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RFD 452

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

December 10, 1963

How Tight a Line in Brazil

9 pages

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This paper was delivered before the Latin American Luncheon Group of Washington, D.C. on November 21, 1963.

The views expressed are those of the author and do not necessarily reflect the views of the Board of Governors of the Federal Reserve System.

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How Tight a Line in Brazil

There is a widespread feeling in Brazil that the economic difficulties of the country are inevitable and perhaps insoluble. Those who argue that Brazil has been the victim of unwise economic policies which could and should be corrected are frequently told that Brazil's problems are unlike those that have ever been faced by any other country in the world and that the solutions that have worked in seemingly similar situations elsewhere simply will not work in Brazil. This attitude is not confined to Brazilians. A recent article by an American economist tells us that the American businessman is wrong to be concerned about rampant inflation and economic and political instability in Latin American countries.1/ These things are inevitable in growing countries, we are told, and the foreign investor should accept them and adapt to them. The idea that the country should make some adaptation so as to give confidence and encouragement to the investor is considered unreasonable if not impossible.

The population problem has been given the blame for the economic difficulties of a lot of countries. We often hear of countries that are in an almost hopeless position because of too many people and too little land. In Brazil, this has been given a different twist. It seems to be fashionable there to attribute a large part of their difficulties to the fact that the country embraces such a large area and is sparsely populated. In other words, there is too much land and too few people. Some economists think that countries that are physically small have particularly difficult economic problems, but in Brazil there is a feeling that the great area which the country embraces is an economic handicap.

These attitudes make it difficult to discuss economic policy in Brazil in terms of the experience of other countries. The frustration would be somewhat lessened if we could compare Brazil with another country which comes very close to matching it in both size and population. There is no such country in the world today, but there was one three-score years ago--the United States.

Brazil's twin

In 1900, the U.S. had 76 million inhabitants and an area of 3 million square miles. Today, Brazil's population is estimated at 77.5 million, and her land area totals 3.3 million square miles. Like Brazil, the U.S. still had plenty of wide open spaces at the turn of the century, and, like Brazil, the population was quite heavily concentrated in the states that bordered the oceans. At that time we had eight cities with over a half million inhabitants. Brazil today has seven.

1/ Grunwald, Joseph, "Why not Invest in Latin America?", Harvard Business Review, November-December, 1963.

There are a number of remarkable similarities between these two countries. Both show about the same percentage of the population active in the labor force and about the same proportion living in rural areas. Both have about the same number of civilian employees in the federal government and the same number of men in the armed forces. Both lack complete vital statistics, but partial data indicate that they have roughly similar death rates, infant mortality rates, and rates of life expectancy at birth. (Life expectancy at birth of a white male in the U.S. in 1900 was only 48 years.)

The differences between these two countries are just as striking as the similarities. Brazil today has twice as much electric generating capacity as the U.S. had in 1900, which is illustrative of the fact that it has available to it a much more advanced technology, but it produces only one-hundredth as much coal and less than a third as much petroleum. The U.S. in 1900 had nearly six times as much acreage in harvested cropland as Brazil had in 1958, even though the rural populations were almost identical in size. Manufacturing accounts for a substantially larger share of GNP in Brazil than it did in the U.S. as of 1900, but unlike Brazil, the U.S. at that time was recognized as an important industrial country, and nearly one-third of U.S. exports consisted of manufactured goods. Even with the more primitive technology of that day, by 1900 the U.S. had achieved considerably higher levels of production than Brazil has at the present time in many fields, even though the two countries had labor forces of roughly comparable magnitudes. One reason for this was that in the U.S. at that time the standard work-week in manufacturing was 57 hours, while industry in Brazil is on a 48-hour week. Moreover, the U.S. employer did not have to contend with such institutions as "estabilidad." This is a provision in Brazilian law which prevents the demotion or dismissal of a worker who has been on the payroll for as long as ten years. Since the workers have a strong tendency to soldier on the job once they get "estabilidad", the employers defend themselves by dismissing most workers after 8 years of service. Needless to say this is economically wasteful.

Both the U.S. in 1900 and Brazil in 1960 had completed a decade of rapid economic growth. Industrial production in the U.S. had risen at an average annual rate of about 3.5 per cent in spite of a couple of recessions, and real GNP had risen almost as much. Brazilian statistics show a more rapid rate of growth -- 9 per cent for industrial production and 5-1/2 per cent for real GDP. This is very impressive, but there are good reasons for believing that these figures overstate real growth. It is significant that the U.S. growth was reflected in an expansion of exports of 60 per cent over the decade, while Brazil's exports actually declined.

