The great depression in Argentina, Brazil and Uruguay: revisiting vulnerabilities and policies

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VI. Brazil, the United States of Coffee and Milk

It is possible to identify the late twenties as a turning point in the long-term development patterns of Brazil. In this regard, it is important to keep in mind that today Brazil ranks among the six biggest economies in the world, which is about five times the economy of Argentina. It has a solid internal market, a profile of diversified exports of competitive worldwide agricultural and resource intensive products, as well as highly technological and capital intensive ones. The country has an important industrial production sector, primarily consumed by its own important internal market, and exports evenly distributed among neighbouring countries in Latin America, the US, the European Union and China. In sharp contrast, by the time of the Great Depression, Brazil was a mostly semi-agrarian country, deeply underdeveloped, even when compared with neighbouring countries like Argentina or Uruguay. The economic downturn of 1928-1932 paved the ground for continuous and striking changes in the country's economic profile up to the present day.

In this chapter we sketch the general situation of Brazil during the late twenties at the sunset of the Old Republic, the political panorama in the background to the Great Depression, the importance of coffee for the country and the obsession of the Luís administration to return to the gold standard. The aim is to introduce the reader to the general panorama of the country in order to understand the forces that influenced the policies applied in the period.

i. The sunset of an old Republic

By the twenties, Brazil was heavily underdeveloped in many aspects. As Hilton (1977, pp. 28-29) recollects, a former Minister of Foreign Affairs said shortly before the Great Depression that Brazil was a country without an army, without a navy, heavily divided and meaningless in international life. People lived on the coast line, but the interior of the country was mostly uninhabited with poor communications. Only the Southeast of the country was better connected by roads and railways. There was no real economic integration of the territory. And recalling a figure from Abreu (2008, p. 286), the agrarian configuration of the Brazilian economy becomes evident from the fact that by the end of the thirties agriculture employed almost 66% of the active economic population[280]. Moreover, Brazil was historically described as a mono-exporter of commodities that replaced each other over time. The Royal Institute of International Affairs (1937, p. 272) judged that Brazil was a one-crop country, except for transitional periods. In the seventeenth century it was the world's largest supplier of sugar; in the eighteenth century gold

[280] This figure was taken from Abreu (2008, p. 286).

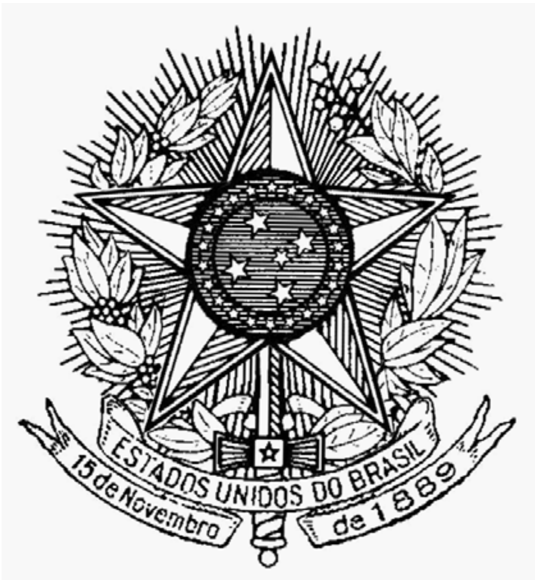
became of greater importance, only to be succeeded by cotton. In the nineteenth century the supremacy in cacao was won and lost, and then rubber became the staple export at the beginning of the twentieth century, only to be replaced by coffee. During the thirties, cotton and fruits rivalled coffee. But as a conclusion, for the period we are interested in, Brazil was mostly known for its coffee.

Indeed, by 1929-1933 the Brazilian coffee accounted for almost 57% of world coffee exports[281], a share of the market which allowed the country to exert oligopolistic influence over the markets. However, this feature meant for Brazil strong vulnerability to the prices and market conditions of this single crop. Moreover, not only were exports strongly concentrated in one commodity, but there was also a heavy dependence on one single market: the United States. Indeed, if we take into account the estimates of the League of Nations, around 45% of Brazilian exports in 1928, mostly coffee, was exported to the United States. Other important trade partners were Germany, France, Argentina, the Netherlands, Italy, the United Kingdom, Belgium and Luxembourg and Uruguay[282]. However, the US did not always make use of its strong commercial leverage on Brazilian policy making, at least before Second World War. This is an important aspect highlighted by several authors that allegedly provided the Brazilian authorities a greater autonomy as compared with their southern neighbours, Argentina and Uruguay, which were heavily dependent on meat exports to the UK. Nevertheless, there is some ground to relativize this assessment, as will be discussed later.

