

New State Activism in Brazil and the Challenge for Law

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There have been significant changes in government policy in Brazil since 2000, and these are having an influence on the law. Emerging from a limited experience with neoliberalism, the country has embraced new forms of state engagement in the economy and social relations. Because these changes are recent and may not yet have been fully consolidated, we follow Arbx and Martin by describing the resulting constellation as “new state activism” (NSA),¹ a term that suggests neither a return to the past nor a clearly consolidated alternative model.

Studies of state activism and law in Brazil show new roles emerging for legal institutions. New policies and institutions, including a new kind of industrial policy and a robust social policy, differ from both classic developmental state and neoliberal approaches. They favor a strong state and a strong market, employ public-private partnerships, seek to reduce inequality, and embrace the global economy.

¹ See Glaucio Arbx and Scott B. Martin, “Beyond Developmentalism and Market Fundamentalism in Brazil: Inclusionary State Activism without Statism” (2010), paper presented at the Workshop on “States, Development, and Global Governance,” Global Legal Studies Center and the Center for World Affairs and the Global Economy (WAGE), University of Wisconsin–Madison, available at http://www.law.wisc.edu/gls/documents/paper_arbx.pdf, accessed July 5, 2012, and Renato Boschi, “Estado Desenvolvimentista no Brasil: continuidades e incertidumbres” (2010), *2 Ponto de Vista*, available at http://netc.iesp.uerj.br/pontodevista/pdf/Ponto_de_Vista_07fev2010.pdf, accessed October 10, 2010. For an account on “new developmentalism” in Brazil, see Luiz Carlos Bresser-Pereira, “From Old to New Developmentalism in Latin America,” 193 *Textos para Discussão – Escola de Economia de São Paulo (FCV-EESP)* (2009), 1–37. See also Eli Diniz, “É possível um Novo Modelo de Estado Desenvolvimentista no Brasil?” (2012), IPEA *Boletim de Análise Político-Institucional*, V.2, 17.

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These policies require policy and rule flexibility, coordination among public actors and between them and the private sector, conditions to maximize synergy between public and private actors, and measures to preserve the legitimacy of government intervention. This, in turn, creates new roles for law. In the following sections we trace the emergence of NSA, identify its salient features, note how it differs from prior forms of state intervention, explore some of the forces that have shaped this new form of state action, and provide a preliminary assessment of the significance and challenge of these developments for the law.

INTRODUCTION: FROM THE “LONG 1990S” (1988–2004) TO NEW STATE ACTIVISM

The evolution of new state activism in Brazil was preceded by a series of policy changes that dismantled some of the institutions of the old developmental state and embraced some aspects of the Washington Consensus. Like several other Latin American developing countries, Brazil had its classic developmentalist moment. From 1930 until the end of the 1980s, economic policies basically consisted of state-led initiatives to promote import substitution, industrialization and growth through state-owned enterprises, economic planning, price control, sectoral regulatory and administrative authorities, and the use of tax and financial incentives.

Between 1988 and 2004, which we call the “long 1990s,” Brazil partially dismantled these structures and policies and shifted to more market-oriented approaches. In 1988, after twenty-four years of military dictatorship and in a context of a threat of hyperinflation,² Brazil passed a new constitution that has influenced and shaped policy ever since. The 1988 Constitution is a social-democratic document that includes civil, political, and social rights as well as a number of policy goals such as building a free, just, and solidaric society; fostering national development; acquiring technological autonomy; eradicating poverty and marginalization; and reducing inequalities. Many of its provisions have a direct effect on government policy and budgetary allocations.

In 1989, immediately after the new constitution came into force, President Collor de Mello was elected. Stressing the need for “modernization,” Collor de Mello rapidly liberalized the economy using drastic tariff reductions, privatization, as well as flawed attempts to control inflation. Under Itamar Franco, the vice president who replaced Collor de Mello after he was impeached, a stabilization plan (*Plano Real*)

² In January 1990 inflation in Brazil reached 56% per month, raising to 73% in February, and peaking at 84% per month in March – see Luiz Carlos Bresser-Pereira & Yoshiaki Nakano, “Hiperinflação e estabilização no Brasil: o Primeiro Plano Collor,” 11 *Revista de Economia Política* 4 (44) (1991), 89. During the same period, inequality reached its worse level ever since it started to be measured (the Gini coefficient peaked at 0.647, according to IBGE, the Brazilian Office of Statistics).

was successfully adopted and inflation was controlled.³ Also, new legislation on social assistance and welfare for the poor was passed.

Franco's minister of finance, Fernando Henrique Cardoso, known popularly as FHC, became the next president in 1994. During Cardoso's eight years in office, Brazil continued to move away from the *dirigiste* policies of the "developmentalist" period, embracing many of the neoliberal prescriptions favored by the Washington Consensus.⁴ In the Cardoso period, state-owned enterprises were privatized, direct subsidies for certain industries scaled back, areas of the economy deregulated, import barriers reduced, competition fostered and enforced, intellectual property rights tightened, bilateral investment treaties protecting foreign investors signed, and fiscal responsibility enhanced. Also, the currency (*Real*) was constantly kept overvalued, and monetary stability was pursued and attained.⁵

The bureaucracy was partially modernized, new regulatory agencies created, public-private partnerships designed, and new social policies adopted. To carry out privatization and encourage foreign investment, the Cardoso government had Congress make several changes in the constitution. But although the country took on board some ideas from the Washington Consensus, it did not wholeheartedly embrace neoliberalism. Privatizations were limited. Banco do Brasil, BNDES, and Petrobrás – three major state-owned enterprises – remained under government control. The bilateral investment treaties were never ratified.

INSTITUTIONAL AND POLITICAL BACKGROUND: THE NEW DEMOCRATIC CONSTITUTION OF 1988 AND THE CARDOSO ADMINISTRATION

During military rule (1964–1985) political parties and social movements were repressed. When the constitution-making process started, there was an eruption of social-political demands that had to be accommodated. Not surprisingly, the result was nicknamed "the citizen's constitution." This citizen's constitution not only included an extensive charter of civil-political and social rights, it also reframed public-private relationships. It included provisions guaranteeing the rule of law,

³ But, as reckons Castro, "[d]espite that, a period of strong deterioration of the Balance of Payments began, which led the current-account deficit to achieve 4.0% of the GDP in 1998. Antonio Barros de Castro, "From Semi-Stagnation to Growth in a Sino-Centric Market," *28 Brazilian Journal of Political Economy* 1 (109) 4 (2008), 3–27.

⁴ FHC has always rejected the neoliberal label and claimed that his goal simply was to modernize the economy.

⁵ "[T]he goal of price stability has remained sacrosanct and the instruments for achieving this goal have been in line with the latest international fashions: central bank independence and inflation targeting," says Cornel Ban in "Brazil's Liberal Neo-Developmentalism: New Paradigm or Edited Orthodoxy?," forthcoming in *Review of International Political Economy*.

protecting individual rights, and guarding against arbitrary state action. But it also created positive – and justiciable – rights that could impose policy obligations. The 1988 charter included rights to health, education, housing, social protection, and pensions. These helped shape a new and complex welfare system including a massive universal public health system and a system of universal pensions. And this has had a major impact on the role of the state and on patterns of government spending.⁶ Instead of cutting back on social spending as many countries did during the 1990s, in this period Brazil increased the percentage of GDP devoted to social protection.⁷

Besides instituting social rights and shaping social policies, the new constitutional regime facilitated modernization of the state apparatus and reframed public-private relationships with consequences for the business environment. The constitution initiated a slow process of professionalizing state administration. Until the 1930s, public employees were hired through the spoils system of political appointments. A partial reform under Vargas instituted meritocratic selection for some key agencies like BNDES and the Foreign Ministry but left most government jobs subject to political appointment.⁸ The 1988 Constitution carried the reform much further, capping state salaries and requiring that all public employees be selected through meritocratic processes.

The constitution also significantly affected relations between the state and business. It required competitive bidding for all state purchases and made the process more transparent. The special Federal Prosecutors (*Ministério Público*) were authorized to combat corruption and enforce laws protecting consumers and the environment. Finally, the constitution protected individuals and businesses against regulatory takings and expropriation without compensation.

Whereas the new constitution embraced social-democratic values and norms and some developmentalist ideas, during the 1990s Brazil flirted with neoliberal policies. In 1994 President Itamar Franco and his Minister of Finance Fernando Henrique Cardoso launched the *Plano Real*, a macroeconomic stabilization effort that eventually managed to control inflation in Brazil.⁹ One of FHC's first acts was to get the Congress to remove some provisions in the 1988 Constitution that enshrined

⁶ See Jorge Abrahão de Castro and José Celso Cardoso Jr., "Políticas Sociais No Brasil: Casos Social do Governo Federal De 1988 A 2002," in *Questão Social e Políticas Sociais no Brasil Contemporâneo*, org. Luciana Jaccoud (Brasília: Brasflia IPEA, 2005), 261–318.

⁷ See Kleber Pacheco de Castro and José Roberto Alfonso, "Gasto Social No Brasil Pós 1988: Uma Análise sob a Ótica da Descentralização Fiscal," *1 Revista de Política, Planejamento e Cestão da Saúde* (2009), 34–56.

⁸ A first initiative to reform the public sector in order to create a more professional public staff was conducted by President Getúlio Vargas (1930–1945), whose government created DASP, the Department of Public Service Management – a preliminary attempt of establishing a public career in the Brazilian state.

⁹ In 1999 Brazil officially adopted an inflation target system (currently the target is 4–5% per year).