In 1900, the U.S. was entering a period of even more rapid growth, but it may well be that Brazil over the coming decade will find it difficult to sustain the pace that she attained in the 1950's. A strong reason for doubting that Brazil will be able to emulate the record of the U.S. lies in the contrasting balance-of-payments position of the two countries. This in turn reflects a big difference in their internal fiscal and monetary policies.

In 1900, U.S. wholesale prices were actually a shade lower than they had been in 1890, and in the next fifteen years they rose at an annual rate of less than 1-3/8 per cent a year. By contrast, Brazilian wholesale prices in July 1963 were 14.5 times the 1953 average.

This difference in the behavior of prices in explicable in large measure by the contrasting fiscal policies of the two countries. Brazil has been the case par excellence of large budget deficits financed by the simple device of printing more paper money. It has been argued that the needs of development--the building of roads, electric power generating and transmission facilities, public social services, education, etc.--are so great in a country like Brazil that "even minimal government expenditures for these purposes are larger than the government revenue systems will yield."2/

The U.S. was faced with no less need for development in the period following the Civil War. This was a period of tremendous growth in the U.S. and great additions were made to what is now called infrastructure. For example, in this period alone, the U.S. laid down more than 7-1/2 times as much railway track as the total trackage existing in Brazil at the present time. Nor was investment in human capital neglected. The proportion of school-age children enrolled in public schools was raised to 72 per cent by 1900. From 1870 to 1900 enrollment in secondary schools rose about 3.5 times as fast as the population between the ages of 15 and 19 years. By way of contrast the latest data available for Brazil show less than a quarter of the school-age population enrolled in schools. In the face of this impressive investment, did the U.S. have difficulty in keeping federal government revenue ahead of expenditure? Not at all. On the contrary, there was an unbroken series of budget surpluses from 1866 up to 1894. A series of six budget deficits were recorded in the U.S. in the 1890's, but they were of very modest proportions. The largest of them occurred during the Spanish-American War, and it amounted to less than 1/2 of 1 per cent of GNP. All were easily financed by the non-inflationary device of selling long-term bonds to the public at interest rates of 3 per cent and under.

The U.S. authorities in this period would have been nonplussed had anyone told them that budget deficits and depreciating money were essential accoutrements of the process of economic development. The keystone of U.S. fiscal policy was a balanced budget based on the minimum expenditures required to maintain an efficient public service. No less important was the maintenance of a sound and stable currency.

The conservative fiscal policies of the U.S. were reflected in a strong balance-of-payments position, while the inflationist policies of Brazil have been reflected in the persistence of a continuing state of balance-of-payments crisis. With the exception mainly of a few years in the 1890's the U.S. had an almost uninterrupted expansion of gold reserves from the 1870's right up to World War II. This was not because commodity price trends were unfailingly favorable to the U.S. It is interesting to note that in 1899 the wholesale price of raw cotton, which was by far the largest single export commodity in the U.S., was 40 per cent lower than it had been in 1890. Prices of wheat and wheat flour, the second largest export, were down a quarter. No one thought to cite these price developments as proof that the U.S. had a structural problem which compelled it to inflate and run a balance-of-payments deficit. There was no inflation, and exports in 1899 were over 40 per cent

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2/ Op. cit., p. 124.

above those of 1890. The U.S. more than offset the sharp declines in the prices of her leading export commodities by increasing the volume of these exports and by achieving substantial gains in the export of other goods.

Brazil in the latter part of the 1950's was beset, as the U.S. was in the 1890's, with sharp declines in prices of her major exports, especially coffee and cotton. The price of coffee in 1960 was about 25 per cent below the 1950 average and the price of cotton was down 40 per cent. It is interesting to note that these price declines corresponded very closely with the drop in prices of the two most important exports of the U.S. in the 1890's, except that in the Brazilian case the smaller decline applied to the more important export. Brazil did not offset these price declines with either expansion of the volume of the major exports or sufficiently large increases in the value of exports of other commodities. Indeed, Brazil's difficulties were intensified by sharp declines in volume as well as in the price of exports of cotton and cocoa.