The twenties and thirties can be considered as a turning point in the productive structure of the country in many ways. Regarding the predominance of coffee in the Brazilian export profile, the collapse of the coffee *defesa* scheme after 1929 and the increasing market pressure from new suppliers abroad favoured the shift of production to other crops. This was the case for cotton, which increased its share from just 1% in the basket of Brazilian exports in 1928 to 19% in 1937[283]. Although in 1929 it did not account for more than 5% of the worldwide supply[284], and probably had a minor impact on the external position of the country as compared with coffee. Other products like rubber, beef and veal, and fats and oils (cottonseed) only made up a negligible portion of the world supply during the twenties. Also bananas, oranges, grape-fruits, tangerines and pineapples were increasingly exported by Brazil. It was also a time of increasing industrial production. As early as 1919, textiles was the main industry in the country, which accounted for up to 30% of the production value and made up the greatest part of the aggregate index of industrial production[285]. But during the twenties other important industries were established, namely the cement and the iron and steel industries, under the umbrella of extensive official support. The emergence of this incipient industrialization process was a driving force behind the ascension of new urban forces that claimed more participation in the country's politics, and entailed a renewed potential trend for protectionist policies.

[281] This figure was taken from Taylor and Taylor (1943, p.68).
[282] According to data from IBGE (1990).
[283] This figure was taken from League of Nations (1942, p. 22).
[284] This figure was taken from Taylor and Taylor (1943, p.26).
[285] This figure was taken from Villanova & Suzigan (2001, p. 175).

Another striking aspect of the Brazilian context was the peculiar political system, which managed since the declaration of the first Republic in 1889 to keep united a country with a size similar to the US and a population close to France. Indeed, most of its population, with an estimate of 37 million people for the period of analysis, was illiterate and excluded from politics, since it was a requirement for casting a vote to be literate. Even for the people that actually voted, the democratic practices of the first Republic were far from optimal. It is fair to say that the country was economically and politically run by landowner families which controlled key state level politic institutions and from there the federal level[286]. The British Embassy in Rio de Janeiro reported to capital that voting in Brazil was open, and that enabled every kind of pressure to be exerted upon the electorate. Furthermore, the electorate itself numbered less than 3 million and these were in general drawn from the propertied class. The lower elements in the population were numerous but powerless[287].



Not surprisingly for a federal State dealing with strong federated oligarchies, Brazil lacked true nationwide politic parties with coherent structures and unified political platforms. Most of the states were run by a local *Partido Republicano*, loosely connected with the government in Rio de Janeiro, and with local strongmen or *caudillos* who directly or in the background retained strong authority or influence. The political system relied also on the so-called '*coroneis*', local rulers who controlled the ballot results and reported to their State Presidents, who on the one hand influenced the election of the Federal President and on the other were influenced by the respective state oligarchies[288]. Among state oligarchies, the strongest ones, of course, were those

[286] Often, the oligarchies were constructed by bonds of family, education and financial power, but were also open to talented individuals who studied law at the main state universities. See for example Casalecchi (1986).
[287] See despatch Nr. 34 from Mr. Seeds to the Foreign Office dated April 1st 1930, p. 128.
[288] As clearly Smith & Vinhosa (2002, p. 97) wrote: "Elections were just as one-sided as during the Empire. The 'politics of the governors' and *coronelismo* were successful in virtually guaranteeing certain victory in state and federal elections for the candidates chosen by the elites and bosses. In terms of the presidential elections the margin of victory was invariably overwhelming and often represented more than 90 per cent of the popular vote. The political system was openly corrupt and repressive. The turn-out at elections was low because the franchise was narrowly restricted and registers of voters were carefully monitored by the *coroneis*.

of São Paulo and Minas Gerais. It was natural that among the twenty states of the Union, the most important coffee producing State, São Paulo, retained strong leverage on the federal affairs. The other key player was the State of Minas Gerais because of its importance as the main constituency inside the Union[289]. The gravitation of these two states heavily influenced the political life of the Union, to the point that for more than three decades there was an alternation of federal Presidents coming from those two major states. Brazilians used to call the agreement '*café com leite'* (mix of coffee produced by São Paulo and milk produced by Minas Gerais)[290].

