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New State Activism in Brazil and the Challenge for Law

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Authors' Note

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The last decade has seen a shift in government policy in Brazil. Emerging from a limited experience with neo-liberalism, the country has embraced new forms of state engagement in the economy and social relations. Observers have dubbed the resulting constellation "new state activism" (NSA), a term which suggests neither a return to the past or a clearly consolidated alternative "model". These changes are influencing developments in the law and form the context for the case studies in this volume. In this chapter we trace the emergence of NSA, identify its salient features, note how it differs from prior forms of state intervention, explore some of the forces that have shaped this new form of state action, and provide a preliminary assessment of the significance of these developments for the law.

1. Introduction: from the "long 1990s" (1988-2004) to the new state activism

In 1988, after twenty-four years of military dictatorship and in the middle of a hyperinflation[1], Brazil passed a new constitution that has influenced policy ever since. The 1988 Constitution is a social-democratic document that includes both civil, political and social rights and a number of specific policy goals like building a free, just and solidarity society, fostering national development, acquiring technological autonomy, eradicating poverty and marginalization, and reducing inequalities. Many of its provisions have direct effect on government policy and budgetary allocations.

In 1989, immediately after the new constitution came into force, President Collor de Mello was elected. Adopting a rhetoric based on the need for "modernization", he abruptly started a liberalization process that included drastic tariff reduction, privatization, as well as flawed attempts to control inflation[2]. Under Itamar Franco, the vice president who replaced Collor after he was impeached, a stabilization plan (*Plano Real*) was successfully adopted and inflation finally controlled.

[1] In January 1990 inflation in Brazil reached 56% per month, raising to 73% in February and peaking at 84% per month in March - see Bresser & Nakano (1991: 89). During the same period, inequality reached its worse level ever since it started to be measured (the Gini coefficient peaked at 0,647, according to IBGE, the Brazilian Office of Statistics).

[2] Paradoxically enough, Collor harshly confiscated savings and deposits owned by Brazilian citizens. This controversial measure has raised several discussions in the Brazilian judiciary.

Franco's Minister of Finance, Fernando Henrique Cardoso, known popularly as FHC, became the next president in 1994. During Cardoso's eight years in office, Brazil continued to move away from the *dirigiste* policies of the "developmentalist" period, embracing many of the neo-liberal prescriptions favored by the Washington Consensus[3]. State owned-enterprises were privatized, direct subsidies for certain industries scaled back, areas of the economy deregulated, import barriers reduced, competition fostered, intellectual property rights tightened, bilateral investment treaties protecting foreign investors signed, and fiscal responsibility enhanced. Macroeconomic stability was attained, the bureaucracy reformed, regulatory agencies created, and a few new social policies adopted. To carry out privatization and encourage foreign investment, the Cardoso government had to get Congress to make several changes in the Constitution. But while the country took on board some ideas from the Washington Consensus, it did not wholeheartedly embrace neoliberalism. Privatizations were limited, Banco do Brasil, BNDES and Petrobrás, three major state-owned enterprises, remained under government control. The bilateral investment treaties were never ratified.

To fully understand the long 1990s and the context from which Brazil's New State Activism emerged, it is important to look more closely at the nature of the 1988 Constitution and the policy changes enacted by the Cardoso administration.

1.1. The new democratic Constitution of 1988

During military rule (1964-1985) political parties and social movements were repressed. When the constitution-making process started, there was an eruption of social-political demands that had to be accommodated. Not surprisingly, the result was nicknamed "the citizen's constitution". This "citizen's constitution" not only included an extensive charter of civil-political and social rights; it also reframed public-private relationships. The Constitution included provisions guaranteeing the rule of law, protecting individual rights, and guarding against arbitrary state action. But it also created positive rights that could impose policy obligations. Thus the 1988 charter included rights to health, education, housing, social protection

[3] Like several other Latin American developing countries, Brazil has had its classic developmentalist moment. From 1930 until the end of the 1980s, economic policies basically consisted of state-led initiatives to promote import substitution, industrialization and growth through the use of "economic law" tools such as state-owned enterprises, economic planning, price control, sectorial regulatory and administrative authorities and the use of tax and financial incentives.

and pensions. These have helped shape a new and complex welfare system including a massive public health system and a system of universal pensions. And this has had a major impact on the role of the state and on patterns of government spending[4]. Instead of cutting back on social spending as many countries did during the 1990s, in this period Brazil increased the percentage of GDP devoted to social protection[5].

Besides bringing social rights and shaping social policies, the new constitutional regime has reframed public-private relationships with consequences for the business environment. The constitution initiated a process of “Weberian deepening” by professionalizing state administration. Until the 1930s, all public employees were hired through the “spoils system” of political appointments. A partial reform instituted meritocratic selection for some key agencies like BNDES and the Foreign Ministry but left most government jobs subject to political appointment. The 1988 Constitution carried the reform much further, requiring that all public employees be selected through “republican” processes and capping state salaries. The Constitution also significantly affected relations between the state and business. It required competitive bidding for all state purchases and made the process more transparent. The new charter also empowered the special federal prosecutors (*Ministério Público*) to take action against corruption and enforce laws protecting consumers and the environment. Finally, the constitution protected individuals and business against regulatory takings and expropriation without compensation.

1.1. Moderated neoliberalism

While the new constitution embraced social-democratic values and norms and some “developmentalist” ideas, during the 1990s Brazil flirted with neoliberal policies. After a tragic attempt by President Collor de Mello to control inflation, President Itamar Franco and his Minister of Finance Fernando Henrique Cardoso launched in 1994 the *Plano Real*, a macroeconomic stabilization effort that eventually managed to control inflation in Brazil[6].

[4] See Castro & Carsoso Jr. (2005).
[5] See Castro &Afonso (2009).
[6] In 1999 Brazil officially adopted an inflation target system (currently the target is 4,5% per year).

Cardoso became president in 1995 and started a more systematic liberalization plan that included privatization, establishment of regulatory agencies, openness to the international trade, adoption of TRIPS (the WTO intellectual property-rights agreement), fiscal austerity, and high interest rates to attract foreign investment. One of his first acts was to get the Congress to remove some provisions in the 1988 Constitution that enshrined "old developmentalist" policies. This included eliminating rules that preserved state monopolies in oil, gas and telecommunications and those that placed restrictions on foreign investment[7].

