Chapter II

STRATEGY OF BRAZILIAN ECONOMIC DEVELOPMENT

Historically speaking, Brazil's early development, as a Portuguese colony, was a prototype of other colonies in Latin America and elsewhere. The economy experienced successive booms by way of production and export of one primary product at one given period of time. Thus, until the twentieth century, Brazil's economic history was characterized by a series of such production cycles during which the country occupied the leading position in world production in what J.F. Normano calls "King products", such as brazilwood, sugar, gold, diamonds, rubber, cocoa and coffee and then lost its primacy in all, except coffee.

The approximate time periods during which the 'king products' dominated the Brazilian economy are as follows: brazilwood cycle - 1500 to 1550; sugarcane cycle - 1550 to 1700; gold cycle - 1700 to 1775; rubber and coffee cycle - 1850 to 1930.

Each economic cycle had its own area of origin, growth and decay, and had different ramifications with regard to the economy as a whole. For instance, brazilwood came from a relatively narrow strip of land along the coast line. With the

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depletion of the product in accessible areas, interest in trade of brazilwood waned. Sugar plantation grew and flourished in the Northeast of Brazil, until the Dutch found it economical and less expensive to develop a sugar industry in the Caribbean region. In the wake of gold cycle, Serra do Espinhaco in Minas Gerais became the centre of economic activity, leading to the development of cattle ranching in the peripheral areas of sertao and south of Sao Paulo. It was necessary because of the growing demand for food, i.e., beef and beasts of burden. Coffee production was mostly concentrated in the states of Rio de Janeiro, Sao Paulo and later in Parana. The growth of Coffee sector in its wake contributed to large scale foreign immigration, development of railways, and stimulated urbanization and promoted domestic market that favoured the growth of indigenous industry.

Each economic cycle developed in isolation and remained unrelated to the other and also, prospered during different time periods. More so, the cycles of limited period/duration, such as gold and rubber, left behind vacuums, causing stagnation and economic recession.

The prosperous period of each cycle was heavily dependent on the peak export of the product. As and when the periods of decline in exports approached, the boom was nearly over. In the third quarter of seventeenth century, international prices of sugar fell to half their former level, thus

3 Ibid., p. 17.
4 Ibid.
causing a decline in real income. The decline in gold production at the end of eighteenth century gave rise to a search for new exports. Cotton came to occupy a preeminent position just at the beginning of nineteenth century. Together with the United States, Brazil was for a while the principal cotton exporter to England, but it rapidly lost its position to USA. Also, at the same time a recovery in sugarcane was noticed, yet Brazil's sugar suffered strong competition from Cuba. It was at this moment that coffee plantation gained ground and occupied a spectacular position in Brazilian economic history for the next century to come. However, at the beginning of the twentieth century, there was an important growth in the exportation of rubber from the Amazon region for a short period, but later the British moved this industry to other regions of the world.

Summing up the periods of economic cycles in Brazil, Stefan H. Robock says:

In Brazil's long history of ever changing production cycles, none ever assumed the character of a broadly based development drive. The cycles created economic islands in the various regions of the country, which were isolated from each other and which prospered during different time periods. The result was a dispersed colonisation, an expansion based on export of raw materials, and little national income integration. (6)

5 In 1800, Brazil exported 30,000 sacks and the United States of America 40,000 but in 1807, the Brazilian export of cotton remained 19,000 sacks as against 171,000 sacks for the USA. See for details, Theotonio dos Santos, "Brazil: The Origins of a Crisis", in Ronald H. Chilcote and Joel C. Eliein, eds., Latin America: The Struggle with Dependency and Beyond (London, 1974), p. 425.

6 Robock, n. 1, p. 17.
Alongside these successive periods of economic cycles, was also seen different emphasis in terms of export expansion and import substitution, though both of which in no way were the deliberately chosen strategies for reinforcing the product cycles. However, this holds good only up to the year of 1947, since when, alternations in either import substitution or export promotion became the pronounced policy of the Brazilian Government. Both these alternatives have been adopted as strategies for economic growth. Each of the alternate period of export oriented development and import substitution industrialization is unique in itself and offers little ground for comparison with the earlier periods.

An attempt is made here to discuss briefly each of these periods.

Until the end of First World War and subsequently, coffee has been the main export item of Brazil and constituted a major portion of national income and export earnings. In 1930s, coffee accounted for 17 per cent of total national income, which fell to 6 per cent in early 1950s. In post-1964 period, coffee as an export item lost ground. By 1974, coffee accounted for only 12.5 per cent of total export earnings as compared to 75 per cent share in 1930s.

Similarly the earlier period of industrialization is based upon the production of simple consumer goods such as textiles, shoes, simple food processing etc., whereas in post-war years, consumer durables - automobiles, refrigerators, television sets and electronic items constituted the higher stage of production, ultimately paving the way for the capital goods production.

The post-war years witnessed deliberate policy measures to orient development based on import substitution or export promotion as against the spontaneous forces of development until the 1930s.
Period of 1822-1919

The period from political independence in 1822 to First World War, is characterized by an expansion of an external sector with a more modern base. At the end of nineteenth century there emerged an export society that was liberal and authoritarian and solidly linked to British and, later to American capital. By the second half of nineteenth century, coffee alone came to represent about 60 per cent of the country's exports. Thus, Brazil achieved an exceptional position in the world market: at the middle of the nineteenth century its coffee exports accounted for about 50 per cent of world coffee; in 1900 this percentage went up to 75. Rubber and cocoa were other important export products. This period witnessed a favourable balance of trade, thus accumulating large financial reserves. An unusual flow of British capital in the form of loans to the Brazilian Government and to individuals for financing the deficits in balance of trade, was another positive factor in the first half of nineteenth century. But in the second half, in the wake of Brazil's favourable balance of trade and foreign reserves, the British encouraged investment in transportation, public utilities, electrical energy and communications. The accumulated foreign reserves enabled the government to import machinery which contributed to industrial development. The capital market began to organize itself and a banking system developed. The development of an export economy allowed the urban middle class to buy foreign manufactured goods at low prices, thus limiting the market for goods produced in Brazil.
This, in turn, undermined the national manufacturing. At best, national industry could develop itself only as a complementary sector dependent on the exporter. However, while on the one hand the highly specialized character of exports (mainly from the coffee sector) destroyed a large part of subsistence agriculture, yet it must be emphasized that it contributed to a certain degree of internal economic dynamism. Massive food requirements of slaves, skilled peasants and urban salaried workers had to be satisfied by national agriculture and cattle raising. Thus, the higher production in these sectors helped in attaining a certain level of industrialization as in the case of salted beef in the state of Rio Grande do Sul, milk products in the states of Minas Gerais and Goias, and improvement in rice and bean cultivation. The textile, food and spare parts industries were stimulated by the demands of salaried urban and rural workers.

