



PII: S0261-3050(99)00004-2

From Industrial Policy to Regional and Local Locational Policy: Experience from Santa Catarina/Brazil

JÖRG MEYER-STAMER

Institute for Development and Peace, Duisburg, Germany and Fundação Empreender, Joinville, Brazil

Abstract — Industrial policy is no longer what it used to be. In the industrialised world and in advanced developing countries alike, the focus has shifted from a top-down, statist approach that sought to create industries to a decentralised, networked approach whose aim is to shape competitive advantages and to create ‘systemic competitiveness.’ This reflects the fact that globalisation and localisation are parallel and mutually reinforcing processes: The firms which do better in a globalised market are rooted in well-developed networks of supporting firms and institutions. The analysis of the case of Santa Catarina, a state which had a strong industrial growth record in the 1970s and 1980s, shows that the relevant actors tend to be slow to move to this kind of pattern. State-level industrial policy mainly consists of participation in a ‘guerra fiscal’ geared to attracting external investment as well as, to a very limited extent, measures aimed at giving financial support to local firms. Yet there is no such thing as an explicit policy at the state level — to say nothing of the local level — designed to support firms by shaping locational advantages. This is due to limitations on the part both of the state and the private sector. As far as the state is concerned, a traditional clientelist and ad hoc style of policy making prevails. In the private sector the business associations (*sindicatos* and the Federation of Industries, local chambers of industry and commerce and their umbrella federation) are slowly adapting to the new conditions presented by an open economy and far more competitive pressure, though they have thus far lagged in putting more pressure on local and state government to support company-level efforts to increase competitiveness. Within this general picture, however, there are differences between industrial clusters. The most advanced of them, made up of world-class firms manufacturing ceramic tiles, may show the way by strengthening associations, shaping locational advantages, and articulating the demands of companies toward the state. © 1999 Society for Latin American studies. Published by Elsevier Science Ltd. All rights reserved

1. INTRODUCTION

Industrial policy is no longer what it used to be. In the industrialised world and in advanced developing countries alike, the focus has shifted from a top-down, statist approach that sought to create industries to a decentralised, networked approach which aims to shape competitive advantages and create ‘systemic competitiveness’ (Esser *et al.*, 1996). This reflects the fact that globalisation and localisation are parallel and mutually reinforcing processes: The firms that do better in a globalised market that are rooted in well-developed networks of supporting firms and institutions. To a certain extent such networks emerge spontaneously, reflecting entrepreneurial opportunities. To a large extent they have to be created through deliberate action, be it on the part of the state or through collective action

(e.g. business associations). What I understand by deliberate action is creating locational advantages, e.g. institutions in fields like technology information and extension or training, which are highly specialised and tend to strengthen local specialisation profiles; Porter (1990) refers to these as advanced and specialised factors. They will often occur at the regional or local level since both opportunities and disadvantages are more evident at these levels. In this paper I will argue that a pattern of decentralised locational policy is emerging at a slow pace in Brazil.

In the following sections, I will first explain why decentralised industrial policy aimed at shaping locational advantages is increasingly important in a rapidly globalising economy. I will then look briefly at the recent Brazilian experience in industrial policy making. In the subsequent sections I will address the experience with decentralised industrial policy in Santa Catarina,¹ a state that was successful in industrial development in the import-substitution era, though it now faces a big challenge in the open economy. State-level industrial policy mainly consists of participation in the 'guerra fiscal,' keyed to attracting external investment, and, to a very limited extent, measures aimed at giving financial support to local firms. But there is nothing on the order of an explicit policy at the state level — to say nothing of the local level — designed to support firms by shaping locational advantages. This is due to limitations on the part of both the state and the private sector. As far as the state is concerned, a traditional clientelist and ad hoc style of policy making prevails. In the private sector, the business associations (*sindicatos* and the Federation of Industries, local chambers of industry and commerce and their umbrella federation) are slowly adapting to the new conditions presented by an open economy and far more competitive pressure, though they have thus far lagged in putting more pressure on local and state government to support the company-level efforts to increase competitiveness. Within this general picture, however, there are differences between industrial clusters. The most advanced of them, made up of world-class firms manufacturing ceramic tiles, may show the way by strengthening associations, shaping locational advantages, and articulating the demands of firms toward the state. The Santa Catarina experience therefore illustrates both the obstacles to new approaches to locational policy, many of which are based in the polity, and some possible means to overcome these obstacles.

2. GLOBALISATION AND LOCALISATION

There is little dispute that globalisation is a salient feature of recent economic development. Globalisation occurs in certain markets (capital market, certain segments of product and labor markets), and it is a feature of the behaviour of firms (transnational corporations, international alliances). The significance of globalisation, however, is highly disputed. There are two main lines of disagreement. The first is concerned with the impact of the globalisation of capital markets and company behaviour on the economic policy options open to nation states; this issue is less relevant in the context of this paper. The second addresses the relationship between a firm and the locations where it actually runs production operations, R & D, administration, and other activities. This issue is highly relevant in the context of this paper. The argument put forward here is based on the thesis that locations do matter, and actually matter more than ever before in the age of globalisation.

To verify this thesis, it is important to look at the geography of industrial production. Foreign direct investment is an indicator of the way firms currently perceive the quality of different locations. It is noteworthy that investments are restricted to a limited number of

countries and, moreover, that the distribution of foreign investments is uneven in these countries themselves. The results of an OECD study (Vet, 1993) are unambiguous: Foreign investment is concentrated in places where wages are high, real estate is expensive, and traffic jams are rampant, for instance in the regions around Frankfurt/Main in Germany and Paris in France as well as in the southeast of England. To put it less polemically: only a minority of investors are looking for greenfield sites and cheap labour. The main motive for investing abroad is a dynamic economy in the target country (e.g. UNCTAD 1996: 41 ff.). An investor wants to benefit from a country's economic dynamism and to enjoy the same competitive advantages his competitors have. It is not by chance that São Paulo is still attracting a substantial share of Brazil's FDI inflows, that a large part of the rest goes to adjacent regions (Minas Gerais, Paraná), and that the northeastern states have not been particularly successful in attracting FDI despite the enormous subsidies they offer (Rodrigues, 1996).

