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The Theory and Operation of a Modern National Economy

Balance of Payments

&

Exchange Rates

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1. Presentation

The Brazilian economic growth reached after the Plano Real implementation, and the competition of foreign products through imports, were the main factors that influenced the fall in exports in transport material and petroleum components and their derivatives; and the low performance of footwear and leather products during the first year of Real.

By this time, research has been done trying to explain the influence on exchange valorization on the trade balance. The classical theory says that when the national currency is overvalued, the tendency is to intensify imports and reduce exports, since external purchases would be cheaper to national consumers. If only this factor is to be considered, there should necessarily be a deficit in the trade balance. Moreover, the economic behavior of a country is not composed only by one variable in its results. Infinite possibilities should be considered that are part of the global magnitude of this economic behavior.

According to research, the low performance of the sectors related above and, mainly, the unbalance in the Brazilian trade cannot be attributed by the theoretical exchange valorization (around 17%). All other industrial sectors that are part of the exporter list did not decline in 1995. Quite the contrary, they had growth rates from 6% (machines and mechanical instruments) up to 17.8% (chemical products).

By the way, is concluded that the smallest growth rate presented by the exports in the year of 1995 was not explained by an eventual exchange valorization, but by other factors, such as the increase in the rhythm in economic activity (intern absorption) and larger international competition, often disloyal in certain products.

The commercial deficits verified at the end of 1994, had as a major factor the substantial volume increase of imports. From 1994 to 1995, imports jumped from US\$ 33 billion to US\$ 50 billion, an increase of approximately 50%.

Some items of import lists, except raw materials, presented strong growth in 1995, especially in the first quarter. These can be highlighted as cars (75.9%), clothes (171.3%), victuals (75.5%) and other goods (86.4%). Such examples indicate that hardly any change in the real exchange rate, would revert the behavior of imports. The growth of imports had as decisive factors the amplification of the consumption market, the real income growth, the best financing obtained from external suppliers, and the exchange rate previsibility.

When the export behavior of industrialized products are compared, we can notice that most of the sectors which presented growth in their exports also obtained better productivity in 1995 and in the subsequent years. It confirms that part of the exchange devaluation during this period was compensated by the productivity increase.

At July 1st, 1997, we completed three years of circulation of a new currency, the Real, a stronger currency than we have ever had before. We have never had such low inflation rates in Brazil for 35 years. The government had to act in several fronts. It had to improve a rigid and at the same time delicate control over the conduct of the exchange and monetary anchors. The results were quite satisfactory, so much that the interest rates and the credit

restrictions, decreased gradually (although this process has to be reviewed, by force of international economic movements). At the same time as the economic opening of the country proceeded, there were delineated signs of sustained growth. The government executed its mission, in spite of the menaces of speculative attacks in the international scenery.

The considerations and studies presented in this work have the purpose to try to illuminate some important subjects of the opening process in the Brazilian economy under different views, without intending to deplete wide and complex subjects by nature.

Between this foreword and the conclusion notes, this work is divided into three main points, where I will approach the important aspects of the exchange rates formation and their devaluations, and the trade balance, focusing on the similarity of exchange rates and prices of goods and services when oriented by the laws of supply and demand. In the balance of payments chapter, an important difference between trade balance and balance of payments will be highlighted, showing and explaining the items that compose one and another. Until then, the study reveals theories in its essence, based upon generic subjects and international formulas. But, from the topic four ("A Brazilian Case..."), I will give emphasis to the national problems, notably to the Brazilian policy of external trade and exchange after "Plano Real" implementation, the current case of the crisis of Asian tigers and some consequences in our economy, the complaints of Brazilian exporters about the Real overvaluation. In the same chapter, at least, the international level of exchange reserves as one of the points of sustenance of the trade balance will be discussed. Seemingly, standing back from the theme, but also worthy of noting, are the international financial crises. From my point of view, the crisis have been strengthening the Capitalist System, an issue that will be briefly discussed in item 5, to recall the lessons of economic freedom along the recent history of the modern economy.

