REVIEW ESSAYS

TRADE, INTERNATIONAL PAYMENTS, AND BRAZIL'S ECONOMIC GROWTH

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FOREIGN TRADE STRATEGIES, EMPLOYMENT, AND INCOME DISTRIBUTION IN BRAZIL. By Benedict J. Clements. (New York: Praeger, 1988. Pp. 167. $42.95.)

POVERTY AND SOCIAL WELFARE IN BRAZIL: A CHALLENGE FOR CIVILIAN GOVERNMENT. By Elizabeth Allen. (Glasgow: Institute of Latin American Studies, 1985. Pp. 47.)

ON THE DETERMINANTS OF BRAZIL'S MANUFACTURED EXPORTS: AN EMPIRICAL ANALYSIS. By Ugo Fasano Filho, Bernhard Fischer, and Peter Nunnenkamp. (New York: Pinter, 1988. Pp. 127. $38.50 paper.)

MARKET STRUCTURE, FIRM SIZE, AND BRAZILIAN EXPORTS. By Larry Wilmore. (Brasília: CEPAL, United Nations, 1985. Pp. 104. $4.00 paper.)

NON-TRADITIONAL AGRICULTURE AND ECONOMIC DEVELOPMENT: THE BRAZILIAN SOYBEAN EXPANSION, 1964–1982. By Anthony B. Soskin. (New York: Praeger, 1988. Pp. 159. $37.95.)

JAPAN'S ECONOMIC STRATEGY IN BRAZIL: CHALLENGE FOR THE UNITED STATES. By Leon Hollerman. (Lexington, Ky.: Lexington Books, 1988. Pp. 284. $41.00.)

THE BRAZILIAN ECONOMY: GROWTH AND DEVELOPMENT. Third Edition. By Werner Baer. (New York: Praeger, 1989. Pp. 400. $55.00 cloth, $19.95 paper.)

EXTERNAL CONSTRAINTS ON ECONOMIC POLICY IN BRAZIL, 1889–1930. By Winston Fritsch. (Pittsburgh, Pa.: University of Pittsburgh Press, 1988. Pp. 265. $49.95.)

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With the price level having neared hyperinflation in early 1990, followed by overnight changes in economic policy by the new government of Fernando Collor de Mello, the Brazilian economy should perhaps be monitored by telex and on-line computers. Happily for those of us who receive our information as *pessoas físicas* and not as *pessoas jurídicas*, most of the works on the Brazilian economy reviewed here are remarkably current and topical. Unlike the telexes and computer screens, moreover, they are well-written, readable, and provide much more perspective on a variety of issues in a troubled but promising economy.

The central concern of much literature on the Brazilian economy in the past decade has been the constraints placed on the country's future by its worsening international economic position in the 1980s. In one guise or another, this question underlies all the works reviewed here, if only implicitly in several. Together they provide a number of insights into the genesis of Brazil's economic quandary and a basis for cautious optimism about possible paths out of it.

The wrenching adjustment in external payments forced on Brazil and other large borrowers by being excluded from international capital markets in the wake of the Mexican debt crisis in 1982 presented policymakers and Brazilian society with the most serious economic challenge since the Depression of the 1930s. Surprisingly, some of the problems that appeared to loom largest in 1982—notably the difficulty in moving abruptly from a large current-account deficit, financed by a net inflow of foreign capital, to a situation of approximate current-account balance through generating a trade surplus large enough to service the debt—today appear to have been more easily surmountable than observers perceived them to be at the time.

In their place, however, a related group of even more serious problems have arisen from the priority accorded by the governments of João Figueiredo and José Sarney to servicing the external debt. Although the necessity of debt service was widely questioned by many sectors of Brazilian society besides the nationalist left, with the Sarney government at times seeming to embrace proposals for a genuine moratorium, it appears from the vantage point of the early 1990s that creditors basically had their way.

By 1980 the foreign debt was largely a public debt, and the foreign exchange necessary to service this debt was primarily being earned by private exporters. An adjustment that was "successful" from the creditors' point of view therefore implied either a severe and politically difficult internal adjustment in the form of a sharp reduction in the public sector's other expenditures and a concomitant increase in real tax revenues or increasing recourse to internal borrowing and inflationary expansion of the money supply. If one accepts the premise that the debt must be substantially repaid in real terms, then no third alternative exists to these

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two unpleasant scenarios. This dilemma, widely known among Brazilian economists as the "transfer problem," lies at the heart of much of Brazil's current economic travail.[1]

One obvious implication of the adjustment process is that unless exports alone grow rapidly enough to provide the necessary foreign earnings, the use of resources by Brazilian residents, whether for consumption, investment, or government purposes, must fall sharply to generate the required trade surplus. It would be ingenuous to expect this kind of nationwide belt-tightening to have a neutral effect on the distribution of income in society. In a parallel fashion, there is no reason to suppose that the increase in exports required by the adjustment of the 1980s was neutral in its effects on income distribution. More disturbingly, it is possible that the politically weaker sectors of society may have borne a disproportionately large share of the adjustment burden. Several of the works under review address this question explicitly, examining in some detail the links between the adjustment process on the export and import sides and the distribution of income within groups in Brazil.