Under Cardoso Brazil experienced strong devaluations of its currency (the *Real*) as a result of a harsh international crisis (Mexican, Russian and Asian). To handle that, the government raised the interest rate to a very high level and this hindered growth. On the other hand, the FHC government managed to embed Brazil in the world economy through trade liberalization and in 2000 ensured fiscal austerity by passing the "fiscal responsibility" act.

Influenced by the principles of new public management, in 1995 the Cardoso government sought to replace Brazil's inefficient mix of bureaucratic public administration and clientelist/patrimonialist practices with a "new public administration". The "state reform" plan distinguished three types of activities: those exclusive to the state which would remain within the control of the executive; those like scientific research and social protection which could be transferred to the non-profit sector with state guidance and support; and those involving production of goods and services for the market that should be handled primarily by the private sector. The reform also created more leeway for outsourcing state functions to specialized entities including "social" non-profits[8].

Under Cardoso Brazil accelerated the privatizations initiated by Collor and Itamar Franco[9]: In 1997, Vale do Rio Doce, a major state owned mining and steelmaking company and Sistema Telebrás, the public-owned telecommunication conglomerate were sold. In the same year, several electricity and gas distribution companies, as well as some state-level banks, were transferred to private owners. During his eight years as president, FHC raised approximately US$ 79 billion through privatization. However, Petrobrás, the Brazilian state oil and gas

[7] Peixoto (2012)
[8] The strategy segregated core activities that should be performed by politicians and senior officials from support activities that may be outsourced, separating policy formulation from policy execution, granting more autonomy and accountability to services performed by the state, which will take the form of either "executive agencies" or that of "social organizations," that is a special type of nonprofit. See Bresser-Pereira (2003).
[9] Franco privatized CNS, an important steel company, in 1995.

company, was not privatized, nor were the three large federal Banks: Banco do Brasil, Caixa Econômica Federal and, the national development bank known as BNDES. Indeed, BNDES played an important role in facilitating privatization by offering credit to buyers, both domestic and international.

As part of the reform, Brazil adapted the US model of regulatory agencies to supervise and enforce post-privatization rules and introduce competition in natural monopolies. As a result, electrical distribution, fixed telecommunication networks and transportation (railways, highways, waterways) were subject to a new legal and institutional framework that substantively changed the patterns of administrative law[10]. New licensing and concession agreements were signed.

The Cardoso administration rejected the idea of industrial policy, long a mainstay of Brazil's developmental state. Finance Minister Pedro Malan said that "…the best industrial policy you can have is not to have one". BNDES, which for decades had provided financing to targeted sectors and supported many state owned enterprises, shifted to support of privatization. Rather than trying to support priority sectors, the government focused more on increasing the efficiency of government services and reforming credit markets. For example, starting with Cardoso and continuing into Lula's first term, the Brazilian central bank sought to reduce the cost of credit. Among the measures undertaken were improvements in bankruptcy procedures and debt collection[11].

The Cardoso period also saw important changes in social policy. Traditionally, the Brazilian welfare state has been regressive, clientelistic and opaque. Between 1994 and 2002 the federal government took a number of measures aimed at transforming this system. This included adding poverty-alleviation programs aimed at specific populations; introducing non-contributory social protection programs; decentralizing social policy implementation; and tackling some of the regressive features of the pension scheme[12].

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[10] The Brazilian administrative law is deeply influenced by the French administrative law. Concepts such as "public service", "administrative act" and "public interest" has to be, thus, revisited and reconciled with the Anglo-Saxon regulatory jargon whose key-words include "regulation", "price cap", "standard setting", "accountability", etc.

[11] According to Fabiani, during the 1999-2006 period the law behind the government's microeconomic agenda was seen as an instrument to protect creditors and ultimately promote economic efficiency See Fabiani (2011).

[12] Almeida (2004) explians that during Cardoso's first term some changes in universal social polices partially confronted the regressive feature of the Brazilian pension system (a constitutional amendment has changes the minimum age and the period of contribution for retirement), although the problematic topic of public servants' pensions – a major source of inequality in the country – remained untouched.

The Cardoso government initiated the use of conditional cash transfers (CCTs). For example, the *Bolsa Escola* Program, implemented 2001, aimed to increase access to education and reduce poverty in the long run, reduce poverty in the short term by transferring cash to impoverished households, reduce child labor and serve as a social protection network. Inspired by successful experiences at the local level, the federal *Bolsa Escola* program reached more than 5 million families by 2003 when, under Lula, it was incorporated into the *Bolsa Família* Program. Other CCT programs widened the scope of protection and helped build a multi-level public-private network of providers[13].

Another important development in this period was LOAS (the Social Assistance Act). Initiated under Itamar Franco, LOAS was implemented by FHC. It seeks to ensure that public policy will guarantee "minimum social standards." It is non-contributory and arguably treats social assistance as a right. LOAS set as goals protecting households, mothers, children, adolescents and the elderly; assisting underprivileged children and adolescents; promoting their integration into the labor market; and training and rehabilitating persons with disabilities and promoting their integration into the community life. The scheme established a multi-level system of social protection involving federal, state, and local governments[14].

1.3 NSA emerges

In 2002 Luiz Inácio Lula da Silva was elected. For two four-year terms, his government preserved some of the policies set by FHC's administration (such as inflation control and openness to foreign investment) while changing others by adopting state-activist initiatives including an active industrial policy and a massive poverty fighting program. In 2010, thanks in part to Lula's personal engagement and support, Dilma Roussef became the first female Brazilian president. Generally speaking, Dilma has maintained Lula's priorities.

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[13] Programs such as PETI (to eradicate children work), Bolsa Alimentação (designed to provide access to food), Auxílio-Gás (to ensure access to natural gas for cooking), Programa de Apoio à Agricultura Familiar (designed to support small-scale family agricultural activities), and Programa Saúde da Família (healthcare to poor families). Like Bolsa Escola, these are all cash-transfer initiatives managed by the federal level

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

Since Lula took office we have seen some modification of FHC's more neo-liberal policies and an increase in the role of the state in the economy. Changes have occurred gradually. As mentioned, some FHC policies, like macroeconomic stabilization, have been preserved. Some of his new social protection and poverty alleviation programs have been improved and substantially expanded. Some of the institutions that survived from the period of state developmentalism like the BNDES have been reinvigorated and redirected. Other developmentalist institutions like industrial policy that were rejected during the neo-liberal period have been revived, albeit in different form. Finally some new institutions have been added including new structures designed to increase coordination between the public and private sectors (e.g, the Public-Private Partnership Federal Act of 2004). Through over a decade of experimentation in which developmentalist institutions have been reinvented, neo-liberal policies partially modified, and new institutions invented, a new form of state activism is emerging.

