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historiadodireito@historia.uf.br

Universidade Federal Fluminense  
Brasil

Ianoni, Marcus

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## **SOME POLITICAL CHANGES IN BRAZILIAN FINANCIAL INSTITUTIONALIZATION PATH**

## **ALGUMAS MUDANÇAS POLÍTICAS NA TRAJETÓRIA DA INSTITUCIONALIZAÇÃO FINANCEIRA BRASILEIRA**

## **ALGUNOS CAMBIOS POLÍTICOS EM LA TRAYECTORIA DE LA INSTITUCIONALIZACIÓN FINANCIERA BRASILEÑA**

## **QUELQUES CHANGEMENTS POLITIQUES DANS LA TRAJECTOIRE DE L'INSTITUTIONNALISATION FINANCIÈRE DU BRÉSIL**

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**Marcus Ianoni<sup>1</sup>**

### **ABSTRACT**

This article discusses recent political changes in the trajectory of financial institutionalisation in Brazil. It considers how, since Lula's two mandates, the Brazilian financial system has trialled several changes to its characteristics in comparison to the events of the 1990s. These new trends have also occurred mainly because during Lula's two mandates and today's mandate under Dilma Rousseff, a developmental economic policy has been implemented in which Brazilian state-owned banks play a more active role. This is especially true of the approach to 2008's international financial crisis and that employed since August 2011, which has seen the Central Bank of Brazil (BCB) liaising with other public economic agencies, such as the Ministry of Finance, under the political authority of the Brazilian president.

**Key words:** financial institutionalization, state-owned banks, Central Bank of Brazil, economic development, monetary policy.

### **RESUMO**

Este artigo argumenta sobre mudanças políticas recentes na trajetória da institucionalização financeira no Brasil. Ele considera que, desde os dois mandatos de Lula, o sistema financeiro brasileiro tem experimentado algumas mudanças em suas características em comparação com o que ocorreu nos anos de 1990. E essas novas

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<sup>1</sup> Professor Adjunto, vice-coordenador do Programa de Pós-graduação em Ciência Política do Instituto de Ciências Humanas e Filosofia da Universidade Federal Fluminense (UFF). E-mail: [marcusianoni@uol.com.br](mailto:marcusianoni@uol.com.br).

tendências tem ocorrido principalmente porque naqueles dois mandatos e agora no mandato de Dilma tem sido implementada uma política econômica desenvolvimentista na qual os bancos públicos brasileiros tem um papel mais ativo, especialmente para fazer frente à crise financeira internacional de 2008 e, desde agosto de 2011, o Banco Central do Brasil (BCB) tem atuado coordenadamente com outras agências públicas econômicas, como o Ministério da Fazenda, sob a autoridade política da Presidência da República.

**Palavras-chave:** institucionalização financeira, bancos públicos, Banco Central do Brasil, desenvolvimento econômico, política monetária.

## RESUMEN

Este artículo argumenta acerca de los cambios políticos recientes en la trayectoria de la institucionalización financiera en Brasil. Él considera que, desde los primeros mandatos de Lula, el sistema financiero brasileño experimenta algunos cambios en sus características en comparación con lo que pasó en los años 1990. Estas nuevas tendencias ocurren sobre todo porque en aquellos dos mandatos y ahora en el mandato de Dilma ha sido implementada una política económica desarrollista en la cual los bancos públicos brasileños poseen un papel más activo, especialmente para hacer frente a la crisis financiera internacional de 2008 y, desde agosto de 2011, el Banco Central de Brasil (BCB) actúa coordinadamente con otras agencias públicas económicas, como el Ministerio de la Hacienda, bajo la autoridad política de la Presidencia de la República.

**Palabras-clave:** institucionalización financiera, bancos públicos, Banco Central de Brasil, desarrollo económico, política monetaria.

## RÉSUMÉ

Le présent article étudie les changements politiques récents dans la trajectoire de l'institutionnalisation financière du Brésil. Il y est défendu que depuis les deux mandats de Lula, le système financier brésilien est passé par des changements dans ses caractéristiques par rapport à la situation des années 1990. Et ces nouvelles tendances ont surtout vu le jour en fonction de la mise en œuvre, lors de ces deux mandats et aujourd'hui avec celui de Dilma Rousseff, d'une politique économique de développement au sein de laquelle les banques publiques brésiliennes ont joué et jouent un rôle des plus actifs, principalement pour affronter la crise financière internationale de 2008. Depuis août 2011, la Banque centrale du Brésil (BCB) agit conjointement avec d'autres organismes

économiques publics, comme le ministère des Finances, sous l'autorité politique de la Présidence de la République.