The proposition that a concentration of firms of the same branch of industry in one place or region is advantageous finds its theoretical foundation in innovation economics, i.e. the branch of economics which deals with the interaction between technological development and innovative entrepreneurial behaviour and the evolution of industries and the national economy in general (OECD, 1992; Freeman, 1994). The central tenet is that innovations are the result of interaction — between firms and customers, firms and suppliers, between firms operating in the same branch of industry (activities in strategic alliances, in employers' associations), and between firms and educational and technology institutions, banks and other supporting institutions. A spatial concentration of firms of the same branch and technology institutions may generate a high amount of formal and informal cooperation and an intense exchange of information. One reason why positive externalities develop is, for instance, that firms cannot keep information on new suppliers or process technologies secret. Since this holds true for all firms, the result is a positive-sum game, i.e. all firms profit from it — any losses due to information leaks are more than made up for by the gains deriving from the transfer of knowledge from other firms (Storper, 1995). Learning processes in firms which benefit from such relationships are faster than in firms which operate in isolation. Inter-firm cooperation raises the efficiency of the firms involved; Schmitz (1995) calls this 'collective efficiency.' Another economic advantage of spatial proximity is that the transaction costs of inter-firm relations are lower than between those of firms distant from one another because expensive provision of information and detailed monitoring of interactions are in the first case less necessary due to high information density and transparency. When firms frequently cooperate with each other, they may also find it considerably less expensive to work out contracts.

Apart from factors at the microlevel, the competitiveness of firms depends on meso-level factors, i.e. the supporting institutions in fields like technology, education, or information.² Advantages at the micro- and meso-level, i.e. a location where there exist a comprehensive and differentiated set of suppliers, subcontractors, and service providers as well as supporting institutions for the industry concerned, cannot be created within a short period of time, but are instead the result of a longer-term process of development and differentiation (Porter, 1990). A location of this kind offers advantages which are difficult to replicate elsewhere. A firm located in a site of this type will be reluctant to transfer development, production (particularly the technologically and organisationally more demanding parts of production), and administration to another place, and other firms will try to gain a foothold in these highly advantageous locations (e.g. by founding a subsidiary

or locating a development laboratory there). In such a location, government will be in a far better bargaining position vis-à-vis firms than is the case in regions without specific locational advantages. Company threats to relocate are less plausible here than in a location which is mainly a greenfield site and offers no specific advantages. If a society succeeds in creating a good number of high-quality locations, this will not only provide a basis for dynamic economic development, it will also entail measures which firms may at first consider a nuisance, e.g. regulation, environmental protection, and redistribution.

Success in creating a high-quality location depends, on the one hand, on the action of national, regional, and local government. Central government defines the macroeconomic conditions as well as many important regulatory framework conditions which may be more or less conducive to local action. For instance, taxing each and every inter-firm transaction, and doing this in a cumulative way rather than on the basis of valued-added, creates an incentive for vertical integration and autarchy, and this in turn militates against all kinds of inter-firm cooperation and collaboration. Central government moreover defines the scope for decentral action — by delegating responsibilities to regional and local governments and by establishing an independent tax base for them. Regional governments (federal states or provinces) may pursue economic development policies on their own, for instance, in fields like SME support, incentives to attract new firms, training programs, or technology extension. Local government may or may not define economic promotion as one of its tasks. What it does will depend on the availability of funds and know-how, but also on the mindset prevalent there. For instance, in a country where industrial policy and economic promotion have for decades been a prerogative of central government, it will not at all be a matter of course for local actors to play a role in this field.

Success in creating a high-quality location depends, on the other hand, on the action of nongovernmental actors and their interaction with government. Individual firms (especially large firms), networks of firms, business associations and chambers, infrastructure providers, and other actors can play an important role here. Their activities in the field of service provision can complement those of government (or may substitute for them), or constitute an alternative. Their lobbying activities are important in terms of putting pressure on local government to take an active role in economic promotion or at least to create favourable conditions. In other words, to understand locational policy it is crucial to look at government, nongovernmental actors, and the interaction between them.

3. THE SCOPE FOR INDUSTRIAL POLICY IN BRAZIL

Brazil has a long tradition of industrial policy, i.e. an active state role in industrial development involving financial instruments, trade policy, and state ownership of key industries. Government played a crucial role in establishing the two leading industrial sectors, namely passenger car manufacturing and the petrochemical industry (Shapiro, 1994; Mathieu, 1991), not to speak of several others. However, while Brazilian industrial policy was not at all bad at creating given industries, it was not good at all at managing the transition from a sheltered market to the necessities of globalised markets and competition. In the late 1980s and early 1990s various attempts to formulate industrial policy merely added more turbulence to an already extremely unstable environment (Meyer-Stamer, 1997a, b). In 1988/89 the Sarney government tried to formulate an industrial policy

intended to prepare domestic firms for a more competitive environment. However, this policy was never really implemented. The Collor government (1990–1992) took steps that had a far stronger impact than any specific industrial-policy measures had in years: In 1990 it engineered a fundamental turnaround in the overall economic framework by gradually opening up the economy (within 3 years) to the world market and removing all sorts of regulatory obstacles. Seeking to add the carrot to the stick, it formulated a number of ambitious industrial-policy programs, though these had no more than a limited impact. This was mainly due to one reason, namely the fact that the government did not succeed in stabilising the economy by reducing the high level of inflation. Industrial policy had little credibility with firms that had to deal with an extremely unstable macroeconomic framework, frequent changes in the rules of the game due to government stabilisation plans, and increasing competitive pressure.

It was only in 1994 that the Franco government (1992–1994) succeeded in bringing down inflation and thus stabilising the economy. The economic team which took office with the move of Fernando Henrique Cardoso into the ministry of finance in 1993 largely remained in place when Cardoso was elected president in late 1994. Key policy makers in the current administration have abstained from industrial policy. They see industrial policy as something that was part and parcel of the import-substitution model of the past but does not really have an important place in today's world, with its open economies. In their view, stabilising the macroeconomic framework and removing regulatory and other obstacles to entrepreneurial activity (i.e. fighting the 'Custo Brasil'³) are sufficient to create a favourable environment for dynamic industrial development. The administration was largely hostile toward the notion of sectoral industrial policy, with just one exception: stimulation of foreign direct investment in the passenger car industry ('*Regime automotivo*'). The industrial-policy concept launched in late 1995⁴ was not really worth its name, since it remained vague except for two areas, namely reform of the basic technology infrastructure (especially in the field of measurement, standards, testing, and quality) and export promotion. The attempt to operationalise this concept still remained vague; the respective document, published in July 1997,⁵ contains proposals for a set of 18 different industries and addresses immediate bottlenecks (like regulatory issues and access to finance) rather than outlining a medium-term strategy for sustained competitiveness.