Brazilian policymakers as well as observers outside the government have recognized that some of the burden of adjustment may be alleviated either by a faster rate of growth of exports or by a partial replacement of the formerly large financial flows of capital into Brazil with direct foreign investment. Export growth and diversification may in fact be one of the few bright spots in the otherwise gloomy picture, and Brazil's ability to increase the level of exports rapidly in the 1980s is the focus of several of the monographs reviewed here. Although the export drive was concentrated in manufacturing, the growth of several nontraditional agricultural exports made a substantial contribution to improving Brazil's trade balance.

The other means by which Brazil might in principle have adjusted less painfully to the fall in net financial-capital inflows in the 1980s would have been by increasing direct foreign investment by multinational firms from high-income countries. Success on this front has been much more limited than in the export sector, in part because such direct capital flows may be complements, rather than substitutes, for the financial capital flows. The determinants of foreign investment in Brazil and its linkages to the domestic economy also make up an important theme in several of the works reviewed here.

Much contemporary writing on Brazil's economic problems, by Brazilians as well as foreign observers, often reads as though history

1. Brazilian usage of the term *transfer problem* differs significantly from the traditional American and British characterization, which referred to the effects on the terms of trade of an income transfer between countries rather than the transfer of real resources from the export sector to the indebted public sector within a country.

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began in the preceding quarter. Good economic history provides an essential antidote for the effects of this *imediatismo* on policy-making. With the sharp worsening of the external payments position of the major developing borrowers in the early 1980s, some economists looked back to the experiences of a number of Latin American borrowers in the 1930s for precedents and insights.[2] Several of the works to be reviewed inevitably strengthen one's sense of déjà vu in the context of today's external payments crisis.

Trade Policy, Economic Adjustment, and Income Distribution

Discussions of Brazilian policies on trade and balance of payments have often ignored the implications of price changes for income distribution among Brazilians. In a parallel fashion, debate over Brazilian income distribution has often been conducted in terms of a closed economy. Benedict Clements's *Foreign Trade Strategies, Employment, and Income Distribution in Brazil* represents an important exception as an explicit attempt to examine Brazilian trade policy in the context of its effects on employment and income distribution.

Economists have long argued that tariffs and other forms of protection that discriminate against imports and increase the incentives for more local production of import-competing goods will tend to raise the incomes of the scarce factors intensively used in producing the goods that compete with imports. This argument, enshrined in modern trade theory as the "Stolper-Samuelson theorem," may be interpreted in a Brazilian context to imply that the phase of import-substituting industrialization of Brazilian economic history, from the end of World War II to the mid-1960s, favored the factors used most intensively by manufacturing industry.[3] At a broad level, this factor is alleged to be capital, both physical and human, the latter in the form of skilled industrial labor. According to this argument, factors that were presumably losers from Brazilian trade policies were unskilled labor and land used in agriculture. Although Brazilian trade policy after 1964 placed greater emphasis on export promotion (unlike the more inward-looking policies of import-substitution industrialization), favoring manufactured exports over agricultural products may have permitted the protection given to capital at the expense of unskilled labor and rural landowners to continue.

2. Notable among these efforts is Carlos Díaz Alejandro, "Stories of the 1930s for the 1980s," in *Financial Policies and the World Capital: The Problem of Latin American Countries,* edited by Pedro Aspe Armella, Rudiger Dornbusch, and Maurice Obstfeld (Chicago, Ill.: University of Chicago Press, 1983).

3. Wolfgang F. Stolper and Paul A. Samuelson, "Protection and Real Wages," *Review of Economic Studies* 9 (1941); reprinted in *International Trade,* edited by Jagdish Bhagwati (Harmondsworth, Middlesex: Penguin, 1969).

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The preceding argument implies that trade policies of the kind followed by Brazil and some other large Latin American economies in the postwar period changed the income distribution between labor and capital relative to what it would have been under a more open trade regime. This interpretation is not quite the same as arguing that it worsened the personal distribution of income or division of national income between rich and poor, but it comes close to the same conclusion, especially when capital ownership is identified with high-income Brazilians and unskilled labor with the poor.

