



4-1-1965

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### Recommended Citation

Wirthlin, Richard B. (1965) "The Impact of Inflation on the Developing Economy: The Brazilian Case," *BYU Studies Quarterly*. Vol. 6 : Iss. 2 , Article 3.

Available at: <https://scholarsarchive.byu.edu/byusq/vol6/iss2/3>

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# *The Impact of Inflation on the Developing Economy: The Brazilian Case\**

RICHARD B. WIRTHLIN\*\*

No generation in history has encompassed such rapid, marked and widespread change in man's environment as that of our own. To a large degree many of these changes have been induced by remarkable advances made in the physical sciences—the incredible truncation of distances occasioned by the advent of jet transportation; the awesome power placed in the hands of man by the discovery of nuclear fission; the arrival of the age when man's material goods can be created without the hand of man by applying computer-controlled automated systems to the tasks of production; man's first feeble venturing into the unbounded limits of space enabled by the coming of age of missile technology. These advances, the fruits of the physical sciences, impinge directly upon man's social, political, and economic environment. Thus man is faced with problems and challenges that a few short decades ago were undreamed.

In some respects these revolutionary changes in man's environment and man's knowledge of his environment have drawn our world together and united it as never before. Contrarily, these same forces have also divided it.

Just as neighbors or families when denied the comfortable buffer of space sometimes generate hostility and frustration, so it seems that in our day the juxtaposition of nations made possible by modern transportation and communication has heightened tension. Invidious comparison of social and political systems, as well as the stark contrast between the "have's" and the "have-not's," are much facilitated by man's new technology. But the overriding factor which casts a pall of suspic-

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\*This article was presented in a slightly expanded form in the Faculty Forum of the College of Humanities and Social Sciences at Brigham Young University, November 1964.

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ion and fear of one nation for another resides in our now extant technology of destruction. Because of progress made in the delivery capacity of missiles and nuclear physics, one-half of the world may destroy the other half in a matter of minutes through a thermonuclear holocaust that portends to be as universal as the flood.

Despite the efforts of the poor nations of the world, and the capital and skill given by advanced countries, the gap between the rich nations and the poor is widening; the frustrations of the inhabitants of the poor countries mount as they realize as never before the baseness of their poverty.

I have chosen to discuss a single dimension of the poor nation in the context of one country for this College of Humanities and Social Sciences faculty lecture. Perhaps there are reasons why this topic may have interest beyond what might be thought of as the narrow limits of economics: First, the poor but developing nation now constitutes the battleground of clashing ideologies. Second, the poor but developing nation sets forth with a broad brush the elements of man's struggle with his total environment. Third, while the problem of insatiable wants clashing with limited means dominates the broad landscape of a poor country and is the economic problem, nevertheless the dimensions of the problem extend far beyond the bounds of economics; for they involve man's interaction with his political, social, and geographical environment.

The primary dimension of analysis will remain economic; the country: Brazil; the problem: inflation.

Economics is chosen as the dimension of analysis simply because of the limits of my own competence. Economics does, however, have some historical claim to offer insight into the process of material ascendancy. Over the long sweep of history the central economic problem of mankind has been survival. Modern economics was not born until a few select nations, specifically, those in which the market system became dominant, felt the first stirrings of material expansion. Early economists such as Robert Malthus and David Ricardo clearly recognized the potential of something better than subsistence for the masses. But quite mistakenly they concluded that the process of economic development was inherently a self-defeating one, that all nations would eventually return to the poverty trap because of the crushing pressure of explosive population growth. This pessimistic conclusion gave rise to the label,

"economics—the dismal science." The label stuck. Even in modern times economics is still referred to as the dismal science, perhaps because people consider the interest of the economist in the economic ills that afflict society, such as unemployment and inflation, as morbid. This interest is, however, no more morbid or dismal than that of a physician whose interests are the ills and symptoms of patients. In both cases interest is evoked because cures are sought.

Economics is also a relevant frame of analysis for the multidimensional problem of the rise to material affluence even though that rise involves a multitude of noneconomic factors, because man's nature, in turn, is molded by his economic welfare. As an early philosopher put it, "A man can be neither a saint, nor a lover, nor a poet, unless he has comparatively recently had something to eat."