"old developmentalist" policies such as state monopolies and restrictions on foreign investment.¹⁰

Under Cardoso, Brazil experienced a strong devaluation of its currency (the *Real*) as a result of a harsh international crisis (Mexican, Russian, and Asian). To handle that, the government raised the interest rate to a very high level, and this severely hindered growth. On the other hand, the FHC government managed to embed Brazil in the world economy through trade liberalization. In 2000 it ensured fiscal austerity by passing a "fiscal responsibility" act, and it sought to modernize public administration by adopting tenets of the "new public administration" that allowed outsourcing of certain functions to the private sector.¹¹

Under Cardoso, Brazil accelerated privatizations initiated by Collor and Itamar Franco¹²: in 1997, Vale do Rio Doce, a major state-owned mining and steelmaking company, and Sistema Telebrás, the public-owned telecommunication conglomerate, were sold. In the same year, several electricity and gas distribution companies, as well as some state-level banks, were transferred to private owners. During his eight years as president, FHC raised approximately \$79 billion (U.S.) through privatization. However, like Petrobrás, the Brazilian state oil and gas company, the three large federal banks – Banco do Brasil, Caixa Econômica Federal and the national development bank known as BNDES – were not privatized. Indeed, BNDES played an important role in facilitating privatization by offering credit to buyers, both domestic and international. Table 2.1 indicates the state-owned enterprises that were privatized in 1990s.

As part of the reform, Brazil adapted the U.S. model of regulatory agencies to supervise and enforce post-privatization rules and introduce competition in natural monopolies. As a result, electrical distribution, fixed telecommunication networks, and transportation (railways, highways, and waterways) were subject to a new legal and institutional framework that substantively changed the patterns of administrative law. New licensing and concession agreements were signed (Table 2.2).

The Cardoso administration rejected the idea of industrial policy, long a mainstay of Brazil's developmental state. Finance Minister Pedro Malan said that "the best industrial policy you can have is not to have one." BNDES, which for decades

¹⁰ João Paulo M. Peixoto, "The Brazilian States since Vargas," in *The Brazilian State: Debate and Agenda*, eds. Maurício Font and Laura Randall (New York: Lexington Books, 2011).

¹¹ The strategy segregated core activities that should be performed by politicians and senior officials from support activities that may be outsourced, separating policy formulation from policy execution, granting more autonomy and accountability to services performed by the state, which take the form of either executive agencies or that of social organizations – that is, a special type of nonprofit. See Luiz Carlos Bresser-Pereira, "The 1995 Public Management Reform in Brazil: Reflections of a Reformist," in *Reinventing Leviathan*, eds. Ben Ross Schneider and Blanca Heredia (Miami: North-South Center Press, 2003).

¹² Franco privatized CNS, an important steel company, in 1995.

TABLE 2.1. State-owned enterprises privatized

Enterprises	Date	Enterprises	Date
UBIMINAS	Oct. 24, 1991	CNS	Apr. 2, 1993
UNIMEC	Oct. 24, 1991	FEM	Apr. 2, 1993
CELMA	Nov. 1, 1991	ULTRAFÉRTIL	June 24, 1993
MAFERSA	Nov. 11, 1991	COSIPA	Aug. 20, 1993
COSINOR	Nov. 14, 1991	AÇOMINAS	Sept. 10, 1993
COSINOR DIST.	Nov. 14, 1991	EAC	Dec. 7, 1994
ENBP	Jan. 14, 1992	EAI	Dec. 7, 1994
APP	Feb. 14, 1992	PQU	Jan. 25, 1994
PETROFLEX	Apr. 10, 1992	CARAÍBA	July 28, 1994
COPELUS	May 15, 1992	EMBRAER	Dec. 7, 1994
ENEL	July 15, 1992	NEVA	Dec. 7, 1994
ALCANORTE	July 15, 1992	ESCELSA	July 11, 1995
ERT	July 23, 1992	LIGHT	May 21, 1996
FOSFÉRTIL	Aug. 12, 1992	VALE	May 6, 1997
GOIASFÉRTIL	Oct. 8, 1992	MERIDIONAL	Dec. 4, 1997
AGESTA	Oct. 23, 1992	TELEBRÁS	July 29, 1998
ENERGÉTICA	Oct. 23, 1992	GERASUL	Sept. 15, 1998
PASA	Oct. 23, 1992	DATA MEC	June 23, 1999

Source: Ministério do Planejamento, Orçamento e Gestão (Brazil).

TABLE 2.2. Activity regulated

Activity regulated	Commission	Foundation	Law
Competition	CADE	1994	8.884/94
Electric power	ANEEL	1996	9.427/96
Oil & gas	ANP	1997	9.478/97
Telecommunication	ANATEL	1997	9.472/97
Health surveillance	ANVISA	1999	9.782/99
Health insurance	ANS	2000	9.961/00
Water	ANA	2000	9.984/00
Water transport	ANTAQ	2001	10.233/01
Land transport	ANTT	2001	10.233/01
Aviation	ANAC	2005	11.182/05

provided financing to targeted sectors and supported many state-owned enterprises, shifted to support privatization. Rather than trying to support priority sectors, the government focused more on increasing the efficiency of government services and reforming credit markets. For example, starting with Cardoso and continuing into Lula's first term, the Brazilian central bank sought to reduce the cost of credit.

Among the microeconomic measures undertaken were improvements in bankruptcy procedures and debt collection.¹⁵

The Cardoso administration's opposition to industrial policy did not deter it from stimulating selected sectors in order to promote competitiveness and innovation. Thus in 1999 it created sixteen sectoral funds charged with fostering innovation in strategic areas such as oil and gas, telecommunications, biotechnology, and agribusiness. The Cardoso period also saw important changes in social policy. Traditionally, the Brazilian welfare state has been regressive, clientelistic, and opaque. Between 1994 and 2002 the federal government took a number of measures aimed at transforming this system. This included adding poverty alleviation programs aimed at specific populations; introducing noncontributory social protection programs; decentralizing social policy implementation; and tackling some of the regressive features of the pension scheme.¹⁶ The Cardoso government initiated the use of conditional cash transfers (CCT). The *Bolsa Escola* Program, implemented in 2001, aimed to increase access to education and reduce poverty in the long run, reduce poverty in the short term by transferring cash to impoverished households, reduce child labor, and serve as a social protection network.¹⁵

Another important development in this period was LOAS (Organic Law of Social Assistance). Enacted under Itamar Franco and implemented by FHC, LOAS seeks to guarantee "minimum social standards." The noncontributory multi-level federal, state, and local program is designed to protect households, mothers, children, adolescents, and the elderly; assist underprivileged children and adolescents to join the labor market; and train and rehabilitate persons with disabilities and promote their integration into community life.¹⁶

¹⁵ According to Fabiani, during the 1999–2006 period the law behind the government's microeconomic agenda was seen as an instrument to protect creditors and ultimately promote economic efficiency. See Emerson Ribeiro Fabiani, *Direito e Crédito Bancário no Brasil* (São Paulo: Saraiva, 2011).

¹⁶ Almeida explains that during Cardoso's first term some changes in universal social policies partially confronted the regressive feature of the Brazilian pension system (a constitutional amendment has changed the minimum age and the period of contribution for retirement), although the problematic topic of public servants' pensions—a major source of inequality in the country—remained untouched. Maria Hermínia Tavares de Almeida, "A Política Social no Governo Lula," 70 *Novos Estudos CEBRAP* (2004), 7–17.

¹⁵ Inspired by successful experiences at the local level, the federal *Bolsa Escola* Program reached more than 5 million families. Other CCT programs widened the scope of protection and helped build a multilevel public-private network of providers.

¹⁶ Under LOAS, the federal government is assigned the task of coordinating and promoting the actions covered by the social assistance program, providing technical advice and financial incentives to states, cities, and welfare entities and organizations. The states must transfer certain funds to municipalities, provide them with technical support, and stimulate the collective rendering of social services. Municipalities must, among other things, execute social assistance and poverty fighting policies, which includes the possibility of establishing partnerships with civil society organizations.

NEW STATE ACTIVISM EMERGES

In 2002 Luiz Inácio Lula da Silva was elected. For two four-year terms, his government preserved some of FHC's policies such as inflation control and openness to foreign investment while changing others by adopting state-activist initiatives including an active industrial policy and a massive poverty fighting program. Dilma Rousseff, elected president in 2010, has maintained Lula's priorities but expanded state activism in key areas.¹⁷

Since Lula took office, there has been a decade of experimentation. Developmentalist institutions have been reinvented, neoliberal policies partially modified, new institutions created, and a new form of state activism is beginning to emerge. Changes have occurred gradually.¹⁸ Some of FHC's policies, like macroeconomic stabilization, have been preserved, and some of his social policy innovations have been improved on and substantially expanded. Institutions like BNDES that survived from the period of state developmentalism have been reinvigorated and redirected. Other developmentalist institutions like industrial policy that were rejected during the neoliberal period have been revived, albeit in a different form. Finally some new institutions have been added to increase coordination between the public and private sectors.¹⁹

Macroeconomic Continuity

Perhaps the most important area of continuity is in macroeconomic policy. Scarred by decades of high and damaging inflation, in the 1990s Brazil adopted policies to preserve monetary stability. The *Real Plan* used various measures to control public spending and regulate the money supply. This has kept the inflation rate low (at least by Brazilian standards) for more than fifteen years and has enshrined monetary stability as a cornerstone of economic policy. During the first Lula administration, emphasis was placed on instituting, developing, and strengthening political and economic credibility using fiscally responsible macroeconomic policy, a floating exchange rate, and inflation targeting. In general terms, these policies have been continued by the Lula and Dilma administrations. However, this has come at a price: the main tools of macroeconomic policy are restrictions on government

¹⁷ See Alfredo Saad Filho and Lecio Morais, "Neo-Developmentalism and the Challenges of Economic Policy-Making Under Dilma Rousseff," 38 *Critical Sociology* 6 (2012), 789–798.

¹⁸ To win the election, Lula had to state that debt agreements would be honored. Talking about the gradual manner through which changes would take place, Lula said in his "Letter to Brazilians" in 2002: "The premise of this transition will naturally be the respect to contracts and obligations enforceable in the country."

