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# INSTITUTIONAL DEVELOPMENT THROUGH POLICY-MAKING

## A Case Study of the Brazilian Central Bank

By MATTHEW M. TAYLOR\*

A number of contemporary studies rightly emphasize the notion that policy outcomes result from institutional determinants.<sup>1</sup> But as a growing literature on institutional development notes, these institutions are themselves impermanent. Sometimes, in crisis moments, institutions are replaced wholesale. More frequently, institutions evolve gradually over time. This article illustrates that the policy-making process itself can be a central driver of such gradual institutional development, with institutions evolving through the accumulation of policy choices made over many years and under different policymakers in response to contemporaneous events and unforeseeable economic and political challenges.

Thus, while institutions have a demonstrable effect on policy choices, the opposite path is also highly significant. Although the resulting institutional frameworks remain important to future policy outcomes, causation frequently flows in the opposite direction: the pace and order of policy choices and the adjustment of institutions to the policy-making process are significant factors in institutional development. The path of institutional change is thus also more complex, evolutionary, and multivariate than commonly assumed. In consequence, critical junctures may prove to be far less significant—or at the very least, far more ambivalent—as moments of institutional change than more quotidian policy paths that respond to the day-to-day challenges of governance.

I illustrate these arguments by analyzing the evolution of the Brazilian Central Bank (BCB) in the six decades following 1945. The benefit

\* Regular discussions over the course of the past four years with Lourdes Sola, the late Eduardo Kugelmas, Maria Rita Loureiro, and Moisés Marques sparked my interest in this theme and have contributed greatly to the arguments herein. Marta Arretche and Rafael Cortez offered helpful suggestions and Sérgio Praça and three anonymous reviewers read multiple iterations of the text, greatly improving it along the way. My gratitude extends to all; remaining errors are mine alone.

<sup>1</sup> E.g., Ahrens 2002; Haggard and McCubbins 2001; Stein et al. 2006.

of this case is that major institutional reform was undertaken at two key moments in Brazilian history: at the outset of the military regime in 1964 and at the genesis of the new democratic regime in the 1980s. Yet the BCB today is remarkably different from the central bank envisioned at these critical junctures; it has evolved into a considerably more autonomous, powerful player than would have been predicted at either moment. As a result, patterns of economic policy-making today are also considerably different from those that might have been predicted at either time.

This article begins with a brief conceptualization of the relation between the policy-making process and institutional development. It then turns to the historical case study at two levels of remove: first, through an analysis of two critical junctures in the four decades between the Second World War and the collapse of the military regime, and second, through a closer look at the molding of the BCB through the policy-making process in the two decades following the drafting of Brazil's 1988 constitution.

#### THE POLICY-MAKING PROCESS AS AN ENDOGENOUS SOURCE OF INSTITUTIONAL CHANGE

Theories of institutional change can be loosely categorized according to whether they describe causation by exogenous or endogenous forces and whether change occurs under exceptional or ordinary circumstances. Early work in the field emphasized exogenous sources of change, perhaps most influentially captured in Stephen Krasner's model of "punctuated equilibrium," where institutions are abruptly replaced, then go through long periods of stasis before being replaced anew. In order for such wholesale punctuated institutional change to occur, a common assumption has been that some form of disequilibrium is needed to trigger the change. Such moments of disequilibria are variously referred to in the literature as critical junctures, switch points, or turning points;<sup>2</sup> the common thread is that they "result in configurations that then set constraints on subsequent developments."<sup>3</sup> Various efforts at describing the causes or triggers of such critical junctures exist in the literature. Most recently, drawing on the lessons of prospect theory, Kurt Weyland notes that the "bounded rationality" of individuals in crisis situations may lead to "drastic rescue efforts" that in the ag-

<sup>2</sup> E.g., Abbott 1997; Collier and Collier 1991; Haydu 1998.

<sup>3</sup> Thelen 2003, 212.

gregate “can explain discontinuous change and striking turnarounds.”<sup>4</sup> Between such exceptional moments, however, the literature frequently assumes that institutions will provide a predictable and stable channeling of societal conflict, reliably placing constraints on policy until the next moment of institutional overhaul. Presumably, such extraordinary circumstances could also be triggered by endogenous change from within an institution. Although less academic attention has been given to endogenous change at extraordinary moments, a corruption scandal within an institution like a central bank or congress might well lead to such an institutional turning point.<sup>5</sup>

Another possibility is that change may be driven by exogenous sources but need not always occur in extraordinary or critical moments. Kathleen Thelen and Sven Steinmo, for example, argue that shifts in socioeconomic and political context can lead to changes by which “previously latent institutions suddenly become salient,” “old institutions are put in the service of different ends,” or institutional “goals or strategies” are shifted.<sup>6</sup> Change is seen as potentially ongoing—institutional change occurs not as a result of a big bang, but rather in accretive fashion.

A final possibility is endogenously driven accretive institutional change. Scholars in this vein presuppose institutional permanence even as they recognize that the underlying institution may shift considerably below the surface. Kellee Tsai’s research on China, for example, examines how “adaptive informal institutions” may facilitate “transformations in formal institutions by providing elites with political support for introducing key reforms.”<sup>7</sup> Endogenous approaches such as Tsai’s emphasize a gradual, evolutionary process of institutional change, albeit with the possibility of significant discontinuity and political contestation.<sup>8</sup>

This article considers another, perhaps more ubiquitous, cause of endogenously driven accretive institutional change: the policy-making process.<sup>9</sup> The policy-making process contributes to solving an impor-

<sup>4</sup> Weyland 2008, 285–87.

<sup>5</sup> I am grateful to Sérgio Praça for suggesting this possibility.

<sup>6</sup> Thelen and Steinmo 1992.

<sup>7</sup> Tsai 2006, 140. Helmke and Levitsky (2006, 10–25), extend this reasoning to describe four types of informal institutions (complementary, accommodating, substitutive, and competing) according to their potential interaction with formal institutions.

<sup>8</sup> Tsai 2006, 122.

<sup>9</sup> I distinguish here between “causes” and “forms” of institutional change. Causes might include those mentioned above—crisis, changes in socioeconomic context, informal institutions, or the policy-making process—they are my central concern here. Forms (or modalities) of change include 1) institutional “layering” by which institutions “conflict or coexist in a synthetic manner” (Lieberman 2002; and Thelen 2003) and 2) “conversion” by which institutions are used in ways that deviate from their

tant theoretical problem by providing a bridge between explanations of institutional genesis and of institutional sustainability over time, which have tended to remain quite distinct.<sup>10</sup> Policy-making can be a causal force that is at work both in the emergence of institutions targeted to specific policy objectives and in their gradual evolution over time. It also provides a useful corrective to the punctuated equilibrium approach, which tends to overstate the stasis “beneath the surface of apparently stable formal institutional arrangements” as well as understate “continuity through putative breakpoints in history.”<sup>11</sup>

My logic follows the arguments of Daron Acemoglu, Simon Johnson, and James A. Robinson (2005) on the endogeneity of institutional evolution. By their reasoning, the distribution of political power and the distribution of resources are key determinants of institutional choice: power and resources determine how collective choices are made and thus, what institutions are created. But once institutions are in place, they “affect the choice of economic institutions and influence the future evolution of political institutions,” resource distribution, and political power.<sup>12</sup> Temporality is the only factor that saves this model from tautology.