There are several reasons why Brazil was selected as the patient; the problems of Brazil represent a sampling of the problems of those nations that quantitatively represent the most important group in the world—the poor nations. The way political winds blow in Brazil directly affects hemispheric unity. Lastly, Brazil is undergoing an economic experience, which frightening in its dimensions, is nonetheless fascinating. That experience—inflation.

In order to come to grips with the impact of inflation on Brazil's growth we will first discuss Brazil's general endowments and, second, review the course of Brazil's inflation during the postwar period. We will then turn to an analysis of the consequences and causes of Brazil's inflation. And lastly, not wanting to leave the patient completely in the throes of her affliction, we will offer a possible cure for her disease and in turn attempt to determine whether or not the experience of Brazil offers any meaningful lessons to other poor but developing economies.

In setting a very broad stage for the discussion of inflation, let us consider briefly Brazil's political, geographic, demographic, and economic characteristics.

Brazil's initial exposure to inter-country relationships was one consequence of Vasco da Gama's Indian voyage. It is generally accepted that Brazil was discovered on April 22, 1500, by Pedro Alvares Cabral, a Portuguese admiral. Like the United States, Brazil was, when discovered, a large and virtually empty country inhabited sparsely by aborigines. Unlike the U.S.,

however, the open frontier and a consequent labor shortage that developed in both countries did not tend to loosen the political and economic bonds of the colony, Brazil, from her mother-country, Portugal. Two factors of Brazil's emergence as an integrated socio-political entity tied her closely to Portugal: the early establishment of an aristocratic socio-political system, which was later reinforced by the second factor, the ensconcing of the royal Portuguese family and its court in Brazil. A third factor which marked Brazil's early development, the remnants of which still affect Brazilian society, is the economically dominant role assumed in the initial period of colonization by Negro slavery.

Brazil's political emancipation from the royal family of Portugal was gradual. The year 1889 marks Brazil's most important single break with her original colonial status; in that year the Proclamation of the Republic was issued. The remarkable continuity of Brazil's early political life was, however, also lost in 1889. Nonetheless, it is doubtful that the forces now transforming the Brazilian economic structure could have been exerted in the environment of stability imposed by the Portuguese monarchy. Brazil has had five constitutions. Since World War II her government has changed hands by "irregular methods" four times. The most recent revolution occurred April 1, 1964. Despite these political changes, the economic power structure has altered little in past decades, although with the rise of industrialization, shifts in Brazil's economic power base are becoming evident.

Brazil's immensity dominates all her other geographic characteristics. She encompasses over three million square miles, occupies 1.7 percent of the area of the globe, 5.7 percent of the dry land, and nearly half of the southern continent. Despite the impressions given the casual viewer of the Amazon and the coast, Brazil is not a country of only lush rain forests and mountains. Fifty-seven percent of Brazil's land area is made up of highlands varying from 650 to 3,000 feet in altitude in which irregular mountain ranges form high plateaus. A great expanse of grass and scrub lands dominates the central and western portions and covers an area larger than the Amazon plains. Much of this land could be used to increase agricultural production.

Total population of Brazil is approximately 75 million. It is expected that this population will double long before the

end of this century. Unlike many other underdeveloped countries, Brazil is rather highly urbanized. In 1960, 39 percent of the population lived in the urban areas. On the other hand, the typical educational characteristics of the underdeveloped country are clearly to be seen in Brazil. Over one-half of Brazil's total population cannot read or write. There are only 107 copies of daily newspapers for every 1,000 people in Brazil. Only one out of every three children between the ages of five and fourteen is enrolled in primary schools.

For every one child that dies in the U.S. before reaching the age of a year, six children die in Brazil before they reach the same age. These high mortality rates, especially among the young, the high illiteracy rates, and widespread malnutrition are all part and parcel of economic backwardness.

In terms of U. S. dollars Brazil's per capita income approximates \$250. This compares with the U. S. per capita income of over \$2,100. In Brazil there are five doctors for every 10,000 people; in the U. S. there are 18 doctors for every 10,000 people.