¹⁹ A notable example is the Public-Private Partnership Federal Act of 2004.

spending and a relatively high interest rate. This puts a brake on public investment and increases the cost of credit, thus possibly hampering growth. To help offset these effects Lula introduced several growth-inducing microeconomic policies. These included both a new form of industrial policy and social policies that have helped spur domestic growth while also relieving poverty and reducing inequality.

Industrial Policy

In 2004, after a decade in which Brazil had explicitly rejected industrial policy,²⁰ the government reintroduced measures designed to foster selected industries. However, in keeping with the climate of the time, Lula's first try at industrial policy was limited and focused primarily on innovation. At the time, there was strong opposition to industrial policy in policy-making circles and academic opinion. It was thought that governments were not able to strategically identify targets and that trying to do so would divert resources from horizontal structural measures like tax reform and infrastructure investment that would benefit the whole economy.

However, at least some were prepared to accept a limited role for government in overcoming market failures and reducing the coordination and systemic problems that hampered innovation: the Cardoso administration had already taken modest steps in this direction. That helps explain why Lula's first foray into industrial policy – called PITCE (Industrial, Technological and Foreign Trade Policy) – stressed a combination of general measures to improve the business environment²¹ and financial support in four sectors in which it could be argued innovation was essential: semiconductors, software, capital goods, and medicines.

PITCE included substantial legislative activity. This included the Innovation Law, which was designed to facilitate partnerships and synergy between universities, companies, and research institutes, and the Foundation Law, which facilitated government support for university research.²² At the same time, the government started building institutions designed to improve coordination within government and between government and the private sector. These included CDES, the Council of Economic and Social Development, designed to help foster inclusive growth; CNDI, the National Council of Industrial Development, a public-private peak

body charged with defining directives for industrial development; and ABDI, the Brazilian Agency for Industrial Development, which was put in charge of coordinating implementation of industrial policy by bringing government, industry, labor, and universities together. Arbix and Martin describe ABDI 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.²³

In 2008, during Lula's second term, the government launched a new initiative called The Program for Productive Development (PDP). PDP replaced PITCE²⁴ and was much more ambitious and complex. It included both horizontal measures designed to increase the overall efficiency of the economy and vertical programs for targeted sectors. Reflecting the scope and complexity of the Brazilian economy, PDP covered a wide range of industries. The program set goals, established a complex governance regime, and placed special emphasis on collaboration between the public and private sectors. This included the use of industry-specific competitiveness councils instituted by FHC and continued under Lula. PDP relied on policy instruments such as financing, tax, public procurement, public-private alliances, coordination and consultation, and regulation.

Horizontal measures in PDP included improvements in infrastructure and education, increased investments in science, reductions in interest rates for investment, tax relief, and improvements in the legal environment including modernizing the rules governing foreign trade. Vertical measures, which dealt with specific industries, were designed to meet three basic challenges. For each of these challenges, there would be different governance mechanisms and a different mix of policies and measures. Measures that might be employed included subsidized credit from BNDES and other public financial sources, tax incentives, technical assistance, advantages in public procurement rules, favorable trade policy, and supportive regulation.

The first challenge identified by PDP was to consolidate and expand leadership in sectors in which Brazil was deemed to have a competitive edge. The goal was to support Brazilian firms that could be world leaders or heavyweights in their industry. Sectors included aviation, mining, steel, cellulose, oil and gas/petrochemical, bioethanol, and meat. The second challenge was to foster and occasionally induce

²⁰ For a history of the rejection of industrial policy, see W. Suzigan and A. V. Villela, *Industrial Policy in Brazil* (Campinas: Editora da Unicamp, 1997).

²¹ These included tax relief and legal measures to improve incentives for innovation and to facilitate better relations between universities and business.

²² The Innovation Law allowed the government to invest directly in private companies as a minority shareholder in order to create new products and processes and provide for sharing of any resulting intellectual property. The Foundation Law facilitated support from FINEP and the National Fund for Scientific and Technological Development for university-based research support foundations.

²³ Arbix and Martin, "Beyond Developmentalism and Market Fundamentalism in Brazil," 17.

²⁴ The discussion in this section draws heavily on Luciano Coutinho, João Carlos Ferraz, Andre Nassif and Rafael Oliva, "Industrial Policy and Economic Transformation," in *The Oxford Handbook of Latin American Political Economy*, eds. Javier Santiso and Jeff Dayton-Johnson (Oxford: Oxford University Press, 2012), 134–188.

mergers and alliances (sometimes with BNDES holding a minority stake) to build up industries that had competitive potential but were not yet at the global frontier. They included capital goods, the automotive complex, wood and furniture, pharmaceutical, meatpacking, personal hygiene, perfumery and cosmetics, construction, various service industries, coastal and marine industry, leather, footwear and artifacts, the agro-industrial system, and plastics. The third challenge was to strengthen high-tech vanguard sectors that had both growth potential and whose growth could improve the technological capacity of the whole economy. These strategic areas included health, biotechnology, defense, nuclear energy, nanotechnology, and information and communication technology.

The governance of PDP was very complex. It included a system of public management that brought representatives of appropriate ministries and agencies together for each of the major tasks and linked them to the private sector through a variety of coordination devices. Observers of the PDP pointed to the importance of public-private coordination at every level from setting overall priorities to working out packages of effective measures for each sector.

It is too soon to assess the overall impact of PDP. Before it got off the ground the plan was overtaken by the global financial crisis. But even if there had been no Great Recession, it is early days for programs like this, which envision major structural changes. Whereas the government can point to some real achievements, critics have questioned whether the plan really shifted resources from traditional sectors to high-tech industries or if it did enough for small and medium industry, which often are a major source of innovation.³⁵

In 2011 the new administration led by Dilma Rousseff introduced an updated version of PDP called *Brasil Maior* (Greater Brazil) with the motto “innovate to compete; compete to grow.”³⁶ This plan continues many of the objectives and policies of PDP. However, reflecting rising concerns about deindustrialization, the plan places new emphasis on efforts to protect domestic industries hard hit by global competition, an over-valued currency, and low-cost imports. Taxes on manufacturing were reduced, more attention paid to anti-dumping measures, and substantial preferences for local producers in government procurement introduced. At the same time, BNDES and FINEP (Studies and Projects Finance Provider) funding have been increased and efforts made to channel more funding to innovative firms and sectors.

³⁵ According to operational information available at the BNDES, in 2008, out of the 179 beneficiary companies, 12 were listed in Bovespa (the Brazilian stock exchange) In 2009, out of the 156 beneficiary companies, 25 were listed in Bovespa. Data obtained on the bank's Web site, http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/BNDES_Transparente/Consulta_as_operacoes_do_BNDES, accessed on May 1, 2010.

³⁶ *Brasil Maior* Web site and other sources.

ABDI identifies three major strategic areas of the *Brasil Maior* plan, and for each it lists the main actions being taken. To increase investment and spur innovation, the plan offers tax relief, increased financing for investment and innovation, and further improvements in the legal framework. To promote exports and protect domestic industry from unfair trade, the plan offers tax relief, export financing and guarantees, trade promotion, and enhanced defense through antidumping and other trade remedies. To give special protection to hard-hit domestic firms, the plan includes several measures including exemptions from payroll tax for selected industries and a 25 percent margin of preference for local firms in government procurement.

An important part of the *Brasil Maior* plan is the system of public-private coordination that builds on structures created for PDP. The system rests on three pillars: CNDI, Sectoral Executive Committees, and the Sectoral Competitiveness Councils. CNDI is a peak institution that includes ministers, the president of BNDES, and eighteen representatives of industry, labor, and the public. Its role is to set strategic guidelines. The *Brasil Maior* plan identifies twenty priority sectors: petroleum, gas and marine construction, chemicals, health, renewable energy, furniture, automotive, mining, civil construction, defense, aviation and aerospace, agro-industry, capital goods, metallurgy, logistics services, electronics, personal hygiene, fragrances and cosmetics (HPPC), services, retail, shoes, textiles, candy and jewelry, cellulose, and paper. For each sector there is an Executive Committee and a Competitiveness Council. The Executive Committee consists of government officials charged with developing an action plan for the sector. These representatives meet with industry and labor in the Sectoral Competitiveness Councils to refine the action plans and explore implementation issues.

Social Policy

In addition to reviving industrial policy, the governments of Lula and Dilma have expanded Brazil's social protection system and antipoverty programs. The result has been a significant decline in the poverty rate, reduction of inequality, growth of a new middle class, and stimulus for the domestic market. Between 2001 and 2008, incomes of the wealthy grew at a moderate pace, while income gains for the poor increased substantively. Approximately 28 million people were raised above the poverty line, and a new middle class has emerged – between 2003 and 2011 approximately 10.5 million Brazilians became part of the middle class, which now includes 35 percent of the population.³⁷ The Brazilian social pyramid is now diamond shaped, with more citizens classified as middle class than as poor.

³⁷ See Marcelo Nery, *A Nova Classe Média – o lado brilhante da base da pirâmide* (São Paulo, Saraiva: 2009), 29.

Recent studies highlight the fact that Brazil's distributive gains achieved in the past decade are the result of a combination of economic and institutional reforms. They include previous efforts such as inflation control and changes in labor markets – which include unemployment reduction and increases in the minimum wage, pensions and social security improvements – and a new generation of social assistance policies, especially the *Bolsa Família* Program (BFP), created in 2003 as a result of a consolidation of previously existing initiatives.²⁸ Health and education spending as a share of GDP have grown considerably in recent years, magnifying impacts of institutional reforms instituted in the late 1990s. In another recent development, SUAS, the Brazilian the Unified Social Assistance System, was institutionalized and formalized by a federal statute in 2011.

