

DEVELOPMENT AND INSTITUTIONAL REFORM: BUSINESSES AND STATE INTERVENTION

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Abstract- This article examines the Rule of Law principle as a theoretical framework based on free private relationships in the central role of setting rules of play within private relationships, with State interference relegated to a secondary role. The Brazilian institutional model is analysed in case studies of state controlled businesses in a competitive economy and of the BNDES (Brazilian Development Bank) as a long-term investment financing provider, and its impact on Brazilian development. The conclusion is that informal institutions can counteract the effectiveness of applying unique models in developing economies.

Keywords - Formal institutional reforms - Models - The Rule of Law - The Law - Development.

I. INTRODUCTION

The Constitution of Brazil defines the state's role on a social democracy basis that, due to subsequent amendments, approximates to the so-called neoliberal State model. When dealing with economic affairs, Brazilian constitutional principles are based on free enterprise, the state being assigned the status of normative and regulating agent. In this context, property and businesses institutions, inseparable from business relationships, are protected.

Although businesses are relevant agents in the economy and although developing business relationships presupposes a free environment, the Brazilian State has not failed to strengthen economic relationships, whether by minimizing the deleterious effects to which economies are subject, or by incorporating new entrepreneurial organizational forms.

The discussion about the State's function in forming an institutional environment that makes development possible falls into a classic conflict between convenience and inconvenience, the efficiency or inefficiency of state interference in the market.

On the basis of this dilemma, this study addresses the case of BNDES (Banco Nacional de Desenvolvimento Econômico e Social), a state-owned enterprise that influences the economic environment by generating investment levels that significantly finance entrepreneurial activity domestically. This fact provokes consideration of boundaries on the prominence public over private economic enterprise and their impact on the economy.

In this context, this article starts by analysing the theoretical foundations of the Rule of Law, so as to position current lines of thought on free private relationships and the central role of setting rules of play, with State interference relegated to a secondary role. The third section of the article deals with the Rule of Law and importing ideal models. Thereafter, in the fourth section, the state, the law, and development are discussed. The regulatory framework for

state enterprises operating in the market and the role of BNDES, the principal long-term financing agent, are then considered.

Finally, conclusions on the role of institutional reforms in promoting national development are presented.

II. NOTES ON THE RULE OF LAW

Enthusiasts of the economic aspects of the Rule of Law advocate an institutional arrangement in which the Law, particularly Private Law, has an auxiliary role in promoting national development.

Current debates about the Law's role in shaping an institutional arrangement capable of providing development include discussion about the realistic possibility of the Law influencing development, on the one hand, and the existence of an ideal model of standards that may be incorporated indiscriminately by different nations, on the other.

The formation of this institutional arrangement is based on the belief that clear and stable institutions, able to promote a safe economic environment for the market and efficient legal protection provided by the Law are essential for development to take place. The state is given a secondary role aimed at protecting the model without being a protagonist in transactions as such.

The Rule of Law is based on an economic development paradigm based on private transactions, which inspired action by international bodies such as the World Bank, which since the first decade of the 21st century has invested substantially in qualifying institutional programmes in various countries: 52% of its disbursements are based within the parameters of this theoretical line of thinking [1].

It is thus clear that the World Bank sees the Rule of Law as a driving force, considering it appropriate for achieving the highest social and economic levels of development. The policy adopted shows belief in the power of a given institutional arrangement comprised above all of the

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possibility of institutions that will foster national economic development regardless of local idiosyncrasies.

The proclaimed development model for World Bank intervention has generated debate as to the validity of considering that a pre-cast institutional set can promote real national development. It also leads to consideration of whether exogenous institutional models are able to change the informal institutions that characterize and influence society.

In addition to consideration of importing models, as historically championed by the World Bank, inquiries may also be directed to the internal environment, to assess the role of the Brazilian State and of Brazilian Law in making a formal institutional arrangement conducive to national development.

III. INSTITUTIONS, THE RULE OF LAW AND THE PRE-CAST MODEL

North [2] defines institutions as conceived constrictions that structure human interaction. He thus explains that the institutional set provides an incentive structure for society, thus constituting mechanisms that shape and filter people's behaviour as rules of play.

The Rule of Law relies on a particular institutional arrangement considered appropriate. The aim of this model is to provide the best possible conditions for the smooth development of private relationships, as these will enable the State to develop economically and socially.

