

Roots of Associated Developmentalism: Comments on the Prussian Style Strategy and Pan-American Cooperation during the *Estado Novo* Regime (1937-1945)

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Abstract

The paper studies the making of a development strategy in Brazil along the 1930's and, particularly, during Estado Novo regime, focusing the reasons which lead Brazilian government to attempt at attracting steel foreign subsidiaries and, failing, to resort to "Pan-American cooperation" in order to obtain resources needed to the first great state industrial investments. The paper also rejects the assumption that a kind of state-oriented nationalistic project which either emphasized autonomous funding of industrial development or dismissed foreign dependence as in so-called "Prussian style" had its coming of age suddenly hindered by local political resistance, for there is no evidence that this kind of national project had been implemented at first. Quite contrary, indications are that Vargas government tried at the start to accompany with foreign funding the limited effort to mobilize local resources, in a historical context plenty of economic and political restrictions to a "Prussian style" development strategy in Brazil.

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O artigo indaga a emergência de um projeto de desenvolvimento industrial na década de 1930 e, sobretudo, no Estado Novo, discutindo razões que levaram o governo brasileiro a tentar atrair siderúrgicas estrangeiras e, fracassando, recorrer à “cooperação panamericana” como forma de obtenção dos recursos necessários aos primeiros grandes empreendimentos industriais estatais. O artigo descarta a noção de que um tipo de projeto nacionalista orientado pelo Estado que enfatizasse financiamento autônomo do desenvolvimento industrial e rejeitasse a associação/dependência externa (como na chamada “via prussiana”) tenha tido a implementação vetada subitamente por resistências locais, uma vez que não há evidências de que este tipo de projeto nacional tenha sido sequer colocado em ação de início. Ao contrário, as indicações são as de que o governo Vargas tentou de antemão acompanhar com fundos externos o esforço limitado para mobilizar recursos locais, em um contexto histórico de severas restrições materiais e políticas a um projeto de desenvolvimento “prussiano”.

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1 Introduction

The events that occurred in late 1937 solved a series of political struggles that had been going on since the early 1930s about the confines of the political regime that resulted from the Revolution of 1930. The Paulista revolt of 1932 and the constituent process had undermined the centralizing impulses of presidency but, after that, the communist threat was skillfully used to legitimate successive coups against the decentralization of power which, according to the speech of the victorious ones in 1937, menaced the promises of Revolution. On the night of November 10, 1937, a new political regime, the *Estado Novo*, was announced by the president in the name of the primacy of political order and economic and social progress. Immediately afterwards, the Constitution was approved, imposing a legal landmark and institutional reforms that widely centered all powers around the executive board: to legislate by decrees, dissolve political parties, replace governors, intervene in employers' and workers' unions, arrest subversive agents, deport spies or troublemakers; establish new administrative departments, social rights and taxes.

Concomitantly with this announcement, Brazil's foreign relations suffered an abrupt rupture. Vargas announced a foreign debt moratorium that resembled radical nationalism, conditioning the country's development ("modernization") to the elimination of an unbearable burden:

“At the moment, the situation calls for the suspended payment of interests and amortizations, until it is possible to reestablish these duties without bleeding and impoverishing our economic body. We should no longer be burdened with the payment of old debts at the cost of incurring larger ones, which may lead us to adopt radical measures within a short time frame ... Our international funds, virtually destined to pay the debt and all requirements related to it, wind up being insufficient to renew the economic organization, upon which relies the country’s development”.

A nova política do Brasil, V, p. 27).

The Constitution strengthened the nationalistic drive. Article 143 and the subsequent ones of the Economic Order preached the principle of “progressive nationalization” of mines, mineral lodes, sources of energy and of essential industries, in addition to acclaiming the Brazilian monopoly on deposit banks, insurance companies, domestic navigation and liberal professions. In December, corporative and consultancy organizations were restructured, especially the Foreign Trade Council. Finally, in February 1938, the president seemed to dismiss the financial dependency that stunted Brazil’s growth:

“With no further analysis, it does not seem that we should continue to use an overstatement that turned out to be commonplace: the government’s dependence on foreign capital and that, without this capital, it is impossible to do anything ... It is common knowledge that, since the world war, capital inflow has considerably decreased and, on the other hand, the process of domestic capital formation reached a high level of development ... Now, the major undertaking in our country is the mobilization of domestic capital”.

(A nova política do Brasil, V, Problemas e realizações do Estado Novo, 1938).

Nevertheless, this “major undertaking” was not carried out during the *Estado Novo* regime. The “modernization” of basic industries during World War II, among which the iron and steel industry was considered to be the foremost, would result more or less from the “mobilization of domestic capital” than from U.S. resources, to such an extent that a leader from the government’s pro-American wing, chancellor Oswaldo Aranha, felt at ease to write to a former exponent of the pro-German wing, Minister of War Gaspar Dutra, warning that the best way to defend Brazil’s interests was to preserve the “political, economic and military supremacy derived from the United States ... This, Dutra, was my conviction long before I started this war and, now, more than ever, I am convinced that either we join their material, moral and military views,... or the future of Brazil will be in everyone’s hands, but in the Brazilians’ own hands” (cf. Hilton (1994), p. 411).

What had taken place since 1937? Had the president relinquished the “Prussian dreams” of autonomous industrialization and financial independence he once cherished? Why? Because of local political resistance? Lack of option? Sudden awareness of unreality? Rational option to explore more readily available opportunities? Or had these dreams never been cherished?

The present article aims to raise some questions and discuss some uncertainties over these issues. It is argued that no evidence exists that “Prussian dreams” were actually cherished, and that local material, political and ideological restrictions hindered the “modernization” of basic industries with the “mobilization of domestic capital”. Thus, the roots of the Brazilian associated developmentalism, i.e., of an industrialization project aimed at the domestic market but dependent on foreign funding, were established at the moment in which the political centralization of the *Estado Novo* did not coincide with sufficient resources to

finance radical nationalistic dreams outside the Pan-American cooperation.