However, the key challenge in Brazil these days is not so much to formulate grand strategies for various industrial sectors but rather to support firms that are struggling to survive in competitive markets. This can be done just as well, if not better, at the regional and local levels, i.e. by state governments and municipalities. These levels of government have played only a modest role in past industrial policy. Since the early 1990s they have played a very active role in one field of industrial policy, namely in attracting new industries; the subsidy race between federal states ('*guerra fiscal*') has been a prominent feature of the recent period (Varsano, 1997). States also have a potential when it comes to creating efficient institutions and effective interaction at the meso-level. The preconditions are not at all bad, since a federal structure is in place, states and municipalities have their own sources of income, and important institutions like the vocational training system (SENAI and SENAC) and the SME support organisation (SEBRAE) are governed at the state level. Municipal governments and other local actors are also able to play a much more active role. Collective efficiency can best be created at the local level — by stimulating inter-firm cooperation and collaboration, and by strengthening interaction between firms and local meso-level institutions.

4. LOCATIONAL POLICIES AIMED AT INCREASED COMPETITIVENESS: CASES FROM SANTA CATARINA⁶

The southern state of Santa Catarina provides examples of the latitude open for formulating locational policies, but also of the obstacles this faces. Santa Catarina is an interesting case for two reasons. First, the local industrial structure is different from that of other industrialised states in Brazil, since here there are very few foreign firms, no big state-owned firms, and the local firms are concentrated in a few sectors and strongly clustered. The latitude for local involvement and decision making is thus higher than in regions where key firms are governed from far-away headquarters or where the industrial structure is heterogeneous and the critical mass of potential clients for mesolevel institutions does not exist. Second, industrial performance was better than the Brazilian average in the 1980s. Over the last decades the growth of GDP per capita was consistently higher in SC than in Brazil as a whole and export performance was better than the Brazilian average during the 1980s; this was to a large degree due to a highly dynamic industrial development. Another indicator is the fact that quite a few firms from SC regularly show up among the best Brazilian firms (Table 1). Creating an environment that meets the demands of globalised locational competition is an option as realistic as it is necessary.

In the following section, I will look at two clusters which fared well in the import-substitution era but have come under intense adjustment pressure in the last years: the ceramic tile cluster around the cities of Criciúma and Tubarão in the southern part of the state and the textile cluster (with its main products knitwear and home textiles); its main location is the Itajaí Valley (with its main city of Blumenau) in the northeastern part of the state. Unlike the other clusters in the state, these two were confronted by a severe crisis, a circumstance that created the opportunity and necessity to develop new approaches to locational policy. Both of them illustrate what, following profound changes in the framework conditions, local actors can do to create competitive advantages. They also illustrate the change in the constellation of actors, with government losing and the private sector gaining in importance.

TABLE 1 *Best Performing Firms from Santa Catarina.*

The Brazilian business magazine *Exame* each year publishes the Brazilian equivalent to the Fortune 500. Using a set of financial performance indicators, it also names the best firms for each industrial branch. A number of firms from SC have in this way been highlighted

Firm	Main product	Category
Malwee	Casualwear	Best clothing firm 1987 and 1992
Marisol	Casualwear	Best clothing firm in 1996
Döhler	Home textiles	Best textiles firm 1994
Consul	Refrigerators	Best electrical and electronics firm 1982, 1984, 1985, 1987, 1988, and 1992
Embraco	Compressors for refrigerators	Best machinery firm 1992 and 1994
WEG	Electrical motors	Best machinery firm 1981, 1984, 1985, 1995
Tigre	Plastic tubes	Best plastic and rubber firm 1988 and 1989
Rudnick	Furniture	Best wood and furniture firm 1993

4.1. *Shaping locational advantages: the case of the ceramic tile industry*

The ceramic tile firms were the first to come under serious adjustment pressure. This was initially due not to the opening of the market but to the fact that the country was on the verge of hyperinflation in 1989/1990, and the economy was stagnating as a result of macroeconomic stabilisation efforts. This led to the collapse of the construction market, and the sales of the firms concerned decreased accordingly. At the same time, real interest rates went up and penalised those firms which had pursued debt-financed expansion and modernisation strategies in the years before. The largest firm filed for the Brazilian equivalent of Chapter 11 in 1991 (*concordata*), and some other firms were on the brink of financial collapse. Yet in the end all survived thanks to vigorous adjustment efforts.

The effort of the ceramic tile industry to improve its competitiveness involved both intra-firm adaptation of new technology and management concepts and inter-firm cooperation aimed at creating positive externalities. The firms claim to be close to taking the lead from Italian and Spanish competitors in terms of production technology, and they have introduced new management techniques on a more widespread basis than firms in other industries. They have made a strong effort in training at all levels; in one large firm, all employees will have completed primary education by 1997, which is quite unusual among industrial firms in Brazil; in one medium-sized firm even 98 per cent of the employees have completed secondary education and 39 per cent have completed or are attending courses in higher education.

In the ceramic tile cluster there is a substantial amount of 'information in the air'.⁷ Substantial exchange of informal information goes on between professionals from tile producers; unlike in other clusters and industries, it is perfectly normal for them to visit competitors' factories. Benchmarking between firms is a well established, regular practice. Behind this is, first, the notion that local firms should stick together to maintain their position vis-à-vis domestic competitors, especially from one region in the state of São Paulo. Second, company engineers claim that production technology is on the whole standardised so that there is little risk of losing crucial secrets. Competitive advantages instead lie in specific design and logistics, i.e. the ability to deliver quickly without having huge stocks; firms are keen to keep their secrets in these areas. Suppliers of inputs and vendors of equipment are other agents that stimulate exchange among firms. For instance, if a vendor has set up a given piece of equipment in one firm, he will use this as a showcase for other firms, and unlike the case in other industries it seems that tile producers actually permit executives from competitors to enter their factories.