While Brazil is beginning to industrialize, she still ranks far behind developed countries in her consumption of energy and steel; her levels of petroleum refining and commercial fertilizer use are very low. Brazil's drive toward industrialization is newly-born. Nevertheless, Brazil is more fortunate than most, for since the end of the second World War her gross national product increased at over 6 percent annually and her per capita income rose by 3.5 percent, one of the highest rates in the world.

Not only, however, has Brazil's capacity to produce goods and services expanded rapidly, but it has also been accompanied by a pervasive and rapid increase in the general level of Brazilian prices. The extent of that increase may be dramatized by the following example: Imagine that you were shopping for Christmas toys back in 1940 in Brazil, and suppose you found a toy that cost one dollar. Today, if the increase in the price of the toy approximates the increase in the general cost of living that took place in Brazil, then instead of costing one dollar in 1940, it would cost \$119.30. In other words, the Brazilian cost of living has increased by 11,930 percent since 1940. We now turn to an examination of this inflation by reviewing its course, by identifying its possible consequences and causes, and by suggesting some possible cures.

Prices have increased every year in Brazil since 1940. The increases during the war were relatively moderate; they never exceeded an annual increase of 17 percent. During the immediate post-World War II period prices remained remarkably stable with the exception of the year 1947 when they increased by 22 percent. The outbreak of the Korean War, however, was accompanied by further increases in Brazil's price level. During this conflict, prices increased at annual rates varying between 23 and 26 percent. At the cessation of hostilities some pressures on prices were relaxed. But beginning again in 1960 prices increased. In 1960 prices rose by 71 percent, in the following year by 38 percent, and in 1962 by 31 percent. In 1963 Brazilian prices increased by 85 percent and during the first quarter of 1964 at an annually adjusted rate of 169 percent.

In sum, Brazil's moderately high increases in prices were kept under a modicum of control until 1960. While a degree of stabilization followed 1960, the pressure on prices grew to pathologic dimensions in 1963 and 1964.

Before 1960 Brazil was often cited as the prime example of a developing economy that could have its inflation but grow, too. Some economists were of the opinion that moderate inflation, if kept in bounds, might provide a buoyancy to the growing economy. Two arguments are proposed to support this position. First, inflation can be used as a means of taxing where other taxes cannot be collected, and second, inflation may act in some respects like an economic pep pill. Economic development requires first and foremost, capital. As the economist uses the term somewhat differently than layman, let me explain it. If you compared physiologically the brain tissue and muscle tissue of an average American with an average Brazilian you would find little organic difference. But the American produces approximately eight times the goods and services produced by an average Brazilian.

Some of the difference in productivity can be explained by the fact that on the average the American is more educated and skilled in performing productive tasks. But this can only explain part of the difference. More importantly, at the disposal of every American worker is a huge stockpile of tools, machines, factories, and efficient transportation and communication systems. All directly assist him in production. In addition to these items, the average American worker has a huge

amount of nonhuman, nonanimal power: electricity, steam, and now even nuclear power. The Brazilian worker, on the other hand, still must depend primarily on human power and animal power to create the goods and the services desired by his society. Tools and machines and even the power that creates goods do not, however, satisfy directly the wants of society; rather they greatly assist in the production of those goods and services that do. Such items are called capital.

Perhaps a more descriptive term for capital would be productive muscle. If the ability of a society to provide a high standard of life is simply dependent on productive muscle, you may ask, why then do not the underdeveloped economies make an all-out effort to obtain the necessary tools, machines, road, transportation systems, and so on? The answer is that such procurements involve a sacrifice, and the sacrifice of creating productive muscle is foregoing present consumption, or saving. People must be willing to forego one loaf today in order that they may have two loaves next year. But when one is living on the razor edge of subsistence, to save and to forego present consumption imposes tremendous hardships. Under a stable price level, foregoing present consumption or savings is either voluntary or taxed. In a mixed economy the government can, by exacting financial resources from the people, use them to build productive muscle or capital. When people are not willing to save voluntarily, or when the government has neither the organization nor the will to tax at a sufficiently high rate to finance development, inflation, it is argued, can play a positive role. The central bank simply lends credit to the government or the government prints new money, which it then spends on capital goods. With the newly created purchasing power, the government is able to bid men and machines producing consumption goods away from that sector and put them to work in creating capital goods or productive muscle. Consumption is thus destined to fall in the creation of capital through inflation. But the cost of this type of creation is an increase in prices.

