The Brazilian Federal State in the Old Republic (1889-1930):

Did Regime Change Make a Difference?

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In the last decade of the 19th century, Brazilian statesmen adopted a federal form of government that would become a permanent feature of the nation´s subsequent history. All six Republican constitutions of Brazil¹ have been at least nominally federalist. Even the centralizing Estado Novo dictatorship (November, 1937-October, 1945) did not formally renounce Brazil´s federal organization. The charter of 1891 provided for a wider dispersion of authority than did those of Argentina (1853, revised in 1860) and Mexico (1857 and 1917), the other two large federal republics in Latin America. Both of these countries placed greater restrictions on their states (or provinces) than did Brazil, notably in not allowing their member units to levy export taxes on goods shipped across state lines.

In Alfred Stepan´s distinction between two kinds of federal states—those that “came together” and those that “held together,” Brazil´s first federal regime (1891), though not mentioned by Stepan in his influential 1979 essay,² was one of earliest of examples of the latter kind. The creation of a cohesive Brazilian territorial state was the achievement of the centralized Empire, but the country only “held together” after the

Republican coup of 1889 by meeting the regional demands of Sao Paulo and other southern states.

Stepan views successful “holding together” regime as characterized by special concessions to minority populations (e.g., Spain, Belgium), but this model doesn’t fit Brazil: The federated units in the 1891 and those of subsequent constitutions had formal equality. This outcome was associated with the fact that Brazil is among the world’s largest federal states with a broadly homogeneous culture, and it is the largest federation in the developing world with that characteristic. But the formal equality of the units masked a grossly unequal federalism in practice, based on fiscal arrangements that favored the rich states. Moreover, there was a sharply limited suffrage (only 3 to 5 percent of the population actually voted during the Old Republic), and the judicial system was significantly decentralized. This was the price of holding together.

Nonetheless, if there was a sharp contradiction between laissez-faire liberalism and state-building in Mexico (Tulio Halperin’s “statist liberalism”), the dispersion of judicial, fiscal, and military power in early Republican Brazil provided a more effective state than had the centralized Empire, partly because of the greater extractive powers of the state at all levels. And, paradoxically, the revenues obtained by the state governments were greater, relative to that of the central government, during the fifteen years of the Vargas period (1930-1945) than the ratio of state to federal income in the second half of the Old Republic. During Vargas’s Estado Novo dictatorship (1938-1945) in particular, all state revenues, taken together, were 56% as large as of those of the central government. Between a third and a half of state income belonged to Sao Paulo.

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Paulo’s revenues relative to those of the central government progressively rose from 1901-1910 to the Estado Novo years (1938-1945).^4

This paper discusses institutional differences between Empire and Federal Republic and looks at fiscal operations (central and state revenues, expenditures, and foreign debt obligations) in assessing “stateness.” It also includes a brief look at state intervention in economy and society.

The issue of federalism in the late Empire

The Republican party of Brazil, founded in Rio de Janeiro in December, 1870, from the beginning was committed to a federalist model. The party’s manifesto ended with the motto, “Centralization—Dismemberment; Decentralization—Unity.” The driving force of the republican movement in the next two decades was the Republican Party of Sao Paulo (formally constituted in 1873), and a defining feature of republicanism in Brazil was that each republican organization was coextensive with provincial boundaries: In reality, there was no national republican party.

Paulistas, like Republicans from other states as well as many monarchists, saw the centralized Empire as sucking resources out of their province (to become a state after 1889). Although the republican movement was inspired by the founding of the Third Republic in France in 1870, the content of its program was even more heavily influenced by Aureliano Tavares Bastos’ book of the same year, A Provincia. Although a monarchist, Tavares Bastos persuasively defended the decentralization of fiscal authority,

