
| RESEARCH ARTICLE

Coffee Valorisation as Government Failure: The Common-Pool Problem and Brazil's Loss of Global Hegemony (1889–1930)

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| ABSTRACT

This article analyses coffee valorisation in Brazil between 1889 and 1930. It contrasts approaches that view the state as aligned with class interests with a public choice perspective centred on organised groups. It argues that valorisation persisted because it generated benefits for exporters while distributing costs across less organised groups, consistent with a fiscal common-pool problem. Evidence from the Taubaté Agreement indicates that price support was financed through external borrowing and implemented through exchange-rate depreciation and monetary expansion. Over time, incentives encouraged supply expansion and reduced Brazil's market position as competitors entered. Fiscal pressure constrained other public spending. The case illustrates government failure.

| KEYWORDS

Coffee valorisation; Taubaté Agreement; Brazilian Old Republic; public choice theory; common-pool problem; coffee oligarchy; exchange-rate depreciation.

| ARTICLE INFORMATION

ACCEPTED: 15 March 2026

PUBLISHED: 11 April 2026

DOI: 10.32996/bjpsh.2026.6.1.2

1. Introduction

This theoretical essay examines how different schools of thought have interpreted state intervention in Brazil's coffee economy during the Old Republic (1889–1930). Traditional interpretations, particularly those from a Marxist and ECLAC/structuralist perspective, have attributed government support for the coffee sector to the dominance of Brazilian coffee-growing elites.

However, these approaches share a common underlying view: they conceive of the State as a unified and rational actor capable of pursuing coherent objectives. For Marxist authors such as Caio Prado Júnior (1966), the State appears as a monolithic entity serving the interests of the coffee oligarchy. For the ECLAC school, during the Old Republic, the State served the coffee oligarchy when it ought to have served the nation as a whole, that is, to promote economic development.

This interpretation differs from the public choice approach. Public choice theory sees politics as an arena of competition and bargaining among organised interest groups. Pressure groups seek to have their demands met, while politicians negotiate electoral support in exchange for votes. This bargaining is difficult for the public to perceive because these groups frequently use the media to present their demands as beneficial to society as a whole.

Government support for coffee prices brought short-term gains for Brazilian producers while the country still held a near-monopoly in the world market. However, these measures also created long-term losses. This episode is a clear example of government failure. The core mechanism is that coffee growers do not bear all the costs, which are shifted onto society, and the longer-run effects eventually feed back to harm the sector itself.

As a result, Brazil lost its dominant position, and the outcome reflects the fact that society bore the costs of the policy, insofar as policy-induced spending reduced investment in other sectors by crowding out fiscal resources, given that the public budget

operates primarily as a tool of political allocation. In addition, the subsidies encouraged excessive production and lowered barriers to entry for new international competitors.

A reading from the perspective of control theory leads to a simple conclusion: policy can be steered. Marxists argue that, to a large extent, it is implemented in favour of the interests of the dominant class. Structuralists associated with CEPAL expect such steering to take the form of industrialisation and a developmental push in peripheral economies. Keynesians, in turn, maintain that stabilisation policy is carried out for the welfare of society. Thus, these three frameworks belong to the same category.

In contrast, under the common-pool approach (Buchanan & Tullock, 1962), the expansion of public expenditure demanded by pressure groups tends to be met by parliamentarians seeking to boost their popularity ratings. In this way, voters organised into groups would exert influence to secure a particular government measure that favours them.

The degree of approval of a Minister of the Economy stems from control over inflation and public spending, whereas the popularity of the other ministries depends on public works. There is also budgetary competition among ministries: meeting the demands of one may prevent those of another due to limited budget allocations.

This divergence of understanding regarding the Brazilian coffee economy stems from the use of different theoretical paradigms. This way of thinking constitutes a worldview, a systematised logical structure for explaining a particular set of phenomena that the paradigm itself defines as relevant, while employing methods deemed acceptable by the majority of scholars in the field.

Within this framework, Marxist Brazilian authors, such as Caio Prado Júnior (1966), interpreted government actions as serving the interests of the agrarian bourgeoisie primarily, in line with Engels' (1878/1970) view that the State exploits the working class in favour of the dominant class. In this context, the Marxist proposal consisted in transferring political power to the working class, aligned with the diagnosis that the State functions as an instrument of the dominant class.