Finally, in June 2011 President Dilma Rousseff launched the *Brasil Sem Miséria*²⁹ program, designed to rescue 16.2 million people from extreme poverty, 59 percent of whom live in the northeast region. *Brasil Sem Miséria* has been presented as a combination of complementary rural and urban sectoral actions in the fields of productive insertion, income transfer, access to public services, education, health, social assistance, and water and sewage; it involves the creation of new initiatives and the reconception of existing ones. This program aims to find and register extremely poor families and integrate them into different programs. Also, *Brasil Sem Miséria* is supposed to offer “exit doors” to those who graduate from *Bolsa Família* (thus boosting “productive inclusion”).³⁰

Social policy is working: poverty has been cut drastically and income inequality reduced. Although Brazil still is one of the most unequal countries in the world,³¹ the decline in poverty and reduction of inequality in Brazil in recent years have been remarkable. Thanks to a wide range of policies, including universal, targeted, and decentralized programs, the Brazilian welfare state is becoming stronger.³²

²⁸ Since its inception in the federal government, *Bolsa Família* has reached more than 12 million families as beneficiaries. If one assumes that each family has four people on average, the total figure for individuals benefiting from BFP reaches 48 million people, or approximately 25 percent of the Brazilian population. Half of its budget has been spent in the northeast part of Brazil, where millions of very poor families live. Considering its gigantic scale, the targeting of BFP (defined as the share of total benefits received by specific groups of the population) has been considered exemplary, outperforming other social assistance programs in both Brazil and internationally.

²⁹ Translated “Brazil Without Indigence.”

³⁰ Also, *Brasil Sem Miséria* changed the number of children and adolescents who can obtain the BFP benefit – now up to five (it used to be three).

³¹ The Brazilian Gini coefficient in 1960 was 0.5367, 0.6091 in 1990 and (still very high) 0.5304 in 2010. Cf. Marcelo Nery, “A Nova Classe Média,” 27.

³² As put by Arbx and Martin: “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.” In 2010 inequality in Brazil reached its lowest level since measurement started in 1960.” Arbx and Martin, “Beyond Developmentalism and Market Fundamentalism in Brazil,” 27.

BRAZIL'S NEW STATE ACTIVISM: SOMETHING NEW UNDER THE SUN?

The emerging profile of state activism differs from state action in both the developmental period and the neoliberal phase of the 1990s. In the developmentalist period from the 1930s to the 1980s, the Brazilian government not only set priorities for industrialization in a top-down fashion, it also was a primary actor in industry. The state bureaucracy set goals; state-owned enterprises played a central role in many sectors including steel, mining, aircraft, automobiles, and banking; and the state development bank provided funding for areas deemed priority by government planners. Emphasis was on “catching up” by building domestic industries. The new industries used imported technology and paid little or no attention to innovation.³³ The state created tariff walls and multiple exchange rates to control imports. Social policy was not focused on redistribution or poverty reduction: social protection programs were elitist, designed to keep the industrial working class and the small middle class happy, and were managed in a clientelistic fashion.³⁴

The 1990s saw a partial reversal of the developmentalist model with privatization, liberalization, dismantling of the instruments of industrial policy, and tentative steps at poverty alleviation. When it took office, however, the Lula government decided it was necessary for the state to resume a more active role in industrial development and take more aggressive steps to relieve poverty and reduce inequality.

The new administration recognized that markets were necessary for inclusive growth but saw that they were not sufficient. The state could do more to promote growth with equity, and it started to act more selectively and aggressively in the economy. Yet this shift away from neoliberalism was as notable for what it did not do as for what it did. Thus, when Brazil began to develop new forms of state activism it did not renationalize former state-owned enterprises, impose price controls, create a top-down development plan, discourage foreign investment, default on international obligations, engage in deficit spending, or close its markets to foreign goods. Rather, it sought to maintain and benefit from openness by ensuring the competitiveness of domestic industry. Efforts focused on constructing new forms of industrial policy that emphasized innovation and partnership with industry. At the same time

³³ During the import substitution period, Brazil adopted Fordist technologies by copying technology from developed countries. A lot of this was in the form of factories owned by foreign companies who located R&D and innovation outside Brazil with no obligations to transfer technology. That meant that Brazilian industry had a very low level of capacity for innovation. See Ignácio Godinho Delgado, “Desenvolvimento, empresariado e política industrial no Brasil,” in *Istado, Empresariado e Desenvolvimento no Brasil*, org. Wagner Pralon Mancuso et al. (Sao Paulo: Cultura, 2012), 131.

³⁴ Arbx and Martin observe that “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.” Arbx and Martin, “Beyond Developmentalism and Market Fundamentalism in Brazil.”

it placed substantial emphasis on social policy and redistribution and is endeavoring to combine its social policy and industrial growth strategies.

Accounting for the Rise and Shape of the New State Activism

What explains the return of state activism, and why has it taken the shape that it has? What impelled the Lula government to reintroduce industrial policy? And when it did, why did it choose to emphasize innovation, engage more directly with the private sector, and structure the program in a bottom-up fashion? Why did the new state activism link industrial and social policy and refocus social policy toward poverty alleviation and reduction of inequality?

No one would claim that Brazil's new form of state activism was planned from the start or that a clear or completely stable model has emerged. There was no master plan that emanated from some government think tank or planning ministry. These policies have evolved in a piecemeal fashion and are still changing. The Brazilian government has been feeling the stones as it crosses the river – to quote Deng Xiaoping – not following some worked out blueprint. However, looking back over a decade of experimentation and policy evolution, one can see several factors that explain the decision to resume an active role for the state as well as forces that affected the form this role would take. In the following sections we look at three main factors that help explain the shape that Brazil's new state activism has taken: political opportunity, structural impediments to growth, and international and domestic constraints. Taken together, they help explain the profile of what Arbx and Martin call new state activism without dominance.

A Political Moment

When Lula was elected in 2002, growth had slowed and unemployment was very high. So it is not hard to see why a government led by the Brazilian Workers Party (PT), already predisposed to state activism, would want to increase the role of the state in the economy. The PT was not alone: this view was shared by at least part of the business community. By 2002 the effects of globalization and liberalization were being felt and Brazilian companies were losing ground. Business in general and many industrialists in particular wanted a more activist state and more voice in government policy.³⁵

While the PT was ideologically committed to state activism, the business community also started to look to the state as a force that could reignite growth. Dissatisfied

by the effects produced by liberalization in the 1990s, powerful industrial groups (including the Federation of Industries of São Paulo) involved themselves in the electoral process in 2002 with the objective of “opening space for developmentalist ideas.”³⁶ Industry had played an important role in the old developmental state so at least some industrialists were comfortable with an increased role for the state as long as they had a voice in state policy.

Whereas Lula's first administration took cautious steps toward state activism, interest in a stronger role for the state grew during the second term (2006–2010). In this period NSA gained appeal, importance, and political support from industrialists, unions, intellectuals, and academics. Brazilian economist Antonio Barros de Castro suggests that the Brazilian elite realized that it needed to deal with China.³⁷ He notes that trade liberalization and the rise of China led much of Latin America to abandon industry and refocus on natural resources. Brazil, because of the large size and central importance of its industrial sector, could not and did not want to take this route. But at the same time, despite the modernization of Brazil's industry – therefore globally competitive in some fields – once China became a major factor, Brazil was no longer as competitive. At the same time, Chinese demand for natural resources drove up the value of the *Real* thus further handicapping Brazilian industry by increasing cost of exports and lowering the cost of imported manufactured goods. This worsened the situation and led to a slowdown in 2005. This then led to a public outcry and calls for more action by the state.

The turning point probably came in 2006. As a result of a political scandal, in March 2006 Antonio Palocci, Lula's finance minister, was replaced by Guido Mantega, a heterodox economist and academic closely linked to Lula and the PT. Although Palocci also was closely linked to the PT, he had maintained an orthodox approach to economic policy and was closer to the financial sector than to industry. His replacement opened a window of opportunity for the industrialists represented by institutions such as CNI (National Industry Confederation), FIESP (Sao Paulo State Industries Federation), and IEDI (Economic Institute for Industrial Development, a business think tank) to push for policies that would allow them to recover and protect industrial chains dismantled during the 1990s, foster international competitiveness, and channel more state funds into infrastructure investments. Business support for neoliberalism, never so robust, declined and its acceptance of state activism increased. Jackson de Toni suggests:

Apparently Brazilian industrialists partly conceded in their unconditional defense of a minimalist agenda for the state in exchange for a political economy that would

³⁶ They “correctly understood Lula's election as a mandate for a pro-growth strategy,” says Cypher, “Brazil's Development Strategy: Maintaining the Industrial Base, Side Stepping the Staples Trap?” (2012), paper presented at LASA, San Francisco CA, 8.

³⁷ Antonio Barros de Castro, “From Semi-Stagnation to Growth in a Sino-Centric Market.”

³⁵ Shunko Rojas suggests that changes in the leadership of FIESP, the Federation of Industry in São Paulo, led to FIESP support for an expanded state role well before the 2002 election. Private communication to the authors, August 2012.

maintain the inherited stability and defend them against external competition, but would also revive public investments in infrastructure.³⁸

In this context, says De Toni, the Lula government boosted with great publicity some new “arenas” for public-private coordination (including councils such as CDES, CNDI, and the so-called competitiveness *fora*) and new agencies (such as ABDI) in an attempt, on the one hand, to ensure legitimacy and, on the other, to control the increasing demands of industrial entrepreneurs.³⁹ At the same time it launched PAC (the Growth Acceleration Program) in 2007. PAC was designed to restart investment using the strength of public companies like Petrobrás to lead the process.

Another factor that helped cement political support for state activism was the global financial crisis. The pervasive and worldwide failure of markets, which were deeply affected by financial disorganization, epitomized the crisis of deregulated capitalism and legitimized the adoption of alternative policies. This gave more support for the expansion of industrial policy and the growing role of BNDES. The government adopted a rhetoric that stressed that the crisis was an opportunity for Brazil to gain comparative advantages, and this required additional proactive state action.