In spite of the apparent stability of the '*café com leite*' pact, key changes were occurring in the background of the first Republic. Other states increasingly contested this predominance, the most notorious being the southern Rio Grande do Sul. This State claimed more influence in federal affairs, and held the sympathy of part of the military, since one-third of the federal army was located at the Brazilian borders to the south with Argentina and Uruguay, along with the main military academy outside Rio do Janeiro. In sharp contrast to the coffee predominance of São Paulo and Minas Gerais, this Southern State produced mostly agricultural and meat products for the internal market. The main produce was *charque* or jerked beef, which was consumed by the low income population of Rio de Janeiro and the pauperized North East of the country. It also produced butter, cattle hides, rice, wheat, wine and mate[291]. But the changes also emerged within urban society. All over Brazil cities were growing, and with them a new bourgeoisie was becoming aware of its increasing political power and aspired to increase its influence on the federal structures. Furthermore, those key families which constituted the bulk of the landowner oligarchy were far from politically unified. Although they shared similar views, their different roles in the long chain of the coffee production, transport, stocking and distribution did not always mean similar interests, which were often conflicting. This characteristic constituted a key element of weakness in face of the nationalistic forces of the time, the emergence of new interest groups in the cities and the crisis in the coffee market.

From the intellectual point of view, there were also changing trends. There were prolific thinkers who since the beginning of the century had analysed the underdevelopment of the

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Moreover, there was no secret ballot and votes were usually cast publicly. Where opposition emerged, it was often suppressed by fraud and violence. The closed nature of the political system facilitated the growth of one-party state politic machines, a development that further stifled political participation and acted as an obstacle to the formation of national political parties with competing ideologies and programs. The power of the state machines was also evident in the National Congress whose members were selected mainly for their loyalty and obedience to their particular state party (…)". According to Dulles (1967, p. 14), votes were reported by the local political bosses, known as 'colonels', whose powerful positions were the reward of supplying election returns satisfactory to the State machinery. The country had no secret vote, and if the vote on a ballot was ever a secret from anyone it was secret only from the person recorded as casting that particular ballot. Not infrequently districts reported the results before the voting was done, and there was plenty of well-founded doubt as to the currency of the lists of electors. Other analysis of this aspect of the Brazilian politics can be found in Aspásia (1983).

[289] The other states were: Amazonas, Pará, Maranhão, Piaú, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia, Minas Gerais, Espirito Santo, Rio de Janeiro, São Paulo, Paraná, Santa Catarina, Rio Grande do Sul, Mato Grosso, Goiás and Distrito Federal.

[290] In words of Dulles (1967, p. 14), there was a "golden rule in Brazil, which ensured that the two wealthiest and most populous of Brazil's twenty states, São Paulo and Minas Gerais took turns supplying presidents of the Republic".

[291] This product is a traditional tea consumed in Argentina, South of Brazil, Paraguay and Uruguay.

country and proposed more nationalistic approaches to overcome what they perceived as the disintegrating forces within the society. That is the case, for example, of Alberto Torres, who between 1910 and 1914 argued for a strong and efficient national government ruling with renewed powers over the federal states. He even proposed to change the name of the country from '*República dos Estados Unidos do Brasil*' to '*República Federativa do Brazil*'- the official name nowadays-, as a way to highlight national unity over local autonomy, with strong federal intervention in all aspects of the country. In a way, the consolidation of the federal structures would become the triumph of the Nation over the decadent structure of the states' oligarchies[292]. Those ideas deeply influenced a generation of young military men, the '*tenentes*', who during the twenties had a leading role in the uprisings from 1922 to 1924 in Rio de Janeiro, São Paulo and Rio Grande do Sul. Although their points of view were somewhat confused, they wanted a deep change in the national administration with a strong federal government, public services devoted to assisting society and a strong national identity. In order to achieve these goals, they believed they had to resort to an elite of technocrats not connected to the political structures of the time.

Regarding the international standing, Brazil chose an uncompromising policy. It retired from the League of Nations, refused to sign the Kellogg–Briand Pact[293] and its part in the Bolivia-Paraguay dispute was ambiguous. Foreign observers such as the British Ambassador to Rio attributed these policies to the state of fraternal peace in which Brazil and its Spanish-speaking neighbours lived, that rendered its adherence to external pacific organisations superfluous[294]. And even though he also criticized the Brazilian diplomacy for being 'slumbering and incompetent'[295], the fact is that the so-called '*Itamaraty diplomacy*' has always been renowned among South American countries as one of the best. Its major achievement has been the consolidation of its enormous territory with secured and defined borders, almost without the conflicts that other nations had to suffer in other to consolidate themselves.

ii. It's all about coffee. Isn't it?

As we have pointed out, the politics of coffee was at the core of the Brazilian economy and politics. Many authors spend significant effort in analysing the role of coffee in the political developments and the economic policies before and after the fall of the old Republic. And indeed it is not possible to understand Brazil in the context of the thirties without the analysis of the Great Depression in coffee.

At the end of the XIX century, Brazil escaped unharmed by the diseases that affected other key world coffee competitors like Ceylon. Good luck, good weather, abundant labour and a well-established coffee growing class consolidated Brazil as the main worldwide supplier of coffee.