To this logic, I add the policy-making process, which is a key conduit between resources and power on the one hand, and institutions on the other. It is not the only factor influencing the allocation of resources, power, or institutional development, of course. And policy-making does not occur in a vacuum; it is influenced by elite attitudes and beliefs, priorities at the apex of the political system, competition between institutions and between actors, and by the course of deliberations over policy ends. But there are several reasons why the policy-making process may be a potent force, especially under ordinary conditions. First, as Paul Pierson has noted, policies have important effects on the rules of the game, “influencing the allocation of economic and political resources, modifying the costs and benefits associated with alternative political strategies, and consequently altering ensuing political development.”<sup>13</sup> Second, even if it is highly contentious, policy-making can subtly shift political power in ways that may be imperceptible even to

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intended purpose (Thelen 2003, 2004), both of which are discussed in Tsai 2006. They might also include 3) “displacement,” 4) “drift,” or 5) “exhaustion,” discussed in Streeck and Thelen 2005. Although many forms of institutional change are present in the case study of the BCB provided here, there is not space to draw attention to them individually.

<sup>10</sup> Thelen 2003, 209.

<sup>11</sup> Thelen 2003, 211.

<sup>12</sup> Acemoglu, Johnson, and Robinson. 2005, 392.

<sup>13</sup> Pierson 1993, 596.

participants, permitting institutional change to take place “below the radar” without a significant realignment of political forces or a discernible redistribution of societal resources. Third, policy-making matters to political institutions because it is, in a sense, what these institutions are all about. And while there is a certain self-preserving inertia to institutions, in the short term they tend to focus more on contestation over policy results than on debates about institutional structure itself. Policy change occurs relatively frequently and, like water flowing daily through a riverbed, can gradually mold institutions to its flow (even though the new shape of the riverbed will constrain the course of future policy-making).

The policy-making process influences institutions in quotidian ways in part by reshaping internal institutional responsibilities. In the process of policy-making, which includes the tasks of designing, choosing, advocating, implementing, and adjusting specific policies, the commitments of individual members of the institution to specific institutional rules may harden or soften, depending on their perceptions about the effectiveness of policy. Policy-making also shapes the internal institutional playing field by reallocating responsibilities and prestige. Successful economic stabilization, for example, may make central banks more likely to focus attention on monetary policy than they might have been previously, and thus may privilege the custodians of monetary policy over a previously elite foreign-exchange trading desk devoted to the complex accounting for exchange transactions under high-inflation conditions. Such flows of talent and resources to new policy foci may remake the institution from the inside. Finally, policy-making often points outsiders—voters, politicians, or constituencies, for example—to institutional changes that would be needed to facilitate adoption or implementation of their preferred policies.

There is of course a problem of infinite regress inherent in any search for the origins of institutional development. (Which came first: policy, politics, agents, or institutions?) It is therefore admittedly futile to search for a single cause of institutional change. But by temporarily freezing the analytic frame on the causal effects of the policy-making process, it should be possible to better understand an important cause of endogenously determined institutional change and in the process address two other important theoretical issues.

First, there is a subtext in the real-world application of institutionalism that if one gets the institutions right, good things such as political or economic development will follow. Such “institutions reductionism,” focused primarily on property rights and the rule of law, has in the

past decade supplanted economic liberalization as a prime concern of many development institutions, with the failure of “first wave” reforms blamed on the absence of strong institutions that could guarantee their efficacy.<sup>14</sup>

But how are institutions chosen? Brazil is intriguing as a case not only because it is Latin America’s largest democracy and economy, but because it has “chosen” institutions that range from the potentially destabilizing (e.g., an independent prosecutorial branch that serves as a “fourth branch” of government)<sup>15</sup> to the downright problematic (e.g., multiparty presidentialism).<sup>16</sup> And yet, despite such choices—indeed, perhaps *because* of them—its institutional framework has proven more stable than many of its regional peers, including countries that made institutional choices believed to be conducive to prevailing prescriptions for growth. Brazil has been slow but steady, as opposed, for example, to its neighbor Argentina—the erratic wonder child of the Washington consensus.

Neither Brazil’s stalwart institutional intransigence nor the failure of Argentina’s radical institutional restructuring is all that surprising. Supposing that one could choose and adequately build entirely new institutions from the ground up, how would a country do so? A second implicit assumption is that institutions can be (and are) chosen at critical junctures, that is, an institution is selected at a determined point in history and remains in place until the next such moment of change. Even scholars cautious about the claims for path dependency are prone to argue that although path dependency does not lock in results, change is bounded “until something erodes or swamps the mechanisms of reproduction that generate continuity.”<sup>17</sup>

But change does not often come in big bangs, which may not be a bad thing given the bedlam that frequently accompanies crisis moments believed conducive to institutional replacement. Even where seemingly wholesale institutional change has occurred, a recurring lesson of historical and sociological new institutionalism is that imposing new institutions on old power structures or cultures seldom yields the expected outcomes.<sup>18</sup> As Thelen notes, “it is hard to think of a single case in which institutions are completely ‘up for grabs,’ even in what

<sup>14</sup> Rodrik 2004, for example, offers a strong critique of such “reductionism,” arguing that institutional quality is highly nebulous and endogenous to income levels, complicating any clear assertion of what institutional form leads to what outcomes.

<sup>15</sup> Mazzilli 1993.

<sup>16</sup> As per Mainwaring 1995.

<sup>17</sup> Pierson 2000, 265.

<sup>18</sup> E.g., Arjomand 1992.

may look like a critical juncture situation.”<sup>19</sup> Given that institutions themselves—especially political institutions—are far from plastic, and reflect existing power arrangements and power distributions,<sup>20</sup> wholesale institutional change is seldom possible. And even supposing that critical junctures were to permit wholesale institutional replacement, the case study in this article illustrates that such choices may end up being far less important to downstream institutional outcomes than minutely incremental adaptation over time that may run in directions contrary to the objectives of institutional architects at moments of great change.

That is not to say that consideration of critical junctures should be eliminated altogether. At its narrowest, the concept provides an important service by identifying nodes from which certain policy paths develop and deepen and thereby generate persistent, path-dependent patterns of development.<sup>21</sup> Further, ideas present at key critical junctures may well provide focal points that guide subsequent institutional development by channeling the institutional preferences of epistemic communities in a common direction. However, the connection between critical junctures and institutional choice is more tenuous than is often supposed. The direct transition from institution A to institution B seldom happens at a specific and well-established moment in time. Rather, change often comes through the accretive accumulation of many discrete policy choices that each trigger various forms of institutional accommodation. Only at the end of a long transition from institution  $A(P_1)$  to  $A(P_{1+x})$ , where  $P_n$  denotes individual policy choices made through the policy-making process, will it perhaps be possible to claim that a new institution  $B(P_1)$  has arisen.