1.3.1 Macroeconomic continuity

Perhaps the most important area of continuity is in macroeconomic policy. Scarred by decades of high and damaging inflation, in the 1990s Brazil adopted policies to preserve monetary stability. These have been continued by the Lula and Dilma administrations. The Real Plan used various measures to control public spending and regulate the money supply. This has kept the inflation rate low (at least by Brazilian standards) for over 15 years and has enshrined monetary stability as a cornerstone of economic policy. However, this has come at a price. The main tools of macroeconomic policy are restrictions on government spending and a relatively high interest rate. This puts a brake on public investment and increases the cost of credit thus possibly hampering growth. To help offset these effects Lula introduced several growth-inducing microeconomic policies. These included both a new form of industrial policy and social policies that have helped spur domestic growth while also relieving poverty and reducing inequality.

1.3.2. Industrial Policy

In 2004, after a decade in which Brazil had explicitly rejected industrial policy[15], the government reintroduced measures designed to foster selected industries. However, in keeping

[15] For a history of the rejection of industrial policy see Suzigan and Villela (1997).

with the climate of the time, Lula's first try at industrial policy was limited and focused primarily on innovation. At the time, opposition to industrial policy in policy-making and academic opinion remained strong. It was thought that governments were not able to strategically select targets and that trying to do so would divert resources from horizontal measures like tax reform and infrastructure investment that would benefit the whole economy. However, at least some theorists and policy-makers were prepared to accept a limited role for government in overcoming market failures and reducing coordination problems that hampered innovation. That may explain why the first foray into industrial policy –called PITCE - stressed a combination of general measures to improve the business environment, legal measures to improve incentives for innovation and facilitate better relations between universities and business, and tax relief and financial support in four sectors in which innovation seemed essential: semiconductors, software, capital goods and medicines.

At the same time, the Lula government started building institutions designed to improve articulation within government and between government and the private sector. These included CDES, the Council of Economic and Social Development, designed to help foster inclusive growth, CNDI, the National Council of Industrial Development, a public-private peak body charged with defining directives for industrial development, and ABDI, the Brazilian Agency for Industrial Development which was put in charge of coordinating implementation of industrial policy by bringing government, industry, labor, and universities together. Arbix and Martin (2010) describe ABDI as a

> "…networked institution, formally under the Ministry of Development, Industry, and Trade. ABDI has played an important role in seeking to develop an industrial policy and helps identify and guides investment decisions in technological research, innovation and industrial development"[16]

In 2008, the government launched a new initiative called The Program for Productive Development (PDP). PDP replaced PITCE[17] and was much more ambitious and complex. It included both horizontal measures designed to increase the overall efficiency of the economy and vertical programs for targeted sectors. Reflecting the scope and complexity of the Brazilian

[16] Arbix and Martin (2010).
[17] The discussion in this section draws heavily on Coutinho *et. al* (2012).

economy, PDP covered a wide range of industries. The program set goals, established a complex governance regime, and placed special emphasis on collaboration between the public and private sectors.

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

The first challenge identified by PDP was to consolidate and expand leadership in sectors in which Brazil was deemed to have a competitive edge. The goal was to support Brazilian firms that could be world leaders in their industry. Sectors selected included aviation, mining, steel, cellulose, oil and gas/petrochemical, bio-ethanol, and meat. The second challenge was to build up industries that had competitive potential but were not yet at the global frontier. They included capital goods, the automotive complex, wood and furniture, personal hygiene, perfumery and cosmetics, construction, various service industries, coastal and marine industry, leather, footwear and artifacts, the agro-industrial system, and plastics. The third challenge was to strengthen high-tech “vanguard” sectors that had both growth potential and whose growth could improve the technological capacity of the whole economy. These “strategic areas” included health, biotechnology, defense, nuclear energy, nanotechnology, and information and communication technology.

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

It is too soon to assess the overall impact of PDP. Before it got off the ground the plan was overtaken by the global financial crisis which had an effect on both government policy and industry. But even if there had been no great recession, it is early days for programs like this

which envision major structural changes. While the government can point to some real achievements, critics have questioned whether the plan has really shifted resources from traditional sectors to high-tech industries or if has done enough for small and medium industry which often are a major source of innovation[18].

In the meantime, the new administration led by Dilma Rouseff in 2011 introduced an updated version of PDP called *Brasil Maior* (Greater Brazil) with the motto “Innovate to compete; compete to grow”[19]. This plan continued many of the objectives and policies of PDP. But, reflecting rising concerns about “deindustrialization”, the plan places new emphasis on efforts to protect domestic industries hard hit by global competition, an over-valued currency, and low cost imports. Taxes on manufacturing were reduced, more attention paid to anti-dumping measures, and substantial preferences for local producers in government procurement introduced. At the same time, BNDES and FINEP funding have been increased and efforts made to channel more funding to innovative firms and sectors.

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

An important part of the *Brasil Maior* plan is the system of public-private coordination which builds on structures created for PDP. The system rests on three pillars: the National Industrial Development Council (CNDI), Sectorial Executive Committees, and the Sectorial Competiveness Councils. CNDI is a peak institution that includes ministers, the president of BNDES and 18 representatives of industry, labor, and the public. Its role is to set strategic guidelines. The *Brasil Maior* plan identifies 20 priority sectors: petroleum, gas and marine

[18] According to operational information available at the BNDES, on 2008, out of the 179 beneficiary companies, 12 were listed in Bovespa (the Brazilian stock exchange) In 2009, out of the 156 beneficiary companies, 25 were listed in Bovespa. Data obtained on the Bank’s website, <http://www.bndes.gov.br/SiteBNDES/bndes/bndes_pt/Institucional/BNDES_Transparente/Consulta_as_operacoes_do_BNDES>, accessed on May 01, 2010.
[19] *Brasil Maior* website and other sources.

construction, chemicals, health, renewable energy, furniture, automotive, mining, civil construction, defense, aviation and aerospace, agro-industry, capital goods, metallurgy, logistics services, electronics, personal hygiene, fragrances and cosmetics (HPPC), services, retail, shoes, textiles, candy and jewelry, cellulose and paper. For each sector there is an Executive Committee and a Competiveness Council. The Executive Committee consists of government officials charged with developing an action plan for the sector. These representatives meet with industry and labor in the Sectorial Competiveness Councils to refine the action plans and explore implementation issues.