[292] For more detailed analyses of Torres' work, see Lauerhass (1986).
[293] The Kellogg–Briand Pact (also so-called the General Treaty for the Renunciation of War or the World Peace Act) was signed by France, Germany, Italy, Japan, the UK and the US among others on August 27th 1928, and it provided for a prohibition on the use of war as 'an instrument of national policy'.
[294] See telegram from Mr. W. Seeds to the Foreign Office (Mr. A. Henderson) dated June 27th 1930. Report presented by the Minister of Foreign Affairs to the President, in FO 371-14200, p. 47.
[295] Ibid.

Coffee also benefited from the abundant credit for financing the opening of new producing land and the depreciation of the Brazilian currency. São Paulo became the main producing State thanks to wise policies that took advantage of newly autonomy from the federal government achieved after the proclamation of the first Republic in 1889, the inflow of immigrants from Europe, and the high productivity of the new coffee lands in the North-west of that State. Those factors contributed to areas being rapidly planted up during the twenties which eventually fostered overproduction and strained its management[296].

In spite of its contribution to the national economy, coffee also entailed a heavy dependence on a very unstable staple. Certainly, the coffee market was strongly price-inelastic, so the demand did not react significantly to price fluctuations. Specifically, in case of plunging prices, the demand tended to be less responsive, and as a consequence the value of exports was more prone to fall than to surge, and if in addition the market deterioration occurred in the context of an economic downturn in the core countries, the prospect of serious balance of payments deterioration was almost certain. Furthermore, the supply side was also unstable. Bumper crops were frequent because of uncontrollable factors such as good weather, combined with the incorporation of new producing areas of high productivity, favoured by structural causes such as high levels of immigration and construction of new roads and railroads, especially in São Paulo.

Coffee was unique at the time because no other staple in Brazil presented the kind of monopolistic market conditions which would make it a suitable candidate for a profitable market control mechanism. And the federated states enjoyed the benefits of the decentralization under the first Republic and were constitutionally able to resort to export taxes to finance the costs of such mechanism and contract loans abroad[297]. Knowing this, the presidents of the states of São Paulo, Minas Gerais and Rio de Janeiro, signed the Taubaté Agreement of 1906 that established the basic outline of what would be called the *defesa* system and would involve also the federal government over time. The mechanism was aimed to increase the value of coffee, to promote its consumption, to regulate its commerce and to prevent the sudden flooding of Brazilian coffee on the world markets which used to destabilize world prices[298]. Following Furtado (1985, p. 179), its main elements were:

- The government would restore the equilibrium between supply and demand by purchasing the excess of supply.
- The purchases would be financed with foreign loans.
- The service of such loans would be financed by a tax to be levied in gold on every bag of coffee exported.

[296] Some authors highlight the weather as a key element. For example, (…) "when full weight has been given to such factors, the weather must be adjudged to have played the most important part. The 1929 bumper crop was mainly just bad luck from the control's point of view, just as it was pure chance that it should have occurred when the impending Wall Street crash made further borrowing impossible. Nevertheless, from Brazil's longer-period point of view, these were fortunate events, for at least they forced the control to draw in its horns, and face the problem as one of liquidation, not continued valorisation" (Rowe, 1965, p. 135).
[297] See Furtado (1985, p. 180).
[298] See Stein (1979, pp. 61-62).

- The state governments would discourage the expansion of plantations in order to reduce the problem of oversupply.

The key element of the *defesa* system was the storage of a significant part of the world coffee stocks at government controlled warehouses, with the aim of regulating world prices and preventing a negative impact on the international balance of the country. Probably the most accurate definition of the Brazilian coffee scheme was given by Rowe (1965, p. 122), who described it as an incomplete national cartel of a compulsory character seeking to influence the world market by regulating exports. It was in no sense an international cartel, even though it was largely financed by bankers in a number of European countries, and at least for the coffee planters and politicians of São Paulo it was beneficial for that State and Brazil as a whole.

For many contemporaries this scheme was a good solution to the overproduction that used to affect the coffee market, and indeed for several years it contributed to some degree of price stability and continuous expansion of the land devoted to the crop. As a consequence, coffee became a key element in the inflow of gold and a major determinant in the exchange stability of the country. It also consolidated São Paulo and its main port, Santos, as the main economic pillar of the country´s economy. However, it entailed two key flaws: distortions in the price transmission mechanism and dependence on the availability of foreign loans. Investments in coffee remained attractive as the scheme artificially ensured steady profitable prices for long periods of time. Thus, the problem of oversupply only deepened over time as the price transmission mechanism was altered and stimulated further investments regardless of market conditions. The authorities were incapable of discouraging plantation since there were no other staples profitable enough to attract investments away from coffee. As explained by Furtado (1985, p. 180-182), the success of the scheme strengthened the power of the coffee elites, which managed to submit the federal government until 1930.