**Mots-clés:** institutionnalisation financière, banques publiques, Banque centrale du Brésil, développement économique, politique monétaire.

## 1. Introduction

This paper aims to discuss some recent political changes in Brazilian financial institutionalization path.<sup>2</sup> We consider that since the two governments of Lula (2003-2010) Brazilian financial system has experienced some initial changes in their characteristics comparing them with what occurred in 90s. And these new tendencies have occurred mainly because the governments of Lula and now in Dilma's it has been implemented a developmentalist economic policy in which both Brazilian public banks had a more active role, especially for facing the international financial crisis, and BCB has acted coordinately with other public economic agencies, like Ministry of Finance, under the political authority of the Presidency of Republic.

In the history of industrialization and economic modernization of Brazil, that started in the 30s, the financing of investments in major development projects was carry out mainly, or by the state or by foreign capital, or by the association between public sector capital and private capital. Medium and small sized projects have had their investments financed by the reinversion of company profits. The Brazilian banking system, especially the private sector, differently, for instance, from the German, traditionally had little involvement in the financing of capitalist investment in the country.<sup>3</sup> Moreover, Brazilian banks have not been effective in incorporating the majority of the population to credit and other financial services. Bank credit in Brazil is still scarce and very expensive.

These characteristics of the Brazilian banking system lead to the debate on the model of financial institutionalization existing in the country. Economics and political economy, as well as the political science literature on *varieties of capitalism*, show the

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<sup>2</sup> It is a first production of a new research in political sociology of financial system in which the author has engaged.

<sup>3</sup> Carvalho, Fernando J. Cardim de (2009). "Uma contribuição ao debate sobre a eficácia da política monetária e algumas implicações para o caso do Brasil". In Oreiro, J. L.; Paula, L. F. de; Sobreira, R. (Orgs.). (2009). *Política monetária, bancos centrais e metas de inflação*, Rio de Janeiro: Ed. FGV, p. 53-69. Carvalho, Fernando J. Cardim de (2010). *Reformas financeiras para apoiar o desenvolvimento*. Brasília, DF: CEPAL-IPEA. Texto para discussão CEPAL-IPEA, 14.

importance of financial institutionalization in the development. In Brazil, one of the most important issues in the debate about development is the model of financial institutionalization and the monetary policy implemented by monetary authority.

We believe that the political and ideological relationship existed between Center Bank of Brazil and the organized financial interests has implied in a conservative monetary policy, mainly, since 1994 until 2009, when some more significant changes pass to occur and are intensified in the Dilma administration, started in January 2011.

This paper considers the Brazilian banking system institutionalization inefficient in terms of its ability to play a more active role to maximize the development possibilities<sup>4</sup>. Brazilian banks intermediate many businesses related to financial flows, via National Treasury bonds, but they are still little involved in the financial intermediation of productive activities, especially the industrial ones.

The transformations in the Brazilian banking industry occurred since the implementation of the monetary stabilization policy in 1994 has not changed that situation. But from 2003, with the formation of the Lula government, some changes started to happen and more yet after the international crises of 2008.

The previous government sustained a macroeconomic policy compose by a tripod, inflation targeting, floating exchange rate and primary budget surplus. Although the two Lula governments held the three major pillars of the macroeconomic policy of its predecessor, they were carried out with a new kind of political managing, whose focus has been the development, implying in public development policies.

We start from the assumption that Lula governments started some incremental changes in the trajectory of relationship between state and financial system. These changes were important to minimize the effects of *international crisis* in Brazil and to demarcate possibilities to shift the pattern of banking institutionalization towards a greater state coordination of the financial market. These changes have been more visible in the public banks and in the monetary policy. Our intention is show that these changes have been occurred because the government opted for them, choosing to play a more active political role in the development policies.

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<sup>4</sup> Carvalho, Fernando J. Cardim de (2004). "O Sistema Financeiro Brasileiro: a modernização necessária". In Sicsú, João; Paula, Luiz Fernando de; Michel, Renault (Orgs). (2004). *Novo desenvolvimentismo. Um projeto nacional de crescimento com equidade social*, São Paulo: Manole, p. 329-346. Jayme Jr., Frederico G. e Crocco, Marco (2010). "Bancos públicos e desenvolvimento econômico: uma introdução". In *Bancos públicos e desenvolvimento*, Rio de Janeiro: IPEA, p. 17-22.