2 Did Vargas Cherish Prussian Dreams?

Not only did the world economic crisis of the 1930s affect the international insertion of Brazil, changing relative prices and gradually driving the country's economy towards the domestic market, but it also discouraged direct investments from abroad, due to either profit losses and funds accumulated by head companies or to the uncertainty about profitability and availability of the exchange market for repatriation of profits generated by subsidiary companies. Moreover, the crisis exerted a long-lasting effect on the international financial system, originating moratoriums and renegotiation of the foreign debt that severed the links between financial centers and indebted peripheries: in Latin America in 1931, in Central and Southern Europe in 1932, and finally, the German dissension in 1933. In Brazil, the initial strategy of the Provisional Government consisted in seeking to make agreements with foreign creditors, preparing the ground for new loan applications. Even when foreign currency restriction required new exchange rate control, in September 1931, it was necessary to establish priorities for the use of the foreign currency in order to afford the partial payment of the foreign public debt. This implied shortage of resources for commercial purposes and protected substitution manufacturing activities - more as a by-product of the power of financial articulations and interests than as a deliberate policy against competitive manufactured imports, at least at the beginning¹.

¹ Compare the high proportion between the debt service and the trade balance (the ratio of trade overdues) in Table 1. Regarding the impact of Niemeyer's mission sponsored by London creditors in

However, during this decade, the interruption of capital inflow would not be temporary, thus gradually doing away with the endeavor to keep the payment of financial services as a priority. Finally, in December 1937, a new exchange rate control was adopted alongside the foreign debt moratorium with the aim of allocating resources to other purposes (mainly imports for public works and modernization of military equipment). At this moment, Vargas's actions and speeches suggest that the government leaders had perceived that they could not immediately rely on private cash inflow and that it was necessary to finance the "modernization" project by way of a more incisive mobilization of local capital and government funds – however, without ruling out the possibility of *combining them* with foreign financial funds.

The hypothesis that at this moment the president had cherished a "Prussian dream", in which he fancied carrying through the development of the Brazilian heavy industry "from top down" via the mobilization of *local* resources without the use of foreign funds, was posited by Fiori (1988), chp. 4, and Fiori (1995), chp. 3. According to this author, local resistance to this project may have led Brazil to establish a closer relationship with the

1931, see Lomax (1932), Abreu (1974) and Abreu (1977), chapter. 3 – and, for his report, compare Carone (1973), part II. Priority use of reserves, determined by the September 1931 currency exchange control, illustrates the power of the creditors: foreign debt and government spending were listed as first order priorities, followed by "essential imports" (not defined in accordance with a criterion that would favorably distinguish those imports which were fundamental to industrial expansion, because they discriminated the imports of oil, charcoal and chemicals) and remittances of profits. For a description of foreign exchange policies in this period, see Villella and Suzigan (1973), pages 309-329, Abreu (1977), ch. 4, Oliveira (1978) and Corsi (2000), ch. 1.

USA after the Aranha's Mission in 1939, which aimed to provide access to government-to-government loans, giving rise to an "associated" strategy for industrial development. Fiori's argument, albeit very useful and seminal – especially with regard to the political origin of the crisis of the developmentalist government and of the associated Brazilian capitalism of the 1980s –, is subject to some historical qualifications².

Some of the necessary qualifications have already been described: according to Corsi (2000), although, at the beginning of the *Estado Novo* regime, Vargas advocated the necessity to mobilize domestic funds, there is no evidence that this could be cogitated *in opposition* to foreign financial funding (to some extent due to

² We are not affirming that the "Prussian Style" was not entirely free from external resources (because it was not) because, after all, the State's control over the application of these resources and over the sectoral implementation of industrialization was unprecedented. see Landes (1989), Kemp (1989), Pollard (1991), Barbosa-Oliveira (1985), Tilly (1986), Nadal et al. (1988), Chandler (1996), part III, Bairoch (1997), Volume II, Pierenkemper and Tilly (2004). In the words of Fiori (1988), pg. 145-6: "In two moments of our history we may have been close to a veritable Prussian alternative, more so in 1938 than in 1974 ... From the point of view of his economic project, Vargas bet the State's resources on implementing a steel industry, believing that it was "the fundamental problem of our economic expansion"... But, his projects soon fell through when Oswaldo Aranha signed the Washington Accords on March 9, 1939 ... And, above all, the course of the national project was redefined, breaking away from the Prussian pathway or the Japanese pathway, when Vargas symbolically decided, in view of the political objection of the business community and the shortage of tax resources, to obtain international funding to implement a steel industry, marking the start of our heavy industry. Many years later, a timid version of this dream led Vargas to commit suicide and Eugenio Gudin to the position of Minister of Finance.

the necessity to finance essential imports, which would not be solved by domestic funding). Thus, perceiving that the inflow of foreign capital would not occur as soon as expected right from the beginning of the Provisional Government and vetoing later inflows were lengths to which Vargas dared not go. Exactly because of that, he was very attentive to the possibility of having to resort to help from abroad if geopolitical conditions allowed. We should recall that between the speeches given at the beginning of the *Estado Novo* regime, which were marked by an emphasis on the protection of national sovereignty in all political fronts – reaffirming a new will and seeking to legitimate the change in the political regime –, and the Aranha’s Mission, in early 1939, there was no significant political shock that could have changed the domestic political situation regarding the moment in which Vargas supposedly had his “Prussian dream”, in the sense that he would veto the concentration of power *reinforced* since then. Indeed, the foreign conjuncture had changed, owing to the *invitation* made by the U.S. president which Vargas did not hesitate to accept – something unlikely if he had rejected foreign funding about one year before (cf. Moura (1980), Moura (1984) and Moura (1991)).