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^4 Sao Paulo’s state revenues in the first period were equivalent to 11.2% of federal revenues, and an average of 22.6% in the Estado Novo period. The corresponding share for all state revenues was 38.2% in the first period, and 55.7% in the second. Joseph L. Love, Sao Paulo in the Brazilian Federation (Stanford, CA: Stanford U. Press, 1980), table 8.2, p. 265.
and called for provincial control of banking and immigration policies. He held that Brazil should follow the recent examples of two other large states, Austria-Hungary and Canada, both of which adopted federal regimes in 1867. Tavares posed the issue in terms of North vs. South, and calculated that the former was contributing more to imperial coffers than the latter.\(^5\) Recent research by the economic historian Andre Villela shows Tavares was right, if one considers the whole period 1844 to 1889 (from early in the reign of Pedro II to the fall of the Empire).\(^6\) This, despite the collective claim of Paulistas and other southerners that their region was being unfairly burdened. In fact, they received more than the North, partly because of government railroad construction. But both regions were subsidizing the imperial capital.

From the monarchical federalism of Tavares Bastos it was a short step to republican federalism. According to a foreign observer, the province of Sao Paulo by the 1880s was indeed being fiscally exploited the imperial regime: It contributed eight times more to the imperial treasury than it received from it.\(^7\) The imperial government was not redistributing the funds to the economically declining Northeastern states but spending it in Rio de Janeiro, the national capital. Moreover, by the 1880s, Sao Paulo’s representation in parliament was well below its share of Brazil’s population, because no reapportionment had taken place over the life of the Empire.

\(^5\) Aureliano Tavares Bastos, A Provincia (Rio de Janeiro, 1870).
\(^6\) Andre Villela, “Distribuciaco regional das receitas e despesas do governo central no II Reinado, 1844-1889,” Estudos Economicos, 37, 2 (Apr.-June, 2007), p. 247-274. Villela’s starting date is 1844, because systematic data only begin in that year. He uses Tavares’s definition of the North, which consists of the provinces of Amazonas, Para, Maranhao Piaui, Ceara, Rio Grande do North, Paraiba, Pernambuco Alagoas, Sergipe, and Bahia. The remaining provinces constitute the South.
\(^7\) Alfred Marc, Le Bresil: Excursion a travers ses 20 provinces (Paris, 1890), vol. 2, p. 178.
The Republican constituent assembly

A handful of Paulista Republicans, along with the Bahiano Rui Barbosa, participated in the military coup of November 15, 1889, when Marshal Deodoro da Fonseca declared Brazil to be a federal republic. A constituent assembly met in 1890 and approved a constitution early the following year. The guiding hand on constitutional theory was that of Rui, who remarked on numerous subsequent occasions that the model he adopted was that of the United States constitution. He even referred to “the institutions that we copied from the United States.” Rui was familiar with the Federalist Papers, but it seems unlikely that he delved very deeply into the history of federalist theory, which goes back to Althusius (1603).

The constitutional convention never questioned the proposition that the new regime should be federalist in organization; rather, the focal issue was the degree of decentralization of political and fiscal powers. In the extensive debates, there were loose coalitions of northern and southern states, but some units, notably Rio Grande do Sul, occasionally joined the north to vote against the coffee interests of Rio de Janeiro, Minas Gerais, and Sao Paulo.

The most important single fiscal issue at the assembly was the distribution of revenues between the Union and its component states. Rui Barbosa had played the leading role in the “commission of 21” (representatives of each state and the federal district) that had presented a draft to the constitutional convention. Rui had defended the

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9 The following discussion of the constituent assembly’s debates is based on my own notes on the three volumes of the published transcript. See Brazil, Congresso constituinte da República, 2nd ed., (Rio, 1924-1926).
position of the provisional government, in which he was the dominant figure, calling for a strong Union based on ample revenues. He argued that adequate financing was imperative if Brazil was to win over foreign investors and bondholders. The chief challenges to Rui’s plan came from Julio de Castilhos of Rio Grande do Sul and Lauro Muller of Santa Catarina. Castilhos, who had represented his state on the commission of 21, wanted all taxing powers not specifically granted to the federal government reserved for the states. The specific levies were those agreed on by the commission, namely, import duties, duties on the entrance and exit of foreign ships, stamp taxes, and telegraph and postal fees. But Castilhos’ proposal failed by a vote of 103 to 123, with most northerners voting for it, and Paulistas against it, because the latter delegation believed they could obtain adequate state revenues through other means, and because they wanted a strong central state to represent their interests abroad.