The central question addressed in Clements's *Foreign Trade Strategies* is whether Brazilian experience in fact conformed to this prediction. His affirmative, albeit qualified, answer rests on various analyses of Brazilian trade, production, and income data, many of them made during the period from 1975 through 1983. The distinction between export promotion and trade policies of import-substituting industrialization is an important one: export promotion appears to have had a more favorable distributional impact than did import substitution, although this outcome must be qualified by the relatively unfavorable effect of both kinds of trade policies on income distribution and efficiency.

The particular methodology used by Clements is both a strength and a weakness. Most of his conclusions derive from the 1975 input-output table for Brazil compiled by the Instituto Brasileiro de Geografia e Estatística (IBGE). This table's augmented form permits calculating the direct and indirect demands for labor, capital, and other inputs implied by a given increase in production of import substitutes and exports or production for domestic final demand. At an empirical level, there is probably no viable alternative to this approach to studying the aggregate effects of trade policy on employment and income distribution. In this sense, Clements's work belongs to the long tradition in applied trade theory that began with Wassily Leontieff's celebrated study of American trade in a Heckscher-Ohlin context.[4] But as Clements himself recognizes, a number of limitations apply to the production structure assumed by the input-output matrix. The most important is assuming fixed relationships among labor, capital, and other inputs and production. This assumption eliminates by hypothesis the possibility of substitution among primary factors or produced inputs in response to the kinds of price changes that might be expected from alterations in trade policies. Although no easy answer can be found to this problem, it suggests that conclusions based on the use of fixed-coefficients production like that employed in the

4. Wassily Leontieff, "Domestic Production and Foreign Trade: The American Capital Position Reexamined," *Proceedings of the American Philosophical Society* 7 (1953); reprinted in *Input-Output Economics,* edited by Wassily Leontieff (London and New York: Oxford University Press, 1966).

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Clements study should be regarded as rough estimates, as the author himself emphasizes.

One interesting distributional question arising from the shift in Brazil's current account after the 1982 crisis is not raised by Clements. If, as noted earlier, Brazilians were required to reduce their absorption of resources after 1982, when net capital inflows disappeared, then the degree to which this burden falls on capital or on labor depends mainly on how much the real wage or the real return to capital can fall. Although impediments exist to moving capital out of Brazil, they are insufficient to avoid massive capital flight if the return to Brazilian capital falls substantially below international levels.[5] Moreover, the need to finance an increasing share of the public-sector deficit in domestic capital markets as external sources dried up forced the government to maintain real interest rates in the 1980s and even to increase them substantially. Brazilian labor markets, in contrast, had few if any links to those in other economies, and a large pool of unemployed and underemployed labor removed any floor for the real wage. In such circumstances, when capital is internationally mobile and labor is not, it is not surprising that the burden of adjustment to the reduced borrowing capacity of the Latin American economies falls so heavily and tragically on the poor.

Some measure of the economic and human depths of this burden is provided in the short monograph by Elizabeth Allen, *Poverty and Social Welfare in Brazil*. Because her study focuses on the provision of social welfare in contemporary Brazil, particularly the role of the Legião Brasileira de Assistência, she does not explicitly examine the relation between external adjustment and Brazilian poverty. Written shortly after the transition from military to civilian government, *Poverty and Social Welfare in Brazil* reflects hopes for an improvement in the lot of the Brazilian poor that was based more on the rhetoric of the incoming Sarney government than on actual events. After half a decade of frustrated adjustment in which real wages have fallen while real interest rates have attained unprecedented levels, it can be presumed that today's income distribution is certainly no better than it was in 1980, the latest date for which Allen provides estimates.

In the context of Allen's study, the probability that the relative position of the poor has been undermined by the external economic shocks of the early 1980s is a particularly grim conclusion. She emphasizes the

5. Although modest during most of the 1980s by Mexican or Argentine standards, capital flight from Brazil is now significant and appears to have grown in the late 1980s as the perceived risk of a fall in the return to capital increased. Estimates of Brazilian capital flight have been made by Donald R. Lessard and John Williamson in *Capital Flight and Third World Debt* (Washington, D.C.: Institute for International Economics, 1987), and more recently by Arno Meyer and Maria Sílvia Bastos Marques in "A Fuga de Capital no Brasil," manuscript prepared for the Fundação Getúlio Vargas in Rio, August 1989.