By contrast, CEPAL authors, such as Celso Furtado, identified in the trajectory of coffee policy the development of a primary-export-oriented production structure, which resulted in the creation of economic dependence on central countries. According to Furtado, politicians defended this policy because the coffee oligarchy dominated political power, such that defending coffee prices ensured the preservation of profits and the stability of the oligarchic regime.

According to the Public Choice Theory framework (Buchanan & Tullock), this government failure is inevitable. This is because political agents seek to maximise their own interests, weighing costs and benefits. It was for this very reason that the State sustained coffee prices in favour of the oligarchy, as it secured electoral support from that group while the costs of the policy were diluted and borne by society.

North (1990) and Weingast (1997) argue that correcting government failures requires the establishment of constitutional rules, enforcement mechanisms for non-compliance, and greater transparency. This would raise the cost of opportunistic practices, which were absent at the time.

Fiscal rules still have uncertain effects today, and they were even less dependable in the past. Brazil today makes this quite clear: although formal fiscal rules are on the books, repeated exceptions and waivers keep chipping away at fiscal discipline. It is exactly this kind of recurring weakness that Buchanan was trying to guard against with stronger fiscal safeguards and institutional checks. This study proceeds from the view that coffee valorisation during the Old Republic persisted in a context shaped by the growing influence of pressure groups over fiscal decisions. Marxist and structuralist interpretations associate these policies with the agrarian bourgeoisie. The emphasis here is on the role of groups within the coffee sector in sustaining price support. The analysis is grounded in a reconstruction of the Taubaté Agreement and its macroeconomic implications.

2. Theoretical Framework: Coffee Valorisation as a Common-Pool Problem

The Brazilian economy during the Old Republic exhibited a structural pattern in which the composition of demand for goods was more diversified than that of supply, which remained heavily concentrated in coffee production. It was an economy with a poorly diversified supply structure, oriented towards the export of primary goods, mainly coffee.

This production structure was typical of a primary-export economy, characterised by low agricultural productivity, rudimentary methods such as slash-and-burn practices, and the near-total absence of mechanisation. This pattern is fully consistent with the Heckscher–Ohlin theorem (Heckscher, 1919; Ohlin, 1933), according to which productive activity and exports tend to concentrate on goods that make intensive use of the factor of production the country possesses in relative abundance, in this case, low-skilled labour. The same logic also aligns with Ricardo (2004), who argued that there is a competition between the employment of machinery and the employment of labour, and that the acquisition of the former depends on a rise in the price of labour.

The finding of Ricardo (2004) had already anticipated that the relatively low cost of labour compared to machinery discouraged entrepreneurs from buying equipment, which was corroborated by Furtado (1959) and Simonsen (2005) for the Brazilian case. The result of the low use of machinery slowed the growth of industrial activities across the board. Even in the coffee sector, workers were rarely replaced by machines, whether in processing or transport.

Furtado (1959) observed that this policy was not a conscious decision by the government, but rather an unintended by-product of defending coffee interests. Consequently, investing in coffee became more attractive than in other sectors of the economy that lacked government protection, where returns were usually more uncertain.

This structural configuration had direct implications for Brazil's insertion into the international market. With demand more sophisticated than domestic supply, the country became dependent on imports of manufactured goods, financed by a poorly

diversified export basket concentrated on coffee. A possible theoretical justification for Brazil's specialisation could be drawn from the theory of comparative advantage: the country exported the goods in which it held a comparative advantage and imported those that could be produced more cheaply abroad. Yet producers naturally prioritised private returns.

Authors from the Economic Commission for Latin America and the Caribbean (CEPAL) advanced a diagnosis for Brazil that emphasised industrialisation as a means of reducing dependence on advanced countries. Prebisch (1950) and Singer (1950) argued that primary-export specialisation entailed high external vulnerability, given the low price elasticity of demand for coffee and the tendency of imports to outpace exports. This pattern reinforced Brazil's dependence on developed nations, in line with the Prebisch–Singer hypothesis.