The first section will present the theoretical approach of this article about the relationship between financial system and growth as well as the importance of the institutional structure of the financial system. Then, another section will discuss some general characteristics of the economical policy of Lula and Dilma governments, arguing that these administrations have chosen to abandon the strong liberal emphasis verified in economic policy of Cardoso to rebuild a more active role of the State in the economic policy aiming retake the development path lost in the 1980s. That more active political function of the state includes a new vision of the financial system. We believe that new changes mark a new path.

## 2. Financial system: Some theoretical elements

Economists disagree about which is the relationship between finance and growth.<sup>5</sup> We agree with theoretical approaches of development economics that contend that financial system is important to economical development.<sup>6</sup> A financial system that plays the function of boosting the development prosecutes mainly two functions. It ensures financial resources to the existing productive process and for the new investments. Further, it creates financial assets attractive to financial investors accumulate wealth.<sup>7</sup>

Firstly, it is necessary to consider that financial regulation is a key issue.<sup>8</sup> The recent international crisis had a financial origin, and regulatory failures in financial markets were important causes<sup>9</sup>. As well as financial regulation is an international concern it is also a problem that Brazil has to face.

An important although controversial concept is the one of financial structure. Financial structure covers financial instruments and contracts, markets, and institutions. It is important making researches that analyze relations between the financial structure and the financial services. In the last years, some authors have been researching the financial institutionalization to show that it is an important variable to understand the capitalist performance of a country because it is fundamental to the financial system functions.

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<sup>5</sup> Levine, Ross (1997). "Financial development and economic growth". In *Journal of Economic Literature*, v. 35, n. 2, p. 688-726.

<sup>6</sup> Ver: Gerschenkron, Alexander (1962). *Economic backwardness in historical perspective*, Cambridge, MA: Harvard University Press. Levine (1997). Op. cit.

<sup>7</sup> Carvalho, F.J.C. (2010). Op. cit.

<sup>8</sup> Ver: Hoenig, Thomas M. (1996). "Rethinking financial regulation". In *Economic Review, Federal Reserve Bank of Kansas City*, Second Quarter. Disponível em: <<http://www.kc.frb.org/publicat/econrev/pdf/2q96hoen.pdf>>. Acesso em: 23 ago.2011.

<sup>9</sup> International Monetary Fund (2009). *Lessons of the Financial Crisis for Future Regulation of Financial Institutions and Markets and for Liquidity Management*. Disponível em: <<http://www.imf.org/external/np/pp/eng/2009/020409.pdf>>. Acesso em: 17 jul. 2011.

Hall and Soskice have developed the *theory of comparative institutional advantage*, whose base is situated in the historical institutionalism. These authors stress that

*firms located within any political economy face a set of coordinating institutions whose character is not fully under their control. These institutions offer firms a particular set of opportunities; and companies can be expected to gravitate toward strategies that take advantage of these opportunities. In short, there are important respects in which strategy follows structure. For this reason, our approach predicts systematic differences in corporate strategy across nations, and differences that parallel the overarching institutional structures of the political economy.*<sup>10</sup>

But they are speaking of institutional structures in general and our problem here is apply that approach to identify comparative advantages between different institutionalization models of financial system.

In that sense, one theoretical relevant distinction is if the financial systems are centered in markets or banks.<sup>11</sup> We can say this in other terms, that is, some financial systems are based in credit and others are based in capital market. Moreover, in both these systems there are internal components that need to be identified. For instance, in a bank centered financial system it is important distinguish the presence and role of private and public banks. The public banks predominance may be a comparative institutional advantage and we think that they really are. Let us read Döring:<sup>12</sup>

*Compared with private banks, the advantages landesbanks and savings banks have as government owned banks are substantial. These advantages stem from the unconditional safeguards that the government provides for the creditors. In contrast to private banks, the landesbanks and savings banks are not corporations whose shareholders' liability is limited. Instead, they are public institutions for which the government takes on unlimited responsibility. This unlimited responsibility stems from legal concepts called "institutional liability" (Anstaltslast) and "guarantor liability" (Gewährträgerhaftung).*

Making an assessing of financial systems in European countries in transition, Grosfeld state:<sup>13</sup>

*Part of the literature advocating the adoption of a bank based financial system in CEEC [Central and Eastern European Countries] does not refer to any theoretical or empirical arguments. A number of authors implicitly accept an agnostic view*

<sup>10</sup> Hall, Peter & Soskice, David W. (2001). *Varieties of capitalism: the institutional foundations of comparative advantage*, Oxford: Oxford University Press, p. 15.