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extent to which lower-income groups had been bypassed during periods of high economic growth in the preceding decades. This common theme runs through much of the literature on Brazilian development and had attracted widespread international attention even by the mid-1970s.[6] What is novel about *Poverty and Social Welfare in Brazil* is its focus on the institutional mechanisms that developed to ameliorate some of the consequences of grinding poverty, especially the Legião Brasileira de Assistência. Many Brazilians view social welfare organizations as having a purely cosmetic role, an attitude summarized in their cynical definition of a social worker as "that nice girl the government pays to feel sorry for us."[7] Allen shows that despite this image, organizations like the Legião Brasileira de Assistência have significantly improved nutrition, hygiene, and child care, at least when resources for these programs have been available.

Social welfare programs are a mere palliative, however, in attempting to deal with the macroeconomic disasters of the Brazil of the 1980s. This point is implicit in Allen's discussion, which emphasizes the gap between basic needs and the ability of poverty workers to satisfy them. Like many genuinely concerned critics of Brazilian poverty (Brazilian and foreign), she hints that the villains are the International Monetary Fund and the international bankers. Allen approvingly notes President Sarney's refusal "to accept any policy, set, for example, by the IMF, which the Brazilian nation cannot support." Yet this same president led one of the world's largest delegations to Paris in 1989 to celebrate the French bicentennial and pushed for a railroad from Brasília to his home state of Maranhão while deferring essential maintenance of highly productive infrastructure. Although substantial real debt relief would unquestionably improve Brazil's macroeconomic prospects sharply (a point that the IMF has been slow to concede), one wonders whether such external improvements alone would do much to improve the relative position of Brazil's poor when domestic economic management has been so dismal.

Export Growth and Foreign Investment

As early as 1964, perceptive observers realized that the benefits of import substitution for the Brazilian economy were nearly exhausted and

6. See, for example, the critical discussion of Brazilian income distribution in Albert Fishlow, "Brazilian Size Distribution of Income," *American Economic Review* 62, no. 2 (May 1972): 391–402; and a subsequent attempt to explain the worsening trend by Gary Fields, "Who Benefits from Economic Development? A Reexamination of Brazilian Growth in the 1960s," *American Economic Review* 67, no. 4 (Sept. 1977):570–82.

7. The Brazilian phrase is "aquela moça simpática que o governo paga para ter pena da gente."

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that further industrial development would have to take a new course.[8] This point was soon recognized by the new regime in the post-1964 period, and a number of policies were instituted to encourage a more outward, export-oriented production structure, particularly for manufactured goods. This shift in trade policy initially received only halfhearted support from Brazilian economists, many of whom continued to endorse policies oriented toward what they regarded as an immense internal market that could be protected from foreign competition. Early skepticism about Brazil's export prospects also rested on "elasticity pessimism," which maintained that the exports of an economy like that of Brazil were unlikely to respond to the price incentives provided by either more competitive exchange rates or tax and other fiscal incentives for exporting goods.

But even the proponents of export promotion were surprised by Brazil's ability to increase exports, both absolutely and as a proportion of national product, beginning in the late 1960s. Although the incentives for exports and the actual results were concentrated in manufactures, notable successes occurred in nontraditional agricultural exports such as soybeans, their derivatives, and more recently, orange juice.

A number of studies of the Brazilian export boom have focused on the tax policies and other fiscal incentives as important determinants of the level and rate of growth of Brazil's manufactured exports.[9] Despite some variation in individual interpretations of Brazilian experience after 1964, these studies broadly support the view that the extensive system of fiscal incentives in the form of tax deductions and credits, tariff exemptions on imported inputs, and later financial subsidies had a major impact on Brazilian export growth.

Ugo Fasano Filho, Bernhard Fischer, and Peter Nunnenkamp have followed in this tradition in their study, *On the Determinants of Brazil's Manufactured Exports*. Like several earlier studies of Brazilian trade, their conclusions are drawn both from time-series data and the standard industrial classification of Brazilian industry used by IBGE, which divides

8. One of the first critical examinations of Brazilian industrialization policies and the potential limits to import substitution is found in Maria da Conceição Tavares, "The Growth and Decline of Import Substitution in Brazil," *Economic Bulletin for Latin America* (Santiago: Economic Commission for Latin America, 1964).