Business associations play an active role in the ceramic tile industry. First, there is the local branch association (*sindicato patronal*) of the tile industry, which has been playing a leading role in stimulating exchange among firms. Second, there is Anfacer, the National Association of Tile Manufacturers. Anfacer plays an important role in stimulating technological exchange among firms, among other things by organising an annual congress of the industry and by maintaining a separate institute, founded in 1993, the Brazilian Ceramic Center (located in São Paulo), which is active in training, research, and consumer information. Unlike the case in other branches of industry,⁸ firms from SC play a very active role in Anfacer.

Local firms and the *sindicato* also play an important role in shaping the supporting environment. They formulate and implement measures to create locational advantages, and in this respect the region of Criciúma has fared outstandingly well by Brazilian standards:

- One of the two largest firms long ago set up its own technical school and opened it up for students from competing firms in 1991.
- Firms have pressed the local university to offer a special course for technicians in ceramics technology, and lobbied the state to authorise this course much more quickly than is considered possible under the usual bureaucratic procedures.
- Together with the state's Federation of Industries (FIESC), in cooperation with the Federal University of SC (UFSC), and with some financial support from the state, the firms founded the Center for Ceramics Technology (CTC), modelled after a similar institution in Spain. Getting this venture off the ground involved a good measure of tough bargaining on the part of the Criciúma firms, and some genuine, and literal, collective action was involved: The presidents of the leading firms boarded a business jet bound for the state capital, Florianópolis, and invaded first the office of the President of FIESC and afterwards that of the state governor to press them for firm commitments for support and financing for CTC.

In explaining this experience of cooperation and joint action aimed at shaping locational advantages, two factors appear to be most important. First, fierce rivalry and noncooperation (which prevailed before 1990) have led some firms to the brink of bankruptcy and compromised the competitiveness, and indeed the survival, of the cluster as a whole. These experiences pointed out the unsustainability of traditional uncooperative behaviour. The two largest firms were involved in a race to become the largest tile producer in the 1980s, investing in new factories and taking over smaller firms. When sales decreased dramatically after 1989/90, both were extremely vulnerable. Smaller firms report that the two large firms were hostile to any kind of cooperation in the past. Moreover, smaller firms sought to distance themselves from the two largest companies, since they feared becoming targets of takeovers as well. All this changed after the crisis of the late 1980s/early 1990s — out of necessity (i.e. the need to consolidate), due to the interventions of creditors (which forced the family out of the management of one of the large firms), and owing to moderation by two key actors from local associations who brought the large firms together to settle their dispute.

Second, this industry found a role model in Italy's tile-manufacturing industrial districts in the 1980s.⁹ Local firms started to develop close links with firms in Italy, in particular with equipment suppliers and manufacturers of inputs, but also with their Italian competitors. Representatives and technicians of Italian firms frequently visit the region, and they behave in the way to which they are accustomed, i.e. they proceed on the notion that firms, even competitors, will cooperate; for instance, they expect that a given piece of equipment installed in one firm will serve as a showcase for other local firms. Moreover, managers and employees of local firms pay frequent visits to Italy and have in this way started to develop an idea of the actual situation in industrial districts in Italy.

State government did not play any further role (i.e. apart from the CTC initiative); and it certainly did not devise any strategies for the ceramic tile sector. Local sources perceive this as discrimination against their region and point to inadequate political representation (for instance, there is no representative from Criciúma in the legislature) as one reason for this neglect. They claim that the state government benefits other regions much more. However, we found little evidence to substantiate this assertion.

Local government did not play any role in supporting the ceramic tile industry, either. There were several factors which help to explain this. First, the city mayor did not perceive

economic promotion as an important activity for local government. Second, when the time finally did come to do something in this field, he failed to see the ceramic tile industry as a priority sector, even though it is one of the main employers in the region. His main priority was the coal industry, which also had entered into crisis in the early 1990s. However, the local coal is of the low-calorie, high-sulphur variety, and is thus structurally uncompetitive, a fact that led to a sharp decline in demand after the Collor government cut the coal subsidies that had previously kept the industry viable. Third, relations between the local business community and local government were not exactly constructive, as the mayor and the president of the local chamber of commerce and industry belonged to rival parties.

4.2. Shaping locational advantages: the case of the textile industry

In the textile industry, competitive pressure started to increase substantially between 1993 and 1995. Initially, the gradual opening-up of the market did not have much impact on consumer nondurables like clothing. Things changed in 1993 at the end of the gradual reduction of tariff protection, and again after the government had launched the Plano Real stabilisation program in July 1994, which proved successful in fighting inflation. One of the results was a boom in consumption, fueled in part by increased confidence, in part by the reintroduction of consumer credit. Local industry did not have the capacities it needed to meet the increased demand, and moreover Brazil all of a sudden looked like a very interesting market for foreign suppliers. Also, as the stabilisation led to a rise in the incomes of poor people, sales chains looked for sourcing opportunities for low-end cheap clothing and found firms in China. One of the results was a substantial increase in textiles imports. The situation changed again at the end of 1994 and in 1995 when the government decided that the economy was overheated, and when the Mexico crisis hit. Curbs on consumer credit and higher interest rates had a cooling effect. However, foreign suppliers had their sales channels established by now and were unwilling to give them up voluntarily. The result was highly increased competition, basically in prices, in the local market.

Firms in the textile/clothing industry initially stuck to the established development path in their adjustment strategies — a high degree of vertical integration (with cotton as the main input and finished clothing as the output), little inter-firm interaction (particularly low in terms of information exchange), and little demand for the services offered by mesoinstitutions. Changes inside and among firms were largely incremental. This meant that rather than critically assessing the way they did business, firms took it for granted that some incremental adaptation to the new conditions would prove sufficient. To them, adjusting for the most part meant cutting costs. The first thing firms noted was that foreign competitors sold their products for lower prices. By cutting their own costs, which they sought to achieve first and foremost by investing in new, more productive equipment and by shedding jobs, firms hoped to catch up with their competitors, in this way regaining a strong market position. They for the most part failed to note that a new competitive pattern was emerging in the textile and clothing industry, where the firms that are successful are the agile, flexible, and customer-oriented ones. To excel on these factors would imply a radical change in the way local firms do business. On the basis of reengineering, they would have to introduce new patterns of internal organisation (flat hierarchies, employee empowerment, customer-driven organisation) and reorganise external relations (deverticalisation, concentration on core competencies, introduction of just-in-time delivery, cooperation with suppliers in engineering, better marketing, new sales channels). Moreover, they would have to intensify

inter-firm collaboration and cooperation with supporting institutions in order to stimulate rapid collective learning processes. These are some of the preconditions for moving up-market, which is unavoidable since local production costs are simply too high to permit competition with low-price imports from East Asia.¹⁰ Other conditions include a bigger effort in fashion design and changes in sales channels.