<sup>11</sup> Ver: Levine (1997). Op. cit. e Von Mettenheim, Kurt (2005). "Commanding Heights: para uma sociologia política dos bancos federais". In *Revista Brasileira de Ciências Sociais*, São Paulo, v. 20, n. 58, p. 47-66.

<sup>12</sup> Döring, Thomas (2003). "German public banks under the pressure of the EU subsidy proceedings". In *Intereconomics, Review of European Economic Policy*, Leibniz, German, p. 96.

<sup>13</sup> Grosfeld, Irena (1994). *Comparing financial systems: problems of information and control in economies in transition*, Center for Social & Economic Research, Warsaw, p. 13.

*about the relative advantages of various systems but claim that in fact reformers do not face any real choice: the stock exchange for a long time will play but a marginal role and the only feasible solution consists in relying on the development of the banking sector. In other words, banks cannot afford to remain passive, they have to actively participate in privatisation, preparing it, underwriting new public issues, providing financial advice, swapping debt into equity, etc. Additionally, it has been argued that in the case of mass privatization implying dispersed ownership, financial intermediaries, and notably banks, may provide control on managers and alleviate agency costs.*

In the first reference, Döring stresses the comparative advantage of public banks before private banks. After, we see Grosfeld show the importance of banking sector in CEEC, group of countries that have some similar characteristics with Brazil, how the little development of capital market. We can see that some researchers argue that public banks have own characteristics that allow them to play an important role either for the long-term development, or for the anti-cyclical policies. This statement is specifically appropriate to Brazil, country where private banks, as we see above, traditionally have had little involvement in the financing of capitalist investment.

Furthermore, the institutional framework of monetary authority and the kind of monetary policy implemented, seen in a Keynesian approach, have significant impact over the economic development. This author believe that it is likely that monetary policy be more important to economic growth than fiscal policy.<sup>14</sup>

Concluding this section, we saw that financial system is fundamental to development as well as the financial system regulation. We saw too that financial system institutionalization is another key variable, and a country can get comparative advantages from the institutionalization model of the financial system. We saw that strong public banks can propitiate comparative advantage of a country. Going beyond, we saw that public banks can have advantage comparing with private ones, because they are government owned and so can propitiate comparative advantage for a country. Finally, we reassert that financial regulation is a key issue.<sup>15</sup> The recent international crisis had a financial origin, and regulatory failures in financial markets were important causes.<sup>16</sup> A key issue of financial regulations is both the institutional structure of the monetary authority as the type of monetary policy implemented by it.

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<sup>14</sup> Carvalho, F. J.C. (2009). Op. cit, p. 67.

<sup>15</sup> Ver: Hoenig (1996). Op. cit.

<sup>16</sup> Ver: International Monetary Fund (2009). Op. cit.



### 3. Lula's government: changes in the economic policy and in banking system

Lula's government changed the pattern of public management, introducing new democratic practices and institutions for processing the relationships of interest between government and civil society. These changes were very important for the democratic management of economical policies that aimed the development. We can mention the Council of Economic and Social Development (CDES). This institution was created at 2003, in the beginning of Lula's government, and gathered employers and employees, entrepreneurs and workers, among others political actors, to discuss social and economics measures that could contribute for producing ideas and agreements aiming development. Acting so the government has got more consensus and legitimacy in a lot of important economical policies since they are negotiated with productive interests organized.

Already in 2003 Lula's government passed the law of the payroll loans, for instance. This law was negotiated between government, workers and bankers in the CDES and got by this way a tripartite consensus. By this policy, workers have got more and less expensive credit and bankers lend more and run less risk. *"At the height of the international economic crisis in 2008, the CDES suggested several measures to maintain employment, income and credit, strengthen the domestic market, maintenance of public investments in infrastructure and reducing the interest rate".*<sup>17</sup>

Furthermore, Lula's government, mainly since 2005, started to implement an economic policy more developmentalist, and that meant an inflection with the persevering neoliberal policies that predominated during the two first years of government. These developmentist actions were implemented in 2009 and 2010 in a more clear way in order to face the international crisis. The developmentalist policies have had three fundamental directions. One kind of them were some measures of fiscal and monetary stimulus to accelerate growth. Others were directed to social development by income transfer and minimum wage increase. And the third measures were the rising of public investment and public planning. These measures have been thought in terms of being important bases of a new development model, with growth and income distribution.