Inflation is also used as a conscious development policy, as an economic pep pill. It is argued that increases in price permit a more complete utilization of the production potential of an economy. There is generally some slack, some men who are unemployed and some equipment unused in a market society. Inflationary pressure, it is argued, can be effectively



used to push a society to maximum effort in producing material things.

Even if inflation exerted these two salutary effects on Brazil's saving and growth, a hypothesis which cannot be supported, few indeed would argue that the impact of inflation on the Brazilian economy in the last three years has been beneficial.

The consequences of a hyperinflation or a run-away inflation are for the economy at large always and inevitably detrimental. Detrimental consequences are also generated in a more moderate inflationary environment such as the one that existed in Brazil prior to 1960, but are not as prominent as they become in a hyperinflationary state. Brazil thus offers a unique opportunity to clearly identify these evils. However, to assess properly the deleterious impact of inflation, we must understand the workings of a market economy.

It is no coincidence that the industrial revolution, which gave birth to material progress undreamed of previously, paralleled the extension and refinement of the market as a mechanism of economic control. The market performs three important economic functions. The competitive market tends to assure that the goods and services that society desires will be produced. It also lends to the most efficient ways of producing those goods and services. Furthermore, in an unencumbered market the entrepreneurs, the economic catalysts in an open economy, are given widest latitude. The market employs a single device to perform the three foregoing functions. That device is price.

If price fails to reward sufficiently those who produce goods and services that society needs because of inflation, if prices of the present and the immediate past portend violent price changes in the future, and if the value of money is debauched because of rising prices, then the strengths of the market system become its weaknesses. A market dominated by violent price increases drives savings that could be used in the creation of new productive muscle into areas where it is most safe from the vicissitudes of inflation. Buildings and unused land, as well as improved real estate, become the "rational" channels into which savings flow. This holds despite the fact that land and real estate are relatively sterile in terms of the contribution they make to the productivity of a society. But in a hyperinflation, savings seek shelter, not productivity. Savings

also, regardless of restrictions imposed by the authorities, take flight from the country of the debauched currency. And so an underdeveloped country which loses savings in this fashion foregoes the opportunity to use indigenous savings to build and strengthen its own economy. Foreign savers who might otherwise place sums of purchasing power in a backward country hesitate to commit their wealth to the wildly gyrating economic chaos that hyperinflation creates. The energies of the entrepreneurs are drawn not to potentially productive projects; rather they attempt to outguess the whims of those in charge of the monetary printing presses. Furthermore, hyperinflation can discredit the market system to the point that individuals and companies resort to the ancient and inefficient practice of barter rather than run the risks of cash transactions. Profits which normally should serve as recompense for the exercise of judicious and wise decisions become dependent on luck and administrative decision. All of these distorting forces can be identified in the Brazilian case.

In regard to the destruction of the market mechanism, John Maynard Keynes once described what might lie at the end of the road for countries experiencing inflation similar in magnitude to that of Brazil. Lord Keynes, whose defense of deficit spending is sometimes and quite erroneously confused with an advocacy of inflation, put it this way:

Lenin is said to have declared that, "The best way to destroy the capitalist system was to debauch the currency. By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and while the process impoverishes many; it actually enriches some. . . ."

Lenin was certainly right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose.

As Keynes indicates, the effects of inflation are not only inefficient but also inequitable. Inflation is a gentle but cruel thief when the price level rises slowly, for it steals purchasing power from the pockets of those who can least afford to lose it—from the widows, the aged, and the orphaned child whose livelihoods are closely tied to a fixed income. In times of hyper-

inflation the rapidly raising price level violently and capriciously snatches wealth from some and bestows it in equally arbitrary fashion on others quite brazenly and without any recourse to a court of law. For example, suppose that 25 years ago you wanted to give someone today purchasing power of \$100,000. Suppose that you had set aside that \$100,000 in Brazilian cruzeiros. Simply and only because of inflation, that purchasing power of \$100,000 would shrink and shrink until today, even though you had the same number of cruzeiros, your purchasing power would amount not to the \$100,000 that it did, but to a paltry \$838.17.