As Baer (2008, p. 3) aptly observes, even decades later—after Brazil had already begun its import-substitution industrialization process—“Brazil's rate of economic activity was largely dependent on the performance of the industrialized centers of the world. [...] industrialization only changed the nature of the dependency relationship”.

If the country had developed an industrial sector and a diversified agricultural output, the import coefficient could have been lower and, consequently, the share of imports in GDP would have been reduced. Even if this is a simplifying assumption, the smaller volume of imports would have contributed to a larger increase in GDP. This growth could, in turn, have been even greater with the expansion of exports and domestic production.

However, the import coefficient (import/GDP ratio) did not decline very much, while the commodity composition of imports changed. Thus, the primary-export specialisation of the Old Republic was not a mere transitory feature; it created a structural dependence that reproduced itself, albeit in a new form, throughout the twentieth century.

Indeed, it was the expansion of coffee cultivation that proved viable in Brazil, for which the country offered favourable conditions for development. It was a production already rooted in the country. Domestic consumption of coffee was common in the more populated regions, such as the North-East and the South-East, so that exports merely represented the extension of a domestic activity. This is precisely the assumption of Linder (1961), for whom it would not be surprising that Finland exported icebreakers, but it would be unexpected that the Eskimos should obtain a comparative advantage in the production of refrigerators.

Coffee cultivation was also made possible by the wide availability of labour and land, which gave it distinctive characteristics. This abundant supply of labour in the coffee-growing region was typical of the country's low level of economic development. Such a labour reserve was further reinforced by migratory flows (around 4 million European immigrants between 1890 and 1930).

The availability of production factors defined the export basket. There was an abundance of land, low-cost labour, and plentiful water. Thus, it was possible to produce in the country at a relatively low cost. During the period of expansion, new land could be incorporated and employment in the sector increased without raising wages (Holloway, 1980). As land was available, with the expansion of the frontier in Western São Paulo, there was no need to cultivate less fertile land and, therefore, Ricardo's differential rent did not materialise.

Thus, in the light of the factor price equalisation theorem (Samuelson, 1948), it would be expected that the wage level in the coffee sector would rise during periods of expanding labour recruitment. However, the excessive supply of workers, greater than demand, together with the abundance of land, allowed entrepreneurs to expand production simply by hiring new workers rather than increasing productivity through the acquisition of goods and equipment (Furtado, 1959). In this way, expansion occurred without an increase in wages or other significant costs. This abundance of labour reduced the incentive for innovation and investment in technology. When labour is plentiful and cheap, it becomes easier to expand production through the incorporation of workers rather than through productivity gains. This tends to reinforce productive specialisations of low added value. Thus, the Brazilian economy displayed comparative advantages in agricultural export production, especially coffee.

For this reason, national production displayed comparative advantages in the international market. The country's output accounted for three-quarters of world supply in the final decade of the nineteenth century, which made it possible to manipulate the supply and price of this product. All that was required was to withhold part of the production from the market, that is, to contract supply. In this way, the performance of the Brazilian export economy was anticipated by Ricardo's theory of comparative advantage (Ricardo 2004) within the so-called international division of labour. This productive structure, with extensive methods and low mechanisation, was consistent with the country's abundance of land and labour.

From a microeconomic point of view, the coffee market had some distinctive features. The product was homogeneous and was produced by a large number of firms, both in Brazil and around the world, with no significant barriers to entry. The price is given by the market. Coffee growing therefore showed the typical traits of a competitive market rather than those of a monopoly. Since no small group of firms controlled supply, they could not fix prices or block new competitors through price wars, the usual weapons of monopolistic companies. As a result, coffee cultivation could not be regarded as a monopoly in the traditional sense.

The commodity was traded on the New York and Hamburg exchanges without significant brand differentiation. However, when viewed at the country level, the international supply structure was oligopolistic. Between 1900 and 1906, Brazil produced between 75% and 83% of the world's coffee, reaching almost five times the output of the rest of the world in 1906 (Topik, 1987). It therefore exercised an almost monopolistic dominance of global supply. Domestically, however, production was spread among thousands of farmers in São Paulo, Minas Gerais and Rio de Janeiro, with holdings of varying sizes competing with one another. International demand was met overwhelmingly by Brazil, as smaller competitors such as Colombia and Guatemala were still marginal at that time.