Before turning to the case study itself, a word on the merit of case studies is warranted. There is a time and a place for formal modeling and statistical analysis, as Alexander George and Andrew Bennett note, and important complementarities between these methods and case-study methods.<sup>22</sup> In this project, however, neither modeling nor statistical approaches would be able to accurately discern the complex and highly contextual nature of the paths of institutional development. A case study thus appears to be the most appropriate means of identify-

<sup>19</sup> Thelen 2003, 220.

<sup>20</sup> Pierson 2004; Moe 2005.

<sup>21</sup> E.g., Mahoney 2000; Pierson 2000 and 2004. According to Pierson, what “makes a particular juncture ‘critical’ is that it triggers a process of positive feedback” (2004, 51, note 26). Of course, this illustrates one problem of critical junctures, which is that they are only identifiable post hoc.

<sup>22</sup> George and Bennett 2005, 5–6.

ing the “causal paths and variables leading to the dependent variable of interest”<sup>23</sup>—in this study, institutional development. I have also chosen not to engage in cross-national comparison, in large part because of the complexity of the various temporal contexts in which institutional change occurs in the Brazilian case, but I hope that future scholars will be able to use this analysis as a starting point for such work and I will point to some comparative applications of the analysis in the conclusion.<sup>24</sup>

### ORIGINS OF THE BCB: THE RELEVANCE OF CRITICAL JUNCTURES

This section provides brief background on the path of Brazilian monetary policy over the past sixty years, focusing primarily on why two critical junctures failed to result in the wholesale institutional change envisioned by reformers. The subsequent section will take up the causal relation between the policy-making process and institutional change.

Central banks play a key role in managing monetary policy and through monetary policy they influence inflation, employment, growth, and fluctuations in the business cycle.<sup>25</sup> A strong consensus exists in contemporary policy circles that greater delegation of power to the central bank—and if possible, central bank independence—is a good institutional framework from the perspective of economic policy formulation; independence provides central banks with greater autonomy from political influences that might impede them from functioning smoothly. Insulating central bankers from politics can improve perceptions of the impartial application of the rules of the game, especially in the formulation of monetary or regulatory policies. It may insulate politicians from politically challenging or costly decisions. Moreover, delegating to central bankers has several interrelated positive externalities. It may signal credibility to domestic and international markets, create predictable policy behaviors by tying the hands of policy oppo-

<sup>23</sup> *Ibid.*, 23.

<sup>24</sup> A word on sources. Largely because of the scope of this study—covering six decades of institutional development in a famously volatile policy environment—I rely almost exclusively on secondary sources. I recognize this as a potential shortcoming, although it should be noted that many of the authors cited were themselves prominent policymakers (e.g., Cardoso, Ellis, Loyola, Nóbrega, Schwartzman, and Simonsen), and other citations (e.g., Ribeiro and *Diário*) refer to interviews or other primary documents. More important, however, is to note that my central goal is not to develop a comprehensive history of the BCB, but rather to use the basic and relatively consensual elements of the BCB’s history to pose a broader argument about institutional development. Given the short space available here, it is hoped the reader will understand this reliance on a largely secondary bibliography.

<sup>25</sup> Lijphart 1999, 234.

nents, and limit the alternatives available to present and future policymakers.<sup>26</sup>

These arguments have been used to justify central bank autonomy since the founding of the United States Federal Reserve in 1913.<sup>27</sup> More recently, strengthening central banks has been an objective peripherally associated with the Washington consensus, with central-bank autonomy helpful in accomplishing at least four of the consensus' ten policy objectives.<sup>28</sup> In Brazil, recognition of the potential importance of the central bank predated its creation in 1964; the idea had been floated in the 1930s and influential policymakers such as Eugênio Gudin and Octávio de Gouvêia Bulhões argued the importance of creating an independent central bank in the 1940s.

Why is it, then, that the BCB's institutional framework remained so distant from this ideal, especially in light of considerable consensus among leading economic policymakers about the desirability of a strong central bank, extensive executive power and discretion under the military regime (1964–85), and the once-in-a-lifetime opportunity for a major institutional change in the BCB during the drafting of the 1988 constitution?

The answer lies in the interplay between the interests arrayed in favor of and against policy change, as well as the compatibility of normative aspirations for the central bank and the pressing challenges of the day. Together, these factors influenced the pace and scope of policy change and ensured that the BCB's institutional development would be halting and lengthy. As a result, at two critical junctures when wholesale institutional change in the BCB was theoretically possible (1964, when the military took power, and 1988, when the new constitution was written), concrete institutional choices had effects that could not be foreseen by their crafters.

Institutional change proceeded in stops and starts and, while a common vision of what a "good" central bank should look like provided a focal point for policymakers (an overarching institutional goal toward which a common epistemic community jointly strove), a new monetary institution in keeping with this vision could not be constructed at

<sup>26</sup> E.g., Lohmann 1998; Maxfield 1997.

<sup>27</sup> Although several European central banks, most notably the Bank of England and the Bank of Sweden, predate the United States Federal Reserve by several centuries, the Fed was the first to benefit from a considerable degree of independence, obtained in part because the member governors served fourteen-year terms that theoretically would extend beyond those of either the executive that appointed them or most of the members of the legislature that approved them.

<sup>28</sup> Namely, fiscal discipline, liberalization of interest rates, (sometimes) a competitive exchange rate, and liberalization of inward foreign direct investment (Williamson 1990).

once. Wholesale institutional reform was not a possibility even under authoritarian rule. In fact, in some ways wholesale change was more constrained under military rule because of the regime's central policy imperative of boosting growth to maintain its own legitimacy. Instead, institutional change largely emerged from successive policy shifts. Even though minor institutional changes were occasionally smuggled in alongside only marginally related policies, such changes were always publicly justified by short-term policy needs.<sup>29</sup>

### 1930s–1960s: HISTORICAL ORIGINS OF AN UNSTABLE MONETARY INSTITUTION

Brazil's monetary arrangements during the first half of the twentieth century were marked by an incestuous relationship between the federal government and the gargantuan state-owned Banco do Brasil that combined the functions of development agency, commercial bank and, however poorly, monetary authority. Given the Banco do Brasil's political strength—derived from its enormous budget, a lengthy history dating back to the early days of the Brazilian Empire, the absence of a strong private-sector alternative, and the practice of doling out important bank posts to powerful political appointees—almost all efforts to create a robust central banking institution were subverted or rejected as too threatening.