9. William Tyler provides one of the most extensive analyses of the growth of Brazilian manufactured exports in *Manufactured Export Expansion and Industrialization in Brazil* (Tübingen, Germany: J. C. B. Mohr, 1976). Several specific aspects of the export promotion program have been examined by Afonso Celso Pastore, José A. A. Savasini, Joal de Azambuja Rosa, and Honório Kume in *Promoção Efetiva das Exportações no Brasil* (Rio de Janeiro: Fundação Centro de Estudos do Comércio Exterior, 1979); Eliana Cardoso, "Incentivos às Exportações de Manufaturas: Série Histórica," *Revista Brasileira de Economia:* (Apr.-June 1980); and Alberto Musalem, "Política de Subsídios e Exportações de Manufaturados no Brasil," *Revista Brasileira de Economia* (Jan.-Mar. 1981).

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manufacturing into some twenty subsectors. Because the effective incentive for exporting provided by Brazilian trade policy varied significantly across subsectors, this approach could yield insights about the effects of the export program that might be hidden at the aggregate level.

One would expect that the activities receiving the greatest incentives should show the greatest export response. The study did not find such an outcome, however, leading the authors to argue that greater disaggregation would be necessary to capture this effect.[10] An interesting alternative hypothesis (apparently not considered by the authors) is that policymakers do not select potential winners when placing their bets, as economists sometimes implicitly assume. Such behavior, however inefficient it may appear in terms of resource allocation, has a long tradition in Brazil and may obey a political rather than an economic logic. A number of studies of the domestic-resource costs necessary to generate a dollar of export earnings in Brazil have shown that some highly protected industrial activities are far more wasteful in their use of capital, labor, and other resources than less favored agricultural activities.[11] In some cases, these sectors may be regarded as important for national security or symbolic reasons. In other cases, organization at the industry level or geographic location may permit the sector to argue more persuasively for special favors.

A strong point of the Fasano, Fischer, and Nunnenkamp study is its evaluation of the hypothesis that protection is given by firm rather than industry characteristics. Although their conclusions on this point are qualified, they do suggest that larger firms received a higher incentive level. Because these firms tended to use more capital than did the average Brazilian enterprise, this pattern reinforces the suspicion that Brazilian commercial policy had potentially regressive effects on income distribution.

A thorough examination of the political economy of Brazilian trade policy has yet to appear in either Portuguese or English, but a growing body of literature, of which the present study is a part, provides a number of hints. One suspects that the protective system that appears so devoid of logic to professional economists may in fact be consistent with the political and bureaucratic pressures that interested groups can bring to bear on Brazilian economic policy-making.

10. When industries were examined at a more disaggregated level, a weak but significant relationship between export growth rates and incentives appeared in the Fasano, Fischer, and Nunnenkamp study.

11. One such group of domestic-resource estimates shows large variations in the domestic resource costs by sector, with agricultural sectors generally being more efficient ways of earning foreign exchange than a number of highly protected industrial sectors. See José R. Mendonça de Barros, Helenamaria Lobato, Maria Angélica Travolo, and Maria Helena G. P. Zockun, "Sistema Fiscal e Incentivos às Exportações," *Revista Brasileira de Economia* (Oct.–Dec. 1974).

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The role of firm size in determining exports is the focus of the CEPAL study authored by Larry Wilmore, *Market Structure, Firm Size, and Brazilian Exports.* Based on a massive sample of 1978 tax data from more than twelve thousand Brazilian firms (one-fourth of them registering some exports), the CEPAL study attempted to identify the factors that would lead a firm to export some of its production. The statistical approach employed, novel in the Brazilian trade context, is to estimate an econometric model of the probability of exporting, in which the explanatory variables include firm size, capital intensity, and a measure of foreign ownership. Firm size had a strong positive effect on the probability that the firm was an exporter, a result plausibly explained as the consequence of the high fixed costs of entering the export market. Larger firms can distribute the costs of exporting across a larger volume of product, thus increasing their competitiveness. Capital intensity was found to have a significant negative effect on export probability, a finding agreeing with conventional trade theory that lower-income economies like Brazil would tend to export goods that are relatively more labor-intensive.

