

Native Capital Financial Institutions and Economic Development in São Paulo, Brazil, 1850-1920

by Anne Hanley

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Native Capital, by Anne Hanley, drives another nail in the coffin of the dependency view of Brazilian history. The book demonstrates the importance of local capital and local institutions in the development of São Paulo, especially during the period 1880-1914. The appearance and success of a local stock market and a number of São Paulo-based banks, railroads, and textile industries, confirms this thesis. Hanley shows how the São Paulo economy grew during various national crises in spite of serious problems elsewhere in the country. The book is a must for economic historians of the Empire and the Republic.

Although Hanley and I agree that Brazil in general and São Paulo in particular controlled their own affairs, we appear to disagree about the existence of a "Republican Revolution" (HANLEY, p. 84), the contribution of the "Republican Government" (i.e. Rui Barbosa, in chapters four and five), and the stabilization policy of Joaquim Murinho (also chapters four and five). What follows is less a traditional

book review than a debate based upon my own research, especially *A Crise Financeira da Abolição*.

As Hanley observes, imperial financial policy created a number of obstacles to development. In 1853, the government obliged the two largest commercial banks, the Banco Comercial do Rio de Janeiro and Mauá's Banco do Brasil, to merge and to yield control to the state. Mauá established a new bank as a limited partnership as the authorities denied him limited liability. In 1857, Mauá's friend, Bernardo de Sousa

Franco, became minister of finance and granted permission for six banks of issue with limited liability in an adaptation of the New York State banking law of 1837. Unfortunately conservative segments of the elite secured passage of the "*Lei das Entraves*" (law of impediments) in 1860 that nullified Sousa Franco's measure.

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As Hanley also notes, imperial mortgage legislation left much to be desired as foreclosure proved to be virtually impossible. The Banco do Brasil mortgage portfolio, established in 1866, used slaves (or urban real estate) as security until 1884. Contemporaries believed that only individuals with excellent connections could obtain mortgages that often constituted re-financing of difficult short-term advances. Additional research may modify current thought that these mortgages were not executable and depended solely on the (rare) goodwill of planters for repayment. The impossibility of foreclosure made mortgages an unacceptable risk in most situations. On the other hand, coffee production rose dramatically without this funding, utilizing family money

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for new plantations and profits for expansion. To the extent that planters used third party funds, these resources came from factors who sold the crops and therefore controlled the proceeds.

Imperial tariff policies suffered constraints in that up to three quarters of the state's income depended upon duties; rates either too high or too low would have resulted in insufficient revenues. European attacks upon free trade as exemplified by Bismarck's tariff of 1879 were studied carefully by the imperial elite but had no immediate effects upon Brazilian legislation.

Perhaps the gravest obstacle to development was the continuation of slavery, a curse that survived until 1888.

On the positive side of the Empire, we have railroad policy that gave Brazil the largest network in Latin America by the fall of the monarchy. The state guaranteed railroad investments to the point where most profitable and a number of not-so-profitable lines were built. The completion

of the São Paulo Railway and the expansion of the Paulista and Dom Pedro II Railroads during the 1860s and 1870s prepared the way for the spectacular growth of São Paulo during the following decades. Also to the Empire's credit, in times of financial crisis, 1857, 1864, and 1875, the authorities acted with considerable vigor to ameliorate these strains on the economy.

Abolition, May 13, 1888, required reforms (HANLEY, p. 121-123). Planters needed liquidity to pay freedmen and, especially in São Paulo, immigrants. João Alfredo, prime minister at abolition, won a major banking reform six months later that revived Sousa Franco's banks of issue. Perhaps the example of the law of impediments dampened the enthusiasm of bankers at this juncture as they failed to take advantage of the opportunities to issue during the remainder of João Alfredo's incumbency. His successor, the viscount of Ouro Preto, realized that further and rapid reforms were necessary to save the Empire that had lost the support of the Rio de Janeiro planters due to abolition without compensation. Ouro Preto began in June of 1889 by repassing large amounts of government funds to planters via privileged banks (including the Banco de Crédito Real de São Paulo; HANLEY, p. 122-123). The regulations of his "*Auxílios à Lavoura*" (aid to agriculture) envisioned the use of crops and machinery as collateral. He also chartered a bank of issue, utilizing the gold-backed bank note option foreseen in João Alfredo's legislation, that would both increase circulation and would place Brazil on a strict gold standard for the first time. The gold standard was significant in that it favored planters by avoiding further appreciation of the milreis.