In the face of recurring domestic and international pressures in the 1930s and 1940s to create some form of central bank to guide monetary policy, the government adopted a half-way solution in 1945 and created the Superintendency of Money and Credit (*Superintendência da Moeda e do Crédito*, or SUMOC). Yet the SUMOC would ultimately be a “toothless tiger,” with nominal responsibility for monetary policy but subject to intense political pressure and with no control over the Banco do Brasil.<sup>30</sup> A focal point of opposition to the SUMOC came from private bankers who feared the establishment of policy instruments, such as reserve requirements, that might lead to excessive government intervention or might be used to cover government deficits.<sup>31</sup>

The SUMOC was thus left with only minor, largely indirect policy instruments, such as the means to conduct research and minor oversight of lending operations, and the Banco do Brasil fought any effort

<sup>29</sup> Nóbrega and Loyola (2006, 83, fn.12), note, for example, that during the Cruzado and Bresser economic stabilization plans, a list of desirable legal changes was prepared within the Central Bank then introduced in only remotely related legislation associated with the plans, in a practice that became known within the Central Bank as ‘smuggling.’

<sup>30</sup> Nóbrega 2005, 285; Skidmore 1988, 30.

<sup>31</sup> Gouvêa 1994, 113.

to build it into a full-fledged central bank. Within the broader federal government, the SUMOC was eyed with suspicion, especially when SUMOC members argued for tighter fiscal policy.<sup>32</sup> Many high-ranking SUMOC directors themselves opposed efforts to develop the SUMOC into a new monetary-policy institution for fear that these external pressures would lead to the creation of a populist central bank out of the extant Banco do Brasil structure.<sup>33</sup>

Over time, the inadequacy of these arrangements became increasingly apparent<sup>34</sup> and by the early 1960s, as part of a broader reform initiative, the government of President João Goulart sent a bill to Congress creating a proper central bank. But in light of the crisis that led to Goulart's toppling by the military and in the face of strong resistance from the Banco do Brasil, its congressional allies, and a politically powerful group of agricultural and industrial borrowers who benefited from the Banco do Brasil's beneficence, this proposal was dead on arrival.

#### 1964: CREATING THE CENTRAL BANK

Upon taking office in 1964, the military faced major economic difficulties, including a potential foreign-debt default, shrinking currency reserves, and rising inflation, which approached an annualized rate of 150 percent during the final three months of the Goulart government.<sup>35</sup> The new economic team, led by Planning Minister Roberto Campos and Finance Minister Bulhões, instituted an economic policy program (the Programa de Ação Econômica do Governo) aimed at tackling accelerating inflation, especially targeting the rapid increase in the money supply that the Goulart government had used to fund government deficits, subsidize industry, and boost wages.<sup>36</sup> Their approach to inflation was heterodox and gradual, but their program included one major institutional change adopted from Goulart: creation of the BCB. Thus, on December 31, 1964, eight months after the military took power, the BCB came into existence.

The coalition that had stymied the creation of a central bank late in the Goulart government was knocked off-kilter by the military regime's

<sup>32</sup> Gouvêa 1994, 110–115.

<sup>33</sup> Santos and Patrício 2002, 98.

<sup>34</sup> Annualized inflation rose steadily from 21 percent in December 1960 to 98 percent in December 1962, and was a leading policy objective of Goulart's 1962 Three-Year Plan, his administration's major economic policy initiative.

<sup>35</sup> Although inflation of "only" 150 percent annually seems quaint in retrospect, especially in light of the four-digit inflation that Brazil faced in the early 1990s, a leading policymaker expressed the concern of policymakers at the time—that one of key challenges facing the military was "not exactly to combat inflation, but to escape hyperinflation." Simonsen 1969, 136.

<sup>36</sup> Skidmore 1988, 29–30.

rapid drive to create the BCB. Top officials led the drive: Bulhões had headed Sumoc, and President Humberto de Alencar Castello Branco (at Bulhões' urging) himself participated in negotiating the creation of the BCB, thus helping to wear down resistance from powerful congressional skeptics.<sup>37</sup>

Yet this institutional change was less of a watershed than might be imagined. Although the reform created a central bank—an important change in nomenclature—once again, the monetary authority was a paper tiger. As Fabiano Santos and Inês Patricio note, Bulhões' conciliatory personality led to a central bank structure that was "less distant from congressional preferences than might be expected" (Santos and Patricio 2002, 98, my translation). Central bank directors' autonomy was easily undermined; although the directorate had fixed terms of office, in policy disputes the new BCB was routinely overruled informally by the Banco do Brasil or the Treasury, or formally by another institutional creation of the military regime, the National Monetary Council (Conselho Monetário Nacional, or CMN). A primary weakness of the new BCB was related to the situation it inherited—federal deficits so large as to render monetary control weak and demand for government bonds lackluster.

Two policy problems arose from the BCB's roots in the SUMOC. First was the undermining of other mechanisms of monetary policy, such as reserve requirements, by the practice of depositing BCB funds at the Banco do Brasil. This monetary budget was promptly used to re-lend funds to the Treasury, meaning—incredibly—that higher reserve requirements could lead to the expansion of the monetary base.<sup>38</sup> Second, a provisional *conta de movimento* (transactions account), which balanced the accounts between the BCB and the Banco do Brasil, was hastily assembled in 1964 to expedite the creation of the BCB without further negotiations with Congress.<sup>39</sup> Although this was ostensibly a stop-gap measure, it took more than two decades for the *conta movimento* to be eliminated. In the interim, the Banco do Brasil was able to use the *conta* to expand its lending activities, with the BCB unable to control its expansionary effects on the monetary base. In sum, as Mailson da Nóbrega and Gustavo Loyola note "...the 1964 reform had, in prac-

<sup>37</sup> Nóbrega 2005, 286.

<sup>38</sup> Ellis 1969, 189; Ribeiro 1990. Ribeiro (1990, 10) notes the perversity of these institutional rules: if reserve requirements were increased to fight inflation, the direct deposit of these funds at the Banco do Brasil meant that rather than shrinking the monetary supply, they increased it.