Lauro Muller proposed that a 15% ad valorem rate be added to federal import duties for the states for five years, renewable, if Congress agreed, in 1896. The northerners, led by Pernambuco’s Rosa e Silva, argued that the southern states might be able to tax agricultural properties and exports, but that the depressed markets for cotton and sugar made these duties non-options for the Northeast. In the larger “North” only Amazonas and Para, exporters of rubber and cacao, would benefit from export taxes, held Rosa e Silva. Like Muller, the Northeastern delegates defended a fixed share of import revenues (the central government’s single most important tax) for the states.

After an initial tie vote, Muller’s measure failed, with Bahia’s delegation (including Rui), Pernambuco, and the rest of the North voting aye, and Sao Paulo, Minas, and Rio Grande voting nay. The final vote was 92 for, and 110 against. In the end, the
states were allotted the right to tax exports. The states gained exclusive rights to the (overseas) export duty (usually the second largest income-earner under the Empire), the transfer tax on property, the urban real estate tax (decima urbana) and licensing fees (industrias e profissoes). The great beneficiary of the export tax was Sao Paulo, whose state revenues from 1891 to 1892 tripled, in constant terms. The states were also given the right to contract foreign loans. Such powers were denied to the Mexican states under the constitution of 1917. The Brazilian states furthermore received title to government-owned lands (terras devolutas) within their boundaries, and the right to alienate them. This authority was of major importance to Sao Paulo, with its expanding coffee frontier, but also to most other southern states. It meant little or nothing to the northeastern states, some of which had no public lands at all.

As regards representation in congress, Epitacio Pessoa10 of Paraiba, a state both poor and small in population, called for an equal number of deputies for each state: “The general interests [of the nation] are the sum of the interests of the states,” he declared. The Paulista plan, calling for representation in the Chamber proportional to the population of the states, was the one that carried. For the presidency, the commission of 21 had proposed an indirect election by Congress. It was Castilhos of Rio Grande who proposed that the president be elected by direct popular vote. Because the literacy requirement for suffrage had already been agreed on, this plan was accepted by delegates from the relatively literate and populous South. The proposition carried narrowly, 88 to 83. The commission had also proposed indirect elections for senators, and again

10 Because of an impasse between the Republican parties of Sao Paulo and Minas Gerais in 1919, the two parties agreed to accept Pessoa as president at the initiative of the Republican party of Rio Grande do Sul. See below on Pessoa as president.
Castilhos offered an amendment for direct elections. The measure prevailed with less opposition, since it did not affect the relative position of the states. (Each state was allotted three senators.)

**The Federal Republic in practice**

The new constitution, promulgated on February 24, 1891, offered a greater decentralization of fiscal and even military authority\(^\text{11}\) than did the federal constitutions of Mexico and Argentina. In this respect, Brazil was an outlier in the period of Latin American history that Claudio Veliz calls the “liberal pause.”\(^\text{12}\) Regionalist politics (that is, pursuing self-serving policies and patronage the expense of other federal units) was enhanced by the fact, as noted, that political party organization was coextensive with the states. Furthermore, direct election of the key post of the presidency meant that the Republican Parties of Sao Paulo, Minas, and later, Rio Grande do Sul, could combine to dominate the political system. The three machines could deliver overwhelming majorities in their respective states. Together, the three states’ Republican parties could elect a president. He, in turn, could control congress through the manipulation of the credentials committees of that body.\(^\text{13}\)

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\(^{11}\) The states were allowed to create their own state police forces that, in the case of Sao Paulo, amounted to a state army by the 1920s. By that time, the Forca Publica possessed artillery, armored tanks, and airplanes. It had even contracted a foreign military mission years before the army did so (French missions of 1906 and 1919, respectively).