Since 1922, the system of price support relied on the direct intervention in the quantity of coffee flowing from the countryside to the main ports of loading in Rio de Janeiro and São Paulo, by crop-withholding at producing areas and at warehouses located at main railway junctions. There were also port entry controls, so that the planter could only ship quantities defined by the federal government according to a first in-first out schedule. The government assumed the responsibility for purchasing the coffee delivered by the farmers to the warehouses, and the farmers received cash advances after the delivery of the product to the warehouses on the basis of the financial system's assessment of the price ruling at the Santos terminal on the day of the actual sale. Normally, cash advances accounted for 60% of the real price of the sale[299].

In 1924 at the end of the Bernardes government, the federal government withdrew from the system and the State of São Paulo took control of the *Instituto de Defesa Permanente do Café*, in a decision that gave for the first time to the state's oligarchy the power to defend its own

[299] To be more precise, the official regulating warehouses, issued negotiable certificates of deposit against which the farmers or their commissaries should procure the cash needed to cover the farms' working capital requirements during the retention period. It was the farmer, as the ultimate holder of the stocks, who would bear the risks of the operations and reap the resulting profits.

interests. This outcome was almost natural if one takes into account that this State alone was delivering by the mid-twenties about 50 or 60 % of the 16 million bags a year provided by Brazil to a world market demand of about 20 million bags a year. The governing council of the Institute was in the beginning a college of five members, but in 1926 a loan provided by Lazard's of 10 million pounds to the government of São Paulo strengthened the state's position and allowed it to transform the governing council into a merely consultative body, appointed directly by the President of São Paulo[300]. The Institute was renamed as the *Instituto do Café do Estado do São Paulo* (ICESP), and was allowed to buy the regulating warehouses and a bank which was renamed *Banco do Estado de São Paulo* to manage the Institute's finances. The main purpose of the ICESP was to negotiate foreign loans and coordinate assistance to the planters, while the *Banco de São Paulo* took responsibility for keeping the Institute's funds and financing the coffee industry. As explained by Fritsch (1988, pp. 128-129), the bank lent the proceeds of the Lazard's loan on the security of warrants issued by the official warehouses against coffee delivered to them, at a fixed valuation of 60 milréis per bag, which was about 40 per cent of the current quotation of the grade 4 option at the Santos market. The system was completed by a special tax of milréis *ouro* in gold on the coffee transported in the State of São Paulo that was levied to warranty the service of the foreign loans. Furthermore, the *Instituto* extended credits to the coffee producers and traders with the warranty of the coffee stockpiles, collected statistics and promoted the coffee in general.

But regardless of the importance of the paulista coffee production, this scheme was not able to work without the cooperation of the other coffee producing states, and for that purpose the *Instituto* was in charge also of negotiating agreements with other coffee state producers, especially in order to promote the extension of the transport tax to the rest of Brazil. Indeed, the 8 million bags that other Brazilian states could produce along with the 7 million produced by other countries, meant a limited potential for the *Instituto* to control the market by itself. It needed the support of the other Brazilian states, especially Minas Gerais and Rio de Janeiro, which represented 20 or 30% of Brazilian output. Consequently, these two states cooperated with São Paulo in order to keep the system running.

However, two important aspects regarding the stability of the coffee scheme need to be kept in mind in relation to the upcoming Great Depression. On the one hand, the federal government did not include coffee as the main priority of its macroeconomic policies. Washington Luís, during his presidency of the State of São Paulo in the early twenties, had not really been open to the idea of artificially supporting the price of coffee. During his federal presidency, he remained consistent to his beliefs and continued to rule out further involvement of the federal government in the coffee *defesa* scheme. Furthermore, since the *paulista* oligarchy tended to identify the national interest with the coffee sector interest, a clash with the federal government was a matter of time. Thus, it is possible to think that the stubborn orthodoxy of the Luís administration and

[300] At the time, it was difficult to find sources of financing in the United States, since the Secretary of Commerce, Herbert Hoover, denounced the Brazilian plans to defend coffee prices, arguing that it would be prejudicial for American consumers. Nevertheless, the London merchant bankers had no difficulty finding a market for the São Paulo bonds (Marichal, 1989, pp. 195-196).

his tendency to subordinate the coffee sector to the big macroeconomic picture under the rationale of the gold standard cannot be ruled out as one contributing factor to the revolution of 1930. And this is possibly an important difference with Argentina and Uruguay, whose governments were more open to debate the enactment of heterodox policies, at least before the arrival of Getulio Vargas to the presidency.