<sup>39</sup> The *conta movimento* and the monetary budget were two rather byzantine arrangements that were poorly understood by most observers—even within the economic policy community. For an illuminating explanation of both, see Nóbrega 2005, chap. 12.

tice, worsened the fiscal and monetary institutions in Brazil...<sup>40</sup> Five years after the BCB's creation a knowledgeable observer wrote, "[i]t is common knowledge that Brazil lacked a central bank for most of its history; it is possibly much less common knowledge that a strong and well-functioning center of monetary control is still very far from being realized."<sup>41</sup>

#### 1970s: DECLINING AUTONOMY AMID INCREASING FUNCTIONALITY

The BCB's autonomy further eroded in the late 1960s, albeit with pressures against autonomy coming largely from within the government. President Artur da Costa e Silva and Finance Minister Antônio Delfim Netto, in particular, were convinced that central bank independence was counterproductive to achieving the military regime's key imperative of growth. Roberto Campos later recounted a conversation with incoming President Costa e Silva. When Campos tried to explain why the government could not substitute the BCB president at will, Costa e Silva responded flatly, "*O guardião da moeda sou eu*" ("I am the guardian of the currency").<sup>42</sup> Not surprisingly, between 1967 and 1974, the central bank became increasingly deferential to the Finance Ministry, a process that culminated in a 1974 law that withdrew the fixed terms of central bank directors.<sup>43</sup>

Simultaneously, however, policymakers tinkering with reforms inserted the central bank into a range of activities that had not previously been a part of its policy repertoire. As the Brazilian financial market expanded and became more sophisticated, so too the BCB was forced to increase its capacity for both regulation and oversight. Its institutional capacity to oversee monetary policy improved and the 1973 creation of open market operations enabled it to better control the effects of an increasingly complex range of foreign exchange operations.<sup>44</sup>

This gradual expansion of the BCB's policy capacity in response to shifting conditions and evolving markets would be more significant to long-run institutional development than the reform of 1964. However, many of the issues originating in the problematic genesis of the BCB persisted: its role in development finance, the continued existence of the *conta movimento*, and most importantly, power sharing with the CMN and Banco do Brasil. By the late 1970s, BCB President Carlos

<sup>40</sup> Nóbrega and Loyola 2006, 67.

<sup>41</sup> Ellis 1969, 188.

<sup>42</sup> *Diário* 1987, 138–150.

<sup>43</sup> Santos and Patrício 2002, 98.

<sup>44</sup> Maneschi 1972, 215.

Brandão was pushing for separation of Banco do Brasil and BCB functions, but the initiatives were torpedoed by pressure from within the Finance Ministry, as well as from within the BCB's own development division, the Departamento de Crédito Rural e Industrial (DICRI), which stood to be written out of existence in any reform.<sup>45</sup>

#### 1980s: CRISIS AND WINDOWS OF OPPORTUNITY

By the early 1980s, rising inflation prompted many within the government to rethink the complications created by the numerous overlapping policy responsibilities shared between the BCB, the Treasury, and the Banco do Brasil. Economic policy became increasingly difficult to manage in light of the OPEC shock, the foreign debt crisis of 1982–83, and stagnating growth, but to complicate matters even further, the election of state governors beginning in 1982 introduced new actors from outside the regime's core. By early 1983 several governors had discovered that their state banks could make direct withdrawals from reserves held at the Banco do Brasil. The BCB often did not find out about any given withdrawal until a month after the transaction had taken place and thus was defenseless against the operations, which had an expansionary effect on the monetary base.<sup>46</sup> For the full decade between 1983 and 1993, the BCB proved extraordinarily weak in relation to governors, unable to rein in their profligacy or to neutralize their effects on inflation.<sup>47</sup>

In response to the deepening crisis, a working group of over 150 economic policymakers convened in August 1984 to draw up a new institutional framework that could be put in place before the new democratic

<sup>45</sup> Nóbrega 2005, 292–93.

<sup>46</sup> Martone 1993; Nóbrega 2005, 295.

<sup>47</sup> I am grateful to Lourdes Sola and Moisés Marques for emphasizing this point to me. Sola, Kugelmas, and Whitehead 2002 suggest that 1982, with the beginning of redemocratization and the debt crisis, should be considered an important critical juncture for the BCB. However, given my desire to describe critical junctures that brought substantive *institutional* change to the BCB and because there was no reframing of (or intent to reframe) institutions, 1982 does not seem as significant as a potential institutional juncture as 1964 or 1988. The year 1982 clearly does mark the beginning of a new set of policy preoccupations in Brazil that contributed significantly to the evolution of the BCB over the next two decades, and in this sense shifted the underlying concerns of policymakers within the BCB and the rest of the economic policy community.

This, however, points to a problem with the concept of critical junctures more broadly: they must be defined as "critical" in regard to something (i.e., structural change, institutional change, policy change, etc.) and depending on the item of interest, we may define these junctures differently. In this case, for example, I have not chosen to emphasize 1982 as a key *institutional* critical juncture analogous to 1964 or 1988, although I strongly concur with Sola, Kugelmas, and Whitehead's argument that it was a defining moment for revising and restructuring the "reigning cognitive and ideological maps" in Brazilian society, and thus helped to reframe the central *policy* concerns of the next generation. Sola, Kugelmas, and Whitehead 2002, 16 (my translation).

government took office in 1985. The group convened with the enthusiastic acquiescence of the presumed future president, Tancredo Neves, and his likely finance minister, Francisco Dornelles, both of whom welcomed the creation of an institutional arrangement that would protect public finances from political pressures, especially if it could be created before their government had to assume the onus of change.

Opposition came from bureaucrats within the DICRI as well as from Banco do Brasil employee representatives who were able to call on allies in Congress to stage stormy hearings on the working group's proposals. The CMN approved the working group's recommendations in late November, but implementation of the changes was halted the very next day by a federal court injunction granted to a congressman with close ties to the Banco do Brasil.

As the chair of the working group acknowledged in hindsight, this defeat was the result of policymakers' inexperience with the challenges of dealing with public opinion; the conspiracy-theory-prone political environment of the period; the relative listlessness of the outgoing regime; and the powerful opposition of the Banco do Brasil, whose influence extended to Congress (where the leader of the government coalition and eleven other congressmen were bank employees), the national auditing body (Tribunal de Contas da União, or TCU), and even to members of the presidential cabinet.<sup>48</sup>

Seemingly, the reform window had closed. Yet one year later, in the face of deepening troubles the new democratic government unearthed the working group's recommendations and the CMN once again approved them. A new injunction was filed by the same congressman, and once again the measures were put on hold in federal court. This time however, Finance Minister Dilson Funaro defended the reforms publicly and government lawyers were able to overturn the injunction on appeal. Among the most important changes that resulted were the end of the *conta movimento* in July 1986, which improved monetary control by the central bank, and the creation of the National Treasury Secretariat, which would facilitate fiscal control. A year after that, as the new government's second stabilization plan (the Bresser Plan) was being prepared (its first plan, the Cruzado Plan, had failed), further working-group recommendations were also implemented: the central bank's developmental function—via the DICRI—was eliminated; the administration of the public debt was shifted to the Finance Ministry; and

<sup>48</sup> Nóbrega 2005, 300–303.

the monetary budget was eliminated by the creation of a single, unified federal budget.<sup>49</sup> These 1987 reforms also created the Integrated Financial Administration System (SIAFI), which permitted oversight of the full federal budget, and new rules that gave Congress authority over the issuance of new public debt bonds.<sup>50</sup>

It was a time of great policy change, leading to important institutional modifications in the midst of enormous political and economic challenges. The window of opportunity for change had arisen out of the country's ongoing crisis, more than five years of policy debate, gradual weakening of the strongest antireform coalitions in the face of new democratic pressures, and the perceived political gains from fighting inflation. This trend was further consolidated in the 1988 constitution, which—although troublesome in many regards—nonetheless produced a chapter on public finance that strengthened policymakers' hands. From a solely monetary perspective, the 1988 constitution was crucial to solidifying prior institutional gains: the BCB was given sole competency for issuing currency and was prohibited from making direct or indirect loans to the national treasury<sup>51</sup> while some autonomy was restored to BCB directors, who were now to be nominated by the president with Senate approval.