\(^{13}\) In early 1900 President Manuel Campos Sales, a Paulista, instituted the politica dos governadores as a means of ensuring that the president would always have a majority in the Chamber of Deputies. To achieve this end, he pushed two procedural changes through the Chamber. One effectively gave the president control of the Chamber's credentials committee. The second required that a majority of county councils in each congressional district certify the winner's vote. Since the establishment party at the state
What did the regime shift from Empire to Republic represent? Disabused Historical Republicans--those who had agitated for the Republic during the Empire--were wont to say, "It wasn't the Republic of my dreams," just as Alphonse Aulard said of the Third Republic, "How beautiful was the Republic under the Empire!" On the centenary of the Republic in 1989, Francisco Iglesias, the distinguished Mineiro historian, wrote in O Estado de S. Paulo, "...in fact, the Republic for its chief creators was a *journée des dupes*. Political practice did not annul any of the fundamental vices of the previous regime." He pointed to the continued, even enhanced, power of rural senhores and coronelismo (bossism in the countryside). The conciliation of competing elites continued, but the people (povo) were excluded, or more precisely, it was manipulated to legitimate and sustain the existing power structure as Brazil passed from monarchy to republic.

The great national problems remained unaddressed: No one considered agrarian reform, then more necessary than ever, in view of the [only] apparent emancipation of the former slaves [after 1888]....

level supported local politicians and vice versa, this was another safeguard against the entry of noncompliant deputies into congress.

Campos Sales introduced the *politica dos governadores* to guarantee congressional support for fiscal and monetary policies required for the Rothschild Funding Loan (1898), consolidating Brazil's external debt. These included such unpopular measures as raising taxes, shrinking both the currency in circulation and government expenditures, and placing a lien on customs collections for Rothschild. Thus the *política* was an adaptation of formal democratic structures to political conditions in a neocolonial economy.

14 The original use of the phrase *journée des dupes* refers to Richelieu’s outmaneuvering his enemies and retaining the authority given him by Louis XIII in 1630. Its first use in Brazil referred to the frustration of the radicals (exaltados) as the moderados took over the Brazilian government on the abdication of the first emperor, Pedro I (7 April 1831).
Citizenship remained restricted to the few…. Resistance to change had won out again, and the essence of the social order wasn’t altered.\textsuperscript{15}

In her widely-influential \textit{Brazilian Empire: Myths and Histories}, the historian Emilia Viotti da Costa eloquently expressed the widely-held view that the transition made little difference to the citizenry. Viotti wrote

\begin{quote}
The main difference [between Empire and Republic] was that the traditional rural oligarchy had been supplanted by a new one: the coffee planters of the [Paulista] West and their allies, who, once in power, promoted only those institutional changes that were necessary to satisfy their own needs. November 15 was thus a \textit{journee des dupes} for all the other social groups who had hoped that the Republic would represent a break with tradition.\textsuperscript{16}
\end{quote}

In the words of Giuseppe Lampedusa (\textit{Il Gattopardo}), things must change in order to remain the same. But is the received interpretation, which was widely diffused no later than Campos Sales's consolidation of the politica dos governadores in 1902, the definitive judgment?

Granted, the change of regime in 1889 was not the October Revolution. Yet the shift made possible a greater realization of what modern states are supposed to be about: Not that the Republic was so much, but that the Empire was so little. Let us consider several aspects of what modern states are supposed to do: First of all, to provide the financial resources to achieve social change, as well as providing the economic

\textsuperscript{15} \textbf{O Estado de S. Paulo}, 11 November 1989.
infrastructure to pay for them. Fundamental social changes include greater educational
opportunity, and improvement of the health of the population

To address these matters it is necessary to examine the fiscal history of the central
government and the provinces (later, states) before and after the change of regime in
1889). A methodological issue immediately arises, namely, what deflator to use. I have
employed those indexes by Luis Catao and Claudio Haddad, widely regarded as the best
currently available.\textsuperscript{17} Catao’s index begins in 1870 and ends in 1913, overlapping
Haddad’s, which begins in 1908. During the six-year period they both cover, they
behave very similarly, and I have employed Haddad’s index from 1914, adjusted to
Catao’s scale.

