

ECONOMIC STRUCTURE AND INTERNATIONAL TRADE:
A BRAZILIAN CASE STUDY

Thesis for the Degree of M. A.
MICHIGAN STATE UNIVERSITY
Raimar Richers
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ECONOMIC STRUCTURE AND
INTERNATIONAL TRADE;
A BRAZILIAN CASE STUDY

BY

RAIMAR RICHERS

A THESIS

SUBMITTED TO THE SCHOOL OF GRADUATE STUDIES OF MICHIGAN
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IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF

MASTER OF ARTS

DEPARTMENT OF GENERAL BUSINESS
1956

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ACKNOWLEDGMENTS

IT IS A GENUINE PLEASURE TO ACKNOWLEDGE THE VALUABLE ASSISTANCE GIVEN TO THIS STUDY.

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EAST LANSING
AUGUST 1956

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INTRODUCTION

THE AIM OF THIS STUDY IS TO INVESTIGATE THE CAUSES UNDERLYING BRAZIL'S SECULAR DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS. AN ATTEMPT IS MADE TO TRACE THE CAUSES TO DOMESTIC CONDITIONS OF THE ECONOMY. PARTICULAR IMPORTANCE IS ATTRIBUTED TO THE DISTRIBUTION OF INCOME, INFLATION, PRODUCTIVITY, AND THE NATURE OF SUPPLY AND DEMAND OF THE FACTORS OF PRODUCTION. THE ORIGINS OF DISEQUILIBRIUM DIRECTLY RELATED TO INTERNATIONAL TRADE WILL BE EXAMINED AS WELL. EVIDENCE SHALL BE GIVEN TO SHOW THAT BRAZIL CANNOT EXPECT TO REESTABLISH A LONG-TERM EQUILIBRIUM IN ITS BALANCE OF PAYMENTS, IF CORRECTIVE MEASURES ARE RESTRICTED TO THE AREAS OF FOREIGN EXCHANGE, CAPITAL INVESTMENTS, PROTECTIONIST CONTROLS, OR IMPROVEMENT IN THE TERMS OF TRADE.

MALDISTRIBUTION OF INCOME AS DETERMINED BY ECONOMIC POLICIES AND AGGRAVATED BY MONETARY INFLATION WILL BE DESCRIBED AS THE MAIN SOURCE OF DISEQUILIBRIUM, BOTH INTERNALLY AND EXTERNALLY. ITS IMPACT ON THE MARKET STRUCTURE WILL BE DISCUSSED, AND THE RELATIONSHIP EXISTING BETWEEN DOMESTIC SUPPLY AND DEMAND FORMATION, AND THE VOLUME AND COMPOSITION OF FOREIGN TRADE ANALYZED.

IN ACCORDANCE WITH THE OBJECTIVE OF THE STUDY SOME CHAPTERS DEAL CHIEFLY WITH DOMESTIC STRUCTURAL CONDITIONS. TO FAMILIARIZE THE READER WITH THE GENERAL PROBLEM AREA, A HISTORICAL OUTLINE OF THE BALANCE OF PAYMENTS DEVELOPMENT WILL BE GIVEN, FOLLOWED BY A BRIEF DESCRIPTION OF THE CHARACTERISTICS OF INCOME DISTRIBUTION IN BRAZIL. SOME OF THE MOST PRESSING ISSUES EXISTING TODAY WILL THUS BECOME APPARENT. THEIR ORIGINS AND IMPACT ON INTERNATIONAL TRADE IS DISCUSSED IN CHAPTER TWO, THREE, AND

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FOUR, BUT FREQUENT REFERENCE IS MADE TO THEM ALSO IN LATER CHAPTERS.

SPECIFIC SUBJECT AREAS DIRECTLY RELATED TO THE MAIN PROBLEM ARE INVESTIGATED IN CHAPTERS FIVE TO NINE. LATIN AMERICA'S ATTEMPT TO GAIN ECONOMIC AUTONOMY THROUGH INDUSTRIALIZATION, AND ITS BEARING ON INTERNATIONAL TRADE IS EXAMINED FROM THE POINT OF VIEW OF PRODUCTIVITY AT HOME AND ABROAD. THE QUESTION OF DISEQUILIBRIUM IS REVIEWED AGAIN WITH RESPECT TO THE IMPACT OF DEMAND ON IMPORTS, AND THE EFFECTIVENESS OF QUANTITATIVE RESTRICTIONS AND EXCHANGE CONTROL. A CRITICAL EVALUATION OF TERMS OF TRADE ANALYSES FOLLOWS, AND, FINALLY, FOREIGN CAPITAL INVESTMENTS AND THEIR POSITION IN THE BRAZILIAN BALANCE OF PAYMENTS ARE DISCUSSED.

THE TENTH AND LAST CHAPTER SUMMARIZES THE RESULTS AND GIVES SOME RECOMMENDATIONS FOR A FUTURE ECONOMIC POLICY FOR BRAZIL.

THE MAJORITY OF THE PROBLEMS DEALT WITH IN THE PAPER ARE APPROACHED FROM A THEORETICAL STANDPOINT. HISTORICAL AND STATISTICAL ANALYSES ARE LIMITED TO A MINIMUM REQUIRED TO PROVIDE AN UNDERSTANDING OF SPECIFIC PROBLEM AREAS. THE THEORIES OF INCOME DISTRIBUTION, OF INTERNATIONAL TRADE, AND OF MARGINAL ANALYSIS ARE THE MAIN TOOLS APPLIED. BASED ON SOME OF THE PREMISES OF THESE THEORIES, THE DEDUCTIVE METHOD IS USED TO ARRIVE AT CONCLUSIONS PERTINENT TO THE BRAZILIAN ECONOMY IN GENERAL, AND THE BALANCE OF PAYMENTS IN PARTICULAR.

THE MANY DANGERS INVOLVED IN THE METHOD OF ANALYSIS USED ARE PERHAPS THE MAJOR LIMITATION TO THE STUDY. BUT THE SCARCITY OF STATISTICAL DATA IN BRAZIL MAKES A MORE QUANTITATIVE STUDY IMPOSSIBLE. CONSEQUENTLY, THE OPINIONS EXPRESSED CANNOT DEFINITELY BE PROVED. THEY CAN BE TESTED THOUGH BY MORE DETAILED STUDIES. THIS, IT IS HOPED, WILL BE DONE IN THE FUTURE.

1. THE HISTORICAL BACKGROUND

EXCEPT FOR SOME RECESSION PERIODS, THE BRAZILIAN ECONOMY HAS EXPERIENCED A STEADY RATE OF EXPANSION. IT HAS MOVED FROM SEVERAL PROSPEROUS MONOCULTURAL CYCLES INTO AN INCREASINGLY DIVERSIFIED PRODUCTIVE STRUCTURE. PRESENTLY, THE GROWTH OF POPULATION AND OF REAL PER CAPITA OUTPUT EXCEEDS AN AVERAGE ANNUAL RATE OF 2%. NEVERTHELESS, BRAZIL IS CONSIDERED AN UNDERDEVELOPED COUNTRY. IS THIS INCOMPATIBLE WITH RAPID DEVELOPMENT?

AFTER ANALYZING FOUR COMMON, BUT UNSATISFACTORY INTERPRETATIONS OF THE TERM "UNDERDEVELOPED COUNTRY", PROFESSOR VINER SUGGESTS THE FOLLOWING DEFINITION: "A COUNTRY WHICH HAS GOOD POTENTIAL PROSPECTS FOR USING MORE CAPITAL, OR MORE LABOR, OR MORE AVAILABLE NATURAL RESOURCES, OR ALL OF THESE, TO SUPPORT ITS PRESENT POPULATION ON A HIGHER LEVEL OF LIVING, OR, IF ITS PER CAPITA INCOME LEVEL IS FAIRLY HIGH, TO SUPPORT A LARGER POPULATION ON A NOT LOWER LEVEL OF LIVING."¹ THIS DEFINITION SHALL BE ACCEPTED HERE SINCE IT NOT ONLY FITS THE BRAZILIAN CASE, BUT ALSO BECAUSE IT "PUTS THE PRIMARY EMPHASIS WHERE I WOULD THINK IT PROPERLY BE-

¹ JACOB VINER, "TENDÊNCIAS MODERNAS DA TEORIA DO COMÉRCIO INTERNACIONAL," REVISTA BRASILEIRA DE ECONOMIA, ANO 5, NO. 2 (RIO DE JANEIRO: FUNDAÇÃO GETÚLIO VARGAS, JUNE 1951), P. 205.

NOTE: QUOTED FROM THE ABOVE PUBLICATION OF A SERIES OF LECTURES DELIVERED AT THE UNIVERSITY OF BRAZIL IN RIO DE JANEIRO AND RE-EDITED IN THE USA UNDER THE TITLE: INTERNATIONAL TRADE AND ECONOMIC DEVELOPMENT (GLENCOE, ILLINOIS: FREE PRESS, 1952),

LONGS ON PER CAPITA LEVELS OF LIVING, ON THE ISSUE OF POVERTY AND PROSPERITY, ALTHOUGH IT LEAVES ROOM FOR SECONDARY EMPHASIS ON QUANTITY OF POPULATION.²

POVERTY AND PROSPERITY--A SHORTER AND MORE PRECISE FORMULA COULD NOT BE FOUND TO DESCRIBE THE BRAZILIAN SOCIAL SCENE, BOTH PRESENT AND PAST. THE EXTREMES OF THE BRAZILIAN ECONOMY ARE REFLECTED IN FIGURES; HOWEVER, SUCH DO NOT GIVE A VIVID PICTURE OF REALITY. THIS MAY BE KEPT IN MIND WHILE READING THE FOLLOWING BRIEF DESCRIPTION, THE PURPOSE OF WHICH IS TO INFORM THE READER ABOUT BRAZIL'S FOREIGN TRADE DEVELOPMENT.

1. EARLY DEVELOPMENTS

IN 1822 BRAZIL BECAME INDEPENDENT OF PORTUGAL THROUGH THE ASCENSION OF ITS OWN MONARCH. ONLY THREE YEARS LATER IT WAS GRANTED ITS FIRST FOREIGN LOAN OF 1.5 MILLION POUNDS STERLING. BY 1860 THE TOTAL AMOUNT OF LOANS AMOUNTED TO 11 MILLION POUNDS STERLING, HALF OF WHICH HAD ALREADY BEEN REFUNDED IN SPITE OF A 28 MILLION POUNDS STERLING DEFICIT IN THE BALANCE OF TRADE. THIS DEFICIT ACCUMULATED FROM 1821 TO 1860.

DURING THE EARLY DECADES OF ECONOMIC DEVELOPMENT, FOREIGN LOANS ENABLED THE COUNTRY TO CONSTRUCT ITS FIRST RAILROADS, TO FINANCE INVESTMENTS IN AGRICULTURE, TO DEVELOP URBAN CENTERS, AND TO AMORTIZE PART OF ITS DEBT TO GREAT BRITAIN.

FROM THE MIDDLE OF THE 19TH CENTURY UNTIL 1931, BRAZIL HAD LITTLE TO WORRY ABOUT AS THE BALANCE OF TRADE REMAINED FAVORABLE FROM 1861 TO 1931 WITH THE EXCEPTION OF FOUR YEARS. ON THE OTHER HAND DETERIORATION OF PURCHASING POWER BECAME APPARENT AFTER 1888 AS A RESULT OF SEVERAL ADVERSE FACTORS. INCLUDED WERE THE ABOLITION OF SLAVERY (1888) AND AC-

²VINER, IBID., P. 205

COMPANYING SOCIAL UNREST, THE OVERTHROW OF THE MONARCHY (1889), THE WORLD CRISIS (1890), AN UNDUE EXPANSION OF THE MONEY SUPPLY, AND THE COFFEE CRISIS OF 1903 IN WHICH PRICES DROPPED TO 1.47 POUND STERLING (PER 60 KILOGRAM BAG) AS COMPARED TO THE 4.09 POUND PEAK OF TEN YEARS BEFORE.³ THE BALANCE OF PAYMENTS PROBLEM WAS FACED BY REPEATED "VALORIZATION" PROGRAMS LAUNCHED TO PREVENT BRAZILIAN COFFEE FROM LOSING ITS ALMOST MONOPOLISTIC POSITION IN THE WORLD. THE VALORIZATION POLICY PROVED TO BE FULLY EFFECTIVE. ONE OF ITS CONSEQUENCES WAS THE WILLINGNESS OF FOREIGN COUNTRIES TO EXTEND SUBSTANTIAL LOANS TO THE BRAZILIAN GOVERNMENT. BETWEEN 1890 AND 1930 THE FOREIGN PUBLIC DEBT WENT UP FROM \$69 MILLION TO \$394 MILLION. OF THE LATTER \$267 MILLION WERE OUTSTANDING IN 1930.⁴

2. THE DEPRESSION OF THE THIRTIES

AT THE OUTBREAK OF THE WORLD DEPRESSION IN 1929, FOREIGN INVESTMENTS AND LOAN GRANTS WERE ABRUPTLY TERMINATED. THUS, YEARLY BALANCE OF TRADE SURPLUSES BECAME THE ONLY SOURCE TO COVER THE HEAVY BURDEN OF NON-TRADE TRANSACTION DEFICITS, AS THE EXISTING RESERVES OF GOLD AND FOREIGN EXCHANGE WERE SOON EXHAUSTED. FURTHERMORE, EXPORT REVENUES WERE STRONGLY AFFECTED BY BOTH PRICE COLLAPSES AND A SHARP DECREASE IN QUANTITATIVE DEMAND FOR BRAZILIAN COMMODITIES. BETWEEN 1921 AND 1930 BRAZIL ACCUMULATED 46 MILLION BAGS OF NON-EXPORTABLE COFFEE WHICH WOULD HAVE BEEN SUP-

³ AFFONSO E. DE TAUNAY, PEQUENA HISTÓRIA DO CAFÉ NO BRASIL (1727-1937) (RIO DE JANEIRO: DEPARTAMENTO NACIONAL DO CAFÉ, 1945).

⁴ A MORE DETAILED ANALYSIS OF THE FOREIGN DEBT DEVELOPMENT IS GIVEN IN H. W. SPIEGEL, THE BRAZILIAN ECONOMY, CHRONIC INFLATION AND SPORADIC INDUSTRIALIZATION, (PHILADELPHIA, TORONTO: THE BLAKISTON COMPANY, 1949), P. 135.--ANOTHER MORE RECENT SOURCE IS: UNITED NATIONS, DEPARTMENT OF ECONOMICS AND SOCIAL AFFAIRS, FOREIGN CAPITAL IN LATIN AMERICA (NEW YORK, 1955).

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FICIENT TO SATISFY WORLD DEMAND FOR ABOUT TWO YEARS.⁵ AS A CONSEQUENCE OF THE SHARP DROP IN EXPORT REVENUE, THE YEARLY SERVICE FOR PUBLIC FOREIGN DEBTS EXCEEDED THE EXPORT SURPLUS BY AS MUCH AS 166% (IN 1935).⁶ THIS CONDITION INDUCED THE GOVERNMENT TO (1) SUSPEND THE PAYMENT OF FOREIGN DEBT SERVICES IN SEPTEMBER 1939, AND (2) SUBMIT TRANSFERS TO RESTRICTIVE RULES IN MARCH 1932. TO THE PRESENT DAY SUCH RESTRICTIONS ON THE RETURN OF EARNINGS HAVE NEVER BEEN FULLY SUSPENDED.

3. EXCHANGE CONTROL

MUCH HAS BEEN WRITTEN ABOUT THE MANY FORMS OF EXCHANGE CONTROL IMPOSED ON BRAZILIAN TRADE SINCE THE DEPRESSION. FOR PURPOSES OF ANALYSIS HOWEVER, AN OUTLINE OF PAST AND PRESENT MEASURES IS SUFFICIENT, AS THE PRESENT STUDY IS MORE CONCERNED WITH THE ECONOMIC EFFECTS THAN WITH THE LEGAL ASPECT OF CONTROL. BASICALLY, ALL EXCHANGE CONTROLS WERE ESTABLISHED WITH TWO INTERRELATED AIMS: TO RELIEVE PRESSURE FROM AN ADVERSE BALANCE OF PAYMENTS AND TO PREVENT THE CURRENCY FROM LOSING PURCHASING POWER AND THE CONSEQUENT DETERIORATION IN THE EXCHANGE RATE.

DURING THE FIRST TWENTY YEARS OF THIS CENTURY, THE BRAZILIAN CURRENCY REMAINED VERY STABLE, AVERAGING BETWEEN A LOW OF Cr\$3,07 PER US DOLLAR IN 1910 TO A HIGH OF Cr\$4,38 IN 1901. FOLLOWING THE RECESSION AFTER WORLD WAR I, IT LOST ABOUT HALF ITS PURCHASING POWER ABROAD. YET IT WAS NOT UNTIL 1931 THAT THE GOVERNMENT IMPOSED EXCHANGE CONTROLS BINDING TRANS-

⁵ RAIMAR RICHERS, UEBER DIE FUNKTION DES KAFFEES IM BRASILIANISCHEN AUSSSENHANDEL DER JAHRE 1938 BIS 1950, (DOCTORAL DISSERTATION, SÃO PAULO, LINOTIPADORA GRÁFICA LTDA., 1953), P. 13.

⁶ P. V. D. MEIREN AND G. LOEB, TRENDS AND PROBLEMS IN ECONOMIC DEVELOPMENT OF BRAZIL, (STUDY MADE BY THE JOINT COMMISSION BRAZIL-UNITED STATES. MIMEOGRAPHED COPY, COURTESY OF THE AUTHORS, RIO DE JANEIRO, 1952).

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ACTIONS TO AN OFFICIAL RATE OF EXCHANGE WITH IMPORT PRIORITIES ESTABLISHED FOR OFFICIAL PURCHASES, DEBT SERVICES AND ESSENTIAL GOODS. A RESTRICTED FREE MARKET WAS ESTABLISHED IN 1934 AND GRADUALLY RELIEVED FOR SELECTED GOODS AND SERVICES UNTIL 1937. FROM THAT YEAR PERMITS WERE REQUIRED FOR ALL IMPORTS. IN 1939 THREE RATES WERE INTRODUCED, CLASSIFIED AS FOLLOWS: (1) AN OFFICIAL RATE APPLICABLE TO 30% OF ALL EXPORT RETURNS, (2) A FREE MARKET RATE APPLICABLE TO 70% OF EXPORTS AND ALL IMPORTS, AND (3) SPECIAL FREE MARKET RATE APPLICABLE TO NON-TRADE PURPOSES. A SINGLE RATE WAS REESTABLISHED IN 1946, FIRST AT Cr\$18,96 PER US DOLLAR AND LATER AT Cr\$18,72 WHICH BASICALLY PREVAILED FOR ALL TRANSACTIONS UNTIL 1952. DURING THESE YEARS INFLATION BROUGHT INCREASING PRESSURE ON THE CURRENCY, CALLING FOR A BLACK MARKET RATE WHICH AT TIMES REACHED Cr\$50,00 AND MORE.

IN FEBRUARY 1953 A SO CALLED FREE EXCHANGE LAW BECAME EFFECTIVE. IT INTRODUCED MULTIPLE EXCHANGE RATES FOR IMPORTS AND EXPORTS, AND SANCTIONED FREE RATES FOR LESS-ESSENTIAL IMPORTS AND FINANCIAL TRANSACTIONS. EIGHT MONTHS LATER THE EXCHANGE SYSTEM SUFFERED A RADICAL MODIFICATION, WHICH, EXCEPT FOR A FEW MINOR CHANGES STILL PREVAILS TODAY. THE MAIN FEATURES OF THE NEW SYSTEM ARE AS FOLLOWS: A) ALL EXPORT PROCEEDS ARE SURRENDERED TO THE BANK OF BRAZIL AT THE OFFICIAL RATE, BUT A CRUZEIRO PREMIUM FOR EACH UNIT OF FOREIGN CURRENCY EARNED IS PAID IN ACCORDANCE TO THE TYPES OF GOODS EXPORTED; B) IMPORTS ARE DIVIDED INTO FIVE CATEGORIES ACCORDING TO THEIR ESSENTIAL CHARACTER; C) THE BANK OF BRAZIL SELLS EXCHANGE RIGHTS FOR IMPORTS AT AUCTIONS ESTABLISHING MINIMUM RATES AND ALLOCATING TOTAL AMOUNTS OF FOREIGN CURRENCY FOR EACH CATEGORY; D) THE FREE MARKET CONTINUES TO EXIST FOR INVISIBLE ITEMS. FURTHERMORE, BOTH THE IMPORTATION AND EXPORTATION OF COMMODITIES CONTINUE TO BE DE-

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THE BRIEF DESCRIPTION OF EXCHANGE CONTROLS INDICATES SOME OF THE FLUCTUATIONS TO WHICH THE BRAZILIAN BALANCE OF PAYMENTS WAS SUBJECTED SINCE THE DEPRESSION OF THE THIRTIES. EXCEPT FOR A FEW YEARS OF LIMITED FREEDOM THE EXCHANGE RATE AS WELL AS THE TRANSACTION OF GOODS AND SERVICES REMAINED UNDER STRICT GOVERNMENT DIRECTION. IN SPITE OF THIS, THE EVER GROWING LOSS OF PURCHASING POWER OF THE CRUZEIRO ON FOREIGN MARKETS COULD NOT BE AVOIDED, EITHER DURING PERIODS WHEN CONTROL WAS EXERCISED FOR THE EXCLUSIVE PURPOSE OF CURBING IMPORTS, OR DURING THE YEARS WHEN IT WAS CONCEIVED TO STIMULATE EXPORTS.

4. DIVERSIFICATION

IN THE LONG RUN THE DEPRESSION HAD AT LEAST ONE POSITIVE CONSEQUENCE: THE BRAZILIAN ECONOMY MOVED AWAY FROM MONOCULTURE AND ESTABLISHED THE BASES FOR DIVERSIFIED PRODUCTION. IN 1933 COFFEE STILL PARTICIPATED WITH 73% ON TOTAL EXPORT RETURNS, ONE YEAR LATER WITH ONLY 61% AND FROM THEN ON WITH EVER DECREASING RATES UNTIL A LOW POINT OF 45% IN THE POST-WAR YEARS. GINNED COTTON AND COCOA, FOLLOWED BY HIDES AND SKINS, LUMBER, FRUITS, CARNAÚBA-WAX AND OTHER PRIMARY PRODUCTS BECAME IMPORTANT ITEMS OF THE BALANCE OF TRADE. NEVERTHELESS, INCREASED EXPORT REVENUES WERE NOT SUFFICIENT TO ACCOUNT FOR THE EVER GROWING IMPORT REQUIREMENTS. BRAZIL THUS TURNED TO INDUSTRIALIZATION, EXPANDING FIRST ITS TEXTILE AND FOOD INDUSTRY UNDER CONSIDERABLE AID FROM THE GOVERNMENT.

⁷A CRITICAL ANALYSIS OF THE EXCHANGE REFORM OF 1953 WAS WRITTEN BY N. F. FIGUEIREDO, CONSIDERAÇÕES SOBRE A NOVA POLÍTICA CAMBIAL BRASILEIRA (SÃO PAULO: ORDEM DOS ECONOMISTAS DE SÃO PAULO, MARCH 1954).

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BY FAR THE STRONGEST IMPACT OF INDUSTRIAL PRODUCTION WAS OBSERVED AFTER 1939, WHEN BRAZIL WAS FACED WITH THE NECESSITY OF ADAPTING ITS ECONOMIC STRUCTURE TO WAR CONDITIONS. BETWEEN 1939 AND 1951 THE PRODUCTION OF THE IRON, STEEL, AND METALWORKING INDUSTRIES ROSE BY ALMOST 500%; CEMENT OUTPUT, MORE THAN DOUBLED; RUBBER PRODUCTS SHOWED A NINE-FOLD EXPANSION; AND CHEMICAL, PHARMACEUTICAL, AND VEGETABLE OIL PRODUCTION DOUBLED. FURTHERMORE, DIVERSIFICATION IS REFLECTED BY THE RAPID GROWTH OF MINOR INDUSTRIES, FOR EXAMPLE, THOSE PRODUCING TRANSPORTATION EQUIPMENT, ELECTRICAL MOTORS AND APPLIANCES, AS WELL AS MACHINERY OF ALL TYPES.⁸

5. THE BALANCE OF PAYMENTS

A MORE OR LESS RELIABLE BALANCE OF PAYMENTS COMPUTATION FOR BRAZIL HAS EXISTED SINCE 1939. SATISFACTORY ESTIMATES WERE PREPARED FOR 1939 THROUGH 1946 BY THE INTERNATIONAL MONETARY FUND. SINCE 1957 THE BRAZILIAN GOVERNMENT HAS ISSUED ANNUAL BALANCES PREPARED ACCORDING TO THE NORMS SET BY THE IMF. THE APPENDIX REPRODUCES THE NET POSITIONS FOR THE YEARS 1947/54.

THE PERIOD BETWEEN 1939 AND 1954 CAN BE DIVIDED INTO TWO DISTINCT PHASES EACH ENCOMPASSING EIGHT YEARS. A SUMMARY OF THE NET CHANGES OF THE BALANCE OF PAYMENTS FOR THE TWO PHASES IS SHOWN IN TABLE I. (SEE P.8).

DURING THE WAR YEARS BRAZIL SUCCEEDED TO ACCUMULATE A C\$15 BILLION SURPLUS OF CURRENT TRANSACTIONS WHICH ENABLED THE COUNTRY TO AMORTIZE SOME FOREIGN DEBTS INCURRED AFTER THE DEPRESSION, AS WELL AS TO ACCUMU-

⁸ INSTITUTE OF INTER-AMERICAN AFFAIRS, FOREIGN OPERATIONS ADMINISTRATION, THE DEVELOPMENT OF BRAZIL, REPORT OF JOINT BRAZIL-UNITED STATES ECONOMIC DEVELOPMENT COMMISSION, (WASHINGTON, D. C., 1953), P. 17.

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LATE SUBSTANTIAL RESERVES IN FOREIGN CURRENCIES, MAINLY IN POUND STERLING. DURING THE FOLLOWING EIGHT YEARS THE CURRENT TRANSACTIONS REPORTED A NET DEFICIT OF ABOUT Cr\$22 BILLION. THE BULK OF THIS DEFICIT WAS COVERED BY SPECIAL LOAN ARRANGEMENTS MAINLY WITH THE EXPORT-IMPORT BANK OF WASHINGTON. THE REMAINDER TOOK THE FORM OF COMMERCIAL ARREARS WHICH AT ONE TIME (1952) SURPASSED THE 11 BILLION CRUZEIRO MARK. THIS LATTER ITEM SHOWS THE DESPERATE POSITION OF BRAZIL'S POST-WAR INTERNATIONAL COMMITMENTS.⁹

TABLE I

NET CHANGES IN THE BALANCE OF PAYMENTS BETWEEN 1939 AND 1954
(IN Cr\$1,000,000,000)

	<u>1939/46</u>	<u>1947/54</u>	<u>1939/54</u>
BALANCE OF TRADE	27.8	24.8	52.6
SERVICES	-10.2	-54.0	-64.2
PRIVATE DONATIONS + CAPITAL MOVEMENTS	- 1.0	6.7	5.7
SPECIAL OFFICIAL FINANCING	<u>- 1.6</u>	<u>0.6</u>	<u>- 1.0</u>
TOTAL CURRENT TRANSACTIONS	15.0	-21.9	- 6.9
COMMERCIAL ARREARS (NET 1954)	---	2.4	2.4
COMPENSATORY OFFICIAL FINANCING	-13.6	17.4	3.8
ERRORS AND OMISSIONS	<u>- 1.4</u>	<u>2.1</u>	<u>0.7</u>
TOTAL COMPENSATORY TRANSACTIONS	-15.0	21.9	6.9

SOURCE: DERIVED FROM APPENDIX

⁹ THE FOLLOWING SELECTED REFERENCES MAY BE USEFUL TO THE READER INTERESTED IN MORE DETAILED DATA AND ANALYSES ON THE BRAZILIAN BALANCE OF PAYMENTS: THE ANNUAL REPORTS OF THE BANK OF BRAZIL PUBLISH YEARLY BALANCE SHEETS, REVISED COPIES OF WHICH ARE REPRODUCED IN THE BALANCE OF PAYMENTS YEARBOOKS OF THE INTERNATIONAL MONETARY FUND. INFORMATION ON CURRENT DEVELOPMENTS ARE PROVIDED BY CONJUNTURA ECONOMICA, (FUNDAÇÃO GETÚLIO VARGAS, RIO DE JANEIRO) AND INTERNATIONAL FINANCIAL STATISTICS (IMF, WASHINGTON, D. C.). PREDOMINANTLY ANALYTICAL STUDIES ARE CONTAINED IN THE PUBLICATIONS OF THE ECONOMIC COMMISSION FOR LATIN AMERICA OF THE UNITED NATIONS, MAINLY IN THE SERIES ENTITLED: ECONOMIC SURVEY OF LATIN AMERICA, PUBLISHED SINCE 1940.

6. THE BALANCE OF SERVICES

TWO REASONS JUSTIFY A BRIEF ANALYSIS OF THE BALANCE OF SERVICES AT THIS POINT. FIRST, BECAUSE IT CONSTITUTES THE MAIN NEGATIVE POSITION IN THE BALANCE OF PAYMENTS (SEE TABLE I AND APPENDIX). SECONDLY, BECAUSE THE ORIGINS OF ITS DEFICITS ARE OF AN ADMINISTRATIVE RATHER THAN ECONOMIC NATURE.

THE MAIN UNFAVORABLE ITEM IN THE BALANCE OF SERVICES IS MADE UP OF FREIGHT ON IMPORTS. DURING THE PERIOD 1947/54 IT AMOUNTED TO CR\$23.2 BILLION OR 43% OF THE TOTAL NET SERVICE DEFICIT. ON THE AVERAGE BRAZIL HAS TO SPEND FROM 12% TO 20% IN FREIGHT CHARGES ON IMPORTS EVERY YEAR. A GREAT PORTION HAS TO BE DISBURSED IN CONVERTIBLE CURRENCIES.

IN BRAZIL NO PRIVATE ORGANIZATION IS PERMITTED TO TRANSPORT CARGO ABROAD. THE ONLY GOVERNMENT CONTROLLED SHIPPING AGENCY, THE LLOYD BRASILEIRO, USES TWENTY VESSELS FOR TRANSATLANTIC SERVICES WITH AN AVERAGE CARGO CAPACITY OF 6,000 TONS. DURING THE PERIOD 1946-54 THESE SHIPS CARRIED AN AVERAGE OF 37,500 TONS PER YEAR--OR SIX TIMES CAPACITY. NEVERTHELESS, THEY HANDLED NO MORE THAN ABOUT 5% OF BRAZIL'S FOREIGN TRADE TONNAGE.¹⁰ THESE FIGURES ILLUSTRATE HOW HARMFUL STATE INTERVENTION IN PRIVATE ENTERPRISE CAN BE.

THE SECOND HIGHEST UNFAVORABLE POSITION IN THE BALANCE OF SERVICES IS COMPOSED OF INVESTMENT INCOMES TRANSFERRED ABROAD. DURING 1947-54 IT ACCOUNTED FOR CR\$16.9 BILLION OR 31% OF TOTAL NET SERVICES. AN ATTEMPT TO REDUCE THIS FIGURE IN THE FUTURE BY IMPOSING FURTHER LIMITATIONS ON THE REMITTANCE OF PROFITS WOULD SERIOUSLY IMPAIR FOREIGN INVESTMENTS.

¹⁰ SEES: "THE BRITISH AND COMMONWEALTH CHAMBER OF COMMERCE IN SÃO PAULO," INFORMATION CIRCULAR NO. 15, SÃO PAULO, AUGUST 5, 1955, P. 288.

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MATTERS ARE DIFFERENT IN RELATION TO THE THIRD ITEM, OR "OTHER SERVICES," COMPRISING ADMINISTRATIVE EXPENSES, RENTALS FOR CINEMATOGRAPHIC FILMS, REMITTANCE OF ROYALTIES, INSURANCES, AND MAINLY COMMISSIONS PAID ON IMPORTS. AT LEAST TO SOME EXTENT THESE DISBURSEMENTS COULD BE DIMINISHED THROUGH AN IMPROVEMENT OF ADMINISTRATIVE ACTION AND STRICT ADHERENCE TO AUSTERITY PROGRAMS.

FINALLY, THERE IS THE ITEM FOREIGN TRAVEL. GIVEN THE LARGE AMOUNT OF BLACK MARKET TRANSACTIONS FOR TOURIST TRAVEL AND OTHER PURPOSES BEFORE THE RATIFICATION OF THE FREE EXCHANGE LAW, THIS POSITION IS PROBABLY UNDERSTATED IN THE OFFICIAL ACCOUNTS. BUT WHATEVER THE REAL FIGURES MAY BE, A DEFICIT IN THE BALANCE OF TOURIST TRADE IS A COSTLY LUXURY FOR A COUNTRY WITH A CHRONIC ADVERSE BALANCE OF PAYMENTS. THERE IS HARDLY A NEED FOR IT IF ONE CONSIDERS THE LOW PER CAPITA INCOME OF THE BRAZILIAN POPULATION AS COMPARED WITH INCOMES OF OTHER NATIONS.

AS LONG AS THE AVERAGE FOREIGNER THINKS OF BRAZIL AS A VAST JUNGLE WITH RATTLE SNAKES AND INDIANS LYING IN HAMMOCKS UNDER BROAD SOMBREROS, BROODING (IN SPANISH, OF COURSE) OVER THE NEXT REVOLUTION, LITTLE CAN BE EXPECTED TO IMPROVE FOREIGN TRAVEL. TO STIFLE SUCH INTERNATIONAL PRESS SPONSORED FAIRY TALES REQUIRES PERSISTENT PUBLICITY. NO BETTER INSTITUTION IS THERE TO PERFORM THE TASK THAN THE BRAZILIAN FEDERAL GOVERNMENT.

AS CAN EASILY BE DERIVED FROM TABLE I, A REDUCTION OF DEFICITS IN THE BRAZILIAN BALANCE OF SERVICES WOULD RELIEVE MUCH PRESSURE FROM THE BALANCE OF PAYMENTS. HOWEVER, AS THE TABLE GIVES NET POSITIONS ONLY, THE HIGH NEGATIVE FIGURES OF THE BALANCE OF SERVICES IS MISLEADING. THE PRINCIPAL PROBLEMS OF BRAZILIAN FOREIGN TRADE STRIKE AT THE BALANCE OF TRADE WHICH HAS TO ACCUMULATE SUBSTANTIAL SURPLUSES TO ACCOUNT FOR THE

NEGATIVE RESULTS OF OTHER POSITIONS. THEREFORE, THIS STUDY WILL BE PRIMARILY CONCERNED WITH THE COMMERCIAL ASPECTS OF THE BALANCE OF PAYMENTS THROUGHOUT THE FOLLOWING SEVEN CHAPTERS. ONLY IN THE NINTH CHAPTER SHALL FOREIGN CAPITAL BE DISCUSSED AS A MEANS TO OBTAIN LONG-TERM EQUILIBRIUM.

II. THE DISTRIBUTION OF INCOME

THE SIZE AND NATURE OF A COUNTRY'S FOREIGN TRADE IS LARGELY DETERMINED BY THE STRUCTURE OF ITS DOMESTIC MARKET. THIS STATEMENT OR RULE HAS A DOUBLE IMPLICATION FOR THE ANALYST CONCERNED WITH THE IMPROVEMENT OF CONDITIONS GOVERNING INTERNATIONAL TRANSACTIONS. FIRST, IT MEANS THAT ANY CHANGE IN THE STRUCTURE OF THE DOMESTIC ECONOMY IS BOUND TO CALL FORTH AN ALTERATION IN THE VOLUME OF TRADE, THE NATURE OF WHICH MUST BE STUDIED. SECONDLY, IT MEANS THAT THE INTENSITY OF FACTORS CAUSING CHANGE MUST BE INVESTIGATED; THOSE PRODUCING FAVORABLE CHANGES SHOULD BE STIMULATED, WHILE THOSE PRODUCING UNFAVORABLE CHANGES SUPPRESSED.