Table 1. Foreign Solvency Indicators (1931-1945) uk£million

Years	Export.	Trade Balance	Public foreign debt services	Services/ Exports (%)	Services/ Balance(%)	Trade Services/ Fiscal Revenue (%)
1931	53.8	23.7	20.4	40.6	86.1	34.6
1932	51.2	20.7	6.8	24.4	32.9	7.5
1933	52.8	11.3	6.2	22.5	105.3	10.7
1934	58.0	16.1	7.1	21.7	78.3	22.7
1935	55.0	9.1	7.5	13.6	82.4	14.1
1936	64.5	17.8	7.9	12.2	44.4	13.5
1937	70.2	3.3	8.5	12.1	257.6	10.9
1938	60.3	0.1	0.0	0	0	0
1939	68.8	10.0	0.0	0	0	0
1940	65.2	3.1	3.4	5.5	109.7	3.7
1941	89.7	15.0	4.1	4.9	27.3	4.2
1942	100.0	35.1	4.0	4.2	11.4	4.0
1943	116.4	31.3	3.9	3.6	12.5	3.0
1944	143.0	32.5	18.8	13.9	57.9	7.1
1945	162.6	43.5	10.8	7.0	24.8	5.6

Source: Abreu (1977), pp. 46, 149 and 236.

In addition to the moratorium and to the establishment of CREA (a Banco do Brasil's agency specialized in long-term credit), Fiori cites, as signs of evidence of the "Prussian dream", only some excerpts of the famous speech made by Vargas in São Lourenço in April 1938, and another speech about citizens' duties towards the country (delivered not before entrepreneurs, but before workers, criticizing again the "rights" conceived by communist utopias). However, in practice, there is no concrete initiative by the government that may be unequivocally provided as evidence of a "Prussian" industrialization project, conducted through the forced concentration of domestic resources to a degree that could make foreign funding seem superfluous (or merely complementary). The limitations of CREA will be discussed further ahead, but the announcement of the moratorium, given the sudden deterioration of the trade balance in 1937 (thanks to the sharp increase in imports), was more of a *fait accompli* than an option (as Vargas himself would repeat over and over), even though it occurred after the endless patience for new inflows of foreign funds had run out, and although Vargas skillfully used the announcement to a) define a new period (the *Estado Novo*), b) consolidate his link to the military modernization project, and c) negotiate further ahead a new foreign agreement under more favorable conditions (and, in that context of exchange rate devaluation, under feasible and credible conditions, as he had always done therefore)³.

³ The announcement of the moratorium did not hide the fact that it was inevitable as a result of a reduction in trade balance (*A nova política do Brasil*, V, pg. 27-8). Later on, Vargas would be even more explicit, like in his 1937 New Year's speech (ditto, pg 122) and, above all, in his February-April 1938 interviews: "Suspending foreign debt payments was not merely whim. It was called for in view of the overwhelming circumstance that we do not have the necessary resources. The decrease in coffee prices, reduction in our export balance, much shorter than the amount required by amortizations, the lack of cover

A more detailed analysis of Vargas's speeches at the beginning of the *Estado Novo* regime does not seem to indicate that the mobilization of domestic capital was regarded as *exclusive* of the association with foreign capital. Very likely, the interviews given in Petrópolis and São Lourenço, in February and April 1938, show the part of Vargas's speech that clearly indicated the necessity to concentrate and centralize domestic funds to finance the "economic modernization"⁴.

Shortly before, in the pronouncement in which he announced the *Estado Novo* (as on other occasions later), he said that "... these accomplishments require that the great steel industry be installed, taking good advantage of the available iron ore, in a vast collaborative program through which the Brazilian government allows the inflow of foreign capital provided that it generates wage-paying jobs, thus eventually founding our basic industries, upon which the national protection problem is incumbent" (idem, p. 28). On the night of December 1937, he said, in a new nationwide declaration: "The inversion of incoming capitals

for our bills of exchange – all these things brought about a situation whose solution could not be different from this. This is, however, a temporary solution. Readjusting our economy will certainly allow us, in the future, to resume the payments if our exports produce considerable balances" (ditto, pg. 186).

⁴ After mentioning a number of development and national integration projects, Vargas goes on: "It is necessary to mobilize large investments to implement these initiatives. With no further analysis, it does not seem that we should continue to use an overstatement that turned out to be commonplace: the government's dependence on foreign capital and that, without this capital, it is impossible to do anything ... It is common knowledge that, since the world war, capital inflow has considerably decreased and, on the other hand, the process of domestic capital formation reached a high level of development ... Now, the major undertaking in our country is the mobilization of domestic capital". (*A nova política do Brasil*, V, pp. 165-6).

should be certainly considered for our progress, but we should not forget that it operates according to the actual possibilities of remuneration found here, in opposition to the low interest rates in the country of origin. It is therefore easy to understand why, if we do not show hostility towards foreign capital, we won't be able to grant them other privileges in addition to the usual guarantees offered by new countries under full development" (idem, p. 122). Between October and December 1937, the exchange of letters between Vargas and Aranha (who tried to get loans from EXIMBANK right at the beginning of the *Estado Novo*) shows, in a reserved contact with an old-time collaborator, a president that was highly interested in the success of negotiations in order to raise foreign funds (cf. Corsi (2000), p. 84).