The appreciation of the national product in the international market, combined with state intervention in defence of its prices during the Old Republic (1889–1930), reinforced the perception that coffee occupied a privileged position in the Brazilian economy. Coffee cultivation yielded high profits, which encouraged the continuation and expansion of production. The absence of significant barriers to entry, both in the country and in the world, favoured the expansion of coffee growing.

From the crisis of 1893, which persisted in the United States, prices began to fall. In 1897, a new depression in the international market once again pushed them downwards. The effects of the 1893 crisis could be partially mitigated by currency depreciation. Even so, coffee growing continued to expand, and coffee production kept increasing, reaching its peak in 1933, in the very midst of the Great Depression.

In this context, the coffee valorisation policy was formalised in the Taubaté Agreement of 1906 (Delfim Netto, 1959). In essence, this policy envisaged government intervention to purchase the surpluses, with the aim of re-establishing the balance between supply and demand. The financing of these purchases would be carried out through external loans, the servicing of which would be covered by a new tax, in gold, imposed on each sack of coffee exported.

The greatest fragility of this economic model lay in the fact that the country's growth depended on the expansion of international demand, since the driving force of the Brazilian economy came primarily from abroad. The rise in coffee prices increased export revenues and, consequently, government income and the earnings of the landowners.

Moreover, the fragility of this growth in the primary-export model was exacerbated by the deterioration of the terms of trade affecting primary products with low capital intensity. This occurred because the prices of labour-intensive goods such as coffee tended to fall relative to those of imported manufactured goods, reducing the country's external purchasing power. This was precisely the situation around 1900 with excess world supply and falling international prices which led to a loss of export revenue. The inefficiency resulting from the state's monopoly over coffee price protection was a factor in the decline of Brazilian coffee. It hindered modernisation, stimulated overproduction, and made the sector vulnerable to competitors' entry.

This loss of competitiveness in export markets, and the consequent decline in income in the coffee sector, prompted the government to resort to currency devaluation in order to support exporters, particularly coffee growers.

The rates of depreciation of the Brazilian exchange rate between 1928 and 1939 are shown in the table below. This substantial nominal depreciation, especially pronounced between 1928 and 1931, can be regarded as a rough proxy for short-term gains in export competitiveness. However, its net effect ultimately depended on the behaviour of domestic inflation relative to that of trading partners and on movements in the real effective exchange rate.

Table 1. Rates of Depreciation of the Brazilian Exchange Rate, 1928–1939

Periodo	$((e - e_{-1})/e_{-1})$
1928–1931	0.68
1931–1933	-0.11
1933–1935	0.37
1935–1937	-0.07
1937–1939	0.19

Source: Author's calculations based on the exchange-rate series (column "e" reported in Cardoso (1980), originally from Peláez and Suzigan (1976) and Malan et al. (1977).

This trend of declining hegemony is clearly illustrated in Table 2, which shows Brazil's share in world coffee production falling from 80% in 1900 to 54% in 1950.

Table 2. Brazil's Share in World Coffee Production (1900–1950).

Period	World	Brazil	Participation (%)
1900	15.1	12.069	80
1910	14.35	10.653	74
1920	20.29	17.116	84
1930	25.23	17.652	70
1940	26.5	15.797	60
1950	31.3	16.754	54

Brazil's Share in World Coffee Production (1900–1950).

However, such a measure made external debt more expensive, leading the government to contract new loans, the servicing of which imposed a fiscal burden. This increase in the cost of debt prompted the government to take on additional debt to cover debt service. Thus, the debt continued to grow, leading the government to transfer resources from budgetary revenue to cover it.

The government encouraged production through privileged financing, subsidies and infrastructure spending. This pattern was consistent with the common pool theory developed by Buchanan and Tullock (1962), even though Delfim Netto (1959) had already described the mechanisms by which state support stimulated the expansion of coffee production during the Old Republic. To finance current expenditure, the government also resorted to issuing paper money.

As with every state intervention, a narrative was constructed to justify such a policy. One argument put forward in favour of this public action was that it contributed to income generation and helped combat unemployment. Pressure groups dictated the direction of policies to the detriment of diffuse (collective) interests which, although broader, were under-represented in the political system.