Other inequities are generated. For instance, the wage of the worker is almost completely dependent upon his political bargaining power rather than on his ability to produce goods and services during periods of hyperinflation. In May of 1963 the following wage increases were recorded in Brazil. Rio's white collar workers received a 65 percent increase above their 1962 salaries. Those who worked for civil service received increases from 40 to 56 percent and the Congress was considering an increase in military pay that ranged from 25 percent to 55 percent. The inequities of determining wage rates on this basis are perhaps illustrated by the case of Brazil's merchant seamen. They were among the highest paid workers in the country. A shipboard cook earned in May of last year as much as a full commander in the Brazilian Navy.

A further consequence of inflation, but one that may eventually stop inflation, is political instability. At the end of 1963 Brazil appeared to be dangerously close to complete economic collapse. Inflation not only sapped the country's productive strength, but because of the consequences described above, the living standards of most Brazilians declined. In northeast Brazil illiterate peasants were being organized by the Red Chinese and armed by the Cubans. But the Army, aided and abetted by business executives and professional men, initiated a revolt in the early hours of March 31, 1964. It lasted only two days. Just as the inflation-induced chaos was the prime mover of the revolt, so the new administration's most immediate economic task became the control of spiralling inflation. Whether or not the new regime will be able to reverse the upward climb of prices is yet to be seen. We may gauge its probability of success more accurately, however, if we examine now some of the causes of Brazil's inflation.

There is no single cause of inflation. An economy suffering from inflation is not too unlike a patient suffering from high blood pressure. Usually a complex of causes works simultaneously, and the forces may differ from one economy to the next. Making rather broad and sweeping simplifications, some economists have attempted to isolate and classify some general pressures on prices.

On the one hand, a demand-pull inflation is identified as one in which desires, backed up by available money (or demand), are sufficiently greater than available goods and services to force prices upward.

The other general class of inflation is called cost-push. In this case the pricing of the ingredients that go into production, such as labor and capital, are the center of the analysis rather than the demand factors. It is argued that these prices can be increased solely because of bargaining power irrespective of whether or not such increases are justified by increases in productivity. If they are not, then the cost of producing goods and services must increase and this, in turn, induces increases in prices. Thus generated, the inflationary spiral begins to lead a life of its own.

A third general class of inflation, also evident in Brazil, is structural inflation. One of the hallmarks of a developing but poor society is found in the transfer of agricultural workers to the cities that occurs as the society gradually but pervasively shifts from an economic base resting on agriculture to one founded on industry. Clearly, in order to provide the rising class of industrial workers with food and raiment, agricultural output must increase. On the other hand, the agricultural sector in most underdeveloped societies, including Brazil, is the most traditional and most unbending when it comes to discarding established techniques of production and adopting new ones that may prove to be more productive. These two forces, namely a rise in the demand for agricultural products produced for the market and the sluggishness of the agricultural sector to adjust its productive techniques to meet this increasing demand, result in increasing food prices.

Let us now examine each of these general classes of inflationary sources more specifically in terms of the Brazilian case.

The pull forces of demand inflation originate in Brazil in both the private and the government sectors. The government became heavily involved not only in large social overhead

capital projects, with the erection of Brasilia being the most prominent, but also attempted to underwrite expensive social welfare projects. Concurrently, the economic expansion that took place in the private sector was spearheaded by a rather remarkable drive for industrialization of the medium and light industries. The creation of several almost self-contained automotive production facilities in Brazil is typical of this development. To the extent that such investment demand reduced the availability of goods and services it contributed to inflation.

Of these two sources of demand for products, the increase in government demand was quantitatively greater and more inflationary. Even on a cruzeiro-for-cruzeiro basis, government demand is generally more highly inflationary than private demand. This follows, because many of the projects initiated by the Brazilian government during the latter fifties and early sixties did not contribute directly to the productive capacity of the economy. This, of course, was not the case in the private sector, to the extent that individuals sought to gain maximum return by enhancing productive capacity, even if that return was somewhat distorted by inflationary pressures. The magnitude of new demand created by the Brazilian government can be gauged by the extent of its debt underwritten by the Bank of Brazil.