Of course, the problem faced by the two countries was not exactly the same. Coffee alone accounted for 60 per cent of Brazilian exports in 1949-51, about the same position cotton occupied in U.S. exports in the early 1870's. Export diversification had proceeded farther in the U.S. by 1890 than it had in Brazil by 1950. However, in 1889-91, three commodity groupings accounted for 64 per cent of all U.S. exports.3/ This compares with 75 per cent for Brazil's top three exports in 1949-51. In the case of the U.S., diversification was probably encouraged by the secular decline in commodity prices that began in the 1870's. The diversification that took place in the 1890's was a continuation of a long-term trend. It brought the share of total exports accounted for by the three largest groupings down to 52 per cent in 1899-1901.

Brazil has not had the "advantage" of a similar long-term decline in commodity prices. Commodity prices rose sharply in the early 1950's, coffee prices reaching a record high in 1954. During the subsequent decline, Brazil's domestic inflation made export expansion extremely difficult. The top three commodities accounted for 64 per cent of export earnings in 1959-61, which would indicate a greater degree of diversification than had prevailed a decade earlier, but this developed mainly as a result of the drop in sales of the leading commodities rather than an increase in sales of other goods.

Brazil's plight

In 1900, the U.S. could boast of growing exports, a healthy balance of payments, a sound currency and expanding industrial might. America was regarded as a good place to live and work and invest. Capital, both human and financial, poured in from abroad. Long-term foreign investment in this country more than doubled from 1897 to 1908, rising from $3 billion to over $6 billion, and nearly 9 million immigrants added to the expansive push in the first decade of the 20th century.

How different is the present position of Brazil. International reserves have almost been exhausted. Exports have actually fallen in value over the past decade, and even though manufacturing represents a substantially larger share of

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3/ This includes raw cotton, wheat and wheat flour, meat and meat products, including animal fats and oils.

GNP in present-day Brazil than it did in the U.S. of 1900, manufactured goods constitute less than 3 per cent of Brazil's total exports. Up to this point Brazil has succeeded in obtaining a substantial amount of debt and equity capital from abroad, but the lion's share of this over the past decade or so has been in the form of official assistance from the U.S. and international institutions. Such assistance totaled more than $2 billion in the ten years ending in 1962, while U.S. private direct investment in Brazil in the 1950's rose by only $300 million. Brazil is now burdened with an overwhelming foreign debt, and since her foreign exchange earnings have been stagnant while the debt has been rising, her ability to bear this burden is subject to serious question. Under these conditions, Brazil is in a very poor position to attract the additional foreign capital that will be required to sustain her economic growth. Indeed, that growth has already been halted, and unless there is a pretty drastic change in policy it is difficult to see how it can be resumed.

What kind of policy could put Brazil on her feet? There is an influential school of Latin American economists which asserts that Brazil's unfortunate condition is quite normal and inevitable. The remedy, according to this school, is for foreign governments and international institutions and foreign private investors to come to the rescue with additional infusions of capital. This is the only way to keep the ball rolling, we are told.

It is not surprising that this prescription has a strong appeal among Brazilians. This is what is known and familiar to them. Brazil's economic experience of the past several years has certainly had its hectic and unpleasant aspects, but there are a number of tangible fruits which are visible to the naked eye which many people consider good. There is the remarkable industrial growth of Sao Paulo, especially the highly visible automobile industry; the construction boom, and, of course, Brasilia. If a Brazilian thinks that inflation is the inevitable result of development, and if he stoutly maintains that a developing country cannot expect to expand exports pari passu with the increase in domestic production, it can be readily understood that he is generalizing on the basis of his immediate, if limited, experience.

However, an increasingly large number of Brazilians now realize that there must be an end--and a rather unpleasant end to the road that Brazil has been following. Some have been reluctantly forced to this conclusion as a result of the drying up of the inflow of foreign capital and the growing realization that the huge debts that Brazil has incurred must either be stretched out or defaulted. The foreign official creditors, including the U.S. and the I.M.F., can be expected to make any appreciable amount of new financing contingent upon drastic fiscal and monetary reforms. To do otherwise would only mean plunging Brazil deeper into the morass, making the eventual extrication even more difficult. No amount of exhortation--even if it appears in the Harvard Business Review--is likely to persuade private foreign investors to turn on the golden faucets and flood Brazil with private capital as long as the existing investments go unserviced or are threatened with repudiation. The pinch is already being felt, and it seems generally agreed that there has been no economic growth in Brazil in 1963.