Finally, the plan established to attract foreign subsidiary companies to the steel sector does not confirm the hypothesis that the government had only resorted to foreign funding after mounting some resistance to a Prussian alternative at the beginning of the *Estado Novo*. Between 1937 and 1939, the aim was to first attract DuPont before the coup, and later the German industries Demag, Krupp and Stahlunion, before the intense negotiation with US.Stell between May 1939 and January 1940. This negotiation collapsed not because of some Brazilian resistance to meeting conditions established by the company, but because of the company's lack of interest despite the mutual desire of the Brazilian government and of the U.S. State Department. This lack of success led the Brazilian government to look for German companies in 1940, instead of seeking the statizing alternative previously proposed by the military, technicians and local nationalistic politicians. The negotiation with the Germans also collapsed, but indirectly led Roosevelt to propose a bargain from one government to another after the celebrated pro-German speeches delivered by Vargas in the mid-1940s. Thus, the U.S. funds that allowed the establishment of the *Companhia*

Siderúrgica Nacional (CSN - National Steel Company) did not even result from the first Brazilian demand on bilateral bargains but from a third or fourth option, indicating that the “Prussian dissension” against the association with foreign subsidiary companies was not current before or after the *Estado Novo*, quite on the contrary (cf. Wirth (1970); Martins (1976); Moura (1984); Corsi (2000)).

In summary, a growing concern with the mobilization of local funds appeared at the beginning of the *Estado Novo*, but the argument that certain speeches and decisions could indicate a Prussian and/or radical nationalistic “turn” seems to be far-fetched. Nonetheless, once qualified, Fiori’s contribution indicates the necessity to assess the restrictions imposed on the “great task” of domestic mobilization of financial funds that was already regarded as an essential (albeit not necessarily preponderant) part of the financing of the Brazilian industry at the beginning of the *Estado Novo*.

3 Could the Heavy Industry be Financed with Domestic Funds?

The concern with the inadequate Brazilian financial system for investments with long maturities and amortization did not arise in the *Estado Novo*. This concern had already arisen in the 1930s and existed alongside a) the growing perception of other deficiencies such as shortage of foreign currency for essential imports, lack of proper infrastructure (energy and transportation) and basic inputs (steel and oil); and b) the idea that the Government should try and circumvent these bottlenecks, since the local private sector was not able or was not interested in dealing with the risks of investment in the basic input and infrastructure sectors

– characterized not only by large industry-scale requirements, initial capital and technological qualification, but also by long maturities and investment amortization. By taking this into account, the following comes as no surprise c) the widespread lack of xenophobia of the industrial entrepreneurs, at least when it came to developing new fields of activity with foreign capital, d) the agreement of major industrial leaders with the defense of government participation, as in the words of Ary Torres (1944), CNPIC counselor, “those activities that are necessary, but not immediately profitable so as to awaken the interest of private capitals”⁵.

Despite the great hindrance to the participation of the Brazilian private sector in the heavy industry, the creation of private industrial investment banks was not ruled out beforehand, as a way to accomplish the “great task” of centralizing financial funds. Thus, from a very early stage of economic recovery in Brazil, legal provisions were established (starting with decree no. 24.575 of July 4, 1934) in favor of the creation of investment banks, but we will see that several projects were proposed, discussed and laid aside for political and economic reasons. While private alternatives did not thrive, other government initiatives attempted to redirect the credit system to operations beyond traditional trade credit operations, financing of urban real estate speculation and exchange rate transactions: the reformulation of the Rediscount Line of Credit (CARED-BB) in December 24, 1930, shortly after

⁵ According to Diniz (1978), pg. 162. For the opinions of business community leaders concerning the two basic questions about what the three pillars of the Brazilian industrial development are, compare Carone (1977); Diniz (1978); Leme (1978); Boschi (1979); and Bielschowsky (1988). For an overview of the limits and opportunities of the late Brazilian industrialization process, Tavares (1985), Cano (1990) and Mello (1987), and for an analysis of the limited industrial diversification until World War II, Suzigan (1986).

the Provisional Government took office; the Banco do Brasil's credit funds to finance a program for the protection of the coffee industry and to support the economic recovery that followed after; the creation of the *Caixa de Mobilização Bancária* (Banking Mobilization Office) in 1932; and the reform of CARED in 1935, which allowed discounting agricultural and industrial securities, and not only trade bills (cf. Neuhaus (1975); Topik (1979) and Topik (1981); Sochaczewski (1980); Triner (1996)).

However, these initiatives only provided short-term credit. In this context, the creation of Banco do Brasil's Agricultural and Industrial Credit Office (CREAI - *Crédito Agrícola e Industrial*) (October 1937) met a general demand for long-term financing and not only for industrial leaders. As a matter of fact, the credit portfolio predominantly aimed at stimulating agricultural diversification (financing of intermediate harvests, purchase of agricultural machinery and livestock), absorbing on average 75% of its resources between 1938 and 1952. In the beginning, the industrial credit portfolio was not authorized to participate in the financing of new basic industries (paper and pulp, aluminum metallurgy, and charcoal steel, among others), being granted such permission only after corporate claims. The loans were granted at subsidized interest rates, initially with maturities of five years (and later, 10 years), with real guarantees, and limited to one third of the future estimates for crop harvest, and 40% of improvements or purchases in industrial operations⁶.

⁶ Compare Villella and Suzigan (1973), pg. 79-80, 187-8, 346-353, Malan et al. (1977), pg. 242-251, and Oliveira (1996). Concerning the credit portfolio, Vargas said in 1940, "The opening of Banco do Brasil branches to provide growing credit opportunities across all production zones is some material evidence that, for the first time after the republican regime was implemented, Brazil is practicing a funding policy especially carried out to benefit the forces that promote the development of the country's economy" (according to Fonseca

The government's effort to collect local funds was not limited to CREAM, although this does not indicate the existence of "Prussian dreams". The same decree that re-established exchange rate control in late 1937 (decree no. 97, of December 23, 1937) created a fund based on a 3% tax on exchange rate operations. In 1938, this tax was increased to 6% (and was reduced to 5% one year later), and from 1939 onwards, the funds obtained in this fashion constituted the major source of the Special Plan for Public Works and Modernization of the Brazilian Defense System (PEOPADN) – a budget similar to the federal one, exclusively destined to investment activities, but with scarce implementational rationality (for other sources of funds, cf. Villella and Suzigan (1973), p. 187). Simultaneously with CREAM and PEOPADN, there was also mobilization of pension fund reserves to finance the construction of industrial plants with mortgage-backed securities, also in 1937 (cf. Missão-Cooke (1948), pp. 325-339)⁷.

