and steadily expanded its role in trade promotion, particularly in the Lula government. This primarily takes the form of an aggressive promotion of these very bilateral and multilateral free trade agreements within and beyond the Americas (and opposition to the Free Trade of the America proposal of the 1990s and early 2000s) as well as energetic defense of perceived Brazilian interests within multilateral trade negotiations. Of note is, that unlike the more straightforward economic nationalism of developmentalism’s yesteryear, this involves an ambitious and elaborate effort to cultivate foreign market access for Brazilian goods as well as increasingly for FDI abroad by Brazilian firms (where for instance Brazilian firms were responsible for 14 mergers and acquisitions in 2008; Arbix and Miranda 2009a). One result of this policy has been a very strong and healthy diversification of Brazil’s foreign trading relationships over the past decade or so, in particular in terms of a relative diminution in its trade dependence vis-à-vis traditional Northern partners among the OECD powers and relative increase in its ties with the global South, most notably China but also sub-Saharan Africa and other regions outside the Americas. This has been closely related to a diversification in the range of exports in terms of sectors, degrees of value added, and types, which include not just simple commodities,
but also value-added commodities such as ethanol or as well as manufactured goods across an increasingly diverse range.

Moreover, while the country has perhaps not been as aggressive as some East Asian countries in trying to use all the remaining tools of permissible selective protection at its disposal within a post-WTO world, Brasília has not shied away from a sometimes aggressive defense of measures such as the automotive regime of the mid to late 1990s (forcing multinationals to invest directly in the country if the wished to receive lower tariffs on imports) or successfully challenging US cotton subsidies within WTO mechanisms (Evans 2005).

In all these cases, whether pursuing multilateral or bilateral trade disputes, or negotiating new trade deals (e.g., taking a much greater role in the Doha round than in the previous Uruguay round of global trade talks), or channeling lines of credit through the BNDES, trade promotion involves increasingly closer relationships of consultation with firms and sectors who can benefit quite tangibly and directly from specific expanded market opportunities. In sum, even within a context of openness that policy elites across the last two presidencies have not just accepted but actively embraced — in a historic shift for Brazil — the state has not taken this a simple cue to retreat into a passive “laissez faire” position of accepting Brazil’s inherited comparative advantage or current structure of imports and exports and trading partners.

2. Besides trade, competitiveness policy has two other key, closely related dimensions — industrial policy and science, technology and innovation policy. In both these areas, one finds an increasingly pro-active role of the state, mainly within the Lula government but to some extent building on some institutional innovations from the Cardoso administration, with respect to (a) strategic policy formulation and related creation of new institutions for such purposes and (b) development finance.

In 1999 the Ministry of Development, Industry, and Commerce was created. This was a step that would loom as more significant after Lula took office in 2003, and began to place greater emphasis on formulating an active competitiveness policy. The process of designing industrial policies under Lula
seems in part an experimental one of trial and error and of policy learning, in which, over time, the degree of coordination among agencies and of explicitness in goals (through a more “results-based” approach) as well as ambition of goals have all tended to increase. In the early years of the first Lula government, when concerns about macroeconomic stability and structural reforms that would cement the government’s credibility with the international financial community prevailed, the Conselho Nacional de Desenvolvimento Econômico e Social (National Council for Economic and Social Development) was established. Its role has been primarily consultative. Nonetheless, in bringing in not only business associations but also labor unions and other civil society organization into a broader debate about national development priorities, the CNDES set an important early tone of dialogue and societal and particularly business participation in a process of promoting a public-private alliance for development, which has remained and grown in subsequent years.