With the global crisis the Brazilian government became more active in shaping the trajectory of economic development. When the financial crisis broke out in 2008, the Brazilian economy was seriously challenged by the lack of credit – echoing events in the United States and Europe, financial institutions halted the supply of credit. In Brazil this led to more pressure by the industrial coalition for state action. As a result, BNDES was heavily capitalized so that it could play a countercyclical role in the economy. The bank sharply raised its disbursements, thus galvanizing a national industrial sector already suffering from reduced competitiveness and an unfavorable exchange rate and now buffeted by credit stringency.

Structural Elements

If the political context was supportive of a more active role for the state, what were the primary problems that policymakers faced and responded to as they shaped new state activism? We suggest that three structural features were most important: (1) major market failures that impeded economic activity, including a low level of investment in infrastructure and a lack of innovation, (2) the long-standing Brazilian social debt, and (3) the international embeddedness of the Brazilian economy and its need to spur competitiveness.

³⁸ Jackson de Toni, “Estado e empresários na política industrial brasileira recente: processos de cooperação e mudança institucional,” paper presented at IPEA CODE 2011, available at <http://www.ipea.gov.br/code/chamada2011/pdf/areaio/areaio-artigo2.pdf>, accessed July 21, 2012.

³⁹ *Ibid.*, 16.

MARKET FAILURES: INNOVATION, INFRASTRUCTURE, FINANCIAL SECTOR, AND COMPETITIVENESS

The first structural barrier policymakers faced was the low level of innovation in Brazilian industry. They recognized that Brazilian industry had slowed down, and they believed that markets alone could not restart the growth process and state intervention was needed. From the early 1980s onward the economy has faced a long period of stagnation, in which growth slowed and Brazil fell behind the rapidly growing Asian tigers. The national economy had its last impetus of vitality in the seventies, during the apogee of “old” developmental state policies. By the end of the 1970s Brazil’s economy had completed its second industrial revolution, thus acquiring a diversified industrial base. But then it started to stagnate because of external and internal factors.

The external factors contributing to the stagnation were changing capitalist accumulation patterns and the consolidation of a knowledge-based economy,⁴⁰ which made the capacity of industrial innovation essential for economic competitiveness. The internal factors were Brazil’s failure to reshape the political economy and the legal-institutional structure that underpinned the old developmentalism. This structure was based on a triple alliance⁴¹ among multinational capital, national capital, and the state. The state provided infrastructure, organized key sectors of the economy through state-owned enterprises, generated savings that could be used for new investment, and created regulations and incentives to protect and promote the private sector. Foreign capital helped develop local industry using technology that had been created and perfected in advanced markets: sometimes this included bringing in equipment that had already become obsolete at home.⁴² The side effect of this arrangement was the excessive insulation of the Brazilian economy from international competition and, at the same time, the increasing transformation of this economy into a buyer of external technology instead of being a national hub of innovation and new technologies. As a result, Brazil was not able to keep the developmental pace. Suzigan and Villela conclude:

It was necessary to change not only to correct these problems, but also because there was consensus that the country had reached the zenith of a historical development process (which many erroneously described simply as import substitution).

⁴⁰ See Michael J. Piore and Charles F. Sabel, *The Second Industrial Divide: Possibilities for Prosperity* (New York: Basic Books, 1984) and David Harvey, *The Condition of Postmodernity: An Enquiry into the Origins of Cultural Change* (Malden, MA; Oxford: Wiley-Blackwell, 1991).

⁴¹ Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton, NJ: Princeton University Press, 1995).

⁴² See Lincoln Gordon and Englebert L. Grommers, *United States Manufacturing Investment in Brazil: The Impact of Brazilian Government Policies 1946–1960* (Whitefish, MT: Literary Licensing, LLC, 2012).

A third source of structural economic failure in Brazil was the limited capacity of the private financial sector. While the private sector has grown in size and importance in recent years, it still provides relatively little long-term finance and thus plays a limited role in funding industrial expansion. State banks, which date back to the developmental period, have filled the gap. When the Lula government decided to move to industrial policy, it looked to the state banks and especially to BNDES to provide the capital and expertise needed for growth, innovation, and competitiveness, and to buffer the effects of the financial crises.⁴³ Unlike other developing countries, Brazil did not dismantle its development bank in the 1990s, so the institution was available when the government decided to intervene more actively in the economy. Today, it is the main source of long-term financing in Brazil and a key actor in the conception and implementation of the industrial policy.

The final structural problem that affected the emergence of state activism was the side effect of the *Real Plan*. Undeniably, the *Real Plan* achieved its goal of ending runaway inflation. Since 1994, when the plan was implemented, inflation has been kept in check at around 5 percent a year. The problem, however, is that this plan is anchored in the interplay of two important macroeconomic variables: (1) interest rate and (2) exchange rate. Whereas the interest rate is the main control against inflation, the exchange rate is directly influenced by the interest rate: if interest rate is high, it attracts foreign investment, which results in an appreciation of the exchange rate. This has two direct consequences. First, the regulation of inflation by management of the interest rate creates side effects on the financial market, inasmuch as its appreciation encourages investors – including foreign investors – to buy government bonds. This means that less money is available for the private sector. Second, the resulting appreciation of the exchange rate causes serious prejudice to industry and makes imports cheaper and exports less competitive. This situation put pressure on policymakers: industry pressed for solutions that would lower the cost of finance and guard against deindustrialization. Industrial policy seemed like a way to handle both.

(4005). Commenting on the infrastructure deficit in Brazil, CEPAL noted: "Although several factors were involved (such as high macroeconomic volatility, the lack of comprehensive policies and regulatory and financing issues), the effects of these physical constraints are obvious and seriously threaten future development." See CEPAL "The Economic Infrastructure Gap in Latin America and the Caribbean," in 293 *I/A. Bulletin*, available at <http://www.cepal.org/usi/noticias/hofall/6/42926/PAL-293-WEB-ENG-2.pdf>, accessed July 20, 2012.

(4) BNDES and the other major state banks have access to public (pensions and treasury) funds so their cost of capital is well below that of the private sector. BNDES also makes profits and raises funds in the capital market, besides offering substantial expertise: the bank has been financing the Brazilian industrial sector for the past fifty years and has developed detailed knowledge of many important sectors and close ties to industry that add to its advantages over the private sector.

TABLE 2.3. Requests for patents by independent inventors at the United States Patent and Trademark Office – sample countries 1980/1990/2000/2009

	1980	1990	2000	2009
South Korea	33	775	5,705	23,950
China	7	11	469	6,879
Singapore	6	36	632	1,225
Brazil	53	88	220	464
México	77	76	190	220
Argentina	56	56	137	146
Chile	8	13	24	66

Source: Brazilian Ministry of Science and Technology and USPTO.

Once built an ample and diversified industrial basis, it was necessary to make it efficient and competitive. It was also necessary to incorporate sectors and industries representing new technologies, particularly informatics and telecommunications, and develop innovation ability, a crucial element in competition.⁴³

Taking these external and internal problems into account, it is hardly surprising that while Asian countries, noticeably South Korea and Taiwan, kept the developmental pace and gave rise to a new round of growth based on knowledge, innovation, and poverty and inequality reduction, Brazil and its Latin American counterparts lost vitality. One indicator is the relative success in patenting: Asians have far surpassed Latin Americans in patents issued in the United States (Table 2.3).

Spurred by statistics like this, Brazilian policymakers took steps to increase the rate of innovation in industrial activity. Modest efforts to stimulate innovation began as early as 1999, but with the reintroduction of industrial policy in 2004 substantial resources have been devoted to improving the overall climate for innovation; supporting restructuring in targeted industries; and fostering the development of new areas of specialization considered relevant and potentially able to consolidate key industrial chains.

A second structural barrier was the low level of investment in infrastructure. The private sector was unwilling to invest in needed infrastructure expansion, and the state had not been able to make up for this deficiency. Although Brazil has one of the highest tax burdens in the world, public sector investment was relatively low, even by Latin American standards.⁴⁴

⁴³ Wilson Suzigan and A.V. Villela, *Industrial Policy in Brazil* (Campinas: Editora da Unicamp, 1997).

⁴⁴ José Roberto Rodrigues Afonso, Erika Amorim Araújo, and Geraldo Biasoto Júnior, "Fiscal Space and Public Sector Investments in Infrastructure: A Brazilian Case-Study," 114 *IPEA Texto Para Discussão*

dominated the governmental agenda until the 1990s. All this changed with globalization and liberalization. In the 1990s Brazil opened itself to international competition and began to more actively pursue export markets. This forced the state to pay more attention to competitiveness.

One of the major decisions made by Lula's government when it took office was the decision not to try to roll back trade liberalization. What it did, instead, was emphasize the need for state action to encourage the kinds of solutions needed to maintain competitiveness. This partly explains both the decision to revive industrial policy and the emphasis that has been given to innovation since the beginning. From PITCE through *Brasil Maior*, policies have focused on boosting the international competitiveness of Brazilian companies. This includes BNDES's support for the internationalization of Brazil's most competitive industries and various mechanisms to subsidize exports. Whereas the government has recognized the importance of competitiveness and has seen that maintaining openness to foreign goods is necessary to preserve competitiveness, it has also taken measures to provide some degree of protection for domestic industries especially in recent years.