One contribution of *Market Structure, Firm Size, and Brazilian Exports* is its evidence regarding market structure and firm participation in foreign trade. In a "monopolistically competitive" market, individual firms have some influence over the demand for their own product, which may be differentiated from substitutes by advertising. In the absence of exports, firms of this type tend to have excess capacity in the sense that their average costs exceed what they would incur at a higher level of production. Exports, which expand the market for the product of the monopolistically competitive firm, exploit this excess capacity. The CEPAL study found a significant relationship between advertising (as a share of domestic sales), which may be treated as a measure of the degree of monopolistic competition, and the probability of exporting. This significant result supports empirically a growing body of theoretical work that emphasizes the role of market imperfections on trade flows.[12]

Market Structure, Firm Size, and Brazilian Exports also examines the relation between firm size and export subsidies, as well as other incentives in Brazil. Not surprisingly, the Brazilian system of export subsidies showed a clear tendency to discriminate against smaller firms. Although the reasons for this pattern are not explored in the study, one may speculate that the process of securing export subsidies and incentives, like exporting itself, requires the firm to incur a certain level of fixed costs

12. Paul Krugman and Elhanan Helpman show how monopolistic competition may create a basis for trade. See Krugman, "Increasing Returns, Monopolistic Competition, and International Trade," *Journal of International Economics* 9, no. 4 (Nov. 1979):469–80; and Helpman, "International Trade in the Presence of Product Differentiation, Economies of Scale, and Monopolistic Competition," *Journal of International Economics* 11, no. 3 (Aug. 1981):305–40.

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in the form of lobbying or simply interpreting the complex regulations to be followed if a Brazilian enterprise is to export profitably. If this inference is accurate, larger firms may have a decided advantage in that they can spread these fixed costs over a larger volume of sales.

In contrast to the preceding two cross-section studies, Anthony Soskin's *Non-Traditional Agriculture and Economic Development: The Brazilian Soybean Expansion, 1964–1982* examines in depth a single activity that has become a star performer on Brazil's export list. Soskin shows that expansion of the Brazilian soybean sector, based largely on an imported technology, came partly at the expense of traditional food crops that were major components of the diet of lower-income groups. Crop patterns in the southern states, where soybean production was concentrated, show a pronounced decline absolutely in acreage planted and as a share of total agriculture acreage in such important crops as black beans, corn, and cassava. Moreover, the soybean sector's relatively high degree of mechanization led to negligible increases in labor demand as the crop expanded.

One must nevertheless be careful not to push the income-distribution implications of the soybean expansion too far, as Soskin recognizes. To the extent that the change in the structure of Brazilian agricultural production resulted in a total amount of crops that was more valuable at world prices, Brazilian national income rose. In principle, the "winners" in this type of production realignment have more than enough gains to compensate the "losers." But in practice, as Soskin shows, most societies (and certainly Brazil) lack any inherent mechanism that would lead to such a result.

Despite the limited distribution of the benefits of the soybean expansion among the population as a whole, some positive features of the experience can be cited. First, it reveals a high degree of supply response to the combination of favorable prices, available technology, and credit. This supply response is important for Brazilian economic policy in suggesting that the structural impediments to agricultural modernization sometimes emphasized in Brazil may be exaggerated. Second, despite the government's role in soybean research and provision of agricultural credit, the expansion was largely a private initiative. Soybean development proceeded without the "help" of the vast bureaucracies like those that have long dominated the coffee and sugar sectors in Brazil.

Private returns on the soybean expansion must be weighed against their social costs, which were large: the paucity of employment, the displacement of other food crops, and the increasing dependence of some regions on a single crop whose world price may vary substantially. In some ways, the Brazilian soybean experience is a microcosm of the country's economic experience in that private successes are not easily spread to the society at large. This remark is not meant to condemn the soybean pioneers but to comment on public policy and the distribution of land, credit, and public power in Brazil.

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A different dimension of Brazil's external economic relations is explored in Leon Hollerman's *Japan's Economic Strategy in Brazil: Challenge for the United States,* which focuses on a range of bilateral economic and political relationships. An obvious economic complementarity exists between an economy like Brazil's, which is abundantly endowed with inexpensive labor and natural resources but has relatively less physical and human capital, and the Japanese economy. This complementarity might be formally modeled in a framework of conventional trade theory, leading to the familiar conclusion that Brazil would import capital-intensive goods from Japan and, in an extended version, receive capital inflows from Japan. Hollerman has chosen an approach that is less structured but richer and more informative. His work is largely based on extensive interviews with participants in Brazilian trade and capital markets and with policymakers from Brazil, Japan, and the United States. This information is supplemented by data from the financial press and official publications, which provide an extensive, if somewhat selective, view of Brazilian trade and investment policies.

