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The Economic Plight of Brazil By WILLIAM G. LEON

THOUGHTFUL people have wondered for many years why Brazil has made such slow economic progress. Here is a nation with a land area larger than that of the United States of America. The population is estimated to be 50 million—one third as large as ours. While it is true that much of Brazil's area is tropical jungle, nonetheless, there is such a vast expanse of fertile plain and so much in the way of untapped mineral resources that the government, at the end of the war, announced plans for large scale immigration from Southern Europe. At the same time, it was made known to the world that Brazil would encourage the investment of foreign capital.

The recognition of a need for immigrants, in itself, establishes the fact that large areas of productive land blessed with good climate and other natural conditions are there to be occupied. No thinking person can any longer seriously consider the proposition of Dr. Malthus—that excess population and lack of natural opportunity are responsible for economic distress and social maladjustments.

There is only one reason why Brazil has made poor progress since the colonization of the country by the Portuguese in the 17th century. For that same reason the rest of the world is in a pitiful condition, and the United States, though far ahead of all other nations in economic and social well being, has a standard of living only half as high as it might be. The reason is that labor and capital do not have free access to natural opportunity. The corollary to this artificial restriction on free enterprise is taxation of production to such an extent that producers are demoralized.

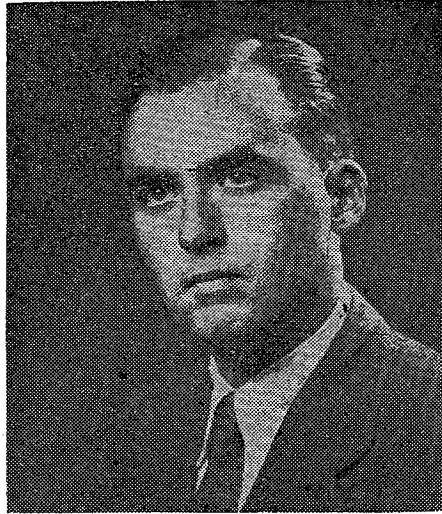
When I was in Brazil in 1945 and 1946, I was impressed by the spirit of the people as they looked forward to a post-war period of development and expansion. Restrictions on foreign capital were relaxed. Investors could, within limits, repatriate their income and the principal amount.

The currency was artificially pegged. An exchange rate of 18.72 to the dollar was established placing a value of 5.25 cents on the cruzeiro. The Banco do Brasil was to play the part of the physician caring for the patient with a clinical thermometer fixed at 98.6 degrees fahrenheit.

During the war, Brazil accumulated an enormous amount of dollar credits. These dollars were earned from the sale of minerals and foodstuffs, as well as military spending. As very little in the way of United States' consumer goods could be imported the dollar balances mounted.

At war's end, Brazil came into the market for automobiles, refrigerators, machinery and every conceivable commodity. This was only natural. It was also only natural that accumulated balances would be spent faster than the annual rate of normal exports to this country by which U. S. dollars are earned.

The Brazilian government thereupon insti-



tuted an exchange control citing the dollar shortage as a reason to impose restrictions upon the importation of "non-essential" goods. Under the control, medical supplies, certain kinds of machinery and government requirements were placed in the top categories for importation licenses. Such items as automobiles and electrical refrigerators gradually found their way toward the bottom when the categories were reshuffled in accordance with the ideas of the control officials with respect to the nation's economic necessities. The thought of a free market as the best determiner of the people's needs was completely discarded.

Under the exchange control all U. S. dollars earned by exporters of Brazilian goods were seized by the government. The exporter was given Brazilian cruzeiros and four-month certificates of indebtedness instead. The cruzeiros given the exporter were valued at the official rate—18.72 to the dollar.

The cruzeiro gradually declined to 33 to the dollar or to 3 cents from 5.25 cents in the free market. The value of the currency could not possibly remain at the official rate. In a free market, the demand for cruzeiros in terms of dollars arises from U. S. importers bidding for the cruzeiros to be used in the payment for the goods to be imported. Under the foreign exchange control the normal demand for cruzeiros disappears. Brazilian goods are sold for dollars. The dollars are seized by the government and then allocated by the government to importers of goods who have obtained the necessary import licenses. At no time does the U. S. buyer of Brazilian goods appear in the market offering dollars in exchange for cruzeiros. Hence the greater part of the demand for cruzeiros no longer exists and the Brazilian currency declines in value to 3 cents at which level it is supported by demand from tourists buying currency in the black market and from Brazilians reconverting dollar balances in the hope that 3 cents is as low as the cruzeiro will go.

I was in Brazil at the time Great Britain devalued the pound sterling. Many Brazilians feared that the cruzeiro would also be devalued; and there were wide fluctuations in the free market for foreign exchange. Within a period of a few weeks, quotations on the cruzeiro against the dollar rose and fell between 25 and 33 to one.

Brazil did not devalue. The government decided that rising coffee prices would result in higher dollar balances thus strengthening Brazil's position. Higher coffee prices are the result of a lack of rainfall in the State of Sao Paulo, where most of the coffee is grown.

These higher prices have helped Brazil considerably. However, a short crop next year will hurt since there will be fewer dollars earned as smaller quantities are shipped. Should the crop be above expectations the price will most likely fall from current levels.

Brazil must devalue eventually. The entire cost structure is based upon the free market value of the currency. Prices of Brazilian commodities which compete in world trade are 25 per cent above prevailing market prices.

Devaluation, unfortunately, will not solve the exchange problem. Pegging the currency at a lower level must still result in a free market quotation at a discount from the official rate, whatever it may be. In order to maintain an official rate for a currency, a government must control or limit the use to which the money will be put. Limitation of the use to which currency can be put immediately places that currency at a discount in a free market.