On the other hand, the simplifying concept of an 'oligarchy' may be misleading, since it was far from politically unified or coherent. In spite of the wealth produced by coffee during the twenties, the relative heterogeneity of the coffee sector and the dependence on foreign loans to keep the valorisation scheme running reduced its autonomy in the face of the federal government. This characteristic becomes evident from the analysis of the ICESP composition. Since 1926 the ICESP was under the complete control of the *Partido Republicano Paulista*, the same political party that projected Washington Luís to the presidency of the State and later to the federal government. This state of things, however, left aside parts of the state's oligarchy, which although sharing similar interests, remained mostly excluded from the benefits of power. In this line of thinking, Fritsch (1990, pp. 64-65) plays down the influence of the oligarchy in the federal government, at least in economic policy. For example, the government ruled out the support of the *defesa* system in 1929 and did not support a federal structure to control the *defesa* system during the twenties. Although the coffee oligarchy was key in the politics of the country, there were other players that had equal or more influence in monetary and fiscal policy. The stubbornness of Luís in keeping the country under the gold standard and the aversion of the foreign bankers, the US government and national conservative sectors, notably in Minas Gerais, to the involvement of the federal government in the control scheme, kept that possibility out of the question. The government only intervened in support of the coffee prices whenever the macroeconomic stability was at stake due to the overall influence of the coffee sector in the economy and in the foreign imbalances. Another aspect to take into account is that there were coincidences between the interests of industrialists and coffee producers, as frequently the latter tended to diversify their interests into the import substituting industries.

As a reaction to this state of affairs, a new *Partido Democrático* was created in 1925, in a move that contested directly the leadership of Luís. It mostly represented the traditional urban middle class, but was also tied to the coffee sector. Eventually, the *Partido Democrático* supported the candidacy of Getulio Vargas for the presidency under the umbrella of the *Aliança Liberal* in 1929, even though as we have explained the opposition did not question fundamentally the coffee valorisation scheme. This particular aspect of the developments of the twenties, namely the role of the coffee interests for both political contenders, is quite important in understanding why the revolution of 1930 was initially so lacking in new economic ideas to correct the deteriorating economic situation of the balance of payments and the consequences of the economic downtown. Probably, the apparent coincidence of interests between the political leaders of the revolution and the paulista coffee oligarchy may explain the fact that during the first years of the Vargas administration the federal government would step again into the rescue of the coffee industry, once the reluctance of President Luís was suddenly ended. However, the end result was an increased centralization of the coffee policy by the federal government, a feature exemplified by the creation of the *Conselho Nacional do Café*, later replaced by the *Departamento Nacional do Café*. This policy, added to the economic dislocation of the agro exporting backbone of the economy in favour of a new emerging industrial and urban centred model, reduced the power of the regional elites, notably the coffee interests in São Paulo. At the same time, the creation of *conselhos econômicos* following the corporative representative model opened new channels of articulating industrial interests within government structures[301]. But this process was neither bloodless nor easy. The paulista coffee interests in particular and the paulista society in general were reluctant to accept a deepened process of subordination to the federal government. That hostility manifested in the so-called *revolução constitucionalista* of 1932 that started on July of that year, and was only suppressed in September. Not only had the agro interests participated in this uprising, but also industrialists and the middle classes. The civil war affected commerce in 1932 at the beginning, but the public expenditure associated with the war attenuated the financial impact of the conflict, and during 1933 the country emerged from depression[302].

Although further involvement in the long-term analysis of the role of coffee in the society and politics of the time lies beyond the scope of this research, it is a matter that will be popping up, as it remains in the background of the policies applied in the face of the international downturn that accompanied the fall of the old Republic and the birth of a new Brazil. The message is that the long-term role of the coffee oligarchy and interests remain as an obligatory framework to understand the short-term economic emergency policies, and were indissolubly linked to the inflow and outflow of gold and the economic and social stability of the country as a whole. That, of course, would change a few years after the new Vargas administration consolidated over time, and especially after 1937 with the so-called *Estado Novo*, but for the time we are interested in analysing, coffee was still a key element in the decision-making process in the face of the Great Depression and the imbalances that it rendered evidently unsustainable. As Furtado (1985, p. 180) notes, the mechanism of the coffee economy was ultimately a process of transferring to the future a problem that would become increasingly worse. Simply put, the supply in Brazil outbalanced a consumption that, for example, remained steady at the end of the twenties in its main export market, the United States. The collapse in our view was unavoidable, even without a Great Depression as a precipitating factor.

iii. A golden illusion

At the beginning of the Luís administration in 1926, the main lines of the deflationist policies pursued by the previous Bernardes administration were retained. At the end of the year the prices had stabilized and the external position was improving, although the government was in deficit. According to Fritsch (1988, pp. 121) it was a time of very tight monetary policy between a past of great exchange rate instability with a strong underlying depreciating trend and a future in which, according to the general expectation, there would be a favourable balance of payments position due, particularly, to the good prospects of foreign capital inflows. Both Luís and

[301] See Diniz (1986, p. 45).
[302] See Hilton (1977, p. 94).