1.3.3. Social Policy

In addition to reviving industrial policy, the governments of Lula and Dilma have expanded Brazil's social protection system and anti-poverty programs. The result has been a significant decline in the poverty rate, reduction of inequality, growth of a new middle class, and stimulus for the domestic market. Between 2001 and 2008, incomes of the wealthy grew at a moderate pace, while income gains for the poor increased substantively. Approximately 28 million people were raised above the poverty line and a "new middle class" has emerged - between 2003 and 2011 approximately 10.5 million Brazilians became part of the middle class and which now includes 55% of the population (Nery, 2011:29). The Brazilian social pyramid is now diamond shaped, with more citizens classified as middle class than as poor.

Recent studies[20] highlight the fact that Brazil's distributive gains achieved in the last decade are the result of a combination of economic and institutional reforms. They include inflation control, changes in labor markets that include unemployment reduction and increases in the minimum wage, pensions and social security improvements and a new generation of social assistance policies, especially the *Bolsa Família* Program (BFP), created in 2003 as a result of a consolidation of previously existing initiatives (Cardoso's *Bolsa Escola* included)[21]. Health and

[20] See more about the recent Brazilian "equity gain" in the chapter by Coutinho, in this volume.
[21] Since its inception the federal government *Bolsa Família* has reached more than 12 million families as beneficiaries. If one assumes that each family has four people on average, the total figure for individuals benefited from BPF reaches 48 million people, or approximately 25 per cent of the Brazilian population. Half of its budget has been spent in the northeast part of Brazil, where millions of very poor families live. Considering its gigantic scale, the targeting of BFP (defined as the share of total benefits received by specific groups of the population) has been considered exemplary, outperforming other social assistance programs in both Brazil and internationally.

education spending as a share of GDP have grown considerably in recent years, magnifying impacts of institutional reforms instituted in the late 1990s (Arbix & Martin 2010).

In another recent development, in 2011 SUAS, the Brazilian the Unified Social Assistance System, was institutionalized and formalized by a federal statute. SUAS, which has existed since 2005, is coordinated by the Ministry of Social Development and Fight Against Hunger (MDS). Its functioning, however, is based on the work of councils in which the federal level, states and cities co-decide the use of funds in a decentralized and participatory manner. Municipalities adhere to SUAS voluntarily and almost all cities in Brazil participate.

Finally, in June 2011 President Dilma Roussef launched the *Brasil Sem Miséria*[22] program, designed to rescue 16.2 million people from extreme poverty, 59% of whom live in the Northeast region. *Brasil Sem Miséria* has been presented as a combination of complementary rural and urban sectoral actions in the fields of productive insertion, income transfer, access to public services, education, health, social assistance, water and sewage and involves the creation of new initiatives and the re-conception of existing ones. This program aims to find and register (using Cadastro Único, the Brazilian sole register of social policies) extremely poor families and integrate them into different programs according to data supplied by the Brazilian Statistics Office (IBGE). It has been announced that there will be an "active search" to locate these people, and this presupposes an extra effort to find them in remote areas. Also, *Brasil Sem Miséria* is supposed to offer "exit doors" to those who graduate from *Bolsa Família* (thus boosting "productive inclusion") [23].

Social policy is working: poverty has been cut drastically and income inequality reduced. Although Brazil still is one of the most unequal countries in the world[24], the decline in poverty and reduction of inequality in Brazil in recent years have been remarkable. Thanks to a wide range of policies, including universal, targeted, and decentralized programs, the Brazilian welfare state is becoming increasingly robust.[25].

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[22] "Brazil Without Indigence".

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

[24] The Brazilian Gini coefficient in 1960 was 0,5367, 0,6091 in 1990 and (still very high) 0,5304 in 2010. Cf. Nery (2011: 27).

[25] As put by Arbix & Martin (2010): "while Brazil's 'welfare state' still has segmented qualities, benefiting the better organized and remunerated in the formal and public sectors disproportionately, this segmentation is now much less acute than it has been for decades, and perhaps since the creation of the country's first social benefits many decades ago. In 2010 inequality in Brazil reached its lowest level since measurement started in 1960

1.3.4 Brazil's new state activism: something new under the sun?

The emerging profile of state activism differs from the state's role both in the developmentalist period and the neoliberal phase of the 1990s. In the developmentalist period from the 1930s to the 1980s, the Brazilian government not only set priorities for industrialization in a top-down fashion; it also was a primary actor in industry. The state bureaucracy set goals, state-owned enterprises played a central role in many sectors including steel, mining, aircraft, automobiles, and banking, and the state development bank provided funding for areas deemed priority by government planners. Emphasis was on "catching up" by building domestic industries using imported technology. The state created tariffs walls and multiple exchange rates to control imports. Social policy were not focused on redistribution or poverty reduction: social protection programs were elitist, designed to keep the industrial working class and the small middle class happy, and managed in a clientelistic fashion[26].

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

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

[26] Arbix and Martin (2010:4) observe that "over the course of several decades, the statist model shifted resources from consumption to investment, limiting real wages and social spending and directing social spending in clientelistic fashion toward more organized segments of society with an eye toward political stability and control".

industry. At the same time it placed substantial emphasis on social policy and redistribution and sought to integrate its social policy and industrial growth strategies.

2.1 Accounting for the Rise and Shape of the New State Activism

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

No one would claim that Brazil's new form of state activism was planned from the start or that a clear model has emerged. These policies have evolved in a piece-meal fashion and are still changing. The Brazilian government has been feeling the stones as it crosses the river — to quote Deng Xaoping — not following some worked out blue-print. However, looking back over a decade of experimentation and policy evolution, one can see several factors that explain the decision to try to resume an active role of the state as well as several forces that helped shape the form this role would take. In the following sections we look at the *drivers* that helped impel increased state activism as well as *conditioning factors* that helped shape the way the new role evolved. The section shows how a dialectical interplay between drivers and conditioning factors have led to what Arbix and Martin have called "state activism without state dominance"[27].