IT SEEMS THAT THE MAJORITY OF FOREIGN TRADE ANALYSES ON SPECIFIC COUNTRIES OR AREAS TEND TO OVEREMPHASIZE THE FIRST IMPLICATION SIMPLY BY UNDERESTIMATING THE IMPACT OF THE SECOND. THIS WILL BE ILLUSTRATED BY EXAMPLE. LET US SUPPOSE THAT A COUNTRY SUFFERS FROM A SECULAR INFLATION CAUSING AN ADVERSE BALANCE OF PAYMENTS AND AN OVER-VALUATION OF THE EXCHANGE RATE. KNOWLEDGE ABOUT THESE RELATIONSHIPS BETWEEN DOMESTIC CONDITIONS AND FOREIGN TRADE INDUCES GOVERNMENT OFFICIALS TO READAPT THE EXCHANGE RATE TO ITS REAL PURCHASING POWER ABROAD. WILL THIS REMOVE THE EVIL OF AN ADVERSE BALANCE? A POSSIBLE TRANSITORY IMPROVEMENT IN BALANCE OF PAYMENTS ACCOUNTS MAY BE EXPECTED, NOT, HOWEVER, A LONG RANGE EQUILIBRIUM AS LONG AS THE PRIMARY CAUSE OF THE EVIL--INFLATION IN THIS CASE--HAS NOT BEEN REMOVED. ANYONE FAMILIAR WITH BRAZILIAN FOR-

EIGN TRADE POLICY WILL AGREE THAT THIS EXAMPLE IS NOT ALTOGETHER UNREALISTIC.

A COMPREHENSIVE METHOD OF STUDYING DOMESTIC CAUSES OF BALANCE OF PAYMENTS DIFFICULTIES CONSISTS IN ANALYZING NATIONAL INCOME CONDITIONS OF THE COUNTRY IN QUESTION. THIS WILL BE ATTEMPTED IN THIS CHAPTER.

1. THE CRUCIAL POINTS OF INCOME DISTRIBUTION

SINCE 1947 THE BRAZILIAN ECONOMIC INSTITUTE OF THE GETÚLIO VARGAS FOUNDATION HAS COMPILED NATIONAL PRODUCT AND INCOME STATISTICS.¹ AN ESTIMATE FOR THE YEAR 1939 WAS PREPARED BY MEIREN AND LOEB.² BASED LARGELY ON DATA SUPPLIED BY THE ECONOMIC INSTITUTE AND OTHER SOURCES, THE ECONOMIC COMMISSION FOR LATIN AMERICA HAS RECENTLY DEVELOPED CURRENT ESTIMATES ON GROSS PRODUCT, OUTPUT, CAPITAL STOCK, AND PRODUCTIVITY DEVELOPMENTS SINCE 1945.³

A STUDY OF THESE DATA REVEALS WHAT MAY BE CALLED THE SEVEN CRUCIAL POINTS OF BRAZILIAN INCOME DISTRIBUTION. SOME HIGHLIGHTS ARE AS FOLLOWS:

(1) BETWEEN 1939 AND 1953 BRAZIL'S GROSS NATIONAL PRODUCT REGISTERED A TENFOLD INCREASE FROM Cr\$40.8 BILLION TO Cr\$408.4 BILLION. WITHIN THE SAME PERIOD THE WHOLESALE PRICE INDEX WENT UP TO 535 (1939 = 100)

¹ PUBLISHED IN REVISTA BRASILEIRA DE ECONOMIA, (RIO DE JANEIRO: FUNDAÇÃO GETÚLIO VARGAS). WITH SUMMARY IN ENGLISH.

² P. V. D. MEIREN AND G. LOEB, TRENDS AND PROBLEMS IN ECONOMIC DEVELOPMENT OF BRAZIL, OP. CIT. TABLE I OF APPENDIX.

³ SEE: UNITED NATIONS, DEPARTMENT OF ECONOMIC AFFAIRS, ECONOMIC SURVEY OF LATIN AMERICA 1951-52 AND FOLLOWING ISSUES, (NEW YORK, 1954 AND LATER).

AND THE COST OF LIVING INDEX FOR SÃO PAULO TO 677 (1939 = 100).⁴

THIS INDICATES THAT THE REAL NATIONAL OUTPUT GROWTH ACCOUNTED FOR LESS THAN HALF THE INCREASE IN NOMINAL TERM. THE REMAINDER REFLECTS INFLATIONARY EXPANSION OF THE PRICE LEVEL.

(2) THE BULK OF BRAZIL'S NATIONAL INCOME IS CONCENTRATED IN SOME AREAS. FOR INSTANCE, IN 1954 THE STATES SÃO PAULO, THE FEDERAL DISTRICT, MINAS GERAIS, AND RIO GRANDE DO SUL HELD 69% OF THE TOTAL NATIONAL INCOME AND ABOUT 45% OF THE COUNTRY'S POPULATION.⁵

(3) THE GEOGRAPHICAL DISTRIBUTION OF INCOME HAS BECOME MORE UNEVEN SINCE THE PRE-WAR YEARS. FOR INSTANCE, IN 1939 THE SOUTHERN STATES ACCUMULATED 44.0%, IN 1950 48.2% OF TOTAL INCOME, THE NORTHERN STATES 2.5% AND 1.8% RESPECTIVELY.⁶

(4) NOMINAL PER CAPITA INCOME VARIES WIDELY AMONG GEOGRAPHICAL AREAS, THE HIGHEST RATE BEING IN THE FEDERAL DISTRICT, THE LOWEST IN THE STATE OF MARANHÃO. IN 1953, FOR INSTANCE, AVERAGE INCOME IN THE FEDERAL DISTRICT WAS Cr\$19.548, IN MARANHÃO Cr\$1.904.⁷

(5) IN SPITE OF A COMPARATIVELY STEADY GROWTH IN TOTAL REAL PRODUCT, THE PER CAPITA INCREASE WAS SLOW IN PAST YEARS IF MEASURED IN

⁴FIGURES BASED ON MEIREN AND LOEB. IBID. TABLE II APPENDIX I; AND CONJUNTURA ECONÔMICA, ANO IX, NO. 1 (RIO DE JANEIRO: FUNDAÇÃO GETÚLIO VARGAS, JANUARY 1955), PP. 9 AND 15.

NOTE: AN OVER-ALL PRICE INDEX FOR BRAZIL IS NOT YET AVAILABLE.

⁵BASED ON: "ESTIMATIVA DA RENDA NACIONAL DO BRASIL--1947-1954," REVISTA BRASILEIRA DE ECONOMIA, ANO 9, NO. 4, DECEMBER 1955, P. 86; AND INSTITUTO BRASILEIRO DE GEOGRAFIA E ESTATÍSTICA, ANUÁRIO ESTATÍSTICO DO BRASIL 1953, ANO XIV (RIO DE JANEIRO, DECEMBER 1953), P. 75.

⁶MEIREN AND LOEB, IBID., P. 4. NOTE: THE BRAZILIAN INSTITUTE OF GEOGRAPHY AND STATISTICS DIVIDED THE BRAZILIAN TERRITORY INTO FIVE AREAS, COVERING THE NORTHERN, NORTH-EASTERN, EASTERN SOUTHERN, AND CENTRAL-WESTERN STATES.

⁷"REDA NACIONAL DO BRASIL--1947-1953", REVISTA BRASILEIRA DE ECONOMIA, ANO 9, NO. 1, MARCH 1955, P. 54.

TERMS OF AVAILABLE MEANS OF EXPANSION. ON THE BASIS OF 1939 (= 100), PER CAPITA INCREASE WAS MODERATE ONLY IN THE POST-WAR YEARS 1948 (= 111), 1949 (=114), 1950 (=117), 1951 (=121), AND 1952 (= 126).⁸

(6) IN NOMINAL TERMS THE DISTRIBUTION OF NATIONAL PRODUCT PER SECTOR HAS NOT SUFFERED MANY CHANGES SINCE THE PRE-WAR PERIOD. IN REAL TERMS CHANGES WERE CONSIDERABLE, MAINLY DUE TO A PROPORTIONATE DECLINE IN AGRICULTURAL PRODUCTION AND INCREASES IN MANUFACTURING. COMPARATIVE INDICES ARE (1939 = 100): 130 FOR AGRICULTURAL AND 261 FOR MANUFACTURING IN 1953.⁹ ALTHOUGH THE DIVERSIFICATION TREND RESULTED IN A REDUCED SENSITIVITY TOWARD RECESSIONS, IT ALSO CONTRIBUTED TO A CONCENTRATION OF INCOME.

(7) A FURTHER CHARACTERISTIC OF BRAZILIAN INCOME DISTRIBUTION IS THE WIDE DISCREPANCY AMONG INCOME BRACKETS, EVEN AFTER DEDUCTION FOR DIRECT TAXES. THE GREAT MAJORITY OF THE POPULATION IS POOR, WHILE A SMALL SEGMENT RECEIVES VERY HIGH NET INCOMES. THE DISCREPANCY HAS PROBABLY GROWN IN RECENT YEARS DUE TO THE ACCUMULATION OF INFLATIONARY PROFITS, ALTHOUGH STATISTICS ARE NOT AVAILABLE TO PROVE THIS POINT.

REASONS ACCOUNTING FOR DEFICIENCIES OF INCOME DISTRIBUTION ARE INNUMERABLE. THEY CAN BE TRACED TO THE COLONIAL ERA AND MONOCULTURAL PRODUCTION. IN SOME WAYS THE PROBLEM IS RELATED TO SOCIAL AND CLIMATIC CONDITIONS, MAINLY IN THE NORTH AND NORTH-EAST. UNDERPOPULATION AND INTERNAL UNREST BEAR UPON IT. SO DO MANY "LACK-FACTORS" SUCH AS THE SHORTAGE OF COMMUNICATION AND TRANSPORT, OF EDUCATIONAL FACILITIES AND TECHNICAL KNOW-HOW, OF ELECTRIC POWER AND CAPITAL. FISCAL POLICIES,

⁸FIGURES FROM G. F. LOEB AND P. V. D. MEIREN, "O DESENVOLVIMENTO DA PRODUÇÃO REAL E DOS RECURSOS DISPONÍVEIS NO BRASIL, 1939-1953", REVISTA BRASILEIRA DA ECONOMIA, ANO 8, NO. 4, P. 142.

⁹LOEB AND MEIREN, IBID., PP. 146 AND 149.

PARTICULARLY THE TAX AND SOCIAL INSURANCE SYSTEM, HAVE CONTRIBUTED TOWARD, RATHER THAN PREVENTED, INCOME CONCENTRATION.

2. INCOME UNDER INFLATION

THE HEAVY IMPACT OF PRICE INFLATION ON THE LEVEL OF DISTRIBUTION IS MOST PROBABLY THE STRONGEST CAUSE OF INTENSIFIED INCOME CONCENTRATION IN THE LAST FEW DECADES. SINCE THIS BEARS HEAVILY UPON THE STRUCTURE OF FOREIGN TRADE, PRICE INFLATION WILL BE DISCUSSED HERE BRIEFLY.

A FEW FIGURES MAY ILLUSTRATE THE POINT. BETWEEN 1939 AND 1946 TOTAL MONEY SUPPLY MULTIPLIED FOUR TIMES, WHILE THE INCREASE IN REAL INCOME WAS ONLY 25%. NATIONAL INCOME FIGURES FOR THE YEAR 1955 ARE NOT YET AVAILABLE, BUT IT IS IMPROBABLE THAT THE REAL GROWTH EXCEEDED 35% BETWEEN 1948 AND 1955. WITHIN THE SAME PERIOD MONEY SUPPLY EXPANDED BY A FURTHER 236%.¹⁰

THE PRIMARY CAUSES OF BRAZILIAN INFLATION CAN BE SUMMARIZED AS FOLLOWS:

- (1) REPEATED BUDGETARY DEFICITS OF BOTH THE FEDERAL AND STATE GOVERNMENTS LEADING TO PAPER MONEY ISSUES UNCOVERED BY A CORRESPONDING INCREASE IN PRODUCTION;
- (2) LAVISH CREDIT POLICIES;
- (3) OVER-INVESTMENT PARTICULARLY IN SOME LOW PRODUCTIVITY SECTORS;
- (4) HIGH COST OF PRODUCTION AS A RESULT OF A STATIONARY OR FALLING RATE OF PRODUCTIVITY;
- (5) DETERIORATION IN TERMS OF TRADE.

IN ADDITION, MANY SECONDARY FACTORS CAN BE ENUMERATED, SUCH AS: THE FREEZING OF EXCHANGE RATES LEADING TO DISTORTIONS BETWEEN THE REAL

¹⁰ CONJUNTURA ECONÔMICA, ANO X, No. 3, MARCH 1956, P. 16.

VALUE AND THE EXTERNAL VALUE OF THE CRUZEIRO, THUS RESULTING IN THE UNEVEN GROWTH OF DOMESTIC PRODUCTION AND THE LOSS OF FOREIGN MARKETS FOR SEVERAL EXPORT GOODS (THE SO-CALLED "PRODUTOS GRAVOSOS"); THE APPLICATION OF THE FACTORS OF PRODUCTION IN SECTORS WHERE THEY PRODUCE WASTE; INEFFICIENT ADMINISTRATION OF FUNDS; SPOILAGE OF COMMODITIES DUE TO A LACK OF STORAGE AND TRANSPORTATION FACILITIES; TEMPORARY PRICE RISES IN EXPORT PRODUCTS, ESPECIALLY COFFEE, AND EARLY SURPLUSES THEREFROM IN THE BALANCE OF TRADE UP TO 1946; INEFFICIENT FISCAL POLICIES. WE CALL THESE SECONDARY FACTORS AS THEY CONTRIBUTE TO AN ACCELERATION OF THE INFLATIONARY TREND, BUT ARE NOT PRIMARY CAUSES IN THEMSELVES. THEY COULD HAVE CONTRARY EFFECTS--FOR INSTANCE STIMULATING OR CONTROLLING EFFECTS IN THE ABSENCE OF INFLATION. THE FACT THAT THEY INTENSIFY THE INFLATIONARY PRESSURE LARGELY EXPLAIN

CESS AND WHY IT COULD NOT IMMEDIATELY BE CHECKED BY RESTRICTING MONEY SUPPLY.

HOWEVER, THIS STUDY IS LESS CONCERNED WITH THE INFLATIONARY PROBLEM ITSELF THAN WITH ITS EFFECTS ON INCOME DISTRIBUTION. IN A COUNTRY WHERE PRODUCTION FACTORS ARE WIDELY DISTRIBUTED AMONG THE ENTIRE POPULATION, AND IN THE CASE OF UNDER-EMPLOYMENT, A MODERATE RISE IN THE PRICE LEVEL MAY BE A CONVENIENT STIMULANT TO ECONOMIC DEVELOPMENT. IN BRAZIL THERE EXISTS EITHER A WIDE DISTRIBUTION OF INCOME NOR UNDER-EMPLOYMENT.

THEREFORE, ANY INCREASE IN MONEY SUPPLY UNMATCHED BY PRODUCTION HAS AN EVIL RESULT, BOTH IN THE SOCIAL AND ECONOMIC SENSE. WHAT HAPPENS IN BRAZIL UNDER INFLATION CAN BE ROUGHLY DESCRIBED AS FOLLOWS: THE MAJORITY OF THE POPULATION DEPEND EITHER EXCLUSIVELY OR PRIMARILY ON LABOR INCOME, WHILE A MINORITY OWNS THE BULK OF THE PRODUCTION FACTORS AS WELL AS CONSUMER OR SEMI-PROCESSED GOODS. WITH THE RISE IN PRICES THE VALUE OF THESE FACTORS AND GOODS INCREASES OBTAINING THUS

HIGHER RETURN THROUGH SALES. IT IS TRUE THAT THE ACQUISITION OF RAW MATERIALS AND FURTHER PRODUCTION FACTORS BECOMES MORE EXPENSIVE AS WELL, BUT THIS IS LARGELY OFFSET BY THE EFFECTS OF THE WAGE-PRICE SPIRAL AND THE ABILITY TO CHARGE HIGH PRICES FOR CONSUMPTION GOODS, DUE TO A GENERAL SHORTAGE OF COMMODITIES IN RELATION TO AN EVER INCREASING NOMINAL INCOME. IN OTHER WORDS, THE OWNERS OF THE PRODUCTION FACTORS CAPITAL AND LAND ARE ALWAYS ONE OR MORE STEPS AHEAD OF LABOR. THE ABSENCE OF WELL ORGANIZED UNIONS CONTRIBUTES TO THIS DISCREPANCY.

ONE OF THE CONSEQUENCES OF THIS PHENOMENON IS THE PRESSURE THAT IS EXERCISED ON THE PROPENSITY TO SAVE OF THE WORKING CLASS, AS SHALL BE ILLUSTRATED BY A SIMPLE EXAMPLE. LET US ASSUME THAT IN ANY GIVEN YEAR THE AVERAGE PER CAPITA INCOME OF A GIVEN GROUP OF WORKERS WAS Cr\$50,000 AND THAT THE AVERAGE AMOUNT SPENT ON CONSUMPTION WAS Cr\$40,000. IN THIS CASE THE AVERAGE PROPENSITY TO SAVE WAS:

$$PS_1 = \frac{Y_1 - C_1}{Y_1} = \frac{50,000 - 40,000}{50,000} = 20\%$$

THE FOLLOWING YEAR, SUPPOSE, THE GROUP'S INCOME WENT UP BY 10% AND THE AGGREGATE PRICE INDEX FOR CONSUMPTION GOODS BY 12%. IT IS FURTHERMORE ASSUMED THAT THE GROUP WILL BUY THE SAME AMOUNT OF GOODS IN THE SECOND AS IN THE FIRST YEAR. THEN THE PROPENSITY TO SAVE WAS:

$$PS_2 = \frac{Y_2 - C_2}{Y_2} = \frac{55,000 - 40,800}{55,000} = 18.5\%$$

AND THE MARGINAL PROPENSITY TO SAVE WAS:

$$MPS = \frac{S}{Y} = \frac{200}{5,000} = 4\%$$

HAD THERE BEEN NO INCREASE IN THE PRICE LEVEL OF CONSUMPTION GOODS, THE PROPENSITY TO SAVE IN THE SECOND YEAR WOULD HAVE BEEN 27.3% UNDER THE ASSUMED INCREASE IN INCOME (Cr\$5,000 OR 10%), AND THE MARGINAL PROPENSITY TO SAVE WOULD HAVE BEEN 100%, PROVIDED THE SAME AMOUNT OF GOODS WOULD HAVE BEEN BOUGHT IN BOTH YEARS. IN OTHER WORDS, THE INCREASE IN

THE PROPENSITY TO CONSUME WAS FICTITIOUS SINCE IT DID NOT REPRESENT A RISE IN REAL INCOME.

OF COURSE, THE RATES OF 10% AND 15% MAY NOT EXPRESS A REALISTIC RELATIONSHIP IN INCREASE. THEY SIMPLY INDICATE A TREND IN THE DISPROPORTIONATE DEVELOPMENT OF INCOME AND PRICES FOR THE WORKING CLASS.¹¹ FOR OTHER SEGMENTS OF THE POPULATION THE TREND IS RECIPROCAL, I. E. THE NOMINAL INCOME TENDS TO EXPAND FASTER THAN THE PRICE LEVEL.

3. CAPITAL FORMATION AND INVESTMENTS

IN ITS ANNUAL REPORT FOR 1953, THE NATIONAL ECONOMIC COUNCIL SHOWS THAT IN 1952 THE AMOUNT DESTINED FOR CONSUMPTION OF THE TOTAL NATIONAL INCOME WAS 77% IN BRAZIL AS COMPARED TO 75% IN THE UNITED STATES.¹² THESE AND OTHER FIGURES INDICATE THAT BRAZIL RESERVES AN APPRECIABLE AMOUNT OF TOTAL INCOME FOR INVESTMENTS. THE COUNCIL DEMONSTRATES THE DRAWBACKS OF SUCH A HIGH RATE IN VIEW OF THE LOW PER CAPITA INCOME, BUT IT DOES NOT ATTEMPT TO EXPLAIN HOW THIS IS MADE POSSIBLE. INDEED, IT IS A THRILLING PARADOX THAT BRAZIL SUCCEEDS TO HAVE A HIGH RATE OF INVESTMENT IN SPITE OF A LOW RATE OF PER CAPITA INCOME AND SAVINGS. THIS IS THE MORE ASTONISHING SINCE WE HAVE SEEN THAT THE MARGINAL PROPENSITY TO SAVE TENDS TO CONTRACT FOR THE WORKING POPULATION WHICH CONSTITUTES THE MAJORITY OF THE OVER-ALL POPULATION. MEASURED AT CONSTANT PRICES, THE PARTICIPATION OF TOTAL INVESTMENTS ON TOTAL AVAILABLE GOODS AND SERVICES WENT UP FROM 10.6% IN 1945 TO 17.6% IN 1952, WHICH MEANS THAT THE PER

¹¹ THE DISPROPORTIONATE DEVELOPMENT IN THE ABOVE SENSE HAS NEVER BEEN FULLY EXPLORED BY BRAZILIAN ECONOMISTS PARTIALLY DUE TO THE LACK OF PERTINENT DATA. PROBABLY SOME VERY VALUABLE RESULTS COULD BE OBTAINED FOR THE APPLICATION OF ANTI-INFLATIONARY POLICIES IF THOROUGH STATISTICAL RESEARCH STUDIES WOULD BE CONDUCTED TO DETECT THE RATE OF DISPROPORTION FOR SELECTED INCOME BRACKETS AND GEOGRAPHICAL AREAS.

¹² CONSELHO NACIONAL DE ECONOMIA, RELATÓRIO PARA O ANO DE 1953, SÃO PAULO, CHAPTER 2.

CAPITA INVESTMENT EXPANDED BY 164% IN THE SEVEN YEARS UNDER CONSIDERATION.¹³

THERE ARE SEVERAL REASONS FOR THIS EXPANSION. ONE IS RELATED TO EXTENDED GOVERNMENT ACTIVITIES. BRAZIL'S GROSS DOMESTIC INVESTMENTS AMOUNTED TO CR\$237.7 BILLION BETWEEN 1947 AND 1952, OF WHICH 45% CAME FROM PUBLIC SOURCES.¹⁴ SECONDLY, AN IMPROVEMENT IN THE TERMS OF TRADE, MAINLY SINCE THE WORLD COFFEE BOOM OF 1949, WAS OF IMPORTANCE. HOWEVER, THESE OR ANY OTHER CONTRIBUTING FACTORS DO NOT REALLY EXPLAIN THE HIGH RATE OF INVESTMENTS IN RELATION TO THE LOW DEGREE OF SAVINGS.

APPARENTLY THIS PARADOX CAN ONLY BE SOLVED IN TERMS OF THE ABOVE DESCRIBED CONCENTRATION OF INCOMES AND ITS BEARING ON CAPITALIZATION. THE INCOME BRACKETS FAVORED BY THE DEVELOPMENT TEND TO REDUCE THEIR MARGINAL PROPENSITY TO CONSUME IN RELATION TO WHAT COULD TECHNICALLY BE CALLED A MARGINAL PROPENSITY TO SAVE, AND IN SPITE OF THE FACT THAT THEIR AGGREGATE PROPENSITY TO CONSUME INCREASES, GIVEN THE INCREASE IN MONEY INCOMES. THE INCREASE IN THE PROPENSITY TO CONSUME HAS LITTLE EFFECT ON TOTAL REAL INCOME FOR THE FOLLOWING REASONS: (1) A SUBSTANTIAL PORTION OF THE INCREASE IN MONEY INCOME IS INVESTED IN LOW PRODUCTIVITY VENTURES; (2) ANOTHER PORTION TAKES THE FORM OF LEAKAGES (MAINLY INTO IMPORTS, AS WILL BE SEEN LATER); (3) INFLATION ABSORBS PART OF THE INCREASE; (4) DEFICIENCIES IN THE SYSTEM OF DISTRIBUTION, MAINLY OF TRANSPORTATION AND COMMUNICATION, PREVENTS A FAST AND EFFICIENT SPREAD

¹³ UNITED NATIONS, ECONOMIC SURVEY OF LATIN AMERICA--1951-52, OP. CIT., P. 56. IT MUST BE NOTED HERE THAT THE RATE OF INVESTMENT GROWTH FELL CONSIDERABLY IN THE YEARS 1953/54 DUE TO CREDIT RESTRICTION AND AN INCREASE IN CONSUMPTION. SEE: UNITED NATIONS, ECONOMIC SURVEY OF LATIN AMERICA--1954, OP. CIT., P. 129.

¹⁴ BASED ON FIGURES OF "ESTIMATIVA DA RENDA NACIONAL DO BRASIL--1947-52," OP. CIT., P. 275.

OF INCOMES; (5) THE MULTIPLIER HAS ONLY A LIMITED EFFECT FOR REASONS TO BE EXPLAINED IN THE NEXT CHAPTER.

IT WAS SAID ABOVE THAT HIGH INCOME BRACKETS HAVE A HIGH MARGINAL PROPENSITY TO SAVE, AT LEAST IN THE SENSE THAT A LARGE PORTION OF THEIR INCOMES IS NOT SPENT. HERE LIES THE SOURCE OF HIGH INVESTMENT RATES. WITH PROGRESSING INCOME CONCENTRATION AND INFLATION ON ONE HAND, AND THE SLOW RATE OF NATIONAL OUTPUT ON THE OTHER, ENTREPRENEURS ACCUMULATE PROFITS MUCH IN EXCESS OF WHAT THEY CAN CONSUME. THESE ARE THEN REINVESTED SOMETIMES WITHOUT EVEN CIRCULATING THROUGH THE BANKING SYSTEM, PARTICULARLY NOT IN THE FORM OF SAVINGS WHICH ARE DISCOURAGED BY INFLATION AND CEILING INTEREST RATES DETERMINED BY THE LAW. MANY INVESTMENTS, MAINLY THE ONES IN REAL ESTATE, WHERE LITTLE OR NO MANAGEMENT IS REQUIRED, ARE DONE SIMPLY BECAUSE EXCESS PROFITS CANNOT BE CONVENIENTLY REINVESTED IN BUSINESS, OR BECAUSE STOCKHOLDERS OR PARTNERS ARE NOT GIVEN OTHER OPPORTUNITIES.

ANOTHER PARADOX RESULTING FROM THE CONCENTRATION OF INCOMES IS THAT BRAZIL SUFFERS AT THE SAME TIME FROM UNDER-CAPITALIZATION AND OVER-INVESTMENTS. INASMUCH AS THE COUNTRY REQUIRES MORE CAPITAL TO MAKE BETTER USE OF ITS FACTORS OF PRODUCTION, PRIMARILY LABOR, IT IS UNDER-CAPITALIZED. INSOFAR AS IT RESERVES TOO MUCH OF ITS INCOME FOR INVESTMENTS, PARTICULARLY IN LOW PRODUCTIVITY VENTURES, IT IS OVER-CAPITALIZED. THIS DISCREPANCY, IT SEEMS, IS BUT ANOTHER EXPRESSION OF BRAZIL'S NUMBER ONE PROBLEM, OR THE DISEQUILIBRIUM IN THE DEVELOPMENT OF INCOME DISTRIBUTION.

III. MARKET STRUCTURE AND ECONOMIC GROWTH

THE OBJECTIVE OF THIS CHAPTER IS TO INVESTIGATE THE RELATIONSHIP BETWEEN THE SIZE AND NATURE OF THE MARKET AND THE DETERMINANTS OF ECONOMIC GROWTH IN BRAZIL. BUILDING UPON THE PRECEDING DISCUSSION OF INCOME DISTRIBUTION, AN ATTEMPT IS MADE TO EXAMINE THE EFFECT OF INCOME CONCENTRATION ON THE DEMAND FOR THE FACTORS OF PRODUCTION AND DOMESTIC GOODS.

1. UNBALANCED GROWTH

THE HIGHEST ECONOMIC AIM ANY COUNTRY CAN STRIVE FOR, IS BALANCED GROWTH. IF IN SPITE OF CHANGING MARKET FORCES EQUILIBRIUM CAN BE FOUND BETWEEN AGGREGATE SUPPLY OF THE FACTORS OF PRODUCTION AND THEIR DEMAND, BETWEEN TOTAL OUTPUT AND MONEY SUPPLY, AND IF IN ADDITION PRODUCTIVITY CAN BE IMPROVED AND THE MAJOR NEEDS OF A GROWING POPULATION BE SATISFIED, STABILITY OF SOCIAL AND ECONOMIC ORDER WILL RESULT. IT IS LARGELY INDIFFERENT THEN WHETHER THE COUNTRY IN QUESTION IS "RICH" OR "POOR" IN ECONOMIC RESOURCES. DEVELOPMENT BECOMES PROBLEMATIC ONLY WHEN LASTING RECESSIONS OR DEPRESSIONS OCCUR, OR WHEN SOME FORCES IN THE ECONOMY HAVE A MARKED TENDENCY TO EXPAND FASTER THAN OTHERS.

IN BRAZIL LITTLE OR NOTHING CAN BE DONE TO CHECK THE FORCES OF DEPRESSION WHENEVER THEY ARE RELEASED. THE ECONOMY IS WIDELY DEPENDENT ON THE CYCLICAL MOVEMENTS OF THE REST OF THE WORLD, AND PRIMARILY ON THE UNITED STATES. IT HAS NO CHOICE BUT TO FOLLOW THE UPS AND DOWNS OF FOREIGN BUSINESS BEHAVIOR. ON THE OTHER HAND A HOME-PRODUCED DEPRESSION IS

IMPROBABLE WHILE INFLATION LASTS.

MUCH MORE SERIOUS IS THE PROBLEM ARISING FROM UNBALANCED GROWTH. FOR MANY THIS IS AN UNAVOIDABLE FEATURE OF UNDERDEVELOPED COUNTRIES. IT HAS BEEN TERMED IN BRAZIL AS THE "CRISIS OF GROWTH." THE POSITION MAY BE TAKEN THAT SUCH A CRISIS IS NOT INEVITABLE, BUT RATHER A RESULT OF DISEQUILIBRIUM IN THE NATURE OF SUPPLY AND DEMAND.

2. THE CHARACTERISTICS OF EMPLOYMENT

IN BRAZIL DISEQUILIBRIUM IS FOUND IN THE RELATIVE SUPPLY OF THE FACTORS OF PRODUCTION. THERE IS A VAST AMOUNT OF LAND, A FAST GROWING POPULATION, AND LITTLE REAL CAPITAL TO EXPLORE THE LAND AND PROVIDE SUFFICIENT JOB OPPORTUNITIES AT HIGH RATES OF PRODUCTIVITY.

IT HAS BEEN SAID THAT THE BRAZILIAN ECONOMY IS FULLY EMPLOYED, HYPER-EMPLOYED, OR SUFFERS FROM DISGUISED UNEMPLOYMENT. DEPENDING ON WHAT IS MEANT BY EMPLOYMENT, ANY OF THE DESIGNATIONS IS CORRECT. FULL EMPLOYMENT HAS BEEN REACHED INSOFAR AS ALL PERSONS INTERESTED AND CAPABLE OF WORKING CAN FIND EMPLOYMENT. HYPER-EMPLOYMENT ALSO EXISTS, BUT DOES NOT DIFFER SUBSTANTIALLY FROM WHAT IS CALLED DISGUISED UNEMPLOYMENT. BOTH TERMS REFER TO THE FACT THAT THE PRODUCTIVITY OF LABOR IS LOW IN MOST SECTORS OF PRODUCTION. HYPER-EMPLOYMENT STRESSES THE ASPECT THAT TOO MANY PEOPLE ARE WORKING TO PRODUCE A LIMITED OUTPUT. DISGUISED UNEMPLOYMENT MEANS, IN THIS CONNECTION, THAT A REDUCTION OF MANPOWER WOULD BE POSSIBLE WITHOUT HEAVILY AFFECTING AGGREGATE OUTPUT, PROVIDED THAT PRODUCTIVITY IS IMPROVED.

IMMEDIATELY, A QUESTION ARISES, NAMELY: WHY DON'T EMPLOYERS REDUCE THEIR LABOR FORCES TO BENEFIT FROM DECREASED COSTS? THERE ARE VARIOUS REASONS; FIRST OF ALL, THE LABOR LAWS PRESENTLY IN FORCE RENDER IT VERY

DIFFICULT TO LAY OFF PERSONNEL. THE MORE YEARS OF SERVICE AN EMPLOYEE HAS WITH A COMPANY, THE HIGHER WILL BE THE INDEMNIZATION TO BE PAID IN CASE OF DISMISSAL. AFTER TEN YEARS OF SERVICE, NO EMPLOYEE CAN BE DISCHARGED. FURTHERMORE, THE AVERAGE EMPLOYER HAS LITTLE CONCERN FOR PRODUCTIVITY IN THE WORKSHOP OR OFFICE, HIS PROFITS ARE OFTEN HIGH ENOUGH TO FEED THE EFFICIENT AS WELL AS THE UNPRODUCTIVE. OF COURSE, THERE ARE EXCEPTIONS TO THE RULE; SOME COMPANIES PROVIDE PERSONNEL TRAINING PROGRAMS, OTHER FINANCE INSTRUCTION IN SPECIALIZED SCHOOLS. THE AVERAGE ENTERPRISE, HOWEVER, IS INDIFFERENT TO PRODUCTIVITY AND ITS IMPROVEMENT THROUGH RATIONAL MEANS.

IT HAS BEEN STATED BEFORE THAT BRAZIL RESERVED A HIGH RATE OF ITS NATIONAL INCOME FOR INVESTMENTS. A COMPERATIVELY LARGE PROPORTION OF SURPLUS PROFITS IS REINVESTED, AND ALTHOUGH MUCH OF IT IS ABSORBED BY INFLATION, SOME PART OF IT DOUBTLESSLY INCREASES TOTAL REAL OUTPUT. POPULATION GROWTH PROVIDES ADDITIONAL LABOR SUPPLY TO ACCOUNT FOR THE INCREASE IN PRODUCTION. IN THIS WAY FULL EMPLOYMENT IS SECURED. UNDER SUCH CONDITIONS NEW CAPITAL FORMATION NORMALLY NOT ONLY ABSORBS ADDITIONAL LABOR FORCE, BUT ALSO CAUSES PEOPLE TO SEEK IMPROVEMENTS IN THEIR STATUS OF EMPLOYMENT. HOWEVER, THIS IS NOT GENERALLY SO IN UNDERDEVELOPED COUNTRIES.¹ APPARENTLY, THE AVERAGE EMPLOYEE IN AN UNDERDEVELOPED COUNTRY IS MORE READILY SATISFIED WITH THE JOB HE HOLDS THAN HIS COLLEAGUE IN AN ADVANCED COUNTRY. CONSEQUENTLY LABOR SUPPLY IS MUCH LESS ELASTIC AND THE MULTIPLIER HAS LITTLE EFFECT. FOR ALL PRACTICAL PURPOSES FULL EMPLOYMENT CAN BE FOUND.

¹SEE: V. K. V. RAO, "INVESTMENT, INCOME, AND THE MULTIPLIER IN AN UNDER-DEVELOPED ECONOMY," THE INDIAN ECONOMIC REVIEW, FEBRUARY 1952, AND: JAMIL MUNHOZ BAILÃO, "OBSERVAÇÕES SUMÁRIAS SOBRE O MULTIPLICADOR DO INVESTIMENTO E DO EMPRÊGO NAS ECONOMIAS SUBDESENVOLVIDAS," REVISTA DE CIÊNCIAS ECONÔMICAS, MARCH 1954, PP. 69-78.

DOES ALL THIS SUGGEST THAT PEOPLE ARE DIFFERENT IN THE LESS ADVANCED ECONOMIES? PERHAPS THERE IS A RELATIONSHIP BETWEEN THE INDIVIDUAL CAPACITY TO PRODUCE AND CLIMATE, AS HAS BEEN CONTENDED BY CONSCIENTIOUS SCIENTISTS LIKE TOYNBEE. NEVERTHELESS, SUCH FATALISTIC ARGUMENTS ARE OFTEN OVER-EMPHASIZED ON THE GROUND OF THEIR EASY INTELLIGIBILITY.

CHRONIC INFLATION PROBABLY HAS A STRONGER IMPACT ON THE WORKING CONDITIONS OF A POPULATION THAN IS COMMONLY REALIZED.² IT CAUSES PEOPLE TO BECOME INDIFFERENT TOWARD THEIR JOBS AND REDUCES THE EFFECT OF THE MULTIPLIER. IF THIS IS TO BE CHECKED, THE LABOR MARKET MUST CHANGE IN FORM AND CHARACTER. PEOPLE WILL HAVE TO REGAIN THEIR CONFIDENCE IN THE VALUE OF THE CURRENCY AND BECOME MORE AWARE OF THEIR SPENDING HABITS. ALSO, THE WORKING POPULATION MIGHT THEN REALIZE THAT IT CAN IMPROVE ITS STATUS OF EMPLOYMENT BY SELECTING JOBS MORE CAREFULLY AND BY DEVELOPING A HIGHER INTEREST IN LABOR PRODUCTIVITY.

THE KEY TO THE LABOR PROBLEM IS, THEREFORE, THE ELASTICITY OF SUPPLY. AS LONG AS PEOPLE ARE NOT WILLING TO CHANGE THEIR STATUS OF EMPLOYMENT, NEW CAPITAL FORMATION IS BOUND TO BE RESTRICTED TO THE RATE OF GROWTH IN POPULATION. IT IS TRUE THAT THE MARGINAL PROPENSITY TO CONSUME TENDS TO RISE UNDER INFLATION, BUT IT WILL CONTRIBUTE LITTLE TO AN INCREASE IN REAL NATIONAL OUTPUT, SINCE THE MULTIPLIER IS SLOWED DOWN BY THE FULL EMPLOYMENT BARRIER. WITH LITTLE REAL CAPITAL AVAILABLE, PRODUCTIVITY IS BOUND TO BE LOW, AND WHERE PRODUCTIVITY IS LOW, REAL INCOMES ARE LOW, AND SO IS THE CAPACITY TO SAVE. CONSEQUENTLY, CAPITAL FORMATION IS RESTRICTED--THERE SEEMS TO BE NO END TO THE VICIOUS CIRCLE.