Taking up the issue of fiscal reach first, we should not neglect the spatial aspects
of an Imperial state that theoretically covered nearly half the South American continent.
Even at the end of the regime, in 1885-87, the central government collected 54 percent of
its revenues in the capital (municipio neutro), and spent 73 percent there. Fiscal
"stateness" was thus basically confined to the city of Rio de Janeiro. Admittedly, the
central government of the Republic was also macrocephalic, and 52 percent of its
revenues were collected in Rio during its first decade of existence. Likewise, on a per
capita basis, central government expenditures remained unchanged from 1882-89 to
1892-99 (1892 being the first fiscal year the new federal system was in effect). But
spending by the states under the Republic advanced rapidly. Using the price index
developed by Catao as a deflator, we find that for the years 1882-89, real provincial

\textsuperscript{17} See Luis A. V. Catao, “A new wholesale price index for Brazil during the period 1870-
530); Claudio L. S. Haddad, Crescimento do Produto Real no Brasil 1900-1947 (Rio:
Fundacao Getulio Vargas, 1978), table 76, p. 166.
expenditures were only 24 percent as large as those of the Imperial government, while in 1892-99, state outlays were 56 percent as large as those by the federal government regime; revenues displayed a similar trend (26 and 55 percent). Spending by the Brazilian states rose even faster relative to federal expenditure after 1900.

It was not only Sao Paulo and other dynamic southern states that profited from the new fiscal system. Deflating the state (formerly provincial) revenues and expenditure for the periods 1882-89 and 1892-99 shows that all states experienced net gains in both income and outlay with the advent of the Republic. This finding implies that the areal diffusion of fiscal "stateness" advanced significantly with the change of regime. Beyond that, the fiscal powers of combined levels of government expanded significantly. Raymond Goldsmith has found that the government share of GDP (including federal, state, and municipio receipts) rose from 10.2% in 1885-86 to 16.4% in 1907.18

The states gained on the federal government in terms of tax resources and spending in every decade from the beginning of the century through 1940. Sao Paulo’s share rose fastest, pioneering in education and social welfare into the 1930s, but total state revenues and expenditures without Sao Paulo were also rising vis-a-vis the federal treasury, albeit less rapidly. The proper emphasis, I believe, is on both state and federal fiscal policies, as government responsibility in economy and society rose at both levels. Although the U.S. government was apparently less fiscally centralized than that of Brazil on the eve of World War II, Brazil's central government during the allegedly centralized Estado Novo dictatorship raised and spent less of government totals than Canada's or

18 Goldsmith, Brasil 1850-1984: Desenvolvimento financeiro sob um seculo de inflacao (Sao Paulo: Banco Bamerindus, 1986), p. 71. The figure had fallen to 12.5% in 1929 and rose again to 13.2% in 1945 (p. 71).
Argentina's federal governments in 1940. While Brazil was legally a unitary state and Mexico a federation in 1938-45 (i.e., during the Estado Novo years), the ratio of state to central government revenues in Brazil was more than three times the ratio prevailing in Mexico in that period.

On the expenditure side of the ledger, the new Federal Government did little for the lower classes beyond extending education and public health measures, but it was highly interventionist by the laissez-faire standards of the day. Its public works and coffee valorization programs are well known, but less well known are the relative dimensions of government income and outlay. Comparing the federal budgets of Brazil and Mexico between 1890 and 1910 (and omitting the larger Brazilian expenditures at the state level), Steven Topik discovered that Brazil's government was able to raise and spend twice the money per inhabitant (in dollar terms) attained by the autocratic regime of Porfirio Diaz. Topik writes: "The greater activism of the Brazilian state is perhaps surprising in light of the popular image of the Porfirian state as robust and centralized, and the Republican state in Brazil as weak and splintered into semiautonomous cantons."19

Another instance of rising state power in the new regime was that of external financing. The enhanced access to hard currency meant greater access to the economic infrastructure--railroads, utilities, and port facilities--necessary for export-driven growth (the model adopted by both Empire and Republic). The value of Brazil's foreign loans (federal, state, and municipal) increased five times, in sterling terms, between the last

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year of the Empire and the outbreak of World War I. In 1889, virtually the whole of the Empire’s total foreign debt was a central government debt. Under the Republic, the Union borrowed at a rapid rate, but the members of the Federation did so at a faster pace, so that in 1933, when foreign borrowing had come to an end, Sao Paulo and its subunits (Sao Paulo city and Santos) accounted for 21 percent of the total foreign debt, and the Union, 60 cent.  