The prospects for stabilization

This doesn't mean that the climate is now perfect for a new stabilization program in Brazil. No one is oblivious to the fact that the country faces a grave economic crisis, but there is no consensus with respect to either its cause or its cure. There are still many people who are quire sure that the country's predicament is traceable to everything except Brazil's own policies. There is widespread recognition that inflation is terrible, but many fear that stopping it would be worse. If Brazil is ever to stabilize successfully, a great many people must first be persuaded that stabilization is not synonymous with economic stagnation.

There are two sharply contrasting schools among Brazilians who are most unhappy with the present state of economic affairs in their country. One recognizes that there may be some political risks in enforcing a tough stabilization program but feels that these risks have to be taken for the sake of saving the economy. The other recognizes the grave economic risks in not adopting a workable stabilization program, but feels that these risks have to be taken in order to save the democratic system.

Those who share the latter view fear that real stabilization might wipe out Brazilian industry and create mass unemployment. This, they argue, would pave the way for a communist takeover. They hope that a president will be elected in 1965 who might be able to stabilize and save democracy at the same time.

The other school is more inclined to think that the shock of stabilization will be more tolerable now than later. They believe the leftists are in a less favorable position to exploit this shock at this time than they may be a year or two years from now. This is based partly on their belief that a dangerous infiltration of communists and their sympathizers into key government positions is taking place. This could mean that time is not on the side of the democratic forces.

Those who fear stabilization now probably exaggerate the shock that would come from ending inflation in Brazil. It is quite unrealistic to think that all, or even a major part, of Brazilian industry would be wiped out. A sound stabilization program would have to be based on the assumption that there would be two processes of adjustment working for the preservation of the bulk of Brazilian industry. One would be the adjustment of the exchange rate to a more realistic level. This would give the more efficient sectors of Brazilian industry a chance to sell their goods in world markets. The other would be the exertion of strong pressure on industry to achieve greater economies and efficiency in the use of all resources. There is bound to be considerable scope for this. For many years, Brazilian industry has faced a protected seller's market, and it has not been necessary to pay much attention to costs. This can and will change very rapidly if the proper stimulus is applied. My limited observations indicate that Brazil has a good industrial labor force whose main weaknesses are inadequate basic education and a tendency to give something less than full time and attention to the job. This can be corrected.

At the General Electric plant in Campinas, Sao Paulo, the average plant worker has a third grade education, and the average foreman has completed the seventh grade. This is not good enough for a plant that is building complicated heavy electric machinery. The plant necessarily has a very intensive training program, including classroom instruction, which embraces half their labor force. Training takes time--as much as four years in this particular plant--and it costs money, but the workers can be trained to meet American standards.

The big investment in training makes it particulary unfortunate that employers feel obliged, with very few exceptions, not to retain on the payroll even those employees who have achieved high degrees of skill for more than eight years in order to avoid the disastrous results that have emerged from the well-intentioned law designed to give wage-earners legal tenure--the "estabilidad" discussed earlier.

Brazilian industry needs a chance to compete

In spite of the obstacles to efficiency, the quality of Brazilian manufactured products can be very high, and the prices, valued at a realistic rate of exchange, can be competitive. The General Electric plant in Campinas is using all Brazilian lathes which the management rated as 85 per cent as good as the best lathes produced in the U.S. I understand that a few lathes are being exported, but at a loss. With a somewhat better exchange rate--somewhere between the overvalued official rate of 600 per dollar and the parallel rate of 1100 per dollar, which appears to undervalue the cruzeiro, Brazil could probably do a good job of exporting lathes. The product is good, the productive capacity is ample, and the only insurmountable barrier is one that has been erected by the Brazilian government itself--an unrealistic exchange rate.

There are, of course, other obstacles to exports which better policies could correct. Not all Brazilian industrial production is as close to being competitive in world markets as are lathes. It is unfair to the efficient manufacturer to saddle him with the requirement that he procure raw materials or equipment locally from producers who are unable to compete in price and quality with foreign suppliers. This may make the difference between an efficient producer being able to export and not being able to export. It is clearly self-defeating and unjust to handicap the efficient by forcing them to pay tribute to the inefficient, but this is precisely what Brazil and many other countries are doing under the illusion that it contributes to economic development. At the very least Brazil should remove the obstructions which limit the access her industries have to the world's store of raw materials and other capital goods.