2. The Exchange Rates

2.1 Generalities

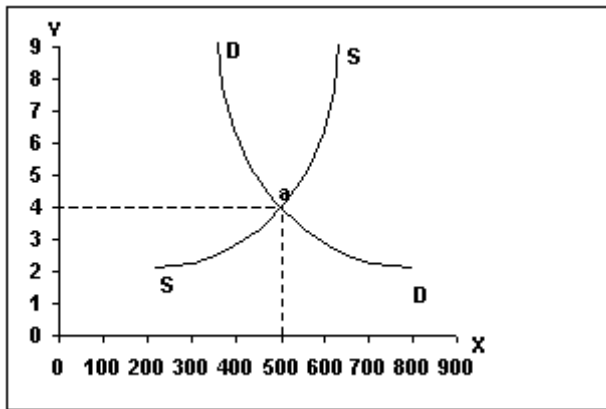
The exchange rate is nothing but the price of a unit of foreign currency in terms of the national currency.

The exchange rate measures the external value of a currency. It provides a direct relation between the domestic and foreign prices of goods and services. With the national and international prices at a definite level, over-valued exchange rates will harm the exports and stimulate imports. This situation can cause a deficit in the balance of payments. On the other hand, if we have under-valuated exchange rates, exports will be stimulated and imports discouraged; that will tend to cause a surplus in the balance of payments.

2.2 Theory about formation of exchange rates

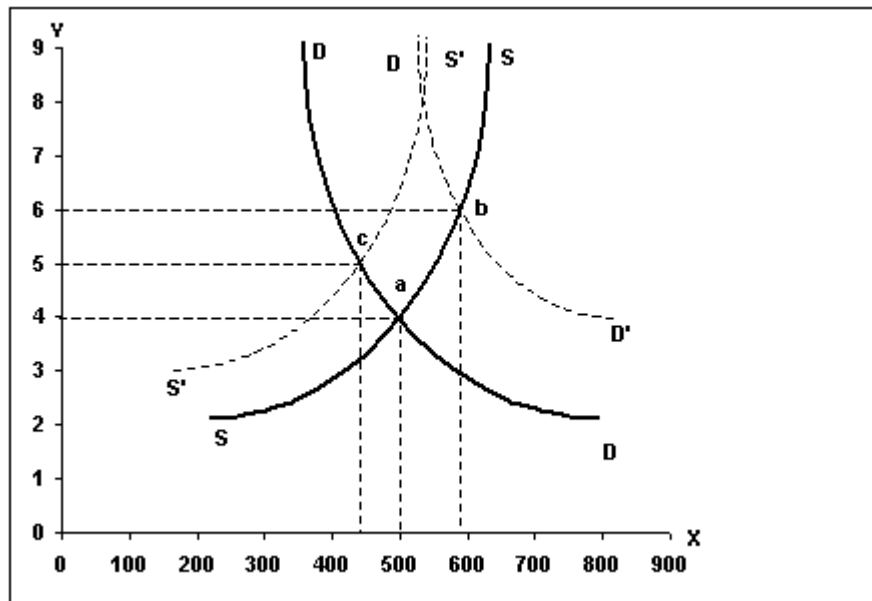
Similar to any merchandise which is for sale, the foreign exchange value is subjected to the law of supply and demand. This is the reason why the exchange rate will be explained by using the same geometric artifices which are used to explain the formation of prices in general.

In the following graph, the demanded and supplied foreign currencies in the market are displayed in the X-axis, in a specific moment. In the Y-axis, the unitary prices (exchange rates) are represented of the foreign currencies, expressed in national currency.