² IN THIS CONNECTION AN ARTICLE SHALL BE MENTIONED THAT DISCUSSES THE INADEQUACY OF THE MULTIPLIER TECHNIQUE IN PERIODS OF FULL EMPLOYMENT AND INFLATION: FRANKLIN D. HOLZMAN, "INCOME DETERMINATION IN OPEN INFLATION," THE REVIEW OF ECONOMICS AND STATISTICS, VOL. XXXII, NUMBER 2, MAY 1950, PP. 150-58.

IN SUMMARY, WHAT CAN BE CONCLUDED FROM THE ABOVE IS MAINLY THE EXISTENCE OF A SHORTAGE OF SUPPLY OF LABOR AND REAL CAPITAL, NOT ONLY IN RELATION TO THE LARGE AMOUNT OF LAND AVAILABLE, BUT CHIEFLY TO THE POTENTIAL POSSIBILITIES OF THE LABOR MARKET AS DETERMINED BY THE FAST GROWTH IN POPULATION.

3. THE NATURE OF DEMAND

IN THE PREVIOUS CHAPTER SOME ASPECTS OF INCOME DISTRIBUTION WERE DISCUSSED WHICH WILL NOW BE USEFUL TO EXAMINE THE NATURE OF DEMAND. IT WAS SHOWN HOW INCOME CONCENTRATION HAS OCCURED IN BRAZIL, BENEFITING A SMALL GROUP OF THE POPULATION TO THE DETRIMENT OF THE MAJORITY. ANOTHER VIEW OF THE SAME PHENOMENON IS: EFFECTIVE DEMAND IS CONSIDERABLY GREATER FOR THE RECIPIENTS OF HIGH INCOMES THAN FOR THE LOW INCOME GROUP. THIS HAS SOME IMPORTANT IMPLICATIONS FOR THE MARKET STRUCTURE.

SOME BASIC CONCEPTS OF MARGINAL ANALYSIS SHALL BE APPLIED HERE TO EXAMINE THE RELATIONSHIP OF INCOME DISTRIBUTION AND DEMAND ON ONE SIDE, AND DEMAND AND TOTAL OUTPUT ON THE OTHER.

LET US EXAMINE THE GENERAL QUESTION OF HOW PEOPLE DIVIDE THEIR TOTAL INCOME IN A GIVEN AMOUNT OF TIME INTO THE PURCHASE OF GOODS AND SERVICES. THEY WILL TRY TO SPEND THEIR MONEY AS TO GAIN A MAXIMUM UTILITY FROM EVERY GOOD THEY OBTAIN. IN ORDER TO MAXIMIZE THE UTILITY THAT CAN BE DERIVED FROM THE TOTALITY OF GOODS TO BE BOUGHT, THEY WILL HAVE TO WEIGHT EACH GOODS'S UTILITY. FOR INSTANCE, IF THEIR TOTAL DESIRE COULD BE SATISFIED BY TWO GOODS ONLY, BUT IF THEY FEEL THAT ONE GOOD IS EXACTLY TWICE AS IMPORTANT AS THE OTHER, THEY WOULD BE UNWISE TO BUY MORE (OR LESS) THAN TWO THIRDS OF THE FIRST GOOD AND BUY LESS (OR MORE) THAN ONE THIRD OF THE SECOND GOOD. K. E. BOULDING HAS CALLED THIS GENERAL RULE

THE "EQUIMARGINAL PRINCIPLE" WHICH HE DEFINED AS FOLLOWS: "IN DIVIDING A FIXED QUANTITY OF ANYTHING AMONG A NUMBER OF DIFFERENT USES, JUST SO MUCH WILL BE APPORTIONED TO EACH USE, TO CAUSE THE GAIN INVOLVED BY TRANSFERRING A UNIT OF DIVIDEND INTO ONE USE TO BE JUST EQUAL TO THE LOSS INVOLVED IN THE USES FROM WHICH THE UNIT OF DIVIDEND IS WITHDRAWN."³

WITHIN LIMITATIONS IMPOSED BY THE INDIVISIBILITY OF GOODS AND THE IMPERFECT KNOWLEDGE ABOUT THE EXACT RATE OF UTILITY EACH GOOD CAN PROVIDE, THE EQUIMARGINAL PRINCIPLE EXPLAINS HOW MANY GOODS OF EACH TYPE WILL BE DEMANDED FOR, GIVEN A FIXED PRICE LEVEL AND CONSTANT INCOMES. WHAT WILL HAPPEN IF THE PREMISE OF CONSTANT INCOMES IS REMOVED OR IF THE INCOME OF SOME CONSUMERS WILL RISE TO THE SAME EXTENT AS IT WILL FALL FOR OTHERS? FOR THE FIRST MENTIONED GROUP, WITH A HIGHER EFFECTIVE DEMAND, THE MARGINAL UTILITY OF MONEY WILL MOST PROBABLY DECLINE. EACH MONETARY UNIT ADDED TO THE CONSUMER'S INCOME WILL BECOME A LESS SIGNIFICANT CONTRIBUTION TO THE SATISFACTION OF HIS DESIRES, PROVIDED THAT THE LATTER DO NOT CHANGE. HE WILL THEREFORE BE WILLING TO EXPAND CONSUMPTION OF THE GOODS HE MOST DESIRES. THEY WILL APPEAR "CHEAPER" TO HIM THE MORE HIS INCOME RISES. HIS DEMAND WILL THUS EXPAND.

THE CONTRARY WILL HAPPEN WITH THE POORER STRATA OF THE POPULATION. UNDER THE ASSUMPTION OF A GIVEN LEVEL OF CONSUMPTION FOR MOST COMMODITIES, THE MARGINAL UTILITY OF GOODS MAY REMAIN PROPORTIONALLY CONSTANT. BUT A CONTRACTION OF INCOMES WILL RAISE THE MARGINAL UTILITY OF MONEY. EACH CURRENCY UNIT "LOST" WILL BECOME MORE PAINFUL FOR THE CONSUMER AFFECTED.

IF THE EXPANSION OF DEMAND ON ONE SIDE IS EXACTLY OFFSET BY A CONTRACTION OF DEMAND ON THE OTHER, INDIVIDUAL COMMODITY PRICES WILL NOT BE

³KENNETH E. BOULDING, ECONOMIC ANALYSIS, (REVISED ED., NEW YORK: HARPER & BROTHERS PUBLISHERS, 1948), P. 622.

AFFECTED; NOR WILL THE GENERAL PRICE LEVEL OF GOODS. THIS, HOWEVER, IS VERY IMPROBABLE IF RADICAL CHANGES IN INCOME OCCUR. WHAT WILL MOST LIKELY TAKE PLACE IS THE FOLLOWING: WITHOUT A NECESSARY CHANGE IN THEIR MARGINAL UTILITY PREFERENCE, THE IMPOVERISHED WILL HAVE TO REDUCE THEIR PROPENSITY TO SAVE, AND, IF INCOME CONCENTRATION PROGRESSES, ALSO THEIR PROPENSITY TO CONSUME. TO SATISFY THEIR MOST URGENT NEEDS THEY WILL SHIFT TO THE CONSUMPTION OF LOW PRICED COMMODITIES. FOR INSTANCE, THEY MAY EAT MARGARINE INSTEAD OF BUTTER, DRINK WATER INSTEAD OF MILK, WALK INSTEAD OF DRIVE, OR CEASE TO GO TO THE MOVIES.

THE ENRICHED ON THE OTHER HAND, WILL EXPAND BOTH THEIR PROPENSITY TO CONSUME AND TO SAVE. IN ADDITION, HOWEVER, THEY WILL BECOME MORE AWARE OF THE "GOOD THINGS OF LIFE." A HIGHER PURCHASING POWER ENABLES THEM TO INCREASE THEIR EFFECTIVE DEMAND. A LOW PRICED CAR WILL NO MORE SUFFICE. THEY WILL WANT TO BUY A CAR WITH MANY SUPERFLUOUS BUT PLEASANT GADGETS, EXPENSIVE TOYS FOR THEIR CHILDREN, FASHION DRESSES FOR THEIR WIFE, A YACHT, APPLIANCES, A WEEK-END HOUSE IN THE MOUNTAINS, ETC. WHAT IS PERHAPS THE MOST IMPORTANT FEATURE ABOUT THEIR CHANGING DEMAND IS THAT ALL THE LUXURY THEY NEVER DREAMT OF BEFORE, WILL SUDDENLY BECOME VERY IMPORTANT FOR THEIR SATISFACTION, BECAUSE THEY SAW ALL THE CONVENIENT OBJECTS WHEN THEY TRAVELLED ABROAD, OR BECAUSE THEIR NEIGHBOURS OR COMPANION CLUB MEMBERS ACQUIRED SOMETHING THEY NOW FEEL ESSENTIAL FOR THEIR HAPPINESS. IN SHORT, THE MARGINAL UTILITY WILL CHANGE WITH A SUBSTANTIAL INCREASE IN INCOME.

THE ABOVE EXPOSITION WAS GIVEN IN DYNAMIC TERMS, I. E. CHANGES IN INCOME DISTRIBUTION WERE HELD RESPONSIBLE FOR A CHANGE IN DEMAND. A STATIC EXPLANATION WOULD PERHAPS BE LESS PERSUASIVE, BUT IT IS IMPORTANT TO NOTE THAT THE DYNAMIC ASPECT DIFFERS ONLY IN DEGREE FROM WHAT

IS AN EVIL ALL THE SAME. IN OTHER WORDS, IT IS NOT SUFFICIENT TO CHECK THE PRESENT RATE OF INCOME CONCENTRATION IN BRAZIL IN ORDER TO REMOVE ITS DRAWBACKS. MORE FAR-REACHING METHODS WILL HAVE TO BE APPLIED, AIMED AT A COMPLETE RESTRUCTURATION OF INCOME DISTRIBUTION.

THUS FAR THE ANALYSIS WAS DEVELOPED UNDER THE ASSUMPTION OF CONSTANT PRICES. IT WILL BE SEEN, HOWEVER, THAT THIS PREMISE CANNOT BE UPHOLD WHEN INCOME CONCENTRATION DEVELOPS. EVEN IN THE ABSENCE OF MONEY INFLATION, SUCH AS DEVELOPS FROM DEFICIT FINANCING, IT WILL BE DIFFICULT TO MAINTAIN A FIXED PRICE LEVEL.

4. THE ORIGINS OF UNBALANCED GROWTH

IN THE SENSE THAT A RISING STANDARD OF LIVING IS A DESIRABLE AIM OF ECONOMIC POLICY, NO OBJECTION CAN BE RAISED TO INCOME CONCENTRATION AS A MEANS TO PROVIDE PEOPLE WITH MORE PURCHASING POWER. BUT WHEN THE CONCENTRATION IS NOT A RESULT OF INCREASED PRODUCTIVITY, BUT IS REALIZED AT THE EXPENSE OF OTHER MEMBERS OF THE SOCIETY, IT MAY BE CONDEMNED. BEYOND SOCIAL RECURRENCES, IT WILL CAUSE UNBALANCED GROWTH.

WHERE PURCHASING POWER IS AVAILABLE FOR A WIDE VARIETY OF PRODUCTS NEW BUSINESS ACTIVITIES CAN BE SUCCESSFULLY UNDERTAKEN. THIS EXPLAINS THE FAST DEVELOPMENT OF DIVERSIFICATION THAT CAN BE OBSERVED IN BRAZIL TODAY. IT IS LESS VENTURESOME TO START A NEW BUSINESS IN ALMOST EVERY FIELD IN BRAZIL THAN IN MORE ADVANCED COUNTRIES. WITH A FAIRLY GOOD PRODUCT, SOME CAPITAL, AND COMPARATIVELY LITTLE MARKET KNOWLEDGE ANY COURAGEOUS ENTREPRENEUR CAN BECOME PROSPEROUS. IT DOES NOT REQUIRE MUCH RESEARCH OR ADVERTISING TO PROMOTE A NEW PRODUCT. IF WELL ADMINISTERED IN THE BEGINNING, YOUNG FIRMS CAN SOON COUNT ON SATISFACTORY OR EVEN

SUBSTANTIAL PROFITS, AND DO NOT HAVE TO FEAR CUTTHROAT COMPETITION.

NEVERTHELESS, A MASS MARKET EXISTS ONLY FOR A VERY FEW GOODS. THE CONSTANT SHIFT IN DEMAND DETERMINED BY INCOME CONCENTRATION PREVENTS AN EVEN EXPANSION OF PRODUCTION CAPACITIES, EXCEPT IN THE FIELDS OF THE MORE VITAL COMMODITIES, LIKE FOOD AND CLOTHING. EVEN THERE, MASS PRODUCTION IS HAMPERED DUE TO THE LOW REAL PURCHASING POWER OF THE RURAL POPULATION, AND OF THE LACK OF MEANS OF TRANSPORTATION AND COMMUNICATION. IN CONSEQUENCE, LARGELY INDEPENDENT MARKETS DEVELOP. IN THE LOW INCOME AREAS, WHICH ARE WIDELY IDENTICAL WITH THE AGRARIAN DISTRICTS, DEMAND CONCENTRATES ON MEANS OF SUBSISTENCE PRODUCED LOCALLY. THE HIGH INCOME AREAS NOT ONLY ABSORB A SUBSTANTIAL PORTION OF RURAL PRODUCTS, BUT ALSO THE MAJORITY OF INDUSTRIAL GOODS.

THE CONTRAST BETWEEN LOW AND HIGH INCOMES IN THE PREDOMINANTLY AGRARIAN AREAS ON ONE SIDE AND THE MAJOR CITIES ON THE OTHER IS ONE ASPECT OF UNBALANCED GROWTH. ONCE A CENTER SUCCEEDS TO DEVELOP ITS MARKET, IT ATTRACTS PEOPLE FROM THE FARM LAND. MIGRATION THUS NOT ONLY ENABLES THE CENTERS TO PROGRESS AT A FAST RATE, BUT ALSO CAUSES OVER-POPULATION AND TRAFFIC CONGESTIONS IN THE MAJOR CITIES LIKE SÃO PAULO, RIO DE JANEIRO, BELO HORIZONTE OR PORTO ALEGRE. IN ADDITION IT SLOWS DOWN AGRICULTURAL PRODUCTION. THIS EXPLAINS, TO SOME EXTENT, THE PRICE INCREASE OF FOOD PRODUCTS, AND THE INABILITY TO EXPAND THE OUTPUT OF EXPORT GOODS TO MEET RISING IMPORT REQUIREMENTS.

UNDER THE GIVEN CONDITIONS, DIVERSIFICATION PRODUCES MORE HARM THAN BENEFITS TO THE NATION. IF IT WERE THE RESULT OF COMPETITIVE FORCES IN THE ECONOMY URGING ENTREPRENEURS TO LOOK FOR MORE EFFICIENT PRODUCTION METHODS AND BETTER PRODUCTS, IT WOULD CONTRIBUTE TO AN IMPROVEMENT IN PRODUCTIVITY AND A RISE IN REAL INCOMES. IN BRAZIL, HOWEVER, ONLY FEW

INDUSTRIES OPERATE UNDER KEEN COMPETITION. THEY TURN TO DIVERSIFICATION BECAUSE OF EXISTING EFFECTIVE DEMAND AND IMPORT CONTROLS. BUT SINCE A LARGE PORTION OF DEMAND IS DIRECTED TOWARD LESS ESSENTIAL GOODS, MANY INDUSTRIES ARE RAISED TO PRODUCE FANCY ARTICLES WHICH ADD LITTLE TO AN IMPROVED STANDARD OF LIVING.

DIVERSIFICATION AND THE LACK OF MASS MARKETS FOR ESSENTIAL GOODS IMPEDES MASS PRODUCTION WHICH, IN TURN, AFFECTS PRODUCTION COSTS. QUITE OFTEN POTENTIAL INVESTORS ARE DISCOURAGED BY EXISTING MARKET LIMITATIONS OR EXCESSIVE COSTS OF PRODUCTION. THIS HAS PARTICULARLY HAMPERED THE DEVELOPMENT OF HIGH FIXED COST INDUSTRIES REQUIRING LARGE VOLUME OUTPUTS TO JUSTIFY ORIGINAL INVESTMENTS. IF PRODUCTIVE EFFORTS AND DEMAND COULD BE CONCENTRATED ON ESSENTIAL GOODS, STANDARDIZATION AND MASS PRODUCTION WOULD BE STIMULATED, AND PRODUCTIVITY BE INCREASED. THIS, HOWEVER, IS NOT POSSIBLE WITHOUT CURTAILING EFFECTIVE DEMAND OF THE WEALTHY AND RAISING DEMAND OF THE POOR. IN SUMMARY, THE DISCREPANCY BETWEEN PURCHASING POWERS OF DIFFERENT STRATA OF THE POPULATION HOLDS DOWN THE DEVELOPMENT OF MASS PRODUCTION AND ENCOURAGES THE PRODUCTION OF LUXURY ARTICLES, THUS CONTRIBUTION TO UNBALANCED GROWTH OF THE FACTORS OF PRODUCTION EMPLOYED IN THE ECONOMY.

ALSO THE PRICE LEVEL IS AFFECTED BY THE DESCRIBED TREND OF UNBALANCED DEVELOPMENT, BOTH DIRECTLY AND INDIRECTLY. THE DIRECT IMPACT IS DETERMINED BY THE SHIFT IN DEMAND FROM MORE TO LESS PRODUCTIVE VENTURES, FOLLOWED BY A CORRESPONDING SHIFT IN THE FACTORS OF PRODUCTION. THE INDIRECT IMPACT MAY BE FOUND IN THE HIGH COST OF AVERAGE OUTPUT DUE TO THE LOW DEGREE OF MASS PRODUCTION, MASS DISTRIBUTION, AND STANDARDIZATION. INFLATION IS NOT NECESSARILY A CONSEQUENCE OF THE RESTRUCTURATION IN THIS SENSE. BUT MEASURED AGAINST THE PRICE LEVELS OF OTHER COUNTRIES OPERA-

TING UNDER MORE STABLE CONDITIONS, THE PRODUCTS OF THE COUNTRY IN QUESTION BECOME MORE EXPENSIVE AND ENCOUNTER EXPORT OBSTACLES. MONEY INFLATION, ON THE OTHER HAND, CAUSES THE TREND TO INTENSIFY FOR REASONS DISCUSSED EARLIER IN THIS STUDY.

ONE LAST ASPECT OF INCOME CONCENTRATION AND MONEY INFLATION MUST BE EXAMINED HERE. DIVERSIFICATION AND A GENERAL EXPANSION OF THE PRODUCTIVE STRUCTURE WOULD BE LESS HARMFUL UNDER THE CONDITIONS OF UNDER-EMPLOYMENT. FOR SOCIAL REASONS, IT COULD BE PROPOSED, ANY STIMULATING EFFECT WOULD BE DESIRABLE FOR THE ECONOMY, EVEN IF IT RESULTED IN A DETERIORATION OF PRODUCTIVITY. THIS, HOWEVER, DOES NOT APPLY TO BRAZIL, WHERE LABOR IS FULLY EMPLOYED IN THE SENSE DESCRIBED IN THE LAST SECTION, AND WHERE CAPITAL FORMATION IS SLOW. THEREFORE, EXCESS DEMAND OVER A LIMITED SUPPLY OF PRODUCTION FACTORS, LABOR AND CAPITAL, INEVITABLY CREATES INFLATION. UNDER SUCH CONDITIONS IT IS AN ADVANTAGE FOR THE COUNTRY THAT AT LEAST ONE FACTOR, NAMELY LAND, IS AVAILABLE IN ABUNDANCE. ALTHOUGH REAL ESTATE INVESTMENTS MAY CONTRIBUTE NOTHING OR VERY LITTLE TO THE IMPROVEMENT OF PRODUCTIVITY, THEY SERVE AS AN EXHAUST VALVE FOR EXCESS DEMAND AND THUS PUT A SOFT BUT NEVERTHELESS EFFECTIVE BRAKE ON INFLATION.

IN SUMMARY, THERE ARE THREE MAIN CHARACTERISTICS OF UNBALANCED GROWTH IN THE BRAZILIAN ECONOMY. ONE IS THE DISPROPORTIONATE DEVELOPMENT OF GEOGRAPHICAL AREAS, THE SECOND IS THE DISPROPORTIONATE EXPANSION OF BUSINESS VENTURES, THE THIRD A DISEQUILIBRIUM BETWEEN AVAILABLE SUPPLY OF PRODUCTIONS FACTORS AND EFFECTIVE DEMAND. ALL THREE CHARACTERISTICS ARE PRIMARILY DETERMINED BY MALDISTRIBUTION OF INCOME AND THEIR EFFECTS INTENSIFIED BY MONEY INFLATION.

IV. DOMESTIC DISEQUILIBRIUM AND THE BALANCE OF PAYMENTS

IN THE PREVIOUS TWO CHAPTERS ATTENTION WAS DIRECTED TO THE CONDITIONS DETERMINING THE DISTRIBUTION OF INCOME AND THEIR EFFECTS ON THE MARKET STRUCTURE. THE PRESENT CHAPTER WILL INVESTIGATE THE WAY IN WHICH THESE CONDITIONS INFLUENCE THE VOLUME AND COMPOSITION OF FOREIGN TRADE AND, PARTICULARLY, THE BALANCE OF PAYMENTS.

DUE TO THE COMPLEXITY OF FACTORS INFLUENCING INTERNATIONAL TRANSACTIONS AT THE PRESENT TIME, IT IS DESIRABLE TO REVIEW IN THE CLASSICAL TRADITION THE EFFECTS OF INCOME ON FOREIGN TRADE, AND TO EXAMINE THE INCOME-TRADE RELATIONSHIP IF THE CLASSICAL PREMISES ARE REMOVED.

1. THE MAXIMIZATION OF INCOME

TO BEGIN WITH, INTERNATIONAL TRADE IS ASSUMED TO FUNCTION UNDER THE FOLLOWING CONDITIONS:

- (1) THE ONLY VARIABLES CONSIDERED ARE EXPORT AND IMPORT COMMODITIES; THEY ALONE ARE SUPPOSED TO DETERMINE THE COMPOSITION AND VOLUME OF TRADE, AS WELL AS THE INTERNATIONAL BALANCE OF ACCOUNTS; CAPITAL MOVEMENTS ARE NON-EXISTENT BECAUSE UNNECESSARY;
- (2) TRANSITORY DEFICITS IN THE BALANCE OF TRADE (OR PAYMENTS) ARE PAID EITHER BY GOLD OR EXCHANGE RESERVES;
- (3) NO COUNTRY USES RESTRICTIVE TRADE MEASURES TO PREVENT THE FREE EXCHANGE OF COMMODITIES;
- (4) VALUES ARE MEASURED AT CONSTANT PRICES, I. E. ONE UNIT OF ANY SPECI-

FIG CURRENCY ALWAYS BUYS THE SAME AMOUNT OF GOODS;

(5) ALL DEMAND AND SUPPLY ELASTICITIES ARE UNITARY;

(6) EACH COUNTRY HAS AVAILABLE A GIVEN AMOUNT OF THE FACTORS OF PRODUCTION.

IT IS THE LAST ASSUMPTION THAT INDUCES COUNTRIES TO TRADE. BECAUSE, IF EVERY COUNTRY WERE ABLE TO PRODUCE ANY GOOD REQUIRED FOR DOMESTIC CONSUMPTION AT PRICES EQUAL TO THE PRICES ABROAD, NO TRADE WOULD TAKE PLACE DUE TO THE COST OF TRANSPORTATION. UNDER THE CONDITION OF UNEQUAL DISTRIBUTION OF FACTORS, THE DIFFERENT COMMODITIES WILL BE PRODUCED AT DIFFERENT COSTS. EACH COUNTRY WILL CONCENTRATE ON THE PRODUCTION OF THOSE GOODS WHICH IT CAN PRODUCE AT RELATIVELY LOWER COSTS THAN OTHERS. THE PORTION IN EXCESS OF DOMESTIC CONSUMPTION WILL BE EXPORTED AND, IN EXCHANGE, GOODS WILL BE IMPORTED WHICH COULD ONLY BE PRODUCED AT HOME AT RELATIVELY HIGHER COSTS. FROM THE EXCHANGE THE IMPORTING AS WELL AS THE EXPORTING COUNTRY CAN EXPECT THE SAME OR MORE SATISFACTION OF WANTS AT A COMPARATIVELY LOWER COST OF PRODUCTION. THUS, THROUGH INTERNATIONAL TRADE, A MAXIMIZATION OF REAL NATIONAL INCOME CAN BE ATTAINED.--IT GOES ALMOST WITHOUT SAYING THAT THESE RELATIONSHIPS WERE FIRST UNCOVERED BY RICARDO.

WHAT MAKES THE RICARDIAN SCHEME OF COMPARATIVE COSTS PARTICULARLY USEFUL IS THE FACT THAT THE ASSUMPTION OF AN UNEVEN DISTRIBUTION OF FACTORS HOLDS TRUE IN REALITY. FOR ALL PRACTICAL PURPOSES THE ASSUMPTION CAN BE MADE OR EVEN STATISTICALLY MEASURED IF TRADE RELATIONS OF SPECIFIC COUNTRIES ARE EXAMINED. THE REASON IS THAT COMPLETE MOBILITY OF FACTORS CANNOT BE ACHIEVED UNDER ANY CONDITION. THIS PREVENTS A WORLD EQUILIBRIUM IN THE DISTRIBUTION OF FACTORS AND, CONSEQUENTLY, OF FACTOR PRICES. FURTHERMORE, DIFFERENCES IN COST STRUCTURES ARE CAUSED BY THE

DIFFERENT WAYS FACTORS MAY BE COMBINED IN DIFFERENT LOCALITIES.

IN SUMMARY, AS LONG AS THE TWO CONDITIONS OF (1) IMOBILITY OF FACTORS, AND (2) DIFFERENT FACTOR COMBINATIONS PREVAIL, COUNTRIES WILL TRADE.

2. TRADE AND INCOME DISTRIBUTION

THE NEXT QUESTION RELATES TO THE WAY INTERNATIONAL TRADE AFFECTS THE DISTRIBUTION OF INCOME.

THE HEAVIER A COUNTRY'S TRADE IS UNDER THE CONDITIONS SET FORTH BY THE SYSTEM OF COMPARATIVE ADVANTAGES, THE STRONGER WILL BE THE IMPACT ON THE DISTRIBUTION OF INCOME. WHEN TRADE BEGINS, THE DEMAND FOR FACTORS NEEDED FOR THE PRODUCTION OF EXPORT GOODS WILL EXPAND. CONSEQUENTLY, THEIR PRICES WILL RISE. THE OPPOSITE WILL HAPPEN IN THE INDUSTRIES IN WHICH THE COUNTRY HAS A COMPARATIVE DISADVANTAGE. THERE, LESS FACTORS WILL BE EMPLOYED AND THE DEMAND FOR THEM WILL CONTRACT.¹ AS LONG AS A COMPARATIVE GAIN CAN BE EXPECTED FROM TRADE, IN SPITE OF RISING FACTOR PRICES IN THE EXPORT INDUSTRIES AND DECLINING FACTOR PRICES IN THE CONTRACTING INDUSTRIES, THE COUNTRY WILL CONTINUE TO CONCENTRATE ON THE PRODUCTION OF EXPORT GOODS. IN OTHER WORDS, THE RELATIVE PRICES PAID FOR THE FACTORS OF PRODUCTION OF EXPORT AND IMPORT GOODS MUST DIFFER IN THE VARIOUS COUNTRIES TO ALLOW AN EXCHANGE OF COMMODITIES.

IF DIFFERING RELATIVE PRICES PREVAIL, FOREIGN TRADE WILL CAUSE A CHANGE IN THE DISTRIBUTION OF INCOME, AS WELL AS A SHIFT IN THE PRODUCTION STRUCTURE, IN DEMAND FOR THE FACTORS OF PRODUCTION, IN EMPLOYMENT,

¹ THE EFFECTS MAY AND PROBABLY WILL NOT BE ALIKE FOR EACH TYPE OF FACTOR EMPLOYED OR WITHDRAWN. SEE: GOTTFRIED VON HABERLER, THE THEORY OF INTERNATIONAL TRADE WITH ITS APPLICATIONS TO COMMERCIAL POLICY, (THIRD ENGLISH IMPRESSION, LONDON, EDINBURGH, GLASGOW: WILLIAM HODGE AND COMPANY, LIMITED, 1950), P. 193.

AND IN FACTOR PRICES. AS A RESULT, THE ENTIRE ECONOMIC LIFE WILL UNDERGO CHANGES, PROBABLY TOWARD AN IMPROVEMENT IN THE STANDARD OF LIVING THROUGH MORE EFFICIENT DISTRIBUTION OF THE FACTORS OF PRODUCTION.

IF THE ABOVE LINE OF REASONING IS CARRIED FURTHER (AS HAS BEEN DONE BY JOHN STUART MILL AND SEVERAL LATER ECONOMISTS) A PERFECT INTERNATIONAL EQUILIBRIUM CAN BE CONCEIVED. EACH COUNTRY WILL PRODUCE AT MAXIMUM UTILITY OF FACTOR DISTRIBUTION AND MINIMUM COST. THROUGH THE FUNCTIONING OF INTERNATIONAL VALUES (GOLD TRANSFERS OR EXCHANGE RATE ADJUSTMENTS) PRICES AND COSTS WILL EQUATE THROUGHOUT THE WORLD.²

3. THE NEED FOR PROTECTION

REALITY NEVER CONFORMS WITH PURE ECONOMIC THEORY. BUT MUCH CAN BE LEARNED FROM THEORY TO INTERPRET REALITY. FOR INSTANCE, IT HOLDS TRUE UNDER ALMOST ANY IMAGINARY CONDITION OF INTERNATIONAL TRADE THAT A CHANGE IN NATIONAL INCOME OF ONE COUNTRY AFFECTS THE INCOME STRUCTURE OF ANY OTHER COUNTRY. THIS CAN BE ILLUSTRATED BY A SIMPLE EXAMPLE.

LET US SAY THAT INCOME IN COUNTRY A, A PREDOMINANTLY INDUSTRIAL COUNTRY, SUFFERS A DECLINE. THE INCOME OF COUNTRY B, A SUPPLIER OF RAW MATERIALS TO A, WILL THEN BE AFFECTED BY ANY OR SEVERAL OF THE FOLLOWING CONSEQUENCES: (1) A DECLINE IN DEMAND FOR THE PRODUCTS OF B USED BY A; A DECLINE IN PRICES OF A PRODUCTS; (3) A DECLINE IN THE VOLUME OF A'S EXPORTS AND B'S IMPORTS (OR THE CONTRARY IF A GOODS BECOME AVAILABLE TO B AT LOWER PRICES); (4) A DECLINE IN INVESTMENTS OF A IN B; (5) A CHANGE

²THE ANALYSIS OF THE LAST TWO SECTIONS WAS CONFINED TO SOME HIGHLIGHTS OF THE THEORY AND IS THEREFORE RATHER SUPERFICIAL. AMONG THE VAST LITERATURE DEALING WITH THE SAME OR SIMILAR PROBLEMS, ONE ARTICLE SHALL BE POINTED OUT DUE TO ITS CLARITY AND CONCISENESS: ELI HECKSCHER, "THE EFFECT OF FOREIGN TRADE ON THE DISTRIBUTION OF INCOME," READINGS IN THE THEORY OF INTERNATIONAL TRADE, SELECTED BY A COMMITTEE OF: THE AMERICAN ECONOMIC ASSOCIATION, (PHILADELPHIA, TORONTO: THE BLAKISTON COMPANY, 1949), PP. 272-300.

IN THE TERMS OF TRADE; ETC.

IF THE ASSUMPTION OF FREE INTERNATIONAL EXCHANGE IS REMOVED, IT MAY BE DANGEROUS TO DRAW SPECIFIC CONCLUSIONS ABOUT THE WAYS A CHANGE IN INCOME OF ONE COUNTRY AFFECTS THE INCOME OF ANOTHER. TOO MANY VARIABLES BLUR THE PICTURE.³ NEVERTHELESS, SOME GENERAL AND TENTATIVE CONCLUSIONS OR HYPOTHESES CAN BE DRAWN. THIS SHALL BE ATTEMPTED FOR THE BRAZILIAN CASE.

FIRST, CONSIDER HOW THE ECONOMY OF UNDERDEVELOPED COUNTRIES WOULD BE AFFECTED IF THE WHOLE WORLD DECIDED TO GRADUALLY INTRODUCE FREE EXCHANGE CONDITIONS. IN THIS CASE DIFFERENCES IN THE RELATIVE INCOME STRUCTURE OF COUNTRIES WOULD BE LEVELED OUT. MOBILE PRODUCTION FACTORS WOULD SEEK AREAS WHERE THEY COULD BE MORE PRODUCTIVELY EMPLOYED. UNDER THE (OVER-OPTIMISTIC) ASSUMPTION THAT THE PROCESS OF ADAPTATION COULD BE PERFORMED WITHOUT ANY MAJOR RECESSIONS OR SOCIAL UNREST, THE DIFFERENT NATIONS WOULD SOON SPECIALIZE IN THE PRODUCTIVITY FIELDS OFFERING THE BEST COMBINATION OF FACTORS/AT LOWEST COSTS. DUE TO THE ADVANTAGE GAINED BEFORE THE CHANGE IN MANY SECTORS OF PRODUCTION, THE MORE ADVANCED COUNTRIES WOULD ATTRACT THE MAJORITY OF MOBILE FACTORS. WITH LITTLE IMMEDIATE ADVANTAGES, PRODUCTION IN UNDERDEVELOPED AREAS WOULD BE CONFINED TO A FEW GOODS ONLY. THE RATE OF ECONOMIC PROGRESS IN UNDERDEVELOPED COUNTRIES WOULD BE HELD BACK AND RECOVER ONLY TO THE EXTENT OF FACTOR LIBERATION IN THE ADVANCED AREAS DUE TO OVER-POPULATION OR OVER-CAPITALIZATION.

³ IN THIS CONNECTION TWO DETAILED (AND IN A SENSE COMPLEMENTARY) STUDIES SHALL BE QUOTED: FRITZ MACHLUP, INTERNATIONAL TRADE AND THE NATIONAL INCOME MULTIPLIER, (PHILADELPHIA: THE BLAKISTON COMPANY, 1943); AND: HANS NEISSER AND FRANÇO MODIGLIANI, NATIONAL INCOMES AND INTERNATIONAL TRADE, A QUANTITATIVE ANALYSIS, (URBANA: UNIVERSITY OF ILLINOIS PRESS, 1953).

THE EXAMPLE GIVEN IS HIGHLY UNREALISTIC. BUT IT PROVIDES AN EXPLANATION OF WHY COUNTRIES TURN TO PROTECTIONISM. IN SPITE OF THE BENEFITS CONNECTED WITH MAXIMUM FACTOR UTILIZATION, FREE TRADE LEADS INEVITABLY TO SPECIALIZATION AND THIS CLASHES WITH THE NATIONAL INTEREST OF ANY MODERN STATE. THE FIRST EUROPEAN TRADE BARRIERS WERE ESTABLISHED NOT TO CORRECT ADVERSE BALANCE OF PAYMENTS, BUT TO PROTECT INFANT PRODUCTION. IN THE SECOND PLACE--AND THIS IS MORE PERTINENT TO THIS CASE--THE EXAMPLE SHOWS THAT UNDERDEVELOPED AREAS WOULD GAIN LITTLE, IF ANYTHING, BY A REMOVAL OF INTERNATIONAL BARRIERS AS LONG AS THEY HAVE SO LITTLE COMPARATIVE ADVANTAGES TO OFFER TO ADVANCED COUNTRIES. IN THE LONG RUN, THEY WOULD BENEFIT FROM INTERNATIONAL DIVISION OF LABOR, THROUGH MORE STABILITY AND A HIGHER REAL NATIONAL INCOME. BUT, HOW LONG WOULD THAT TAKE AND HOW MUCH WOULD HAVE TO BE SACRIFICED TO REACH THIS POINT?

IT IS IMPORTANT TO STRESS THAT A GRADUAL RETURN TO FREE TRADE OR A SITUATION CLOSE TO IT IS CONDITIONED BY A REORGANIZATION OF THE ECONOMIC STRUCTURE. ONLY AFTER THE DOMESTIC CAUSES OF DISEQUILIBRIUM ARE REMOVED, AND AFTER THE COUNTRIES IN QUESTION HAVE GAINED A BETTER COMPARATIVE COST POSITION, CAN A RELAXATION OF CONTROL MEASURES BE EXPECTED TO DO SOME GOOD.