However, this happy blend of situation could not last for long. By the end of First World War, there grew a crisis in the traditional external sector. Factors contributing to the ensuing crisis were the declining trend of world coffee prices by the end of nineteenth century; stagnant level of consumption in coffee importing countries such as USA in early 1930s; heavy protectionist policy through price support programme to maintain artificial high price contributing to large accumulated inventory and encouragement to coffee planters of other countries. And finally, the great depression of 1929-34
dealt a severe blow to the 'coffee king'.

A number of measures were adopted to offset the ill-effects of depression. These were: (1) allowing the currency to depreciate in order to stimulate exports and (ii) withdrawing a part of the coffee from the market and destroying it to keep the price high and bring a balance between demand and supply. But these measures could not prove effective for, in the first instance, the degree of depreciation was much smaller than the fall in prices. Secondly, withdrawal of a part of coffee meant less exportable surplus and invitation to other coffee producing countries such as Colombia and the French colonies to penetrate into international market. As a consequence, Brazil lost the monopolistic status as a coffee producer and Europeans changed their sources of supply, which proved injurious to the Brazilian coffee in the recovery period.

However, the coffee economy of Brazil was responsible for

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8 The average value per sack was £4.09 in 1893, came down to £2.91 in 1896 and £1.48 in 1899. See Theotonio dos Santos, n. 5, p. 432.

The per capita consumption of coffee in USA was 13.1 pounds in 1937 as compared with 13.9 pounds in 1931 and 12.5 pounds in 1933. Further from September 1929 to September 1931 the world price for coffee dropped from 22.5 cents to 8 cents per pound and continued at slightly below the 1931 level until 1939. The government continued to support coffee prices by buying up surplus coffee stocks and in only four years, from 1930 to 1934, took 50 million bags out of circulation of which 34 million were burned. By 1944, 78 million bags, or 5.5 times total exports in 1929, had been destroyed in the valorization effort to bring supply in line with demand. For details see, Stefan H. Robock, n. 1, p. 22.
a number of transformations in the Brazilian economic life. For instance, labour and capital moved from Northeast to South and South-Centre; the state of Sao Paulo became most prosperous and progressive in Brazil by the beginning of twentieth century. Above all, rich coffee plantation heralded the Brazilian industrialization in the beginning of twentieth century and southern Brazil became the centre of industrial activity. The relative position of agriculture and industrial sectors in national income also underwent changes. Thus at the end of nineteenth and beginning of twentieth centuries, industrialization, thanks to the coffee boom, had tended to complement the export sector. It was the internal market stimulated by the export sector that allowed for industrial development. The export sector generated income for the importation of machinery and raw material needed for the industrial sector.

Period of 1919-1945

The coffee boom was responsible for the first phase of industrial growth. No doubt, as late as 1889, Brazil had over 6,000 miles of railroads, over 11,000 miles of telegraph lines, a coastal shipping network and some manufacturing of food products, construction materials, textiles, iron and iron

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9 National income derived from coffee declined from 17 per cent to 6 per cent between the 1930s and 1950s. Agriculture and industry represented 27 per cent and 21 per cent respectively of GNP in 1947. In 1961, agriculture contributed 22 per cent of the GNP, while industry was responsible for 34 per cent. See for details, Theotonio dos Santos, n. 5, p. 434.
products and ships. The large number of immigrants employed in coffee and coffee related sectors provided a great market for cheap consumer goods. Further, tariff protection, direct government aid to certain sectors and occasional devaluations of the Brazilian currency *vis-a-vis* the pound in a much smaller way, accelerated the rate of industrial growth. Thus by 1919 out of 13,336 industrial establishments, 55.4 per cent had been founded prior to 1914 and the average size of these firms was larger than those established during the First World War.

The War itself, however, interrupted the industrial growth as it became difficult to import the much-needed capital goods and no capital goods industry existed in Brazil at that time. There was the increased utilization of the capacity in food and textile industries and by the close of the war (1919), production of textiles, clothing and shoes accounted for 50 per cent of value added; on the other hand, cement and steel consumption declined considerably. In the period of 1920-29, the average rate of industrial growth was around 3 per cent as compared to 4.6 per cent in 1911-20.

Among the major causes of the decline in the rate of industrial growth, mention also must be made of the overwhelming free competition from industrial countries to the infant

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industries of Brazil and the lack of government policy to protect actively and/or further stimulate the modest industrial base. Further, government's emphasis shifted to coffee sector by its active support of the price system. In the face of an almost stagnant quantity of exports, coffee passed through an enormously prosperous period internally. According to a leading Brazilian authority, it was not "strange ... that the old prejudices against industry reappeared vigorously and that the economic literature of Brazil sharply attacked the national industry in the name of the well-being of the people." 12

During the depression period of 1929-34, a considerable fall in export earnings slashed the imports. For instance, between 1929 and 1932 the value of Brazilian exports fell from US$446 million to US$181 million. It has been estimated that the fall in monetary income in real terms was 25-30 per cent between 1929 and the nadir of the depression. This result was largely due to the fact that coffee comprised about 70 per cent of total exports at the outset of the depression, and coffee prices fell from 15.75 cents per pound in 1929 to 8.06 in 1932 and 5.25 cents in 1938. This experience led policy-makers to


13 Furtado, n. 2, p. 211.

question the efficacy of export-led development. However, a definite trend seemed to emerge at the same time by way of promoting manufactured exports from Brazil in the face of its heavy dependence on a single export crop, coffee. The alternative was the development of industrial sector. The great spurt of industrial production in the thirties' was first based mainly on increased utilization of existing capacity and addition of new capacity. By 1939, the share of industrial production was 43 per cent as compared to 21 per cent in 1907 or 1919. Net investment grew considerably. Both steel and cement consumption, which got a trough in 1931, regained their peaks in 1937. By 1939, industrial production in textiles was higher by 147 per cent than in 1929. The production of metal products went up three times the level of 1929 and similarly paper products

In Getulio Vargas period, the interests in export sector did not vanish altogether, yet there was an awareness that in an underdeveloped country, industrial progress requires a healthy agro-export sector. Industrial spokesman such as Roberto Simonsen could well label coffee "the backbone" of the economy, since the sudden retraction of foreign markets for coffee and other primary products - during 1929-30 "nearly paralysed" industries in Sao Paulo. As the value of coffee sales dropped, rural demand declined and the result was extensive closing down of plants.