Initially (i.e. beginning in 1995), increased subcontracting by some Blumenau clothing firms was the only discernible adjustment strategy that broke away from the established development path. The *ex ante* rationale behind this was the possibility of saving substantially on labour costs (not so much due to lower wages at subcontractors as because they found ways to reduce social charges).¹¹ Thus this strategy seemed to fit into the pattern of defensive adjustment, but it was more than that, since these firms had initiated the move from the situation of completely closed to partially open firms. Yet most of the firms concerned failed to consider this way out of the dilemma facing them, mainly because reducing interaction with suppliers and subcontractors was so deeply rooted in the local business culture.

It was only after some time that adjustment efforts started to go beyond individual company-level activities. This was mainly due to the commitment of the president of the largest and oldest firm in Blumenau, a firm that in several respects has always played a pivotal role, e.g. when it came to introducing new types of equipment or new management techniques. In late 1996, this person took the initiative of organising a visit of local owners and managers of textile firms to Italy in order to learn about best practice, particularly in terms of inter-firm relations and a highly developed supporting meso-environment. This visit initiated an ongoing dialogue among a number of medium-sized and large firms on measures to create collective efficiency. Initial activities included

- conducting a benchmarking study involving seven medium and large firms (which showed that these firms, though local leaders, showed weaker performance than comparable European firms),
- improving information flows among firms (e.g. on customer credit standing and prices of key supplies),
- stimulating the development of new training courses at vocational schools,
- stimulating cooperation between firms and the local university, especially in the field on ongoing training for middle management,
- starting an initiative to create a quality brand for products from the region,
- studying the feasibility of setting-up a technology center.

A further outcome of the changes was that the president of the largest firm was elected president of the Chamber of Commerce and Industry in Blumenau where he is now working to widen and sustain initiatives for industrial adjustment and upgrading.

The interaction between the business sector and the political sphere has, so far, followed the traditional pattern: The textile industry bargained for, and in the end received, fiscal incentives at the state level. This reflects the current practice in Brazil: Locational strategies at the state and local level rarely amount to more than fiscal incentives, particularly for new investors, and provision of real estate. Creative policies that seek, for instance, to give shape to the mesolevel have thus far been rare exceptions. Firms and business associations have only very recently started to articulate their demand in this respect vis-à-vis state and local governments. In the case of Blumenau, this has been working surprisingly well given the fact that January 1997 saw the accession to office of a new mayor took who belongs to the leftist

Workers' Party (PT). In Brusque, the second largest city of the cluster, the president of the local chamber of industry and commerce was nominated as a candidate for mayor, and was actually elected. Both occurrences reflect the frustration of both the local business community and the overall community with the performance of the traditional political class.

4.3. *The changing role of business associations: embarking on a new path*

The role of business associations (industry associations/*sindicatos* and chambers/ACIs) has begun to change profoundly over the last years, with some of them starting to provide various services to their members and to support the emergence of competitiveness, i.e. to take an active role in shaping the mesolevel.

For the firms, membership in the industry association (*sindicato patronal*) is mandatory. They are organised by branch at the municipal level. The main role of the industry associations is collective bargaining. Yet some of them have recently started to broaden their profile. For instance, the textile industry *sindicato* in Blumenau has explored sourcing alternatives abroad, e.g. in Argentina. It also has adopted an active role as a political lobbyist for the industry. The ceramics industry *sindicato* in Criciúma has played an important role in lobbying for the construction of a pipeline to provide the local industry with natural gas to reduce energy costs. It has also played a prominent role in joint activity of various associations related to the construction industry aimed at persuading the government to start housing programs.

The Federation of Industries of Santa Catarina (FIESC) is the umbrella organisation of the *sindicatos*. Owing to the initiative of a new president, who came to office in 1992, i.e. basically due to an individual initiative, FIESC has played an active role in recent years in preparing firms for globalisation and increased competition:

- It has organised journeys of groups of local business people to international exhibitions, e.g. the Hannover fair.
- It has invested in publicity campaigns to present the state of Santa Catarina abroad as an attractive location for industry.
- It has set up a well-equipped centre for foreign trade information.
- It plays an important role in informing local firms about the necessities implied by the introduction of the ISO 14000 system of eco-audit norms.
- It has organised the creation of a venture capital fund.

All this, however, has been accompanied only to a limited extent by organisational development, in particular professionalisation of an entity which has always tended to be quite politicised, and thus FIESC's future performance will again depend on the initiative and efforts of the future president.

Apart from the *sindicatos*, there also exist Associations of Commerce and Industry (ACI) with voluntary membership at the municipal level; there is also an umbrella organisation (Federation of ACIs, FACISC), although the latter is influential only if its president is an important person with well-established contacts to politicians. In the past, these organisations tended to resemble clubs of local business people (Müller-Glodde, 1993). Their basic tasks were to administer the register of firms and to provide their members with legal advice. Many of them had no professional staff at all, and even the largest ones employed no more than a handful of people. In the northeastern part of the state a German technical cooperation project provided the impetus for change and helped to establish a partnership

between initially 10, later 17, ACIs and the Munich Chamber of Craft and Trade. Essentially, it was the result of a German initiative to involve German private business more actively in development cooperation, an initiative that led to a number of partnerships between German chambers and business associations in several developing countries. As the north-eastern part of SC was an area marked by German colonisation, local actors liked the idea of this partnership, although they failed to appreciate the profoundness of the change it would induce. In fact, the visits to their German partners led to a serious shock among representatives of the ACIs as they noted the impressive size, the large number of employees, and the broad spectrum of services provided by the Chamber in Munich. Following these experiences, the presidents of ACIs were much more open-minded about the changes proposed by the project staff. These changes, which took about five years to materialise, resulted essentially in four things.