Was this enough to finance the "modernization" of basic and infrastructure industries? A far cry from that. At best, CREAM

(1989), pg. 261; italics are mine). The pressures from industrial organizations for the expansion of the CREAM's scope were analyzed by Diniz (1978), pg. 137-8.

⁷ On December 29, 1943, the Works and Equipment Plan (POE - Plano de Obras e Equipamentos) replaced PEOPADN for a five-year period. Although it distinguished between economic development and military issues, its funding sources and its limitations were similar; see Costa (1971) and Draibe (1985), ch. 1. The arguments in favor of PEOPADN objectives included in a Ministry of Finance Report of January 1939, claimed: "The central idea of the Government consists in promoting the creation of the so-called basic industries, implementing productive public works and modernizing national defense without affecting the results expressed in this year's positive budget balance" (according to Corsi (2000), pg. 72).

and PEOPADN (or POE) minimized the lack of funds, and were unable to finance the desired “economic modernization” and promote a “Prussian” alternative to industrialization.

To have an idea of the disparity between the supply and demand for funds for the “modernization”, note that the funds of CREA until 1941 came from the underwriting of Treasury bonds to the value of Cr\$ 75 million (cruzeiros according to the currency pattern used in 1942), plus compulsory deposit as of February 1941 (cf. Malan et al. (1977), pp. 242ff). By comparing, for instance, the magnitude of this source of funds with the financial requirements of CSN, it should be underscored that the EXIMBANK loan value alone, used in the construction of CSN, amounted to US\$ 45 million, i.e., nearly Cr\$ 880 million at the free rate of Cr\$19.60/US\$ that ruled private imports or, at the official rate of Cr\$16.60/US\$, something around Cr\$ 750 million (much of which was applied in the import of machinery and equipment bearing no comparison with similar Brazilian products and yet unavailable in the international market, not influenced by geopolitical issues). As the efforts into the autonomous generation of technology would probably be costlier, uncertain and time-consuming, the centralization of funds was far beyond CREA, unless its source of funds was totally reformulated, if the resource allocation pattern between agriculture and industry were abruptly reversed and, finally, if the amount of available resources and the decisive centralization of its application were quite different from that which was observed.

We should not forget that even the activities undertaken by CREA regularly exceeded its own resources, being covered by Banco do Brasil’s “general cash funds” and by funds from CARED (cf. Malan et al. (1977), pp. 245-7). Moreover, a letter of Macedo Soares and Guilherme Guinle to Vargas in late 1942 estimated, at that moment, that Cr\$ 670 million would be neces-

sary for domestic expenditures and US\$ 20 million for expenses with imports so as to finish the construction of the plant (GV 42.11.05). And the U.S. help was not restricted to loans from the EXIMBANK. During the war, Brazil received a total of US\$ 332 million (something around Cr\$ 5.5 billion at the official rate, or Cr\$ 6.5 billion at the free rate) in compliance with the terms of lend and lease agreements, corresponding to nearly 20% of all Brazilian imports between 1941 and 1945 (cf. Abreu (1977), pp. 332).

If the “great task” was beyond the reach of CREAM, the magnitudes involved were still beyond the domestic collection of profits from industrial entrepreneurs in the country’s most thriving region, not allowing for any national private effort without full approval of the government. Note that, according to census information at that time, all the capital stock accumulated at nearly 13,000 factories in São Paulo amounted to Cr\$ 4.6 billion in 1939, year in which the diplomatic management system was implemented, leading to the later construction of CSN (cf. Villella and Suzigan (1973), p. 368). Using the deflator proposed by the IBGE (1990, p. 177), this was equivalent to a *total stock* of approximately Cr\$6.5 billion at the prices in effect in 1942, when new *flows* of investment were considered to be *even* more necessary, around Cr\$ 670 million in domestic expenditures and US\$ 20 millions in imports (nearly Cr\$ 335 million based on the official rate of 1942-3, and almost 400 million at the free rate), i.e., a value greater than Cr\$ 1 billion for the concluding works of the steel plant, or about 15% of the capital from industries in São Paulo in 1939.

As if that were not enough, recall that the largest privately-owned industrial companies (in terms of capital stock) were the textile ones, i.e., they mastered a set of technical qualifications whose diversification portfolio (not to mention its capital sur-

plus) were not close to matching those qualifications required to manage heavy steel technologies. On the other hand, since there were diversification horizons for local capital that were less unrealistic and risky, taking advantage of several “lighter” opportunities of investment indicated by the structure of imports, a movement of concentration and centralization of capital that came from the local private sector in order to overcome the “heavy” challenges of late industrializations, cannot be regarded as mandatory to ensure the microeconomic reproduction of individual companies, nor “spontaneous” in view of the profitability/risk calculations. In other words, the industrial diversification of local capital was able to seize certain opportunities of investment after the barriers against imports, but these opportunities did not cover the basic investments necessary for the economic “modernization” of Brazil. It is important to highlight that CREA allocated funds for private financing (not at lost funds), and while loan portfolios did not exceed 40% of the capital necessary for improvements or purchases in industrial operations, the magnitude of capital available to entrepreneurs was a restriction on loan applications for new investments.

Since the budgetary resources of POEPADN also were relatively restricted (three billion cruzeiros distributed in five annual installments among several domains, especially to the Ministry of War and Navy, and the Ministry of Roads and Public Works), an autonomous effort to finance several “basic modernization” projects should be directed towards forms of concentration and centralization of funds far deeper than the ones previously implemented. Was that possible?