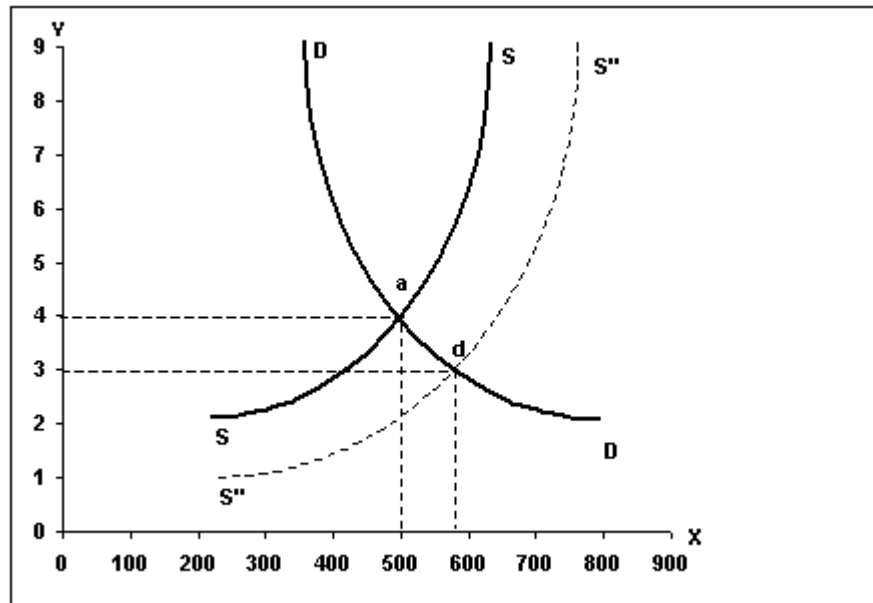
The foreign exchange demand value is represented by the curve DD, whose plan leans down, from left to right, indicating that, in general, the lower the price of the foreign currency, the higher the demand. The foreign exchange supply value is represented by the curve SS which is inclined upward, from left to right, indicating that, usually, the higher the price, the lower the supply. Those two curves will cross at the point "a" which corresponds to the rate 4. It means, to that rate, the amount of foreign currency supplied is the same to the demanded amount, and the market is stable.

We considered now that, to the already existent demand of foreign exchange, there is an increase in demand.



The representative curve of demand will move from DD to D'D', and its intersection point with the supply curve will be at the point "b", which corresponds to the rate 6. Therefore, that increase of demand was assisted, but at a higher rate. A decrease in foreign exchange supply will be represented by a displacement of supply curve from SS to S'S', also implying an exchange rate increase (point "c").

Let us suppose, now, that the initial demand is maintained constant, represented by the curve DD; if the supply increases, moving from SS to S'S', the rate will drop from 4 to 3 (point "d"). Other situations can be presented using these schemes.



As exposed, it is verified:

1. the exchange rate tends to be stable in the following situations:

- the supply and demand don't vary;
- the supply and demand increase proportionally;
- the supply and demand decrease proportionally.

2. the exchange rate tends to appreciate if:

- the demand increases and the supply stays stable or decreases;
- the demand increases along with the supply;
- the supply decreases and the demand remains stable;
- the supply decreases along with the demand, but in lower proportion;

3. the exchange rate tends to depreciate when:

- the supply increases and the demand stays stable or decreases;
- the supply increases along with the demand, but in lower proportion;
- the demand decreases and the supply remains stable;
- the demand and the supply decrease, but the supply in lower proportion.

That supply and demand for foreign exchange can represent the normal movement of transactions with the exterior (export and import of goods, payment or income of services, entrance or exit of capital, etc.), as well as can result from risky business transactions by groups interested in profits with elevations and abrupt falls of exchange rates.

Although the rate movements can be quite significant (in a free market), they tend to depreciate over the long term. In fact, if the foreign currency demand is maintained over the supply for a long time, its price can become so high that it will provoke a discouragement of the national importers, with repercussion on demand. Thus, the

rate will again return to a normal level. An increase in the currency supply will also contribute to that, caused by the increment of exports to the country of a more valued currency, appearing then a balance between entrances and exits of foreign exchange.

Besides, objectifying to eliminate the exaggerated floatations, the government can intervene in the market, "freezing" the exchange rate, or through the exchange stabilization funds.