The shares of Ouro Preto's privileged banks, many organized primarily to take advantage of free government funding, began to trade at growing premiums on the Rio Stock Exchange. Thus began the *Encilhamento*

bubble. Hanley correctly differentiates between the *Encilhamento* in Rio, which began with Ouro Preto, and the *Encilhamento* in São Paulo that began only when Rui Barbosa, his successor, revived the bubble in January of 1890 (HANLEY, p. 233). While the favoritism and abuses of Ouro Preto's policies were condemned immediately, he enjoyed several advantages over his replacement: free access to international capital markets, a reputation as a financier, and a commitment to the gold standard that acted as a break on reckless inflation.

Ouro Preto could not give the São Paulo planters what they wanted: control of local taxes, election of the governor, and the separation of church and state to encourage Protestant immigration as the emperor and Princess Isabel opposed these measures. The Paulistas joined with the unsatisfied Rio de Janeiro planters and the military to overthrow the Empire on November 15, 1889. For their participation, the Paulistas soon received separation of church and state, the right to elect their own governor, and the right to levy many taxes for the state.

Rui Barbosa became the new government's minister of finance. As Hanley observes (p. 123) "...the Republicans recognized the value of this new banking legislation and did nothing to dismantle it when they took over the government". In fact, Rui Barbosa first gave an ultimatum to Ouro Preto's chartered banks to issue convertible notes or forfeit their issue rights. The banks elected to pass as the exchange fell abruptly from 27 to 24 pence on massive capital flight. The Rothschilds, Brazil's bankers, closed their doors to a government that had yet to prove its legitimacy. Rui Barbosa had the same desire to provide the Rio planters with liquidity that his monarchist predecessors had. To achieve this goal, he turned to Francisco Mayrink, one of the leading bankers of the Empire. Upon Mayrink's suggestion, Barbosa promulgated

the decree of January 17, 1890 that gave Mayrink the privilege of doubling the circulating medium at his will (without the requirement of convertibility that regulated Ouro Preto's banks or the enforcement of the obligation to present bonds as in the case of Sousa Franco's institutions).

Upon hearing of this decree, five of the seven ministers of the Republican Provisional Government threatened to resign, including Campos Salles, the sole representative of São Paulo at that time. Campos Salles argued that privileged banks won the last monarchist elections for Ouro Preto and insisted that São Paulo receive such a bank (ABRANCHES, 1953, p. 91; these are the original minutes of the cabinet meetings of the Provisional Government). Barbosa accepted this demand so

Campos Salles remained. There was no discussion of universal banking or development, as Hanley suggests, just practical politics. One of the ministers, Demetrio Ribeiro, could not be bought off and left the government

while the press denounced the privileges, and Barbosa found himself forced to twice lower the issue ceiling for Mayrink's bank.

This bank issued aggressively provoking inflation. A symptom of this inflation was the devaluation of the milreis. At Barbosa's accession, the exchange was 27 pence, its parity against sterling since 1846. When he left office in January 1891, the exchange stood at 20 pence; Lucena, his successor, a Northeastern sugar planter with no pre-coup ties to the Republican movement, continued the Mayrink-led bubble as the exchange fell to 12 pence by November of the same year. That month President Marshal Deodoro da Fonseca and Lucena executed the "Stock Market Coup", closing Congress and ruling by force for

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20 days until they were overthrown. Vice President Marshal Floriano Peixoto took over with a policy of stabilization. The circulating medium amounted to thrice its outstanding when Barbosa came into office. Fraud and corruption gave the Republic a bad name (HANLEY, p. 88, 91). Incidentally the exchange rate collapsed during a period of huge exports of coffee and rubber, that under normal conditions, would have led to the appreciation of the milreis.