4 What is the Role of Domestic Political Restrictions?

Given the business limitations for the financing of the necessary modernization projects, any financial centralization effort should be directed through more comprehensive government projects than those of CREAM and PEOPADN, with the aim of collecting funds for industrial undertakings. How come this was not carried out?

One cannot deny the existence of corporate projects requesting government support from private investment banks, since some requests were made but denied (even before considering the possibility of relying on U.S. government funds to finance Brazilian projects). However, the proposals for the creation of investment banks failed to succeed because of a) the paucity of regulatory and fiscal resources that could support them, b) political impasse that hindered the processing of projects, c) corporate resistance to venture into financial projects that involved risk and long-term return without wide support from the government. These deadlocks illustrate the nature of the political agreement upon which the industrialization project of the *Estado Novo* was based and the problems concerning late industrialization. In summary, the financial and technological requirements imposed by heavy investments in the basic input and infrastructure sectors proved unachievable for the local private sector, without the need of more advanced forms of concentration and centralization of capital. The political conditions necessary to further this concentration/centralization process were not reached⁸.

⁸ For the “paralysis” of several proposals for the creation of private industrial investment banks, compare particularly Diniz (1978), pg. 134-150, and, in an excellent revision of his conclusions, Draibe (1985), 122-5; for proposals for the establishment of a central bank, compare Sochaczewski (1980), ch. 1. According to Oliveira (1996),

The disadvantages of the most ambitious and articulate project lie in the political and economic difficulties related to the creation of investment banks. It is concerned with a difficult political processing, initiated in 1943 and quickly withheld, of the project developed by Luiz Betim Paes Leme, industrialist and CTEF counselor interested in inaugurating an industrial bank with government support. His basic claims included a law reform concerning corporations (in such a way that it favored major stockholders and increased fund raising) and wide and direct incentive, in the form of market guarantee and minimum price. The proposal was vetoed by different actors before the sudden death of its author: a) banker Gastão Vidigal, who was reluctant to the law reform and to the claims of market reserve and guaranteed remuneration, for obvious reasons; b) of Eugênio Gudin, stating that industrial financiers demanded benefits that were disproportionate to the effort they intended to make and to the benefits they could provide; c) of DASP (Public Service Administrative Department), stating that the government's *preference*, at that stage, was for the establishment of government-owned or mixed-economy companies in the basic industrial sectors.

After harshly criticizing the Paes Leme project, the contenders

Vargas's administration would, from the start, propose changes to the finance system, and "for a good grasp of the meaning of this policy, consideration must be given to the important Decree n 24.575 of July 4th, 1934. In the "whereas" section of the said document the legislator argues that: a) the country's industrial development depends on a domestic banking organization which, by offering a wide range of credit facilities, makes it possible to step up and improve production; b) this support can only rest permanently on a banking organization specialized in a systematic granting of industrial credit". It goes without saying that the legal support for the establishment of private investment banks has not followed by sufficient political and economic support.

began to fight among themselves. The opinion of DASP produced a reply from Vidigal against what he saw as the exclusivist view of Government's capitalism (although he supported government intervention, Vidigal did not see it as an exclusive option of the stimulation of feasible private initiatives, even though he did not find the Paes Leme proposal feasible either); Gudin's opinion produced a reply from Aluzio Campos, of DASP, against the intransigent position unable to note that conditions specific to the Brazilian economy did not recommend the application of orthodox principles – since in agricultural countries, it was impossible to create basic industries under free competition and to deny official intervention would be like “wanting to impose on Brazil a policy of permanent maintenance of colonial economy” (*apud* Diniz (1978), p. 148). Under the game of conflicting political pressures, the decision was withheld, without even being dispatched (favorably or not) by Vargas. Before and afterwards, other projects failed because they were unable to gather political and fiscal policies to implement the incentive they claimed, even though the implementation of their claims was not a guarantee of success: for instance, how to attract borrowers if the guarantee of minimum prices (a floor for the decrease in interest rates) limited the competition with credit lines subsidized by CREA? Anyway, these projects were not rejected due to difficulties in the implementation phase, as none of them had their implementation supported by the president.

It was evident, though, that the processing of these projects did not depend only on the president's willpower, and that they were restrained by structural hindrances. What actually got in the way of financial reform projects and rendered private projects in the basic sectors unfeasible (leading government-owned companies to develop them), was, on the one hand, the extent of the industrialization challenge under historically late conditions (which actually required advanced forms of capital concentra-

tion/centralization); on the other hand, the lack of a political hegemony that determined losses and gains unequivocally (albeit not necessarily exclusive) that were *favorable* to industrial leaders in the private sector. In other words, favorable to the “unstable commitment equilibrium” of Vargas’s government failed to promote, on a large scale, that which would be very common in other late industrialization processes, and which might have been later brought up during Geisel’s tenure (with known limits): to clearly choose some “national champions” to command the financial and industrial centralization process in the private sector⁹.