One virtue of an interview-based study like Hollerman's is that it may yield insights into the behavior of policymakers and market participants that are more difficult to obtain by other means. Yet such an approach requires some structure or organizing principle, and in this regard, Hollerman's study is sometimes disappointing. The free-form interviews often mix wisdom with trivia and lack editorial direction and any attempt to evaluate the statements made. For example, in an interview with the head of the Companhia Vale do Rio Doce, readers learn that as a result of the development of the Cerrado region, there "will be no need for grain commodity exchanges." Those familiar with Brazil will sometimes wonder if such statements and opinions were not always meant to be taken seriously, although the author offers little help in making such judgments. Despite these shortcomings, Hollerman's *Japan's Economic Strategy in Brazil* is unique. For the reader who is willing to separate the wheat from the occasional chaff, the material presented is valuable for understanding Brazilians' perceptions of their own economy and the country's relation to one of its important trade partners. The work also yields insights into business practices in Brazil, Japan, and by comparison, the United States.

The Long View of Brazilian Economic Development

Nearly a generation of students of the Brazilian economy have consulted earlier editions of Werner Baer's *The Brazilian Economy,* one of the most widely cited general works on the Brazilian economy in English. The third edition, published six years after its predecessor, reflects some of the macroeconomic events of Brazil in the 1980s, notably the Cruzado

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Plan. Of the three new chapters, the one on the Cruzado Plan provides a lucid account of the events leading up to its adoption and a discussion of some of the reasons for its downfall.[13] Baer is reluctant to use the plan's failure to condemn "heterodox" approaches to stabilization, arguing that such policies were not given a fair test.

What is meant in the literature by *heterodox* is not always clear because it is often defined only implicitly as whatever is not *orthodox*. The many Brazilian economists who basked in the apparent success of the Cruzado Plan in its early stages held many definitions of the "orthodoxy" they opposed, making heterodoxy an amorphous concept at best. Baer's discussion of the differences in policy approaches is therefore a welcome contribution in clarifying some of the major elements of "heterodoxy."

Another new chapter examines the resurgence of inflation in Brazil after the first oil shock. Here Baer frankly states his sympathies for the "neostructuralist" tradition in analyzing Brazilian inflation, as exemplified by the work of Luiz Carlos Bresser Pereira and Yoshiaki Nakano as well as others.[14] This treatment of inflation, which claims to rest partly on the observation that many Brazilian markets are not perfectly competitive, would have benefited from a clearer distinction between the price level and inflation itself, which is a change in the price level. Structuralists have provided a variety of plausible explanations of why market rigidities lead to a higher level of prices. What they have yet to provide is a more coherent account of *how* the price level continues to rise. Baer suggests that some of the explanation lies in Brazil's indexation system, a point made by many Brazilian economists, including some of the "orthodox" ones. This point has been accepted, if only tardily, by the IMF.

In the 1980s, particularly after Brazil lost access to international capital markets after 1982, the government was forced to make increasing use of domestic credit markets and monetary expansion to finance its expenditures. Domestic credit markets implied growing interest payments in the future, raising the specter of future monetization, which could be postponed but not avoided.[15] The role of the "inflation tax" as a source of revenue for the Brazilian government, which is hardly men-

13. This material appeared earlier in Werner Baer and Paul Beckerman, "The Decline and Fall of Brazil's Cruzado," *LARR* 24, no. 1 (1989):35–64.

14. Luiz Carlos Bresser Pereira and Yoshiaki Nakano, *Inflação e Recessão* (São Paulo: Editôra Brasiliense, 1984). The roots of the "neostructuralist" tradition are deep in Brazil and include among others the work of Celso Furtado, *Formação Econômica do Brasil* (Rio de Janeiro: Fundo de Cultura, 1959); and Ignácio Rangel, *A Inflação Brasileira* (Rio de Janeiro: Tempo Brasileiro, 1963).

15. The inevitability of eventual inflation in the presence of a large government budget deficit is the focus of an influential theoretical analysis by Thomas Sargent and Neil Wallace, "Some Unpleasant Monetarist Arithmetic," Federal Reserve Bank of Minneapolis *Quarterly Review* 5, no. 3 (Fall 1981):1–17. This analysis has been cited by "orthodox" (i.e., nonstructuralist) Brazilian economists.

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tioned by Baer, would make a worthy topic for inclusion in the fourth edition.

As with previous editions, one of the strong points of *The Brazilian Economy* is its long view of Brazilian economic development, which Baer traces in the first eight chapters in increasing detail from colonial times to the 1980s. Recent revisions of earlier work on the stages of Brazilian industrialization receive attention, particularly the World War I and interwar periods. The transition from what might be characterized as "accidental industrialization" via revenue-motivated tariff protection to an explicit industrialization policy under the Juscelino Kubitschek government is now a familiar story, partly because earlier editions of *The Brazilian Economy* have helped make it so.