The exchange stabilization funds are constituted of substantial gold and foreign currency reserves under government possession. The government can influence the exchange rates objectifying its maintenance at a desired level. When, for example, a considerable elevation of a foreign exchange price is verified, the government would throw in the market, for sale, a certain contingent of those foreign exchange, using its reserves or acquiring from another country. In the case of accentuated price fall, the government would try to balance the market, purchasing massively those foreign exchange. It should be emphasized that the utilization of those exchange stabilization funds doesn't invalidate the structure of a free exchange market.

2.3 Exchange rate devaluation and trade balance

Several countries have used the exchange devaluations in several times, as an attempt to correcting deficits in its trade balance.

Let us consider that the value of the US dollar is R\$ 1.00. We name "A" the group of goods that Brazil imports from the rest of the world and "B" the group of goods that Brazil exports to several countries.

Let us admit that all those transactions are only realized in US dollar (that's practically what happens in fact).

Finally, let us suppose, in addition, that one unit of "A" as well as one unit of "B" has the same price: US\$ 1.00.

We would then have:

US\$ R\$

price of "A" 1.00 1.00

price of "B" 1.00 1.00

Let us suppose now, that the government devalues the Real in relation to the dollars). Let's say that the dollar value will rise 5%, for example.

The new situation will be the following:

US\$ R\$

price of "A" 1.00 1.05

price of "B" 1.00 1.05

It is observed that the imports will cost more "real" for the Brazilian importers and the Brazilian exporters will receive more "real" for its exports. This situation can make the exporters decrease the price of its products in dollars, objectifying to export larger amounts.

In essence, such situation can provoke an import decrease and an export increase, contributing to improve the trade balance.

In fact, that result will depend upon how the demands for exportables and importables will react to the price variations. Perhaps devaluation deteriorates the trade balance deficit even more.

Let us suppose that the prices (in US\$) of exportables decrease. The exported amounts can increase. Even so, unless the variation of the revenue exchange resultant of an increase in the exported amounts is the same or more than the negative variation represented by a decrease in the exportable's prices, the exchange revenue will decrease. In this case, the foreign expenditures in imports will have to decrease substantially to compensate for the decrease in revenue of foreign exchange from exports.

2.4. Elasticities

The variations in the exported and imported amounts depend upon a series of factors. One of them, perhaps the most important, is the price-elasticity of exportables and importables' demand. In few words, it is the demand reply to a variation in the price of products.

There are several ways, some more sophisticated, others less, to calculate the price-elasticity. What matters, is to understand its operation. This will be explained now.

Let us consider that the price of a product increases (or decreases), for instance 10%. If the demanded amounts decrease (or increase) 10%, we will say that the demand has unitary elasticity. If the demanded amounts decrease (or increase) more than 10%, it is said that the demand is elastic. Even so, if the demanded amounts decrease (or increase) less than 10%, the demand is called inelastic.

How do the elasticities influence the imports? If the importables' demand is elastic, then the imported amounts will be reduced in larger proportion than the increase in the prices (in R\$), as a result, the total expenditure in dollars will decrease.

Let us now look into what happens with exports. An exchange devaluation will allow the Brazilian exporters to receive more "real" for its exports. This will allow them to reduce the prices in dollars, without sacrificing its revenues in terms of "real". If the foreign demand for our products is elastic, the increase of the demanded amount will further compensate the smallest price in dollars for exported unit, so the revenue in dollar will increase.

Combining the new expenditure in exchange value destined to import, with the increase of revenue from the export increasing, the result will be a favorable balance.

Moreover, what will happen if the elasticity-price of importables and exportables' demand are low, that is, if the demands are inelastic?

The amount of imports can decrease, but in much smaller proportion than the increase in prices (in R\$) of those products. To complicate the situation even more, it can happen, in the case of essential products, that the demand does not decrease, in spite of prices' increase.

On exports, the situation will be worse. Our product demand can increase, but in a smaller proportion than the fall of prices. Result: the export revenue will decrease.

For example: let us suppose that, to the price of US\$ 1.000, a company exports 1,000 units of a merchandise. Its exchange revenue will be, therefore, US\$ 1 million. If there is an exchange massive devaluation, the company will receive more "real" for its dollar of export. The company decides, then, to decrease the price in dollars, in order to sell larger amounts. Let us suppose that the price is reduced to US\$ 700 and, with that, the company reaches the sale of 1,200 units. Its exchange revenue will be US\$ 840 thousand, inferior, therefore, than that received when its products' price was higher. The same can happen with the products of other exporting companies, provoking exchange revenue reduction of a country.