4. THE ORIGINS OF DISEQUILIBRIUM

UNDER THE EXISTING CONDITIONS OF A WIDE VARIATION IN REAL NATIONAL INCOMES OF COUNTRIES, BRAZIL HAS TO RESORT TO CONTROL MEASURES TO AVOID EXCESSIVE IMPORTATION AND A STEADY DETERIORATION OF ITS BALANCE OF PAYMENTS AND EXCHANGE RATE. EVEN IN THE ABSENCE OF INFLATION, CONTROLS ARE NECESSARY WHILE THE DISCREPANCY IN INCOME PREVAILS. INFLATION AND THE DETERIORATION IN THE TERMS OF TRADE ARE AGGRAVATING BUT NOT PRIMARY FAC-

TORS IN BRAZIL'S ADVERSE BALANCE OF PAYMENTS.

WHY DID BRAZIL HAVE AN ADVERSE BALANCE OF PAYMENTS DURING YEARS WHEN ITS INFLATIONARY RATE DID NOT EXCEED (OR DID NOT MUCH EXCEED) THE INFLATIONARY RATES OF OTHER COUNTRIES? THIS QUESTION IS CLOSELY RELATED TO ANOTHER BROADER ONE, NAMELY: WHY WAS BRAZIL'S ECONOMIC DEVELOPMENT SLOWER AT TIMES OR LESS STABLE THAN THAT OF THE MAJORITY OF THE INDUSTRIAL COUNTRIES? PROBABLY BOTH QUESTIONS CAN BE ASKED REASONABLY FOR EVERY UNDERDEVELOPED COUNTRY.

IN THE ABSENCE OF FREE TRADE SOME COUNTRIES ARE ALWAYS MORE ADVANCED THAN OTHERS. THEIR DEGREE OF ADVANCEMENT IS REFLECTED IN A HIGHER STANDARD OF LIVING WHICH, IN TURN, IS A CONSEQUENCE OF A HIGHER REAL PER CAPITA INCOME. WHY, IT MUST BE ASKED, IS A REAL INCOME HIGHER IN SOME COUNTRIES THAN IN OTHERS? THERE ARE MANY EXPLANATIONS, BUT ALL OF THEM CAN BE REDUCED TO EITHER MONETARY OR REAL FACTORS. LET US FIRST CONSIDER THE LATTER.

THE REAL DETERMINENTS OF INCOME RESULT FROM A MORE OR LESS EFFICIENT COMBINATION OF THE FACTORS OF PRODUCTION. THE COMBINATION CAN BE MEASURED--AT LEAST THEORETICALLY--BY THE AMOUNTS REQUIRED OF EACH FACTOR TO PRODUCE A GIVEN PRODUCT IN A GIVEN AMOUNT OF TIME. THE LOWER THIS AMOUNT (OR INPUT), THE HIGHER WILL BE THE PHYSICAL PRODUCTIVITY. IF ADDITIONAL UNITS OF INPUT ARE ADDED AND THE RESULTING PRODUCT (OR OUTPUT) IS GREATER THAN THE ADDITIONAL INPUT, THE MARGINAL PHYSICAL PRODUCTIVITY HAS INCREASED. AND, THE HIGHER THIS MARGINAL PRODUCTIVITY, THE LOWER WILL BE THE REAL COSTS OF PRODUCTION FOR THE GIVEN PRODUCT.

UNDER THE LAW OF COMPARATIVE COSTS TRADE CAN TAKE PLACE EVEN UNDER CONDITIONS OF ABSOLUTE DIFFERENCES IN THE COST LEVEL OF COUNTRIES. IN ORDER TO SPECIALIZE IN THE PRODUCTION OF GOODS THAT CAN BE PRODUCED AT

RELATIVELY LOWER COSTS (IN THE RICARDIAN SENSE), EACH COUNTRY HAS TO EMBARK ON A REORGANIZATION OF ITS PRODUCTION STRUCTURE: IT HAS TO CONCENTRATE ON THE PRODUCTION OF SOME GOODS AND ABANDON OR GREATLY RESTRICT THE PRODUCTION OF OTHERS. IN TIMES OF POLITICAL AND ECONOMIC INSTABILITY, NO COUNTRY IS USUALLY WILLING TO UNDERGO SUCH A REORGANIZATION AS THIS MIGHT INCREASE ITS VULNERABILITY IN THE CASE OF WAR OR DEPRESSION. CONSEQUENTLY, TRADE BARRIERS ARE ERECTED AND THE COMPARATIVE COST SYSTEM LOSES ITS EFFICACY.

WHEN BRAZIL GAINED ITS INDEPENDENCE IN THE BEGINNING OF THE 19TH CENTURY, ITS POTENTIAL SUPPLIES WERE ALREADY HIGH INCOME COUNTRIES WITH WIDELY DIVERSIFIED PRODUCTION STRUCTURES. POLITICAL INSTABILITIES, AND MAINLY THE INDUSTRIAL REVOLUTION LED TO TARIFFS AND OTHER MEASURES OF INFANT PROTECTIONS. BRAZIL HAD A HIGH DEMAND FOR IMPORTS AND FOREIGN CAPITAL TO SUPPORT AND FINANCE EARLY DEVELOPMENTS. UNLIKE THE UNITED STATES, IT DID NOT SUCCEED TO PRODUCE A SUFFICIENTLY VARIABLE AMOUNT OF EXPORT GOODS AT COSTS LOW ENOUGH TO COMPETE IN INTERNATIONAL MARKETS. ITS TECHNICAL PROGRESS AND PHYSICAL PRODUCTIVITY WAS SLOW, TOO SLOW TO COMPETE WITH EUROPEAN COUNTRIES AND, LATER ON, WITH THE UNITED STATES.

AT TIMES IT SEEMED THAT BRAZIL WOULD OVERCOME ITS DIFFICULTIES AND BE CAPABLE OF FULLY INTEGRATING ITSELF INTO THE INTERNATIONAL TRADE PICTURE. DURING THE SECOND HALF OF THE PAST CENTURY COFFEE BECAME THE ABSOLUTE MASTER OF THE BRAZILIAN ECONOMY. FERTILE SOILS AND THE LOW COST OF RURAL LABOR, FAVORED BY A WORLD BOOM IN DEMAND FOR COFFEE, ENABLED THE COUNTRY TO GAIN LARGE EXPORT REVENUES. DURING THE TWENTIES, SUCCESSFUL COFFEE DEFENSE PROGRAMS BROUGHT ABOUT A SECOND BOOM. BUT THE BUBBLE DID NOT LAST. OVERPRODUCTION, STIMULATED BY LAVISH CREDIT POLICIES AND

SPECULATION, GAVE RISE TO A CHAIN OF COLLAPSES.⁴

DURING THE DEPRESSION IT BECAME APPARENT THAT BRAZIL HAD LOST A UNIQUE OPPORTUNITY TO ADAPT ITS ECONOMIC STRUCTURE TO WORLD CONDITIONS. INSTEAD OF DIRECTING A PART OF ITS EXPORT GAINS FROM COFFEE INTO MORE DIVERSIFIED PRODUCTION, BRAZIL OVERINVESTED IN ONE AREA, AND NEGLECTED OTHERS. AFTER THE DEPRESSION BRAZIL WAS INCAPABLE OF RECOVERING ITS MONOPOLISTIC POSITION AS A WORLD SUPPLIER OF COFFEE, AND HAD TOO FEW OTHER EXPORT PRODUCTS TO MEET ITS INCREASED IMPORT REQUIREMENTS.

IN SUMMARY, THERE IS GOOD REASON TO BELIEVE THAT AN ADVERSE BALANCE OF PAYMENTS WOULD HAVE PERSISTED DURING THE LAST HUNDRED YEARS EVEN WITHOUT THE IMPACT OF MONETARY INFLATION ON THE DEMAND FOR FOREIGN GOODS. HIGH PROFIT MARGINS ACCUMULATED IN THE HANDS OF A SMALL GROUP OF ENTREPRENEURS CONNECTED WITH THE COFFEE TRADE (AND LATER ON WITH OTHER BUSINESS VENTURES), IN CONJUNCTION WITH A FISCAL POLICY HAMPERING A WIDER DISTRIBUTION OF INCOMES, CAUSED A CHAIN OF UNFAVORABLE EVENTS. ON THE SUPPLY SIDE IT PREVENTED THE FACTORS OF PRODUCTION FROM SPREADING OVER A MORE DIVERSIFIED FIELD OF ACTIVITIES THUS REDUCING THE VOLUME OF EXPORTABLE GOODS. ON THE DEMAND SIDE IT CREATED A CUMULATIVE DESIRE AND PURCHASING POWER AMONG THE WEALTHY TO IMPORT, PARTICULARLY SINCE DOMESTIC REAL OUTPUT LAGGED BEHIND THE OUTPUT OF THE INDUSTRIAL NATIONS. THE RESULTING RELATIVE SHORTAGE OF NATIONAL GOODS WAS COMPENSATED FOR BY IMPORTS. FURTHERMORE, TRADE BARRIERS OF THE ADVANCED NATIONS GRADUALLY LIMITED THE EFFECTS OF COMPARATIVE COST STRUCTURES. EACH COUNTRY'S PRICE

⁴FOR MORE DETAILED REFERENCES SEE TWO PUBLICATIONS WRITTEN SHORTLY AFTER THE BREAK-DOWN BY J. W. ROWE, "BRAZILIAN COFFEE," LONDON AND CAMBRIDGE ECONOMIC SERVICE, STUDIES IN THE ARTIFICIAL CONTROL OF RAW MATERIALS, NO. 3, (LONDON, JANUARY 1932), AND: MARKETS AND MEN, (CAMBRIDGE: UNIVERSITY PRESS, 1936).

LEVEL BECAME INCREASINGLY MORE INDEPENDENT OF OTHER PRICE LEVELS. AND DUE TO THE LOW RATE OF PRODUCTIVITY, BRAZIL'S EFFORTS TO KEEP PACE WITH THE ADVANCEMENTS IN REAL PURCHASING POWER OF THE INDUSTRIAL NATIONS FAILED.

IN VIEW OF THESE DEVELOPMENTS, BRAZIL'S AND OTHER LATIN AMERICAN COUNTRIES' ATTEMPT TO ACHIEVE INCREASED ECONOMIC AUTONOMY ARE UNDERSTANDABLE. THE QUESTION IS, HOWEVER, WHETHER SUCH AN AUTONOMY CAN BE REACHED WITHIN THE NEAR FUTURE, AND WHAT HAS BEEN ACHIEVED SO FAR IN THIS CONNECTION. THIS PROBLEM SHALL BE DISCUSSED IN THE FOLLOWING TWO CHAPTERS.

V. SOME ASPECTS OF INDUSTRIALIZATION

LATIN AMERICA IS PRESENTLY UNDERGOING A PROCESS OF ECONOMIC FORMATION CHARACTERIZED BY A PRONOUNCED INSTABILITY. AMONG THE MANY QUESTIONS FOR WHICH NO SATISFACTORY ANSWER HAS YET BEEN FOUND IS THE PROBLEM OF THE MOST ADEQUATE FORM OF ADMINISTERING ECONOMIC GROWTH.

BEING PART OF THE WESTERN HALF OF A DIVIDED WORLD, LATIN AMERICA'S NATURAL TENDENCY IS TO FOLLOW THE GENERAL PATTERNS OF WESTERN BELIEFS IN BOTH MORAL AND POLITICAL MATTERS. YET SEVERAL EVENTS HAVE TURNED AGAINST THE STRICT ADHERENCE TO THIS CONVICTION, SOME OF THEM BEYOND THE PARTICULAR COUNTRIES' CONTROL. TO MENTION SOME IN THE ECONOMIC FIELD, ONE MIGHT CONSIDER THE IMPACT OF THE PROTECTIVE POLICIES OF EUROPE AND THE UNITED STATES AFTER THE INDUSTRIAL REVOLUTION, THE WORLD DEPRESSIONS, AND TWO WORLD WARS. AS A RESULT NONE OF THE LATIN AMERICAN COUNTRIES COULD MAINTAIN FREE TRADE CONDITIONS. AND AS SPECIFIC CONTROL MEASURES SELDOM REMOVED THE CAUSES OF EVIL AGAINST WHICH THEY WERE APPLIED, OTHER MEASURES FOLLOWED. TODAY THE WAY BACK TO LIBERALISM IS BARRED WITH MANY OBSTACLES, THE STRONGEST OF WHICH MAY BE THE LACK OF CONFIDENCE IN THE PRACTICAL VALUES OF A RETURN TO FREE ENTERPRISE.

THE INDECISION TO CHOOSE BETWEEN ONE OR THE OTHER SOLUTIONS IS REFLECTED NOT ONLY BY THE SOMETIMES CONTRADICTIONARY MANNER OF POLICY APPLICATION TO PARTICULAR PROBLEM SITUATIONS, BUT ALSO BY THE CONTROVERSIAL POSITION TAKEN BY SOME OF THE MOST INFLUENTIAL ECONOMISTS AND POLITICIANS.

I. LIBERALISM VERSUS PROTECTIONISM

IN RECENT YEARS THE DEBATE HAS TURNED TO THE CONTROVERSIAL ISSUE OF THE MOST DESIRABLE BALANCE BETWEEN THE PRODUCTION OF INDUSTRIAL VERSUS PRIMARY GOODS. ALTHOUGH THE PROBLEM IS GENERALLY STATED IN SPECIFIC TERMS SUCH AS THE EFFECTS OF INDUSTRIALIZATION ON PRODUCTIVITY, THE TERMS OF TRADE, OR THE DISTRIBUTION OF INCOME, THE UNDERLYING CAUSE OF DIVERGENCIES IN OPINION POINTS TO THE BASIC BELIEF OR DISBELIEF IN THE VALUES OF THE CLASSICAL AND NEO-CLASSICAL THEORIES. THUS THE PROBLEM IS REALLY ONE OF PRINCIPLES.

THE LIBERAL SCHOOL--IF ONE MAY CALL IT SO--DOES NOT GENERALLY DISAGREE WITH THE BENEFIT OR EVEN NEED FOR INDUSTRIALIZATION IN UNDERDEVELOPED COUNTRIES. HOWEVER, IT PREFERS INDUSTRIALIZATION TO RESULT FROM A NATURAL PROCESS OF DEVELOPMENT IN WHICH THE ENTREPRENEUR DECIDES WHERE TO INVEST AND WHAT FIELD TO PROMOTE. THE OPPOSITION MAINTAINS THAT INDUSTRIALIZATION CANNOT BE FULLY DEVELOPED WITHOUT GOVERNMENT ASSISTANCE AND THAT UNDERDEVELOPED COUNTRIES WOULD REMAIN IN A DISADVANTAGIOUS POSITION IN RELATION TO THE MORE ADVANCED COUNTRIES IF THEY RELY MAINLY ON THE PRODUCTION OF PRIMARY COMMODITIES.

FROM A PURELY ACADEMIC POINT OF VIEW, THE LIBERAL SCHOOL CAN PRESENT TONES OF THEORETICAL SUPPORT FROM THE MANY CLASSICAL AND NEO-CLASSICAL AUTHORS. THEREFORE, THE MAJORITY OF THE ARGUMENTS FAVORING PLANNED ECONOMY ARE NECESSARILY CONFINED TO CRITICISM OF THE CLASSICAL SCHOOL IN LIGHT OF ECONOMIC AND POLITICAL EVENTS SINCE THE BEGINNING OF THE CENTURY.¹

¹ MANY ATTEMPTS TO DEVELOP A COMPLETE THEORETICAL SCHEME OF PLANNED ECONOMY REFER CONSTANTLY BACK TO "ERRONEOUS" STATEMENTS OR ANALYSES OF THE CLASSICS. IN THE AREA OF INTERNATIONAL TRADE, SEE FOR INSTANCE: MIHAIL MANOIILESCO, THE THEORY OF PROTECTION AND INTERNATIONAL TRADE, (LONDON: P. S. KING & SON, LTD., 1931).

IN SPITE OF THE THEORETICAL SHORTCOMINGS OF PROTECTIONIST ANALYSES, THE FACT REMAINS THAT THE CALL FOR INCREASED GOVERNMENT INTERVENTION IS BECOMING LOUDER EVERY DAY IN LATIN AMERICA, MAINLY IN THE FIELDS OF INDUSTRIAL EXPANSION.

2. THE CLASSICAL THEORY AND "THE PERIPHERY"

PERHAPS THE MOST INFLUENTIAL RECENT PUBLICATION AND THE ONE THAT MOST DIRECTLY DEFENDS THE STIMULUS FOR INCREASED INDUSTRIALIZATION IN LATIN AMERICA WAS WRITTEN BY THE EXECUTIVE SECRETARY OF THE ECONOMIC COMMISSION FOR LATIN AMERICA, PROFESSOR RAUL PREBISCH.² IN SPITE OF ITS SMALL SIZE, THE BOOKLET CONTAINS A VAST AMOUNT OF VALUABLE INFORMATION, BRILLIANT ANALYSES, AND ABOVE ALL, PRESENTS SOME REVOLUTIONARY IDEAS. IN THE BEGINNING PREBISCH STATES THE BASIC ISSUE IN THE FOLLOWING WAY: "IN LATIN AMERICA REALITY IS UNDERMINING THE OUT-DATED SCHEMA OF THE INTERNATIONAL DIVISION OF LABOR.... UNDER THAT SCHEMA, THE SPECIFIC TASK THAT FELL TO LATIN AMERICA, AS PART OF THE PERIPHERY OF THE WORLD ECONOMIC SYSTEM, WAS THAT OF PRODUCING FOOD AND RAW MATERIALS FOR THE GREAT INDUSTRIAL CENTERS. THERE WAS NO PLACE WITHIN IT FOR THE INDUSTRIALIZATION OF THE NEW COUNTRIES."

WHETHER INTENDED OR NOT, THE AUTHOR IMPLIES THAT THE CLASSICAL ECONOMISTS WANTED TO ASSIGN SPECIFIC TASKS TO SPECIFIC COUNTRIES. IN THIS CONNECTION A PARAGRAPH FROM PROFESSOR VINER IS INTERESTING:

ANYONE WHO HAS THE SLIGHTEST ACQUAINTANCE WITH THE ACTUAL WRITINGS OF THE ENGLISH CLASSICAL SCHOOL KNOWS THAT INTELLECTUALLY AND TEMPERAMENTALLY THEY WERE INCAPABLE OF STAKING OUT CLAIMS TO PARTICULAR

²UNITED NATIONS, ECONOMIC COMMISSION FOR LATIN AMERICA, THE ECONOMIC DEVELOPMENT OF LATIN AMERICA AND ITS PRINCIPAL PROBLEMS, (LAKE SUCCESS, NEW YORK: 1949).-- ALL QUOTATIONS IN THIS CHAPTER, UNLESS OTHERWISE STATED, ARE FROM THE INTRODUCTION OF THIS BOOK.

INDUSTRIES FOR PARTICULAR COUNTRIES EXCEPT ON THE ONE CRITERION THAT COUNTRIES SHOULD SO ALLOCATE THEIR RESOURCES AS TO GET THE MAXIMUM ECONOMIC RETURN. WHATEVER MAY HAVE BEEN THEIR FORECASTS, THEY WOULD NOT HAVE DENIED TO LATIN AMERICA, OR TO ANY OTHER REGION, FULL RIGHT AND JUSTIFICATION TO ESTABLISH ANY KIND OF INDUSTRY WHICH GAVE GENUINE PROSPECTS OF BECOMING AN ECONOMICALLY HEALTHY INDUSTRY. THERE WAS NO PLACE IN THEIR SCHEMA FOR THE SETTling OF ECONOMIC ISSUES BY THE INVOCATION OF TERRITORIAL JEALOUSIES AND INFERIORITY-COMPLEXES.³

IF THE CLASSICAL THEORY FAILED TO BE OF PRACTICAL VALUE TO LATIN AMERICAN COUNTRIES, THE DEFAULT CANNOT BE ASCRIBED TO THE CLASSICS BUT MUST BE SOUGHT ELSEWHERE. PERHAPS THE FAILURE TO ADHERE TO CLASSICAL PRINCIPLES IN LATIN AMERICA AND OTHER REGIONS IS THE PRIMARY CAUSE OF DISTURBANCE. PREBISCH DOES NOT CONSIDER THIS POSSIBILITY, AT LEAST NOT DIRECTLY, SINCE HE CONTENDS THAT THE SCHEMA OF THE INTERNATIONAL DIVISION OF LABOR IS OUT-DATED. HE AGREES THAT "THE REASONING ON THE ECONOMIC ADVANTAGES OF THE INTERNATIONAL DIVISION OF LABOR IS THEORETICALLY SOUND, BUT THAT IT IS BASED ON AN ASSUMPTION WHICH HAS BEEN CONCLUSIVELY PROVED FALSE BY FACTS."

THEORY IS THUS EITHER PROVED OR DISPROVED BY FACTS. THIS ARGUMENT CAN BE FOUND IN ALMOST ANY BOOK FAVORING PROTECTIONISM AND GOVERNMENT INTERVENTION.⁴ DURING THE PAST FIFTY YEARS OR SO THE WORLD HAS CONTINUOUSLY ACTED AGAINST THE ESSENTIAL RECOMMENDATIONS OF ECONOMIC THEORY. BUT THIS HAS NOT CREATED A HAPPIER OR MORE BALANCED MANKIND. THEREFORE FACTS PROVE NOTHING ABOUT THE VALIDITY OR NULLITY OF ECONOMIC THEORY WHOSE FUNCTION IS TO PROVIDE US WITH A MODEL, NECESSARILY IDEAL AND

³ VINER, "TENDÊNCIAS MODERNAS DA TEORIA DO COMÉRCIO INTERNACIONAL," OP. CIT., P. 96.

⁴ ONE QUOTATION MAY ILLUSTRATE THIS: "THE PLAIN FACT IS THAT ALL ADVANCED INDIVIDUAL NATIONS HAVE MOVED AWAY FROM THE ATOMIC INDIVIDUALISM OF THE MID-NINETEENTH CENTURY" AND THEREFORE "MODERN MEN MUST ERECT A NEW SOCIAL STRUCTURE ADAPTED TO THE CHANGED CONDITIONS." FROM: ALVIN H. HANSEN, ECONOMIC POLICY AND FULL EMPLOYMENT, (NEW YORK, LONDON: MCBRAW HILL BOOK COMPANY, INC., 1947).

ABSTRACT IN NATURE, BUT USEFUL AS A BASIS FOR POLICY FORMULATION.

JUST AS EASY AS THEY MAY BE APPLIED TO DISPROVE THE TENETS UNDERLYING A LIBERAL SOCIETY, FACTS MAY BE USED TO DEMONSTRATE THE EFFICIENCY OF FREE ENTERPRISE IN SPECIFIC SITUATIONS. FOR INSTANCE, IT CAN HARDLY BE DENIED THAT THE MOST PROGRESSIVE COUNTRIES IN THE WORLD, SUCH AS THE UNITED STATES, SWITZERLAND OR CANADA, ARE MORE LIBERAL IN THEIR ECONOMIC POLICIES THAN THE LESS ADVANCED NATIONS. OTHER COUNTRIES, MAINLY GERMANY, WHICH MADE STRONG EFFORTS TO RETURN TO THE 'OUT-DATED' CLASSICAL MODELS HAVE EXPERIENCED A HIGH RATE OF DEVELOPMENT SINCE WORLD WAR II.⁵

ALL THIS PROVES, IS THAT ONE CANNOT JUMP TO CONCLUSIONS ON EMPIRICAL EVIDENCE ALONE. IN SOCIAL SCIENCES FACTS ARE ILLUSTRATIVE AND SOMETIMES INDICATIVE OF TRENDS OR EVENTUAL LAWS, BUT NEVER CONCLUSIVE PROOF OF A THEORY'S FINAL VALIDITY.

FORTUNATELY, PREBISCH DOES NOT CONTENT HIMSELF WITH A MERE STATEMENT OF FACTS. HE SPECIFIES THAT THE "FALSE ASSUMPTIONS" UNDERLYING THE REASONING ON THE ECONOMIC ADVANTAGES OF THE INTERNATIONAL DIVISION OF LABOR ARE THAT "THE BENEFITS OF TECHNICAL PROGRESS TEND TO BE DISTRIBUTED ALIKE OVER THE WHOLE COMMUNITY, EITHER BY THE LOWERING OF PRICES OR THE CORRESPONDING RAISING OF INCOMES....IF BY THE COMMUNITY ONLY THE GREAT INDUSTRIAL COUNTRIES ARE MEANT, IT IS INDEED TRUE THAT THE BENEFITS OF TECHNICAL PROGRESS ARE GRADUALLY DISTRIBUTED AMONG ALL SOCIAL GROUPS AND CLASSES. IF, HOWEVER, THE CONCEPT OF THE COMMUNITY IS EXTENDED TO INCLUDE THE PERIPHERY OF THE WORLD ECONOMY, A SERIOUS ERROR IS

⁵ IN THIS CONNECTION THE FOLLOWING QUOTATION MAY BE OF INTEREST:
"GERMANY'S ADOPTION OF A POLICY OF FREE MARKETS AND FREE ENTERPRISE... DOES NOT IMPLY AN ECONOMY ALTOGETHER FREE FROM GOVERNMENT INTERVENTION....BUT IT DOES REPRESENT A SHARP CHANGE OF DIRECTION, AND THERE IS AMPLE JUSTIFICATION FOR REGARDING FREEDOM AS THE KEY NOTE OF GERMAN ECONOMIC POLICY." FROM: HENRY C. WALLICH, MAINSRING OF THE GERMAN REVIVAL, (NEW HAVEN: YALE UNIVERSITY PRESS, 1955).

IMPLICIT ON THE GENERALIZATION."

IMPLIED IN THE ABOVE IDEA IS THE ASSUMPTION THAT TECHNICAL PROGRESS IS LARGELY IDENTICAL WITH INDUSTRIALIZATION, IN OPPOSITION TO A RELATIVELY SLOWER RATE OF PROGRESS IN THE PRODUCTION OF PRIMARY GOODS. SOME AUTHORS BELIEVE THAT THIS IS NOT NECESSARILY SO. BUT FOR THE SAKE OF ARGUMENT, LET US ACCEPT THE THESIS NOW AND RETURN TO IT LATER.

3. THE INTERNATIONAL DIVISION OF LABOR

IF IT IS CORRECT THAT THE BENEFITS OF TECHNICAL PROGRESS HAVE SPREAD OVER THE COMMUNITIES OF THE INDUSTRIAL CENTERS, THERE IS NO REASON WHY THEY SHOULD NOT SPREAD OVER THE COMMUNITIES OF THE PERIPHERY, UNLESS SOMETHING PREVENTS THEM FROM DOING SO. WHAT IS THIS "UNLESS"? PREBISCH EXPLAINS IT IN TERMS OF RELATIVE INCREASES IN THE RATE OF PRODUCTIVITY, OF PRICES AND INCOME IN THE INDUSTRIAL CENTERS COMPARED TO THE PERIPHERY. THE FOLLOWING IS A SUMMARY OF HIS LINE OF THOUGHT.⁶

FIRST, IT CAN BE DEMONSTRATED THAT THE RATE OF INCREASE IN PRODUCTIVITY HAS BEEN GREATER FOR THE PRODUCTION OF MANUFACTURED GOODS THAN FOR PRIMARY GOODS. SECONDLY, THERE ARE TWO WAYS OF DISTRIBUTING THE BENEFITS OF INCREASED PRODUCTIVITY OVER THE ECONOMY, ONE THROUGH A PRICE DECREASE ROUGHLY PROPORTIONAL TO THE INCREASE IN PRODUCTIVITY, THE OTHER THROUGH AN INCREASE IN THE REMUNERATION TO THE FACTORS OF PRODUCTION. BOTH METHODS LEAD TO AN IMPROVEMENT IN THE STANDARD OF LIVING OF THOSE AFFECTED BY THE CHANGE. THE SECOND METHOD, HOWEVER, DOES NOT NECESSARILY AFFECT THE PERIPHERY SINCE IT WILL NOT CAUSE A REDUCTION IN THE PRICES

⁶ IN ORDER NOT TO SPEND MUCH SPACE WITH THE REPRODUCTION OF THE POINTS INVOLVED, THE ANALYSIS IS GREATLY SIMPLIFIED. WE THEREFORE REFER THE READER BACK TO THE ORIGINAL PUBLICATION MENTIONED IN FOOTNOTE ON P. 44 OF THIS STUDY.

OF EXPORT GOODS IN THE INDUSTRIAL CENTERS. UNFORTUNATELY FOR LATIN AMERICA, THE INDUSTRIAL CENTERS, AND IN PARTICULAR THE UNITED STATES, HAVE SELECTED THE SECOND WAY, OR THE HIGHER REMUNERATION OF THE FACTORS OF PRODUCTION TO COMPENSATE FOR INCREASED PRODUCTIVITY. CONSEQUENTLY, THE AVERAGE PRICES OF INDUSTRIAL GOODS WENT UP RATHER THAN REMAINED STABLE DURING THE LAST DECADES. IF THE CONTRARY HAD HAPPENED, THE PERIPHERY WOULD HAVE DIRECTLY BENEFITED FROM THE IMPROVEMENT OF PRODUCTIVITY THROUGH THE IMPORTATION OF MANUFACTURED GOODS. THE SITUATION WAS AGGRAVATED BY THE FACT THAT THE PRICE INCREASE OF PRIMARY COMMODITIES LAGGED BEHIND THE PRICE INCREASE OF MANUFACTURED GOODS. SINCE LATIN AMERICA IS A POTENTIAL EXPORTER OF PRIMARY GOODS AND A POTENTIAL IMPORTER OF INDUSTRIAL GOODS, THE EXPORT-IMPORT RATIO TURNED AGAINST THE UNDERDEVELOPED AND FAVORED THE ADVANCED AREAS.⁷

FROM THIS ANALYSIS PREBISCH DRAWS TWO CONCLUSIONS. ONE IS THAT THE DISEQUILIBRIUM RESULTING FROM THE DESCRIBED EVENTS "DESTROYS THE BASIC PREMISE UNDERLYING THE SCHEMA OF THE INTERNATIONAL DIVISION OF LABOR." WHAT HE MEANS IS NOT ABSOLUTELY CLEAR. IF HE CONTENDS THAT THE EVENTS PROVE THE FALSENESS OF THE THEORY OF INTERNATIONAL DIVISION OF LABOR, SOME QUESTIONS ARISE. WHAT HAPPENED WAS THAT THE COUNTRIES WHERE TECHNICAL PROGRESS OR THE IMPROVEMENT OF THE RATE OF PRODUCTIVITY ADVANCED FASTER THAN IN OTHERS, CREATED ARTIFICIAL TRADE BARRIERS TO DELIBERATELY PREVENT THE DISTRIBUTION OF BENEFITS OVER THE WORLD. IN SOME COUNTRIES, THE BARRIERS TOOK THE FORM OF TARIFFS AND RATES IMPOSED ON IMPORTS. IN OTHERS, AND THIS HAS APPARENTLY BEEN MORE EFFECTIVE, THE INTERNATIONAL MOVEMENT OF LABOR WAS PREVENTED BY STRICT IMMIGRATION LAWS. FOR INSTANCE, IT IS VERY UNLIKELY THAT THE UNITED STATES COULD PRESERVE ITS LEAD IN WORLD ECONOMY IF LABOR WOULD

⁷FOR SPECIFIC DATA SINCE 1881-85 UNTIL THE WORLD WAR II, SEE: UNITED NATIONS, THE ECONOMIC DEVELOPMENT OF LATIN AMERICA AND ITS PRINCIPAL PROBLEMS, OP. CIT., P. 9.

MOVE FREELY AMONG THE NATIONS. IN THIS CASE, IMMIGRATION TO THE UNITED STATES WOULD CONTINUE AS LONG AS REAL WAGE RATES REMAINED HIGHER THERE THAN ELSEWHERE. FURTHERMORE, ANY IMPROVEMENT IN AMERICAN PRODUCTIVITY WOULD CAUSE A DECREASE IN THE PRICE LEVEL RATHER THAN AN INCREASE IN NOMINAL INCOME, DUE TO THE GROWING LABOR SUPPLY. CONSEQUENTLY, ALL COUNTRIES TRADING WITH THE UNITED STATES WOULD BENEFIT FROM TECHNICAL PROGRESS, AND, IF ALL BARRIERS WERE REMOVED, INDIVIDUAL PRICE LEVELS WOULD AUTOMATICALLY ADAPT THEMSELVES TO ONE WORLDWIDE LEVEL.

ON THE OTHER HAND, IF PREBISCH MEANS NOTHING ELSE BY HIS "BASIC PREMISE" BUT THAT THE INTERNATIONAL DIVISION OF LABOR WILL NOT BE EFFECTIVE BECAUSE OF EXISTING TRADE BARRIERS, ONE CANNOT OBJECT. IN ALL PROBABILITY THIS IS A SOUNDER PROPOSITION AND ON THIS BASIS ONE MAY ASSERT THAT LATIN AMERICAN COUNTRIES SHOULD NOT WAIT FOR BETTER DAYS TO COME OR THE REMOVAL OF BARRIERS IN THE ADVANCED COUNTRIES BUT REACT AND ADAPT THEIR ECONOMIES TO CHANGING CONDITIONS. THE QUESTION IS, WHAT KIND OF ACTION IS MOST APPROPRIATE.

FOR PREBISCH THE ANSWER IS CLEAR. HE RECOMMENDS INTENSIFIED INDUSTRIALIZATION WHICH "IS NOT AN END IN ITSELF, BUT THE PRINCIPAL MEANS AT THE DISPOSAL OF THOSE (NEW) COUNTRIES OF OBTAINING A SHARE OF THE BENEFITS OF TECHNICAL PROGRESS AND OF PROGRESSIVELY RAISING THE STANDARD OF LIVING OF THE MASSES." ACCORDING TO PREBISCH, THE EXTENT OF INDUSTRIAL EXPANSION SHOULD BE DETERMINED BY ITS RELATIVE CAPACITY TO INCREASE THE RATE OF PRODUCTIVITY. IN OTHER WORDS, IF A POTENTIAL INVESTOR WOULD BE WILLING TO APPLY HIS CAPITAL IN EITHER INDUSTRIAL OR AGRICULTURAL PRODUCTION, AND IF THE FORMER WAY PROMISES TO BE MORE PRODUCTIVE, HE SHOULD GIVE PREFERENCE TO IT. IN ANOTHER CASE, IT WOULD BE PREFERABLE TO DIVERT FACTORS OF PRODUCTION FROM PRIMARY SOURCES INTO INDUSTRY AND THUS REDUCE

THE VOLUME OF EXPORTS, IF THE AMOUNT OF GOODS PRODUCED DOMESTICALLY WOULD BE GREATER THAN WHAT COULD BE OBTAINED IN~~E~~XCHANGE FOR EXPORTS.

AS FAR AS THESE OR SIMILAR POLICIES WOULD ACTUALLY LEAD TO AN IMPROVEMENT IN THE STANDARD OF LIVING OF THE BRAZILIAN POPULATION, THEY SHOULD, NO DOUBT, BE ADOPTED. THE PROBLEM THEN IS, UNDER WHAT CIRCUMSTANCES PRODUCTIVITY POLICIES CAN BE MADE EFFECTIVE.

VI. RELATIVE PRODUCTIVITY AND FOREIGN TRADE

THE LAST CHAPTER RAISED A QUESTION MERITING INVESTIGATION.

I. AGRICULTURAL AND INDUSTRIAL PRODUCTIVITY

FIRST, THE WIDELY DISPERSED OPINION THAT PRODUCTIVITY IS HIGHER IN SECONDARY THAN IN PRIMARY PRODUCTION MUST BE DISCUSSED. MANOILESCO CALLED THIS PLAINLY "THE INTRINSIC INFERIORITY OF AGRICULTURE OPPOSED TO THE INTRINSIC SUPERIORITY OF INDUSTRY."¹ HE TRIED TO PROVE THIS BY COMPARING AGRICULTURAL AND OTHER ACTIVITIES' INCOMES OF SEVERAL COUNTRIES ON THE BASIS OF LABOR EMPLOYED. THE COMPARISON, HOWEVER, IS MADE IN PURELY NOMINAL TERMS. IT DISREGARDS REAL INCOME ITEMS OF THE RURAL POPULATION, SUCH AS FOOD PRODUCED LOCALLY, SAVINGS DERIVED FROM LESSER USE OF CLOTHING, LAUNDRY, TRANSPORTATION, PUBLIC UTILITY SERVICES, AND MANY OTHERS.² WHATEVER THE TRUE RELATIONSHIP BETWEEN AGRICULTURAL AND INDUSTRIAL PRODUCTIVITY MAY BE, A COMPARISON OF NOMINAL INCOMES DOES NOT PROVE ANYTHING.