Further, the policy-makers stressed constantly in 1930s to develop an industrial export capacity as a vehicle for the expansion of Brazil's political influence in South America. A number of industrial concessions were granted. One such concession was the inclusion of a draw back clause in the tariff of 1934 to encourage exports of manufactured products. As a consequence of all that, Brazil did show the capacity to export manufactured products. For details see, Stanley,

(Contd. on next page)
grew seven times that of 1929 level. By this time, Brazil was close to self-sufficiency in consumer goods and supplied over 80 per cent of its own intermediate goods and 50 per cent of its investment goods.

During the war period of 1939-45, industrial production grew at an annual rate of 5.4 per cent. Manufactured exports were rising rapidly and cotton textiles constituted 20 per cent of total exports in that period. The war provided an opportunity for industrialization based on import substitution. The existence of a large market and the natural advantage in the production of ferrous metals, metal products and chemicals encouraged this process. By the end of war, manufacturing accounted 20 per cent of gross domestic product.

No doubt, the war period provided a temporary bonanza to the export sector, yet this was not, in any significant way, detrimental to the development process of the economy. Celso Furtado observes:

In the case of development induced from without - as in Brazil - the first consequence was a demand for manufactured goods. At first this was met by imports; but the dynamic factor began to act internally, here on the side of demand, from the moment demand could not be met by external supply. On the one hand, the stability in the level of money income and on the other, instability in importing capacity, acted cumulatively to guarantee attractive conditions for investments linked with the domestic market.


Werner Baer and Annibal V. Villela, n. 11, pp. 226-8.
The industrial nucleus based on demand for manufactured goods formerly met out of imports commenced with light industries producing general consumption articles such as textiles and processed foodstuffs. Thus three sectors came to co-exist within the economy: one was the "remanent economy" with a predominance of subsistence activities and a minor money flow; the second comprised activities directly connected with foreign trade; the third consisted of activities connected with the domestic market for general consumption manufactured products.\(^{17}\)

**Post-Second World War Period of 1947-64**

The era of post-Second World War presents a systematic approach to the adoption of a deliberate policy of economic development based on import substitution industrialization strategy. A number of factors were responsible for adopting such a strategy.

In the post-war years, Brazil was once again dependent on a few primary products - coffee alone accounted for more than half of the total export earnings. It could not provide a stimulus for growth in the changed conditions. As Furtado summed up:

> The dynamic factor of the Brazilian coffee economy was external demand, not volume of investment within the coffee sector. If such investments were found to be excessive, the ultimate effect may be a loss of real income through decline in the coffee prices.\(^{18}\) During phases of prosperity, the profit in the coffee sector tended to concentrate in that same sector without playing any basic role in altering the structure of the system.\(^{18}\)

\(^{17}\) Celso Furtado, *n. 2*, pp. 135-6.

\(^{18}\) Ibid., pp. 134-5.
The low income elasticity of demand for coffee in importing countries, the overvalued exchange rate for non-coffee products leading to export stagnation, and the pent up demand for imports caused a strain on balance of payments. A general consensus seemed to have emerged among policy-makers that the main bottleneck, at least, during the 1950s and the beginning of 1960s, was the non-availability of foreign exchange. The apparent concern over the non-availability of foreign exchange led the policy-makers to promote the substitution of domestic production for importable goods during the 1950s.

Industry was viewed as the natural channel through which modern technology could flow into the economy. It was believed that import substitution was comparatively a riskless activity, at least compared with exporting, since the demand was already in existence. The development of the automobile industry is one such glaring example in the decade of fifties.

The political context, within which such an economic strategy was considered in Brazil, is best explained by Nathaniel H. Leff in his recent study. His contention is that economic policy in Brazil had not evolved from the various claims of conflicting pressure groups adjudicated by government, as in the USA. Instead, a national consensus had emerged about the importance of national economic development. To quote Leff:

This autonomy in economic policy-making grew, as we noted, from a system of clientelistic politics which neutralises many of the pressures from interest groups and socio-economic classes. Clientelist politics made possible
policy action based on elite opinion, which in post-war Brazil followed a modernizing economic ideology. With the availability of the tecnicos, in turn, these ideas could take effective programmatic action. (19)

The Prebisch-Singer thesis of the deterioration of the terms of trade for peripheral countries vis-a-vis the centre countries had a ready audience in Latin America. Brazil was no exception to it. Brazil's traditional plantation exports had come from the large planters of the Northeast and the coffee growers of South and involved merchant houses that had often been in the hands of foreigners. The easy way out was industrialization of the economy and the avoidance of the fluctuations of the export earnings of primary commodities.