Structural Elements: Conditioning Factors

It is not hard to see why a government led by the Brazilian Workers Party, taking office at a time of low growth and relatively high unemployment, would decide to increase the role of the state in the economy. But that leaves open the question of why Brazil's reengagement with the developmental state has taken the shape that it did. Why did Brazil opt for an innovation-focused and collaborative public-private form of industrial policy rather than, say, renationalization as Venezuela, Argentina, Ecuador, and Bolivia have chosen? Why has it been supportive of foreign investment in most sectors? In this section we sketch a number of factors that seem to have influenced the choices Brazil made as it searched for new ways for the state to help the economy regain dynamism and promote inclusive growth. Among these conditioning factors we can point to, four seem especially important: (1) constitutional restraints, (2) the strength and scope of the domestic market and sophistication of domestic industry, (3) limits imposed by international economic law and policy, and (4) concern about the reaction of global financial markets.

The 1988 Constitution influenced the choice of strategies and measures by making direct state control of industry both more expensive and less important. First, it protected property rights and regulatory commitments, thus making renationalization of privatized industries an expensive proposition. Second, it reduced the possibilities for corruption and for private capture of state power, thus increasing the government's capacity to steer the private sector and providing control and

Another structural issue affecting NSA was the Brazilian social debt. Four problems stand out: (1) absolute poverty, (2) social inequality, (3) unemployment, and (4) the tendency of wages to lag behind productivity. The Lula administration had pledged to deal with social issues: these accumulated "debts" helped shape the responses it made.

In 1981, 31 percent of the Brazilian population was living on less than two dollars a day. Other social indicators were as bad: child mortality was high, life expectancy at birth was 63 years, illiteracy was widespread, and many people had no regular access to sanitation and potable water.⁴⁶ Inequality was extreme. Brazil has been profoundly unequal and unjust for a long period: in 1990 the Gini coefficient was 0.6091. The degree of inequality is aggravated when one pays attention to race and gender. Unemployment was also high: from the 1980s to 2000 unemployment was an important political issue and the rate of unemployment reached 10 percent in the early 1990s.⁴⁷ This issue was aggravated by the problem of education, as the education system does not produce the number of skilled people needed by a growing and competitive economy. That means that industrial policies designed to spur technological upgrading could be hampered by lack of adequate human resources and people might find themselves without the skills needed by a changing labor market. This issue led the government to recognize a need for job creation and skills upgrading in connection with social and welfare initiatives.

Finally, there is the problem of wage lag. Because of the large rural population in most Latin American countries including Brazil, there is a huge pool of underemployed workers whose presence depresses wage levels.⁴⁸ As a result, domestic demand does not grow as fast as domestic production, thus hindering growth of the domestic market. Economists have stressed the need for government action to offset this by an incomes policy that will bring wages up to optimal levels.⁴⁹

International Embeddedness and the Need to Spur Competitiveness

A final structural feature affecting the emergence of NSA was created by the decision to liberalize the economy and maintain openness after Lula's election. While export promotion has been a development target since the 1960s, domestic industrialization

⁴⁶ Data in this section is taken from Mauricio Font and Laura Randall, *The Brazilian State: Debate and Agenda* (New York: Lexington Books, 2012).

⁴⁷ *Ibid.* Some put the effective rate as high as 20%.

⁴⁸ This is what W. Arthur Lewis called development with "unlimited supplies of labor."

⁴⁹ Luiz Carlos Bresser-Pereira, "From Old to New Developmentalism in Latin America," *Textos para Discussão - Escola de Economia de São Paulo* (FGV-EESP, 2009), 193.

accountability mechanisms for the public sector. This made state ownership seem less necessary. Finally, by creating an open and democratic political structure the constitution enhanced the power and participation of civil society, including industry, *vis-à-vis* the state.

A second factor that influenced the choice of collaborative innovation-oriented industrial policy rather than rationalization is the size, complexity, and sophistication of the private sector in Brazil. Although still weak in certain areas, the Brazilian economy includes many well-developed sectors and a growing capital market. Many firms are either at the global competitive frontier or close to it. Others have incipient capabilities. In many sectors there is acceptance of the need for restructuring and continuous improvement. Many firms have the kind of deep knowledge essential for effective innovation even though they may not be able to fully utilize this knowledge without public incentives and support.

As a practical matter, it must have seemed much easier to create incentives for these firms to innovate and provide support for new private start-ups than to try to replace them with state-owned enterprises. At the same time, the size and scope of the private sector meant that once democracy was restored it gained an important voice in public affairs. And it turns out that the private sector was eager to support an expanded role for the state as long as it was done in collaboration with industry and provided the kind of support the private sector felt was needed to resume growth. Thus, Cypher notes:

Given the many endemic macroeconomic problems that had made the 1990s a period of slow growth in spite of the restructuring of industry, powerful industrial groups (including the Federation of Industries of São Paulo) involved themselves in the electoral process in 2002 with the objective of “opening space for developmentalist ideas” (Delgado 2010: 125) ... the business federations – the organizations representing the interests of Brazil’s vast and diversified industrial base – correctly understood Lula’s election as a mandate for a pro-growth strategy and as an indication that a structural change would occur opening-up channels of direct intermediation between the industrial sector and the new administration... In short, there was a consensus between the PT and important fractions of industrial capital to reverse “the loss of the centrality of the State as an agent of accumulation.”⁵⁰

A third conditioning factor can be found in international economic law and policy. WTO law places restrictions on some policies that had been used by the Asian developmental states, so it was necessary either to work around these restraints or find

ways to defend them in WTO litigation. Brazil did a little of both by defending some heterodox policies and modifying others.⁵¹ Brazil did not encounter similar restrictions in international investment law as it never ratified the Bilateral Investment Treaties signed in the 1990s. But because the government recognized that foreign investment was important for its innovation strategy, and sought to encourage its own firms to invest in foreign markets, it has nonetheless obeyed many of the principles of the investment regime. Similarly, whereas Brazil’s export surpluses and growing reserves have made it less dependent on the international financial institutions, it may have been influenced by the discourse of the World Bank and other international financial institutions that have promoted market solutions but accepted some role for industrial policy as long as it respects comparative advantage and focuses on innovation.

The fourth conditioning factor is the role played by foreign investors and global capital markets. The government’s strategy relies on foreign investment to help it reach and maintain international competitiveness. It must have realized that rationalizations and classic protectionism would threaten the availability of such investment, whereas an innovation-oriented and collaborative industrial policy offering selected benefits and incentives to both foreign and domestic firms would be acceptable to investors.

Other Influences on the Emergence of NSA: Enhanced Government Efficiency and New Economic Theories

There are several other factors that help explain the profile of Brazil’s NSA. They include the increased professionalism of the state apparatus and bureaucracy, which made it possible to carry out industrial policy, and the rise of alternative economic theories that tended to legitimize state activism. The macro-institutional arrangement provided by the 1988 Constitution has contributed to upgrading state capacity and has played an important role in NSA. In the past decades, the Brazilian state has enhanced internal coordination, increased public-private collaboration, and learned how to better define policy mandates. Thus, NSA is partly the result of institutional learning through which the Brazilian state progressively acquired greater administrative capacity and the expertise needed to implement complex and ambitious development policies.

Until recently, the vast majority of public employees were appointed politically, and this weakened the public service ethos necessary to build a professional bureaucracy staffed by people with technical expertise who could administer policies rationally and efficiently. There were some islands of excellence in public

⁵⁰ James Cypher, “Brazil’s Development Strategy: Maintaining the Industrial Base, Side-Stepping the Staples Trap?,” paper presented at the 2012 Congress of the Latin American Studies Association, San Francisco, May 2012.

⁵¹ See Alvaro Santos, Chapter 5, and Michelle Ratton Sanchez Badin, Chapter 6, this volume.

administration: some key institutions of developmental coordination were professionalized, including BNDES, Petrobrás, Embraer, Ipea, and the Central Bank. But these cases were in stark contrast to the rest of public administration, which seriously compromised state capability. This lack of professionalism was changed by the 1988 Constitution, which made mandatory recruitment of public employees through public and official exams (*concurso públicos*). As a result, there has been a substantial increase in the percent of public employees selected meritocratically.

The constitution also regulated the ceiling of earnings, determining that the maximum wage should be no higher than the one received by members of the Supreme Court (*Supremo Tribunal Federal*). This rule was designed to limit public expense and curb discretionary distortions in the level of salaries. It is true that both distortions (meritocratic recruitment and wage policy) face problems of enforcement, even so they represent an important improvement in terms of governmental quality. When the Lula administration began to expand the state's role, it could count on a more professional workforce in government.

Other measures helped enhance state capacity, making it easier to carry out the measures called for by new state activism. The constitutional framework established in 1988 gave rise to several policy initiatives designed to implement rights and modernize the state. New ministries have been created, several others reorganized, subministerial entities added, and councils and committees formed to increase participation by business and labor. Add to this the growing role and expertise of BNDES, which has played an increasingly important role in industrial policy.