In 1961 the Bank of Brazil extended credit to the Brazilian government in the amount of 64.4 billion cruzeiros; in 1962, 114.8 billion cruzeiros; and in 1963, 223.7 billion cruzeiros. Without question, this increase in government credit had considerable influence on the expansion of the money supply which almost doubled between 1960 and 1963. The printing press was also employed to cover government deficits. Between 1960 and 1963 currency in circulation increased over threefold.

The simple increase in the quantity of money does not give a sufficiently accurate index of the influence of government spending on prices for two reasons. First, as money held quickly loses its value as prices increase, people become unwilling to hold cash balances. Therefore, during inflation the number of times one cruzeiro goes from individual to individual in say one month, doubles and triples and even quadruples. This means that the money supply serves two, three, or four times the transactions as earlier. Before long, as the purchasing power of money depreciates, individuals must carry it around in suitcases to transact their business. In 1962 the largest note in

circulation in Brazil was one thousand cruzeiros. It was worth less than \$1.35 at that time.

Second, inflationary pressure, induced from the side of government spending, tends, when prices begin to increase rapidly, to become self-reinforcing. This is especially true in a country such as Brazil where the tax structure is relatively inflexible and not highly geared to taking a larger bite when income and prices increase. Under such circumstances a well-conceived budget designed to reduce the deficit may, in fact, end up increasing it, unless the administrators accurately predict price increases of the coming year. Such a prediction for a regime committed to "solving the inflation problem" is almost politically impossible. Then the deficit may be incurred simply because the cost of government expenditures doubles or triples due to price increases while government revenues remain stable. Thus, the government ends up with a large deficit instead of a surplus. This deficit must be financed. In order to finance the deficit the government must borrow from the central bank. This pumps more money into the society which in turn adds to the inflationary pressure.

This is apparently what has happened in Brazil. Budgets proposed in recent years might have resulted in surpluses if the costs of government had not increased so rapidly. In October of 1961 Finance Minister Calmon submitted to the Council of Ministers a plan that called for reducing national budgetary deficits by cutting government spending during the remainder of 1962 and raising federal revenue by increasing taxes in 1963. In 1962 and 1963 the Brazilian government ran the largest deficits in the history of the nation: over a 240-billion-cruzeiro deficit in 1962 and approximately a 400-billion-cruzeiro deficit in 1963. Some observers claim that had Goulart remained in power, the deficit would have topped 1.5 trillion cruzeiros in 1964.

Just as pressure on prices can be generated on the demand side, so also they can be pushed upward by increases in cost. It is from this source of inflation that individuals derive benefit or harm from price increases in direct proportion to their bargaining positions vis-à-vis their employers. The distortions that result from this pressure on wages sometimes are ludicrous, as in the case cited above where a shipboard cook in Brazil's Navy enjoyed a salary equivalent to that of a full

commander in the Brazilian Navy. Cooks must have been in a better bargaining position than full commanders.

But when everyone is trying to keep up with the Joneses through wage increases, this simply leads to an increase in prices, which leads in turn to further increases in wages. Even the government may be unable to cope with these pressures.

For example, in April of 1963 all state-owned industries, which includes the largest steel plant in Brazil, the Volta Redonda, were informed that no price increases would be granted. Simultaneously, bills were introduced into Congress suggesting wage increases from 40 to 56 percent of civilian and military government employees. Some civil service groups were pressing for wage increases of 75 percent. Scarcely 30 days later when the Congress legislated wage increases for its employees, the Volta Redonda steel plant in quite predictable fashion increased its prices 40 percent. The automotive companies then in turn sent a commission to the Ministry of Industry in Congress pleading for permission to increase prices of automobiles to correspond somewhat with the legislated increases in steel prices and salaries. But the cycle does not stop there. Once prices generally rise, even those who have gained increases in wages often find that despite such increases they are able to purchase no more than they did before they received their wage increase.

It is relatively easy to identify the forces that work in creating cost-push inflationary pressures. It is quite another thing to bring them to a stop. In some respects it is like playing musical chairs. There must always be some groups, or some individuals in society, who will lose regardless of when or how the inflationary music stops.

The last general complex of forces we wish to discuss in conjunction with Brazil's recent experience emanate from the inherent characteristics of a backward country undergoing the transformation of economic growth. One of the lessons that can be clearly drawn from Brazil's inflationary experience is that it is extremely difficult for a country to industrialize unless the agricultural sector is sufficiently productive to provide an adequate surplus to feed those being drawn into the industrial labor force from the rural areas. There is considerable evidence that one of the primary and general pressures on Brazilian prices arose from an insufficient supply of foodstuffs and clothing for the urban masses.