2.1 Drivers for the increasing state role

Among the drivers or factors that may explain why the government has assumed a more interventionist stance we can identify three: (i) economic elements including market failures and the social debt (ii) new theoretical interpretations and changes in policy discourse, and (iii) international competition and the pressure to develop active polices to support international competitiveness. At the same time, it is fair to say that the move to more state activism has been

[27] We quote Arbix & Martin (2010: 34): "whatever precise terminology might be most appropriate — a debate we seek to open without attempting to resolve here — the final question that calls out for greater analysis is to examine what is new, not only what is old, to capture the conditions under which this emerging inclusionary state activism without statism can be consolidated or not".

assisted by "Weberian deepening" which increased the efficiency of state institutions thus making it more likely that interventionist policies will work.

2.1.1. Economic weaknesses and market failures

The reforms of the 1990s may have brought about improvements in Brazil, including significant restructuring of key industries. But they did not lead to rapid growth. The Lula administration took office at a time when growth had slowed and disillusion with neo-liberalism had begin to set in. This generated a series of analyses and a growing conviction that the state had to play a more aggressive role if Brazil was to resume growth and do it in an inclusive fashion. Three areas seem to have been most important: (i) major market failures that impede innovation and initial successes from innovation policy, (ii) weakness in financial markets and the availability of public banks as an alternative, and (iii) the need to offset negative effects of the exchange rate.

2.1.1.1 Externalities and the potential for innovation policy

Hausmann & Rodrik, (2007) point to major market failures that surround the developmental process. For them, development is a process of national self-discovery by which nations learn what is most promising to be produced, considering the technological frontier and local conditions. Private entrepreneurs must conduct this process and the collective result of their actions will be the reconfiguration of national competitive advantages. But especially in developing countries, the process is hampered by externalities and coordination problems. Private actors may underinvest because they cannot secure the full benefits of innovation or ensure that necessary complementary investments are made. These problems have been recognized as legitimate reasons for state intervention in developed countries: they are even more salient in the case of developing countries, which are further from the technological frontier and have less industrial complementarities[28].

[28] These market failures are still more relevant in developing countries: they face even more substantial problems of appropriateness, due to legal-institutional failures, and also they have more sectoral gaps at the industrial chain, face stronger difficulties to master technologic cycles, which makes the coordination of complementary investment particularly challenging. Therefore, the incremental process of economic updating toward the enrichment of innovation

In the Brazilian case the need to restart the process of self-discovery was especially important. The national economy had its last impetus of vitality in the seventies, during the apogee of developmental state policies. Schapiro (2012) notes that by the end of 1970's Brazil's economy had completed its second industrial revolution, thus acquiring a diversified industrial economy. However, from the early 1980's onward the economy has faced a long period of stagnation, in which the growth slowed and Brazil fell behind the rapidly growing Asian "tigers".

This stagnation was caused by external and internal factors. The external factor refers to the changing of capitalist accumulation patterns, or the consolidation of knowledge based economy (Piore & Sabel, 1984; Harvey, 1992), which made the capacity of industrial innovation essential for economic competitiveness. The internal reasons for this stagnation has been Brazil's failure to reshape the political economy structure that underpinned the old developmentalism. This structure was based on a triple alliance (Evans, 1978) among multinational capital, national capital and the state, in which the state was in charge of producing infrastructure and also implementing regulations and incentives to protect and promote the private side of the economy. The side effect of this arrangement was paradoxically the excessive insulation of Brazilian economy from international competition and, at same time, the increasing transformation of this economy in a buyer of external technology, instead of being a national hub of making local innovations and new technologies (Amsden, 2001). As a result, Brazil was not able to keep the developmental pace. Suzigan & Villela conclude:

> "It was necessary to change not only to correct these problems, but also because there was conscience that the country had reached the zenith of a historical development process (which many erroneously described simply as import substitution). Once built an ample and diversified industrial basis, it was necessary to make it efficient and competitive. It was also necessary to incorporate sectors and industries representing new technologies, particularly informatics and telecommunications, and develop innovation ability, a crucial element in competition" (Suzigan & Villela, 1995).

Taking these external and internal problems into account, it is hardly surprising that while Asian countries, noticeably South Korea and Taiwan, kept the developmental pace and gave rise to a new round of growth based on knowledge and innovation, Brazil and its Latin-American counterparts lost vitality. Data presented by Schapiro, concerning to the amount of patents requested by these countries to the USPTO illustrates this contrast between Asians and Latin

Americans (see table below). In Hausmann & Rodrik's terms, one might assume that the Brazilian arrangement was able to support the national self-discovery that sustained the second industrial revolution, but it was not able to do the same when the pattern of accumulation underwent a substantial change in the 1970's and 1980's.

Chart 1
Requests for patents by independent inventors at the
United States Patent and Trademark office – sample countries 1980/1990/2000/2009

	1980	1990	2000	2009
South Korea	33	775	5,705	23,950
China	7	111	469	6,879
Singapore	6	36	632	1.225
Brazil	53	88	220	464
México	77	76	190	220
Argentina	56	56	137	146
Chile	8	13	24	66
Source: Brazilian Ministry of Science and Technology and USPTO				

Recently, however this scenario of stagnation has been gradually challenged by the blossoming of new sectors, by a new type of entrepreneur and by a renewed appetite for innovation (Arbix). Lately, after the long stop-and-go process experienced throughout the 1980's and the greater part of the 1990's, there has been an increase in the rate of innovation in the Brazilian economy, which means that enterprises have started to explore new types of competitive strategies and new attempts of at innovation[29]. There is reason to believe that these developments are to some degree a response to increasing state attention to innovation policy which started in 1999 As Schapiro (2012) describes, the Federal Government has channeled budgetary resources into sectorial funds that finance innovative strategies. From 2004 onwards this policy was strengthened with the reintroduction of more robust industrial policy.

The government felt that innovation and national self-discovery were not going to happen spontaneously. They had seen that the hands-off approach followed in the 1990s had not worked due to market failures. They decided that only with significant state intervention could Brazil overcome the market failures and coordination programs hampering innovation. They were encouraged by the positive responses to timid innovation-fostering initiatives of the FHC administration and were determined to go much further.

[29] This can be verified in the profile of patents registered at Brazilian patent office: there has been a subtle growth of invention in comparison to the other less innovative type of patent – utility model.