More recently, Maria Conceicao Tavares in his study of the growth and decline of import substitution in Brazil provides two most important aspects of the growth of import substitution. He holds:

Expansion and structural changes in production were accompanied by a markedly entrepreneurial response on the part of most of the coffee growers who also embarked on industrial activities. This change-over is only one of the two aspects of another favourable element in the development of Brazilian industry, which up to a point is peculiar to Brazil, as far as Latin American countries are concerned. This is the geographical overlapping of the most dynamic productive sectors in both development models. This overlapping, initially due to the relative abundance of external economies in the area lying between Rio de Janeiro and Sao Paulo, transformed the Centro-Sul region into an

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area with a high concentration of economic activity, through a cumulative process which greatly facilitated the growth of import substitution, although it led to a sharp increase in regional imbalances. (20)

Thus, the pace of import substitution industrialization gathered momentum as balance of payments difficulties were mounting. This process of industrialization was seeking the maximization of vertical linkages within the economy. For example, the so-called "law of similars" was revised and it became one of the effective instruments for carrying out vertical linkages. Also, in early 1955, a decree was issued by the central bank authorities which enabled foreign investors to import capital equipment without the need for exchange cover, if the investment was deemed desirable by the authorities for the development of the country. This attracted the flow of foreign capital into industries considered basic such as iron and steel, and automobile including equipment and machinery. On the other hand, public sector investments rose rapidly and production and investment subsidies with strong aggregate demand did not deter private investment as well. The inaugural of a state owned 207 thousand ton integrated steel mill at Volta Redonda in 1946, the foundation of the National Economic Development Bank (BNDE) in 1952, and the foundation of the state owned petroleum monopoly (Petrobras) in 1954 were important beginnings in public investment and investment subsidies in the

infrastructure and basic industries.

The deliberate policy of overvalued exchange rate on the part of the government gave further impetus to the policy of import substitution. The import licensing system from 1947 to 1953, the multiple exchange rate system from 1953 to 1957, and the modified system prevailing since that time only slowly became conscious instruments for the active promotion of an industrial complex. However, the combination of domestic inflation and an overvalued exchange rate were most conducive for the spurt in industrial activity. In 1956-62, the average yearly growth rate of the real product was 7.8 per cent, industry leading with 10.3 per cent and agriculture 5 per cent. A number of factors were responsible for this increase in growth rate, such as (i) subsidies and special treatment in the form of low or negative real interest rate, tariff exemptions and lower exchange rates for a significant quantity of imported capital goods; (ii) liberal profit remittance regulations for foreign investors; and (iii) formation of 'Executive Group' in various industries. Such groups combined planning and execution formed by representatives of cabinet ministers and of the heads of other important institutions such as BNDE and CPA, and worked closely with manufacturers and had the power to implement their plans for investment and production in various industries.

As a result of these policies, the rise in the proportional share of heavy industries became pronounced. Metal

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products, machinery, electrical equipment, transport equipment and chemical industry registered substantial growth. Baer and Kerstenetzky have measured the repercussion effects which resulted from the industrialization of Brazil in the 1950s. These effects include such variables as employment, gross value added, backward-forward linkages, capital-output ratio and sectoral growth rates. Thus commenting on the process of industrialization through a deliberate policy of import substitution, Baer and Kerstenetzky summed up:


The main conclusion of this study are as follows:

Between 1949-62, the motor vehicle industry generated an increased level of employment and gross value added with highest overall linkage effects, closely followed by the machinery sector with a strong direct impact in terms of employment and value-added and relatively weaker, though not ineffectual, linkage coefficients. The highest import substitution occurred in the chemical industry, especially in petroleum products. Iron and steel are relatively low in terms of import substitution. It reveals a substantial area for further import substitution, i.e., an increase in steel producing capacity. A similar analysis will hold for the paper and paper products industry. Textile and food products grew at a much slower rate in terms of increased employment and gross value added. In capital goods industries such as machinery and transport equipment, the forward linkage is lower than the backward linkage. This is due to the fact that investment is treated in the input-output table as a final demand sector.

About capital-output ratio and sectoral growth in Brazil, the conclusion is that the low-overall incremental capital-output ratio (ICOR) in the industrial sector, which is also the most rapidly growing sector, results into low overall ICOR. The Brazilian industrial ICOR might also be influenced by a greater degree of labour intensity in Brazilian industries, especially in areas marginal to the firm like the handling of materials.
It could thus be claimed that even if the protective devices used by the government stimulated industries of a non-essential nature, complementary policies provided substantial incentives for vertical integration and thus for the ultimate establishment of a productive base. (23)

A somewhat similar analysis on the repercussions of initial industrialization has been put forth by A.O. Hirschman. He argues that the spread of industrial activity beyond the national capital in one or two centres is most desirable. A few Latin American countries had developed such centres. As he says:

The importance of having a somewhat isolated, inbred and self-consciously proud industrial centre during the early stages of industrialisation is demonstrated by the roles played by Sao Paulo, Monterrey and Medellin. (24)

At another place, stressing the socio-political atmosphere for initial development strategy to determine the backward linkages in Brazil, Hirschman holds: "It has been in fact due to the regulations issued by the technicos of the Kubitschek administration that backward linkage was enforced rapidly in the Brazilian automotive industry in the late fifties." (25)

The policy of import substitution industrialization brought in its wake some changes in Brazilian import structure.

23 Ibid., p. 414.


25 Ibid.
For instance, important decline was noticed in the import of processed goods from 86 per cent to 68 per cent between 1949 and 1962. Further, if we look at change in imports as percentage of total supplies, it had decreased considerably during the period 1949-1964, as is reflected in a study carried out by Joel Bergsman.

Imports as Percentages of Total Supply, 1949-64

<table>
<thead>
<tr>
<th>Year</th>
<th>Consumer goods</th>
<th></th>
<th>Producer goods</th>
<th></th>
<th>All manufactured goods</th>
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<tr>
<td></td>
<td>Durables</td>
<td>Non-durables</td>
<td>Intermediate</td>
<td>Capital</td>
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</tr>
<tr>
<td>1949</td>
<td>64.5</td>
<td>3.7</td>
<td>25.9</td>
<td>63.7</td>
<td>19.0</td>
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<td>1955</td>
<td>10.0</td>
<td>2.2</td>
<td>17.9</td>
<td>43.2</td>
<td>11.1</td>
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<tr>
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<td>6.3</td>
<td>1.1</td>
<td>11.7</td>
<td>32.9</td>
<td>9.7</td>
</tr>
<tr>
<td>1964</td>
<td>1.6</td>
<td>1.2</td>
<td>6.6</td>
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No doubt, Brazil had created the most modern and diversified industry in Latin America but it had also added miserably to a number of problems which found the decade of 'sixties' in crisis. One such problem was of regional economic imbalances - the contrast between Northeast and Sao Paulo, presents an indigestible theme of the industrialization process. But the overall level of industrial activity should not make one complacent

that it was not appropriate for a country of the size of Brazil. The year 1962 was the last year of sustained industrial growth. The average annual industrial growth rate during the fifteen year period (1948-62) had been 9.8 per cent, never falling below 5 per cent.