Before mention these measures, let's see some general indicators of financial and credit areas. The relationship between credit and GCP evolved year by year since 2002, when it was 22,0% and reached 46,4% in 2010. This relationship is yet low if we compare them with another emerging markets, like China or India, but the important here is show

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<sup>17</sup> This quote was extracted and translated by me of the CDES's site, and can be found in <http://www.cdes.gov.br/noticia/21194/cdes-realiza-a-primeira-plenaria-do-ano.html>.

that it increased. And we argue that this increase was the result of decisions, policies and actions taken and implemented by the federal government. By other side, at December 2002, there were 87.6 million of bank accounts, and at December 2010 this number grew for 161.7 million. But it is important note that both in 2002 and in 2010, the biggest part of these accounts, respectively 89.09% and 91,88%, was of low value (R\$ 5.000, equivalent to € 2240), what indicates the low income level of most Brazilians. But if we observe not the number of accounts, but the percentage of individuals who have a bank account, this indicator has passed by 39% in 2007 for 51% in 2010. Even so, the financial exclusion is high in Brazil, since half the population have no bank account.

During the two tenures of Fernando Henrique Cardoso (FHC – 1995-2002), the average growth of Brazilian economy was of 2.3% while in the two tenures of Lula, it was 4%. Beyond that the economic stabilization was not compromised, on the contrary, a lot of macroeconomic indicators improved at the same time that inflation was kept under control. The average prime rate was significantly smaller during Lula's government than in FHC's government. The smaller prime rate of FHC was 15.7% and the biggest was 85.74%. The smaller prime rate of Lula was 8.75% and the biggest was 26.35%. In this fifteen months of Dilma government the biggest prime rate was 12,5% and the smaller, existing now (march 2012) is 9,75%.<sup>18</sup> Public debt to GDP also fell significantly. In December 2005, Brazil paid all foreign debt with the IMF and became lender of that international organization in January 2010. Since 2008, Brazil has reached investment grade by international agencies that assess the credit risk.

How we were saying above, the economic area of Brazilian government implemented several anticyclical measures for opposing to the expected impact of the international crisis in the national economy. Already at the end of 2008 the government reduced the reserve requirements of banks to face the credit shortage and supporting the interbank market. But this measure was not sufficient to recover the credit flow. Then the government decided to use public banks as a source of credit injection into the economy, both for production and for consumption. Three public banks have fulfilled this function, National Bank of Economic and Social Development (BNDES), Bank of Brazil (BB) and Federal Savings Bank (CEF). Beyond that, it was decided that public banks would do more aggressive action to compete with private banks in the credit markets, mainly by reducing spreads of interest rates to increase their share in the banking market. *“Considering the*

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<sup>18</sup> Recently Minister of Economy said that prime rate goes follow in fall.

*most critical phase of the crisis, between September 2008 and July 2009, public banks have increased their supply of credit by 33%, while national private institutions grew 4%, and the institutions foreign, 1.5%.”<sup>19</sup>*

Mettenheim assess that for whom agrees with perspectives of the market economies State-centered and coordinated, public policies and political forces are indispensable to development and social inclusion. According to his thinking, *“if a bank multiplies money, the public bank multiplies the public policies”*.<sup>20</sup> Speaking clearly, the Lula’s governments were headed by the Workers’ Party (PT), whose social grassroots are originated from the popular classes. Public banks have traditionally rooting in those social bases. Really, Federal Savings Bank (CEF) and Bank of Brazil (BB) have played an important role in matters of financial inclusion, microcredit to poor people go out of poverty. These changes are yet new and must be expanded for that can effectively impact in the national economy.