As a matter of fact, the government’s subsidy to specific private entrepreneurs stumbled upon political and fiscal impasses inherent to the amplitude and, sometimes, to the internal incoherence of interests that were in sharp conflict in the *Estado Novo*, a regime closed to electoral representation, but open to corporative leaders who discussed about and influenced public policies at the moment of having them appraised at the “technical councils”. This is quite clear in the arguments gathered

⁹ Diniz (1978), pg. 149 offers crystal clear comments on the deadlocks of the projects: “The lack of a consensus on the structuring of this type of bank, given the country’s economic conditions and the unrealistic private nature of the proposal, as well as the lack of resources on the part of the business community ... ultimately rendered the initiative unfeasible and the decision was not made”. A critical summary of the justifications of the Paes Leme project within the overall framework of proposals for the establishment of investment banks, advocating the unmonopolizing participation of the Government in this sector, was presented by then federal deputy (and future Minister of Finance) Horácio Lafer: *O Crédito e o Sistema Bancário no Brasil*, 1948, pg. 129-138. As we know, Lafer would later on be responsible for proposing and negotiating in Congress the legislation that established BNDE: see Martins (1976), pg. 381-389.

by the most diverse characters in order to veto the Paes Leme project, whose sole similarity concerned the fact that all of them were included in the *Estado Novo* councils, fighting one another. This was not an exception, but an essential (and quite often indicated) characteristic of the “Brazilian Bourgeois Revolution” represented by the Revolution of 1930 and its developments in the *Estado Novo*: the aggregation of new interests in the power condominium (except for rural workers) occurred without expropriating the sources of power of old interests, and without the establishment of a hegemony of the local industrial bourgeoisie (this means that, although it was able to influence certain decisive agendas, it did not control them). If, on the one hand, the process of aggregation of interests gave the presidential body the possibility of regarding itself as the only representative of the country’s general interests (splitting in order to rule), it also fragmented and limited the possible scope of centralization of decisive and financial resources, as sectoral claims pressed scarce resources.

In this text, the proliferation of sectoral organs, institutes, agencies, councils, committees, through which corporate interests were directly channeled, had a clear objective: prevent or control the “leak” of conflicting issues out of their apparatuses, seeking to find their internal solution and ensuring the reproduction of the regime. However, given the broad and heterogeneous block of interests represented by the Government’s apparatuses, the “solution” to certain issues often was submitted to the *paralysis* of the most controversial propositions. Thus, certain changes that affected the accommodation of interests contained in the power condominium were suppressed (without Vargas’s exposure by vetoing these changes, which had been *paralyzed* even before they got to the government body). Apparently, this is the case of financial reform proposals discussed by the councils, which were vetoed because they proposed an unfeasible level of

support (from a political and fiscal viewpoint) to public funds in order to foster them: Vargas did not have to directly refuse to transfer the large volume of funds they requested because they were vetoed before that. Of course Vargas could have overlooked the technical councils, but he decided not to take sides on either of the private projects; if we grant credit to the DASP representative who took part in the analysis and veto against the Paes Leme project, perhaps because the president thought that mobilization and control over the destination of federal funds (and maybe the success of the task) was guaranteed by the establishment of government-owned firms than by transfers to private entrepreneurs.

Recall that the veto of DASP against the Paes Leme project was based on the fact that the government shows preference for the establishment of state-owned or mixed-economy companies in the basic industrial sectors. One cannot affirm that the position of DASP could be mixed up with that of Getúlio Vargas, although Luís Simões Lopes, chairman of DASP, was one of his “right-hand men”. In that context, however, the direct intervention of state-owned companies, albeit submitted to resistance as well, was a strategy that *minimized* political conflicts regarding regulatory and fiscal difficulties to foster private investments in the “basic sectors”. From the fiscal and financial standpoint, for instance, it was possible to justify the establishment of new taxes (especially “related funds”) to finance investment projects of state-owned companies, but difficultly to finance specific private undertakings. Actually, several financial reform projects came upon, among other vetoes, the refusal to decree the new taxes they explicitly wanted to see supported, since they would directly benefit specific entrepreneurs. If such type of transfer to private undertakings were vetoed, the access to more advanced forms of financial and decisive centralization would prove feasible to state-owned companies, through (i) foreign loans taken out

by the federal government, (ii) parafiscal funds strictly linked to their specific projects and (iii) financial transfers (cf. Coutinho and Reichstul (1977)).

The establishment of state-owned companies was a faster and more straightforward way to attain the goals that the regulatory power of Vargas's *Estado Novo* (understood as the capacity to accomplish purposes by inducing private activities in the desired direction) was not able or did not want to achieve – if it were withheld, at a safe distance, of direct intervention in the production system.

Did the creation of state-owned companies run into insurmountable resistance in the period? Quite on the contrary, state-owned companies were not under the influence of entrepreneurs' radical objection during World War II, except for some isolated resistance. On the one hand, the investments intended by them were not competitive but complementary to the privileged fields of action of local entrepreneurs (although the same does not always apply to the representatives of subsidiary companies, which at that moment were at least interested in "sitting" on public service concessions that allowed for later exploitation); on the other hand, the expansion of Banco do Brasil's credit portfolio met several current requirements of Brazilian entrepreneurs, even though it kept them a far cry from being "industrial champions" that could lead heavy investments. Thus, bearing in mind the difficulties in privately financing the basic "economic modernization" and the existence of profitable and less risky investment opportunities, the creation of state-owned companies during World War II (financed, far from revolutionary impositions, by foreign loans negotiated by Vargas's diplomacy, by parafiscal funds strictly linked to specific projects and by financial transfers) did not arise as an "act of force" imposed despite resistance – since where state-owned companies intended to make invest-

ments that perhaps would not be possible without them, there existed unwavering entrepreneurial support, in spite of partial resistance (cf. Carone (1977); Diniz (1978); Leme (1978); Boschi (1979); and Bielschowsky (1988)).

But wouldn't the creation of state-owned companies suffer greater internal resistance if it had to rely especially on local tax resources? By the way, one should recall that the initial projects of both *Companhia Vale do Rio Doce* and *Companhia Siderúrgica Nacional* were designated as state-owned but ended up being widely financed, after several negotiations, by the international transfer of U.S. federal funds, reducing occasional pressures on clearly scarce and insufficient fiscal funds¹⁰.

5 Conclusion

That being said, can we say that a "Prussian-style" industrialization funding project was refused at the beginning of the *Estado Novo*, making Vargas's government plead for Pan-American cooperation?