2.1.1.2 Financial underdevelopment and the availability of public banks

There is a second source of economic failure in Brazil that pointed towards a need for state activism: the pervasive problems of the financial system. As is well-known, neither the capital market nor the banking system have been able to provide adequate funding for Brazil's development needs. On the banking side, there is a pervasive lack of competition. The industry is an oligopoly in which the four main players have around 80% of market share, thus leading this market to a low level of competition. This increases the cost of debt but also affects equity financing by driving up underwriting costs. The situation is aggravated by monetary policy which keeps interest rates very high and diverts savings from productive investments to government bonds. Although the capital market has grown in size and importance in recent years, it still plays a limited role in funding industrial expansion.

State banks, which date back to the developmental period, have filled the gap. When the Lula government decided to step back into industrial policy, it looked to the state banks and especially to BNDES to prove the capital and expertise needed to spur innovation and maintain competiveness. BNDES and the other major state banks have access to public funds so their cost of capital is well below that of the private sector. BNDES also offers substantial expertise: the bank has been financing the Brazilian industrial sector for the last 50 years and has developed detailed knowledge of many important sectors and close ties to industry which add to its advantages over the private sector. Unlike other developing countries, Brazil did not dismantle its development bank in the 1990s so that the institution was available when the government decided to intervene more actively in the economy. Today, it is the main source of long-term financing in Brazil.

2.1.1.3 Effects of the exchange rate on industry and the need for countervailing measures.

The third market failure that seemed to require the state activism is the side effect provoked by the institutional arrangement structuring the Real Plan. Undeniably, the Real Plan is

a success. It was able to tackle the, until then, undefeated inflationary problem. Since 1994, when the Plan was implemented, inflation has been kept in check at around 5% a year. The problem, however, is that this plan is anchored in the interplay of two important macroeconomic variables: (i) interest rate and (ii) exchange rate. While the interest rate is the main regulator against inflation, the exchange rate is directly influenced by value of the interest rate: if interest rate is high, it attracts foreign investment, which results in an appreciation of the exchange rate. This interplay has two direct consequences: (i) first, the regulation of inflation by management of the interest rate creates side effects on the financial market, inasmuch as its appreciation encourages investors to buy government bonds, instead of channeling savings to the private sector, (ii) the appreciation of the exchange rate causes serious prejudice to industry due to the concomitant increase in imports.

This arrangement and its side effects is the third *driver* that constantly put pressure on policy makers. Industry pressured for solutions that would alleviate both problems of financing cost and deindustrialization. Industrial policy seemed like a way to handle both.

2.1.2. Social Debt

The second source of pressure that has spurred moves toward state intervention is the Brazilian "social debt" a relevant political topic during the 1980s and 1990s. Social concerns and pressures for change pushed policy makers to develop new initiatives. Three problems stood out: (i) absolute poverty, and (ii) social inequality, and (iii) unemployment: these have driven policy makers to explore programs for poverty alleviation, inequality reduction and job creation.

Regarding absolute poverty, in 1981 31% of the Brazilian population was living on less than US$ 2.00 a day. Other social indicators were as bad: child mortality was high, life expectancy at birth was 63 years, illiteracy was widespread, and many people had no regular access to sanitation and potable water.[30] Inequality was very high. Brazil has been profoundly unequal for a long period: In 1990 the Gini coefficient was 0.6091. The degree of inequality is aggravated when one pays attention to race and gender.

[30] Data in this section is taken from Font and Randall (2012)

Finally, an additional social problem is unemployment. During the period from the 1980's to 2000 unemployment was an important political issue: the rate of unemployment reached 10% in the early 1990s.[31] This issue was aggravated by the problem of education, as the education system does not produce the number of skilled people needed by a growing and competitive economy. That means that industrial policies designed to spur technological upgrading could be hampered by lack of adequate human resources and people might find themselves without the skills needed by a changing labor market. This issue led the government to recognize a need for job creation and skills-upgrading.

2.1.3. International embeddedness and the need to spur competitiveness

Nowadays development not only depends on the internal capacity of mobilization and coordination, but also on international competitiveness. In a large extent, the pressure for this international embeddedness is considerably different from the pattern that underpinned the old developmental period, at least in Latin America. At that time, emphasis was on catching up through import substitution and policies focused on the domestic market. Despite the fact that export promotion was a development target as long ago as the 1960s, domestic industrialization dominated the governmental agenda. All this changed with globalization. In the 1990s Brazil opened itself to international competition and began more actively to pursue export markets.

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

[31] Ibid. Some put the effective rate as high as 20%.

2.1.4. Theoretical changes

With the turn to a more robust role in the economy, and the particular profile it is taking in Brazil, we see corresponding changes in the intellectual scene. Internationally, more attention is being paid to the positive role industrial policy might play and even the World Bank has endorsed certain types of industrial policy (Trubek, 2012). Similar developments are occurring in Brazil. Far be it for us to suggest a causal link from theory to new practice (or vice-versa). But it is clear that the academic turn provides analytical tools and offers intellectual justifications that can help sustain policy experimentation. Some have labeled the emerging set of ideas "new developmentalism". Economist James Cypher describes this approach:

> On the one hand, New Developmentalism, [rejects] prevailing ideas of neoclassical economics regarding a passive reliance on an export-led, resource-based economy [and agrees with]….the original developmentalist economists such as Rosenstein-Rodan, Hirschman, and Nurkse, and their emphasis on the centrality of a developmentalist state (Cypher and Dietz 2009: 142-151). On the other hand, New Developmentalism stresses a "growth with equity" approach along with an emphasis on industrial policy, highlighting public, growth-supporting, infrastructure spending, and a "neoschumpeterian" emphasis on building a national innovation system through deep public-private cooperative programs that will drive investment expenditures toward productivity-enhancing science and technology applications throughout the national industrial base of the economy (Erber 2011: 45-48)[32].

In the Brazilian case, after the 1990s, in which there was a relative theoretical hegemony of liberal ideas associated with the Washington Consensus, there has been a burgeoning heterodox literature that has lent support for new state activism. This can be seen in two different fields: (i) economics including both macroeconomy and microeconomy and (ii) political science.