Bernardes agreed about the need to return to the gold standard, as well as the negative differential effects of exchange fluctuations on the real income of the social classes, although the latter prioritized the short-term effects of the exchange rate fluctuations on the economy and society. The key difference was the rate at which to peg the exchanges and the timing of stabilization. Bernardes was deeply influenced by the orthodox opinions common in financial circles that stressed the risks of devaluation-induced inflation and their negative impact on labour.

For the new Luís administration tight monetary policy, currency stabilization and budgetary equilibrium were the three main pillars. Luís favoured immediate stabilization without revaluation, in order to allow a sustained increase in the balance of payments. With the subsequent reinforcement of foreign capital inflows and loans, the accumulation of gold reserves needed to achieve the ultimate objective of returning to the gold standard would be possible**.** For that purpose, on November 21st 1926, a currency bill was introduced with the objective of eventually reintroducing the gold standard in three stages: stabilization proper, convertibility, and coinage of the gold cruzeiro to replace the milréis. In the first stage, a new standard for the milréis was fixed at 200 milligrams gold, .900 fine, which corresponded almost exactly to 40 milréis to the pound sterling. A special agency called *Caixa de Estabilização* (stabilization fund), effectively functional since April 16th 1927, was granted the authority to receive all present and future gold stocks in the country and to issue paper currency against Brazil's gold credits in London and New York. And as a consequence, at the time there coexisted in Brazil three kinds of currency: the Treasury's unconvertible bills, the old notes of the *Banco do Brasil* and the gold certificates of the stabilization fund[303]. Similar authority would be granted to the *Banco do Brasil* if the stabilization fund were extinguished, in order to keep the exchange at the new parity, at rates that should correspond exactly to the national monetary situation. The second phase would be implemented as soon as the stock of gold accumulated at the *Caixa* reached a level suitable to allow for the convertibility of all other circulating currency, including the notes not issued by the *Caixa*. Finally, the *Banco do Brasil* would assume the full authority to issue a newly created currency that would be named the *Cruzeiro*, equal to one milréis per unit[304]. Behind this proposed program lay the big debate of the time, namely the convenience or not of transforming the *Banco do Brasil* into a full Central Bank, an idea debated at least since 1905 and opposed by the conservatives[305].

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[303] According to Frisch (1990, pp. 57-59), the creation of the *Caixa* in 1926 had a clear political objective. It was designed to comply with the domestic producers' demands, who sought a reduction in the appreciation path of the currency and more credit. The expected recovery and the expansion of the American and British investments in the context of the gold standard meant an automatic increase in the *Caixa* issues, reversing in that way the contraction of the monetary base in previous years. On the other hand, the gold standard forced the government to apply fiscal constraint and a non-discretionary monetary policy, both aspects mostly welcomed by policymakers and most importantly by the external creditors.

[304] See for example Fritsch (1990, pp. 56-57), Fritsch (1988), Bello (1966, pp. 259), among others.

[305] According to Frisch, by the twenties the so-called real bill doctrine in the monetary policy was increasingly influential in the debates, which holds that issuing money in exchange for real bills is not inflationary: "This agitation, as noted by Neuhaus, also reflected the worldwide growing influence of the real-bills doctrine among Brazilian banking and business circles, which saw in the granting of certain central banking powers to the *Banco do Brasil* the solution to the problem of adjusting the supply of money to the seasonally variable