The debt situation of the states reflected their ability to borrow (based on potential export earnings) but also the daring of their state leaders. After the complex valorization transactions of 1906-08, Sao Paulo undertook by itself to protect the price of coffee on the international market, financing the operation overseas, in a process that began a long effort by both the state and the Union to maintain monopoly pricing. The federal government assumed responsibility for valorization in 1921, returned that task to the state of Sao Paulo in 1924, and took it over once more in 1931, assisted this time by Sao Paulo. That enterprise would involve both units into the 1940s, despite its failure after 1929.

By the outset of the Depression, Sao Paulo's debt amounted to half that of all the states and, despite the Union's intervention in the coffee market, the Paulista debt averaged a quarter as much as the federal debt between the outset of the Depression and the Estado Novo. By taking out huge loans for coffee support and others for more conventional purposes, Sao Paulo's leaders chose to forego a heavy reliance on the federal government (useful to Minas and inevitable for most states), opting instead for dependence on foreign creditors. Thus, in an array of dependencies, Sao Paulo preferred

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20 Love, Sao Paulo, p. 248.
a clientage to overseas lenders, a situation that provided political options within Brazil not available to other states. All the same, in the Great Depression Sao Paulo turned to the federal treasury, and got much of what it wanted: Half the Bank of Brazil's outstanding loans in 1937 to the federal government were for matters related to coffee defense. In addition, Sao Paulo by that year had garnered half the Bank's loans to the state governments, and two-fifths the Bank's loans to private concerns. (This was in addition to the Vargas government's cancellation of half of coffee planters' debts in 1933, in the Economic Readjustment. 21

It was that same state government, rather than the Union, that initiated programs in public health. Sao Paulo's leaders realized that immigration was an essential element in their agricultural development model, and they quickly discovered that investment in public health was required to attract the targeted European population. In the second decade of the Republic, such measures were taken by many other states and the federal government in Rio: The campaign against yellow fever in the national capital under President Rodrigues Alves (a Paulista) was a response to a previous campaign in the state of Sao Paulo. True, this would not have been possible under the Empire, since the etiology of yellow fever was not yet known, but Sao Paulo had already shown its ability to control an epidemic of bubonic plague early in the new regime. We have some indication of what the Imperial regime could do regarding public health from its behavior in the great drought in Ceara and neighboring provinces in 1877-79. The central

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21 See Love, Sao Paulo, p. 51.
government tried to provide relief, but the dinosaur-like state machinery had almost no
effect at all on the problem, and 200,000 people in the Northeast starved.\textsuperscript{22}

Other evidence further suggests that the Republican regime had a greater impact
on the health of the Brazilian population than its predecessor. Over the period 1872-90,
average life expectancy improved only 1 percent, while in the following decade, under
the Republic, it improved 7 percent, though still only rising to 29.4 years. General
Brazilian mortality rates fell from 30.2 per thousand in 1872-90 to 27.8 in 1891-1900, a 9
percent difference.\textsuperscript{23} (And this, before the federal government’s campaign against yellow
fever.)

In education, as in public health, Sao Paulo state pointed the way, partly because
its leaders viewed a healthy and productive labor force as dependent on basic literacy.
By 1912 Sao Paulo alone (in constant terms) was spending almost as much on public
education as the Empire as a whole--central and provincial governments together--had
spent per annum in the late 1880s.

At the national level, progress in education, as in public health, must be judged
against the miserable situation bequeathed to the Republic by the Empire. In 1886 there
was only one student in primary or secondary school for every 75 Brazilians (and most
students were in private schools). This situation was worse than that of the previous
census year, 1872, when the ratio was 1 to 68, compared to 1 to 5.5 in the United States
at that time. By 1907 the ratio in Brazil was 1 to 33, better than twice the Imperial rates

\textsuperscript{22} For a study of the drought and the imperial government's ineffective efforts to succor
\textsuperscript{23} Eduardo Arriaga, \textit{New Life Tables for Latin American Populations in the Nineteenth
Moreover, the number of primary pupils in Brazil doubled between 1887 and 1907. As for literacy, the available census data indicate a slight decline in the last eighteen years of the Imperial regime—from 16 percent in 1872 to 15 percent in 1890 (for all persons five and older). By 1900 the rate had risen to 26 percent.