Hanley calls her fifth chapter "The Republican Revolution and the Failure of Universal Banking". Contemporaries did not discuss the concept of universal banks although they were aware of German banking. After Germany's victory over France in 1870, that country became a model for Brazil, of al-

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most equal importance to England, the United States, and France itself. The only new São Paulo institution Hanley terms a universal bank, the Banco União de São Paulo, was exactly the bank that Campos Salles wrung out of Barbosa.

This bank did not form part of the minister's plans. It ceased banking in 1906 after a less than spectacular career (HANLEY, p. 125-135, 141). On November 3, 1891, the day of Lucena's "Stock Market Coup", Barbosa defended his actions as finance minister on the floor of the Senate. "If our London keepers [the Rothschilds] remove themselves from the City to study our problems in our theater of action..., they will learn that we went from unpaid labor in the agriculture of our countryside and the industries of our cities to paid labor... of some 1,300,000 workers receiving total annual salaries of 115 to 120 or 140,000 contos" (BARBOSA, 2005, p. 117-118). Barbosa recognized that the *Encilhamento* was about paying freedmen and immigrants rather than about universal banks.

As Hanley discusses, a São Paulo stock exchange emerged during the *Encilhamento*, closed before the end of the bubble, and revived in 1895. She notes "Ironically, a stock market was not envisioned by the government policymakers" (p. 190). While the easy money of the *Encilhamento* did help a few companies to organize, the real impetus to industrial growth came from the expansion of the coffee economy and the appearance of a domestic market of wage-earning immigrants and freedmen. By the 1880s, this market was already evident as demonstrated by the corporaion legislation of 1882; abolition and immigration accelerated its rise. Industrialization occurred before (HANLEY, p. 46), during, and after the *Encilhamento* with the best years being 1906-1913, after the success of Murtinho's stabilization plan (HANLEY, p. 101). Only one textile firm listed on the São Paulo Stock Exchange in 1905 while 24 listed in 1913. Of the *Encilhamento*, Hanley states "Research has shown, however, that in spite of the clearly rampant speculative environment, real business expansion took place" (p. 86). To defend this point, she cites Stanley Stein's *The Brazilian Cotton Manufacture* (1957). Stein, chapter seven, notes that some industries did start during the bubble but spends most of his attention on Floriano Peixoto's pro-industry actions. Peixoto, as mentioned, fought for stabilization and terminated the *Encilhamento*.

Barbosa's decree of January 17, 1890, that established Mayrink's bank, also modified the imperial corporation law of November 4, 1882. Of Barbosa's measure, Hanley argues: "The economic revolution introduced by the new Republican government freed up the domestic economy from all the restraints imposed on it by the old imperial regime" (p. 85). In fact the decree of 1890 differed relatively little from that of 1882. The earlier law permitted joint-stock companies to form without a

government charter except for banks, religious associations, insurance companies, food wholesalers, and foreign entities. The 1890 law continued to demand government charters for all of these categories except for religious associations as the church had just been separated from the state.