UNFORTUNATELY, THE IMMEDIATE IMPRESSIVENESS OF SUCH ANALYSES HAS LED PEOPLE TO JUMP TO PREMATURE CONCLUSIONS. ECONOMIC MATTERS ARE, HOWEVER, MUCH MORE COMPLEX THAN THEY APPEAR ON THE SURFACE. THIS CAN BE

¹ MANOILESCO, OP. CIT., P. 40.

² AN OFT CITED STUDY OF THE US DEPARTMENT OF AGRICULTURE MADE IN 1941 DEMONSTRATED THAT THE NOMINAL INCOME OF LOW-INCOME FARMERS IN THE US WOULD HAVE TO BE RAISED BY TWO THIRDS TO BECOME COMPARABLE TO URBAN INCOMES.

ILLUSTRATED BY THE FACT THAT THERE ARE POPULATIONS WITH A HIGH PER CAPITA INCOME BOTH AMONG PREDOMINANTLY AGRICULTURAL COUNTRIES, LIKE NEW ZEALAND, DENMARK, OR AUSTRALIA, AND COUNTRIES WITH A MIXED AGRICULTURAL AND INDUSTRIAL ECONOMY, LIKE THE UNITED STATES, CANADA, OR SWITZERLAND. APPARENTLY WHAT SEEMS TO BE THE ONLY PERMISSABLE CONCLUSION IN THE ABSENCE OF FULLY RELIABLE DATA IS THAT NO GENERALIZATION CAN BE DRAWN WHEN THE ANALYSIS IS BASED ON SPECIFIC AREAS.

MANOILESCO'S BOOK IS OVER TWENTY-FIVE YEARS OLD. IT MAY BE CONTENTED, THEREFORE, THAT ITS ARGUMENTS HAVE BECOME ARCHAIC. YOUNGER AUTHORS, HOWEVER, HAVE DEFENDED SIMILAR THESES.³ IN BRAZIL, THE DUBIOUS THEORY THAT THE RATE OF PRODUCTIVITY NECESSARILY INCREASES MORE IN INDUSTRY THAN IN AGRICULTURE HAS FOUND MANY PARTISANS. TO SOME EXTENT THIS MUST BE ATTRIBUTED TO HEAVY ACCUMULATIONS OF PRIVATE INCOMES IN SOME INDUSTRIES CREATING FAVORABLE PUBLIC IMPRESSIONS. THE ACCUMULATION RESULTED FROM A COMBINATION OF FACTORS HAVING LITTLE OR NOTHING TO DO WITH PRODUCTIVITY. AMONG THEM WAS THE INFLATIONARY STIMULUS OF NOMINAL INCOMES, THE DISPARITY BETWEEN COST (MAINLY WAGES) AND PRICES, THE GENERAL SCARCITY OF MANUFACTURED GOODS, THE LACK OF A PROPERLY PROGRESSIVE RATE OF TAXATION, AND THE IMPORTATION OF CHEAP EQUIPMENT AT FAVORABLE, CONTROLLED EXCHANGE RATE. IT IS DOUBTFUL THAT THE RESULTING INCREASE IN INDUSTRIAL INCOME HAS CONTRIBUTED MUCH TO THE IMPROVEMENT OF THE OVER-ALL STANDARD OF LIVING. A FRANK AND COURAGEOUS STATEMENT ON THIS MATTER WAS MADE NOT LONG AGO BY BRAZIL'S FORMER MINISTER OF FINANCE, PROFESSOR E. GUDIN. HE WROTE (LITERALLY TRANSLATED): "WHAT I AM AGAINST ARE THOSE LAZY INDUSTRIES THAT AMASS FORTUNES FOR A MINORITY OF PRIVILEGED PERSONS AT THE EXPENSE

³ SEE, FOR INSTANCE: H. W. SINGER, "THE DISTRIBUTION OF GAINS BETWEEN INVESTING AND BORROWING COUNTRIES," AMERICAN ECONOMIC REVIEW, PROCEEDINGS, MAY, 1950, PP. 472-494.

OF THE CONSUMER UNDER A REGIME OF HIGH PRICES AND A VERY LOW PRODUCTIVITY."⁴ IN THE SAME ARTICLE ON PRODUCTIVITY, GUDIN DEMONSTRATES THAT, MEASURED IN REAL TERMS ON THE BASIS OF AVAILABLE FIGURES, THE RATE OF PRODUCTIVITY ROSE IN THE INDUSTRIAL AND THE AGRICULTURAL SECTORS AS FOLLOWS: IN THE FORMER BY 25% BETWEEN 1939 AND 1949, IN THE LATTER BY 28% TO 34% BETWEEN 1939 AND 1952.⁵ MORE RECENT FIGURES SHOW THAT AGRICULTURAL PRODUCTIVITY HAS IMPROVED BY 29% BETWEEN 1948 AND 1955.⁶ NEVERTHELESS, PRODUCTIVITY IS STILL VERY LOW IN BOTH SECTORS, AS WAS WELL DEMONSTRATED BY TWO INDEPENDENT REPORTS.⁷

2. THE DEPENDENCE ON EXPORTS

A COUNTRY THAT CAN REASONABLY EXPECT TO BECOME SELF-SUFFICIENT BY STIMULATING ONE OR ANOTHER SECTOR OF PRODUCTION MUST NOT BE CONCERNED WITH THE EFFECTS OF SUCH POLICY ON ITS FOREIGN TRADE. IT MAY DERIVE SOME PRODUCTION FACTORS FROM A SECTOR WHERE THEY ARE MORE PRODUCTIVE, TO EXPAND ANOTHER SECTOR EVEN IF THIS WOULD RESULT IN A DETERIORATION OF ITS TERMS OF TRADE, AS IN THE LONG-RUN IT WOULD BENEFIT FROM TWO POSSI-

⁴E. GUDIN, "PRODUTIVIDADE," REVISTA BRASILEIRA DE ECONOMIA, ANO 8, NÚMERO 3; (RIO DE JANEIRO, SEPTEMBER 1954), P. 22.

⁵IBID., P. 25.

⁶CONJUNTURA ECONÔMICA, ANO X, NO. 1, JANUARY 1956, P. 32.

⁷THE FIRST TECHNICAL STUDY ON LATIN AMERICAN PRODUCTIVITY WAS PREPARED BY THE UNITED NATIONS' ECONOMIC COMMISSION FOR LATIN AMERICA. IT IS ENTITLED LABOUR PRODUCTIVITY OF THE COTTON INDUSTRY IN FIVE LATIN AMERICAN COUNTRIES, (NEW YORK, 1951), AND SHOWS THAT 91% OF THE SPINDLES AND 95% OF THE LOOMS IN THE BRAZILIAN TEXTILE INDUSTRY WERE OUT-OF-DATE AT THE TIME THE STUDY WAS MADE.

THE OTHER REFERENCE DEALING IN ITS THIRD CHAPTER WITH THE OVER-ALL PROBLEM OF PRODUCTIVITY IN BRAZIL IS: CONSELHO NACIONAL DE ECONOMIA, RELATÓRIO PARA O ANO DE 1953, (RIO DE JANEIRO, 1954).

BLE ADVANTAGES: (1) IT WOULD BECOME LESS DEPENDENT ON THE FOREIGN SUPPLY OF CERTAIN GOODS ESSENTIAL TO ITS DEVELOPMENT; (2) IT CAN EXPECT TO BECOME A COMPETITIVE EXPORTER OF GOODS IT FORMERLY HAD TO IMPORT. ON THESE BASES A PROTECTIVE POLICY, FOR INFANT INDUSTRY, MAY BE ADVISABLE, PARTICULARLY AS A MEANS OF SELF-DEFENSE AGAINST PROTECTIVE MEASURES APPLIED BY A PARTNER OF TRADE. THIS DOES NOT MEAN, HOWEVER, THAT THE POLICY CONTRIBUTES TO THE OVER-ALL STIMULUS OF WORLD PRODUCTIVITY. ON THE CONTRARY, IT GRADUALLY DESTROYS THE ADVANTAGES THAT CAN BE DERIVED FROM THE INTERNATIONAL DIVISION OF LABOR OR FROM THE COMPARATIVE COST STRUCTURE OF THE COUNTRIES INVOLVED IN INTERNATIONAL TRADE. NEVERTHELESS, IT WOULD BE SHORT-SIGHTED IF THE UNDERDEVELOPED AREAS WOULD WAIT FOR THE MORE ADVANCED ECONOMIES TO RETURN TO FREE TRADE MERELY BECAUSE THEY COULD DERIVE DIRECT ADVANTAGES FROM IT. IT IS, THEREFORE, NECESSARY TO DEAL IN REALISTIC TERMS AND TO ASK WHAT A COUNTRY LIKE BRAZIL, THAT CANNOT EXPECT TO GAIN ECONOMIC AUTONOMY IN THE NEAR OR DISTANT FUTURE, WOULD HAVE TO DO TO IMPROVE ITS INTERNATIONAL POSITION.

BRAZIL COULD BY NO MEANS INDUSTRIALIZE WITHOUT FOREIGN SUPPORT. DESPITE THE NEED FOR FOREIGN INVESTMENTS, INDIRECT SUPPORT IS REQUIRED THROUGH THE IMPORTATION OF EQUIPMENT AND TECHNICAL KNOW-HOW. EVEN IF IT WOULD BE POSSIBLE TO BUILD UP THE INDUSTRY WITHOUT EXTERNAL HELP, THIS WOULD RESULT IN A HEAVY WASTE CAUSED BY LACK OF EXPERIENCE, CAPITAL, BASIC TOOLS, AND INEFFICIENT PRODUCTION METHODS. LITTLE OF THE SKILL DEVELOPED BY THE MORE ADVANCE COUNTRIES COULD BE USED, TO THE DETRIMENT OF BRAZILIAN PRODUCTIVITY. IT IS THUS OBVIOUS THAT AN EXCLUSIVELY NATIONAL DEVELOPMENT PROGRAM WOULD ONLY BE ADVISABLE UNDER UNUSUAL CIRCUMSTANCES, FOR INSTANCE A WAR ECONOMY OR UNDER THE THREAT OF A DEPRESSION AND UNEMPLOYMENT. IN NORMAL TIMES, FOREIGN PARTICIPATION IS NOT ONLY NECES-

SARY BUT ALSO CONVENIENT. THE CONVENIENCE IS EXPRESSED IN THE BENEFIT THAT CAN BE DERIVED FROM THE USE OF FOREIGN TOOLS AND EQUIPMENT TO IMPROVE PRODUCTIVITY.

ON THE OTHER HAND, BRAZIL MUST IMPORT AND, THEREFORE, EXPORT MORE AND MORE AS IT INDUSTRIALIZES. THIS IS PARTIALLY DUE TO THE IMMEDIATE DEPENDENCE ON FOREIGN EQUIPMENT AND CAPITAL, BUT ALSO DUE TO THE FEEDER EFFECT. MOST INDUSTRIES DEPEND ON OUTSIDE SUPPLIES TO DEVELOP THEIR PRODUCTS, AND THE SUPPLIERS, IN TURN, DEPEND ON FOREIGN CAPITAL TO LAUNCH THIS PRODUCTION. FOR INSTANCE, THE DEVELOPMENT OF THE AUTOMOTIVE INDUSTRY HAS, IN RECENT YEARS, ENCOUNTERED GREAT OBSTACLES, IN CONSEQUENCE OF THE DIFFICULTIES IN SECURING LOCAL SUPPLIES OF PARTS AT SUFFICIENT QUANTITIES AND/OR SATISFACTORY QUALITIES. THIS ILLUSTRATES THAT ONE STEP IN INDUSTRIAL EXPANSION USUALLY CALLS FOR ANOTHER, AND BEFORE ONE INDUSTRY IS SUFFICIENTLY EQUIPPED TO SATISFY POTENTIAL DEMAND FOR ITS PRODUCTS, SUBSIDIARY INDUSTRIES MUST DEVELOP.

AS BRAZIL'S ABILITY TO EXPAND ITS OVER-ALL PRODUCTION CAPACITY IS DETERMINED BY THE LIMITATIONS OF LABOR AND CAPITAL FORMATION, ONLY A COMPARATIVELY SMALL SHARE OF PRODUCTIVE EFFORTS CAN BE INVESTED IN INDUSTRY. THE BULK OF THESE EFFORTS MUST BE RESERVED FOR PRIMARY PRODUCTION REQUIRED FOR DOMESTIC CONSUMPTION AND EXPORTS. IN RECENT YEARS THE FAST EXPANSION OF PER CAPITA INCOME IN BRAZIL GREATLY STIMULATED THE DEMAND FOR HOME PRODUCED (AND IMPORTED) GOODS. CONSEQUENTLY THE RATIO OF PRIMARY PRODUCTION AVAILABLE FOR LOCAL CONSUMPTION AND FOR EXPORTS HAS TURNED AGAINST THE LATTER.⁸ THIS IN CONJUNCTION WITH OTHER FACTORS DISCUS-

⁸THIS IS REFLECTED BY THE FOLLOWING AGRICULTURAL PRODUCTION INDEX (1950 = 100):

	<u>1952</u>	<u>1953</u>	<u>1954</u>	<u>1955</u> (PROVISIONAL)
FOR EXPORTS	111.4	99.7	99.8	107.5
FOR DOMESTIC CONSUMPTION	101.4	107.9	117.9	123.7

SOURCE: UNITED NATIONS, ECONOMIC COMMISSION FOR LATIN AMERICA, ECONOMIC BULLETIN FOR LATIN AMERICA, VOL. I, NO. 1, (SANTIAGO, CHILE, JANUARY 1950), P. 17.

SED IN LATER CHAPTERS) REDUCED THE VOLUME OF EXPORTS AND THE AVAILABILITY OF FOREIGN EXCHANGE FOR IMPORTS. SINCE EXCHANGE PRIORITY IS GIVEN TO SOME IMPORT COMMODITIES (MAINLY OIL AND ITS BY-PRODUCTS, WHEAT AND FLOUR, AND NEWSPRINT) THE IMPORTATION OF FINISHED CONSUMER GOODS, AND OF MACHINERY REQUIRED FOR INDUSTRIALIZATION HAS SUFFERED A SHARP DECREASE. THIS TREND IS BOUND TO CONTINUE IN THE NEAR FUTURE AND IMPOSE FURTHER LIMITATIONS ON THE COUNTRY'S DEVELOPMENT.

THERE IS REASON TO BELIEVE THAT THE PROBLEM SITUATION COULD HAVE BEEN AVOIDED, AT LEAST PARTIALLY, HAD EFFORTS BEEN CONCENTRATED MORE HEAVILY ON THE DEVELOPMENT OF PRIMARY PRODUCTION WITH SPECIAL EMPHASIS LAID UPON PRODUCTIVITY. HERE, THE FIELD IS PRACTICALLY UNLIMITED. NOT ONLY CAN THE PRESENT AGRICULTURAL AND MINERAL OUTPUT BE IMPROVED AND INCREASED THROUGH BETTER TECHNICAL METHODS OR FERTILIZATION, BUT ALSO A WIDE VARIETY OF YET UNEXPLORED COMMODITIES CAN BE TAPPED AND DEVELOPED. IT IS TOO EASILY FORGOTTEN THAT BRAZIL IS PERHAPS THE COUNTRY WITH THE WORLD'S LARGEST WEALTH IN NATURAL RESOURCES.

BY INTENSIFYING THE PRODUCTION OF PRIMARY COMMODITIES A CONTROL OVER TWO MAJOR PROBLEM AREAS CAN BE EXPECTED. FOR ONE, A GRADUAL LIBERATION OF PRODUCTION FACTORS IN UNDERPOPULATED AND UNDERDEVELOPED PARTS OF THE COUNTRY WOULD CONTRIBUTE TOWARD A RE-ESTABLISHMENT OF ECONOMIC EQUILIBRIUM. CAPITAL AND LABOR WOULD BE DIVERTED FROM THE MAJOR POPULATION CENTERS, THE CONSTRUCTION OF HIGHWAYS AND RAILROADS INTO THE "INTERIOR" WOULD BECOME MORE WORTHWHILE, COMMUNICATIONS WOULD IMPROVE, AND THE STANDARD OF LIVING OF THE RURAL AREAS WOULD BE RAISED. SECONDLY, A WIDER RANGE OF EXPORTABLE PRODUCTS WOULD PROVIDE FOR AN INCREASE IN THE VOLUME OF EXPORTATION AND RELIEVE THE PRESSURE ON THE BALANCE OF PAYMENTS. NO DOUBT, TO CARRY OUT THE PLAN IN ALL ITS PHASES WOULD ALSO HAVE

A SLACKENING EFFECT ON INDUSTRIAL PROGRESS, AT LEAST IN THE BEGINNING AND UNTIL INCREASING EXPORTS ALLOW FOR INCREASED IMPORTS OF EQUIPMENT AND MACHINERY. THIS TRANSITORY DISADVANTAGE WOULD BE MORE THAN OVER-COMPENSATED BY THE BENEFITS DERIVED FROM THE RESULTING REDISTRIBUTION OF INCOME AND A NEWLY FOUND BALANCE. IT MUST BE STRESSED, HOWEVER, THAT THE DOMESTIC DEVELOPMENT PROGRAM WOULD HAVE TO BE ACCOMPANIED BY A FISCAL REORGANISATION AIMED AT CHECKING INFLATION.

3. PRODUCTIVITY AND FOREIGN TRADE

ANOTHER MATTER DESERVING ATTENTION IS THE RELATIVE PRODUCTIVITY AT HOME AND ABROAD. THERE IS LITTLE DOUBT THAT BRAZIL'S PRODUCTIVITY IN BOTH SECTORS, THE PRIMARY AND SECONDARY, IS LOWER THAN IN MOST HIGHLY INDUSTRIALIZED COUNTRIES. FURTHERMORE, IT SEEMS TO BE TRUE THAT PRODUCTIVITY IN PRIMARY PRODUCTION IS NOT AS LOW IN BRAZIL COMPARED TO PRIMARY PRODUCTION ABROAD AS IN DOMESTIC SECONDARY PRODUCTION/COMPARED TO SECONDARY PRODUCTION IN MORE ADVANCED COUNTRIES. OF COURSE, THERE ARE NO MEANS AVAILABLE TO PROVE THIS POINT MATHEMATICALLY, BUT SEVERAL INDICATIONS BEAR IT OUT. ONE IS RELATED TO THE COMPARATIVELY CHEAP BRAZILIAN COST OF LABOR WHICH CONSTITUTES THE MAIN COST FACTOR IN AGRICULTURE. ANOTHER IS THE LOW DEGREE OF MECHANIZATION AND MASS PRODUCTION IN THE BRAZILIAN AS COMPARED TO THE AMERICAN OR EVEN AVERAGE EUROPEAN INDUSTRY. PERHAPS THE STRONGEST EVIDENCE CAN BE DERIVED FROM THE INABILITY OF BRAZILIAN MANUFACTURED GOODS TO COMPETE IN THE INTERNATIONAL MARKET.⁹

AS A CONSEQUENCE OF WIDE DISCREPANCIES BETWEEN SECONDARY PRODUCTIVITY AT HOME AND ABROAD, BRAZIL HAS LITTLE HOPE TO BECOME A POTENTIAL EX-

⁹DURING THE SECOND WORLD WAR BRAZIL SUCCEEDED TO EXPORT INDUSTRIAL COMMODITIES--MAINLY TEXTILES TO SOUTH AFRICA--BUT IMMEDIATELY LOST ITS OVERSEAS' MARKETS AFTER PRE-WAR COMPETITORS REAPPEARED.

PORTER OF MANUFACTURED GOODS. THEREFORE, WHATEVER THE TRUE RELATIONSHIP BETWEEN PRODUCTIVITY IN INDUSTRY AND AGRICULTURE MAY BE, INDUSTRIALIZATION MUST PRIMARILY BE FINANCED THROUGH THE EXPORTATION OF PRIMARY GOODS.

IN SUMMARY, TO INDUSTRIALIZE MORE INTENSIVELY, BRAZIL MUST EXPORT INCREASINGLY MORE GOODS, OR IT MUST DO EXACTLY WHAT IT TRIES TO OVERCOME BY INDUSTRIALIZATION, NAMELY TO REDUCE ITS VOLUME OF TRADE. LITTLE CAN BE DONE TO ESCAPE THIS VICIOUS CIRCLE.

VII. SOURCES OF DISEQUILIBRIUM AND METHODS OF CONTROL

IN CHAPTER FOUR CERTAIN ASSUMPTIONS WERE MADE CONCERNING THE WAY BRAZIL'S BALANCE OF PAYMENTS SUFFERED FROM FUNDAMENTAL CAUSES OF DISEQUILIBRIUM. IT WAS STATED THAT AN ADVERSE TREND WOULD HAVE DEVELOPED EVEN IN THE ABSENCE OF MONETARY INFLATION, AS WELL AS UNDER THE EXISTENCE OF BALANCED FOREIGN CAPITAL ACCOUNTS, AND UNITARY ELASTICITIES FOR EXPORT AND IMPORT COMMODITIES. THE ONLY SIGNIFICANT CONDITIONS WERE TRADE BARRIERS ALLOWING FOR INDEPENDENT CHANGES IN THE COST AND PRICE LEVELS AMONG COUNTRIES.

THE PURPOSE OF THIS CHAPTER IS TO FURTHER ELABORATE THE ABOVE LINE OF THOUGHT, TO CONSIDER HOW THE BALANCE OF PAYMENTS DISEQUILIBRIUM WAS AGGRAVATED BY MONETARY FACTORS, AND TO DISCUSS THE EFFECTIVENESS OF QUANTITATIVE RESTRICTIONS AND EXCHANGE CONTROL.

1. THE DEMONSTRATION EFFECT

ONE POINT NOT YET COMPLETELY DISCUSSED IS WHY THE DEMAND FOR FOREIGN GOODS EXCEEDS THE DEMAND FOR BRAZILIAN GOODS ABROAD. TO SOME EXTENT THIS MAY BE ATTRIBUTED TO A LOW VOLUME OF EXPORTS, HOWEVER, THIS DOES NOT EXPLAIN THE DISCREPANCY BETWEEN FOREIGN AND BRAZILIAN DEMAND. USUALLY A REDUCTION IN EXPORTS AUTOMATICALLY CALLS FOR A PROPORTIONAL REDUCTION IN IMPORTS. WHY IS THIS NOT THE CASE?

THE ANSWER TO THIS QUESTION IS PROVIDED BY TWO AUTHORS. IN HIS BOOK ON INCOME AND CONSUMER BEHAVIOR DR. J. S. DUESENBERY DEVELOPS A THEORY ACCORDING TO WHICH THE INDIVIDUAL PROPENSITY TO CONSUME IS GREAT-

LY STIMULATED BY THE SURROUNDING WORLD, NEW OR BETTER ARTICLES, NEW PROCESSES AND APPEALS STIMULATE PEOPLE TO SPEND MORE. THE AUTHOR APPROPRIATELY CALLS THIS THE "DEMONSTRATION EFFECT."¹ PROFESSOR NURKSE APPLIED THE THEORY TO THE INTERNATIONAL PLANE.² HE WRITES: "THE INTENSITY OF THE ATTRACTION EXERCISED BY THE CONSUMPTION STANDARDS OF THE ECONOMICALLY ADVANCED COUNTRIES--THE DEMONSTRATION EFFECT ON THE INTERNATIONAL PLANE--IS DETERMINED BY TWO FACTORS. ONE IS THE SIZE OF DISPARITIES IN REAL INCOME AND CONSUMPTION LEVELS. THE OTHER IS THE EXTENT OF PEOPLE'S AWARENESS OF THEM."³

THE IMPROVEMENT IN INTERNATIONAL COMMUNICATIONS IN THE LAST FEW DECADES HAS ESTABLISHED MORE CONTACT BETWEEN NATIONS. MOVIES, TELEVISION, RADIO, AND ABOVE ALL THE ADDED FACILITIES OF INTERNATIONAL TRAVEL HAVE GIVEN THE CITIZENS OF UNDERDEVELOPED COUNTRIES MORE OPPORTUNITY TO BECOME AWARE OF THEIR RELATIVELY LOWER LEVELS OF LIVING. THEIR DESIRE FOR FOREIGN GOODS HAS INCREASED. AS A RESULT, THEIR PROPENSITY TO SAVE CONTRACTED, CAUSING A DECREASE IN THE RATE OF CAPITALIZATION, THE VOLUME OF DOMESTIC OUTPUT, AND THE RATE OF PRODUCTIVITY. THE DISCREPANCY BETWEEN REAL NATIONAL INCOMES OF UNDERDEVELOPED AND INDUSTRIAL COUNTRIES HAS BROADENED, AND ADDITIONAL PRESSURE WAS EXERCISED ON THE BALANCE OF PAYMENTS. THIS IS HOW THE DEMONSTRATION EFFECT BEARS UPON INTERNATIONAL TRADE. IT EXPLAINS WHY "THERE IS SOMETHING LIKE A NATURAL TENDENCY TOWARDS DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS BETWEEN A RICH AND A POOR COUNTRY."⁴ IN FACT, IT PROVIDES AN EXPLANATION, BOTH FOR THE EVER IN-

¹ J. S. DUESENBERY, INCOME, SAVING, AND THE THEORY OF CONSUMER BEHAVIOR, (CAMBRIDGE: HARVARD UNIVERSITY PRESS, 1949).

² RAGNAR NURKSE, PROBLEMS OF CAPITAL FORMATION IN UNDERDEVELOPED COUNTRIES, (NEW YORK: OXFORD UNIVERSITY PRESS, 1953), P. 58.

³ NURKSE, IBID., P. 63

⁴ NURKSE, IBID., P. 72

CREASING STIMULUS TO IMPORT, AND FOR THE DETERMINING EFFECT THE DISCREPANCIES IN REAL INCOMES HAVE ON THE LEVEL OF PRODUCTION IN UNDERDEVELOPED COUNTRIES. NOT ONLY IS THE TOTAL VOLUME OF OUTPUT AFFECTED BY THE INCREASING PROPENSITY TO CONSUME AND IMPORT, BUT ALSO THE VOLUME OF EXPORT COMMODITIES. FOR A WHILE INCREASED IMPORTS MAY CAUSE AN IMPROVEMENT IN THE STANDARD OF LIVING, AT LEAST FOR THAT PART OF THE POPULATION WHICH DIRECTLY BENEFITS FROM THE COMPARATIVELY LOWER PRICES OF BETTER QUALITIES FO FOREIGN GOODS. HOWEVER, AS SOON AS THE UNDERDEVELOPED COUNTRY'S EXCHANGE OR GOLD RESERVES ARE EXHAUSTED, THE DISPROPORTIONATE DEVELOPMENT BETWEEN EXPORTS AND IMPORTS IS BOUND TO PRODUCE HARMFUL RESULTS. IT EITHER CREATES A DETERIORATION IN THE EXCHANGE RATE, OR AN INFLATION, OR BOTH.

IT MUST BE STRESSED THAT UNDER THE ABOVE ASSUMPTIONS, INFLATION IS NOT OF A MONETARY NATURE. IT RESULTS FROM INCREASED PRESSURE ON THE DEMAND SIDE, AND A CORRESPONDING CONTRACTION IN THE VOLUME OF PRODUCTION. TO SOME EXTENT INCREASED IMPORTS COMPENSATE FOR THE LOSS IN REAL OUTPUT, BUT THE MORE THE DEMAND TURNS TOWARD FOREIGN GOODS THE STRONGER WILL BE THE IMPACT OF THE ADVERSE BALANCE ON THE DOMESTIC PRICE LEVEL. THUS A DISEQUILIBRIUM IN A COUNTRY'S BALANCE OF PAYMENTS CAN OCCUR IN THE ABSENCE OF MONETARY INFLATION, AS A RESULT OF A LOW REAL INCOME AND A HIGH PROPENSITY TO CONSUME AND IMPORT.

AN OBJECTION TO THE ABOVE ANALYSIS MAY BE RAISED. IN THE LONG-RUN IT WOULD BE REASONABLE TO EXPECT THAT THE MORE ADVANCED COUNTRIES WOULD INCREASE THEIR DEMAND FOR THE PRODUCTS OF UNDERDEVELOPED COUNTRIES AS A CONSEQUENCE OF THE LATTERS' DETERIORATION OF EXCHANGE RATES. IT WOULD BE PROFITABLE FOR THE INDUSTRIAL NATIONS TO IMPORT MORE AT LOWER PRICES. THE STIMULUS THUS RECEIVED IN THE UNDERDEVELOPED AREAS TO EXPAND THE OUT-

PUT OF EXPORT GOODS WOULD RE-ESTABLISH SOME OF THE LOST PROPENSITY TO SAVE. INCREASED EXPORTS, PLUS A DECREASED INDUCEMENT TO IMPORT WOULD RELIEVE PRESSURE FROM THE BALANCE OF PAYMENTS. MOST PROBABLY THIS COUNTERBALANCING MOVEMENT ACTUALLY REDUCES THE IMPACT OF THE DEMONSTRATION FACTOR, BUT IT DOES NOT SEEM TO BE SUFFICIENTLY STRONG TO COMPLETELY ANNULL ITS EFFECTS. THERE MAY BE SEVERAL REASONS; AMONG THEM THE DEGREE OF SELF-SUFFICIENCY IN THE ADVANCED AREAS, TRADE BARRIERS, AND THE PERSISTENT DIFFERENCES IN REAL INCOMES OF THE VARIOUS NATIONS. IN ANY EVENT, CONVINCING EVIDENCE HAS BEEN PROVIDED THAT THE MARGINAL PROPENSITY TO IMPORT TENDS TO BE LOWER IN THE PREDOMINANTLY INDUSTRIAL COUNTRIES THAN IN THE AGRICULTURAL COUNTRIES.⁵

2. FOREIGN TRADE UNDER PROGRESSING INCOME CONCENTRATION

THUS FAR THE ANALYSIS HAS DEALT WITH THE DEMONSTRATION EFFECT UNDER THE CONDITION OF ABSOLUTE DIFFERENCES IN THE TOTAL NATIONAL INCOME OF NATIONS, AND IN THE ABSENCE OF MONETARY INFLATION. IT IS NOW NECESSARY TO ASK WHETHER CHANGES IN THE RELATIVE INCOME STRUCTURE AND MONETARY INFLATION INFLUENCE THE IMPORT-EXPORT COMPOSITION OF UNDERDEVELOPED COUNTRIES, SUCH AS BRAZIL. IT MUST BE POINTED OUT THAT THE ASPECTS TO BE CONSIDERED IN THIS CONNECTION ARE HYPOTHETICAL IN THE SENSE THAT THEY CANNOT BE MEASURED STATISTICALLY.

IN BRAZIL THE POOR STRATA OF THE POPULATION CONTRIBUTES CONSIDERABLY MORE TO THE PRODUCTION OF EXPORT/GOODS AND DEMANDS LESS IN TERMS OF IMPORT GOODS THAN THE WEALTHIER PART OF THE POPULATION. THERE ARE EXCEPTIONS, OF COURSE. FOR INSTANCE, THIS DOES NOT APPLY TO THE OWNERS

⁵ SEE THE ENLIGHTENING STUDY BY TSE CHUN CHANG, CYCLICAL MOVEMENT IN THE BALANCE OF PAYMENTS, (CAMBRIDGE: UNIVERSITY PRESS, 1951), P. 34.

OF FARMS. THE OVER-ALL PICTURE THOUGH CONFIRMS THE HYPOTHESIS. THIS MAY BE ATTRIBUTED TO THE FOLLOWING: (1) ALMOST IN TOTAL BRAZILIAN EXPORTS ARE COMPOSED OF PRIMARY GOODS PRODUCED IN LOW INCOME AGRICULTURAL AREAS; (2) IN THESE SECTIONS EFFECTIVE DEMAND IS LOW, AND (3) MARKET KNOWLEDGE IS LIMITED, SINCE ONLY A MINORITY OF IMPORT (AS WELL AS HIGH PRICED DOMESTIC) GOODS ARE WIDELY DISTRIBUTED THROUGHOUT THE COUNTRY. THEREFORE, THE HIGH PROPENSITY TO CONSUME IN THE RURAL AREAS IS NOT PARTICULARLY DIRECTED TOWARD IMPORT GOODS BUT PRIMARILY TOWARD FIRST NECESSITY COMMODITIES, MAINLY FOOD. THE DEMONSTRATION FACTOR HAS LITTLE EFFECT AMONG THE RURAL POPULATION.

ON THE OTHER HAND, THE INDUCEMENT TO IMPORT IS VERY HIGH AMONG THE WEALTHY. AND, THE HIGHER THEIR NOMINAL INCOMES, THE HIGHER IS THEIR EFFECTIVE DEMAND. THIS IS OF PARTICULAR IMPORTANCE FOR THE COMPOSITION OF IMPORT DEMAND; IT STIMULATES THE IMPORTATION OF LUXURY GOODS AND EXPLAINS, IN PART, THE FABULOUS PRICES FOR AUTOMOBILES, APPLIANCES, AND FOREIGN BEVERAGES IN BRAZIL. NO IMPORT RESTRICTION OR EXCHANGE CONTROL WILL EVER BE ABLE TO CURB THIS TREND, UNLESS IT IS PRECEDED BY MEASURES IMPOSING A LIMITATION ON EFFECTIVE DEMAND.

THE IMPACT OF INFLATION ON SUCH AN INCOME STRUCTURE IS ALARMING. BEYOND THE FACT THAT INFLATION CREATES EXCESS PURCHASING POWER, IT INDUCES PEOPLE TO LOSE THEIR CONFIDENCE IN THE CURRENCY AND INCREASE THE VELOCITY OF SPENDING. SAVINGS ARE DISCOURAGED, CAPITAL FORMATION IS IMPAIRED, TOTAL OUTPUT AND PRODUCTIVITY SUFFER, PRICES EXPAND WITH NO END TO THE SPIRAL. THE RISE IN THE DOMESTIC PRICE LEVEL, THE POTENTIAL SHORTAGE OF GOODS, AND THE HIGHER QUALITY OF FOREIGN GOODS STIMULATES PEOPLE TO SPEND MORE AND MORE FOR IMPORTS. FOR THOSE BENEFITING FROM INFLATION, IN THE SENSE THAT THEIR NOMINAL INCOMES EXPAND FASTER THAN

THE PRICE LEVEL (SEE CHAPTER II), THE CONTINUING LOSS OF THE CRUZEIRO'S PURCHASING POWER ABROAD HAS LITTLE DETERRING EFFECTS ON THEIR DESIRE TO IMPORT, TO THE DETRIMENT OF THOSE WHICH CANNOT FOLLOW THE RUNAWAY PRICES. MEANWHILE THE BALANCE OF PAYMENTS IS EXPOSED TO A DOUBLE PRESSURE: ONE RESULTING FROM INCREASED COST AND REDUCED VOLUMES OF EXPORT COMMODITIES, THE OTHER FROM THE EXPANDING DEMAND FOR IMPORTS. THUS THE ADVERSE TREND BECOMES A CHRONIC EVIL.

3. THE EFFECTS OF CONTROL MEASURES

TO COPE WITH INFLATION AND THE ADVERSE BALANCE OF PAYMENTS, THE BRAZILIAN GOVERNMENT HAS APPLIED SEVERAL MEASURES. AMONG THEM ARE PRICE CONTROLS AND QUANTITATIVE IMPORT RESTRICTIONS.

THAT A COMBINATION OF THE TWO MEASURES CAN PRODUCE LASTING RESULTS HAS BEEN PROVED BY EUROPEAN EXPERIENCE. AFTER WORLD WAR II, FOR INSTANCE, GREAT BRITAIN WAS EXPOSED TO AN INFLATIONARY PRESSURE RESULTING FROM AN ADVERSE BALANCE OF PAYMENTS THAT WAS TEMPORARILY CHECKED BY STRICT ADHERENCE TO PRICE CONTROL AND IMPORT RESTRICTIONS. EXCESS SPENDING POWER THEN TOOK THE FORM OF REDUNDANT MONEY.⁶

REPEATED ATTEMPTS TO FREEZE PRICES FAILED IN BRAZIL. NOT ONLY WAS INFLATION TOO POWERFUL TO BE DETAINED BY ARBITRARY OBSTACLES, BUT ALSO CONTROL MEASURES WERE APPLIED TOO LEISURELY. IN A WAY THIS WAS FORTUNATE. IT PREVENTED A FURTHER CONTRACTION OF AGRICULTURAL OUTPUT FOR WHICH THE MAJORITY OF PRICE REGULATIONS WERE DESIGNED. PARADOXICAL AS IT SOUNDS, HERE IS A CASE WHERE GOVERNMENT FAILURE WAS BENEFICIAL TO THE

⁶SEE: R. G. HAWTREY, THE BALANCE OF PAYMENTS AND THE STANDARDS OF LIVING, (LONDON AND NEW YORK: ROYAL INSTITUTE OF INTERNATIONAL AFFAIRS, 1950), P. 36.

ECONOMY.