- First, and most importantly, the role definition of the ACIs changed as they increasingly developed services geared to the demands of their members and sought to attract new members.
- Second, there was an increase in the number of employees as ACIs started to employ consultants to look after the needs of their members.
- Third, sectoral working groups were formed in the ACIs which united business owners of one sector (typically between eight and 15 persons) or were organised around a given problem, e.g. environmental protection.¹² In many cases, the sectoral working groups established for the first time a forum of exchange of business-related issues between local firms.
- Fourth, ACIs started to play a much more active political role at the local level. For instance, in the case of Joinville the ACI started an initiative to reduce the number of candidates for state-level parliamentary elections, thus increasing the probability of a substantial level of local candidates being elected.¹³ As the Brazilian political system is highly clientelist,¹⁴ having more local politicians in the state assembly increases the probability of gaining access to state funds.

4.4. *The role of local government*

Locational policies at the municipal level hardly exist in SC. Only in the largest municipalities do certain initiatives exist which can be classified as elements of a locational policy. This refers, first of all, to initiatives in Joinville and Blumenau to attract a car assembly factory (*montadora*). It certainly is not unfair to state that industrial and locational policy in Brazil has suffered from a *montadora* syndrome throughout the last years. The car industry was the only industrial sector that had an explicit industrial policy during the 1990s. In 1992 the agreement in the sectoral chamber of the car industry to reduce substantially the prices for small cars (*carro popular*) had a pronounced stimulating effect on demand, leading to expansion plans in this segment. Once the *Plano Real* had led to a stabilisation of the economy the passenger car market as a whole took off, leading to the announcement of a number of investment projects both by incumbents and other international firms. This again led to a contest between both states and municipalities to attract new car plants. Joinville held a promising position in the contest for the Renault factory, which in the end was won by Curitiba. Blumenau never really had a chance, but this did not deter local politicians from concentrating all their locational-policy efforts in this area.

Apart from trying to attract *montadoras*, the only local initiatives in locational policy worth mentioning were undertaken in the software industry, where Florianópolis, Blumenau, and Joinville set up business incubators. They were only to a small extent financed locally, but local government undertook considerable lobbying efforts at the state and federal levels to raise funds.

To understand the limited activities at the local level, it is necessary to point out two aspects of the policy. First, it is important to remember that any and all industrial policy has always been an activity of central government, i.e. there is no tradition of decentralised locational policy. Accordingly, local policy makers tend to think that locational policy is not part of their task and feel that it should instead be left to firms and business associations.

Second, the political turbulence at the local level is not less than that at other, more visible levels of government. It is quite rare for a ruling party or coalition to remain in office for more than one term. And even during its term, there will be frequent changes in office. Thus it is quite remarkable for a municipal secretary for economic development to stay in office for more than, say, two years. Accordingly, the pattern of action is for the most part ad hoc and tends less to pursue a longer-term strategy (which usually does not exist in the form of a written document in any case).

It is important to note that changes in the ACIs have entailed change in political practice at the municipal level in some places. This has typically taken two forms. First, ACIs started to define more clearly what they expected from their local government, for instance in terms of local infrastructure provision, public transport, local environmental issues, or education. Second, key ACI actors started to play a more active role in political life, i.e. by taking on jobs as secretaries for economic development or even as mayors. What was new about this was the fact that this did not so much indicate personal ambitions toward a political career. Instead, it represented the willingness to transport the dedication and professionalism of a key group of civil society into the public service.

4.5. *The role of the state government*

Santa Catarina was once famous for two things: its beautiful beaches and the annual *Oktoberfest* in Blumenau. Recently, it has also become infamous because the state government (i.e. the administration headed by Governor Paulo Afonso Vieira that entered office in 1995) is involved in the *precatórios* scandal, i.e. illegal practices surrounding certain government bonds. The fact that Santa Catarina became involved in that scandal is more than a mere coincidence. To be involved in the *precatórios* scandal is a synonym for having serious financial problems; and the source of these financial problems is usually traditional political practices, especially clientelism.

Brazil's political system is to a large extent based on clientelism. Since parties are weak, each politician has to make sure that he makes a certain number of people happy in order if he is to be (re-)elected (Avritzer, 1995). Elections are less the act of a sovereign people in determining its representatives to serve the common good than an implicit deal between citizens and politicians in which votes are traded for material or other benefits (Avelino Filho, 1994).

One of the effects of this political model is its limited ability to pursue strategies, i.e. to stick consistently to a certain line of action for a certain period of time. Long-term strategies like that which led to a far above-average of quality of life in Curitiba are exceptions which are only possible if a party or coalition stays in power for more than one term and is not

overly divided internally. Under the prevailing conditions, political action typically amounts to realising a variety of projects — in the sense of undertakings which are clearly located and limited in time (what is referred to as *obras* in Brazil), like constructing a new road or a new school. It is not by chance that substantial amounts of the state's income on all levels used to be specifically earmarked; this is seen as the only way to assure that certain tasks are consistently fulfilled.

In the context of locational policy the project and *obra* orientation is not an altogether bad approach. It is good news in the sense that it can help to fund the creation of a new institution (like the technology center CTC in the case of the ceramics cluster). In fact, the last state administration in SC (Governor Kleinübing, 1991–1994) did have a locational policy in this sense. More precisely, it delegated industrial policy making to FIESC, which then proposed a number of projects to be funded by the state government. Apart from CTC, this included an information technology center (CTAI) in the state capital Florianópolis and an environmental testing laboratory in Blumenau. Apart from that, the state government supported the creation of technology incubators in Florianópolis and Blumenau.