Changes in the world of ideas have also facilitated new state activism. With the turn to a more robust role for the state in the economy, and the particular profile it is taking in Brazil, we see corresponding changes in the intellectual scene. Internationally, more attention is being paid to the positive role industrial policy might play, and even the World Bank has endorsed certain types of industrial policy.⁵² Similar developments are occurring in Brazil as Brazilian economists seek to explain and guide the evolving new configuration. At the same time, Brazil has attracted the attention of theorists around the world who hope to create a new political economy of development.⁵³

Far be it for us to suggest a causal link from theory to new practices (or vice versa). But it is clear that the academic turn provides analytical tools and offers intellectual justifications that can help sustain policy experimentation. Some have labeled

the emerging set of ideas "new developmentalism." James Cypher describes this approach:

On the one hand, New Developmentalism, [rejects] prevailing ideas of neoclassical economics regarding a passive reliance on an export-led, resource-based economy [and agrees with] . . . the original developmentalist economists such as Rosenstein-Rodan, Hirschman, and Nurkse, and their emphasis on the centrality of a developmentalist state. . . . On the other hand, New Developmentalism stresses a "growth with equity" approach along with an emphasis on industrial policy, highlighting public, growth-supporting, infrastructure spending, and a "neoschumpeterian" emphasis on building a national innovation system through deep public-private cooperative programs that will drive investment expenditures toward productivity-enhancing science and technology applications throughout the national industrial base of the economy.⁵⁴

In the Brazilian case, after the 1990s in which there was a relative theoretical hegemony of liberal ideas associated with the Washington Consensus, there has been a burgeoning heterodox literature that has lent support for new state activism. This can be seen in two different fields: (1) economics including both macroeconomy and microeconomy and (2) political science. In economics, one important contribution refers to the exchange rate and its effect on industrialization. According to this argument, developed mainly by Bresser-Pereira, there has been appreciation of the value of the *Real*, leading to the "Dutch disease" effect, which promotes deindustrialization.⁵⁵ Because of the floods of dollars that have been reaching the Brazilian economy, the currency has become overvalued; this has had a negative effect on national industry. By showing that free-market policies can lead to these negative effects, Bresser-Pereira and his colleagues have created a rationale for an aggressive industrial policy. This criticism has been accompanied by microeconomic studies that also challenge the market-oriented model. These studies include sectoral and market analyses and document-specific and pervasive market failures that require active industrial policies.⁵⁶ Finally, microeconomists and political scientists have

Cypher notes that "as yet, New Developmentalism has not been rigorously defined. Some find that trial and error rather than the adoption of a coherent 'model' such as 'new-developmentalism' better describes the current conjuncture," citing Arbix and Martin. Cypher, *op. cit.*, note 49 *supra*.

The Dutch disease refers to the effect of a commodities boom on industry. Increased demand for commodities leads to appreciation of the currency, which makes industrial exports less competitive. This occurred in the Netherlands with the discovery of natural gas, hence the label. See Luiz Carlos Bresser-Pereira, "The Dutch Disease and its Neutralization: A Ricardian Approach," *Brazilian Journal of Political Economy* 1109 (2008), 47-71.

Two issues have been highlighted: (1) failures in the market for innovation and (2) gaps in the industrial chain. Studies conducted by Arbix, Pacheco, and by Ipea (Institute for Applied Economic Research) show need for innovation policies while Erber, Cassiolato, and Kupfer highlight gaps in supply chains that need government action to close.

⁵² Justin Yifu Lin, *New Structural Economics: A Framework for Rethinking Development* (Washington: World Bank, 2012).

⁵³ For a detailed discussion of Brazil and the new developmentalism, see Chapter 1, this volume.

also been providing inputs to social policy. On the economic side, new studies conducted demonstrated how inequality itself is a problem, thus detaching this problem from poverty. This sort of consideration has given impulses to the formulation of two different sets of social measures: (1) poverty alleviation measures and (2) general instruments aimed at reducing inequality.

THE CHALLENGE FOR LAW

What does the emergence of NSA mean for the law, and vice versa? As the role of the state in the economy and social protection changes, it seems inevitable that there will be corresponding changes in the law. And it seems possible that law will shape and channel the path for policy innovation, as well as allow room for adaptation. In this section we outline some general considerations about NSA's challenge for law.

Whereas it is easy to say that law and new state activism must in some way be mutually constitutive, it is another matter to say just how NSA is affecting the law and vice versa. Part of the problem derives from the complexity of the situation; part from the paucity of empirical studies. Whereas abstract models of political economy like neoliberalism and new developmentalism suggest clear delineations, in the real world, policies are often a mix of the old and the new, layered on top of one another and sometimes contradictory. This complexity and contradiction at the policy level carries over into the legal domain: key legal variables are difficult to define, and causalities involving changes in the law and in policy outcomes are blurred. As a result, studies on relationships between the law and any development policy present serious methodological challenges.

We cannot deal with all these complexities here, and a full understanding of the relationship between law and NSA must await further empirical work and theoretical analysis. In this chapter we discuss methods, outline some functionalities that NSA seems to demand, and provide a few examples of how the law has responded to these functional needs.

New Roles, New Frameworks of Analysis, and New Functionalities

We can posit a priori that NSA will generate pressures for new laws and new roles for law. Much will be straightforward. Statutes will get changed and procedures altered. There is plenty of that going on in Brazil today, as there was in the past. Laws were necessary to create ABDI, MDS (Ministry of Social Development and Hunger Fight), *Cadastro Único*, and other institutions that are central in Brazil's new state activism. Laws aiming at specific goals like innovation and competitiveness were also important: we have described some of them. While recognizing the importance of

these legal changes, in this section we focus on the new functionalities — roles for law that have not been as important (or did not exist in the Brazilian case) in the past and take on new importance because of NSA.

To identify new functionalities and legal responses, we used three sources: the research done by LANDS, the project on Law and the New Developmental State of which this study is a part, other research on law and development polices conducted in Brazil, and “reverse engineering.”⁵⁷ Reverse engineering means starting with policies and programs, describing the functions associated with them, and seeing if law has contributed, or could contribute, to those functions. We reasoned that for new state activism to be successful and the new development policies to work, it is essential to maintain flexibility, orchestrate the relations among public actors and between them and the private sector, create conditions that will maximize synergy between actors, and preserve legitimacy. These functional needs point to new roles for law: if we isolate the role law can play in these new functionalities, we can identify four roles the legal system could play: (1) safeguarding flexibility, (2) stimulating orchestration, (3) framing synergy, and (4) ensuring legitimacy.

Safeguarding flexibility means using legal norms to allow room for experimentation, promote innovation, and facilitate feedback from experiments to policy. NSA demands legal regimes that permit learning by doing and encourage path correction. Differently from both import substitution and neoliberalism, NSA requires that some degree of flexibility and learning is ensured to implement initiatives that in most cases do not resemble preexisting recipes or strategies: that is one reason why NSA ultimately employs several “new governance” tools.⁵⁸

Stimulating orchestration means using law to structure state activities for effective new-style industrial and social policy. This means facilitating coordination and articulation within the state — both horizontally (i.e., between entities that belong to the same bureaucratic state level) and vertically (i.e., between entities that are subject to hierarchies or belong to different state levels). Practically, it can consist of norms and procedures that assign institutional tasks and foster cooperative (rather

⁵⁷ The idea of reverse engineering appears in a piece by David Kennedy, in the context of a discussion of the postwar consensus (1945–1970). Kennedy reckons that although there was a clear demand for instrumental law, the legal theory was implicit. In order to reveal it, he proposes: “We need to reverse engineer the legal theory of mainstream development professionals from their economic and political projects, and from the attitudes toward law they manifested in managing developing policies within national administration. A great deal of law was required to translate the leading economic theories of development economic policy.” David Kennedy, “The Rule of Law, Political Choices, and Development Common Sense,” in *The New Law and Development – A Critical Appraisal*, eds. David Hubek and Alvaro Santos (New York: Cambridge University Press, 2006), 102.

⁵⁸ For a thorough account on new governance and its legal functions and tools, see Orly Lobel, “The Renew Deal: The Fall of Regulation and the Rise of Governance in Contemporary Legal Thought,” *by Minnesota Law Review* (2004), 262–390.

than competitive) governance regimes including rules that encourage government to work with the private sector. Also, it can mean supporting policy networks that share tasks and interact in a complementary way to implement policies: this can include defining policy hubs. Finally, it can mean using norms that harmonize new policies with preexisting ones to ensure coherence. Norms and processes playing these roles are crucial in NSA because it fundamentally relies on actions that integrate different fields.

Framing synergy involves using the law to frame public-private partnerships and ensure they are more effective than purely public or private solutions. Framing modalities include collaborative governance regimes that create incentives for public-private cooperation (through incentive alignment and/or the use of private contracts by public entities), risk sharing⁵⁹ and hybrid instances in which public and private players regularly meet to interact and exchange opinions, and regulatory and contractual instruments that bring private expertise and public financial capacity together.

Ensuring legitimacy means keeping government transparent and ensuring adequate participation. NSA seems to require a regime in which it is easy for new ideas to percolate upward and be widely shared. This makes older authoritarian models obsolete and increases the importance of democracy. Legal regimes must ensure accountability, transparency, and participation in development policies. That requires norms for disclosure, frameworks for participation, methods to hold policymakers accountable for results, and ways to avoid capture at the same time public-private dialogue is fostered. To illustrate how Brazil is dealing with some of these new needs and functionalities, we look at a few developments in industrial and social policy.

Flexibility and Synergy in Industrial Policy

The new industrial policy promoted by NSA in Brazil is as much process as policy. It is part of a joint public-private discovery process, a collaboration through which the partners experiment with different trajectories to identify products and processes that are optimal for individual firms and sectors as a whole. Efforts to encourage innovation and do it through a full-scale partnership with the private sector bring the state into new territory. For example, instead of the traditional arms-length lending with well-defined goals set in advance, internationalization strategies for Brazilian companies and innovation financing call for substantial flexibility, risk sharing, and alliances; this requires legal innovation.

⁵⁹ Diogo R. Coutinho and Paulo T. L. Mattos, "Law and the New Developmental State – Brazil Pilot Project," paper presented at the Workshop on "Law and the New Developmental State: Latin America and Beyond," Global Legal Studies Center – Center for World Affairs and the Global Economy (WAGE), University of Wisconsin–Madison (2008).

One area in which this is occurring is BNDES's new innovation program. BNDES has launched a new program to foster innovation and has replaced its traditional form of fixed obligation loan agreements with a variety of flexible devices that support collaboration and experimentation. The tools developed for this purpose represent a break in BNDES's legal pattern: in this area the bank relies on flexible legal structures that, formally or informally, support a financial relationship that permits changes of trajectory and adaptation of plans.