In economics, one important contribution refers to the exchange rate and its effect on the industrialization. According to this argument, developed mainly by Bresser-Pereira, there has been appreciation of the value of the Real leading to the "Dutch disease" effect which promotes deindustrialization[33]. Due to the floods of dollars that have been reaching the Brazilian economy, the currency has become overvalued and this has had a negative effect on national industry. By showing that free market policies can lead to these negative effects, Bresser-Pereira and his

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

[33] Bresser-Pererira (2008).

colleagues have created a rationale for an aggressive industrial policy. This criticism has been accompanied by microeconomic studies that also challenge the market-oriented model. These studies include sectorial and market analyses and document specific and pervasive market failures that require active industrial policies[34]. Finally, microeconomists and political scientists have also been providing inputs to social policy. On the economic side, new studies conducted by Neri and Paes de Barros demonstrated how inequality itself is a problem, thus detaching this problem from poverty. This sort of consideration has given impulses to the formulation of two different set of social measures: (i) poverty alleviation measures and (ii) reduction of inequality instruments.

2.1.5. State modernization and policy capacity building

These *drivers* are supported by a macro institutional arrangement that was provided by the 1988 Constitution which has contributed to upgrading state capacity. In the 1930's the vast majority of public employees were appointed politically, by partisan affiliation. Getulio Vargas, who started Brazil's industrialization drive, tried to reform the Executive but the reforms were not very successful. There were some islands of excellence in public administration: some key institutions of developmental coordination, such as BNDES, Petrobrás, Embraer, IPEA, and the Central Bank, were professionalized. But these cases were in stark contrast to the rest of public administration, which seriously compromised state capability. This lack of "Weberianism" was changed by the Constitution of 1988 which made mandatory recruitment of public employees through public and official exams (*concursos públicos*). As a result, there has been a substantial increase in the percent of public employees selected meritocratically [35]

The Constitution also regulated the ceiling of earnings, determining that the maximum wage should be no higher than that one received by members of Supreme Court (*Supremo Tribunal Federal*). This rule was designed to limit public expense and curb discretionary distortions in the level of salaries. It is true that both dispositions (meritocratic recruitment and

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[34] Two issues have been higlighted: (i) failures in the market for innovation and (ii) gaps in the industrial chain. Studies conducted by Arbix, Pacheco and also by Ipea (Institute for Economic Applied Research) show need for innovatiion policies while Erber, Cassiolato and Kupfer lighlight gaps in supply chains that need government action to close. (cites)

[35] Before 1988 the rate of publicly selected employees relatively to the whole amount of employees was around XX%, currently, this number is about XX%.

wage policy) face problems of enforcement, even so they represent an important improvement in terms of governmental quality. When the Lula administration began to expand the state's role it could count on a more professional workforce in government.

2.2 Conditioning factors

It is not hard to see why a government led by the Brazilian Workers Party taking office at a time of low growth and relatively high unemployment would decide to increase the role of the state in the economy. Such changes were occurring in other parts of Latin America at the beginning of the 21st Century so it is little surprise that they took place in Brazil as well. But that leaves open the question of why Brazil's reengagement with the developmental state has taken the shape that it did. Why did Brazil opt for an innovation-focused and collaborative public-private form of industrial policy rather than, say, renationalization as Venezuela, Argentina, and Bolivia have chosen? Why has it been very supportive of foreign investment in most sectors? In this section we sketch a number of factors that seem to have influenced the choices Brazil has made as it searched for new ways for the state to help the economy regain dynamism and promote inclusive growth. Among these "conditioning factors" we can point to, four seem especially important: (i) constitutional restraints, (ii) the strength and scope of the domestic market and sophistication of domestic indutsry, (iii) limits imposed by international economic law and policy, and (iv) concerns about the reaction of global financial markets.

The 1988 Constitution influenced the choice of strategies and measures by making direct state control of industry both more expensive and less important. First, it protected property rights thus making renationalization of privatized industries an expensive proposition. Second, it reduced the possibilities for corruption and for private capture of state power thus increasing the government's capacity to steer the private sector. This made state ownership seem less necessary. Finally, by creating an open and democratic political structure the constitution enhanced the power and participation of civil society, including industry, vis-à-vis the state.

A second factor that influenced the choice of collaborative innovation-oriented industrial policy rather than renationalization is the size, complexity, and sophistication of the private sector in Brazil. Although still weak in certain areas, the Brazilian economy includes many well-developed sectors and a growing capital market. Many firms are either at the global competitive frontier or close to it. Others have incipient capabilities. In many sectors there is acceptance of

the need for restructuring and continuous improvement. Many firms have the kind of deep knowledge essential for effective innovation even though they may not be able fully to utilize this knowledge without public incentives and support.

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

> "… given the many endemic macroeconomic problems that had made the 1990s a period of slow growth in spite of the restructuring of industry, powerful industrial groups (including the Federation of Industries of São Paulo) involved themselves in the electoral process in 2002 with the objective of "opening space for developmentalist ideas" (Delgado 2010: 125)… the business federations—the organizations representing the interests of Brazil's vast and diversified industrial base—correctly understood Lula's election as a mandate for a pro-growth strategy and as a indication that a structural change would occur opening-up channel of direct intermediation between the industrial sector and the new administration (Delgado 2010: 125). In short, there was a consensus between the PT and important fractions of industrial capital to reverse "the loss of the centrality of the State as an agent of accumulation" (Delgado 2010: 107)."

A third conditioning factor can be found in international economic law and policy. WTO law places restrictions on some policies that had been used by the Asian developmental states so it was necessary either to work around these restraints or find ways to defend them in WTO litigation. As Santos and Badin (this volume) show, Brazil did a little of both by defending some heterodox policies and modifying others. Brazil did not encounter similar restrictions in international investment law as it never ratified the BITs signed in the 1990s. But because the government recognized that foreign investment was important for its innovation strategy, and sought to encourage its own firms to invest in foreign markets, it has nonetheless obeyed many of the principles of the investment regime. Similarly, while Brazil's export surpluses and growing reserves have made it less dependent on the International Financial Institutions, it may have been influenced by the discourse of the World Bank and other international financial

institutions which have promoted market solutions but accepted some role for industrial policy as long as it respects comparative advantage and focuses on innovation.

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

3.0 The challenge for law

What does the emergence of NSA mean for the law, and vice versa? That is a central question posed by this volume. As the role of the state in the economy and social protection changes, it seems inevitable that there will be corresponding changes in the law. And it seems possible that law will shape and channel the path for policy innovation. In this section we outline some general consideration about NSA's challenge for law. Further detail is provided in remaining chapters.

