

CAPITAL MARKETS IN THE DEVELOPMENT PROCESS

Capital Markets in the Development Process

The Case of Brazil

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MACMILLAN

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Softcover reprint of the hardcover 1st edition 1993 978-0-333-51329-3

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First published 1993 by
THE MACMILLAN PRESS LTD
Houndmills, Basingstoke, Hampshire RG21 2XS
and London
Companies and representatives
throughout the world

ISBN 978-1-349-11213-5 ISBN 978-1-349-11211-1 (eBook)
DOI 10.1007/978-1-349-11211-1

A catalogue record for this book is available
from the British Library.

To the memory of Howard A. Welch, Jr.

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Preface

The importance of financial and capital markets has become a focal point of recent research in economic development. Views on the benefits from vigorous financial and capital markets range from efficiently allocating scarce capital resources to increasing domestic saving and investment to enhancing macroeconomic stability. The trick, however, is to create working financial and capital markets where none exist. Recent policy prescriptions have emphasized liberalizing financial markets, allowing the free play of market forces to establish the incentives for the creation of financial institutions and instruments that heretofore had not existed. The financial reforms whose only instrument was liberalization, however, have been failures on the whole, e.g. the Southern Cone countries of Latin America of Argentina, Chile, and Uruguay.

The distinguishing characteristic of the Brazilian experience is that not only were reformers successful in creating robust financial and capital markets: they also combined the liberalizing technique of increasing real interest rates to borrowers and lenders with an institution-building approach. Brazilian reformers created a Central Bank, a National Housing System with the centrepiece the National Housing Bank (BNH), expanded the powers of the National Development Bank (BNDES), created tax incentives for the issuance of common stock, and, most importantly, created inflation indexation of financial assets. The reforms and institutions did encounter problems and failures but the financial system grew throughout the economically turbulent 1970s and 1980s.

An understanding of the motivations of the reforms, the resulting financial structure, and the performance and problems of the resulting financial system should provide some insight into the Brazilian success story and indicate where improvements are needed. This study is meant to systematically analyze developments in Brazilian financial and capital markets to this end.

This book is the culmination of six years of research. I hope it will prove an important step in understanding the role of financial markets in Brazil and in Latin America and developing countries in general. This work would not have been possible if not for the help of many people. I would like to thank Werner Baer, who as adviser and friend guided my research and writing from start to finish. Further, I

would like to thank the Fulbright-Hayes Foundation, the University of Illinois, Oakland University School of Business Administration, and the University of North Texas for funding my research in Brazil. I would like to thank all the faculty and students at the University of São Paulo who provided an intellectual home away from home, especially Roberto B. M. Macedo, Celso L. Martone, Carlos Alberto Primo Braga, and Paulo de Tarso Afonso de André. I would like to thank Sergio Sister and Airton Ribeiro of *Análise Financeira* for their help in data collection and for sharing their understanding of the behavior of Brazilian financial intermediaries. Thanks also go to Eliza Willis of Tulane University, Leslie Armijo of Northeastern University, Luigi Manzetti of Southern Methodist University, Robert McComb of the Texas Tech University, and Sylvia Maxfield of Yale University for helpful comments on earlier versions of the manuscript. I would like to thank the members of my dissertation committee, Donald Coes, Paul Newbold, and Case Sprenkle, whose comments and work improved the quality of the study immensely. Finally, I would not have been able to persevere without the love and help of my wife, Debbie, and son, Cory.

JOHN H. WELCH

Acknowledgements

The author and publishers are grateful to the following for permission to reproduce copyright material: The Ohio State University Press for a diagram from 'Money and Capital or Financial Deepening in Economic Development?' by Maxwell L. Fry, *Journal of Money, Credit and Banking*, Vol. 10, No. 4 (November 1978) © by the Ohio State University Press; The American Economic Association for diagrams from 'Credit Rationing in Markets with Imperfect Information', by Joseph E. Stiglitz and Andrew Weiss in *American Economic Review*, June 1981.