On the other hand, *obra* orientation and the delegation of industrial policy to FIESC had its limitations. First, the problem of financing the recurrent costs remained unsolved. Second, industrial policy did not amount to much beyond the projects mentioned. Prior to 1991, industrial policy, if there was one in the first place, was conducted at the state planning secretariat. The Kleinübing administration delegated this activity to FIESC. However, FIESC was utterly unprepared to take over this activity. Its president¹⁵ had a clear vision of the challenges the firms from SC had to confront in connection with the opening-up of the market and globalisation. But FIESC had virtually no dedicated staff for this activity and no people with adequate experience in this field. Preparation and execution of the projects mentioned above was delegated to SENAI, the vocational training system that is part of the FIESC system, and it was already was overburdened and underfunded. The Instituto Euvaldo Lodi (IEL) — a branch of FIESC that had been in charge of brokering internships in firms — was revitalised to deal with industrial matters. By late 1995 there were four professionals working at IEL; in 1998 their number had reached ten. Since this necessarily took time, FIESC contracted a private consulting firm to prepare a diagnosis of the competitiveness of SC firms and to propose an industrial policy. The consulting firm started its work in 1992 and presented its report in 1993. By this time the revitalisation of IEL was underway, and IEL's director did his best to undermine the consulting firm's activities (its report was in fact never published, and its main proposal, the creation of a Fórum Santa Catarina, consisting of leading business people and political agents, was never even seriously considered).

The subsequent state government (Governor Paulo Afonso Vieira) has been even less active in the field of industrial policy. It tried to reestablish the planning secretariat, but without getting very far with the project, mainly because it assigned only a handful of people to this activity, and the secretary soon became involved in a public scandal bound up with fraud in one of his former offices. Industrial policy mainly consisted in reformulating a fiscal incentive program for new investment. This program actually existed, without much effect, since 1988, offering tax credits to new investors. The reformulation meant that new investment and amplification investment of local firms also qualified for tax credit. However, in our field research in February — April 1996 (see Meyer-Stamer *et al.*, 1996) we did not find a single firm that was aware of this modification. Possible explanations are

insufficient communication between the administration and the private sector or technical details which made it impossible for local firms to benefit from this program. It was only in late 1996 and in early 1997 that two special lines were created in this program that deliberately aimed at stimulating increasing competitiveness in two local industries, namely food-processing and textiles. Since then, the *precatórios* scandal (specifically: avoiding the impeachment of the governor) has absorbed most of the state government's attention, and sectoral policies such as industrial policy are completely marginalised.

5. CONCLUSION: BUSINESS, GOVERNMENT, AND LOCATIONAL POLICY

Business people in Santa Catarina tend to see business and the state as totally different spheres. A rhetoric that denounces the state as someone who benefits from private businesses' successes without contributing to them, and that indicates that business dynamism is exclusively due to individual achievement, is not uncommon. It reflects a notion that is widely shared in the business community, even though it is historically incorrect. The federal government has for a long time played a pivotal role in the industrialisation process, and state government stimulated industrial development during the 1970s. At the same time, there is little doubt that since the early 1980s the state has created a highly business-unfriendly environment. Private businesses mostly regard the state as the creator of turbulence and as an agent that fails even to provide for basic necessities like physical and social infrastructure. Yet it is interesting to note that business people take advantage of the state's failure to present their achievements in a more glorious light. One might rather expect them to put pressure on the state, in particular at the local and state levels, to deliver — to build infrastructure, to introduce transparent and responsible budget practices, and to create stable framework conditions. This, however, is far from the case. Many business people we interviewed in 1996 complained at length about the state. But we did not find that firms or their associations were systematically putting pressure on the state to improve its performance.

The prevailing political pattern used to be one of clear separation between business and government. This is due to traditional structures of the polity, i.e. within the political parties (personalism), within the executive (preference for hierarchical governance), between the legislative and executive branches (clientelism), and between the political-administrative system and business associations (no clear articulation of business interests). Some firms may be heading for world-class manufacturing, inter-firm relations may deepen, but the state-business relationship is archaic, and even when industrial promotion measures are discussed, they follow a traditional pattern. In other words, path dependence is more deeply entrenched in the political arena than anywhere else.¹⁶ This has a lot to do with the 'mental model' of most of the key actors, who can hardly imagine a different *modus operandi* on the part of politics. To explain this, two possible factors come to mind. First, the traditional model of clientelist politics has a long tradition in Brazil, and has never been challenged seriously. On the contrary, it was cast in the form of a rigid corporatist system in the 1930s, and this system still exists and serves many interests; for instance, mandatory membership is of course convenient for *sindicatos*. Second, the traditional polity opens up promising career opportunities, especially for business leaders who succeed in being coopted into the political class. Therefore, alienating political actors by pursuing an explicit, outspoken strategy of interest articulation may appear as a personally unattractive option to business leaders.

The type of locational policy that has recently been observed in some industrialised countries — based on policy networks that involve different government agencies, business associations, and other relevant actors, formulating strategies and consistently implementing them (Esser *et al.*, 1996) — is unlikely to emerge in SC under the given conditions. This, however, does not mean that there can be no locational policy at all. Rather, the Criciúma and Itajaí Valley examples show a likely path: locational policy based on the initiative, and a certain planning capacity, of business associations, with the state acting as a financing agency for certain, clearly delimited projects. Such a locational policy is inherently limited in its scope as it is not based on a longer term, broad-based strategy that involves government, the private sector, and public–private partnership. It is limited to individual projects in a restricted range of activities, with only limited activities in areas like infrastructure or education. It is thus better than nothing, but it is doubtful whether it will be enough for a region to flourish in a globalised economy.

How might the current prevalent pattern be overcome, and by whom? Probably business associations could play the main role, provided they continue on the trajectory of organisational development, broadening their membership base, and articulating business interests at the local and state level. They can offer various services to member firms, and they can mediate between firms and other mesolevel institutions. They could join forces with other nongovernmental organisations in demanding more accountability, more transparency in public budget practices, more continuity in government action, especially once changes in administration have been effected. This requires another change in mindset, which, to a certain degree, is already discernible within business associations: here newly elected presidents today have less latitude for random decisions than they had in the past. It is not without irony that the necessity to shape locational advantages might thus lead to a democratisation of the polity at the local and state level. This is quite the opposite of what most globalisation scenarios suggest.