MUCH MORE EFFECTIVE PROVED TO BE THE IMPOSITION OF IMPORT RESTRICTIONS, ALTHOUGH THEIR APPLICATION WAS AT TIMES OBSTRUCTED BY ADMINISTRATIVE CIRCUMSTANCES. DEPENDING ON THE CONDITIONS IN PARTICULAR YEARS AND THE SERIOUSNESS OF THE FOREIGN TRADE SITUATION, IMPORT RESTRICTIONS VARIED IN NATURE AND EXTENT.⁷ NONETHELESS, THEIR OVER-ALL PURPOSES WERE AIMED AT A COMBINATION OF A RESTRICTION IN THE VOLUME OF IMPORTS AND A CHANGE IN THE COMPOSITION OF IMPORTS. AS A GENERAL RULE IT CAN BE SAID THAT THE SECOND OBJECTIVE WAS MORE SUCCESSFULLY ACCOMPLISHED. CONSEQUENTLY, THE STRUCTURE OF BRAZILIAN IMPORTS DURING THE POST-WAR YEARS ROUGHLY CORRESPONDS TO THE FOLLOWING BREAK-DOWN: OIL AND ITS BY-PRODUCTS PLUS WHEAT AND FLOUR IMPORTS ACCOUNT FOR SOME 25% OF TOTAL IMPORT EXPENDITURE AND ARE GIVEN EXCHANGE PRIORITY; NEXT IN LINE ARE ESSENTIAL MACHINERY AND EQUIPMENT ACCOUNTING FOR 40%; METALS, CHEMICAL PRODUCTS AND OTHER SEMI-PROCESSED GOODS ACCOUNTING FOR ABOUT 25%; LEAVING 10% FOR ITEMS SUCH AS PASSENGER CARS, APPLIANCES, TIRES AND TUBES, AND OTHER CONSUMPTION GOODS.⁸

AT FIRST GLANCE, THE BREAK-DOWN SEEMS TO REFLECT A HIGHLY SATISFACTORY COMPOSITION OF IMPORTS. IT PROVIDES FOR A REDUCED VOLUME OF CONSUMPTION AND A RELATIVELY HIGH VOLUME OF INVESTMENT GOODS. THUS THE GREATER PART OF IMPORT DISBURSEMENTS ACT AS COMPULSORY SAVING. HOWEVER, THIS IS ONLY PART OF THE STORY. WHAT HAS TO BE ASKED IN ADDITION IS HOW COMPULSORY SAVING AND THE LARGER VOLUME OF IMPORTED CAPITAL GOODS AFFECT THE DOMESTIC ECONOMY.

⁷ FOR A HISTORICAL DEVELOPMENT OF IMPORT RESTRICTIONS BETWEEN 1931 AND 1949 SEE: R. RICHERS, OP. CIT., PP. 79-84.

⁸ NOTE THE HIGH PROPORTION OF IMPORTS DESTINED FOR INDUSTRIAL DEVELOPMENTS. IN CONTRAST, ONLY ABOUT 1% OF TOTAL IMPORT EXPENDITURE IS USED FOR FERTILIZERS.

ONCE AGAIN, IT IS NURKSE WHO GIVES THE CLUE TO THE PROBLEM. FIRST, HE EXPLAINS WHY IMPORT RESTRICTIONS ARE BOUND TO PRODUCE INFLATION. SINCE PEOPLE DO NOT VOLUNTARILY CONSENT TO A REDUCTION IN THEIR CONSUMPTION, "THEY WILL SEEK TO MAKE UP FOR THE REDUCTION IN THEIR IMPORTS BY AN INCREASE IN THEIR EXPENDITURE ON DOMESTIC GOODS AND SERVICES....WHEN THE ESCAPE VALVE OF CONSUMABLE IMPORTS IS SHUT OFF, THE PRESSURE OF THE STEAM IN THE SYSTEM INCREASES; DEMAND BECOMES EXCESSIVE IN RELATION TO DOMESTIC SUPPLY AND TENDS TO PUSH UP THE LEVEL OF PRICES."⁹ FURTHERMORE, THE INCREASED CONSUMER EXPENDITURE IN THE HOME MARKET "WILL TEND TO BID FACTORS OF PRODUCTION AWAY FROM DOMESTIC INVESTMENT AND MAINTENANCE AND WILL DRAW THEM INTO ACTIVITIES CATERING FOR CURRENT CONSUMPTION....THE INCREASE IN IMPORTS OF INVESTMENT GOODS TENDS TO BE OFFSET BY REDUCED DOMESTIC INVESTMENT ACTIVITIES, OR ACTUALLY DOMESTIC DISINVESTMENT CAUSED BY FAILURE TO MAINTAIN AND REPLACE CAPITAL AS IT WEARS OUT."¹⁰

THOUGH THE OBJECTIONS RAISED ARE TECHNICALLY CORRECT, ONE MUST BEWARE OF OVEREXTENDING THEIR MEANING. THEY DO NOT IMPLY THAT SELECTIVE RESTRICTIONS MISS THEIR GOAL COMPLETELY OR SHOULD BE DISCARDED. UNDER THE GIVEN SITUATION OF INCOME DISTRIBUTION IN BRAZIL, PRICE INFLATION AND THE DESCRIBED INFLUENCE OF HIGH CONSUMPTION EXPENDITURE ON CAPITAL FORMATION WOULD TAKE PLACE EVEN IF MORE CONSUMPTION GOODS WERE PERMITTED TO BE PROCURED ABROAD.

THE MAIN LESSON THAT CAN BE LEARNED FROM PAST EXPERIENCES WITH QUANTITATIVE IMPORT CONTROLS IS THAT THEY CANNOT BE EXPECTED TO IMPOSE SUFFICIENTLY STRONG LIMITATIONS ON FOREIGN TRANSACTIONS TO RE-ESTABLISH BALANCE OF PAYMENTS EQUILIBRIUM AS LONG AS STRUCTURAL AND MONETARY CAUSES

⁹ NURKSE, OP. CIT., P. 112

¹⁰ NURKSE, IBID., P. 113

OF DISEQUILIBRIUM PREVAIL AT HOME. THEREFORE, IMPORT RESTRICTIONS MUST BE BACKED UP BY EXCHANGE CONTROL.¹¹

4. EXCHANGE CONTROL

A HISTORICAL REVIEW OF BRAZIL'S FOREIGN EXCHANGE SITUATION WAS GIVEN IN CHAPTER I. MUCH MORE COULD BE SAID AND MANY MORE DETAILS DEVELOPED. FOR THE ISSUE TO BE CONSIDERED HERE, HOWEVER, A GENERAL UNDERSTANDING OF PAST PERFORMANCES IS SUFFICIENT.

ALL FORMS OF EXCHANGE CONTROL IMPOSED IN BRAZIL SINCE 1931, INCLUDING THE MULTIPLE EXCHANGE SYSTEM INTRODUCED IN 1953, HAVE ONE POINT IN COMMON: THEY FAILED TO RE-ESTABLISH LONG-TERM EQUILIBRIUM IN THE BALANCE OF PAYMENTS. THIS HAS LED TO A WIDESPREAD BELIEF THAT THE PRIMARY CAUSE OF AN ADVERSE BALANCE MUST BE SOUGHT IN THE INFLEXIBILITY OF EXCHANGE RATES AND THAT A RETURN TO A SINGLE FLUCTUATING RATE WOULD BE ADVISABLE.¹²

ALL THAT CAN SAFELY BE SAID, HOWEVER, IS THAT FIXED RATES HAVE CONTRIBUTED TOWARD A DETERIORATION SINCE THEY HAMPERED EXPORTATION, AND STIMULATED IMPORTATION AND CAPITAL FLIGHT. AT TIMES WHEN THERE HAS BEEN WIDE DISPARITIES BETWEEN THE RATE AND THE REAL PURCHASING POWER OF THE CRUZEIRO AT HOME AND ABROAD, THE IMPACT OF OVER-VALUATION HAS BEEN VERY HEAVY. THIS DOES NOT IMPLY THOUGH THAT OVER-VALUED RATES WERE FUNDAMENTAL TO THE DISEQUILIBRIUM OBSERVED. ON THE CONTRARY, HAD THERE NOT BEEN OTHER REASONS, THE COMBINATION OF IMPORT RESTRICTIONS AND FIXED RATES COULD HAVE PREVENTED AN AGGRAVATION OF IMBALANCE.

¹¹THE FUNCTION OF SPECIFIC TARIFFS IS NOT DISCUSSED HERE AS IT FAILS TO BE OF DECISIVE INFLUENCE AS A TRADE BARRIER IN BRAZIL DUE TO LOW CUSTOM RATES LARGELY OFFSET BY INFLATION.

¹²IN PRINCIPLE, ALTHOUGH NOT EXPLICITLY EXPRESSED, THIS THESIS IS ALSO CONTAINED IN A MUCH DISCUSSED REPORT BY THE COUNCIL OF THE FOREIGN CHAMBERS OF COMMERCE PREPARED IN MEMEOGRAPHIC FORM AND ENTITLED: "CON-TRÔLE DE CÂMBIO E COMÉRCIO EXTERIOR," 1954.

STRICTLY SPEAKING, THERE ARE SOME ADVANTAGES RESULTING FROM OVER-VALUED AND INCONVERTIBLE CURRENCIES. GIVEN THE FEW EXPORT PRODUCTS AND THEIR INELASTICITY OF DEMAND IN FOREIGN COUNTRIES, BRAZIL INDIRECTLY PROFITS FROM A REDUCED VOLUME OF EXPORTS. IT CAN REASONABLY EXPECT AN IMPROVEMENT OF ITS TERMS OF TRADE.¹³ A GREATER ADVANTAGE THOUGH IS AN INDIRECT ONE. IN BRAZIL, EXCESS SPENDING POWER PROVIDED BY INFLATION EXERTS PRESSURES ON BOTH THE DOMESTIC PRICE LEVEL AND THE BALANCE OF PAYMENTS. OVER-VALUATION CAUSES AN INCREASED PORTION OF THIS EXCESS POWER TO BE DIRECTED TOWARD THE IMPORT MARKET, REDUCING THE INFLATIONARY PRESSURE ON THE GOODS DESTINED FOR HOME CONSUMPTION OR EXPORTATION.

AS INFLATION GAINS MOMENTUM, THE MOVEMENT OF PRICE AND EXCHANGE DEPRECIATION EXCEEDS THE RATE OF INCREASE IN MONEY SUPPLY AND CIRCULATION. PSYCHOLOGICAL FACTORS CAUSE A FLIGHT TO HOARDING OF FOREIGN CURRENCIES, MAINLY DOLLARS, AND GOODS. DISINVESTMENTS, SPECULATIONS AND BLACK MARKET TRANSACTIONS FURTHER UNDERMINE THE CURRENCY'S STABILITY. THIS HAS OCCURED IN BRAZIL TO AN ALARMING EXTENT. IN THIS CONNECTION IT MAY BE WELL TO REMEMBER HOW CLOSE BRAZIL'S LATE CURRENCY EXPERIENCE FOLLOWS THE GERMAN PATTERN AFTER WORLD WAR I.¹⁴

REPEATED EXCHANGE RATE ADJUSTMENTS ARE A MUST UNDER THE DESCRIBED CONDITIONS. AFTER SEVERAL DEVALUATIONS FAILED TO RESTORE THE DESIRED EQUILIBRIUM IN THE BALANCE OF PAYMENTS, BRAZIL RESORTED TO MULTIPLE RATES

¹³A SIMILAR POINT WAS RAISED BY HENRY C. WALLICH, "UNDERDEVELOPED COUNTRIES AND THE INTERNATIONAL MONETARY MECHANISM," MONEY, TRADE AND ECONOMIC GROWTH, IN HONOR OF JOHN HENRY WILLIAMS (NEW YORK: THE MACMILLAN COMPANY, 1951), P. 30.--ANOTHER POSSIBLE ADVANTAGE MENTIONED BY WALLICH, NAMELY THAT "AN OVER-VALUED RATE FACILITATES THE TRANSFER OF RESOURCES FROM THE EXPORT INDUSTRIES...TO THE SECTORS OF THE ECONOMY THAT ARE CANDIDATES FOR DEVELOPMENT" (P. 30) APPLIES TO BRAZIL, BUT WE HESITATE TO CALL IT AN ADVANTAGE ON THE GROUNDS GIVEN IN CHAPTER VI.

¹⁴SEE: HABERLER, THE THEORIE OF INTERNATIONAL TRADE, OP. CIT., PP. 54-62.

WITH SEVERAL ADVANTAGES IN ITS FAVOR. AMONG THEM ARE: (1) EXCHANGE ALLOCATIONS BECAME LESS ARBITRARY FOR IMPORTERS DUE TO THE AUCTION SYSTEM; (2) THE PRICES OF IMPORT GOODS VARIED MORE IN ACCORDANCE WITH EXPORT REVENUES, DOMESTIC DEMAND, AND THE ESSENTIALITY OF IMPORTS; (3) EXCHANGE ALLOCATIONS FOR IMPORTS COULD NOT EXCEED EXPORT RETURNS; (4) TO SOME EXTENT COMMERCIAL ARREARS COULD BE PAID OFF AND FURTHER BACKLOGS PREVENTED; (5) IN CONJUNCTION, THESE FACTORS CONTRIBUTED TOWARD AN IMPROVEMENT IN THE BALANCE OF PAYMENTS POSITION AND CLOSED SOME OF THE PRICE GAPS FORMERLY EXISTING BETWEEN IMPORT AND HOME-PRODUCED GOODS.

A FEW YEARS HAVE PASSED SINCE BRAZIL INTRODUCED MULTIPLE EXCHANGE RATES. AMONG THE TWO ALTERNATIVES OF EXCHANGE ADJUSTMENTS, DEVALUATION AND MULTIPLE RATES, THE LATTER PROVED TO BE MORE EFFECTIVE. NEVERTHELESS, IT DID NOT SUCCEED IN RESTORING EQUILIBRIUM. THERE ARE SEVERAL REASONS WHY THIS COULD NOT BE ACCOMPLISHED,¹⁵ THE MAIN ONE BEING THE CONTINUED PRESSURE EXERTED BY DOMESTIC CONDITIONS ON THE BALANCE OF PAYMENTS. AS WAS POINTED OUT BY PROFESSOR HANSEN, EXCHANGE RATE ADJUSTMENTS CANNOT BE EXPECTED TO CORRECT FUNDAMENTAL DISEQUILIBRIA, NEITHER OF CYCLICAL NOR OF SECULAR NATURE.¹⁶

ALL THIS DOES NOT MEAN THAT A RETURN TO A SINGLE FLUCTUATING RATE WOULD BE OUT OF QUESTION FOR BRAZIL. ON A LONG-TERM BASIS IT IS THE MOST DESIRABLE OBJECTIVE, AND THIS SHOULD BE KEPT IN MIND WHEN FOREIGN TRADE POLICIES ARE ESTABLISHED. UNDER THE PRESENT CIRCUMSTANCES OF WIDE

¹⁵IN THIS CONNECTION A THOROUGH STUDY BASED LARGELY ON THE PERUVIAN AND ARGENTINIAN EXPERIENCE IS ILLUMINATING: EUGENE RICHARD SCHLESINGER, MULTIPLE EXCHANGE RATES AND ECONOMIC DEVELOPMENT, (PRINCETON, NEW JERSEY: PRINCETON PRESS, 1952). SEE MAINLY THE CONCLUSIONS (PP. 73-76) MOST OF WHICH CAN BE DIRECTLY APPLIED TO THE BRAZILIAN CASE.

¹⁶ALVIN H. HANSEN, "FUNDAMENTAL DISEQUILIBRIUM," FOREIGN ECONOMIC POLICY FOR THE UNITED STATES, ED. SEYMOUR E. HARRIS (CAMBRIDGE: HARVARD UNIVERSITY PRESS, 1948) PP. 379-83.

DISCREPANCIES BETWEEN REAL PER CAPITA PURCHASING POWER AND PRODUCTIVITY
AT HOME AND ABROAD, AS WELL AS UNDER INFLATION AND DOMESTIC IMBALANCE OF
INCOME DISTRIBUTION, A FREE RATE WOULD BE DISASTROUS.

VIII. PRICE ELASTICITIES AND THE TERMS OF TRADE

AN IMPORTANT ASPECT OF INTERNATIONAL TRADE HAS THUS FAR BEEN OMITTED FROM THIS STUDY: THE TERMS OF TRADE AND THEIR DEPENDENCE ON PRICE ELASTICITIES. FOR MANY THIS MAY BE A SINFUL OMISSION. INDEED, TERMS OF TRADE ARE OF GREAT IMPORTANCE TO UNDERDEVELOPED COUNTRIES, BUT THEIR MEASUREMENT AND APPLICATIONS ARE NOT ALWAYS AS SIMPLE AS MAY APPEAR ON THE SURFACE.

1. THE BENEFITS OF THE TERMS OF TRADE

THE TERMS OF TRADE MEASURE THE RATIO OF RELATIVE PRICES OF EXPORT AND IMPORT GOODS OF A COUNTRY. RELATIVE PRICES, IN TURN, ARE A FUNCTION OF DEMAND ELASTICITIES ABROAD AND AT HOME. AN IMPROVEMENT IN THE TERMS OF TRADE IS SAID TO BE FAVORABLE FOR A COUNTRY FOR THE SIMPLE REASON THAT A GIVEN QUANTUM OF IMPORTS BECOMES CHEAPER IN RELATION TO A GIVEN QUANTUM OF EXPORTS, EITHER DUE TO AN OVERPROPORTIONAL INCREASE IN EXPORT OVER IMPORT PRICES, OR TO AN UNDERPROPORTIONAL DECREASE IN EXPORT OVER IMPORT PRICES. CONVERSELY, A DETERIORATION IN THE TERMS OF TRADE IS SAID TO BE UNFAVORABLE FOR A COUNTRY.

ACCORDING TO A STUDY OF THE UNITED NATIONS "IMPROVEMENTS OF THE TERMS OF TRADE...AFFECT THE NATIONAL INCOMES OF UNDERDEVELOPED COUNTRIES AS DEFINITELY AS IMPROVED TECHNOLOGY, INCREASES IN EMPLOYMENT, OR CHANGES FROM LESS PRODUCTIVE TO MORE PRODUCTIVE EMPLOYMENT SUCH AS OCCUR IN THE

PROCESS OF INDUSTRIALIZATION."¹ FURTHERMORE, IN THE CASE OF ACCUMULATED FOREIGN DEBTS, "FAVORABLE CHANGES IN THE TERMS OF TRADE OF UNDERDEVELOPED COUNTRIES IMPROVE THEIR ABILITY TO MEET DEBT SERVICES ON FOREIGN LOANS AND WITHDRAWALS OF EARNINGS OF FOREIGN-FINANCED INVESTMENTS."² THIS EXPLAINS THE IMPORTANCE THAT IS BEING ATTRIBUTED TO THE TERMS OF TRADE IN UNDERDEVELOPED COUNTRIES.

A QUESTION THAT ARISES IS WHETHER FAVORABLE TERMS OF TRADE ARE ALWAYS BENEFICIAL. IN THE FIRST INSTANCE THERE IS A TENDENCY TO ANSWER THE QUESTION IN THE AFFIRMATIVE, SINCE IT SEEMS DUBIOUS THAT A CHEAPER ACQUISITION OF GOODS SHOULD BE ADVANTAGEOUS TO THE PURCHASING COUNTRY. HOWEVER, THERE ARE SOME IMPORTANT EXCEPTIONS.

UNDER THE CONDITION OF INELASTIC DEMAND IT IS CONCEIVABLE THAT A COUNTRY MAY REDUCE ITS VOLUME OF EXPORTS DELIBERATELY IN ORDER TO OBTAIN HIGHER UNITARY PRICES FOR ITS GOODS ABROAD. IN THIS CASE THE TERMS OF TRADE IMPROVE BUT TOTAL EXPORT RECEIPTS DIMINISH RATHER THAN INCREASE. HENCE THE OVERALL CAPACITY TO IMPORT IS REDUCED. FURTHERMORE, THE REDUCTION IN THE VOLUME OF TRADE IS BOUND TO CALL FOR A RE-ALLOCATION OF PRODUCTION FACTORS OR A CHANGE IN THE LEVEL OF EMPLOYMENT THAT DOES NOT HAVE TO BE ADVANTAGEOUS TO THE COUNTRY CONCERNED. CASES OF THIS NATURE HAVE BEEN REPORTED BY THE AFOREMENTIONED STUDY OF THE UNITED NATIONS.³

MOREOVER, REDUCED EXPORTS DO NOT NECESSARILY PRODUCE UNFAVORABLE RESULTS. IT ALL DEPENDS ON HOW SURPLUS RESOURCES DERIVED FROM INCREASED EXPORT PROCEEDS ARE USED. THERE ARE, ESSENTIALLY, THREE DISTINCT POSSI-

¹ UNITED NATIONS, DEPARTMENT OF ECONOMIC AFFAIRS, RELATIVE PRICES OF EXPORTS AND IMPORTS OF UNDER-DEVELOPED COUNTRIES, (LAKE SUCCESS, NEW YORK, DECEMBER 1949), P. 121.

² UNITED NATIONS, IBID., P. 16.

³ UNITED NATIONS, IBID., PP. 121-123.

BILITIES OF APPLICATION. SURPLUS RESOURCES MAY INCREASE: (A) DOMESTIC INVESTMENTS, (B) IMPORTS, OR (C) SPENDING. IN GENERAL, A COMBINATION OF THE THREE USES MAY TAKE PLACE. THUS THE EFFECTIVENESS DEPENDS ON THE EXTENT TO WHICH PROCEEDS ARE APPLIED FOR ONE OR THE OTHER PURPOSE.⁴

IF THE MAJORITY OF SURPLUS RESOURCES ARE INVESTED IT TAKES THE FORM OF SAVING WITHOUT REDUCING THE VOLUME OF CONSUMPTION. IN THIS CASE IT CAN BE REASONABLY EXPECTED THAT THE IMPROVEMENT OF THE TERMS OF TRADE IS BENEFICIAL FOR MOST UNDERDEVELOPED COUNTRIES, PROVIDED (1) THAT INVESTMENTS ARE APPLIED IN INDUSTRIES CONTRIBUTING TO ECONOMIC DEVELOPMENT, FOR INSTANCE BY IMPROVING THE RATE OF PRODUCTIVITY, AND (2) THAT THE LEVEL OF EMPLOYMENT PERMITS AN EXPANSION IN ECONOMIC ACTIVITIES WITHOUT INFLATION. THIS SECOND CONDITION PRESUPPOSES EITHER A LOW DEGREE OF UNEMPLOYMENT OR AT LEAST INVOLUNTARY DISGUISED INEMPLOYMENT. IF FULL EMPLOYMENT EXISTS BEFORE SURPLUS PROCEEDS ARE INVESTED, THEIR ADVANTAGEOUS EFFECT IS BOUND TO BE OFFSET BY AN INCREASE IN THE WAGE AND PRICE LEVEL.

IF SURPLUS RESOURCES ARE USED TO INCREASE THE VOLUME OF IMPORTS, THE BENEFIT IS DEPENDENT UPON THE KIND OF IMPORT PRODUCTS DEMANDED. IF THEY ARE CAPITAL GOODS, THE COUNTRY IN QUESTION WILL INCREASE ITS REAL CAPITAL SUPPLY AND HENCE IMPROVE ITS SITUATION. THIS, HOWEVER, MUST OCCUR BEFORE THE ADDITIONAL MONETARY INCOME OF EXPORTERS IS SPENT ON THE HOME MARKETS. TO ENABLE THIS, EXPORTERS MUST THEMSELVES IMPORT CAPITAL GOODS, OR THE GOVERNMENT MUST EXERCISE SOME KIND OF A CONTROL OVER EXCESS EARNINGS TO PREVENT AN INFLATIONARY PRESSURE. IT IS VERY LIKELY, HOWEVER, THAT EXPORTERS WILL USE THEIR ADDITIONAL INCOME FOR CONSUMPTION PURPOSES, AND THE PRICE LEVEL WILL RISE. IF SOONER OR LATER SOME OF THE EXCESS INCOME

⁴MUCH OF THE SUBJECT MATTER IN THIS SECTION IS BASED ON NURKSE, OP. CIT., PP. 97-103.

IS USED TO IMPORT CONSUMPTION GOODS, THE INFLATIONARY PRESSURE WILL BE RELIEVED DUE TO SHIFTING DEMAND.

FROM THE ABOVE, IT CAN BE CONCLUDED THAT AN IMPROVEMENT IN THE TERMS OF TRADE IS BENEFICIAL ONLY WHEN SURPLUS RESOURCES ARE EMPLOYED TO INCREASE CAPITAL FORMATION, AND ONLY UNDER CERTAIN USE CONDITIONS, AND IN THE PRESENCE OF UNEMPLOYMENT. ONLY THEN SURPLUSES PERFORM THE FUNCTION OF REAL SAVING AND STIMULATE ECONOMIC DEVELOPMENT.

TO APPLY THESE GENERAL RULES TO A SPECIFIC CASE IS DIFFICULT. THERE ARE NO STATISTICS REFLECTING HOW SURPLUS RESOURCES ARE USED IN AN ECONOMY. ACTUALLY, IT IS EVEN DIFFICULT TO DISTINGUISH BETWEEN SURPLUS AND "NORMAL" EXPORT REVENUES. NEVERTHELESS, SOME HYPOTHETICAL SOLUTIONS CAN BE DERIVED FROM CONSUMPTION AND SAVING HABITS OF A COUNTRY.

IN BRAZIL THERE IS A TENDENCY TO SPEND RATHER THAN TO REINVEST EXCESS PROFITS. THE URGE TO DO SO IS STRONG IN PART BECAUSE OF INFLATION, IN PART DUE TO THE CONSUMER'S DESIRE TO IMPROVE HIS STANDARD OF LIVING. THE GOVERNMENT DOES NOT PROVIDE FOR COMPULSORY SAVING DERIVED FROM EXPORT RETURNS, AT LEAST NOT IN TERMS OF CRUZEIROS. THERE ARE NO TAXES TO SPEAK OF ON EXPORT PROCEEDS. ON THE OTHER HAND, FOREIGN EXCHANGE EARNED MUST BE YIELDED TO THE GOVERNMENT WHICH CAN DISPOSE OF IT EITHER TO PAY OFF FOREIGN DEBTS, OR TO INCLUDE IT IN THE AMOUNTS RESERVED FOR AUCTIONING, OR FOR ANY OTHER PURPOSE. IN VIEW OF THE CHRONIC SHORTAGE OF FOREIGN EXCHANGE, THE GOVERNMENT MUST BE CAREFUL IN THE WAY IT USES PROCEEDS. ANY INCREASE IN RESERVES IS WELCOMED AND USUALLY APPLIED FOR BENEFICIAL PURPOSES. THIS IS TRUE FOR FOREIGN EXCHANGE; HOWEVER, WHAT HAPPENS WITH THE CRUZEIRO DISBURSEMENT? IF AN UNEXPECTED AMOUNT OF PROCEEDS ACCUMULATES DUE TO A SUDDEN IMPROVEMENT OF THE TERMS OF TRADE, THE GOVERNMENT MAY NOT (AND OFTEN DOES NOT) DISPOSE OF SUFFICIENT CURRENCY RE-

SERVES. THEN IT INVARIABLY PUTS THE MONEY PRESS INTO ACTION. SURPLUS MONEY SUPPLIES PLUS SURPLUS INCOMES EXERT A DOUBLE INFLATIONARY PRESSURE ON THE PRICE LEVEL. HENCE FAVORABLE TERMS OF TRADE ARE BY NO MEANS GUARANTEED) STIMULATIVE AGENTS FOR ECONOMIC DEVELOPMENT. THIS IS THE FIRST RESTRICTION THAT HAS TO BE IMPOSED ON THE TERMS OF TRADE ANALYSIS.

ONE MUST BE CAREFUL THOUGH NOT TO INVERT THE RULE. THE RESTRICTION DOES NOT MEAN THAT A DETERIORATION IN THE TERMS OF TRADE IS OF ADVANTAGE. UNFAVORABLE TERMS ARE ALMOST EXCLUSIVELY DEROGATORY.

2. DEMAND ELASTICITY AND PRODUCT RANGE.

ON THE MARSHALLIAN SCALE OF DEMAND ELASTICITIES IT IS VERY UNLIKELY THAT A COUNTRY HAS A CONTINUED INELASTIC DEMAND FOR ALL ITS EXPORT PRODUCTS.⁵ IN CONTRAST, A LARGE AMOUNT OF STATISTICAL COMPUTATIONS IN MORE RECENT YEARS DEMONSTRATES THE EXISTENCE OF A SECULAR TREND OF DETERIORATION OF RELATIVE PRICES FOR PRIMARY GOODS. SINCE THE MAJORITY OF UNDERDEVELOPED COUNTRIES ARE EXPORTERS OF PRIMARY AND IMPORTERS OF INDUSTRIAL GOODS, THEIR TERMS OF TRADE ARE BOUND TO GROW WORSE. DOES THIS PROVE MARSHALL WRONG?

HAD MARSHALL HAD THE EVIDENCE WE HAVE TODAY, HE WOULD PROBABLY HAVE ATTRIBUTED MORE IMPORTANCE TO WHAT HE HIMSELF CONSIDERED AN EXCEPTION. HE COULD HARDLY HAVE FORSEEN THAT THERE ARE CERTAIN COMMODITIES WITH A PERSISTENTLY LOW ELASTICITY OF DEMAND, AND EVEN LESS COULD HE HAVE PREDICTED THE IMPACT OF PRESENT TRADE BARRIERS FORCING COUNTRIES TO A HIGH DEGREE OF SPECIALIZATION. APART FROM THESE HISTORICAL LIMITATIONS, HIS ANALYSIS CONTINUES TO BE A VERY USEFUL TOOL.

⁵SEE: HABERLER, THE THEORY OF INTERNATIONAL TRADE, OP. CIT., PP. 150-169.

MARSHALL ARGUED THAT IT IS IMPROBABLE THAT THE ELASTICITY OF DEMAND IN THE IMPORTING COUNTRY IS LOW FOR ALL COMMODITIES OF THE EXPORTING COUNTRY "FOR THE RELATIVELY REDUCED WAGES OF G (THE EXPORTING COUNTRY) WILL BRING NEW COMMODITIES INTO THE CATEGORY OF HER EXPORTS."⁷ IF, AT A GIVEN TIME, THE WEIGHTED AVERAGE DEMAND FOR ALL OF THE EXPORTING COUNTRY'S GOODS IS INELASTIC IN THE IMPORTING COUNTRY, REDUCED FOREIGN TRADE REVENUES WILL CAUSE A CONTRACTION OF SUPPLY AND OF COSTS IN THE EXPORTING COUNTRY'S OUTPUT. CONSEQUENTLY, OTHER PRODUCTS, NOT EXPORTABLE BEFORE, WILL NOW BECOME AVAILABLE FOR SHIPMENT ABROAD. IN THIS MANNER, THE EXPORT-IMPORT STRUCTURE OF BOTH (OR ALL) COUNTRIES INVOLVED WILL ADAPT ITSELF TO THE MOST FAVORABLE CONDITION OF TRADE FOR EACH COUNTRY, NOT ONLY IN TERMS OF COMPARATIVE COSTS BUT ALSO IN RELATION TO PRICE ELASTICITIES. AND SINCE ELASTICITIES VARY FOR INDIVIDUAL COMMODITIES IN THE DIFFERENT PRODUCING AND CONSUMING COUNTRIES, IT IS IMPROBABLE THAT ANY COUNTRY WILL PRODUCE AND EXPORT ONLY COMMODITIES WITH LOW DEMAND ELASTICITIES.

ALTHOUGH THE FULL EFFECT OF THIS BALANCING DEVELOPMENT IN THE EXPORT-IMPORT STRUCTURE IS PARTIALLY OBSTRUCTED BY INCREASED IMMOBILITY OF FACTORS AND TRADE BARRIERS UNDER TODAY'S CONDITIONS, EVERY COUNTRY'S TRADE WILL TEND TOWARD AN EQUILIBRIUM IN THE ABOVE SENSE. TO OVERCOME THE OBSTACLES IMPOSED BY MODERN BARRIERS, COUNTRIES MUST BE PARTICULARLY CAREFUL WITH THEIR COST STRUCTURES. ONLY WHEN THEY CAN PRODUCE GOODS OFFERING SPECIFIC ADVANTAGES IN PRICE OR QUALITY OVER COMPETITIVE PRODUCTS ABROAD, WILL THEY BE ABLE TO EXPORT SUFFICIENTLY. IT IS IN THIS SENSE THAT THE MAJORITY OF THE LATIN AMERICAN COUNTRIES SUFFER. THEY CANNOT KEEP PACE WITH THE PROGRESS OF THE MORE ADVANCED NATIONS. HENCE,

⁷HABERLER, IBID., P. 157.

THEY CONCENTRATE ON THE PRODUCTION OF COMMODITIES WHICH THE INDUSTRIAL NATIONS COULD NOT PRODUCE IN SUFFICIENT QUANTITIES OR NOT AT ALL. SINCE THERE ARE NOT MANY SUCH COMMODITIES, THE RANGE OF THEIR EXPORT GOODS IS LIMITED.

IN THE LAST ODD HUNDRED YEARS BRAZIL'S EXPORT PRECEEDS DEPENDED FROM OVER 70% TO ABOUT 45% ON COFFEE. IT IS, THEREFORE, NOT ASTONISHING THAT THE BRAZILIAN TERMS OF TRADE ARE SUBJECT TO WIDE CYCLICAL FLUCTUATIONS. HOWEVER, EXPORT OPPORTUNITIES ARE FAR FROM BEING EXHAUSTED. MANY MORE GOODS COULD BE INCLUDED IN THE CATEGORY OF EXPORTS, PROVIDED THEIR PRODUCTION BE LAUNCHED ON A LARGE SCALE AND AT PRICES ATTRACTIVE ENOUGH TO STIMULATE FOREIGN DEMAND. THIS IS PERFECTLY FEASIBLE, IF THE VAST MINERAL POTENTIALS OF MINAS GERAIS AND THE AGRICULTURAL POTENTIAL OF THE NORTHEAST WERE EXPLOITED MORE INTENSIVELY. APART FROM THE DIRECT BENEFITS TO BE DERIVED FROM THE ECONOMIC DEVELOPMENT OF UNDERPOPULATED AREAS, AND THE INCREASE IN EXPORT TRADE, SUCH A POLICY WOULD AFFECT THE BRAZILIAN TERMS OF TRADE.

IT IS THUS THAT THE LOW RANGE OF EXPORT GOODS CONTRIBUTES TO THE INELASTICITY OF DEMAND FOR BRAZILIAN PRODUCTS ABROAD, A WIDER RANGE WOULD AT LEAST REDUCE THE DRAWBACKS OF AN OVER-ALL INELASTICITY SINCE DEMAND FOR INDIVIDUAL COMMODITIES DIFFERS IN THE IMPORTING COUNTRY. IN CONFORMITY WITH THIS EXPERIENCE, THE SECOND RESTRICTION CAN BE FORMULATED AS FOLLOWS: THE BRAZILIAN TERMS OF TRADE SHOW A DETERIORATING TREND NOT ONLY BECAUSE OF THE RELATIVELY MORE INELASTIC DEMAND FOR PRIMARY PRODUCTS, BUT ALSO BECAUSE OF THE LOW RANGE OF EXPORTABLE COMMODITIES.

WHAT CAN BE CONCLUDED FROM THE TWO RESTRICTIONS MENTIONED SO FAR IS THAT THE BRAZILIAN TERMS OF TRADE DO NOT HAVE TO SUFFER FROM AN UNAVOIDABLE TREND TOWARD DETERIORATION, AND THAT AN IMPROVEMENT OF THE TERMS

OF TRADE MUST BE CHanneled INTO SAVING TO PRODUCE FAVORABLE EFFECTS.