Announced in March 2004, the first industrial policy was focused on innovation. To coordinate and implement the new policy, the Agência Brasileira de Desenvolvimento Industrial (ABDI, National Agency for Industrial Development) has been created as a networked institution, formally under the Ministry of Development, Industry, and Trade. ABDI has played an important role in seeking to develop an industrial policy and helps identify and guides investment decisions in technological research, innovation and industrial development. A second set of industrial policies has been developed under the Chief of Staff of the President of the Republic (actually, the strongest Ministry of the government) in 2008, labeled Política de Desenvolvimento Produtivo (PDP, Policy for Productive Development), and stressed the importance of public investment and innovation to “build capability in infrastructure, capital goods, exports, and technology firms” (Trubek 2008). Another new institution, also created in 2004, was the Conselho de Desenvolvimento Industrial (CNDI), an inter-ministerial body comprised of call the main ministries with responsibilities for economic, social, and environmental policy, other development-related agencies along with representatives from civil society. Its primary function is to
“propose to the President national policies and specific measures to promote Brazil’s industrial development”.⁵

Along with the creation of new institutions, traditional institutions have been strengthened. Of note, particularly with regard to science and technology, or national innovation, policy is the strengthening of (a) the Ministry of Science and Technology’s funding agency for public, private, and mixed projects of applied and basic research, Financiadora de Estudos e Projetos (FINEP, Financing Agency for Studies and Projects) and (b) state-level foundations and technology institutes that play similar roles at the subnational level. With promotion of firm-level innovation now articulated as a major policy goal under the 2004 National Innovation Law, the FINEP’s funding has increased substantially and also its emphasis on lending directly to firms has been enhanced significantly.

The goad of industrial policy under Lula has been to redefine the policy’s scope and tools, to drive the country into knowledge-intensive sectors, seen as the only way to sustain long-term growth. In sum, industrial policies of the present are essentially different than past experiences, and are innovation-oriented. As there is not much room left for protectionism, nor for any autarkic development, state interventions must be very different from what they were during the heyday of the developmental state.

While it is true the Brazilian state has lost the ability unilaterally to define necessary industrial policies, it is capable of building new institutions and promoting new interactions between the public and private sector.

The table below notes some key changes in Brazilian industrial policy and S&T trajectory in the last few years.

Inspired by Freeman (2008), we put emphasis on five dynamics to build the table below: (a) Improvement, adoption, imitation and development of new tools and techniques of production; (a) Generation of knowledge; (c) Economic innovation machine (incentives, production and distribution of goods, services and income); (d) Political and legal structure; (e) Values and customs.

The National Plan of S&T&I established four priorities: (i) Expansion and Strengthening of the National Science, Technology and Innovation Systems, (ii) Promotion of Technological Innovation in Companies (iii) Research, Development and Innovation in Strategic Areas, and (iv) Science, Technology and Innovation for Social Development. For the first time a national plan fixed the support of innovation in enterprises as one of its main priorities. Based on the Innovation Law (#10.973/2004) and the Law of Common Goods (# 11.196/2005) new instruments have been created to support enterprises: (i) New tax-incentive mechanisms to support R&D available automatically to companies, (ii) Subsidized programs aimed at diffusion and generation of

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These changes can also be followed by more specific indicators, like as the disbursements of the sector funds. About 50% of the Funds’ resources were designated to researchers with links to industrial companies and services, since the beginning of its functioning. Between the 24,645 groups of researchers registered in CNPq, 2,922 declared that they interacted with 4,483 companies (CNCT-MCT, 2010).
technology, (iii) Subsidized programs for companies to hire R&D specialists, (iv) Supporting start-ups and venture capital market.

The National Plan invested US$ 22 billion in 2009, only through the federal budget. Between 2007 and 2009, the Ministry of Science and Technology’s budget increased from US$ 2.3 billion to US$ 3.5 billion. The national expenditure on Science, Technology and Innovation represented by the sum of investments in research and development (R&D) and scientific activities and related techniques, rose from $ 14.3 billion to $ 43.4 billion, an increase of 200% between 2000 and 2008.

The overall investment in R&D in relation to GDP was 1.13% in 2008. In 2005 investment in R&D was 0.97%, while public investment was 0.48% and 0.49% in the private sector. In 2008 public investment was 0.6% and private investment of 0.53%.

The evolution is clear, and permeates, albeit timidly, the productive sector. However, the progress made is more similar to a process of a "hard slog than a leap frog", as described by Hobday (1995: 200) regarding the experience of East Asian countries. To paraphrase the author, instead of a "leap frog", the public sector and Brazilian companies are involved in a painful and incremental learning process in the long term.