Appropriate rules of play are thus considered as promoting legal certainty, encouraging private business and mitigating state intervention, which generate national economic and social development [1].

The Rule of Law is based on the concept that private enterprise always searches for the best alternative available [3]; in other words, always following a rational and coherent point of view [4], enterprises will weigh the costs and benefits of available alternatives and choose the one that proves most profitable [5].

For the Rule of Law, institutions must necessarily respect elements which promote and ensure the practise of private economic activity, the mainstay of development.

For Davis and Trebilcock [6], once property rights are well defined and alienable, the formal system of flexible contract law and a business law regime clearly define rights and obligations, simplifying capital investment, and development can consolidate.

In this context, it can be seen that the Rule of Law model recognizes in the Law a component that guarantees individual economic activity, essentially focused on protecting a safe environment for business concluded between non-public economic entities. In this way it acts by establishing the necessary ideal conditions for private businesses that will promote social and economic national development.

The state, in turn, is an important agent of societal stability itself, contributing to public order and, particularly, so that institutions are kept healthy when crises arise.

It is thus important to have an environment of confidence in the private economic sector, in which profits are really obtained in successful cases and effectively lost in those that fail.

This is due to the very fact that business relationships can only develop successfully in an environment that favours legal certainty and predictability [7].

The State, however, cannot find a solution to all societal problems, due to its size and the limited rationality and opportunism of those that create and develop public policies, which realize that public resources are diffuse, but do not necessarily engage in optimizing them for society.

A logical consequence is therefore the transfer of some responsibilities to the private sector. Limited rationality and opportunism are also typical of private enterprises but, as resources are not diffuse, they can be better monitored and leveraged.

Such Rule of Law assumptions indeed inspire institutional reforms in order that the private business environment moves closer to being safe, stable and ethical, minimizing costs in monitoring contracts, enforcing agreements, looking for solutions in the Judicial System or similar forms, enabling social and economic national development.

The main challenge lies in making such an institutional advance operational. A standard set of formal institutional solutions (derived from experimentation in a determined developed country that has its own institutional conformity) proved unable to generate the same results in the paradigm country.

The universal character of Rule of Law solutions inspires the adoption of a ready institutional arrangement to be implemented in different countries with different cultures. This concept presents obstacles that must be analysed.

For this, Amartya Sen and Douglas North's observations may be cited when respectively approaching the notions of positional perspective and path dependence.

Sen [8] developed the idea that the observer's position is the starting point of any study intended, since the context in which the observer is placed shall by definition have a certain understanding of each subject.

By supporting formal institutional arrangement implementation by States with different historical and cultural backgrounds, the Rule of Law ignores the observer's position, inadequately considering reality, bearing in mind that each State's peculiarities, in addition to contributing to the institutional environment, also influence the each person's understanding thereof.

Regarding the role of the Law, for example, a normative control cannot be enforced without taking into consideration the environment in which it will be applied. This is because both formal and informal institutions already present in a given society directly affect the applicability or inapplicability, suitability or unsuitability, prevalence or non-prevalence of a new institutional arrangement to be implemented through normative controls, with the purpose of having an effect on objective reality.

North [2] explains the concept of path dependence which is basically reflected in the maxim that culture (all knowledge acquired by individuals over time) provides the key to societal development.

Each society's peculiarities can provoke distinct reactions in human behaviour when confronted with imported institutions. Formal institutions alone cannot change reality, because if the institution concept is connected to rules of play on the one hand, on the other it relates to something that cannot be altered by simple changes in terminology, since they are the result of history, culture, shared values in every society.

Focusing on Brazilian reality, marked by major social inequality and still slow development, to dispense with state economic intervention through radical institutional reforms would be reckless.

On the other hand, an external observer may think development achieved is not higher because of Brazilian internal policies not providing favourable conditions through a proper institutional arrangement to develop economic affairs.

The need to invest in infrastructure is undeniable, as well as the urgency to simplify labour and tax laws. The need to ease the Brazilian tax burden is arguable, as being excessively high and deriving from a complex tax system. However, changing institutions through the incorporation of new ones, especially legal systems coming from different cultures, will hardly improve the situation by themselves.

IV. THE STATE, THE LAW AND DEVELOPMENT

The social democracy State model implemented in part of Continental Europe is perhaps the closest initiative to fulfilling the scope of providing citizens with better living conditions or, at least, basic conditions for them to develop their abilities as the population desires.