3. THE COMPUTATION OF TERMS OF TRADE

IT IS NECESSARY TO TAKE A GLANCE AT THE TECHNIQUES OF TERMS OF TRADE COMPUTATION. PROFESSOR VINER CATEGORICALLY STATES THAT "THE PROCEDURES BY WHICH AND THE DATA FROM WHICH SUCH (LOW) ELASTICITIES HAVE BEEN CALCULATED HAVE ALWAYS BEEN SUCH AS TO MAKE THEM IRRELEVANT OR EXTREMELY UNRELIABLE, AND HAVE USUALLY BEEN SUCH AS PROBABLY TO GIVE THEM A DECIDED BIAS IN THE DIRECTION OF ZERO."⁷ HE CITES FOUR REASONS TO SUPPORT HIS ARGUMENT. IN SUMMARY, THEY ARE AS FOLLOWS: (1) TERMS OF TRADE DATA DERIVED FROM HISTORICAL ANALYSIS ARE RARELY ADJUSTED TO CYCLICAL FLUCTUATIONS IN DEMAND; (2) THE RELEVANT PAIRS OF PRICE AND QUANTITY DATA ARE COMMONLY COMPOSED OF PRICE QUOTATIONS AND VOLUME OF ORDERS OF THE SAME UNIT PERIOD; (3) PRICE DATA USUALLY ACCOUNT FOR ADJUSTMENTS IN THE PURCHASER'S SCALE OF OPERATIONS TO FUTURE PRICES THAT ARE BOUND TO CHANGE IN THE SAME DIRECTION AS PREVIOUS CHANGES BUT DO NOT CORRESPOND TO THE RELEVANT PRICES FOR WHICH PURCHASES ARE MADE; AND (4) ELASTICITIES HAVE BEEN CALCULATED MOSTLY FOR COMMODITIES WITH LOWER ELASTICITIES THAN AVERAGE.⁸

WITH THE EXCEPTION OF THE FOURTH ITEM, THE DEFICIENCIES MENTIONED BY VINER MAY BE REMOVED BY A LONG-TERM CALCULATION OF TERMS OF TRADE WITH DUE ADAPTATIONS MADE FOR CYCLICAL FLUCTUATIONS. MOST PROBABLY, NO SUCH STUDY IS PRESENTLY AVAILABLE FOR BRAZIL. NEITHER THE UNITED NATIONS RE-

⁷VINER, "TENDÊNCIAS MODERNAS DA TEORIA DO COMÉRCIO INTERNACIONAL," OP. CIT., P. 55.

⁸FOR A MORE COMPLETE EXPOSITION OF THESE FACTORS SEE: VINER, IBID., PP. 55-57.

PORTS NOR THE ESSAY OF MEIREN AND LOEB⁹ ARE ADAPTED TO CYCLICAL CHANGES. AN ATTEMPT TO DO SO, ALTHOUGH NOT BASED ON CORRELATIONS, WAS MADE BY H. SCHLITTLER SILVA FOR THE PERIOD 1900-50.¹⁰

THREE MAIN CHARACTERISTICS CAN BE DEPICTED FROM THE DEVELOPMENT OF BRAZILIAN TERMS OF TRADE DURING THE FIRST HALF OF THIS CENTURY, I. E.:

(1) THEY WERE SUBJECT TO WIDE CYCLICAL FLUCTUATIONS, WITH MARKED IMPROVEMENTS DURING THE TIMES OF WORLD PROSPERITY AND MARKED DETERIORATIONS DURING WORLD RECESSIONS; (2) THEY DEPENDED STRONGLY ON THE PRICE VARIATION OF COFFEE EXPORTS; AND (3) THEY SUFFERED APPARENTLY FROM A SECULAR TREND OF DETERIORATION.

THE FIRST TWO CHARACTERISTICS CAN BE EXPLAINED BY: (A) THE DEPENDENCE OF BRAZIL'S EXPORT TRADE ON COFFEE; (B) THE LOW ELASTICITY OF DEMAND OF COFFEE AND OTHER PRIMARY EXPORT COMMODITIES ABROAD; (C) THE TENDENCY OF PRICES FOR PRIMARY GOODS TO EXPAND FASTER DURING PERIODS OF PROSPERITY AND TO CONTRACT FASTER DURING RECESSIONS THAN THE PRICES FOR INDUSTRIAL GOODS; (D) BRAZIL'S UNUSUALLY LARGE PORTION OF CONTROL OVER THE WORLD COFFEE SUPPLY.

AS FAR AS THE SECULAR TREND IS CONCERNED, EXTREME CAUTION IS NECESSARY NOT TO OVERESTIMATE ITS IMPORTANCE. APART FROM THE OBJECTIONS RAISED BY VINER, ITS INTERPRETATION MAY EASILY BE BIASED BY ANOTHER TECHNICAL SHORTCOMING. TERMS OF TRADE ANALYSES ARE ACCURATE YARDSTICKS TO MEASURE CHANGES IN THE VOLUME OF EXPORTS AND IMPORTS. HOWEVER, THEY EXPRESS NOTHING ABOUT VARIATIONS IN QUALITIES OF GOODS EXCHANGED. AND

⁹ MEIREN AND LOEB, "TRENDS AND PROBLEMS IN ECONOMIC DEVELOPMENT OF BRAZIL," OP. CIT., PP. 29-33.

¹⁰ HÉLIO SCHLITTLER SILVA, "ÍNDICES DE PREÇOS NO COMÉRCIO EXTERIOR DO BRASIL," REVISTA BRASILEIRA DE ECONOMIA, ANO 6, No. 2, (RIO DE JANEIRO, JUNE 1952), PP. 69-103.

THERE IS SUFFICIENT EVIDENCE THAT THE MAJORITY OF LATIN AMERICAN IMPORT PRODUCTS HAVE UNDERGONE MORE INTENSIVE QUALITATIVE ALTERATIONS THAN THE EXPORT PRODUCTS. TAKE ANY EXAMPLE OUT OF THE RANGE OF TYPICAL LATIN AMERICAN EXPORT COMMODITIES AND COMPARE IT TO THE MAJOR IMPORT GOODS TO ILLUSTRATE THE POINT IN QUESTION. FOR INSTANCE, PERCENTAGEWISE THERE WAS LITTLE CHANGE IN THE QUALITATIVE COMPOSITION OF COFFEE EXPORTED FROM BRAZIL BETWEEN THE BEGINNING AND THE MIDDLE OF THIS CENTURY. DURING THE SAME PERIOD THE AMERICAN AND EUROPEAN INDUSTRIES HAVE TURNED OUT PRODUCTS WITH WIDE IMPROVEMENTS IN QUALITY AND USE, BUT WHICH IN OFFICIAL STATISTICS STILL CARRY THE SAME NAMES AND FALL UNDER THE SAME CATEGORIES. ONE MAY THEREFORE ASK: CAN A COUNTRY EXPECT TO EXCHANGE AN EQUAL AMOUNT OF COFFEE BAGS FOR EITHER A MODEL T FORD OR AN AUTOMATIC STREAMLINE CAR OF TODAY?

THIS DETERMINES THE THIRD AND LAST RESTRICTION: TERMS OF TRADE COMPUTATIONS ARE NOT SUFFICIENTLY ACCURATE TO EXPRESS FRACTIONAL CHANGES IN THE DEVELOPMENT OF RELATIVE PRICES. THIS MAY OR MAY NOT INVALIDATE THE SECULAR TREND ANALYSIS. IN ANY EVENT IT DEMONSTRATES THAT THE PESSIMISM OFTEN DERIVED FROM TERMS OF TRADE STATISTICS LACKS A SOLID FOUNDATION.

IX. FOREIGN CAPITAL AND THE BALANCE OF PAYMENTS

OF ALL COMPONENTS MAKING UP THE BALANCE OF PAYMENTS, THE BALANCE OF TRADE IS PARTICULARLY AFFECTED BY STRUCTURAL DISEQUILIBRIUM. THEREFORE, THE ANALYSIS HAS BEEN CONFINED THUS FAR TO THOSE ASPECTS BEARING DIRECTLY UPON COMMERCIAL TRANSACTIONS. TO COMPLETE THE ANALYSIS IT IS NOW NECESSARY TO CONCENTRATE ON THE FUNCTION OF FOREIGN CAPITAL IN BRAZIL'S INTERNATIONAL TRADE. THE BASIC QUESTION DISCUSSED HERE IS: DOES FOREIGN CAPITAL CONTRIBUTE OR NOT TO RELIEVE THE SECULAR DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS, THIS AUTOMATICALLY ELIMINATES CYCLICAL ASPECTS.

1. THE CAPITAL PROBLEM

TABLE 1 ON PAGE 8 GIVES A SUMMARY OF NET POSITIONS IN BRAZIL'S BALANCE OF PAYMENTS BETWEEN 1939 AND 1954. PRELIMINARY FIGURES FOR 1955¹ SHOW THE FOLLOWING CURRENT DEVELOPMENTS: DESPITE UNUSUALLY LOW EXPORT PROCEEDS, THE BALANCE OF TRADE CLOSED WITH A SURPLUS OF Cr\$5.4 BILLION IN 1955. IMPORTS (FOB) FELL BACK TO THE 1953 LEVEL OF Cr\$20.6 BILLION. THE BALANCE OF SERVICES REGISTERED A DEFICIT OF Cr\$5.2 BILLION. THE SURPLUS IN THE CAPITAL BALANCE ALLOWED FOR A REDUCTION OF Cr\$0.4 BILLION OF COMMERCIAL ARREARS AND A Cr\$0.6 BILLION INCREASE IN EXCHANGE AVAILABILITIES.

¹ ADAPTED FROM DOLLAR TO CRUZEIRO VALUES FROM: "THE BRITISH AND COMMONWEALTH CHAMBER OF COMMERCE IN SÃO PAULO," INFORMATION CIRCULAR NO. 9, (SÃO PAULO, MAY 4, 1956), P. 176.

TABLE 11

NET CHANGES IN THE BRAZILIAN BALANCE OF PAYMENTS BETWEEN 1947 AND 1955
(IN Cr\$1,000,000,000)

BALANCE OF TRADE		30.2
CAPITAL: PRIVATE	8.2	
OFFICIAL FINANCING	<u>16.0</u>	<u>24.2</u>
COMMERCIAL ARREARS (NET 1955)		2.0
ERRORS AND OMISSIONS		<u>2.8</u>
TOTAL POSITIVE ITEMS		59.2
BALANCE OF SERVICES		-59.2

SOURCE: TABLE I AND FOOTNOTE ON PAGE 56.

ACCORDING TO THE DATA OF TABLE 11, BRAZIL ACCUMULATED Cr\$24.2 BILLION WORTH OF NET CAPITAL ACCOUNTS IN THE PAST NINE YEARS. IF OUTSTANDING COMMERCIAL ARREARS ARE ADDED TO THIS FIGURES,² THE TOTAL CORRESPONDS ALMOST EXACTLY TO THE AVERAGE ANNUAL EXPORT REVENUES OF THE SAME PERIOD. IN OTHER WORDS, IT TOOK BRAZIL NINE YEARS TO ABSORB AS MUCH NET FOREIGN CAPITAL AS COULD BE PRODUCED IN ONE YEAR BY EXPORTS.

THIS MAY NOT BE A COMPLETELY SATISFACTORY WAY OF MEASURING A COUNTRY'S CAPACITY TO ATTRACT CAPITAL, BUT IT IS AT LEAST INDICATIVE OF AN AFFLICTING SITUATION, NAMELY THAT FOREIGN LENDING CONTRIBUTES VERY LITTLE TO IMPROVE THE BALANCE OF PAYMENTS. IF ONE CONSIDERS, IN ADDITION, THE PAINFUL WAY WITH WHICH BRAZIL OBTAINED FOREIGN LOANS OR GRANTS IN RECENT YEARS, THIS IMPRESSION IS RE-INFORCED. IT CONFIRMS WHAT PROFESSOR KINDLEBERGER WROTE ABOUT FOREIGN LENDING, NAMELY: "STRUCTURAL DISEQUILIBRIUM MAY BE MORE EASILY CORRECTED WITH INTERNATIONAL LENDING THAN WITHOUT, OR MAY BE CORRECTED WITH LESS NECESSITY TO REDUCE THE STANDARD OF LIVING OF A COUNTRY IN DISEQUILIBRIUM. THE DIFFICULTY, HOWEVER, LIES IN THE FACT THAT REPAYMENT OF LOANS THUS INCURRED IS NECESSARILY PROBLEMATIC. THE

²TECHNICALLY COMMERCIAL ARREARS CAN BE CONSIDERED FOREIGN LENDING, ALTHOUGH INVOLUNTARY.

INCREASED PRODUCTIVITY MADE POSSIBLE BY BORROWING IS ALREADY COMMITTED TO MEETING THE DISEQUILIBRIUM. IT CANNOT BE USED AT THE SAME TIME TO PAY INTEREST AND TO REPAY PRINCIPAL."³

2. OBSTACLES TO INVESTMENTS

IT SEEMS TO BE UNIVERSALLY TRUE THAT THE MAIN IMPEDIMENT TO THE FLOW OF INTERNATIONAL CAPITAL IS DUE TO INVESTORS' APPREHENSION ABOUT GOVERNMENT INTERFERENCE. MORE SPECIFICALLY, THERE IS A "FEAR OF EXPROPRIATION OF DIRECT INVESTMENTS OR DEFAULT ON BONDS, AND FEAR OF THE SUSPENSION OR DELAY OF PROFIT OR INTEREST REMITTANCES THROUGH MORATORIA OR EXCHANGE CONTROLS."⁴ AN OPINION RESEARCH CONDUCTED BY J. F. GASTON IN 1951 AMONG THE MAJORITY OF UNDERDEVELOPED COUNTRIES, INCLUDING 55 COMPANIES IN BRAZIL, DEFINITELY CONFIRMS THIS OBSERVATION OF RELUCTANT INVESTMENT ATTITUDES DUE TO EXPECTED GOVERNMENT INTERFERENCE.

EXCEPT FOR SOME MINOR ASPECTS THE REPLIES GIVEN IN THE POLL BY INVESTORS (SEE TABLE III) SEEM TO BE RATHER OBJECTIVE.⁵ ABOVE ALL, THEY SHOW THE HIGH DEGREE OF FEAR OF NATIONALISTIC POLICIES OF THE LATIN AMERICAN REPUBLICS. ALTHOUGH THIS FEAR MAY BE MORE PSYCHOLOGICAL THAN REAL IT IS NOT ENTIRELY UNFOUNDED. BRAZIL IS NO EXCEPTION; DISCRIMINATORY ATTITUDES AND LAWS DO EXIST AND HAVE UNDERMINED MANY PROMISING PROJECTS

³ CHARLES P. KINDLEBERGER, THE DOLLAR SHORTAGE, (PUBLISHED JOINTLY BY THE TECHNOLOGY PRESS OF MIT AND JOHN WILEY & SONS INC., NEW YORK, 1950), P. 251.

⁴ NORMAN S. BUCHANAN AND HOWARD S. ELLIS, APPROACHES TO ECONOMIC DEVELOPMENT, (NEW YORK: THE TWENTIETH CENTURY FUND, 1955), P. 344.

⁵ IN THE LIGHT OF MORE RECENT EVENTS, THE FOLLOWING PERSONAL COMMENTS MAY BE SUITABLE: WITH THE EXCHANGE REFORM OF 1953, LIMITATIONS ON PROFIT REMITTANCES HAVE BEEN SOMEWHAT RELIEVED; ITEM 1 THEREFORE MAY BE OVER-EMPHASIZED FOR PRESENT DAY CONDITIONS; THIS APPLIES ALSO TO ITEMS 7, 8, AND 10; TODAY ITEM 9 HAS BECOME A STRONGER BURDEN; THERE ARE NO SUCH RESTRICTIONS AS MENTIONED UNDER 11 EXCEPT FOR THE USUAL RED TAPE, COMMON TO ALL COUNTRIES.

TABLE III

FREQUENCY OF PROBLEMS ENCOUNTERED BY INVESTORS IN BRAZIL

<u>RANK</u>			
<u>LATIN</u>	<u>BRAZIL</u>		<u>REPLIES FOR BRAZIL</u>
<u>AMERICA</u>			
2	1	LIMITATION ON REMITTANCE OF PROFITS	37
1	2	EXPORT OR IMPORT QUOTAS	36
4	3	CONTROL OF CAPITAL MOVEMENTS	30
7	4	LACK OF ADEQUATE ROADS, RAILROADS, HARBORS OR STORAGE FACILITIES	22
6	5	LACK OF TRAINED NATIVE PERSONNEL	19
3	6	BURDEN OF SOCIAL SECURITY LEGISLATION	18
15	7	UNDERDEVELOPED BANKING SYSTEMS OR OTHER CREDIT FACILITIES	12
11	8	INADEQUACY OF HOUSING, RECREATIONAL AND SHOPPING FACILITIES FOR EMPLOYEES	11
9	9	INADEQUATE POWER FACILITIES	10
11	10	SPECIAL TAXATION OF FOREIGN ENTERPRISE	9
8	11	FOREIGN RESTRICTION ON IMPORTATION OF PERSONNEL FROM HOME COUNTRY	8
	12	OTHER ITEMS (TOTALING 11)	28
	13	NO PROBLEMS	44
		NUMBER OF REPLIES	55

SOURCE: CONDENSED FROM J. FRANK GASTON, OBSTACLES TO DIRECT FOREIGN INVESTMENTS, (NEW YORK: NATIONAL INDUSTRIAL CONFERENCE BOARD, INC. APRIL 1951), TABLE 160, P. 158, AND TABLE I, P. 8.

AND OPPORTUNITIES FOR ECONOMIC DEVELOPMENT. THEY HAVE BEEN USED AND MISUSED FOR POLITICAL PURPOSES. BUT THEY HAVE NEVER CREATED A LASTING HOSTILITY TOWARD FOREIGNERS, BECAUSE THE BRAZILIAN NATIONAL CHARACTER DOES NOT LEND ITSELF TO RACIAL OR POLITICAL PREJUDICES. AND IT CAN THEREFORE BE EXPECTED THAT A REVISION OF NATIONALISTIC LEGISLATION WOULD SOON REMOVE THE EVILS CAUSED BY THEM. THIS APPLIES IN PARTICULAR TO THE UNFORTUNATE BILL INSTITUTING A STATE MONOPOLY IN THE DRILLING AND REFINING OF BRAZILIAN OIL.

3. FOREIGN EXCHANGE SOLVENCY

ON THE OTHER HAND, IT MUST BE UNDERSTOOD THAT NATIONALISM IS NOT THE ONLY MOTIVE CALLING FOR RESTRICTIONS. THE THREE MAIN OBSTACLES TO FOREIGN INVESTMENTS IN BRAZIL, AS RANKED IN TABLE III, ARE CHIEFLY DUE TO EXCHANGE SHORTAGE. OR, AS J. J. POLAK PUT IT: "THE CRUCIAL PROBLEM ATTENDING FOREIGN LENDING IS THE SOLVENCY OF THE DEBTOR COUNTRY ON INTERNATIONAL ACCOUNT."⁶

ACCORDING TO POLAK THERE ARE THE FOLLOWING THREE MAIN REASONS WHICH MAY LEAD TO A SHORTAGE OF FOREIGN EXCHANGE:

(1) THE RATE OF INVESTMENT IS TOO HIGH IN VIEW OF THE INITIAL RATE OF CAPITAL INFLOW;

(2) INVESTMENT IS IMPROPERLY DISTRIBUTED; TOO SMALL A PROPORTION BEING DIRECTED TOWARDS THE PRODUCTION OF EXPORTABLE GOODS;

(3) THE RATE OF CAPITAL INFLOW DECLINES TOO RAPIDLY.⁷

TO AVOID EXCHANGE SHORTAGES THE GOVERNMENT MUST BUDGET SO THAT THE APPLICATION OF INITIAL CAPITAL INFLOW IN DOMESTIC ACTIVITIES PRODUCES EXPORT GOODS AND FOREIGN EXCHANGE IN SUFFICIENT AMOUNT TO MEET SERVICE COSTS AND TO REPAY PRINCIPAL IN DUE TIME.⁸ THIS PRESUPPOSES ACCURATE KNOWLEDGE OF THE EXPECTED EFFECTS OF INVESTMENTS ON THE MARGINAL PROPENSITIES TO SAVE AND CONSUME. LET THIS BE CLARIFIED BY AN EXAMPLE.

SUPPOSE THAT AN AMERICAN ENTERPRISE INVESTS ONE MILLION DOLLARS IN

⁶J. J. POLAK, "BALANCE OF PAYMENTS PROBLEMS OF COUNTRIES RECONSTRUCTING WITH THE HELP OF FOREIGN LOANS," READINGS IN THE THEORY OF INTERNATIONAL TRADE, OP. CIT., P. 461.--MUCH OF THE ANALYSIS CONTAINED IN THIS SECTION IS DERIVED FROM THIS ARTICLE.

⁷POLAK, IBID., P. 479.

⁸BASED ON THE ASSUMPTION THAT THE CAPITAL BALANCE IS SELF-FINANCING, I. E. THAT THERE ARE NO OTHER ACCOUNTS IN THE BALANCE OF PAYMENTS TO COVER CAPITAL DEFICITS, AND THAT NO FOREIGN CAPITAL IS REQUIRED TO COVER DEFICITS OF OTHER POSITIONS IN THE BALANCE OF PAYMENTS.

BRAZIL. THE BANK OF BRAZIL WILL BE CREDITED FOR THIS AMOUNT, AND IT WILL, IN TURN, PAY A CORRESPONDING AMOUNT, SAY 80 MILLION CRUZEIROS. THE MONEY IS USED IN BRAZIL TO PAY THE FACTORS OF PRODUCTION NEEDED FOR THE OUTPUT OF INVESTMENT GOODS. FROM THERE ON THE MONEY WILL BE CIRCULATING FREELY. IF THE PROPENSITY TO CONSUME OF RECIPIENTS IS HIGH, DEMAND WILL TEND TO TURN TO IMPORTS AND THE DOLLAR RESERVES INITIALLY ACCUMULATED BY THE BANK OF BRAZIL WILL SOON BE DRAINED. IF THE PROPENSITY TO SAVE IS HIGH, THE TIME LAG FOR THE IMPORT PROPENSITY TO BECOME EFFECTIVE WILL BE GREATER. MEANWHILE, THE EXCHANGE SITUATION MAY HAVE BEEN RELIEVED AS A RESULT OF ADDITIONAL OUTPUT EITHER PRODUCING FOREIGN EXCHANGE THROUGH EXPORTS, OR SAVING EXCHANGE BY REDUCING IMPORTS.

THIS DOES NOT MEAN THOUGH THAT THE RATE OF INVESTMENT MAY NOT EXCEED THE RATE OF ORIGINAL CAPITAL INFLOW. AS LONG AS FOREIGN EXCHANGE HOLDINGS ARE NOT ENTIRELY SOLD TO IMPORTERS, THE BANK OF BRAZIL'S NET RESERVE POSITION IMPROVES. IT CAN THUS EXTEND ITS CREDIT LINE. BUT THE HIGHER THE MARGINAL PROPENSITY TO IMPORT, THE FASTER WILL ADDITIONAL INVESTMENTS TURN TO A DEMAND FOR FOREIGN EXCHANGE TO PAY FOR MORE IMPORTS. THIS EXPLAINS, THE FIRST FACTOR MENTIONED BY POLAK POSSIBLY LEADING TO A SHORTAGE OF FOREIGN ASSETS. BECAUSE, GIVEN A HIGH MARGINAL PROPENSITY TO IMPORT, EXCHANGE RESERVES WILL BE EXHAUSTED THE SOONER, THE HIGHER THE RATE OF INVESTMENT BASED ON INITIAL CAPITAL INFLOW.

MUCH DEPENDS, ON THE OTHER HAND, ON THE TYPES OF INVESTMENTS. THE HIGHER THE PORTION OF INVESTMENT RESERVED FOR THE PRODUCTION OF GOODS DIRECTLY OR INDIRECTLY RELIEVING THE EXCHANGE BUDGET, THE LESS STRENUOUS WILL, OF COURSE, BE THE EXCHANGE POSITION. IN OTHER WORDS, INVESTMENTS SHOULD PREFERABLY BE DIRECTED INTO THE SECTORS PRODUCING EXPORT GOODS OR REPLACING IMPORT GOODS. IF THIS REQUIREMENT IS NOT RESPECTED, I. E. WHEN

THE BULK OF THE NEW INCOME IS INVESTED IN INDUSTRIES PRODUCING GOODS THUS FAR NOT AVAILABLE ON THE LOCAL MARKET, A SHORTAGE OF FOREIGN EXCHANGE IS DUE TO COME ABOUT. HERE TOO, THE DEGREE OF EXCHANGE SHORTAGE DEPENDS ON (1) THE AMOUNT OF INVESTMENT FINANCED BY BANKS, AND (2) THE MARGINAL PROPENSITIES TO CONSUME AND IMPORT.

THE THIRD REASON GIVEN BY POLAK THAT MAY BE RESPONSIBLE FOR AN EXCHANGE SHORTAGE IS OF CYCLICAL RATHER THAN SECULAR NATURE. ALTHOUGH IT MAY BE OF GREAT IMPORTANCE FOR A COUNTRY, FOR INSTANCE AT TIMES OF UNEXPECTED DEPRESSIONS IN THE LENDING NATION, IT SHALL NOT BE DISCUSSED HERE.

4. FOREIGN CAPITAL AND THE PROPENSITY TO IMPORT

HOW DOES THE ABOVE APPLY TO BRAZIL? APPARENTLY THE CLUE TO THIS QUESTION IS DETERMINED BY THE RELATIONSHIP BETWEEN THE MARGINAL PROPENSITIES TO CONSUME DOMESTIC PRODUCTS AND TO IMPORT, DERIVED FROM AN INCREASE IN INCOME AND INVESTMENT.

FOR REASONS DISCUSSED EARLIER IN THE STUDY (SEE CHAPTERS II, III, AND VII) IT CAN BE ASSUMED THAT THE MARGINAL PROPENSITY TO IMPORT IS HIGH IN BRAZIL. THIS MEANS THAT THE BANK OF BRAZIL AS WELL AS ANY COMMERCIAL BANK WOULD HAVE TO FOLLOW A VERY CAREFUL CREDIT POLICY IN ORDER NOT TO OVER-EXTEND LOANS BACKED UP BY FOREIGN ASSETS. THIS REQUIRES (1) A STRICT SELECTION OF INVESTMENT PROGRAMS, AND (2) A LIMITATION OF INVESTMENT CREDITS TO AMOUNTS NOT FAR EXCEEDING THE RATE OF INITIAL CAPITAL INFLOW.

TWO CONFLICTING ASPECTS RENDER IT DIFFICULT TO ADHERE TO THE SELECTION PRINCIPLE. IT IS GENERALLY TRUE THAT THE RATE OF CAPITAL TURNOVER (OR THE RATIO OF THE VALUE OF OUTPUT TO THE VALUE OF CAPITAL INVESTED TO PRODUCE THE OUTPUT IN A GIVEN PERIOD OF TIME) SHOULD BE AS HIGH AS POSSIBLE IN A COUNTRY WITH A SHORTAGE OF CAPITAL AND CONSUMPTION GOODS. THE HIGHER THE TURNOVER THE FASTER WILL BE THE SUPPLY

OF GOODS AND, AMONG OTHER ADVANTAGES, THIS WILL RELIEVE THE FOREIGN EXCHANGE SITUATION. FROM THIS STANDPOINT IT IS CONVENIENT FOR BRAZIL TO INVEST LARGE SUMS IN MANUFACTURING INDUSTRIES AND IN TRADE ORGANIZATIONS WHERE THE RATE OF TURNOVER IS CONSIDERABLY FASTER THAN IN PUBLIC UTILITIES REQUIRING SUBSTANTIAL INVESTMENTS, LONG CONSTRUCTION PERIODS, AND WHICH OPERATE AT LOWER PROFIT MARGINS. ON THE OTHER HAND, BRAZIL NEEDS MORE THAN ANYTHING ELSE AN IMPROVEMENT OF PUBLIC SERVICES AND TRANSPORTATION FACILITIES.

AS FAR AS THE LIMITATION OF INVESTMENTS IS CONCERNED, PROBLEMS ARE EVEN MORE STRIKING. IN CHAPTER II IT WAS SHOWN THAT THE MULTIPLIER IS NOT VERY EFFECTIVE IN BRAZIL DUE TO CONDITIONS COMPARABLE TO FULL EMPLOYMENT. NEW INVESTMENTS, THEREFORE, TEND TO INCREASE THE WAGE LEVEL AND THE MARGINAL PROPENSITY TO IMPORT IN CONSEQUENCE OF THE DIFFERENCE IN QUANTITATIVE AND QUALITATIVE OUTPUT BETWEEN BRAZIL AND THE MORE ADVANCED COUNTRIES. THIS JUSTIFIES A LOW RATE OF INVESTMENTS. ON THE OTHER HAND, BRAZIL NEEDS CAPITAL URGENTLY TO IMPROVE ITS RATE OF PRODUCTIVITY AND TO INCREASE ITS TOTAL OUTPUT. TO WHICH OF THE TWO OPPOSING POLICIES SHALL PREFERENCE BE GIVEN? THIS DEPENDS, OF COURSE, ON THE TYPE OF INVESTMENT. IN LINE WITH THE ABOVE ARGUMENTS, PREFERENCE MUST BE GIVEN TO THE PRODUCTION OF EXPORTABLE GOODS. UTILITIES AND TRANSPORTATION ARE LIKEWISE IMPORTANT, IN SPITE OF THEIR LOW RATE OF CAPITAL TURNOVER, SINCE THEY ARE INSTRUMENTAL FOR IMPROVED PRODUCTIVITY IN THE EXPORT INDUSTRY AND OTHER FIELDS. TOO LITTLE HAS BEEN DONE THUS FAR IN THIS CONNECTION. THE DEVELOPMENT OF PUBLIC UTILITIES IS BEING HAMPERED BY GOVERNMENT INTERFERENCE OR POOR ADMINISTRATION. PRACTICALLY NO FOREIGN CAPITAL IS BEING INVESTED TO STIMULATE EXPORTS, PARTIALLY DUE TO HIGHER PROFIT MARGINS AND MORE AUTONOMY TO BE GAINED FROM THE INDUSTRIALIZATION OF NEW PRODUCT

FIELDS.

AS DESIRABLE AS A REFORMULATION OF INVESTMENT POLICIES MAY BE, IT CANNOT BE EXPECTED TO ENTIRELY REMOVE THE DANGER OF FOREIGN EXCHANGE SHORTAGE. THE REASON IS THAT THE PRODUCTION OF MORE EXPORT GOODS/YIELD A HIGHER RETURN IN FOREIGN ASSETS BUT DOES NOT AFFECT THE PROPENSITY TO IMPORT. THE LATTER IS ALWAYS BOUND TO INCREASE FOLLOWING A RISE IN INCOME, GIVEN THE RATE OF CAPITAL INFLOW. THEREFORE, THE CLUE TO THE PROBLEM WOULD BE TO REDUCE THE MARGINAL PROPENSITY TO IMPORT WITHOUT IMPAIRING CAPITAL INFLOW. HOW CAN THIS BE DONE? BEFORE THIS QUESTION IS ANSWERED, A SUMMARY OF WHAT HAS BEEN DISCUSSED THUS FAR MAY BE CONVENIENT. THE FOLLOWING STEPS WERE OBSERVED:

(1) DUE TO THE LACK OF CAPITAL FORMATION IN BRAZIL, AS WELL AS THE SECULAR TREND OF DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS, FOREIGN INVESTMENTS ARE HIGHLY DESIRABLE;

(2) BRAZIL HAS TO ATTEMPT TO AT LEAST BALANCE ITS FOREIGN CAPITAL ACCOUNTS ON THE LONG RUN IN ORDER NOT TO WEAKEN THE POSITION OF THE BALANCE OF PAYMENTS; I. E. THE INVESTMENTS DERIVED FROM CAPITAL INFLOW MUST PRODUCE SUFFICIENT FOREIGN EXCHANGE TO SERVICE AND AMORTIZE ORIGINAL INFLOWS WHEN DEBTS BECOME DUE;

(3) DUE TO THE HIGH PROPENSITY TO IMPORT THE REQUIREMENT MENTIONED UNDER (2) IS DIFFICULT TO MEET; I.E. THE MARGINAL PROPENSITY TO IMPORT RISES WITH A RISE IN INCOME, AND THE HIGHER THE CREDITS GRANTED FOR INVESTMENTS ON THE RESERVE BASIS OF FOREIGN ASSETS, THE FASTER WILL DEVELOP THE MARGINAL PROPENSITY TO IMPORT DUE TO THE INEFFICIENCY FOR THE MULTIPLIER; CONSEQUENTLY, THE DEMAND FOR FOREIGN EXCHANGE WILL EXCEED ITS SUPPLY (ALL OTHER FACTORS REMAINING EQUAL);

(4) THUS, INSTEAD OF RELIEVING THE ADVERSE TREND, FOREIGN INVEST-

MENTS TEND TO WEAKEN THE BALANCE OF PAYMENTS.

THREE IMMEDIATE MEASURES CAN BE EMPLOYED TO CURTAIL THE PROPENSITY TO IMPORT, NAMELY: QUANTITATIVE RESTRICTIONS, EXCHANGE CONTROL, AND LIMITATION TO REAL CAPITAL IMPORTS. THE FIRST TWO ARE INSUFFICIENT TO COPE WITH THE BALANCE OF PAYMENTS PROBLEMS, AS HAS BEEN SEEN BEFORE (SEE CHAPTER VII). NO OBJECTION CAN BE MADE TO THE IMPORTATION OF REAL CAPITAL, BUT IT IS PRACTICALLY IMPOSSIBLE FOR ANY COUNTRY TO OBTAIN ALL ITS CAPITAL NEEDS FROM ABROAD IN TERMS OF CAPITAL GOODS. MORE RADICAL AND FAR-REACHING METHODS HAVE TO BE APPLIED.

PROGRESSIVE INCOME CONCENTRATION STIMULATED BY INFLATION PERMITS THE WEALTHIER STRATA OF THE POPULATION TO INCREASE ITS MARGINAL PROPENSITIES TO CONSUME, TO SAVE, TO INVEST, OR TO IMPORT. THE MORE UNEQUAL THE DISTRIBUTION OF INCOME, THE HIGHER WILL BE THE RATE OF PROPENSITY EXPANSION AMONG THE WEALTHY AND PROPENSITY CONTRACTION AMONG THE POOR. HOWEVER, THE INCOME RECIPIENTS ARE NOT ENTIRELY FREE TO SELECT THE DEGREE AND DIRECTION OF CHANGE FOR EACH OF THE MAGNITUDES. FOR INSTANCE, ONLY PART OF THE RISE IN INCOME WILL ALLOW FOR AN INCREASE IN THE PROPENSITY TO CONSUME, PARTICULARLY IF THE ECONOMY IS NEARLY FULLY EMPLOYED AND THE MULTIPLIER EFFECT IS RETARDED. UNDER THE CONDITION OF EQUAL NATIONAL OUTPUTS IN THE TWO YEARS CONSIDERED, THE RISE OF CONSUMPTION PROPENSITIES OF THE WEALTHY CANNOT MUCH EXCEED THE FALL OF CONSUMPTION PROPENSITIES OF THE POOR, UNLESS THERE ARE SUBSTANTIAL STOCKS AVAILABLE FOR SALE. THIS FALL WILL NOT BE VERY HIGH, SINCE THE POOR WILL RATHER REDUCE THEIR SAVING PROPENSITY THAN THEIR CONSUMPTION PROPENSITY UNDER CONTRACTING REAL INCOME. TO FIND AN OUTLET, INCREASED INCOMES OF THE WEALTHY WILL SPREAD INTO LEAKAGES. FOR INSTANCE, IT WILL SEEK INVESTMENTS THROUGH INCREASED SAVINGS. BUT HERE, TWO OBSTACLES WILL BE ENCOUNTERED. SHORTAGE OF LABOR AND LOW PURCHASING POWER OF THE MAJORITY

OF CITIZENS RESTRICT THE EXPANSION OF CONSUMPTION AND INVESTMENTS GOODS. HOARDING MAY TAKE PLACE, ALTHOUGH NOT MUCH OF THE EXTRA MONEY WILL BE KEPT FROM CIRCULATING UNDER PROGRESSIVE INFLATION. RECIPIENTS WILL RATHER INVEST THEIR INCOMES IN REAL ESTATE OR ANY FIELD REQUIRING LITTLE LABOR SERVICES. GIVEN THE SUBSTANTIAL PRICE AND QUALITY DIFFERENCE BETWEEN DOMESTIC AND FOREIGN GOODS, A GREAT PORTION OF EFFECTIVE DEMAND WILL BE DIRECTED TOWARD IMPORTS. THE MARGINAL PROPENSITY TO IMPORT EXPANDS IN SPITE OF RISING IMPORT PRICES. THUS ECONOMIC DEVELOPMENT WILL BE IMPAIRED BY A REDUCTION (OR AT LEAST RETARDING EXPANSION) OF TOTAL REAL OUTPUT, AND THE BALANCE OF PAYMENTS WILL BE AFFECTED BY REDUCED EXPORTS AND THE GROWING DEMAND FOR IMPORTS.

ALL THIS CAN BE AVOIDED IF BETTER USES OF THE FACTORS OF PRODUCTION ARE MADE. COMPETITION AMONG THE AVAILABLE FACTORS, UNDISTURBED BY INCOME DISCREPANCIES AND AN INFLATIONARY SPIRAL, IS THE FORMULA BRAZIL HAS TO SEEK. AMONG OTHER BENEFITS, A REDISTRIBUTION OF INCOME WILL PREVENT THE STRONG IMPACT OF IMPORT PROPENSITIES ON THE BALANCE OF FOREIGN CAPITAL BY RELIEVING THE EXCHANGE SITUATION AND AVOIDING THAT FOREIGN ASSETS INVESTED IN DOMESTIC ACTIVITIES STIMULATE THE INDUCEMENT TO IMPORT.