Between January 1962 and January 1964 the price of foodstuffs increased by 280 percent and the price of clothing by 260 percent. The hardship imposed on the laboring classes by such increases was reflected in mass demonstrations that took place near Rio in July of 1962. In that year a Brazilian family dependent upon a minimum salary would spend a total of 128 percent of its income just to eat adequately. Milk prices increased 120 percent in a five-month period in 1962; the current Branco regime still faces this same problem. After the revolution the price of milk increased 86 percent in two months, and the price of lard increased 233 percent in the same period. Shortages of foodstuffs initially created because of the structural changes occurring within a developed society are further exacerbated when the populace and retailers begin to hoard such basic items in expectation of further price increases.

The second hallmark of the backward society that creates a favorable milieu for inflation is found in the political structure of such societies. Underdeveloped societies are weak economically and politically. One Latin American economist argues that the postwar Brazilian inflation experience had its origin in the political revolution of the last twenty or thirty years when the old oligarchic type of government was replaced by governments truly elected by the people. He argues that in the old type of government the president had considerable power both because he was generally chosen by agreement between the powerful oligarchic groups and also because he was almost entirely free of pressure from demagogues and labor unions. This kind of political structure gradually gave way in Brazil to ones more truly democratic.

In order for a candidate to ascend in peaceful fashion to the presidency, it is almost necessary for him to enter into quid pro quo arrangements with other parties and to make many promises to influential members of his own party. Thus he is greatly hamstrung in making the hard political choices so necessary if the cost-push sources of inflation are to be rooted out. Furthermore, his success is often measured by his capacity to accomplish—that is, by his ability to complete or at least to start the building of roads and stadiums and new cities and so on, no matter what the price of increased indebtedness. It is estimated that over half of Brazil's government debt was used to cover imports of capital equipment to provide for the construction of such social overhead. If such spending is profligate,



the country's economy is further distorted and disorganized; hence, seriously unbalanced budgets may be both the natural consequence as well as the mainspring of inflation.

A second political wave sweeping through the South American countries explains another element of inflation. This is the wave of nationalism.

Foreign capital has in the past represented an almost free gift of productive muscle to the underdeveloped country; it permits the expansion of productive facilities and lets off some of the pressure on price. Through nationalistic eyes it is viewed, however, with great suspicion by those in the underdeveloped countries. Brazil has passed many laws, including a profits-remittance law, which have discouraged foreign capital from going into Brazil. The profit-remittance law was passed in Brazil in 1961 to regulate the outflow of foreign capital and to place restrictions on the use of foreign capital once it reached the country. Foreign investments in Brazil declined from 112 million dollars in 1961 to 71 million dollars in 1962, 31 million dollars in 1963, and nothing in the first half of 1964.

In the Brazilian case it would appear that such laws are unfriendly to both foreign and domestic investors. During a period of governmental control of foreign investment between 1946 and 1953, the average annual capital inflow had been 15 million dollars as against an outflow of Brazilian funds of 47 million dollars. During a period of freedom from governmental control that was instituted from 1954 to 1961, investment entries increased and outflows decreased as the average annual inflow reached 90 million dollars against an outflow of only 35 million dollars.

Foreign capital stanches inflation two ways. First, it creates greater productive capacity, and secondly, it provides that productive capacity without imposing any demands on scarce domestic saving.

While we have identified and discussed three general sources of inflation that have seemed to play prominent roles in Brazil's economic difficulties, it should be kept in mind that demand-pull, cost-push, and structural inflation are not only internally self-reinforcing, but each in turn also reinforces the inflationary pressures built up from the other sources. It is for this reason that the task of bringing a halt to inflation is an extremely difficult one. But it is to this task that the Branco

regime must dedicate itself if only the first fruits of the April first revolution are to be realized.

There are some encouraging signs that the inflationary process in Brazil will be reversed.