The stagnation during 1963-65 was caused by a combination of factors, some acting throughout the period and others only occasionally.

By 1961, import substitution of industrial products had already reduced the potential for rapid future growth based on demand for imported products. Manufacturing costs started rising. Export exchange rate was low and was subject to considerable uncertainty in real terms due to inflation and the generally absent export mentality on the part of most Brazilian manufacturers. Restrictive policies by the developed countries on imports of industrial products from developing countries added one more problem.

Secondly, at the most aggregated level, imports as a percentage of real gross national product (GNP) actually

27 For a detailed critical analysis of the problems of industrialization in the 1960s, see Bergsman and Candal, n. 21, pp. 49-54

28 A study of the comparative costs of producing light-trucks shows that the ex-factory price in Brazil was 70 per cent above that in the USA. Further, the Economic Commission for Latin America (ECLA) study of 45 products in the categories of simple consumer goods, durable goods, construction material and capital goods between USA and Brazil shows unit price variation from 15 per cent to 500 per cent.

Quoted in J.T. Winpenny, n. 14, p. 84.
increased during the period of heaviest import substitution from an average of 9.6 per cent in 1947-49 to 11.3 per cent in 1959-61. However, at the same time, imports as a percentage of total availability of goods fell noticeably in most of the major classes of product in Brazil between 1949 and 1961. Nevertheless it would amount to say that the progress made in import substitution in manufactures was offset to some extent by the reverse happening in other sectors, especially primary production. As noted earlier, the share of manufactured goods in total Brazilian imports fell from 86 per cent to 68 per cent between 1949 and 1962, the share of non-processed raw materials in total imports rose by an offsetting amount. This may explain why the total import coefficient increased slightly. For, net import substitution in most of the manufacturing sectors consumed large amount of raw materials and foodstuffs from sectors where import substitution was not taking place to the same extent.

Thirdly, the decline in foreign private investment was probably caused largely by declining opportunities for import substitution and by the political factors. A new law to control profit remittances was enacted in September 1962, whereby only 10 per cent of officially registered capital was permitted to be remitted. Royalty payments to foreign parent firms were prohibited. Nationalization of foreign investment in power

and transportation was carried out. Thus the political tone of the government was hostile to foreign capital with the result average inflow of capital, which was $102 million in 1956-61, came down notably to $28 million in 1964.

Fourthly import substitution was restricted by the actual or potential size of the domestic and/or foreign market. The Brazilian motor vehicle industry is acclaimed by Baer and Kerstenetzky as the most successful case of import substitution in terms of employment, gross value added and linkage effects. Yet in 1970, the total production was little more than .4 million units, a volume of production that would hardly exhaust the economies of scale at a single North American or European plant. Though the share of nationally produced cars in the total Brazilian fleet had risen from 3.8 per cent in 1957 to 65 per cent in 1967, yet the wave of recent mergers and takeovers in the industry can hardly be overlooked.

Lastly, general political instability and lower priority given to industrial growth was responsible for the decline. As a study by ECLA concluded, "the swelling proportions assumed by the inflation problem (in 1961-1963) shifted the centre of attention from industrial development to the control of inflationary process.... No longer were exchange, monetary and fiscal measures placed at the service of industrialization without due thought." In 1961, the annual rate of inflation

30 Winpenny, n. 14, p. 12.

rose above 30 per cent for the first time and by 1964, it reached 91 per cent. By August 1961, President Janio Quadros resigned and Joao Goulart who succeeded, adopted measures to support growth, combat inflation, increase real wages and agrarian reform which produced contradictory and unsuccessful results. The poor economic results of 1963 proved the ousting of Goulart by a military coup in April 1964 that had wide support from urban middle classes, business and land holding interests. Even the stabilization programme of 1963 could not produce the desired results as this period was marked by strikes and labour unrest.

Incidental to these was a shift of general emphasis from import substitution industrialization to export promotion strategy to accelerate the process of economic development in Latin American countries. The United Nations Conference on Trade and Development (UNCTAD) under the leadership of Raul Prebisch became the leading agent in exploring new export opportunities for developing countries in both primaries and manufactures and identifying the chief barriers in such exports. No where else have these changes been more in evidence than in Brazil.

**Period of 1964-74 and Export-Oriented Growth**

The advent of the military regime in 1964 witnessed a new trend in the development strategy. The first military government under President Castello Branco faced three critical economic tasks: combating inflation, resolving the balance of
payments situation, and restoring growth.

On the domestic front, controlling inflation was considered a pre-condition for restoring growth. Two schools of thought had emerged in an effort to combat inflation. One school led by Roberto Campos and Otavio Bulhoes advocated and applied orthodox approach of restricting demand, with the principal weapons such as restrictive fiscal policy, forced wage restraint and an unorthodox technique of indexing. The result of such policy was increased bankruptcy of Brazilian firms and a very low rate of economic growth, i.e., below 3 per cent in both 1964 and 1965, rising to 5.1 per cent in 1966, as a result of temporary stimulants to industrial production in 1965.

The other school represented by Delfim Netto (and subsequently Mario Henrique Simonsen) advocated an inflation rate of 15 per cent as a tolerable limit for the economy and easing the credit to the private sector by expansion of money supply, adopting wage and exchange rate flexibilities. The obvious outcome of these policy measures resulted in the so-called Brazilian "economic miracle" since 1968. For example, from 1968 through 1974 Brazil's real growth rate averaged a phenomenal 10.1 per cent annually. The industrial sector expanded at an average annual rate of 11.9 per cent, and agricultural output rose by 5.9 per cent per year on the average. Growth rates in

32 Stefan H. Robock, n. 1, pp. 31-36.
33 Ibid.
commerce - in transport and communication category - 11 and 11.7 per cent respectively, were slightly above the overall growth rate.