As result of that combined effect, we will have a worsening of trade balance bad situation.

Several other situations can be considered, combining different types of elasticity for the exports and for the imports.

In practice, it would be very difficult for the "controllers" to calculate the elasticity-price of demand of all the products (exportables and importables), especially in countries with deficiency of statistics, as Brazil. Besides, the elasticities can vary with time, due to several circumstances (change of habit, alterations in the individual's income, new products in the market, etc.).

Therefore, the government presupposes that such the exportables' demand, as well as the importables', are quite elastic and that an exchange devaluation, increasing the prices of imported goods and allowing a reduction in the prices of exported goods, will provide a reduction in the total expenses with import and an increase in total revenues of export. Even so, nothing can guarantee *a priori* that it will happen.

3. The International Balance of Payments

The main objective of International Balance of Payments would be to record all economic transactions between the residents of the reporting country and residents of foreign countries. The record is useful for a variety of reasons. At one extreme, the financial authorities, i.e., the officials of the National Treasury and Central Bank, who have the responsibility for national monetary and trade policy and action, will want to know the character and dimensions of the equilibrium or disequilibrium between their country and the rest of the world. They have to have a record of the amounts and kinds of payments being made by and to their country.

Though, even the private institutions have interest in accompanying the subject, once and for all that the measures taken by the authorities with relationship to the balance of payments tends to repercute about all the national economy and, consequently, about the economy of the companies.

3.1 Concept

There are several concepts of balance of payments, some are simpler, others are more complex, although perhaps none of them can be considered as completely satisfactory.

A quite common definition is the one that considers it as a registration of transactions involving receipt or payments to/from abroad. In fact, even so, balance of payments also registers transactions that don't create payments or receipts. It is the case of Unilateral Transfers (especially goods contributions).

According to Richard Ward, the Balance of Payments Accounts are "a systematic accounting of a nation's economic transactions with the rest of the world, over a given time period."

To the International Monetary Fund, "Balance of Payments is the systematic registration of all accomplished economic transactions, over a given time period, between residents of the country and residents of another country, called foreign."

The word "residents" was mentioned. What would its meaning be? To Poul Host-Madsen, "residents would be those individuals or institutions that have a permanent association with the territory of a country, together with the government authorities of the mentioned country, in all levels. In that concept are included, therefore, all individuals and economic units that are subordinated to the national authorities, although they can be foreign."

Notice that the expression "subordinates to the national authorities" is important. Embassies, foreign military missions or personnel of foreign government agencies, although located in the country, are not subordinated to the national authorities. Thus, transactions with those entities/people are registered as if they were accomplished directly with the authorities of the respective countries.

Let us suppose that the embassy of United States, located in Brazil, receives a US government remittance of dollars. That operation won't consist of Brazilian's Balance of Payments, because it was considered as having been accomplished inside United States. But, if those dollars received by the embassy are used for accomplishment of expenses in Brazil, then they will be included in Brazilian's Balance of Payments.

In case of people, it becomes more difficult to separate residents and no-residents. A common procedure has been to consider all the ones that work at a country as being resident, except the border workers, that daily cross the country's border line. According to Host-Madsen, "tourists and other travelers are considered residents of nations from where they come".

As I already mentioned, none of the transactions registered in the Balance of Payments create payments or receipts in rebuttal. Hence some authors affirm that a more correct denomination would be "Balance of International Transactions."

I warn: although the International Monetary Fund makes all efforts to obtain uniform methods to the balance of payments, they still differ from a country to another. Reason why the analysis of the transactions of each country can be different, assisting to the peculiarities of its registrations. Such fact should be taken in consideration, especially when we want to compare balances of several countries.

3.2. Structure

The Balance of Payments can be unfolded in the following main items:

I) Current Account

1) Merchandise (Balance of Trade):

- goods;
- non-monetary gold movement.