The dilemma to be resolved may be summarized as follows: “Delayed switch to the innovation-based strategy reduces growth because the economy is not making best use of innovation opportunities.”(Acemoglu et al. 2006: 39). That is, the more a mature economy remains tied to the old standard of competitiveness, the greater the risk of entering a vicious circle that hinders and prevents its evolution to the most advanced areas of technology.

By following the evolution of recent industrial policies, from the first version, in 2004, to the more comprehensive PDP (2008), it is noticeable that the axis of innovation and investment has gained importance. However, one of the two terms, "investment" (especially in infrastructure), still receives far superior and preferential treatment than the second term, "innovation". The difference in treatment is established in programs, actions, and, ultimately, in budgets. It is to
be hoped that, gradually, a more balanced relationship will come to be established, so as to overcome this trap, which is a major obstacle to technological development in the country.

3. The long-standing National Development Bank dating from the advent of developmentalism in the 1950s, the BNDES, has recently enjoyed a higher-profile, revamped role: the Bank’s assets stood at US$1200bn as of end-2008, according to The Economist, and its annual lending portfolio is now larger than that of the World Bank (Trubek 2009), at around US$100bn. Stressing that “[I]n the past its funds were sometimes handed out according to political expediency, to dying companies and in pursuit of a patchily successful industrial policy”, The Economist notes the BNDES’ recently expanded role as a venture capitalist and direct provider of trade finance during the recent credit crunch as well as its “slim” administration comprised of “career civil servants” that has engaged in “less political lending of late.”

The BNDES’ new role as a venture capitalist (which began late in the Cardoso government and has since been expanded) is of particular importance because it reflects not just a new policy instrument but also a strategic shift toward greater emphasis on promoting innovation in nascent or promising new sectors as well as traditional lending to established firms and sectors. And while this role no doubt grew in the context of the quite agile stimulative and anti-crisis posture that the Brazilian state in general has displayed with respect to limiting the impacts of the global recession on the country’s growth, this evolution has been underway for a number of years under the Lula presidency. We reproduce the following summary from Trubek (2009) that builds on the work of several Brazilian specialists:

“BNDESPAR’s [the investment bank arms of BNDES] goals include support for technological innovation, small business and start-ups producing innovative and competitive products, the creation of a seed money and venture capital market, and support for the acquisition of foreign assets by Brazilian firms. BNDESPAR both operates like a private equity fund and venture capitalist and supports other institutions that perform these roles. BNDESPAR
can make direct investment in start-ups and unlisted companies, participate in their management, and affect corporate strategy and governance. In some cases, BNDESPAR requires that firms receiving its support submit innovation plans. It also encourages the firms it supports to secure private capital through IPOs. But the bank also supports closed investment funds that provide private equity and venture capital especially for small and medium size firms. BNDESPAR invests in privately managed closed funds that are targeted at specific sectors and attract substantial private funding: currently these funds have raised $4 for every $1 committed by the Bank."

This novel role for the BNDES in terms of close public-private collaboration in support of private entrepreneurship and innovation is characterized by Mattos and Coutinho (2008) as a new “model of risk-taking” that the Brazilian state is arguably taking on. The authors insightfully contrast this new type of state role in industrial policy with the state’s industrial policy role as “owner of state-owned enterprises” and “picking winners” under developmentalism as well as the passive model of the 1990s.

4. A fourth area where state capacity was weakly developed under developmentalism and has become much more so since the 1990s is in social policy. Despite some modest expansions of social security benefits, health care access, and local educational spending requirements under the military regime, Brazil’s welfare regime remained highly segmented and regressive in its impact on income distribution during this period. Newly created programs such as FUNRURAL as well as terms of access for newly incorporated groups in the social security system were riddled with patronage for the official ARENA party, and “cash benefits to the rural and urban informal sectors—about one-half the