It was also during periods of economic slowdown that the coffee sector contributed to the maintenance of income and employment. In such circumstances, entrepreneurs tended to keep workers employed, since coffee cultivation is a long-term investment with high capital immobilisation. Once the plantation was established, it was not possible to reduce the cultivated area without incurring significant losses. Moreover, land used for coffee cultivation could not be easily redirected to other agricultural activities. As there were no immediate alternative uses for the labour employed, halting production would imply a substantial loss of income. This explains why, even amid falling international coffee prices, efforts were made to maintain employment levels during periods of economic stagnation.

Maintaining the coffee policy required higher public spending, but this did not translate into economic gains. Inflation rose, public debt expanded, and activity declined.

The expansion of the money supply raised the price level. Higher inflation then exerted pressure on the exchange rate by eroding the domestic currency's purchasing power. As domestic prices rose faster than external prices, domestic goods became relatively more expensive, which stimulated imports.

Table 3 illustrates this pattern. The expansion of the money stock was accompanied by increases in industrial and import prices, as well as a depreciation of the exchange rate.

Table 3

Money Stock and Price Indices, Brazil (1928–1939)

Year	Money Stock (H)	Dollar Exchange Rate (e)	Import Prices (ePm*)	Industrial Prices (P)	GDP Deflator
1928	52.9	44.3	56.7	84.4	102.7
1929	52.2	44.3	54.6	78.1	98.7
1930	46.8	48.4	59.4	64.8	86.5
1931	49.9	74.5	69.2	69.4	77.0
1932	56.5	73.4	60.1	69.7	78.4
1933	62.2	66.1	59.4	71.6	76.6
1934	65.4	73.4	63.0	75.0	81.5
1935	70.0	90.6	85.7	77.5	85.6
1936	76.5	90.1	91.3	82.8	86.9
1937	84.8	83.9	94.8	86.2	95.1
1938	100.1	91.7	99.0	93.8	98.2
1939	100.0	100.0	100.0	100.0	100.0

Note. H = money stock annual average; e = exchange rate; ePm* = import price index adjusted by exchange rate; P = industrial price index.

Source: Data reported in Cardoso (1980), originally from Pelaez and Suzigan (1976) and Malan et al. (1977).

In sum, a relationship was established between external borrowing, budget deficits, monetary issuance and current account imbalances in the balance of payments, indicating dependence on foreign capital inflows. The economic costs became evident over time. Financing coffee price support through higher public debt and expenditure cuts worsened fiscal conditions. The reduction in public investment also affected income and constrained tax revenue growth. Expenditure cuts limit the economy's capacity to grow by removing key sources of support. Shortages appeared across several sectors, while rising debt levels pushed up interest rates and held back growth.

In practice, this shows that public intervention in a single sector entails a broader cost, borne by the rest of the economy. Declines in export revenues generated current account deficits in the balance of payments, explained by recurrent trade deficits and dependence on imports.

This pattern of governmental action is consistent with the common-pool theory, according to which organised pressure groups seek to influence the political process to obtain favourable public policies, in which concentrated benefits and diffuse costs sustain inefficient policies over time. At the beginning of the twentieth century, this coffee activity, at the national level, was conducted mainly by the bourgeoisie of São Paulo and Minas Gerais. It is worth recalling Seitenfus (1985, p. 31):

“The dominant oligarchy during the first decades of the republican regime was essentially constituted by the large planters and traders of the states of São Paulo and Minas Gerais. Thus, it is natural that this domination should be reflected in the formation of the central government.”

The policymakers of these two states, together with the social classes that backed them, pushed hard for measures to keep coffee production going and to shield it from the ups and downs of the international market. As Hayek (2010) had already pointed out, once governments start yielding to the demands of particular organised groups, there is rarely any natural limit to how far those pressures will grow. In the end, such policies tend to make large parts of the electorate dependent on the continued flow of benefits.