2) Services (Balance of Services):

- freight;
- international trips (tourism);
- insurance;
- banking;
- film rentals;
- royalties, etc.

II) Unilateral Transfers

- contributions;
- charitable donations, etc.

III) Capital Account (Balance of Capitals)

1) Long Term:

- direct investments;
- portfolio securities: bonds and shares;
- amortizations.

2) Short Term:

- rights;
- obligations.

3) Monetary Gold Movement.

Let us see some details on these items:

The group "Merchandise" includes all the exports and imports of goods. The registration should be proceeded by FOB (free on board) value, although some countries adopt the approach of registering exports by FOB value and imports by CIF (cost, insurance and freight) value. By this way they try to give a better idea of the obligation represented by the goods' acquisition abroad. The use of FOB values, to imports as well as exports, does not distort the registrations. The other expenditures related to goods' transactions, such as: freights, insurances, etc., should be registered in the group "Services".

In the rubric "merchandise" is also registered the movement of non-monetary gold. In this case, the gold would be a merchandise as any other one and, in essence, it could be included in the normal movement of export and import of goods. Though, gold is a merchandise on which the governments like to maintain control, reason why its transactions are registered in a specific item. But what should be understood for "monetary gold and non-monetary gold"? Monetary gold is that whose movement implies alterations in the official reserves. The portion not considered as such, will be classified as monetary gold (used for artistic or industrial purposes). As Host-Madsen says, alterations in the international reserves of a country are an essential characteristic of the Balance of Payments registration.

The difference between the value of exports and imports provides the trade balance result. That result is many times motive of confusion with the Balance of Payments as a whole. That group can have a great participation in the Balance of Payments, but it does not happens always. Other times, the Trade Balance's "favorable" results can be more than annulled by a debit in another group, as "Services", for example.

In the group "Services", also called "invisible's group", are registered all the transport operations, international trips (tourism), insurance, incomes of investments or loans (interests, dividends, profits, etc.) and several services (commissions, advertising, copyrights, subscriptions of newspapers and magazines, rent of films, royalties and patents, etc.).

The sum of Trade Balance and Balance of Services will create the Balance of Current Account, which constitutes the main part of the balance of payments, in most of the cases.

It can be pointed out that some countries as Brazil includes in the Balance of Current Account the rubric "Unilateral Transfers".

The rubric "Unilateral Transfers" registers all the transactions that don't involve obligations in rebuttal, such as: contributions, war repairs, legacies, immigrants' transfers, remittances for the maintenance, etc.

In the rubric "Capital Account", are counted all the operations that represent variations in the accrediting-debtor international position of the country and in its monetary reserves. Consequently, are registered: loans, investments, amortizations of loans, as well as monetary gold movements. Notice that interests, dividends, profits, etc. are registered in "Services" and not in "Capitals".

According to Raymond Barre, those capital movements can be classified according to the following approaches:

- a) its object (loans, investments, amortizations, financings, etc.);
- b) its duration (long and short run);
- c) its regime (private or public).

It is worth to notice that the long and short run classifications are a little arbitrary. Assets with maturities greater than one-year are usually considered as long run. The operations considered as short run are the ones of less than one year.

4. A Brazilian Case...

4.1 External trade policy

The Brazilian commercial policy is faced mainly with the maintenance of the commercial opening process, stimulated from 1990. According to the tariff levels consolidated after Uruguay Round, the country tried to be worth of the allowed flexibility, adapting the tariffs of the import tax to the economy's needs.

In that way, the aliquots (ad valorem tariff) of some products were altered in order to attend the exigencies of the Common External Tariff (TEC) exceptions' list. To some electric products, electronic portable, bicycles and motorcycles, the aliquots around 70%, were lowered to 35%. To the "white line" (stoves and refrigerators) such aliquots fallen to 30% and the ones of shoe sector, that were up to 56%, fell to 40%. That initially, because it is scheduled a reduction of aliquots to the medium level of 20% at the year 2001. This schedule has been observed. The adoption of this rule aimed not only technological modernization, as well as it tried to favor the national consumer, by reduction of prices in domestic market.