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7 This discussion draws on Haggard and Kaufman (2008:100-103). The notable extensions of coverage included: the extension of noncontributory pensions to some peasants and rural poor under the newly created Fundo de Assistência ao Trabalhador Rural (FUNRURAL) in 1971; the 1979 expansion of rural clinics in the Northeast under the Programa de Interiorização das Ações de Saúde e Saneamento (PIASS) and extension of access to emergency health-care for all citizens; and a 1983 constitutional amendment mandating that states spend at least 15% of all federal transfer on education.
minimum wage....remained minimal compared to those going to the civil service, other formal sector workers, and (of course) the military itself” (Kaufman and Haggard 2008: 101-102). Filgueira and Filgueira (2002:138-39) characterize Brazil’s welfare regime through the end of the 1970s as “dual...with an almost universal development of primary education and a significant through stratified degree of health coverage.....[exacerbated by] the problem of territorial heterogeneity....[S]ocial protection systems [such as this] cushion social segmentation only for those sectors incorporated into modern frameworks of protection. These systems exacerbate stratification between the latter and those not fortunate enough to be part of such frameworks.” In addition, of course, the military regime heightened the coercive elements of the state-corporatist structure of labor organization and labor relations (which was extended to agricultural wage-laborers), which helped allow for a model of de facto flexible external and internal labor markets.

The process has been uneven across policy spheres, and full of its fits and starts, but gradually under Brazil’s nearly quarter century as a “new democracy” a system of social protection has taken shape and expanded, with particularly decisive strides made since the late 1990s and under the current government.

One of the most notable elements of the initial period of the Nova República (under Jose Sarney, Fernando Collor, and Itamar Franco) was the relative absence or failure of concrete social reform despite the rhetorical emphasis on social inclusion, as documented and analyzed at length by Weyland (1996). Yet there were important constitutional provisions in the 1988 document, inserted through active pressure from civil society, the labor movement, and politicians seeking to cater to these interests, which expanded general if vaguely defined rights in access to education, health care, and social security. In addition, specific benefits were created or extended in the Constitution (or in subsequent legislation by the Sarney government), such as sick leave, maternity leave, and unemployment insurance. These principles became important as they established normative goals as well as in some cases institutional templates (in particular, devolution of resources and responsibility to subnational governments) that influenced concretely subsequent reforms
efforts. Meanwhile, there was contradictory movement in regulation of labor markets and labor relations, as expanded worker benefits as well as rights to strike and freedom of association created in the 1988 Constitution were limited in practice by the absence of subsequent implementing legislation or subsequent legislation that interpreted them narrowly. Meanwhile, the labor market reforms of the Cardoso era were “flexibilizing” in nature, even if the government did not achieve as much as it sought due to opposition from unions and their political allies in the opposition.

While the Cardoso government chipped away at some of the social and labor market protections of formal-sector (mostly private-sector) workers in terms of individual labor and social security, it also pursued important health and education reforms that expanded access to previously uncovered or underserved groups at the same time. There was considerable pressure from below from the sanitarista movement on health care, building on the 1988 constitutional provisions and ordinary legislation adopted in 1990 implementing decentralization to municipalities as well as strengthening the Ministry of Health and weakening INAMPS. Responding to this pressure and through a series of executive decrees, the Ministry of Health oversaw a large-scale reorganization of the health care system occurred over the course of the 1990s: “By 2002, almost all of Brazil’s 5560 municipalities had met the regulatory standards for primary-care services, and about 560 of these receive funding for all services in their jurisdiction” (Haggard and Kaufman 2008:285, citing Arretche 2004)

In education, there was a modest “reallocat[jion] of resources within the primary-education sector and recasting [of] the regulatory and oversight function of the ministry of education” (Haggard and Kaufman 2008:285-286; see also Draibe). At the same time, proposals to impose fees and cut wages in higher education were beaten back by political and labor opposition. Meanwhile, the government managed to gain passage from Congress of legislation expanding, under the military-created FUNDEF (Fundo de Manutenção e Desenvolvimento do Ensino Fundamental), federal transfers to primary education with mandated shares for teaching pay. A noteworthy aspect of both these modest but significant health and education reforms was that not only did they expand services to previously
excluded or underserved regions and populations, but they also did so without focusing on a “neoliberal” social policy orientation centered on privatization, private care or insurance, vouchers, and the like.