Attempts are being made to reduce the government's six-trillion-cruzeiro debt. A bill which would provide for a three percent tax on all registered capital of commercial and industrial firms operating in the country has been submitted to the Chamber of Deputies. There is evidence that the Brazilian businessmen and landowners will support this voluntary special tax to help cover the federal budget deficit. Such a tax would have provided the treasury with 500 billion cruzeiros in 1964 alone. The government is also attempting to keep the lid on further wage increases. Without question, the success or failure of the Brazilian economy to eliminate the inflation that has been plaguing it for the past several years will depend upon the success of the government in meeting these two objectives. Both require hard political decisions.

On the other hand, further steam has been taken out of the Brazilian inflation by the reaction of both foreign investors and governments to the dismissal of the Goulart regime. The United States under the Alliance for Progress program recently granted Brazil a loan of approximately 80 million dollars. This act helped to demonstrate to Brazil's foreign creditors that the United States had faith in the new Branco regime's capacity to successfully combat soaring inflation. The United States also pledged to send Brazil 90 million dollars' worth of food. Relieving pressure in this most sensitive area will lessen the probability of further inflationary price changes. Other countries followed the lead of the United States: West Germany agreed to loan Brazil 200 million marks; Great Britain is considering a grant to Brazil of four million pounds.

The climate for private investment in Brazil has also improved considerably. The profits-remittance law, which was so objectionable to foreign investors, has been rewritten to exclude its most onerous portions. Investors abroad have responded to this change in climate. Willys-Overland announced plans in July for a 32-million-dollar expansion program that will take place in the next twenty-eight months. During May of 1964 business executives of thirty-five major U. S. corporations visited Sao Paulo to investigate the investment atmosphere under the new Branco government.

While the initial foreign reaction, both private and public, to the new regime's development program, lessens the danger of economic disaster, nevertheless the question of whether or not Brazil will be able to conquer the economic disease which has been eating away at her innards depends, in the final analysis, on the internal adjustments that are made in Brazil. The new government must actively encourage the further rapid economic growth in the country, but at the same time put brakes on the inflationary spiral. Because these two objectives, as indicated earlier, are not completely self-consistent, it is still an open question whether Brazil has as yet conquered her inflation. Prices could certainly be stabilized if the rate of economic growth were diminished and if the economy would countenance some unemployment. On the other hand, Brazil could certainly continue her economic growth, but this would be difficult to accomplish with absolutely stable prices.

At present the Branco government is criticized both for its inability to keep inflation in line and for the slight rise in unemployment its anti-inflationary policies are creating. One critic of the present government indicted it on both counts. He claimed that the failure to curb the soaring cost of living had tarnished very seriously the prestige of the revolutionary regime, and added that the public could not understand how the government which had the power to depose first governors, then political rights, and to abrogate legislation was still unable to stabilize prices and control inflation. On the other hand, he attacked the administration's stupid reforms, charged that unemployment was causing more harm in Brazil than stealing, and concluded by predicting that the people sooner or later would return the power to the thieves who had at least given them employment.

While inflation has a multitude of causes and consequences and thus defies easy generalizations, I believe that the lesson of Brazil's inflation for the poor but developing economy is clear. Inflation is a thief that robs the members of an economy who can least afford it, and may steal the opportunity of that economy to break out of the poverty trap without recourse to the totalitarian controls which debase the free agency of man.

Those of us who are fortunate enough to live in affluent societies can, I believe, face optimistically the exciting challenges posed by the application of nuclear power to peaceful ends, the further extension of automation, and the conquering

of space. One wonders what excitement these challenges hold for that preponderant portion of humanity which still grapples with the brutal problem of day-to-day physical survival. Is not the bridging of the gap between rich nation and poor nation every bit as exciting a challenge as those posed by nuclear fission, automation, and space? If so, we cannot stay our hand from aiding those societies in desperate need of help. While our aid will not guarantee the conquering of poverty in these countries, yet as in the case of Brazil's inflation, it may give these economies time to catch their breath; such pause may tell the difference between success and failure in reaching the high road of material progress. Not only would such success relax tensions now existing between nations by allowing the poor countries to afford the economic luxuries of political enlightenment, social compassion, and cultural achievement, but aid from the rich to the poor, when judiciously given, cannot help but strengthen and tighten the bonds of brotherhood. For me, this is man's greatest challenge.