There are many reasons why Brazil maintains an exchange control. Manufacturers in Brazil have more protection under exchange control than they would have under a tariff. Foreign goods can come in if duties are paid. Under an exchange control they can be arbitrarily excluded. At the same time the government ostensibly cooperates in programs aimed at lowering tariffs throughout the world. Brazilian tariffs may now be lowered or completely eliminated, but no competing goods can enter. Instead of arguing about the relative advantages or disadvantages of the tariff system a government operating under an exchange control merely announces that there is a dollar shortage.

Another reason why Brazil maintains a foreign exchange control is that the government thereby enjoys a major source of income. When a dollar is seized from an exporter the government repays with 18.72 cruzeiros instead of 33. There is a clear profit of 14.28 cruzeiros on each transaction. Most of these dollars are allocated to importers under the law. One needs little imagination to comprehend the corruption and bribery involved in the allocation of dollars at 18.72 when they are worth 33. The methods used by businessmen to obtain dollars from bureaucrats are the subject of parlor stories comparable to anecdotes about hunting and fishing. How many dollars are allocated for commercial purchases and how many are kept

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by the government for its own use is not known but it is highly probable that the government tends to keep as much as it dares.

My residence in Brazil concerned itself with the financing of new power plants for a system of U. S. controlled public utility companies. These companies were purchased from British interests in 1929 just before the economic disaster. At that time the cruzeiro was valued in the free market at 12 cents U. S. Under Brazilian law these utilities are allowed to earn 10 per cent on the investment. No allowance is made for devaluation of the Brazilian currency. Each dollar invested in 1929 is now worth 45 cents if the cruzeiro is taken at 18.72, the official rate, or 25 cents if taken at the free market rate. Ten per cent is a nice return on an investment but not if the principal amount declines to one half or one quarter the original amount. The decline in the value of the currency, explains why interest rates are high in Brazil; why the American controlled utilities sought financing locally instead of from New York and why these interests live in fear of official devaluation of the currency.

It has been observed throughout the ages that wage and interest rates tend to rise and fall together. Those familiar with Ricardo's Law and the derivations therefrom understand why this must be. In this country we have seen a long term decline of interest rates. Concurrently, there has been a similar decline in wage rates. We speak now of real wages—adjusted for inflation—and refer to wages as a proportion of production, not as a quantity, just as interest rates express a percentage or proportion of nominal amount. In Brazil we observe low wages and high interest rates and are puzzled by this unnatural phenomenon. The explanation is very simple. The high interest rates obtainable in Brazil do not reflect a pure rate of interest but rather a premium for risk. In this country the pure interest rate is observable in the return on the loans that involve the least risk. Government bonds yield $2\frac{1}{2}$ per cent. Thirty years ago, the government borrowed at $4\frac{1}{4}$ per cent.

In Brazil, government bonds payable in cruzeiros return 12 per cent. Private loans yield 15 to 20 per cent. Borrowers and lenders observing the long term decline in the value of the cruzeiros realize that by the time a loan is repaid the money will be worth less. As a result a higher interest rate is quoted to compensate for this devaluation risk. In this country, loans that involve risks yield a return three and four times the pure rate available on loans that involve a minimum of risk.

The U. S. corporation which owns operating public utilities in Brazil has adopted a policy of financing future expansion in Brazil through the sale of shares in these operating properties to Brazilians for cruzeiros. Apparently this corporation no longer desires to invest more dollars, and this policy is understandable in view of the experience of the past 20 years during which a loss of from 50 to 75 per cent was incurred as a result of devaluation.

Financing expansion through the sale of stock cannot succeed, however, because of the limitations imposed by the Brazilian government upon public utilities. The government determines rates for service calculated to allow a net return of 10 per cent on the value of the utility property. Consequently, there is a prac-

tical limitation of a 10 per cent return on the shares. As the utility property valuation is determined in cruzeiros there can be no hedge against further inflation. The return on the shares to be sold is 10 per cent while 12 per cent is obtainable on a better risk. Therefore, few shares will be sold. Until the government allows a return of 15 per cent on utility investments, private financing is impractical. However, U. S. taxpayers may eventually do the financing. The import-export bank has already made loans at $4\frac{1}{2}$ per cent. Under the Point Four program, which will underwrite foreign exchange losses, the controlling corporation in New York can send more U. S. dollars to earn 10 per cent with better assurances than those of 1929.

The attitude of the Brazilian politician on public utilities is not difficult to understand. Those seeking office may arouse the public indignation if rates are increased. Those already in office are not interested in a foreign owned company's problems. There is still a shortage of power capacity in Brazil and it is more difficult to get a telephone installed than it was in New York back in 1946. However, the public cannot complain because no one dares suggest that Brazilian management take over. It would be readily admitted by all Brazilians that under

their own management the situation would be worse.

The foregoing are unimportant details. These developments are the consequence of something fundamental. Brazil still lives in the feudal tradition. Privilege is respected. Labor is not. The government has been so corrupt for so long that no practical person would think seriously of reform. Anyone suggesting reform is guilty of "Quixotismo" — tilting at windmills like Cervante's Don Quixote.

An attempt has been made to encourage construction, production and higher living standards through a change in the methods of taxation. Led by Americo Werneck, a small group was able to submit to the City Council of Rio de Janeiro a bill that would shift taxation from improvements to ground rentals. Many councillors are in favor of this bill. However, its purposes are so expertly distorted in the press that the public has no clear idea of the subject.

Brazil's problems are similar to those of other countries, although more acute than most and more challenging due to the natural conditions existing. Prospects for social and economic reform appear to be more remote than in European countries where the threat of communism acts as a stimulant to re-examine the real meaning of free enterprise.