On the external side, both as a growth strategy and as a means of improving Brazil's balance of payments situation, foreign trade policy became a key-stone of the military governments. The promotion of non-traditional exports, a logical extension of the import substitution strategy, in view of both the demand barrier and the foreign exchange constraint, assumed prime importance in this new trend. Thus, any analysis of the Brazilian strategy for economic development in recent years shows that the possibilities of maintaining high rates of growth for the economy depended primarily on the performance of the country's exports. For, it is the high growth rate of exports that allowed Brazil to maintain its high overall rate of growth with tolerable levels of foreign debt.

Thus the external sector was assigned an important role to maintain the high rate of growth of the economy, especially since 1968. A liberal import policy, with the aim of avoiding bottlenecks in the increased rate of growth of the economy, was adopted. As a consequence, total imports increased at an

34 Ibid.

average rate of around 20 per cent during the period 1967-70, increasing to 34.5 per cent in recent years (1970-73), thus raising the import coefficient from 4.7 per cent in 1967 to 11 per cent in 1973. More so, 80 per cent of total imports were accounted for industrial imports of the most dynamic sectors, e.g., metallurgy, engineering, electrical materials, transport materials and chemicals.

Of much more importance has been the substantial inflow of foreign capital since 1967 under an active policy of the military governments. This has either taken the form of suppliers' credits or money loans. As a result, Brazil's external debt increased at an annual average rate of 25 per cent, and grew from 3,300 million dollars in 1967 to 12,600 million in 1973. The positive side has been the accumulation of international reserves - amounting to 6.4 billion dollars by 1973, after meeting the growing deficits in current transactions.

In view of the growing external debt and the increasing deficits in current transactions, it had become necessary to adopt an aggressive export policy. This facilitated financing the growth of imports, and remittances of interests and profits and coping with servicing the debt itself.

In order to promote exports, especially of manufactures, a broad based incentive policy was applied. Exports were

37 Ibid.
exempted from indirect taxes; income tax ceased to be applied to export profits; sales of manufactures were subsidized, special interest-subsidized lines of finance were set up for products for the external market; and from 1968, a system of periodic devaluations of cruzeiro was adopted in order to achieve a stable balance between domestic and external prices.

As a result of this policy, Brazilian exports increased at an average annual rate of 24.5 per cent during the period 1967-1973, and their money value increased from US$1600 million to US$6200 million during the same period. Of this total, exports of manufactures, which were insignificant in 1964, accounted for US$1900 million in 1973, or 31.3 per cent of total exports.

However, the possibilities of a considerable enlargement of exports in the short-run probably lay in non-traditional primary products. It must be recognized that it is indispensable to stimulate a higher participation of industrial products in Brazil's exports, since they have a higher income elasticity of demand. This is more important from the point of view when the share of export of manufactures out of total manufacturing product had only gone up from 3.1 per cent in 1968 to 6.3 per cent in 1973. This is insignificant when this share is compared with 36 per cent in the case of Taiwan and 18 per cent in

38  Ibid., p. 59.
39  Ibid.
South Korea for the year 1969.

In addition to introducing new primary products in the flow of exports, it will also be necessary to alter their composition in order to increase the average income elasticity of demand for export product as a whole. For example, the export of sugar, soybeans and its derivatives and coffee accounted for US$3.2 billion out of a total export of US$7 billion approximately, about 43 per cent of the total exports in 1974. Their respective absolute share was $1,259 million, $888 million and $877 million. The sudden spurt in sugar and soybeans exports was due to the booming price conditions in the world market, which was only a temporary phenomenon. But more important was the deliberate policy of the Brazilian Government to alter the composition of primary product exports.

Undoubtedly, in recent years both policy-makers and economists have been devoting considerable attention to the problems of increasing manufactured exports from the less developed countries as a means of fostering their development. Much of this attention has been concentrated on the trade barriers erected by developed countries. However, given these barriers the export policies of less developed countries

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41 *Economic Times* (Delhi), 16 June 1975.

themselves can be crucial in promoting industrial exports. Policy instruments must be evaluated in terms of their effects on export behaviour.

Doubts have been expressed in various forums about the feasibility and practicability of export-oriented model in recent years. Most of the issues raised relate to: (i) inter-sectoral imbalances in industrial sector as well as between agriculture and industry; (ii) heavy reliance on foreign enterprises, and (iii) accentuation of the distribution of income. An attempt is made below to review each one of the factors in detail.

One can grasp the nature of this model by looking at the type of industrial development that took place. While the dynamic industrial sectors had a relatively high growth rate, the so-called traditional industries such as textiles, food-stuffs, clothing, shoes, furniture, beverages, etc., in terms of production grew at less than one per cent annually between 1962 and 1968 and did not show any appreciable degree of dynamism during the period of recovery between 1969 and 1971.

The most important dynamic sectors to grow fast have been the processing of non-metallic minerals, metallurgy, metal transforming etc., transport materials and equipment, chemicals and plastic products. It may be noted here that the growth of imports in the economy together with the substantial increase in import coefficient, was unquestionably bound up with the

43 Theotonio dos Santos, n. 5, p. 470.
expansion of the dynamic core of the industry, which played an important role in ensuring and maintaining high growth rates for the product. While on the one hand this provided a possibility of speeding up of growth, on the other hand, it constituted the vulnerable aspect of such growth, in that it imposed increasing rigidity on the pattern of imports, which came to constitute a bottleneck in the future. And this proved extremely right in the wake of oil crisis in 1974 onwards, when, the government was not in a position to maintain a liberal import policy as it has already maintained.

The imbalance between agricultural and industrial sectors was another aspect which did not receive considerable attention throughout this period. For instance, between 1948 and 1974, the agriculture sector expanded by an annual average of 4.6 per cent against 9 per cent in industry. Even though when,

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44 It must be borne in mind that the import coefficient rose from 7 per cent to 10.2 per cent in the period of four years, which means that the annual growth rate of imports was 22 per cent. The recent trend indicates that for every 1 per cent of growth of the product, the volume of imports must increase by over 2 per cent. See for details, UN, Economic Survey of Latin America, 1974, p. 223.