Much the same could be said about the two-stage social security reform across the Cardoso and Lula governments. It was, as Haggard and Kaufman (2008) underline, “gradual and parametric,” focusing not on privatization and individual accounts or even a “multi-pillar” approach involving creating parallel private systems. Instead, reform focused on shoring up and rationalizing the public system, and equalizing benefits across the public and private sectors and avoiding anomalies that allowed for multiple pensions for certain occupational groupings. To be sure, even these limited reforms were contentious, and in particular the more ambitious and draconian 1995 proposals by the Cardoso government had to be scaled back considerably to secure passage by 1998, given the strenuous opposition of well organized pensioners and unionists as well as from the political opposition led by the Partido dos Trabalhadores (PT, Lula’s Party).

The most notable innovation in social policy, of course, has been in terms of targeted social assistance to the poor. This began to occur on a significant scale through the conditional cash transfer scheme known as Bolsa Escola, adopted in 1997 and building on experiences in subnational governments from both the PT and PSDB (Cardoso’s Party) as well on parallel experience with other smaller-scale conditional cash transfers at the federal level (Soares et. al. 2007).

The program, which is based on various human development conditionalities tied to school attendance, vaccinations, nutritional monitoring, and pre and post-natal tests, has subsequently been extended enormously by the Lula government, from the 1.2 million families it reached by November 2003 to a total of 11.9 million in 2009 and from 0.15% of GDP in 2002 to 0.4%-0.5% as of early 2009 (Ministry of Social Development, 2010). Studies have found that it has had positive impacts on reducing dropout rates and on raising family
income (Morley and Coady 2003, cited in Haggard and Kaufman 2008:287) as well as on reducing poverty (see below) and inequality (Soares et. al. 2007). Of particular importance from a state capacity-building perspective is the degree of institutional innovation and efficiency of this scheme in terms of its careful and highly progressive targeting (even better than that of CCTs in other countries, according to Soares et. al. 2007), its decentralized implementation through municipalities, and its minimization of leakages and overhead costs (82% of spending reaches beneficiaries’ pockets, it has been estimated; see IPEA 2006).

Another important development is expansion of coverage of the social security system, which has steadily grown from 54.4% of the economically active population in 2002 to 59.6% in 2008, according to IPEA. Unlike some previous expansions that took place by bringing in non-contributors through the Seguro Especial (and thus contributing to the fiscal problems of the Previdência), this expansion has occurred almost entirely through bringing in new contributors to the system or already covered individuals shifting to contributory status.

![Social Security Coverage - 2001-2008](image)

Source: IPEA, 2009

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8 By breaking the fall in the Gini over the 1995-2004 into factor components, the authors reach the conclusion that conditional cash transfer schemes (centralized in the Bolsa Família from 2003) accounted for 21% of the total drop
Moreover, health and education spending as a share of GDP have grown considerably in recent years, magnifying impacts of institutional reforms instituted in the latter 1990s. After gradual expansions that began in 2000 and brought spending up to approximately 1.8 to 1.9% each in 2002, outlays have approximately doubled to 3.65 and 4.05%, respectively, by 2008. While it is difficult to quantify evolution over time, spending on job training and labor market assistance reached 9.38m families as of 2008 and 2 million families benefited under the PROGER microcredit program as of 2007, while unemployment insurance was received by 6.9 million families in 2008. Total social spending, at the federal, state, and local levels, as a share of GDP, has grown considerably from the 1980s to 1990s and then into the first decade of the twenty-first century.

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Social Spending, as Share of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>13.9%</td>
</tr>
<tr>
<td>1985</td>
<td>13.3%</td>
</tr>
<tr>
<td>1990</td>
<td>19.0%</td>
</tr>
<tr>
<td>1995</td>
<td>19.2%</td>
</tr>
<tr>
<td>2005</td>
<td>21.9%</td>
</tr>
</tbody>
</table>

Source: Own elaboration, based on data from Médici and Maciel (1996), Fernandes et al. (1998), and IPEA (2007).