With marked social concern, this State model seemed to reflect a global trend of creating an environment that produces economic development from internal growth, based on effective state action.

The State acts through positive obligations assigned to it, in opposition to the classical liberal idea of it being merely the guardian of citizens' rights with a minimal role of merely rebalancing economic relationships.

However, social policies tend to encounter limited resources when confronted with endlessly growing human needs. European national social democracy States show undeniable signs of exhaustion in the 21st Century.

Austerity measures have consequently been recently imposed, such as cuts in social benefits, causing continual strikes and protests in much of Europe, as a form of demonstration of popular discontent at the removal of benefits.

The early years of the 21st century show that formal institutional reforms were not enough to achieve development objectives. Less developed countries did not reach expected targets in their attempt to implement the (basically US

inspired) Rule of Law model, nor did Europe achieve its goals of economic unification and reduced inequality.

With regard to excessive State intervention in adopting welfare measures, and the lack of public resources, there is room to place value back in the private sector replacing the previously expected State role, as seen, for example, in the growing acceptance of defining a social role for private property and businesses.

In Brazil, the realization that the concept of the State is in crisis is not new. At the same time as seen by the population as a mirror of the society's demands, with clear identifiable goals, the same state's members at all levels are often associated with embezzlement, use of public structures for private purposes, and government corruption at all levels.

These and other social ills work together to establish a lack of confidence in the State really being an agent for more efficient social transformation to improve the lives of citizens.

An equivalent analysis can be made in relation to the Law, because it emanates from the State and thus derives from an equivocal source. The usefulness and propensity for effectiveness of rules permeates the understanding of the environment in which they are generated. Besides expressly making rules, it is extremely complex to search for group influences represented by public policies and lawmakers. A search to understand the methods used in law making, especially regarding producing expected results and their sustainability (in order to establish the possibility of keeping them over time).

Lack of confidence similarly questions the effectiveness and real role played by Brazilian Law. For instance, our constitution is notoriously full of principles, but the effectiveness of many of its provisions is doubtful. How public policies are made is questioned, without much concern over the precise perception of the importance of maintaining an economic environment where public and private coexist harmoniously, raising reasonable questions about the effective normative contribution to actually improving and sustaining the lives of Brazilian citizens.

It is worth recalling the now classic debate about the Brazilian minimum wage actually being enough for workers and their families to meet basic needs of housing, food, education, health, leisure, clothing, hygiene, transportation and social security, as stipulated in the Constitution of Brazil.

When it comes to the Law's role, prescription unrelated to reality is useless. The word itself, expressed in any way (law, regulation, article), cannot change the nature of everyday reality. Action, resources, joint efforts are needed to achieve a better Brazilian State, which all acting together must face the social institutions, unwritten but rooted in the most diverse cultures.

As if the questionable effectiveness of the Law were not enough, we also live in fear of the 'law that does not apply', causing disarray over (i) what the Law is, (ii) what the Law is for and (iii) what the role of the Law is in achieving fundamental institutional reforms targeting improvement of social and economic relationships.

Within this framework, we find all lines of thought about institutional reform and the effectiveness of proposals for formal institutional reform – that is, those controlled by definitively published public policy rules (or politics, in other words).

Businesses whose capital is totally or partly owned by the State – State enterprises - represent an interventionist strategy, as does the maintenance of State financial institutions.

V. THE SEARCH FOR THE BRAZILIAN MODEL

In the following paragraphs, two issues related to the practice of business activities are addressed: the need for formal institutional reform regarding state-controlled enterprises in Brazil and the role of BNDES in the Brazilian economy.

V.1 State-Controlled Enterprises

Institutional reforms do not necessarily bring development to a country, but they may be useful if accompanied by strategies for economic and social improvement.

The role of state enterprises in business operations focusing on supplying of goods and services is often questioned by doctrine, by the Courts, and by social conscience. The conflict between the private and public offer of goods and services - whether of a public nature or not – has increased since the 1990s due to the gradual retreat of public enterprise and its restriction to monopolies, such as oil exploration, which yielded to the attractions of the market and potential production and supply optimization.

State enterprises and their sister companies offer their (private law) corporate structure in the collective interest that targets social welfare. But unlike other times in history, today's public offer takes place in a competitive regime through the private enterprise structure, which requires general guidelines for such, as permitted by the Constitution of Brazil.