On page 66, Hanley states that the 1882 law hampered the spread of corporations because of reserved liability and because shareholders might be liable to return fraudulently – declared dividends for a period of five years. Reserved liability was a common practice in England until the failure of the City of Glasgow Bank in 1878 when shareholders who had paid in as little as a fifth of the value of shares subscribed had to produce the other four fifths or have their assets seized and auctioned. After this event, the full value of shares subscribed tended to be paid in within a short period of time and the practice of reserved liability disappeared. Brazil's 1882 law stipulated that shares could only be traded if they were at least one fifth paid in. Subscribers were liable, in case of insolvency, for the unpaid in portion even if they had sold their shares less than 5 years prior to insolvency. This reserved liability continued in Brazil: Law 3150 of November 4, 1882, article 7. Article 2 of this law states that shareholders are liable only to the extent of their shares – implicitly once fully paid in – while article 7 permits bearer shares once the shares have been entirely paid in. Reserved liability was clearly meant to affect corporations only in their formative period and was seen as an incentive for shareholders to pay up their entire subscriptions. The 1890 decree had similar articles 2 and 7 and also included reserved liability. In Barbosa's decree the liability of a seller of shares terminated when the shareholders' meeting approved the annual accounts. In practice during the *Encilhamento*, before many company's first annual shareholders' meeting, investors, with

complete impunity, "*roeram a corda*" ("bit the leash") failing to honor their subscription commitments. Reserved liability under Barbosa existed on paper but not in practice.

Barbosa's decree modified the treatment of recipients of fraudulently – declared dividends. In Article 13 of the 1882 law, both directors and shareholders held responsibility for such dividends for a period of five years. In article 13 of Barbosa's decree, only the directors continued liable. But the 1882 law already exempted recipients in due course of dividends. We may conclude the institutional improvements of Barbosa's measure contributed much less to the exuberance of the bubble than his easy money policy did.

In assessing Barbosa as a developmentalist, we must examine his tariff policy. Neither before nor after office was he considered to be an industrialist spokesman (LUZ, 1961, p. 168-177). Early in office, he discarded a moderately protective schedule prepared by Ouro Preto. Barbosa's

gold tariff came at the end of his incumbency as an explicit attempt to shore up the falling milreis. All his tariffs were for revenue; he did not give textiles the special treatment required to protect this industry from foreign competition. The only finance minister of this decade identified with industrial interests, Serzedelo Correia, in office from 1892 to 1893, strove to reverse the effects of the *Encilhamento* by stabilizing the currency. Correia obtained a protective tariff for textiles, then the leading industry of Brazil.

To summarize our evaluation of Rui Barbosa: he had no grand plan for Brazilian development. The banks he created were solely to provide quick liquidity for angry Rio planters; he had no vision of a São

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Paulo stock market, his corporate legislation altered little the existing imperial legislation, and he lacked a pro-industry tariff policy. He and his republican successors never made any serious attempts to reform mortgage legislation or improve creditors' rights. That Mayrink presented Barbosa with a palace adds to our doubts concerning the minister's motives.

The advent of the Republic was not devoid of significance bringing with it the increased autonomy that facilitated the spectacular growth of São Paulo in terms first of agriculture and then of industry. The new incorporation laws included in the decree of January 17 constituted a modest step forward although the excesses of the bubble may actually have retarded development

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for a decade, precisely until the success of stabilization. On the negative side, the first five years of the Republic witnessed two authoritarian military governments, two successful coups, a major civil war, and a prolonged financial crisis. There was

great hope after the proclamation of the Republic and great popular support for the second military president, Marshal Floriano Peixoto. But the military government terminated in generalized disillusion. The oligarchy of planters, merchants, and officials continued in power allowing relatively little opportunity for upward mobility except for immigrants. Within this changing oligarchy, the Republic brought a relative decline in the influence of planters and politicians from the Northeast and from Rio de Janeiro and a relative rise in the powers of those groups from São Paulo, Minas Gerais, and Rio Grande do Sul, a geographic but hardly a structural change. Politicians who served the Empire often continued their careers under the new regime; two senior imperial

leaders, Rodrigues Alves and Afonso Pena, became presidents of the Republic. We can recognize a "Republican Adjustment", but "Revolution", as used by Hanley, is too strong a term.