In higher education, the number of faculdades (professional schools) expanded significantly beyond the half-dozen of all sorts bequeathed by the Empire, as more states demanded institutions of higher education within their borders. By 1908 there were 25 such institutions in Brazil (12 public, 13 private). Note that Getulio Vargas and his generation of political leaders in Rio Grande (Flores da Cunha, Joao Neves, Osvaldo Aranha, etc.) studied law in Porto Alegre, while the previous generation (Julio de Castilhos, Pinheiro Machado, and Borges de Medeiros) had studied in Sao Paulo and Recife.

Recent evidence on the differences between Empire and Republic

In the last dozen years, economic studies have tended to support the thesis of constructive change as Brazil passed from Empire to Republic. Consider Stephen Haber’s “Financial Markets and Industrial Development,” a comparative study of Brazil and Mexico. He points out the unpredictability of regulatory policies under the Brazilian Empire, showing how the regime further impeded corporate ownership with unlimited liability for stockholders. Two months into the new regime, Rui Barbosa introduced limited liability, deregulated the banking industry, and offered fiscal incentives to new companies. Although the euphoria of the Encilhamento boom changed to pessimism with the sharp bust in 1891, Brazil enjoyed a relatively large and well-integrated capital

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24 Love, Sao Paulo, p. 93; IBGE, p. 5.
market by the latter years of the Old Republic. Mexico, by contrast, had much weaker
capital markets and much less-widespread corporate ownership (4% of companies
chartered in Mexico City vs. 18% of those in Rio). Furthermore, opening capital markets
in Mexico tended to increase concentration of corporate ownership, while in Brazil, it
broadened participation. Haber speculates the difference might be explained by the
market-distorting cronyism of the Porfiriato.25

Nathaniel Leff’s “Economic Development in Brazil, 1822-1913” in the same
volume contends that Brazil grew slowly in the nineteenth century in part because of
crippling transport costs, in particular owing to a meager rail network. This in turn owed
significantly to insufficient state support of development under the Empire (1822-89).
After the Republic replaced the Empire, the combined levels of government disposed of
greater taxing powers, which was used in part to stimulate railway construction.
Domestic agriculture and industry benefited, along with coffee.26

It is well known that the Empire’s lack of legislation permitting limited liability in
joint stock companies hampered economic development. In Anne Hanley’s words, the
imperial statutes of 1849, 1869 and 1882 “either gave the government extraordinary
oversight of private firms or saddled investors with unlimited liability.”27 In the
Republic, Sao Paulo’s economy moved from financial dependence on merchants and

Latin America Fell Behind: Essays on the Economic Histories of Brazil and Mexico,
26 Nathaniel Leff, “Economic Development in Brazil, 1822-1913” in Haber, How Latin
America Fell Behind, pp. 34-64.
27 Anne Hanley, Native Capital: Financial Institutions and Economic Development in
Sao Paulo, Brazil, 1850-1920 (Stanford, Calif.: Stanford U. Press, 2005), p. XX.
money-lenders to a modern array of dozens of banks and two stock exchanges. This was chiefly result of government regulatory policy.

Gail Triner’s Banking and Economic Development\(^{28}\) contributes to a rising perception that the Old Republic was a crucial period of state-building in Brazilian history, and was far from being “more of the same”—that is, an extension of the institutional history of the Empire. Like other studies cited here, Triner’s findings also imply that the Vargas years (1930-1945) did not create modern Brazil \textit{ex nihilo}.

The creation of a currency board in 1905 to buy and sell national currency (the mil-reis) at a fixed rate of 15 pence, along with coffee valorization, helped the national treasury obtain foreign loans. The government-associated Banco da Republica was reorganized the same year as the Banco do Brasil, a commercial bank acting as the agent of the federal government; the Bank slowly withdrew notes from circulation and raised foreign and domestic investors’ faith in the financial system. Thus the Republic’s “modern banking system” came into in place in 1906, even though an authentic central bank would only arrive in 1945\(^{29}\).