As we could see, there is no evidence that this project had ever been dreamt up or proposed, and much less likely implemented and withheld. Very likely, there would have been strong resistance to a project that sought to concentrate domestic funds to

¹⁰ Several incremental reforms of the tax system have enhanced the importance of the taxes relating to the domestic market and income until 1945; however, in all the years from 1930 to 1954 they were not sufficient even to prevent deficits in the performance of the current budget, let alone to fund public investment budgets which depended on auxiliary funds: compare Villella and Suzigan (1973), pg. 56-7, 185, 222-4, Almeida (1978), pg. 125ff and Draibe (1985), pg. 119ff.

a level that allowed for the autonomous funding of the heavy industry. This resistance was to some extent inherent to the heterogeneous set of interests met by technical or corporative organs created in the 1930s. However, in the short period of time between the beginning of the *Estado Novo* and the U.S. invitation that would result in the Aranha's Mission, there occurred no insurmountable resistance to the processing of some new project that made Vargas suddenly realize the sense of unreality of his supposed "Prussian dream", obliging him to accept help from abroad.

The types of resistance Vargas complained about before and after the *Estado Novo* (localism, liberalism, nepotism, privatism, parasitism and even the cowardice of regional oligarchies) were not new, and it is possible that they were not strongly felt by Vargas only in 1938. In order for the implementation of the supposed Prussian project to be vetoed by resistances that arose after its initiative (such as the ones of the Brazilian Congress in the 1950s, regarding some strategies to overcome "bottlenecks"), this would have demanded that Vargas not anticipate and internalize some political limits to which he might want to go, but if he did, his unrealistic initiatives would not be frustrated *ex post* because they would not have been tried *ex ante*. No matter whether these resistances were anticipated or not or whether the supposed Prussian project was dreamt up or not, the truth is that this project was not withheld after being implemented, since there are no decisions indicating an extreme Prussian/nationalistic proposal implemented right away or resistances from local political struggles which, soon after the proclamation of the *Estado Novo*, could have withheld the processing of some project that represented the "Prussian dream".

Conversely, as we observed before and after the *Estado Novo*, the government administration did not follow the proposals made by

the military, technicians and local nationalistic politicians concerning a state solution to the “iron and steel issue”, exploring the line of attraction of U.S. subsidiary companies (DuPont or US. Steel) or, when these showed no interest, German subsidiary companies (Demag, Krupp and Stahlunion). The insistence of the government upon attracting subsidiary companies was so strong that it had to test the pendulum between rival subsidiary companies twice between 1937 and 1940, before the invitation by Roosevelt to receive official funds for the CSN – state-owned company that could not be created before 1941, not because of local political defeats of the government (but because of defeats of the nationalistic wing regarding the National Committee for Iron and Steel since 1931), and which was only created after 1941 due to the government’s unsuccessful attempt to lure U.S. subsidiary companies and interest in ensuring the Brazilian alignment.

Counterfactual exercises are always problematic, and sometimes totally unnecessary. However, let us suppose that Vargas had espoused the idea of carrying the Prussian project through before he had time to do it, and let us reformulate the way J. L. Fiori understood the Aranha’s Mission in 1939. As widely known, the decision-making process consolidated in the *Estado Novo* was centralized (based on Vargas’s decisions) and excluded uninvited corporate groups – although the government sought to assess the opinions and interests of “summoned” groups in corporative forums for debates and “counseling”. Under the centralized decision-making process of the *Estado Novo*, if the decisions regarding an extreme Prussian/nationalistic proposal were not made after being brought up (much less likely withheld), this was so because a) the government administration reassessed the proposal and found it unfeasible after the first political settlements (supposing it was the most desirable alternative), or b) because an alternative considered to be the most feasible (and more or

less desirable) arose in the late 1930s – before one had enough time to institute the “Prussian dream”. This may be the case of the Pan-American Cooperation, which may have been a timely attempt at a “Prussian-style” development strategy and at the conflicts inherent to it. Under these circumstances, if Vargas had envisaged taking the risk of a radical Prussian/nationalistic pathway at the beginning of the *Estado Novo*, local conflicts for its implementation would not even occur (and, what conflicts actually occurred at that time?), because Vargas had considered the (less politically risky) possibility of accepting the U.S. invitation in order to raise funds for the desired “economic modernization”. In this regard, it does not seem that he was only “pushed” out by the shortage of local financial resources and by anticipated political resistance in case he had to circumvent it by increasing the tax burden; in a given moment, he would have also been “pulled in” (or “captured”, “seized”) by an opportunity that had not developed from his imposition (due to domestic needs), but which arose from a U.S. president’s invitation.

The most optimistic possibility is that the government would succeed in overcoming local resistance and implementing the Prussian strategy later on, had the Pan-American cooperation not emerged so soon, offering less resistance. However, a less optimistic possibility that was not experienced at that time (although the liberal campaign during the crisis of the *Estado Novo* portrays this issue to a lesser degree: Bastos (2001) and Bastos (2004) is that internal political battles necessary for the implementation of a modernization project through the mobilization of local funds would have been lost or not even raged, had there not been the invitation from the U.S. government. In other words, the invitation from the U.S. government would not replace a more nationalistic line of associated industrial development, but it would work sort of a miracle, allowing us to make headway in the heavy industry, given the possible resistance that

would impede more radical financial and tax reforms.

Evidently, it is difficult to infer about the results of battles that were not waged at all. However, it is possible to make a relatively accurate inference that the roots of the Brazilian associated developmentalism, i.e., of an industrialization project aimed at the domestic market but dependent on foreign funding, were established at the moment in which the political centralization of the *Estado Novo* did not coincide with sufficient resources to finance radical nationalistic dreams. In practice, the need for foreign funds obtained through the Pan-American cooperation coexisted domestically with large decentralization of funds aimed at fostering the harmony between heterogeneous interests – a political approach that restricted the centralization of local funds to modernization projects, as may be seen in previous and subsequent moments of the Brazilian history.

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