A general law for state enterprises operating in the market must at least be concerned with -Article 173 §1 of the Constitution [9] - dealing with function of statutes, their control and administration, respecting the various interests related to the company, their contracts, balance sheets and goals, directly dependent on the relevant collective interest or national security interest, inseparable from the state entrepreneurship in the Economy.

It is believed that for state enterprises to reach desired efficiency levels, alternatives to public procurement procedures, for example, are required in order for state-controlled businesses to be as competitive as private businesses. Formal institutional change, in this sense, would facilitate the implementation of (legal) reforms needed.

V.2 The Case of BNDES

Founded in 1952, BNDES is a Brazilian public bank that fosters long-term financial operations that invest in diverse businesses and social activities, supporting agriculture, industry, the infrastructure and trade and services, offering special terms for micro, small and medium size companies.

The Bank also invests in health and education, family-run agriculture, basic sanitation and urban transport.

Between 1990 and the early 2000s, formal institutional reforms were imposed on the financial sector aimed at the privatization of most state-owned banks. This took place not only in banking but also in sectors such as telephony and power supply, where state-owned businesses operated. At the time, policy-makers understood that state enterprises were inefficient and there was a general belief that the public budget for specific economic affairs was insufficient.

These institutional reforms followed a global trend of removing the State directly exercising economic activity capable of being performed by private enterprises in a competitive system.

Despite the volume of privatized banks and the transposition of institutional models compatible with international guidelines regarding stabilizing markets to attract financial institutions able to deal with the investment volume needed in our country, Schapiro [1] provides useful data about the BNDES' national production performance. He highlights, for example, that the amount annually injected by BNDES into the Brazilian economy exceeds the calculated capital of debenture bonds issued via stock exchange.

Schapiro [1] finds that, in Brazil, the state presence as a financial agent remains because of flaws in the stock market, credit, shortages in fund-raising and allocation of projects able to produce positive results in terms of development.

In Brazil, private banks typically engage in short-term operations; there remains a lack of longer term investments reconciled with the need of companies operating in the country.

The presence of BNDES in financing productive activity therefore represents a component of the Brazilian institutional arrangement which contradicts the experience of other economies that were consolidated solely by injection of funds by way of Private Banks since the 1990s.

It is worth mentioning that, though the World Bank favours private relationships and private enterprise in the economy, Brazilian peculiarities did not permit implementation of this arrangement, whether due to traditionally keeping the State financially involved or, due to flaws, our institutional environment was unattractive for private long-term investment, essential to business practice.

Thus institutional reform models do not always operate in the same way, when implemented in different social structures, their degree of acceptance and effectiveness differing, due to differences in the institutional environment, especially considering the weight of some informal institutions that can compromise the implementation of specific institutional reforms.

This difficulty in making and observing development models, for some, undermines the belief in the power of institutional reforms to promote national development.

In any case, although formal institutional reforms do not guarantee the development proposed, the absence of the power of the State and the Law in creating and improving

social arrangements does not guarantee better results than those achieved by their intervention.

VI. CONCLUSION

Not all formal institutional reforms result in development. Lack of faith in the relationship between the Law and Development arises from the impossibility - until now - of legally establishing institutional models to be used by developing countries that guarantee achieving expected results.

It is worth mentioning that informal institutions established in a particular country may withhold or delay the expected outcome of the model implemented.

However, while institutional reform implemented through the Law itself is no guarantee of development, no economic or social model can be built up without a suitable normative environment existing.

Proponents of the Rule of Law praise business relationships and private enterprise as promoters of development for whom the definition of property rights (and the binding force of contracts) is essential for the development of the economy and society. The Law is given a specific role (as guarantor of business relationships) and the State is given a secondary role.

However, European social democracies assign political leadership and management deemed necessary to improve social welfare to the State and the Law.

The Rule of Law model is not effective in all countries, nor were social democracies thereby able to sustainably pursue their social welfare policies.

In Brazil, considering the influence of international policies based on the Rule of Law and standardized institutional reforms, specific institutional features, many of an informal nature, keep the state as an essential financial and business agent.

In financial activity, the role BNDES plays to date is an example of Brazil not adapting to institutional reformist movements that defended state withdrawal from exercising such activity.

However, regarding state enterprises acting in the market, it is believed that formal institutional reform, through regulation of their activity (a constitutionally permitted prerogative), is essential for this business model to become more efficient and competitive.

This small contribution we provide in reflection on institutional reforms and development in Brazil XXI century.

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