By 1930 the new banking system could claim these achievements: 1) Deposits in foreign banks fell from 37% of the whole in 1907 to 19% in 1930. 2) Overall deposits rose thirteen times (in real terms) during this period, whereas GDP only increased 2.5 times. Brazil was seriously “underbanked” in 1906, and bank deposits represented only 3% of national income; by 1930, the share had risen to 18%. 3) Though the Banco do


\(^{29}\) The Superintendency of Currency and Credit (SUMOC). It met the requirements of a modern central bank—controlling the interest rate and money supply, and serving as a lender of last resort to the commercial banks.
Brasil was not a real central bank, it was generally able to pursue an effective countercyclical policy in its supply of currency, helping to smooth out the business cycle. 4) Bank deposits as a share of money supply rose from 20% in 1906 to 68% in 1930. This development, related to item 2), was important because it showed increasing public confidence in the banking system, lowering the cost of borrowing, and raising the efficiency of the economy. 5) Finally, the growth of the Banco do Brasil and the broader banking system expanded the power and legitimacy of the Brazilian state. 30

And yet, there may have been a downside to these significant gains. Andre Martinez-Fritscher and Aldo Musacchio, in a forthcoming paper, have argued that the constitutional framework of the Old Republic was a weighty determinant in shaping the Brazil of our own day, with its long history of impressive growth before the “lost decade”—about 3% a year of per capita GDP from 1900 to 1980 31--coupled with extreme interpersonal and interregional inequality. Addressing interregional disparities, they offer a revisionist challenge to the prevailing orthodoxy that Latin American regional inequality is traceable to the colonial period. 32 In opposition to the orthodox position, Martinez and Musacchio argue that regional inequality is in significant measure traceable only back to the first Republican regime. According to these authors, the reservation of major revenue streams for the leading exporting states under the constitution of 1891 structured the inequality characterizing the relationship between the per capita incomes of

30 Triner, passim.  
the Brazilian Northeast and the Center-South (Sao Paulo, Rio de Janeiro, and Minas Gerais). Natural endowments mattered, of course, but the “extreme” form of federalism adopted in 1891, coupled with the commodity boom of the period, allowed the fortunate states to collect taxes that were in turn invested in public goods, including public health and education. These measures coupled with rich endowments (Sao Paulo’s tera roxa soil and warm, but not hot, annual temperatures on the planalto) ultimately yielded payoffs in higher per capita incomes, differentiating the exporting states (coffee growers, and, for a time, rubber exporters as well) from the rest. Relatively high revenues per capita in turn led to differentials in the cost of foreign capital. More investments at lower rates of interest led to more growth in the favored states in a kind of cumulative causation. Of course, this doesn’t mean that a centralized state would have achieved the growth rates that the federal regime actually attained, so greater regional equality might have been obtained at the cost of lower overall growth. Whether a more centralized regime could have pursued an effective regional income redistribution policy is also doubtful. The Northeast development program of Epitacio Pessoa (President, 1919-22) was a failure, and regional income redistribution schemes adopted in the first forty years after 1945 were also without great effect. But a counterfactual outcome in which similar rates of economic growth with better a regional distribution of income are not necessary for the Musacchio-Martinez Fritscher argument to be valid.

Concluding remarks

To sum up, the change of regime in 1889 had complex and significant effects that are still being identified and examined. I do not deny that established economic interests

33 This thumbnail sketch of their argument is based on Martinez-Fritscher and Musacchio, “Can Endowments Explain Regional Inequality?” MS, 2009.
controlled the Republican regime more directly and effectively than the Empire. The monarchy did not respond adequately to the opportunities implicit in the boom in world trade generated by the Second Industrial Revolution in the North Atlantic basin after 1880, and powerful provincial interests consequently declared for a federal system. The feebleness of the old regime in implementing economic and social policy perhaps contributed as much to its collapse as its lack of attention to specific regional interests. The Empire was the paper leviathan. The Republican regime of February, 1891, did make a difference. It just wasn't enough, and may have contributed to the regional inequality of income that characterizes Brazil today.