Among the legal tools employed in this area are: (1) partnerships with technological institutes and grants to promote the development of new products; (2) relational loan contracts that include nonbinding performance criteria, staged disbursements, and constant BNDES monitoring through shared governance mechanisms; (3) equity investments coupled with shared governance established through shareholder agreements that give BNDES a seat on the board and subject certain corporate decisions to its approval; and (4) arrangements by which BNDES participates in the investment committee of venture capital funds that it assists.⁶⁰

Other new legal mechanisms connected with industrial policy include risk sharing with the private sector, soft law, and special public-private partnerships. Risk-sharing agreements are designed to encourage private investors to increase investments in technological research and innovation, expand industry capacity and exports, and acquire assets abroad in order to exploit comparative advantage in sectors where Brazil is a global leader. Soft law has also been used to induce investment. Thus governmental letters of intent communicate public investment strategies and serve as signals for the private sector, inducing private investments decisions. Other tools that create incentives for private companies to innovate include public-private partnership contracts, cooperation agreements between government and research centers, as well as flexible private law contracts (credit contracts and shareholder and investors agreements) between government and corporations.

Orchestration and Decentralization in Social Policy

As Brazil has strengthened its welfare state, it has sought to do it through cooperation among the several levels of government in the federation. It is also bringing together different types of social policies to deal with major problems. This requires continuing orchestration of different levels and types of policies (universal and targeted, federal and local, and contributive and noncontributive). To do that, the

⁶⁰ Mario Schapiro, Chapter 4, this volume. Whereas the bank's innovation funding clearly represents a new form of state activism and new approaches to law, Schapiro makes it clear that the program represents a tiny portion of the bank's total portfolio, and it is unclear whether this segment of the program will expand in the future.

government has found new uses for old administrative law tools and has created new instruments.

This can be seen in *Bolsa Família*. The program uses a registry for all social programs (*Cadastro Único*) and a decentralized management index (IGD) to coordinate the work of several ministries, local administrators, and other public actors and encourage policy innovation. BFP uses conditionalities – obligations of recipients for child education and health – which it enforces through revisable regulatory rules such as ordinances. It employs the *Cadastro Único* to gather data and reduce asymmetric information with the purpose of expanding education and health coverage. It also adopted a “carrot-based” federal arrangement – through the use of financial incentives such as IGD to get municipalities to gather data on very poor families.

In addition, IGD aims to encourage Brazilian cities to deliver effective performance by employing funds to reward those who provide dependable and quality information, maintaining updated data in the *Cadastro Único*, and providing information on the effect of the health and education conditionalities. BFP uses contractual arrangements with cities to ensure that they set up local agencies of social control and participation. These agencies receive funding from IGD to support the BFP management and to develop activities with recipient households, including managing conditionalities and benefits, monitoring recipient households, registering new households, updating and reviewing data, implementing complementary programs for basic adult literacy, providing occupational training, creating jobs and income, stimulating regional development, and strengthening social control of BFP in the city.

This system leads to a more collaborative (rather than imposed) and flexible (rather than based on rigid rules and sanctions) relationship between the federal level and local level.⁶¹ Such an articulation tends to foster decentralization (with federal guidance, steering, and expertise) and can be ultimately described as the result of a broader picture in which, whereas universal programs remain central, “targeting within universalism” has been fostering development outcomes.

Experimentation and Synergy in Labor Law

In a recently published study of new approaches to the enforcement of labor laws in Brazil, Roberto Pires showed that labor inspectors using flexible and reflexive experimentalist governance approaches had more success than their peers who employed more traditional management tools.⁶² The study compares two different styles of

⁶¹ Diogo Coutinho, Chapter 7, this volume.

⁶² Roberto Pires, “Promoting Sustainable Compliance: Styles of Labour Inspection and Compliance Outcomes in Brazil,” 147 *International Labour Review* 2–3 (June/September 2008): 199–220.

enforcement: one, drawn from new public management (NPM), stresses specific targets and quotas; the other, which draws more on the experimentalist governance (EC) literature, stresses public-private cooperation, dialogue, exploration of options for compliance, careful analysis of the causes of violations, and revision of goals and standards as mutual learning progresses. Pires shows that through a system of hybrid governance that employed experimentalist methods while keeping sanctions in the background, health and safety inspectors in Pernambuco were able to significantly reduce the incidence of industrial accidents.

The key to this success, he suggests, was in creating institutions that allowed interaction among government, business, and labor; encouraged the search for ways companies could revise their business plans so they could comply with the law and still prosper; and facilitated experimentation with new technologies that might reduce risk of accidents at low cost. He notes that because of successes of these methods in this and other enforcement areas the experimentalist model has been scaled up to the federal level. Although Pires does not relate his study and the growth of experimentalism in governance directly to the new political economy of development or possible shifts in the way the Brazilian government is redefining its role in development, the elective affinity between these changes in public administration and the policies the development literature supports and the Brazilian government has adopted seem obvious.

Building Legal Capacity for Development: Trade Law

In addition to adapting the law to deal with functionalities demanded by NSA, Brazil has built the legal capacity needed to shield the new industrial and social policies from restrictions that might be imposed by international law and policy. Built into the NSA are policies that challenge some orthodox prescriptions, some of which are backed by international economic law. The clearest example of this kind of legal response is in the field of trade law.⁶³

When it initially joined the WTO, Brazil accepted the whole package of WTO agreements and did not adjust its domestic institutions to ensure that it could protect key policies. But as neoliberal enthusiasm waned, successive administrations have protected domestic policy space by challenging restrictive interpretations of global trade rules. This growing willingness to challenge WTO-based restrictions is a result of changes in development policy and in the way trade policy is formulated in Brazil. As the state began to play a more robust role in the promotion of economic growth and social protection, trade policymaking has become more closely integrated with overall development policy and Brazil has invested in the legal and

⁶³ See Alvaro Santos, Chapter 5, and Michelle Ratton Sanchez Badin, Chapter 6, this volume.

CONCLUSION: ASSESSING THE BRAZILIAN EXPERIENCE IN DEVELOPMENT POLICY AND LAW

The Brazilian foray into new state activism is a work in progress. Plans proliferate and policies are altered as domestic and international conditions change. But there is real movement. Industrial policy seems to be working and is helping the country to weather the storms from the global financial crisis and resume economic dynamism. World markets have accepted this judgment, and foreign investment has soared. Brazil has shown that significant gains have been made in poverty alleviation and reduction of inequality.

Yet questions remain. Is a coherent model of a new developmental state emerging, and is it likely to become consolidated? Does the government have the capacity to manage and implement the ambitious set of processes and policies that have been put in place? Can Brazilian legal institutions develop and sustain the new roles demanded by NSA? Finally, is the Brazilian experience unique to that country, or can it be replicated?

There are difficult questions. Although it is premature to speak of a "new Brazil model" in the sense of a coherent and relatively stable configuration of state, law, and political economy, trends show continuous movement toward a new set of policies that could cohere into a sustainable model. The government has shown that it has some of the technical expertise and administrative capacity needed to operate the ambitious industrial and social policies in today's complex environment. And Brazilian legal institutions have demonstrated some ability to adapt to new demands. Nonetheless, problems remain. Despite efforts to professionalize government services, corruption and bureaucratic rigidity persist in some areas. And whereas our case studies show legal innovation is possible in a few fields, overall, the legal system still requires substantial reform.

The Brazilian experience has been a step-by-step process as domestic institutions adapt to internal and external pressures and opportunities. Brazil's new state activism owes a lot to unique features of Brazilian history and institutions such as the combination of a large and sophisticated industrial sector, a history of success with industrial policy, and the continued presence of successful developmental institutions like BNDES. So it would be a mistake to conclude that there is a Brazil "model" that can be copied tout court by other countries. Yet there is much to be learned from the Brazilian foray into new forms of state activism and the adaptation of legal institutions to the new needs it creates.

related skills needed for success in trade disputes. At the same time the arena for discussion of trade policy has been expanded as more government agencies began to participate and the private sector and a flourishing civil society movement entered the debate. The result has been that in the cases studied and other instances Brazil has been able to use trade law as a shield for policy innovation.

In the case of intellectual property, Brazil was able to carve out space within the TRIPS regime that allowed it to negotiate better prices for antiviral drugs. Although initially it looked like TRIPS would preclude this kind of action, a number of changes in law, politics, and government organization at the domestic level as well as action in the international arena helped strengthen the government's capacity to shape domestic health policy in the face of international constraints. The judiciary entered the arena to enforce a constitutional right to health, administrative changes were made that opened trade policy discussions to a wider range of interests, and the legislature was mobilized.

Specific legal changes at the domestic level included: (1) reforms of the legal system in order to eliminate TRIPS-plus provisions; (2) authorization for use of such flexibilities as compulsory licenses; (3) the approval of new mechanisms implicitly authorized by the international system that favor access to technology (such as the Bolar exception); and (4) the creation of new government institutions that could serve as countervailing powers to industry interests in the patent approval process. At the same time, Brazil and other developing countries carried on a campaign at the international level that led WTO and WIPO to take a more supportive stance toward the use of policy space in this field.

The trade finance case also shows how Brazil has been able to legally protect domestic policy space from restrictions from the WTO. As part of its new industrial policy, Brazil sought to build Embraer into a national champion and facilitate its efforts to develop market share in the global regional jet market. One thing it did was provide subsidized government financing for sales of Embraer planes. Such financing is an essential part of the deal for all aircraft manufacturers, and Embraer was hampered by the high cost of financing available to Brazilian companies. To deal with this, the government provided a subsidy to the institutions that provided finance for Embraer sales. This practice was challenged by Canada's Bombardier as a violation of the WTO subsidies code. After a long and drawn-out litigation, Brazil was forced to make changes in its subsidies. But through a partially successful campaign that drew on the growing capacity of government and industry working together in the trade law field, Brazil was able to preserve part of the subsidy program and shift the whole issue of aircraft financing terms into the OECD where it felt it had a better chance of achieving its goals. By moving the issue to the OECD, Brazil got a voice in the main forum affecting global rules for aircraft finance. This meant it has a say in the terms affecting its competitors and thus more bargaining leverage in the continuing dispute with Bombardier.