Inefficiency in the service sector can also impose crippling burdens on industry. A classic example of this in Brazil can be found in the shocking inefficiency and high costs which prevail in the country's ports. This has become so bad that it is said to be cheaper to ship goods long distances between some of the ports by road rather than by ship. The wages paid to the port workers are so far out of line with the market that many of them hire others to do the work they are being paid to perform. With competition as keen as it is in the world today, this kind of thing can add enough to the cost of exportation to kill the possibility of many a sale. Reform would not be easy, but it should not be impossible.

Understanding is needed

One of the things which might be helpful and reassuring to the Brazilians is knowledge of the fact that the problems they face in developing economically are not unique, as many of them now appear to think. It has become almost a cliché to say that the U.S. experience is not a helpful model for the less developed countires today, but I have the feeling that this idea has been largely popularized by people who don't know too much about the facts of U.S. economic development, but who do know that they don't like the orthodox economic policies which this country long pursued. There is no good reason why Brazilians could not study the U.S. experience with great profit. Those who fear that a balanced budget and stable money necessarily mean the end of economic growth might have their eyes opened. Those who think that a country heavily dependent on the export of raw materials cannot hope to become a vigorous exporter of manufactured goods might take heart from the American experience. Those who think that only government planning and enterprise can build a mighty economy and open up a new land might well look with wonder and amazement at a country that accomplished these deeds magnificently without planning and with government expenditures amounting to only 2 to 5 per cent of GNP.

There is no telling what Brazil will elect to do, how tight a line she may follow, once the chips are down and the decision can no longer be postponed. Experience has shown that a stabilization program forced on an unwilling country by outside pressure has little chance of success. Brazil can stabilize only if her leaders really understand what this means for the country and sincerely want to make the program work. Perhaps the most important thing to do at this point is to try to increase understanding in circles that count of what a sound economic policy is and what can be expected of it. When enough Brazilians come to appreciate the fact that their present predicament is the product of poor policies, not fate, we may see a program that will permit fuller realization of Brazil's great potentialities.

The U.S. and Brazil

	U.S.-Circa 1900	Brazil-Circa 1960
Population	76 million	77.5 million (1963)
Area, square miles	3 million	3.3 million
Cities with pop. over 500,000	8	7
Deaths per 1000	17.2 (partial data)	18-20
Deaths for under 1 year	162.4 (partial data)	171 (1950 est.)
Life expectancy at birth	48 yrs. (white male)	42-43 (1950 est.)
Immigration over previous century	18.8 million	4.8 million
Per cent of population of 5-17 years enrolled in school	72.4 (public only)	24
Labor force, per cent of population	37%	35% (1958 est.)
Labor force, per cent of population over 14	55%	58% (1958 est.)
Civilians employed in federal government	256,000	247,000 (1958)
Total armed forces	260,000	252,000 (1950 census)
Increase in wholesale prices over preceding decade	None	1450% (1952 to July 1963)
Electricity generating capacity	2.4 million kw.	5 million kw. (1960)
Railway mileage	193,346	24,000 (end of '59)
Rural population as per cent of total	60	64% (1950 census)
Land in farms (millions acres)	839	650 (1958)
Harvested cropland	295	46 (1958)
Commercial fertilizer consumption, metric tons	2.5 million	315,000 (1958 est.)
Farm animals, million head		
Horses	18.3	8.4 (1960)
dairy cows	17.1	9.0 (1960)
Other cattle	50.6	62.0 (1960)
Coal production, metric tons	205 million	2.3 million
Petroleum production, barrels	100 million	29.6 million
Steel production, metric tons	10 million	2.2 million (1960)
Exports	$1,394 million	$1,269 million
Imports	$ 850 million	$1,293 million
Per cent of exports accounted for by 3 highest categories	52 (1899-1901)	64 (1959-61)
Same, 10 years earlier	64 (1889-1891)	75 (1949-51)
Increase in value of exports over decade	60%	- 6%
Industrial production growth over previous decade	40%	140%
Real GNP growth over decade	38% (1887-91 to 1897-1901)	73% (Real GDP 1950-60)
National Inc. originating in industry	18.4 (1899-1908)	28 (1960)
National Inc. originating in agriculture	16.7 (1899-1908)	26%
Prices in terms of minutes of labor at average manufacturing wage		(All Oct. 1962)
boned sirloin steak, lb.	100 (NY price, Nat'l wage)	69 (Rio price, Sao Paulo wage)
rice, lb.	22 " " " "	25 " " " " "
sugar, lb.	17 " " " "	9 " " " " "
coffee, lb.	83 " " " "	55 " " " " "