X. CONCLUSIONS AND RECOMMENDATIONS

THE OBJECTIVE OF THIS STUDY HAS BEEN TO INVESTIGATE THE CAUSES UNDERLYING BRAZIL'S SECULAR DISEQUILIBRIUM IN THE BALANCE OF PAYMENTS. ONLY MINOR EMPHASIS WAS PLACED ON CYCLICAL FLUCTUATIONS OF PAST DECADES. AN EXAMINATION OF THESE FLUCTUATIONS WOULD PROBABLY REVEAL THAT BRAZIL'S BALANCE OF PAYMENTS IS MORE STRONGLY AFFECTED BY BUSINESS CYCLES ABROAD THAN AT HOME, DUE TO THE DEPENDENCE ON FOREIGN DEMAND FOR BRAZILIAN PRODUCTS OF LOW PRICE ELASTICITY, OR THE NEED FOR LONG-TERM CAPITAL INVESTMENTS.

THE SECULAR TREND OF DISEQUILIBRIUM IS REFLECTED IN THE CONTINUOUS DETERIORATION OF THE CRUZEIRO'S PURCHASING POWER ABROAD. REPEATED DEVALUATIONS AND EXCHANGE ADJUSTMENTS HAVE ACCOMPLISHED LITTLE IN THE PAST TO RELIEVE PRESSURE FROM THE BALANCE OF PAYMENTS, BECAUSE THEIR EFFECTS WERE ALWAYS OFFSET BY MORE DEEP-SEATED FORCES. THESE, IT HAS BEEN PROPOSED IN THE STUDY, ARE DETERMINED BY A STRUCTURAL DISEQUILIBRIUM IN THE DOMESTIC ECONOMY.

1. THE BALANCE OF PAYMENTS' COMPOSITION

FOR PURPOSES OF ANALYSIS, THE BRAZILIAN BALANCE OF PAYMENTS CAN BE DIVIDED INTO THREE SEGMENTS, AS FOLLOWS: (1) THE BALANCE OF TRADE, (2) THE BALANCE OF SERVICES, AND (3) THE BALANCE OF CAPITAL ACCOUNTS. THE LATTER INCLUDES ALL LONG-TERM AND SHORT-TERM CAPITAL ITEMS OF PRIVATE AND OFFICIAL CHARACTER. COMMERCIAL ARREARS ARE INCLUDED ALSO, AS THEY CAN

TECHNICALLY BE REGARDED FOREIGN LENDING.

THE MAJOR BRAZILIAN BALANCE OF PAYMENTS DEFICIT IS THE BALANCE OF SERVICES, THE REASON BEING THAT BRAZIL DEPENDS HEAVILY UPON FOREIGN SERVICES. CONSEQUENTLY, THERE ARE VERY FEW SURPLUS POSITIONS, AND THE NET BALANCE IS NEGATIVE. TO REMOVE THIS UNFAVORABLE SITUATION MUCH CAN BE DONE. IT IS OF EXTREME IMPORTANCE THAT THE BRAZILIAN MERCHANT FLEET BE EXPANDED AND IMPROVED, PREFERABLY UNDER PRIVATE COMPETITION. TOO, WITH LITTLE COST THE GOVERNMENT COULD STIMULATE FOREIGN TRAVEL TO BRAZIL THROUGH MORE EFFICIENT PUBLICITY ABROAD.

IN ORDER TO OBTAIN FOREIGN GOODS REQUIRED FOR DOMESTIC CONSUMPTION AND GROWTH, AND TO FINANCE EXPENSES ACCRUED IN OTHER ACCOUNTS, THE BALANCE OF TRADE MUST ACCUMULATE LONG-RANGE SURPLUSES. GENERALLY, BRAZIL'S FOREIGN TRADE POSITION IMPROVES AS SURPLUSES MOUNT. COMMERCIAL TRANSACTIONS ARE, THEREFORE, THE CLUE TO EQUILIBRIUM IN THE COUNTRY'S BALANCE OF PAYMENTS.

2. EXCHANGE CONTROLS

AMONG THE REASONS POINTED OUT AS MAIN DETERMINANTS OF AN ADVERSE BALANCE OF PAYMENTS IN BRAZIL, THREE ARE PERHAPS MOST FREQUENTLY MENTIONED: (1) EXCHANGE STABILITY, (2) LACK OF FOREIGN CAPITAL, AND (3) DETERIORATING TERMS OF TRADE.

AT TIMES FIXED EXCHANGE RATES HAVE CONTRIBUTED CONSIDERABLY TOWARD IMBALANCES. UNDER A PROGRESSIVE DETERIORATION OF THE CRUZEIRO'S PURCHASING POWER, AND CONTINUED INCREASES IN THE COST OF PRODUCTION, FIXED RATES CAUSED A CONTRACTION IN THE VOLUME OF EXPORTS AND AN INFLUX OF IMPORTS. UNDER SUCH CONDITIONS QUANTITATIVE IMPORT CONTROLS HAVE ONLY A LIMITED EFFECT. THE PEOPLE ARE URGED TO ACQUIRE IMPORT LICENCES AT ALMOST ANY PRICE. FAVORITISM BECOMES ALMOST UNAVOIDABLE.

NEITHER IMPORT NOR EXCHANGE CONTROLS ALONE ARE CAPABLE OF REMOVING THE CAUSES OF STRUCTURAL DISEQUILIBRIUM. BUT THEY ARE INDISPENSABLE TOOLS IN ALLEVIATING THE SEVERITY OF STRUCTURAL DISEQUILIBRIUM. TO BE FULLY EFFECTIVE THEY MUST BE ADAPTABLE TO THE CHANGING CONDITIONS OF THE ECONOMY. THE MULTIPLE EXCHANGE SYSTEM INTRODUCED IN BRAZIL IN 1953 HAS PARTIALLY CORRECTED THE LIMITATIONS OF FIXED RATES, ALTHOUGH IT HAS DONE LITTLE TO RE-ESTABLISH LONG-TERM EQUILIBRIUM.

3. FOREIGN CAPITAL

A COUNTRY SUFFERING FROM A SECULAR ADVERSE BALANCE OF PAYMENTS WILL ALWAYS BE SHORT OF RESERVES. IT WILL HAVE TO IMPOSE RESTRCITIONS ON THE TRANSFER OF INVESTMENT EARNINGS AND REPATRIATION OF FOREIGN CAPITAL. CONSEQUENTLY, IT WILL DISCOURAGE FOREIGN INVESTMENTS EVEN IF DOMESTIC EARNING PROSPECTS ARE HIGH.

IT IS SOMETIMES CONTENDED THAT THE LOW RATE OF CAPITAL INFLOW INTO BRAZIL IS RESPONSIBLE FOR THE COUNTRY'S ADVERSE BALANCE OF PAYMENTS. THIS POINT OF VIEW OVERLOOKS THE NEED FOR REPAYMENT AND SERVICING OF FOREIGN ASSETS. OF COURSE, IT WOULD BE DESIRABLE IF MORE, AND ABOVE ALL, MORE REGULAR CAPITAL INFLOWS TOOK PLACE, BUT THIS WOULD NOT GUARANTEE RELIEF IN THE BALANCE OF PAYMENTS. EVERYTHING DEPENDS UPON THE APPLICATION OF FOREIGN VALUES IN THE DOMESTIC ECONOMY. IN BRAZIL, ONLY A SMALL PORTION OF FOREIGN CAPITAL IS DIRECTED TOWARD THE PRODUCTION OF EXPORTABLE GOODS. THE MAJORITY IS USED FOR INDUSTRIAL EXPANSION. THE GOVERNMENT STIPULATES THAT FOREIGN INVESTMENT PROJECTS MUST LEAD TO A SAVINGS IN FOREIGN EXCHANGE. THEY MUST PRODUCE GOODS AND SERVICES ESSENTIAL TO THE BRAZILIAN ECONOMY WHICH WOULD OTHERWISE HAVE TO BE IMPORTED. THIS IS, NO DOUBT, A VALUABLE CRITERION FOR SELECTION, BUT IT PROVIDES NO GUARANTEE

FOR ACTUAL SAVINGS IN EXCHANGE.

GIVEN THE LIMITED RATE OF EXPANSION IN BRAZIL, AS DETERMINED BY THE SCARCITY OF LABOR, PLUS THE HIGH EFFECTIVE DEMAND FOR CONSUMER GOODS, ANY INCREASE IN INCOME TENDS TO CAUSE A RISE IN THE PROPENSITY TO IMPORT. SINCE FOREIGN INVESTMENTS INVARIABLY LEAD TO AN INCREASE IN INCOME, WHAT CAN BE SAVED ON ONE SIDE IN TERMS OF FOREIGN EXCHANGE WILL BE SPENT ON THE OTHER IN TERMS OF A RISING EFFECTIVE DEMAND FOR IMPORT GOODS. SOMETIMES THIS DEMAND EXCEEDS THE AMOUNT OF ORIGINAL CAPITAL INFLOW AS WHEN THE BANKING SYSTEM EXTENDS CREDIT IN EXCESS OF FOREIGN CURRENCY HOLDINGS.

THE IDEAL SITUATION FOR BRAZIL WOULD BE TO LIMIT THE DEMAND FOR IMPORTS DERIVED FROM CAPITAL INFLOW AT LEAST TO THE POINT WHERE THE GAINS OBTAINED FROM THIS INFLOW EXCEED THE AMOUNT OF ORIGINAL INVESTMENTS, PLUS THEIR SERVICES. AT THIS POINT THE IMPORT VOLUME COULD BE EXPANDED BY THE NET DIFFERENCE BETWEEN THE TOTAL GAIN MINUS REPAYMENT OF PRINCIPAL PLUS SERVICE COSTS. ONLY THEN WOULD THE BALANCE OF PAYMENTS REMAIN IN EQUILIBRIUM (PROVIDED, OF COURSE, THAT THERE ARE NO OTHER FACTORS CONTRIBUTING TO DISEQUILIBRIUM). IN FACT, IN THIS CASE BRAZIL WOULD BENEFIT FROM AN INCREASED CAPACITY TO IMPORT WHICH COULD PERHAPS OFFSET OTHER UNFAVORABLE TRENDS IN ITS INTERNATIONAL TRADE, AS A DETERIORATION IN THE TERMS OF TRADE.

THE CLUE TO BRAZIL'S CAPITAL PROBLEM, IN OTHER WORDS, IS THE PROPENSITY TO IMPORT. AS LONG AS THE HIGH IMPORT PROPENSITY CANNOT BE CHECKED, FOREIGN CAPITAL INFLOW WILL CONTRIBUTE LITTLE, IF ANYTHING, TO RELIEVE PRESSURE FROM THE BALANCE OF PAYMENTS.

4. THE TERMS OF TRADE

ADVERSE TERMS OF TRADE ARE OFTEN HELD RESPONSIBLE FOR SECULAR DISEQUILIBRIA IN BALANCE OF PAYMENTS IN UNDERDEVELOPED COUNTRIES. IT IS ARGUED THAT THE DEMAND FOR PRIMARY COMMODITIES IS LESS ELASTIC THAN FOR INDUSTRIAL GOODS. AND SINCE UNDERDEVELOPED NATIONS ARE USUALLY EXPORTERS OF PRIMARY, AND IMPORTERS OF INDUSTRIAL GOODS, THEIR TERMS OF TRADE HAVE A MARKED TENDENCY TOWARD DETERIORATION.

THIS MAY OR MAY NOT BE CORRECT. IN ANY EVENT, CAUTION IS NECESSARY WHEN ONE INTERPRETS TERMS OF TRADE STATISTICS. THE MAIN LIMITATION OF THE TERMS OF TRADE ANALYSIS IS DETERMINED BY THE FACT THAT THEY DO NOT MEASURE CHANGES IN QUALITIES OF GOODS EXCHANGED. MOST PRIMARY GOODS REMAIN STABLE IN QUALITY, WHILE INDUSTRIAL GOODS ARE SUBJECT TO SUBSTANTIAL ALTERATION THROUGH TIME. DURING THE PAST DECADES INDUSTRIAL GOODS HAVE CHANGED MARKEDLY, BUT THIS IS NOT RECORDED BY STATISTICS.

A SECOND LIMITATION IS THAT FAVORABLE TERMS OF TRADE ARE NOT NECESSARILY STIMULATIVE AGENTS FOR ECONOMIC DEVELOPMENT. ONLY WHEN THE SURPLUS RESOURCES THEY CREATE ARE TEMPORARILY SAVED AND EMPLOYED TO INCREASE CAPITAL FORMATION DO THEY CONTRIBUTE TO ECONOMIC GROWTH. IT IS DOUBTFUL, THOUGH, WHETHER SURPLUS RESOURCES ARE GENERALLY APPLIED THIS WAY IN BRAZIL.

FINALLY, IT MUST BE NOTED THAT THE BRAZILIAN TERMS OF TRADE SHOW A DETERIORATING TREND DUE NOT ONLY TO INELASTIC DEMAND FOR PRIMARY COMMODITIES, BUT ALSO TO THE LIMITED VARIETY OF GOODS AVAILABLE FOR EXPORT.

NONE OF THESE LIMITATIONS MAY, HOWEVER, COMPLETELY INVALIDATE THE THESIS THAT UNFAVORABLE TERMS OF TRADE EXIST AND AFFECT THE BALANCE OF PAYMENTS ADVERSELY. THEY INDICATE, HOWEVER, THAT THEIR IMPACT IS PROBABLY NOT AS STRONG AS IS OFTEN THOUGHT.

5. INDUSTRIALIZATION

TRADE BARRIERS AND RESTRICTIONS IMPOSED ON THE INTERNATIONAL MOBILITY OF LABOR PREVENT AN EVEN DISTRIBUTION OF ADVANTAGES DERIVED FROM TECHNICAL PROGRESS AND INCREASES IN PRODUCTIVITY RATES AMONG COUNTRIES. THERE ARE TWO WAYS IN WHICH SUCH ADVANTAGES CAN CREATE AN IMPROVEMENT IN THE STANDARD OF LIVING. ONE IS THROUGH A CONTRACTION OF PRICES, THE OTHER THROUGH AN INCREASE IN INCOMES. IF THE MORE ADVANCED NATIONS HAD CHOSEN THE FORMER, THE UNDERDEVELOPED COUNTRIES WOULD BENEFIT FROM TECHNOLOGICAL ADVANCEMENTS THROUGH AN IMPROVEMENT IN THEIR TERMS OF TRADE. UNFORTUNATELY, THIS IS NOT THE CASE. THE GAP EXISTING BETWEEN THE STANDARD OF LIVING OF THE ADVANCED AND THE UNDERDEVELOPED NATIONS IS THUS WIDENED WHEN TECHNOLOGY PROGRESSES IN THE ADVANCED COUNTRIES. IN CONSEQUENCE, LATIN AMERICA MUST EITHER ACCEPT CONDITIONS AS THEY ARE AND REDUCE ITS VOLUME OF IMPORTS, OR IT CAN TURN TO A MORE AUTONOMOUS DEVELOPMENT. BRAZIL HAS GIVEN PREFERENCE TO THE SECOND ALTERNATIVE.

INDUSTRIALIZATION HAS BECOME A MAJOR POINT IN DEFENSE. IT IS VERY UNLIKELY, HOWEVER, THAT FORCED INDUSTRIALIZATION WILL LEAD THE WAY OUT OF THE DILEMMA. FIRST, IT HAS NOT BEEN PROVED THAT THERE IS SUCH A THING AS AN "INTRINSIC" ADVANTAGE IN THE PRODUCTIVITY OF SECONDARY OVER PRIMARY PRODUCTION. SECONDLY, EVEN IF THE HYPOTHESIS WERE CORRECT, NO UNDERDEVELOPED COUNTRY COULD VENTURE ON A FULL-SCALE INDUSTRIALIZATION PROGRAM WITHOUT STIMULATING THE EXPORTATION OF PRIMARY GOODS. HENCE, ITS NEED TO CONCENTRATE MORE ON AGRICULTURAL PRODUCTION THE MORE IT WISHES TO INDUSTRIALIZE. THIS INTER-DEPENDENCE ACTUALLY LIMITS BOTH AGRICULTURAL AND INDUSTRIAL EXPANSION, BUT MORE SO THE LATTER. THIRDLY, IMPROVED PRODUCTIVITY IS NOT THE ONLY CRITERION TO ACCELERATE A COUNTRY'S ECONOMIC DEVELOPMENT, EVEN IF IT COULD BE REGARDED AS THE ONLY MEANS TO OBTAIN A

BETTER EXPORT-IMPORT RELATIONSHIP. SOMETIMES SOCIAL CONSIDERATIONS SHOULD PREVAIL OVER ECONOMIC CONSIDERATIONS. IN THE CASE OF BRAZIL IT SEEMS MORE DESIRABLE TO CONCENTRATE EFFORTS ON THE PRODUCTION AND DISTRIBUTION OF PRIMARY GOODS IN ORDER TO RAISE THE LIVING STANDARD OF THE RURAL POPULATION THAN TO BUILD A STRONG INDUSTRIAL POTENTIAL AIMED AT ECONOMIC AUTONOMY. THE REASONS ARE VARIOUS. THERE IS THE URGENT NEED FOR IMPROVED HYGIENE AND EDUCATION IN THE RURAL AREAS. SECONDLY, THERE IS AN INSUFFICIENCY OF BALANCED GROWTH AMONG THE VARIOUS PRODUCING INTERESTS.

IT COULD BE ARGUED THAT SUCH A BALANCE WOULD BE A NATURAL RESULT OF INDUSTRIALIZATION AS ITS BENEFITS WOULD SPREAD OVER THE ENTIRE COUNTRY. IN THE LONG-RUN THE EFFECTIVENESS OF THIS SPREAD CANNOT BE DENIED. IT CAN NOW BE TRACED TO SOME RURAL AREAS LOCATED CLOSE TO INDUSTRIAL CENTERS, CHIEFLY IN THE STATE OF SÃO PAULO. HOWEVER, ITS DEVELOPMENT IS SLOW AND HAMPERED BY ADVERSE FACTORS, SUCH AS THE DEFICIENCY OF COMMUNICATION MEANS AND TRANSPORT FACILITIES. THEREFORE, AN EXCESSIVE PORTION OF THE INCREASED INCOME DERIVED FROM INDUSTRIAL GAINS IS BEING APPLIED TO THE DEMAND FOR NON-ESSENTIAL CONSUMER GOODS RATHER THAN FOR RE-INVESTMENTS.

A FURTHER SERIOUS CONSEQUENCE OF RAPID INDUSTRIALIZATION IN BRAZIL IS THE FAST EXPANSION OF DEMAND FOR IMPORTS HEAVILY BURDENING THE BALANCE OF PAYMENTS. CONTRARY TO WHAT IS BEING STRESSED BY PROTECTIONISTS, BRAZIL SAVES LITTLE IF ANY FOREIGN EXCHANGE AS A RESULT OF INDUSTRIALIZATION IF THE IMPORTATION OF IMMEDIATE EQUIPMENT PLUS THE EQUIPMENT OF FEEDER INDUSTRIES IS TAKEN INTO ACCOUNT,

DOES ALL THIS MEAN THAT BRAZIL SHOULD ABSTAIN FROM INDUSTRIALIZATION? CERTAINLY NOT. MANY FACTORS WARRANT ITS ENCOURAGEMENT. IT IS CLEAR, HOWEVER, THAT INDUSTRIALIZATION IS NOT IN ITSELF A MEANS TO FIGHT DISEQUILIBRIUM. SINCE IT REQUIRES AN INCREASED VOLUME OF FOREIGN TRADE,

IT MUST BE A CAREFUL AND SLOW PROCESS. THE PRESENT TREND TO SUPPORT, OR AT LEAST FAVORABLY REGARD THE ESTABLISHMENT OF ALMOST ANY INDUSTRIAL ENTERPRISE WITH THE ARGUMENT THAT IT CONTRIBUTES TO FOREIGN EXCHANGE SAVINGS IS DANGEROUS. FIRST, THE ARGUMENT HOLDS TRUE ONLY WITH SOME INDUSTRIES, LIKE OIL, STEEL, CEMENT, PAPER, OR, IN GENERAL, MOST BASIC INDUSTRIES UTILIZING PRIMARILY DOMESTIC RESOURCES. SECOND, INDUSTRIALIZATION TENDS TO ACCELERATE INCOME CONCENTRATION. THIRD, MANY INDUSTRIES CAN SURVIVE ONLY THROUGH IMPORT RESTRICTIONS; IN OTHER WORDS, THEY DO NOT NECESSARILY CONTRIBUTE TO IMPROVED PRODUCTIVITY. FURTHER, PUBLIC UTILITY SERVICES ARE INSUFFICIENT FOR THE PRESENT INDUSTRIAL EXPANSION AND PRODUCE WASTE WHENEVER PLANTS TEMPORARILY CLOSE DOWN.

IN SUMMARY, IT IS SUGGESTED THAT PRODUCTIVE EFFORTS BE CONCENTRATED IN THREE AREAS WITH THE FOLLOWING ORDER OF PREFERENCE:

- (1) AGRICULTURAL AND MINERAL PRODUCTION WITH THE PURPOSE OF INCREASING RURAL PRODUCTIVITY OF GOODS FOR BOTH DOMESTIC CONSUMPTION AND EXPORT;
- (2) PUBLIC UTILITY SERVICE, MAINLY ELECTRIC POWER AND TRANSPORTATION;
- (3) EXPANSION OF BASIC INDUSTRIES ACCORDING TO THE AVAILABILITY OF PRODUCTION FACTORS AFTER THE FIRST TWO CONDITIONS ARE FULFILLED AND GIVING PREFERENCE TO THE FOLLOWING ACTIVITIES:
 - (A) OIL EXTRACTION AND REFINING;
 - (B) MINING;
 - (C) METALLURGY.

A WIDESPREAD PROGRAM OF THIS KIND CANNOT BE CONDUCTED WITHOUT SOME GOVERNMENT CONTROLS. HOWEVER, IT IS HIGHLY COMMENDABLE THAT OFFICIAL FUNCTIONS BE COOPERATIVE RATHER THAN RESTRICTIVE.

6. STRUCTURAL DISEQUILIBRIUM

WHAT HAS BEEN POINTED OUT THUS FAR CAN BE SUMMED UP AS FOLLOWS:

NEITHER AN ADAPTATION OF EXCHANGE RATES TO THE REAL PURCHASING POWER OF THE CRUZEIRO ABROAD, NOR A SUBSTANTIAL INCREASE IN CAPITAL INFLOW, NOR A SECULAR IMPROVEMENT IN THE TERMS OF TRADE, NOR INDUSTRIALIZATION WILL SOLVE BRAZIL'S BALANCE OF PAYMENTS PROBLEMS. THESE MEASURES COULD RELIEVE PRESSURE FROM THE BALANCE, BUT COULD NOT REMOVE STRUCTURAL DISEQUILIBRIUM.

STRUCTURAL DISEQUILIBRIUM IS CAUSED BY A PERSISTANT EXCESS OF DEMAND FOR IMPORTS OVER THE CAPACITY TO EXPORT. RESPONSIBLE FOR THE DISCREPANCY ARE: (1) MALDISTRIBUTION OF INCOME, AND (2) INFLATION.

IN BRAZIL, INCOME CONCENTRATION AND INFLATION HAVE AFFECTED THE SUPPLY OF EXPORTABLE GOODS BY HAMPERING THE EXPANSION OF NATIONAL OUTPUT, BY TRANSFERRING FACTORS OF PRODUCTION FROM ESSENTIAL TO NON-ESSENTIAL ACTIVITIES, BY IMPAIRING THE RATE OF PRODUCTIVITY, AND BY RAISING THE COST AND PRICE LEVEL.

THE MOST MANIFEST CONSEQUENCE OF INCOME CONCENTRATION IS FOUND IN UNBALANCED GROWTH. THIS BECOMES APPARENT BY THE EXCESS OF DEMAND OVER THE CURRENT SUPPLY OF PUBLIC UTILITY SERVICES, MAINLY ELECTRIC POWER. IT IS LIKEWISE REFLECTED BY THE SHORTAGE OF MEANS OF TRANSPORT AND COMMUNICATION. FURTHER, INCOME CONCENTRATION HAS RESTRICTED THE CREATION OF A SKILLED LABOR SUPPLY. IT HAS PREVENTED THE DEVELOPMENT OF MASS PRODUCTION OF ESSENTIAL GOODS, AND ENHANCED THE OUTPUT OF LUXURY ARTICLES AND HIGH-PRICED HOUSING FACILITIES. IT HAS PERMITTED A DISPROPORTIONATE DEVELOPMENT OF GEOGRAPHICAL AREAS, AND HAS WIDENED THE GAP BETWEEN POVERTY AND WEALTH. IT HAS INJURED THE SAVING CAPACITY OF THE POORER STRATA OF THE POPULATION, AND RETARDED CAPITAL FORMATION. AS A RESULT, BRA-

ZIL'S ECONOMIC PROGRESS IS IMPAIRED--NOT SO MUCH IN TERMS OF TOTAL OUTPUT AND NATIONAL INCOME, BUT IN RELATION TO COMPARATIVE OUTPUT OF GOODS AND AGGREGATE PRODUCTIVITY. TOO MANY SUPERFLUOUS GOODS ARE PRODUCED FOR DOMESTIC CONSUMPTION AND TOO LITTLE FOR EXPORTS. IN ADDITION, BOTH SECTORS, THOSE PRODUCING FOR DOMESTIC CONSUMPTION AND THOSE FOR EXPORT, SUFFER FROM LOW PRODUCTIVITY, THUS INCREASING THE COST AND PRICE LEVEL AS MEASURED AGAINST THE LEVELS OF MORE ADVANCED NATIONS.

RESTRICTED EXPORT CAPACITY, HOWEVER, IS BUT ONE ASPECT OF STRUCTURAL DISEQUILIBRIUM. THE OTHER IS THE HIGH DEGREE OF EFFECTIVE DEMAND AMONG THE WEALTHIER SEGMENT OF THE POPULATION. IN BRAZIL, ECONOMIC GROWTH IS LARGELY LIMITED TO THE INCREASE IN POPULATION AND THE LOW RATE OF CAPITAL FORMATION, SINCE THE MULTIPLIER IS LESS EFFECTIVE THAN IN THE MORE ADVANCED COUNTRIES. THE MOST COMMON LEAKAGES FOR INCREASED INCOMES ARE FOUND, THEREFORE, IN REAL ESTATE INVESTMENT AND IN THE PROPENSITY TO IMPORT. GIVEN THE DIFFERENCE OF PRICE LEVELS BETWEEN BRAZIL AND OTHER NATIONS (AT TIMES INTENSIFIED BY ARTIFICIAL EXCHANGE STABILITY), AND THE DIFFERENCE IN THE RANGE OF GOODS AVAILABLE FOR CONSUMPTION, A SUBSTANTIAL PORTION OF INCREASED EFFECTIVE DEMAND TURNS TOWARD IMPORTS. THE MORE INCOME CONCENTRATION PROGRESSES, THE HIGHER RISES THE DEMAND FOR LESS ESSENTIAL IMPORTS, AS THE MAJORITY OF THE VITALLY IMPORTANT COMMODITIES ARE AVAILABLE AT HOME.

IN SUMMARY, INCOME CONCENTRATION IS THE MAIN SOURCE OF STRUCTURAL DISEQUILIBRIUM IN THE BRAZILIAN BALANCE OF PAYMENTS. AMONG OTHER CONSEQUENCES, IT CAUSED A REDUCTION IN THE CAPACITY TO EXPORT, AND STIMULATES THE DEMAND FOR IMPORTS, PARTICULARLY OF NON-ESSENTIAL GOODS. IT IS CONCEIVABLE AND EVEN PROBABLE THAT STRUCTURAL DISEQUILIBRIUM COULD HAVE DEVELOPED IN THE ABSENCE OF MONEY INFLATION, SINCE INCOME CONCENTRATION CAN

TAKE PLACE EVEN IF MONEY SUPPLY IS HELD CONSTANT IN RELATION TO TOTAL OUTPUT. HOWEVER, SINCE MONEY INFLATION STIMULATES INCOME CONCENTRATION IN BRAZIL AND RAISES THE GENERAL PRICE LEVEL, IT HAS AGGRAVATED THE IMPACT OF STRUCTURAL DISEQUILIBRIUM ON THE BALANCE OF PAYMENTS IN PAST DECADES.

7. FISCAL REORGANIZATION

THE MAIN CONCLUSIONS TO BE DRAWN FROM THIS ANALYSIS ARE OBVIOUS. RE-ESTABLISHMENT OF DOMESTIC EQUILIBRIUM IS A PRE-REQUISITE TO EQUILIBRIUM IN THE BALANCE OF PAYMENTS. BOTH THE INTERNAL AND EXTERNAL SECTORS OF THE ECONOMY CAN BE BALANCED BY CHECKING INFLATION AND REDISTRIBUTING NATIONAL INCOME, ONLY THE GOVERNMENT IS CAPABLE OF SUCCESSFULLY CARRYING OUT THE TWO POLICIES. THE MOST URGENT TASK IS A REORGANIZATION OF THE FISCAL STRUCTURE. THE SPENDABLE INCOME OF THOSE HOLDING THE MAJORITY OF THE FACTORS OF PRODUCTION MUST BE CURTAILED AND THE FUNDS THUS OBTAINED USED TO EXPAND PRODUCTIVE EFFORTS WHICH WOULD ENABLE THE POORER STRATA OF THE POPULATION TO RAISE THEIR REAL INCOMES. TO ATTAIN THIS OBJECTIVE, MORE PROGRESSIVE TAXES MUST BE LEVIED ON INCOME AND PROPERTY.

THERE IS NO DOUBT THAT FISCAL REORGANIZATION, AND PERHAPS EVEN THE CURBING OF INFLATION, WOULD DAMPEN THE PRESENT RATE OF GROWTH. INITIALLY AT LEAST, INDUSTRIAL ACTIVITIES WOULD BE DISCOURAGED. ON THE OTHER HAND, A NEW ORDER COULD CREATE CONDITIONS UNDER WHICH ONLY PRODUCTIVE ORGANIZATIONS CAN SURVIVE, PROVIDED THAT GOVERNMENT ACTIVITY IS LIMITED TO CONTROL MEASURES. PRIVATE ENTERPRISES MUST BE GIVEN THE OPPORTUNITY TO EXPAND ACCORDING TO INDIVIDUAL POTENTIALS.

THE ABOVE RECOMMENDATIONS ARE, OF COURSE, MUCH MORE EASILY EXPRESSED THAN APPLIED. BUT, WHAT CAN BE ANTICIPATED AS A RESULT IS HIGHLY PROMI-

SING. A FISCAL REORGANIZATION WOULD PROBABLY ENCOUNTER TWO MAIN OBSTACLES IN BRAZIL; ONE IS OF A TECHNICAL NATURE, SUCH AS THE DIFFICULTY OF DETERMINING THE MOST APPROPRIATE RATE OF PROGRESSION. THE OTHER--AND THIS IS FAR MORE DISCOURAGING--IS CAUSED BY THE POSITION OF BOTH THE GOVERNMENT AND THE PEOPLE TOWARD TAXATION. IT SEEMS THAT THE NEED AND FUNCTION OF TAXES ARE NOT YET FULLY REALIZED IN BRAZIL. TOO MUCH OF THE REVENUES COLLECTED IS USED TO FILL GAPS IN THE FEDERAL, STATE, AND MUNICIPAL BUDGETS. MOST CITIZENS, THEREFORE, TRY TO EVADE THEIR TAX OBLIGATIONS, AND ARE GENERALLY SUCCESSFUL, AS THE GOVERNMENT HAS NOT SUFFICIENT MORAL STRENGTH TO ENFORCE THE LAW. MATTERS ARE NOT MUCH DIFFERENT AS FAR AS INFLATION IS CONCERNED. A CHANGE IN ATTITUDE MUST PRECEDE A COMBATING OF THE INFLATION PROBLEM. REPEATED ATTEMPTS IN THIS DIRECTION HAVE THUS FAR FAILED TO PRODUCE LASTING RESULTS. BUT THEY DO INDICATE THAT BRAZIL IS CONCERNED WITH THE FUNDAMENTAL CAUSES OF DISEQUILIBRIUM.

APPENDIX

THE BRAZILIAN BALANCE OF PAYMENTS (1947/54)
(IN \$1,000,000)

<u>ITEMS</u>	<u>1947</u>	<u>1948</u>	<u>1949</u>	<u>1950</u>	<u>1951</u>	<u>1952</u>	<u>1953</u>	<u>1954*</u>
<u>A. GOODS AND SERVICES</u>								
EXPORTS, F.O.B.	21,400	21,884	20,344	25,137	32,748	26,192	28,477	28,894
IMPORTS, F.O.B.	-18,990	-16,733	-17,514	-17,277	-31,498	-31,480	-20,652	-26,172
BALANCE OF TRADE	2,410	5,151	2,830	7,860	1,250	- 5,288	7,825	2,722
NON-MONETARY GOLD	---	---	---	- 1	14	5	12	- 43
FOREIGN TRAVEL	- 593	- 94	- 28	- 52	- 284	- 69	- 472	- 261
FREIGHT ON IMPORTS	- 3,240	- 3,380	- 2,370	- 2,330	- 4,261	- 4,312	- 2,494	- 3,174
OTHER TRANSPORTATION	472	494	478	105	- 286	140	88	42
INVESTMENT INCOME	- 1,013	- 1,943	- 1,881	- 2,027	- 2,896	- 2,240	- 2,333	- 2,610
OTHER SERVICES	- 720	- 918	- 1,208	- 1,563	- 2,185	- 1,430	- 1,339	- 1,780
TOTAL	- 2,684	- 690	- 2,179	1,992	- 8,648	-13,194	1,287	- 5,104
<u>B. PRIVATE DONATIONS AND CAPITAL MOVEMENTS</u> (EXCLUDING F)								
REMITTANCES	- 329	- 142	- 64	- 60	- 61	- 72	- 304	- 149
LONG-TERM CAPITAL MOVEMENTS	774	1,116	820	548	1,056	1,749	806	1,212
SHORT-TERM BANK BALANCES IN U.S.	93	488	- 252	- 204	- 66	56	- 204	- 259
MOVEMENT IN CRUZEIRO BALANCES	---	- 122	39	117	1	135	275	- 327
TOTAL	538	1,340	543	401	930	1,868	573	477
<u>C. SPECIAL OFFICIAL FINANCING</u>								
AMORTIZATION, INCLUDING LEND AND LEASE	- 544	- 754	- 530	- 1,571	- 495	- 633	- 723	- 1,792
LOANS OBTAINED ABROAD	594	179	742	513	700	642	722	4,292
SUBSCRIPTION TO IMF AND IBRD	---	- 693	---	---	---	---	---	---
OFFICIAL DONATIONS	- 107	15	11	15	16	32	- 1	---
LONG-TERM CAPITAL	8	---	---	---	---	- 1	---	20
TOTAL	- 49	- 1,253	223	- 1,043	221	40	- 2	2,520
<u>D. TOTAL (ITEMS A, B, AND C)</u>	- 2,195	- 603	- 1,413	1,350	- 7,497	-11,286	1,858	- 2,107
<u>E. ERRORS AND OMISSIONS</u>	- 815	531	1,518	- 380	2,099	- 972	645	- 503
<u>SURPLUS OR DEFICIT (-)</u>	- 3,010	- 72	105	970	- 5,398	-12,258	2,503	2,610
<u>F. COMMERCIAL ARREARS</u>	1,516	630	515	- 1,917	552	10,435	- 7,496	- 1,819
<u>G. COMPENSATORY OFFICIAL FINANCING</u>								
PURCHASE OF BRITISH INVESTMENT	---	- 1,045	---	- 60	- 540	---	---	---
DEBT SETTLEMENT	- 357	---	- 342	---	---	---	---	---
CREDITS GRANTED TO FOREIGN COUNTRIES	- 185	---	---	---	3	39	37	---
US STABILIZATION FUND LOAN	1,480	- 370	- 1,110	---	---	---	---	---
EXIMBANK LOANS	---	---	694	---	518	518	518	---
USE OF IMF RESOURCES	---	---	---	---	---	---	---	---
PAYMENTS AND CLEARING AGREEMENTS	3,069	- 389	760	451	x	x	x	653
SHORT-TERM BALANCES (INCREASE -)	- 2,513	553	- 613	573	4,883	2,319	- 1,097	3,490
MONETARY GOLD (INCREASE -)	---	693	- 9	- 17	- 18	- 17	- 15	- 15
TOTAL	1,494	- 558	- 620	947	4,846	1,823	4,993	4,429

SOURCE: SUPERINTENDÊNCIA DA MOEDA E DO CRÉDITO

NOTES: * SUBJECT TO ALTERATION

X INCLUDED IN SHORT-TERM BALANCES

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