Finally, let us consider the policies of Finance Minister Joaquim Murinho. He and President Campos Salles, 1898-1902, followed in the footsteps of Floriano Peixoto and his successor, Paulista leader Prudente de Morais, the first civilian president, in office from 1894 to 1898. As soon as he came to power, Floriano Peixoto battled to stabilize the exchange and eliminate the excesses of the *Encilhamento*. Further bank note issues were prohibited. His second finance minister, Serzedelo Correia, achieved passage of a tariff that protected textiles and lent government funds to industry while negotiating an external loan with the Rothschilds and enjoying a slight appreciation in the exchange rate. Ultimately Floriano Peixoto failed in his stabilization attempt because he became involved in a costly civil war. Prudente de Morais also did not succeed in stabilization although he actually reduced the circulating medium during the first half of his term. The collapse of coffee prices, as the massive plantings around the years of the bubble bore fruit, deprived Prudente of revenues necessary for stabilization. Campos Salles and Joaquim Murinho succeeded largely because the volume of exports recovered during their administration.

Joaquim Murinho worked hard at stabilization in addition to the fortunate revival of coffee. He increased government income, reduced expenses and privatized. He received much criticism from contemporaries and from historians. Perhaps his target for the appreciation of the exchange was mistaken. When Murinho came to power, the official parity remained 27 pence although at no time since 1891 had it exceeded 14 pence. Early in his tenure, the milreis stood at 7 pence. He apparently felt that 27

pence should be the ultimate goal to prove that Brazil meant to protect the interests of creditors and investors. A revaluation of this magnitude required a violent contraction of the circulating medium and severe hardship for merchants, planters, industrialists, and workers. Murtinho followed in the tradition of the British government after the Napoleonic Wars that resumed convertibility at par though prices stood 80 per cent higher. The United States paper money declined to 39 per cent of its gold value during the Civil War yet that country resumed convertibility at its old parity by 1879. Both the US and the UK suffered during these contractions of the circulating medium, but subsequent growth served to vindicate the proponents of stability.

At the beginning of 1900, Murtinho still found the exchange rate at 7 pence. During that year, buoyed by coffee earnings, his fiscal policy, and the contraction of the circulating medium, the exchange rose to 14 pence to the great pain of exporters. Banks also had difficulties adjusting to the contraction of the circulating medium, and many institutions lost heavily in the volatile exchange market. Furthermore several institutions, including the Banco da República, had huge portfolios of bad loans from the days of the *Encilhamento*. A major panic ensued accompanied by numerous defaults. Murtinho acted vigorously to limit the effects of the crisis in effect taking the failed Banco da República under his wing. Confidence returned, and the survivors enjoyed a period of prosperity. During the following government, Brazil went on a true gold standard for the first time at a parity of 15 pence. Many industries were established between 1900 and the First World War.

Murtinho and many others felt that this epoch of progress was due, at least in part,

to the Brazilian government's stabilization plan. Stability gave both foreign and domestic lenders and investors confidence to risk their funds. We may question whether Murtinho would have been wiser had he chosen a less ambitious revaluation target. Could confidence have been restored at 10 pence? Unquestionably, stabilization led to growth.

While those unemployed by Murtinho's contraction suffered and should not be ignored, it seems unfair to call him anti-business (HANLEY, p. 91). Murtinho was merely doing what Floriano Peixoto and Prudente de Moraes before him and Rodrigues Alves after him did: struggle to stabilize. He did not want to de-industrialize or surrender the country to foreigners. Rather he wanted Brazil to take advantage of the opportunities presented by the international capital markets. His nationalist opinions are documented (LUZ, 1981). Former Minister Serzedelo Correia, a spokesman for industry, supported Murtinho as did many financiers and merchants who believed that stability was good for business.

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In this text, I have emphasized differences with the author. There are many points where we agree, and I congratulate Prof Hanley on the quality of her research. In our journal, we hope to provoke debates. We welcome contrary opinions. Those who feel the advent of the Republic constituted a revolution, Rui Barbosa had a clear vision of development, and Joaquim Murtinho was anti-business are all welcome to their say here. We hope to be part of a continuing debate.

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