But Brazilian public banks have faced an economic problem that can limit their social role. They are having a private management standard both to compete with private banks how to adapt themselves to fiscal and monetary disciplines required by public opinion, mass media and governmental economic area. In FHC’s government Brazil passed by a huge privatization program. Nevertheless in public banking area only regional banks were sold to private capital. Federal banks were not privatized. But until 2002 they were not viewed with a developmentalist look, by contrast, were seen as inefficient and unfair by the standpoint of neoliberal ideology that predominated in 1990s. The international crisis changed strongly for some political actors this point of view about Brazilian public banks because they were very important in addressing the crisis.<sup>21</sup> While neoliberal thinking imagined that the Brazilian financial system would converge to private banks and capital markets, the reality showed that this prediction was wrong.<sup>22</sup>

If we look for the Brazilian financial system since 1994, when Plano Real stabilized the high inflation, we will see that most important changes were of liberal content. Foreign

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<sup>19</sup> Barbosa, Nelson e Souza, José Antonio Pereira de (2010). “A inflexão do governo Lula: política econômica, crescimento e distribuição de renda”. In Sader, Emir e Garcia, Marco Aurélio (Orgs.) (2010). *Brasil: entre o passado e o futuro*, São Paulo: Boitempo, p. 90. Tradução do autor.

<sup>20</sup> Von Mettemheim, Kurt (2010). “Para uma análise transdisciplinar dos bancos públicos federais na democracia brasileira”. In Jayme Jr., F. G; Crocco, M. (Orgs.) (2010). *Bancos Públicos e desenvolvimento*, Rio de Janeiro: IPEA, p. 115.

<sup>21</sup> Vidotto, Carlos Augusto (2010). “Caráter estratégico dos bancos federais: a experiência brasileira recente”. In Jaime Jr., Frederico G. e Crocco, Marco (Orgs.) (2010). *Bancos públicos e desenvolvimento*, Rio de Janeiro: IPEA, p. 73-104.

<sup>22</sup> Von Mettemheim, Kurt (2005). Op. cit.

banks came to Brazil, it happened a high level of banking concentration, the volume of internal and external financial transactions growned, and so on. A lot of liberal laws were enacted since the 1990s.<sup>23</sup> Some changes in this hegemonic tendency are being built in the last years.

Another very important change is claiming since August 2011. It lies in the behavior of the Brazilian Central Bank (BCB) and monetary policy. The system of inflation targets in which the monetary policy is based no longer is implemented without take in account their impact on economic growth and employment. That is, the priority of controlling inflation is maintained, but without the interest rate depress the economy. There is more coordination in economic policy. The Central Bank has been increasingly a government agency, not an institution apart.<sup>24</sup>

The federal constitution of 1988 says in Article 192 that financial system must be regulated for *promote the balanced development of the country and serve the collective interests*. However until now this constitutional determination was not carried out by Brazilian political system, neither in formal way nor in the fact. Bankers have opposed to this regulation. They only support law in a liberal content. But at the same time Lula's government implemented some changes with socialdemocratic characteristics without breaking politically with bankers. Dilma government has changed the monetary policy and the performance of BCB. We consider that these transformations mean a political change in Brazilian financial institutionalization path.

There is an important demand of social and political actors for that indeed the Brazilian financial system finances the development, devoting yourself less to the handling of public securities of easy profits and, by the contrary, that it passes to offering credit through lower interest rates.

#### 4. Conclusion

We argued that a financial system with an adequate institutional structure is an important leverage to growth and development. Comparative researches of economic institutions show that financial institutionalization may be a key variable to provide comparative advantages. One of these advantageous institutions can be a financial

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<sup>23</sup> Ver: Ianoni, Marcus. "Ciência Política e sistema financeiro no Brasil: o artigo 192 da Constituição Federal". In *Política & Sociedade*, Florianópolis, v. 9, n. 17, p. 173-204.

<sup>24</sup> The author is grateful to the economist João Sicsù for having granted the interview in which underpin this new perception of the functions of monetary policy.

system based in banking credit of public banks. This idea is contrary to the neoliberal thinking.

We have built a line of reasoning empirically based in order to show that the Brazilian financial system has undergone significant changes, although recent and not yet definitively established.

This new path has occurred mainly because Lula's government implemented a developmentalist economic policy in which Brazilian public banks had a more active role especially for facing the international financial crisis. Now Dilma government has given continued to the developmentalist economic policy of Lula and too it has deepened the changes in the monetary policy. The aim of monetary policy is not only the control the inflation. It also focuses on economic development and employment. So the recent paths may be marking a changing in the pattern of financial system regulation, banking institutionalization and monetary policy towards a greater State coordination of the financial market.

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