The combined impact of institutional reforms in existing entitlements coupled with institutional innovations in the form of cash transfers, together with fiscally sustainable increases in spending for both types of programs, is the creation of a considerable network of social protection that has not existed previously in Brazil. And while Brazil’s “welfare state” still has segmented qualities, benefiting the better organized and remunerated in the formal and public sectors disproportionately, this segmentation is now much less acute than it has been for decades, and perhaps since the creation of the country’s first social benefits many decades ago.

While it is related to economic policy more than social policy, we also must not forget the impact of the successive annual increases in the minimum wage, which have raised its purchasing power considerably after many years of real
decline. Combined with formal-sector job creation, this measure has contributed significantly to income gains at the lower end of the income spectrum.

The combination of growth in GDP and per capita incomes, rising formal-sector employment, increases in the minimum wage, and expansion of cash transfer and social security coverage along with social benefits and assistance more general — all in a context of low inflation and macroeconomic stability — has been a rapid fall in poverty and inequality.

As can be seen in Figure 2 below, poverty fell by 36% and absolute poverty by 50% over the 2003-2008 period. Disaggregating real income growth in graph below:

![Inequality: Household Income Growth (annual average) Per deciles - 2001-2008](image)

Source: IPEA, 2009

It becomes evident that the level of average annual growth in household income across the 2001-08 period is inversely proportional to the income decile — that is, the poorer one’s household, the faster one’s income grew.

**Figure 2. Evolution of Rates of Poverty and Extreme Poverty in Brazilian Households, 2003-2008**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Years</th>
<th>% Change 2003-2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>2007</td>
<td>2008</td>
</tr>
</tbody>
</table>
Overall, the country’s Gini coefficient has been declining sharply from its historically extremely high levels since 2001, as revealed by a third graph.

The graph shows that inequality began to drop in 1998 but then rose again over the period when Brazil felt the worst impacts of a financial crisis in 1999-2000, then began its steady downward path.

What seems to be taking shape in contemporary Brazil is a new development model of “growth with equity” that relies not just on export demand but also
increases in domestic consumption that build on more buoyant incomes, labor markets, and government income transfers.

This more balanced relationship between internal and external demand stimulus would seem to be at least one of the factors that has contributed to Brazil’s more rapid recovery from the global recession than that of its Latin American neighbors. Another factor relates to our point about expanding and re-oriented state capacities; in response to the global recession, the government took a number of measures that amounted to about 1% of GDP\(^9\) — increase trade financing via BNDES and expanding *Bolsa Família* coverage, as noted above, as well as expanding consumer access to credit for purchases of white goods and consumer durables — to blunt the impact of global trends and bring the country quickly out of what proved to be a very brief and mild recession, lasting only two quarters, with growth resuming in the third quarter of 2009 at a solid clip. In addition, the newly expanded network of social protection had its own automatic counter-cyclical or cushioning impact as well.

The combined impact of short-term measures and the benefits of longer-term changes in social policy — together with the country’s high level of reserves and other policies of macroeconomic stability — clearly demonstrates a capacity for crisis management that the Brazilian state has historically lacked in response to external shocks, such as the oil shocks of the 1970s, debt crisis of the 1980s, or even (in terms of rapidity of adjustment) the financial crisis of the late 2000s. It will be important, of course, to see if the trends of steady, significant decline in poverty and inequality continue unabated or instead experience at least a “pause” given the brief recession and decline in annual growth projections in 2009, when such numbers become available. But there are certainly strong grounds for optimism that social impacts have been much more limited than was initially feared.

What stands out, in a state capacity-building perspective, in the creation or expansion of these key equity-enhancing social programs and policies is the degree to which they have been largely free from the widespread fraud,

corruption, and clientelism of Brazil’s notoriously patrimonial state, even amidst unrelated high-level scandals touching deep into the halls of power in both the current and previous administrations. De-centralization has much to do with that, and the bases for decentralization were initially set by the much-maligned 1988 Constitution, though careful program design and monitoring are required to avoid siphoning off of resources via traditional local patronage. While this dimension of the reforms has perhaps not been as fully analyzed and explored as it might, there is a notable degree of transparency and administrative competence and even-handedness that was lacking historically in the provision of Brazil’s social services.