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

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

examples of how the law has responded to these functional needs. Further detail is available in subsequent chapters.

3.1 New roles, new frameworks of analysis, new functionalities

We can posit *a priori* that NSA will generate pressures for new laws and new roles for law. Much will be straight-forward. Statutes will get changed, procedures altered. There is plenty of that going on in Brazil today, as there was in the past. However, we focus on the "new functionalities"—roles for law that have not been as important in the past and take on new importance due to NSA.

To identify new functionalities and legal responses, we used three sources: the LANDS case studies in this book, other research on law and development polices conducted in Brazil, and "reverse engineering".[36] Reverse engineering means starting with the policies and programs, describing the functions associated with them, and seeing if law has contributed, or could contribute, to those functions. Using these methods we identified four new functionalities: (i) safeguarding flexibility, (ii) stimulating orchestration, (iii) framing synergy, and (iv) ensuring legitimacy.

Safeguarding flexibility means using legal norms to allow room for experimentation, promote innovation, and facilitate feedback from experiments to policy. It requires rules and procedures that force regular assessments of policy effectiveness and permit revision. It demands legal regimes that permit learning-by-doing and encourage path correction.

Stimulating orchestration means facilitating coordination and articulation within the state – both horizontally (i.e., between entities that belong to the same bureaucratic state level) and vertically (i.e. between entities that are subject to hierarchies or belong to different state levels). Practically, it can consist of norms and procedures that assign institutional tasks and foster cooperative (rather than competitive) governance regimes including rules that encourage

[36] The idea of reverse engineering appears in Kennedy (2006), in the context of a discussion of the postwar consensus (1945-1970). Kennedy reckons that although there was a clear demand for instrumental and propositive law, the legal theory behind that context was an implicit one in that period. In order to reveal it, he proposes: "We need to reverse engineer the legal theory of mainstream development professionals from their economic and political projects, and from the attitudes toward law they manifested in managing developing policies within national administration. A great deal of law was required to translate the leading economic theories of development economic policy" (Kennedy, 2006: 102)

government to work with the private sector. Also, it can mean supporting policy networks that share tasks and interact in a complementary way to implement policies: this can include defining policy “hubs”. Finally, it can mean using norms that harmonize new policies with pre-existing ones to ensure coherence.

Framing synergy involves using the law to frame public-private partnerships and ensure they are more effective than purely public or private solutions. Framing modalities include collaborative governance regimes that create incentives for public-private cooperation (through incentive-alignment and/or the use of private and contractual by public entities) and regulatory and contractual instruments that bring private expertise and public financial capacity together.

Ensuring legitimacy means keeping government transparent and ensuring adequate participation. NSA seems to require a regime in which it is easy for new ideas to percolate upwards and be widely shared. This makes older authoritarian models obsolete and increases the importance of democracy. Legal regimes must ensure accountability, transparency and participation in development policies. That requires norms for disclosure, frameworks for participation, methods to hold policy makers accountable for results, and ways to avoid capture.

3.2 New functionalities in action

To illustrate how Brazil is dealing with some of these new needs and functionalities, we look at a few developments in industrial and social policy.

3.2.1 Flexibility and synergy in industrial policy

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

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

Among the legal tools employed in this area are: (i) partnerships with technological institutes and grants to promote the development of new products; (ii) relational loan contracts that include non-binding performance criteria, staged disbursements, and constant BNDES monitoring through shared governance mechanisms; (iii) equity investments coupled with shared governance established through shareholder agreements that give BNDES a seat on the board and subject certain corporate decisions to its approval; and (iv) arrangements by which BNDES participates on the investment committee of venture capital funds that it assists.[37]

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

3.2.3 Orchestration and flexibility in social policy

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

As Brazil has strengthened its welfare state, it has sought to do it through cooperation among the several levels of government in the Federation. It is also bringing together different types of social policies to deal with major problems. This requires continuing orchestration of different levels and types of policies (universal and targeted, federal and local, contributive and non-contributive). To do that, the government has both found new uses for old administrative law tools and created new instruments.

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

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

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

3.2.3 Experimentation and synergy in labor law

In a recently published study of new approaches to the enforcement of labor laws in Brazil, Roberto Pires showed that labor inspectors using flexible and reflexive experimentalist governance approaches had more success than their peers who employed more traditional management tools. The study compares two different styles of enforcement: one, drawn from new public management (NPM), stresses specific targets and quotas; the other, which draws more on the experimentalist governance (EG) literature, stresses public-private cooperation, dialogue, exploration of options for compliance, careful analysis of the causes of violations, and revision of goals and standards as mutual learning progresses, Pires shows that through a system of hybrid governance that employed experimentalist methods while keeping sanctions in the background, health and safety inspectors in Pernambuco were able to significantly reduce the incidence of industrial accidents.

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

3.3 Building legal capacity for development: trade law

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

The clearest example of this kind of legal response is in the field of trade law canvasses in this volume by Santos and Badim.

When it initially joined the WTO, Brazil accepted the whole package of WTO agreements and did not adjust its domestic institutions to ensure that it could protect key policies. But as neo-liberal enthusiasm waned, successive administrations have protected domestic policy space by challenging restrictive interpretations of global trade rules. This growing willingness to challenge WTO-based restrictions is a result of changes in development policy and in the way trade policy is formulated in Brazil. As the state began to play a more robust role in the promotion of economic growth and social protection, trade policy-making has become more closely integrated with overall development policy and Brazil has invested in the legal and related skills needed for success in trade disputes. At the same time the arena for discussion of trade policy has been expanded as more government agencies began to participate and the private sector and a flourishing civil society movement entered the debate. The result has been that in the cases studied and other instances Brazil has been able to use trade law as a shield for policy innovation.

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

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

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

Conclusion

The Brazilian foray into new state activism is a work in progress. Plans proliferate and policies are altered as world conditions change. But there is real movement. Industrial policy seems to be working and is helping the country both weather the storms from the global financial crisis and resume economic dynamism. World markets have accepted this judgment and foreign investment has soared. Brazil has shown that significant gains have been made in poverty alleviation and reduction of inequality. There is a chance that Brazil is moving towards a new model for development. The law has accompanied these changes and will continue to do so.

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