45 Since December 1975 the following measures have been taken to control imports. The length of forward payments of import deposits has been doubled to 360 days. The number of exemptions from the import deposit scheme has been cut, and imports of nearly 300 kinds of luxury goods have been banned. From June 1976, Brazilians travelling abroad have to pay a deposit of $1150. The public sector is likely to sacrifice a quarter of its import quota. The Economist (London), 31 July 1976, p. 15

46 Ibid., p. 22.
about six times as many people worked on the land in Brazil than in the United States they produced about eight times less. Further, Brazilian industry had an employment/production ratio of only 0.28, meaning thereby that, if industry contributed 10 per cent of gross national product it was only capable of creating 2.8 per cent of the jobs.

The second objection is about the role of foreign enterprises. The fundamental assumption of the Brazilian development model since 1964 has been that Brazil will take the lead in a new international division of labour within the capitalist world. Industrialization and export promotion activities taking place in Brazil were largely due to multinational corporations (MNCs) decision to transfer the production of manufactured goods to their branches in Brazil. Basically the MNCs had two important objectives in terms of their operation in Brazil - one, to do more sourcing for their global system in Brazil and two, taking the locational advantage to meet the growing import requirements of Latin America. And third, the MNCs were interested in the type of industries in developing countries in general and Brazil; in particular, in which they can obtain a much higher rate of return than would be the case with similar investments in a developed country like USA, provided a country like Brazil offers a solid base for industrialization. Brazil already exported autoparts, some machinery and electronic parts to the US and Europe and a large part of its exports were products of MNCs branches. To attract more capital, control

47 A joint study by (Brazilian) Institute of Applied
(Contd. on next page)
on profit remittances were made liberal and a variety of investment guarantees gave new preferences to foreign interests over local investors. Payments for technical services and royalties and for services such as shipping increased. There had been a rise in the foreign debt, and foreign debt/export ratio had reached crisis proportions. The servicing of this debt only accounted for an average of 53 per cent of the value of exports during the three year period of 1971-73. International reserves accumulated by Brazil to the extent of more than $6 billion by 1973, have been responsible to increase the domestic level of finance for working capital and investment, although it could be said that the credit granted was to a large extent selective, since it benefitted the relatively more dynamic activities or those controlled by foreign capital.

Economic Research and United Nations Economic Commission for Latin America shows that in 1967, MNCs were responsible for 34 per cent of manufactured exports. The proportion for the four main product groups was as follows: chemical products 17 per cent, machinery and vehicles 72 per cent, manufactured classified by raw materials 22 per cent and miscellaneous manufactures 21 per cent. Further the data for 1970 in terms of total sales (domestic plus export) of manufactures originating from MNCs shows a substantial increase at least in some sectors. See for details, J.T. Winpenny, n. 14, pp. 39-40.

Also see Jornal do Brasil (Rio de Janeiro), 18 April 1974, p. 59.

By the end of 1975, Brazil recorded the largest foreign debt i.e. £22,500 million and net foreign debt/export ratio has gone up from 1.03 in 1973 to 1.52 in 1974 and 2.10 in 1975. Latin America Economic Report (London), 7 November 1975, p. 174; and UN, Economic Survey of Latin America, 1974 (New York, 1976), p. 57.
or both. It should also be observed that the large intake of external resources dangerously increased the external vulnerability of the economy, and also represented a constant factor for inflationary money growth. For the year 1973 alone, MNCs were to get a payment of US$400 million in lieu of technology payment, which, of course, could not be paid because of balance of payments difficulties.

The spectacular rate of growth accentuated the problem of distribution of the growth fruit. The lot of the 5 per cent of population had considerably gone up, 15 per cent enjoyed the same cake and rest 80 per cent found its economic situation deteriorating. Celso Furtado has criticized the government for failing to transfer the benefits of economic growth to the working class. There has been lack of basic feedback for any increase in productivity. It did not get transmitted into higher wages and no account of mass consumption goods was considered. At the same time the salaries of technical employees and executives increased, generating an increase in the country's median wage level. This, according to Theotonio dos Santos, accomplished two important objectives: first, an increase in consumption goods requiring advanced technology that led to the growth

49 Ibid., p. 59.

50 As the Bank of Boston commented that "it is reasonably certain that the government has simply decided that it cannot afford to bleed away 400 million dollars in technology payment pressure." In Salzburg, at least Simonsen stood firm, commenting that 'had we surrendered, it would have been a disaster'. Latin America (London), 20 June 1975, p. 188.

51 The Economist, 2 September 1972, p. 33.
of most modern industrial sector; second, the political objec-
tive of winning the backing of the most active sectors of the
petty and medium bourgeoisie and the skilled workers who could
guarantee a base of support for the system. Thus there is
some truth in what President Medici, had proclaimed that "the
Brazilian economy is doing well, but the people are doing
badly." In a similar way, Joel Bergsman and Arthur Candal
concluded:

Nevertheless we believe that something like
the consumption model offers better prospects
for Brazil in the long run - not only because
it seems to be more likely to be self-sustain-
ing and appeals more to our sense of equity,
but because it seems to offer greater chances
of reducing the tremendous gap between modern
Brazil and the underdeveloped Brazil. (54)

Current Phase

A period of crisis in the highly growth-oriented economy
became an established fact by the end of 1974 primarily on
account of oil price crisis, recessionary conditions in the
world economy and internal growth of inflation. Even the newly
elected President Geisel sounded a sombre note of warning in
1974 when he observed that external factors can, by their very
nature, disturb, to a greater or lesser extent, the picture of
our financial-economic situation. He pointed out three areas

52 Theotonio dos Santos, n. 5, pp. 469-70.
53 Ibid.
54 Joel Bergsman and Arthur Candal, n. 21, p. 58.
of concern: (i) there is imported inflation, resulting from the increased prices of imports which will make it increasingly difficult to maintain the projected 12 per cent inflation level for 1974; (ii) the high growth rate of industry and increase in exports have been creating considerable problem in the supply of foodstuffs and raw material to the internal market; and (iii) rigorous governmental measures to control the entry of foreign loans to the country since the conversion of such loans into Cruzeiro could put pressure on the money supply and upset the battle against inflation.