Brazil’s developmentalist-era state was known for promoting an income-concentrating economic model and for promoting a pattern of limited transfers almost exclusively to key organized constituencies, which left out the bulk of the truly needy and was largely regressive in its distributive impact. In the current decade we bear witness to an economic model that has broadened employment, promoted wage growth, and expanded consumption in the bottom half of the income spectrum. It is reinforced by an emerging new pattern of social spending that has greatly improved positive impacts on income poverty (and arguable other aspects of poverty); together, the two have helped lower inequality, as measured by the Gini, considerably.

Moreover, while some may attribute Brazil’s economic success up to the onset of the global recession primarily to the global commodity boom, our discussion above the diversified sectoral profile of Brazilian innovation and exports paints a different picture. On the more narrow but significant question of the impact of commodity prices on drops in inequality and poverty — an issue sometimes raised by skeptics about the durability or uniqueness of Brazil’s recent social gains — Huber (2009) finds statistical evidence from regression analysis that the positive impacts of public spending on inequality and poverty (including absolute poverty) of the Lula government and other governments she similarly categories as “social democratic” in Latin America (Bachelet and Lagos in Chile and Vásquez in Uruguay) are robust even when controlling for the commodity boom.
Leaving aside the politically charged issue of who should take the most credit among the past two governing parties and presidents in Brazil, we wish instead to emphasize the cumulative impact of economic and social reforms that were begun at an earlier moment under a different economic environment and that have been carried forward, in some cases re-oriented, and backed by greater resources in a global and domestic environment that has been more permissive.

Conclusion

If we find the major analytical categories that authors apply to contemporary Brazil’s development trajectory all wanting — the developmental state, social-developmentalism, or even a disguised neoliberalism — the question remains, how then can we best categorize and conceptualize this trajectory?

Is Brazil experiencing a social democratic breakthrough? While it is tempting to make that argument, and the country’s recent trajectory bears some important resemblance to hallmarks of social democracy, particularly in its manifestations in the global South (Sandbrook et. al 2007), ultimately we believe that considerable caution must be exercised in applying this concept too readily.

Brazil’s development trajectory seems to occupy some kind of intermediate space, where perhaps it is appropriate to speak of hybrid categories, but not of it exhibiting, or moving clearly towards, broadly encompassing “models” such as neo-developmentalism or neoliberalism. We see the emergence and some steps toward the possible consolidation of a new type of state, which takes on an enabling position of pro-market intervention via competitiveness policy and a stronger role in providing social services and benefits that is increasingly linked to fostering market inclusion for the previously underserved and excluded and not simply transferring income in targeted fashion to the poor.

The Brazilian experience offers four important—if not entirely original—insights into the transformation of dirigiste and state-centered political economies. The first is that the pathway towards a more market-friendly political economy is prepared with more state interventions, albeit of a decidedly different nature. The second is that there is no road to a democratic polity and open economy without
the state, particularly in the poor, unequal social contexts of the South. The third insight is that to abolish particular practices, tools and policies supported by a specific state framework is not equal to dismantling that framework itself. The fourth — is that state institutions can mutate, being adapted around new roles and policies.

Whatever precise terminology might be most appropriate — a debate we seek to open without attempting to resolve here — the final question that calls out for greater analysis is to examine what is new, not only what is old, to capture the conditions under which this emerging inclusionary state activism without statism can be consolidated or not. A related question for the future research agenda—since we have proposed here the main lines of state evolution without attempting to resolve the underlying causal dynamics — concerns what type of explanatory framework best captures this transformation. Competing currents within comparative political economy would suggest, for instance, different analytical “bets” regarding the relative importance, and interplay, of ideas, interests, and institutions in terms of explaining major shifts in public policy in response to crises and external shocks. Investigating and parsing what roles shifting policy paradigms among elites versus politicians’ efforts to formulate new distributional coalitions versus processes of institutional and policy learning within state agencies themselves — to cite only three possible approaches to the shifting public policies and state roles we identify — is a fruitful line of inquiry if scholars are to comprehend more fully the emergence and possible future paths of the new state activism without statism.

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