High coffee prices were kept artificially high by government action. To the individual producer this looked like a straightforward signal: the business was still profitable. Each farmer, relying on his own local knowledge of land, costs and conditions, the dispersed knowledge that Hayek (1945) emphasised, simply did what made sense at the time and planted more. Yet no central planner could possibly foresee the collective result. In the end, the policy only made the supply problem worse, amplifying the very imbalance it had been designed to fix.

Thus, government action sought to stimulate coffee exports and reduce the vulnerability of this activity to fluctuations in international market supply and demand. State intervention sought to defend the price of coffee in the international market through valorisation policies, the institutional landmark of which was the Taubaté Agreement of 1906. Contradictorily, this intervention, aimed at defending the interests of coffee growers, ended up creating conditions that contributed to the sector's disorganisation by postponing a solution to a problem that would worsen over time. The pursuit of individual interests threatens the management of shared resources, generating undesirable consequences for the collective. Maintaining elevated coffee prices entailed fostering conditions for greater supply and for the imbalance between supply and demand to grow further.

This measure, in light of the common-pool theory, was a government failure, since by distorting market signals and artificially sustaining a specific sector, the State aggravated economic inefficiency and compromised long-term equilibrium.

The decline in international coffee prices discouraged economic growth and, in turn, led to fiscal difficulties in the Old Republic. To cope with these pressures, the government resorted to currency devaluation to preserve export revenue. The result was the formation of a cycle in which the fall in external revenues led to currency devaluation, which, while favouring the export sector, simultaneously widened fiscal and external imbalances. In the end, the whole community lost, as the country's hegemony in international markets as a supplier was lost.

3. Conclusion

From the nineteenth century onwards, conditions in Brazil seemed highly favourable for the expansion of coffee cultivation. Yet this very success eventually exposed the classic resource curse. The country possessed clear comparative advantages in agriculture: it was a rural economy with vast areas of land and abundant cheap labour.

Production could therefore grow without machines, simply by opening up more land and hiring extra workers. Immigration from abroad and from within Brazil kept the supply of labour plentiful. However, the combination of inelastic global demand and ever-rising supply undermined the long-term viability of coffee growing in Brazil. This intervention made coffee supply grow both at home and abroad. Production came from numerous small and large producers. It kept rising even in the middle of an economic crisis. The government supported the price of the product. This encouraged producers to maintain and expand their output. Yet it all came at the cost of rising public indebtedness.

Stopping the policy would come at a heavy political price. By that point, the government had already spent huge sums of money, and producers had expanded their farms a lot, so it seemed much easier to keep the support going than to admit the whole thing had been a mistake, even though the costs kept piling up year after year.

The government used fiscal, monetary and exchange-rate policies to keep coffee prices stable. This increased the public debt. Interest payments then ate into the budget, leaving less money for other things. At the same time, printing more money fuelled inflation. Currency depreciation made the situation even worse: it pushed prices higher and made imports more expensive. In the end, these measures fed off each other and simply drove inflation higher.

These policies only boosted domestic production in the short term. That, in turn, created the need for even bigger loans. The problem kept growing, like a snowball rolling downhill.

In terms of political economy, the prevalence of interests linked to coffee cultivation conditioned policy-making, turning price protection into the central element of a strategy that socialised risks and privatised gains.

The difference between these approaches becomes much clearer when we look at their basic assumptions. Traditional Marxist and structuralist interpretations take a holistic view. They see the State as a single unified actor that is either captured by the coffee oligarchy or that has failed to serve the nation as a whole.

The common pool approach is based on methodological individualism. It assumes that politicians and organised producers are individuals who pursue their own interests. They treat the public budget as a common resource (Hardin, 1968). In short, the coffee experience illustrates how the defence of a dominant sector, without exit mechanisms or productivity counterparts, tends to perpetuate structural imbalances. The shock of the 1930s made these limits explicit and precipitated the transition to a development pattern less dependent on a single product.

The lesson that emerges is the need for productive diversification, investment in technology and skills, and stabilisation instruments with budgetary discipline and a defined time horizon, so that countercyclical policies do not become the permanent support of inefficiencies.

Funding: This research received no external funding.

Conflicts of Interest: The authors declare no conflict of interest

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Publisher's Note: All claims expressed in this article are solely those of the authors and do not necessarily represent those of their affiliated organizations, or those of the publisher, the editors and the reviewers.

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