In sum, the two moments often cited as the critical junctures of institutional change in Brazil's monetary authority were less relevant to the development of the monetary authority than might be expected, and were either followed (1960s) or preceded (1980s) by much more significant institutional modifications resulting from contemporaneous policy-making imperatives. The significant expansion of the BCB's powers in 1964 was limited at the outset by negotiations with Congress, and while some preliminary protections for BCB officials were created, these were far from the ideal and had been undermined by the time President Castello Branco stepped down in 1967. Not only did the 1964 institutional reform not measure up to reformers' original expectations, but it also proved to be transitory in the face of the new pro-growth policy path adopted by President Costa e Silva. By the time the 1974 law withdrawing BCB directors' autonomy was approved, it was widely

<sup>49</sup> Nóbrega 2005, 305.

<sup>50</sup> Santos and Patrício 2002, 99.

<sup>51</sup> An otherwise disastrous decision to place a 12-percent cap on real interest rates in the constitution was sidestepped by a legal argument that this chapter of the constitution could not be implemented without an additional complementary law, Nóbrega 2000, 93–105. Caps on real interest rates are not an innovation of 1988, however: a 1933 usury law also prohibited interest rates above 12 percent a year.

seen as merely de jure acknowledgement of the de facto situation that had evolved since Castello Branco left office.<sup>52</sup>

The 1988 institutional reform to the BCB was likewise less significant as an institutional juncture than many have argued. It was the capstone to a long process of policy change recognizing a *fait accompli*—the exhaustion of the previous monetary-policy regime—rather than sculpting entirely new institutions from scratch. The 1988 constitution consolidated the gains that had been made in the monetary authority incrementally over the previous decade and especially those that emerged over the course of developing the Cruzado and Bresser stabilization plans. As Nóbrega and Loyola note, these stabilization plans provided economic policymakers with some control over the political process, “permitting [them] to introduce institutional changes of great importance,” such as the extinction of the *conta movimento* in 1986 and of the *DICRI* in 1987.<sup>53</sup> Compared to these two changes, the 1988 constitution provided few additional institutional innovations; the majority group within the constituent assembly (a group known informally as the “big center,” or *Centrão*) focused largely on preserving the existing institutional framework against challenges from the leftist developmentalist faction that dominated the early stages of constitutional debate in the Constituent Assembly. In fact, the Assembly devoted little time to proposals regarding the BCB and public attention to the theme was low. Research by Praça (2008), for example, shows that while the Assembly was convened there was only one reference to the BCB in 679 mentions of politics in the prominent weekly newsmagazine, *Veja*. But even when proposals were advanced, such as one subcommittee proposal for an independent and autonomous BCB, they did not make it into the final draft of the constitution.

Neither critical juncture led to wholesale institutional change and in fact, a decade after each (in 1974 and in 1998), the central bank was radically different from what had been envisioned at either moment of potential institutional reform. Far more important to the BCB’s institutional identity was its development in response to intervening policy imperatives and to a series of political relationships between it and other economic and political institutions. The next section focuses more clearly on the relationship between policy choice and institutional development in the period following the Constituent Assembly.

<sup>52</sup> Santos and Patrício 2002, 98–99.

<sup>53</sup> Nóbrega and Loyola 2006, 72.

## THE EXPANSION OF CENTRAL BANK AUTONOMY AFTER 1988

This section examines the influence of layered policy changes on the BCB's institutional development—specifically, on the key institutional criterion of central bank autonomy—during five key policy-making initiatives between 1988 and 2006. I am guided by Lourdes Sola, Eduardo Kugelman, and Laurence Whitehead's argument that "...economic stabilization has less to do with 'getting institutions right,' and is more a consequence of a dynamic bargaining game."<sup>54</sup> The policy-making processes at the heart of this dynamic game are not only important to policy outcomes such as economic stabilization, but may be constitutive of the very institutions needed to support stabilization.

The BCB's impressive institutional evolution can best be seen in the contrast between attitudes toward the BCB in the drafting of the postauthoritarian constitution during the 1987–88 Constituent Assembly and then nearly two decades later under the government of Luis Inácio da Silva (Lula), which many believed might take a leftist turn that would not respect the BCB's institutional autonomy. In 1988, as the previous section notes, the BCB was almost an afterthought in constitutional deliberations and many of the most significant changes in the constitution in fact went in the opposite direction from those desired by economic policymakers. A centrist coalition approved a constitution that—with a few exceptions described earlier—was largely statist on economic matters and, partly as a result, provided little hope of increased BCB autonomy. Two decades later the key article of the 1988 constitution regarding the central bank had been rewritten, and the Lula government had respected BCB autonomy and appointed a market-friendly BCB chief (despite electoral campaign threats to do otherwise). Most remarkably, the Lula government publicly trumpeted the autonomy of the BCB president, who—albeit still subordinate to the president—was no longer formally subordinate to the finance minister.

This contrast in politicians' stances toward the BCB as an institution was not the result of a new institutional blueprint imposed by the outgoing military government. Rather, as the first section of this paper illustrates, it was the result of an ongoing cycle of evolving political relations in which policy success drove confidence in the monetary authority, which in turn weakened key principals who had substantively influenced bargaining over policy choices in the past, and thus shifted the policy players the BCB responded to as well as the key policy-making domains and criteria by which the monetary authority is judged.

<sup>54</sup> Sola, Garman, and Marques 1998, 129.

During the 1900s the main changes in the BCB were spurred by a loose consensus among economic bureaucrats and incumbent politicians (primarily in the federal executive) regarding the benefits that would accrue from the policy goal of monetary stability. Yet crucially, in the effort to achieve stabilization it was not possible to simply impose central bank autonomy and hope the rest would take care of itself. The BCB remained tightly bound by statutory and even constitutional obligations to state-owned and private banking institutions, state and municipal governments, and domestic and foreign financial actors. These relationships shifted only gradually in response to five major policy-altering events, which in turn allowed for a gradual institutional evolution toward greater autonomy: the Collor Plan, the Brady Plan, the *Real* Plan, the banking and debt scandals of the mid to late 1990s, and the need to assuage financial-market fears regarding the new Lula government.

#### THE COLLOR PLAN

The 1990 Collor Plan is representative of the learning experience of the seven stabilization plans attempted in Brazil between 1986 and 1994. Each was ultimately unsuccessful but contributed to a growing body of lessons learned, as well as to marginal shifts in the BCB's institutional framework. On the face of it, the failure of the Collor Plan might have been expected to lead to significant long-term constraints on BCB autonomy: this was particularly the case with the eighteen-month freeze of citizens' bank accounts that was at the crux of the plan, a draconian measure that generated widespread opprobrium and repudiation from citizens and policymakers alike.