Baer is cautious in discussing the motives for economic policies under successive governments, leaving a number of questions unanswered. For example, one would like to know why education received so little attention from regimes intent on modernizing the country. Baer provides some hints, citing the argument of Celso Furtado and others that the extreme inequality of income distribution in Brazil produces a "distorted" demand profile.[16] If the expenditure pattern of the Brazilian public sector is a response to demand dominated by upper-income groups, then one might expect a high level of expenditure on higher education relative to primary education, as appears to be the case in Brazil.

One of the most fascinating issues raised by the Brazilian experience is the tolerance of a level of inflation that would be unimaginable in other societies. Here too analysts would like to know more. Indexation is part of the answer, as Baer suggests, but it does not explain why the Brazilian political system chooses to finance public expenditure in ways that are eventually inflationary. Despite the continuing, but rather sterile, debate between the "orthodox" and the "neostructuralist" schools, contemporary macroeconomics has increasingly emphasized the point that the money-supply process is not an ultimate cause but is itself determined by a number of variables.[17] The underlying phenomenon of interest is the way in which the public sector finances its expenditures, which may or may not be inflationary, or if they are inflationary, may be so only tomorrow rather than today. This view provides rich material for political scientists and historians as well as for economists.

Good economic history reminds us that few if any economic issues

16. This argument is developed in Celso Furtado, *O Mito do Desenvolvimento Econômico* (Rio de Janeiro: Editôra Paz e Terra, 1974).

17. Several recent attempts to explain why a society might choose a particular level of budget deficit are those of Alex Cukierman and Allan Meltzer, "A Political Theory of Government Debt and Deficits in a Neo-Ricardian Framework," *American Economic Review* 79, no. 4 (Sept. 1989):713–32; and Guido Tabellini and Alberto Alesina, "Voting on the Budget Deficit," *American Economic Review* 80, no. 1 (Mar. 1990):37–49.

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are completely new. Winston Fritsch's *External Constraints on Economic Policy in Brazil, 1889–1930* is an excellent example of this truism. Based on his Cambridge doctoral dissertation, Fritsch's study successfully combines macroeconomic analysis with extensive historical research of primary sources in Brazil, Great Britain, and the United States.

In December 1906, Brazil's exchange stabilization law fixed the exchange rate between the *milréis* and gold, paralleling similar fixed-exchange-rate arrangements in other Latin American economies. Fritsch provides a detailed account of the events and discussion that led up to this policy and analyzes its subsequent operation. Modern examinations of the gold standard have focused on the "center" countries in the system, notably Britain, the United States, and France. Countries on the "periphery" like Brazil, whose export list at the time was heavily dominated by coffee, were less favored by the gold standard, which in effect established a link between shocks in balance of payments and the domestic money supply. As Robert Triffen and others have argued, the operation of this system was hardly ever as smooth as its proponents (either those of the period before World War I or today's goldbugs) would have us believe.[18] Fritsch's study suggests that instability was certainly the case in Brazil, both before World War I and in the brief period (1926–1930) when Brazilian policymakers tried once again to make the gold standard work.

One is struck today by the parallels between the collapse of Brazil's capacity to borrow in international financial markets in 1930 and its exclusion more than half a century later from the same markets, following the 1982 Mexican debt crisis. In both cases, loss of the external borrowing option severely constrained Brazil's internal macroeconomic policies and set the stage for political upheaval. Although it is still too early to tell how far the parallel will extend, one important difference is apparent. The crisis of 1930 led to Brazil's withdrawal from international trade, with the value of coffee exports and the imports they financed falling to less than half of their former levels between the late 1920s and the early 1930s. As a consequence, Brazil adopted exchange and other direct controls in the first stages of a turn inward that lasted well into the 1960s and profoundly transformed the structure of supply. The intellectual heritage of this period may have been even more important in that it created a whole generation of policymakers who were deeply suspicious of depending on foreign markets to supply domestic needs.

The effects of the shocks of the 1980s have been equally profound. But they have not reduced Brazil's participation in world export markets, and imports have fallen considerably less. Instead, Brazil has turned

18. Robert Triffen, "The Myth and Realities of the So-Called Gold Standard," in Triffen, *The Evolution of the International Monetary System* (Princeton, N.J.: Princeton University Press, 1964).

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inward in the sense of capital accounts, rather than trade. If the crisis of the 1930s moved Brazil in the direction of greater self-sufficiency in the goods market, it is possible that the crisis half a century later may have moved it toward self-sufficiency in a financial sense. Neither kind of isolation is desirable, however, and the macroeconomic consequences of forced self-sufficiency in the capital market may be more severe in the long run than the withdrawal of Brazil from trade markets in the 1930s.

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