NOTES

1. This article is based, first, on field research that was conducted as a joint project between the Federation of Industries of the State of Santa Catarina (FIESC), various local Chambers of Commerce and Industry, and the German Development Institute between February and April 1996 during which we interviewed 85 firms and 43 government and mesolevel institutions. It is based, second, on information obtained in the course of ongoing advisory work with FIESC and Fundação Empreender, a training and advisory organisation maintained by the chambers of industry and commerce.
2. The mesolevel is one of the four analytical levels of the concept of ‘Systemic Competitiveness’ (Esser *et al.*, 1996: 63 ff.: see also Altenburg *et al.*, 1998). The key message of the concept is that in order to understand successful industrial development it is essential to look not only at micro- and macroeconomic factors but also at the mesolevel, i.e. selective policies and specific institutions, and the metalevel, i.e. the basic model or economic organisation, the overall development strategy, and the capacity of key actors to formulate and implement visions and strategies.
3. The term ‘Custo Brasil’ refers to the specific cost disadvantages firms in Brazil due to red tape, high taxes and a complex tax system, high incidental labour costs, and an inefficient infrastructure (especially little rail transportation and disorganised ports); see World Bank (1996).
4. ‘Política Industrial, Tecnológica e de Comércio Exterior. Reestruturação e Expansão Competitivas do Sistema Industrial Brasileiro. Governo Fernando Henrique Cardoso. 1995–1999’, no location and date given.
5. <http://www.mict.gov.br/spi/asac/asac0000.htm>.
6. For a detailed account, see Meyer-Stamer *et al.* (1996).
7. This term goes back to Alfred Marshall, who was the first to describe the positive effects of the clustering of firms. For an overview of the recent discussion see Schmitz and Nadvi (1994).

8. For instance, there are very active business associations in the capital goods industry (ABIMAQ, ABDIB, ABINEE), but capital goods firms from the Joinville cluster in the northeast of Santa Catarina do not play an active role in them.
9. On industrial districts in the Italian tile industry, see Russo (1985) and Porter (1990: 210ff).
10. In particular, the cost of labour is relatively high. A seamstress in Blumenau will typically earn about US\$ 380–450 per month. The effective cost to the firm is twice that amount due to social charges and other indirect labour costs (World Bank, 1996).
11. In an ex post perspective large firms report that increased subcontracting has contributed significantly to quality improvements, as control of merchandise delivered by subcontractors has proven more rigorous than internal controls were.
12. See Meyer-Stamer (1997) for a case study.
13. On the peculiarities of the Brazilian party system that established the logic of this initiative, see Mainwearing (1992).
14. Avelino Filho (1994) gives an overview of this feature.
15. Osvaldo Moreira Douat, dominant figure in a family from Joinville that owns a medium-sized metal-engineering company and a synthetic fibre firm.
16. On path dependence, see Meyer-Stamer (1998).

REFERENCES

- Avelino Filho, G. (1994) Clientelismo e Política no Brasil. Revisitando Velhos Problemas. *Novos Estudos CEBRAP* **38**, 225–240.
- Avritzer, L. (1995) Transition to democracy and political culture: an analysis of the conflict between civil and political society in post-authoritarian Brazil. *Constellations* **2**(2), 242–67.
- Borges, L. M., Almeida, C., and Altivo, R. A. (1996) Novas Aglomerações Industriais e Desenvolvimento Regional Recente no Brasil. *Revista Econômica do Nordeste* **27**(4), 725–761.
- Esser, K., Hillebrand, W., Messner, D. and Meyer-Stamer, J. (1996) *Systemic Competitiveness: New Governance Patterns for Industrial Development*. Frank Cass, London.
- Freeman, C. (1994) The economics of technical change. *Cambridge Journal of Economics* **18**, 463–514.
- Müller-Glodde, R. (1993) *Organisationsentwicklung in brasilianischen Unternehmensverbänden. Fallstudie des Partnerschaftsprojekts zwischen brasilianischen Handels- und Industrieverbänden in Santa Catarina und der Handwerkskammer für München und Oberbayern*. Eschborn: GTZ, Aus der Arbeit der Abteilung 403, Nr. 16.
- Mainwearing, S. (1992) Brazilian party underdevelopment in comparative perspective. *Political Science Quarterly* **107**(4), 677–707.
- Mathieu, H. (1991) *Transnational corporations, the state, and class formation in industrial policy development: the brazilian automotive, chemical, and electronics industries in comparative perspective*. Draft of a Ph.D. thesis for Submission to the London School of Economics and Political Science.
- Meyer-Stamer, J. et al. (1996) *Industrielle Netzwerke und Wettbewerbsfähigkeit. Das Beispiel Santa Catarina Brasilien*, German Development Institute, Berlin.
- Meyer-Stamer, J. (1997a) *Inter-firm cooperation in environmental management: experience from Santa Catarina/Brazil*. Bonn: GTZ-Pilot Programme for the Promotion of Environmental Management in the Private Sector of Developing Countries, P3U-Working Paper No. 7e.
- Meyer-Stamer, J. (1997b) *Technology, Competitiveness and Radical Policy Change: The Case of Brazil*. London, Frank Cass, GDI Book Series No. 9, Portland Or.
- Meyer-Stamer, J. (1998) Path dependence in regional development: persistence and change in three industrial clusters in Santa Catarina/Brazil. *World Development* **26**(8).
- OECD. (1992) *Technology and the Economy. The Key Relationships*. The Technology/Economy Programme, OECD, Paris.
- Porter, M. E. (1990) *The Competitive Advantage of Nations*. The Free Press, New York.
- Rodrigues, D. A. (1996) Cenários de Desenvolvimento Regional. *Revista do BNDES*, No. 6.
- Schmitz, H. and Nadvi, K. (1994) *Industrial Clusters in Less Developed Countries: Review of Experiences and Research Agenda*. IDS, Brighton.
- Schmitz, H. (1995) Collective efficiency: growth path for small-scale industry. *Journal of Development Studies* **31**(4), 529–566.

- Shapiro, H. (1994) *Engines of Growth. The State and Transnational Auto Companies in Brazil*. Cambridge University Press, Cambridge.
- Storper, M. (1995) The resurgence of regional economies, ten years later: the region as a nexus of untraded interdependencies. *European Urban and Regional Studies* 2(3), 191–221.
- UNCTAD. (1996) *Incentives and Foreign Direct Investment*. United Nations, New York, Geneva.
- Varsano, R. (1997) *A Guerra Fiscal do ICMS: Quem Ganha e Quem Perde*. Rio de Janeiro: IPEA (Texto para discussão No. 500)
- Vet, J. M. (1993) Globalisation and local and regional competitiveness. *STI Review* (13), 89–122.
- World Bank. (1996) *Brazil: The Custo Brasil since 1990–92*. Washington, Report 15663-BR.