Paradoxically, although the freeze was possible precisely because of the absence of real BCB autonomy, the one tangible and significant institutional change that emerged from the policy-making process surrounding the Collor Plan was the liberalization of monetary and foreign exchange markets, which were freed from direct central-bank oversight. This led to a change in the BCB's most important principal-agent relations, liberating it from the most onerous forms of pressure from market players, industrial and commercial federations, and other politically powerful lobbies. In the process, the BCB was freed from related political interference in both monetary and exchange-rate policy. This alone was responsible for a greater increase in autonomy than any other body of policy change prior to the *Real* Plan, although in the process the BCB willingly surrendered direct control over market players.

### THE BRADY PLAN

The second major event that triggered institutional development was the policy response to the debt crisis. The renegotiation of Brazil's massive foreign debt, culminating in 1993 with the Brady Plan, "...not only conclude[d] a painful episode but also permitted Brazil to forge ahead in its quest to separate the functions of the Central Bank and the Treasury..."<sup>55</sup> The responsibility for dealing with foreign debt was moved from the BCB to the Treasury. This was significant in large part because it shifted the relationship with foreign creditors out of the BCB, permitting the BCB to emphasize more technocratic responsibilities and lessening (but not eliminating) the threat posed to monetary control by foreign-debt imperatives. Once again, the BCB gained autonomy by being freed from a politically sticky bailiwick; it lost policy responsibilities but gained some institutional freedom from political interference.

### THE *REAL* PLAN

The *Real* Plan implemented in 1994 was a watershed for policy-making and, as a result, for institutions. This heterodox stabilization plan, which because of its unorthodox nature was not anointed by the major international financial institutions, was implemented early in the year and prompted astonishingly quick and lasting stabilization after the new *real* currency was introduced on July 1.

In terms of its institutional effects, the fixed-exchange-rate strategy at the heart of the plan transferred unprecedented power to the BCB, generating the "effective supremacy of monetary policy" over all other economic instruments.<sup>56</sup> President Fernando Henrique Cardoso and his finance minister of eight years Pedro Malan preferred to delegate monetary policy authority and centralize it in the BCB. These preferences translated into effective (albeit still highly contingent) BCB autonomy on many policy fronts. So long as Cardoso and Malan were on board, the BCB's policy influence and autonomy relative to other actors in the political system was free to grow. Because the BCB's preferences closely mirrored those of the executive branch, it was able to act autonomously, with little interference from the President and his cabinet.

A second circumstantial change resulted from the *Real* Plan's unprecedented effect on national politics. The remarkable success of the *Real* Plan not only catapulted Cardoso into the presidency, but also—especially in his first term—enabled the creation of a congressional

<sup>55</sup> Nóbrega and Loyola 2006, 75.

<sup>56</sup> Cardoso 2000.

coalition unlike any other previously seen in the postmilitary period. Although it occasionally slipped, this coalition was able to push a clear legislative agenda. Its strength derived largely from the *Real Plan's* popularity; public pressure encouraged congressmen to support the measures needed to sustain the plan.<sup>57</sup> Economic stabilization was no longer perceived as a bitter pill to be swallowed by a reluctant public, but rather as a public good that needed to be defended from populist economic policies.<sup>58</sup> Because of this shift in the public view of stabilization, the *Real Plan* contributed to establishing a contingent form of BCB autonomy relative to Congress. The Cardoso government transferred some oversight responsibilities to Congress but, for the most part, the BCB benefited from the executive's delegation of power to it in regard to a number of crucial economic policy issues.<sup>59</sup> In sum, the successes of the policy-making process in the case of the *Real Plan* contributed to BCB autonomy by broadening popular support for currency stability and the policies needed to preserve it.

The third change resulting from the *Real Plan* was a significant shift in the BCB's relation with state and local governments on both fiscal and monetary issues. As David Samuels notes, "...the *Real Plan* provided the Cardoso administration with leverage to constrain the capacity of subnational actors to affect Brazil's economy."<sup>60</sup> Cardoso's preference for BCB autonomy arose in part because an autonomous and empowered BCB insulated him somewhat from difficult policy decisions. Perhaps most important in this regard were policies aimed at reining in fiscal profligacy: state banks were privatized and their expansionary effects on the monetary base eliminated; state and municipal debts were renegotiated in binding fashion; and the new Fiscal Responsibility Law, approved in 2000, instituted a hard budget constraint for subnational governments.<sup>61</sup>

Nonetheless, BCB autonomy remained highly contingent during Cardoso's first term and relied on two supports: presidential backing and policy performance. Without an executive committed to BCB autonomy (which was perceived as essential to the administration's policy and political success) and without public support for the outcomes of policy (which reinforced executive commitment to BCB autonomy), the BCB's

<sup>57</sup> As president Cardoso later wrote, "It dawned on [congressmen] that they would lose their jobs unless they met society's demands to end inflation. That was the power of democracy: an accountability that was new to Brazil." Cardoso 2006, 189.

<sup>58</sup> Sola and Kugelmas 2002, 95–102.

<sup>59</sup> Santos and Patrício 2002, 100.

<sup>60</sup> Samuels 2003, 547.

<sup>61</sup> Martone 1993; Nóbrega 2005; Abrucio and Loureiro 2005.

return to its institutionally subordinate status of the hyperinflationary early 1990s was distinctly possible.

#### SCANDALS AND CRISIS

Ironically, it was scandal and crisis that helped to deepen the still embryonic autonomy of the BCB and generate support, especially within the executive branch, for a more distant institutional relationship between the central bank and the presidency. This effort to shift from autonomy based on a highly contingent presidential “grant” to a more institutionalized and permanent autonomous standing was based in no small part on the need to distance the president from the most politically damaging outcomes of the central bank policy-making process—whether monthly decisions regarding monetary policy or less periodic decisions about the restructuring of state banks.

The tough and unpopular responses needed to address a string of international financial panics, banking crises, a scandal over state debt issuance, and congressional investigations of the BCB’s policy decisions, all contributed to the increasingly arm’s length relationship between the executive branch and the central bank during the late 1990s and early 2000s, culminating in Lula’s milestone pre-inaugural commitment to the BCB’s operational autonomy. Given the underlying policy goal of perpetuating currency stability, it made increasing sense for the executive branch not only to isolate the BCB from congressional pressures, but also to distance BCB decision making from the president’s own political fortunes where possible.