The stabilization process benefited from favourable conditions on several fronts. Until the crisis of the coffee sector in 1929, there was a continuous influx of gold so that the *Banco do Brasil* received 10 million pounds sterling for its exchange activities and the *Caixa* another 20 million pounds (in total around one-third of 1929 exports). As predicted by the gold standard model a renewed inflow of gold reversed the previously restrictive monetary policy by increasing the monetary base and fuelled an inflationary process, in an environment of improving economic activity since the second half of 1927. This trend allowed Brazil's gold reserves to rise back up to 35 % of the total outstanding issue by mid-1928. As the government did not issue long-term domestic debt, those measures reinforced the expansionary effect of the increased monetary base during 1928. This monetary easing, together with the expansion of the commercial bank loans that lasted up to the first semester of 1928, contributed to the improving economic performance since the second half of 1927. According to Bulmer-Thomas (1994, p. 191), excluding cotton textiles, where ferocious international competition took its toll, industrial output rose by 55% between 1920 and 1929, meaning an annual growth rate of 5%. Many new industries were established in the twenties, including a number of firms making capital goods, and the iron and steel industry made some progress. Perhaps most importantly of all, imports of industrial equipment rose sharply, creating new industrial capacity and modernizing existing plants. Indeed, imports of industrial machinery reached a peak in 1929. Foreign trade also peaked in 1928 and as it explained 47% of the government's revenue in 1928, the fiscal balance improved significantly. Furthermore, the Luís administration also increased tariff revenue due to the suppression of tariff exemptions on certain imports of intermediate and capital goods, and made a conservative use of public social spending. All of which resulted in a substantial budgetary surplus for the first time since 1907.

The dark side of this booming economy is that the country increased its dependence on foreign loans. Many important firms took risky financial positions due to the good prospects for the economy and to the lenience of the Brazilian bankruptcy laws[306], and the accumulation of foreign debt amounted to 1,142 million US dollars by 1928 or 2.36 times the annual exports of the country[307]. The public sector also boosted its share in the economy supported by foreign loans. By 1930 the federal government owned close to one-third of all Brazilian railroads, half the merchant marine and the largest bank. Only Uruguay could be mentioned as a frontrunner in this regard during the thirties, with its monopolies in banking, insurance, ports, electricity and

'needs of trade'. The idea of reforming the Bank on these lines, endowing it with powers to issue inconvertible notes on a fractional gold reserve basis as proposed by its President had, however, encountered strong opposition during the war from a group of influential politicians who held orthodox views on monetary policy" (Fritsch, 1988, p. 55). "The idea of eventually having the *Banco do Brasil* operating as a Central Bank, under a fractional gold reserve system with full convertibility, was still envisaged. Although not explicit in the reform Bill, the President (Luís) repeatedly proclaimed his intentions to devolve central banking powers to the Bank after full convertibility was achieved" (Ibid., p. 125).

306 See Fritsch (1988, pp. 140-141).

307 See Abreu (2008, p. 290). According to this author, it is important to highlight the importance of the debts from states and municipalities. Regarding this matter, a decree brought the financial support of the Federation for the payment of the state debts on December 20th, 1930. Later, in 1933, the *Comissão de Estudos Financeiros e Econômicos dos Estados e Municípios* was created, with the main task of analysing the problem of debts at state and city level.

fuels, among other strategic economic infrastructures. The federated Brazilian state governments also became public entrepreneurs, using foreign loans to assume control of local railways and ports. Similarly, municipal governments used foreign funds to become chief promoters of the electrical power industry, there being more than 400 municipal lighting companies by the twenties[308]. This reliance on foreign loans would become one important source of vulnerability for the Brazilian economy.

Conclusion

By the twenties, Brazil was heavily underdeveloped. It was a mono-exporter of commodities. By 1929-1933 almost 57% of world coffee exports were of Brazilian origin, and for that reason Brazil had an oligopolistic influence over the markets. Thus, the country was highly sensitive to the volatility of international prices of the product and other market conditions of this single crop. There was also an important dependence on exports to the US, as around 45% of Brazilian exports in 1928 were exported to that country, followed by European countries. Consequently, in the balance of complex vulnerabilities, even though Brazil had influence on the international market of coffee, it was highly vulnerable to changes in the policies affecting its trade.

However, the Great Depression can be considered a turning point in the productive structure of the country in many ways. Coffee success was the result of direct intervention of the government through the coffee *defesa* scheme. Even before the failure of the coffee policy during the Great Depression, other agricultural products such as cotton, as well as new industrial activities, started to change for good the productive profile of the country. The emergence of a process of steady industrialization was a driving force behind the ascension of new urban forces that claimed more participation in the country's politics, and entailed a renewed potential trend for protectionist policies.

From the political point of view, during the twenties there was an erosion of the first Republic created in 1889, marked by a growing opposition to the '*café com leite*' pact between the states of Minas Gerais and São Paulo, by other states seeking more influence in the federal government. Any difficulty in the economic front would put this pact to further strain.

Finally, the issue of the gold standard had a strong influence on the policy decision-making of President Luís' administration. The return of Brazil to the gold standard was a strong governmental vow, but that commitment was supported with increased reliance on foreign loans, and determined potentially a risk of strong tight monetary policy in an eventual context of strong deficit in the foreign balance of hard currency.

[308] See Marichal (1989, p. 199).

Map of the Oriental Republic of Uruguay in 1911