In fact, in the view of some observers, there is increasing realization among Brazilian official economists that concentrating on primary products may be a better investment in the long run than competing with industrialized nations. It has long been argued by opponents to the policies of earlier Finance Minister Delfim Netto that concentration on manufactured exports, with the need for heavy subsidies and import of raw material, would not in the long run be in Brazil's interests. In their view, the formation of larger internal market, with more rapid development of the rural areas, would in the end do more to promote exports, and would protect the country from the vicissitudes of the international economic situation. There are some indications that President Geisel may subscribe to this view, and this is reflected in his recent trips to the rubber producing areas of the Amazon, the cocoa plantation in Bahia and cattle ranches of the centre-west and agricultural

55 Latin America, 8 February 1974, p. 42.
university at Piracicaba in Sao Paulo.

In a similar note, the Agriculture Minister Elysson Paulinelli, on his swearing-in as Minister said: "the solutions adopted for industry will also be good for agriculture." At the beginning of the month of September 1976, Planning Minister Joao Paulo dos Reis Veloso called on the motor industry to shift its present emphasis from the production of passenger cars to more utilitarian vehicles.

These pronouncements make one to believe that the government's policy seems to be one of carrying out a substantially different course of economic strategy. This is reflected in the government's Second National Development Plan (1975-1979). Energy resources are given top-most priority to make the country self-sufficient by the end of the century. Oil production in Brazil is expected to rise to about 260,000 barrels a day, or about 24 per cent of consumption by the end of 1977. Oil accounted for $3073 million of Brazil's imports in 1975, over $2000 million more than the oil bill in 1973. The days of heavily imported cheap oil are over. Brazil is exploring new oil fields and is determined to increase the supply so as to meet 40 per cent of its requirements by the end of the decade. The government is also looking at the alternatives, such as vegetable alcohol, shale oil, coal, lignite and natural

56 Ibid.
57 Latin America, 17 May 1974, p. 151.
gas. West Germany is offering the Brazilians to develop nuclear energy and by 1990, eight nuclear reactors would be in operation. Under a deal signed with Paraguay in 1974, a massive dam built at Itaipu on the Parana will be producing 12.6 kilowatts by 1983.

There will be a deliberate switch back to investment in the capital goods industries and to some measure of import substitution. They are planning a five year expansion of their rail network, costing $7 billion. They are also hoping to make heavy investments from domestic savings in iron and steel, non-ferrous metals, petrochemical products, fertilisers, pesticides, paper and cellulose, raw materials for the pharmaceutical industry, cement, sulphur and non-metallic metals. The total cost of these projects is put at $23 billion. Such investments could give Brazil a long term saving of about $500 million a year on imports. The climate to attract foreign capital is not going to be changed much. Even though some mild conditions have been imposed, the general atmosphere on the part of investors seems to be encouraging.

59 See for details of the new rules for foreign investors in Brazil in Latin America Economic Report, 18 April 1975, pp. 59-60. It discusses in main the foreign participation in Brazil's stock market, restricted only to participate in investment societies. The minimum participation in an investment society by a foreign individual or corporation will be US$15,000 or the equivalent and the minimum period of such an investment will be three years. Taxes on dividends remitted from Brazil will range from 25 per cent to 60 per cent during the first five years of the investment, but thereafter will range from 15 per cent to 40 per cent. Capital
Until now, Brazil like most LDCs, has concentrated on the expansion of industry and exports at the expense of agriculture and home market. Agricultural output during 1973 grew by only 4-5 per cent, roughly comparable to the 4.1 per cent of 1972, and well below the record agriculture growth of 11.4 per cent of 1971. Yet agriculture remains the great opportunity for development under the able guidance of agronomist Elysson Paulinelli, the new Agriculture Minister. With him has started the process of revitalization of agriculture sector by increasing the irrigated land area, loans to farmers and availability of agricultural inputs. He is also bent upon diversifying the agricultural sector. Disasters in the coffee and sugar industries have emphasized the danger of Brazil's continued dependence on these export crops. Spreading the agricultural risk could reduce exports, but it could also reduce

gains tax will also be reduced if the investment is left in Brazil for a long period. It will be charged at 25 per cent if the investment is realized within six years, falling to zero if it is left for 10 years.

On the question of investors' favourable response: A Swiss bank representative said that "for Brazil conditions will always be good, because it is one of the only alternatives in the world for the application of capital whether in the form of loan or investment, since it has political stability and the prospects of rapid economic development."

This view was echoed by the director of the Bank of Boston and the Vice-President of the Bank of Tokyo who added that Japan's investment and loans to Brazil will increase in the next few years, although in the case of other countries they will be reduced. See for details, Latin America, 8 February 1974, p. 44.
the dangers. Increased prosperity in the countryside would also create a bigger market for basic foodstuffs. In terms of import substitution, wheat is the most important item which any scheme of agricultural development should seriously take into consideration.

Thus the major plank of economic activity in this period once again switches to a period of import substitution, whether it is energy, capital goods or agriculture sector. However, one should not be complacent to think that export sector has been assigned a secondary role in this plan. The same plan document sets forth the export target up to the end of the decade, i.e., 1980 and the government has always treated exporters generously. In January 1976, the CACEX offered the exporters extra capital credits at what effectively amount to negative real interest rates. As a recent survey points out:

For the moment it is sufficient to say that if its second national development plan is to be believed, Brazil is due to make a major switch in economic policy, away from headlong growth at practically any cost and back possibly to some measure of import substitution. The wheel would then have

According to a recent study, the Brazilian export, it is estimated, will expand from a level of US$6.2 billion in 1973 to US$24 billion by 1980 in constant prices. In other words, it amounts to a projected increase of about 400 per cent in seven years. This provides scope for manufacturing and semi-manufacturing exports to increase from as less as $2 billion in 1973 to almost $15 billion in 1980 assuming that exports of primary products will expand from US$4.1 billion to more than US$9 billion during the same period. See for details, Stefan H. Robock, n. 1, p. 171.
been brought back to full circle. The soldiers who deposed the civilian government in 1964 wanted to transform a supposedly protected, import substituting Brazil into an open, export geared world power. The oil crisis and world recession now appear to be forcing the generals who have succeeded them to think again. For the Brazilians themselves this is not bad. (61)