This was particularly the case with the most politically contentious BCB policy choices of the era, including the refurbishing and sale of state banks; the closing of a number of prominent and politically influential private banks, such as Banco Econômico and Bamerindus; the imposition of controls on state and municipal debt issuance in the wake of the so-called *precatórios* scandal (in which state and municipal governments were found to have carried out flawed and corrupt bond issues); the extraordinarily stringent monetary policies implemented to fight contagion from foreign crises; and the more transparent rules on inflation-targeting established after the 1999 currency devaluation. Furthermore, because a floating currency can contribute to autonomy by lessening the perceived effectiveness of organized political pressures on a central bank, the successful floating of the *real* in 1999 may have done more to detach the BCB from the political fray and strengthen it relative to potential pressure groups than any other single policy choice in the 1990s.

In each case, the executive branch's policy objectives coincided completely with the BCB's general response to the underlying problem, but by playing up the BCB's technocratic guardianship of the policy-making process and supposed operational autonomy, the president was able to deflect at least a portion of the blame for the pain associated with these policy outcomes. By setting clear rules within which the BCB could operate with complete discretion, a degree of autonomy could be extended at low risk while the political onus of the policy measures would fall increasingly on the BCB. Furthermore, as Schwartsman (2004) notes regarding adoption of the inflation-targeting system, increased delegation to the BCB had the benefit of enabling greater flexibility in BCB policy-making (albeit within certain preestablished bounds) while also improving BCB performance. The executive thus faced lower political costs from the monetary policy-making process and, other things equal, may have obtained better economic performance than under a system in which BCB policies were contingent on its direct support and approval.

#### THE LULA GOVERNMENT

Finally, in the early 2000s, Lula's impending election and his first term in office served to increase *de facto* BCB autonomy considerably. Prior to the 2002 election, facing a financial market meltdown, Lula pledged his commitment to policies guaranteeing monetary stability and BCB operational autonomy. Once in office, the nomination of a market-friendly BCB president drawn from the banking sector and other BCB directors drawn from equally market-amenable private and public sector origins helped to consolidate the institution's policy autonomy. The 2004 extension of cabinet status to the BCB president—a move made to circumvent potential lawsuits (cabinet ministers are provided privileged standing against lawsuits) rather than one calculated to increase autonomy by removing the BCB from its previous subordination to the finance minister—nonetheless increased autonomy. The move later proved essential to Lula's argument that the BCB was under his command rather than that of his finance minister; this position was instrumental in preserving market confidence in the wake of one finance minister's scandal-induced downfall in 2005 and the nomination of a less market-friendly substitute.<sup>62</sup>

<sup>62</sup> Prior to this moment, the close ties among members of the elite economic policy bureaucracies in the Finance Ministry and central bank (Loureiro 1997) had often served to protect BCB autonomy, or at least to prevent an overt clash of preferences between the two bureaucracies.

## CONCLUSION

The ends often drive the evolution of the means. This is the lesson from six decades of economic policy-making in Brazil, where the shifting objectives of the policy-making process have been the guiding forces behind the gradual, accretive development of the BCB and, over time, contributed to efforts to increase its autonomy. From the first battles over the SUMOC's relationship with the Banco do Brasil to BCB president Henrique Meirelles' triumphant (if unintentionally ironic) 2006 declaration that, "I met President Lula and he reaffirmed the central bank's autonomy...", it has been a slow and tortuous path.

Yet the wholesale imposition of institutional change has never been a credible possibility and, as the critical junctures of 1964 and 1988 illustrate, seldom do attempts at wholesale institutional change in fact provide the lasting institutional solutions their creators envision. Rather, in sedimentary fashion, a succession of shifting policy challenges—such as dealing with the debt crisis, addressing profligate state banks, tackling hyperinflation, and devaluing the currency—have laid down wave upon wave of minor changes driven by the policy imperatives of the moment. These various, sometimes overlapping policy-making processes have slowly and almost imperceptibly reshaped the underlying institution. The resulting institutional framework of the BCB is vital to determining what policy alternatives can be implemented today, but it did not arrive out of whole cloth, nor could it have. A first conclusion, then, is that by recognizing such slow and accretive processes of endogenous institutional development through the policy-making process, it may be possible to reintroduce the importance of politics and policy choice to a field where institutions have increasingly become the predominant independent variable explaining policy results and the course of economic development.

A second conclusion relates to central banks themselves. Central bank independence is never a dichotomous variable.<sup>63</sup> Different policy spheres may well contribute to varying degrees of accountability to distinct policy actors at any given moment in time, as well as to distinct policy-making processes. As a result, institutional development will seldom be a one-shot deal and changing policy imperatives—and the distinct policy-making processes they engender—are likely to lead to institutional innovation and change in ways that differ from any institutional blueprint that could possibly be laid out a priori.

<sup>63</sup> E.g., Eijffinger and Hoerberichts 2002.

How can the lessons of this article be extended? One obvious place to turn would be other central banks. Certainly few central banks have followed the path of the United States Federal Reserve, whose independence has been formally guaranteed since the moment of its genesis. But even the Fed has undergone institutional evolution through policy-making: it was dramatically reshaped by Richard Nixon's policy decision to take the U.S. off the gold standard, for example. Similarly, policymakers' decision to remove Argentina from its dollar peg in 2002 led to a major institutional restructuring driven by the central bank's new policy focus on steering monetary policy and prices.

But the overarching argument here about institutional development through policy-making need not be restricted to central banks and, indeed, examples of similar processes of institutional development in other domains are widespread. The rising power of the Brazilian Treasury over the past two decades, for example, has resulted in part because of a policy-making process that set aside a share of tax revenues for the federal government through measures such as the Emergency Social Fund of 1994. It has also come through seemingly unrelated policy-making processes such as the creation of a Fund for Primary Education, which restricts state and local government options in education policy in part by concentrating the education budget in the Treasury.<sup>64</sup> Similar stories of institutional development through policy-making are available in other national contexts, including the effects of U.S. housing and transportation policies after World War II in creating later constraints on policymakers in realms as distinct as energy policy and school desegregation, and the effects of different policy responses to the Great Depression in shaping Swedish, British, and U.S. government institutions (and thus influencing their later ability to adopt Keynesian policies).<sup>65</sup>

In sum, incremental and endogenous institutional development through the policy-making process is a potent source of change in a range of institutions across the whole range of political regimes and under diverse political conditions. Further, it is more common than wholesale institutional replacement and, in many cases, perhaps preferable. Especially in new democracies with new and untested institutional frameworks, and particularly in policy-making arenas where "risk aversion is high because the effects of policy decisions are uncertain and

<sup>64</sup> Arretche 2007, 60.

<sup>65</sup> Although he is not discussing the policy-making process' effects on institutional development per se, both examples are drawn from Pierson 1993, who in turn is referencing the work of Jackson 1985, Danielson 1976 and Weir and Skocpol 1985.

the stakes are also high”<sup>66</sup> (such as economic stabilization, tax, or pension policies), gradual policy change may be a far more preferable path of institutional development than extensive, wholesale institutional reforms with uncertain and potentially destabilizing results.

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<sup>66</sup> Melo 2004, 326.

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