Moreover, with the objective of assisting the needs of technological and industrial modernization, the aliquots of several products, as exception of TEC, were reduced to zero.

In terms of export promotion, the eligible goods for the "Program of Incentive to the Export" (PROEX) were defined reaching also the installation services, assembly and maintenance, of machinery and equipment of national production, when executed by the company exporter of goods.

Credit lines and financing were opened by the Economic and Social Development National Bank (BNDES), to the sectors more reached by the external competition and to those considered of larger potentiality in new markets conquest. Mainly the autopart sectors, footwear, textiles, pieces of furniture, tools, etc., were benefited.

By the new monthly import volumes registered after the economic opening and the consequent commercial deficits, the Brazilian exporter sector demanded larger incentives, which are being established by tax reduction, meaning also cost reduction. The largest profitability, due to this reduction of costs, will continue attracting investments to exporter sectors, while the tax reduction of exports should increase the competitiveness of Brazilian products in the international market.

Of highest importance for the external sales growth was the institution of credit insurance to exports, with the objective of guaranteeing the exports of goods and services against commercial, political and extraordinary risks, which should impel, mainly, the operations accomplished with the emergent markets. A specific private insurance company will cover the commercial risks, while the political and extraordinary risks will have covering of the National Treasury, with budgetary resources. The total covering of Treasury is US\$ 3 billion maximum, being limited at 85% of the effective losses, and the 15% remaining will due to the insured.

In terms of regional integration, Brazil tried to strengthen the relationship with MERCOSUL, considered one of the Brazilian foreign policy priorities. Highlighted the signature of economic complementation agreements with Chile and Bolivia. To Brazil, that adhesion favors the access to Pacific, with great importance for the trade amplification with Asian countries.

In spite of the liberalization policy promoted by Brazil, the Brazilian external sales were harmed by barriers imposed by the commercial partners, hindering the placement of national products in the external market. Restrictions by United States, Japan and European Union still existing to products marketed "in natura", for phytosanitary subjects; surcharges to steel and metallurgical, under dumping allegation; establishment of restrictive shares and exigency of technical norms that increase the prices of Brazilian products. Brazil has been trying to follow the norms in accord with TWO, contributing to the preservation of multilateral trade

agreements, intending to reduce, more and more, the incidence of such barriers that harm the world free trade and to diversify its trade list, such in terms of products as commercial partners.

4.2 Exchange rate policy.

Before "Plano Real" the exchange policy intended to maintain the real level of exchange rate, meaning that the internal increases of prices had to be incorporate to the exchange rate. With that, practically everyday the government acted in the exchange market, buying or selling foreign currencies. Therefor, the exchange rate performs similarly to the inflation expectations.

By the favorable conditions offered by the country for entrance of external resources, there was strong pressure on the exchange rate to decline, since the supplied volume of foreign currencies was larger than the market required. Intervention was necessary in the market, acquiring great amounts of foreign currencies to allow the gradual increase in exchange rate.

Thus, the maintenance of a real exchange rate allowed the adaptation of the international reserves levels, as well as the exporters could adjust their revenues to external sales, neutralizing the effects of the current internal costs elevation, caused by inflation. But, when acquiring foreign currencies in the market, the government put national currency in the system, stimulating the demand for products in levels not always compatible with the supply capacity, that created pressure on prices. Another problem was that, when maintaining the daily correction of exchange rate, a strong mechanism of price indexation was created, that hindered any attempt of reducing the inflation in the country.

From July 1994, the exchange policy started to have a new dimension in the economic policy context. The exchange rate would start to play a different role from that observed in the periods of high inflation. With the introduction of the new currency, the Real was permitted to adjust, initially, according to the supply/demand conditions for foreign currencies in the market, without the government's participation (Central Bank), that had the commitment of intervening in the market when the rate reached the level of R\$ 1.00/US \$1.00.

As result, significant change was observed in the net supply level of foreign currencies, from a monthly average of US\$ 3 billion (apr-jun/94) up to US\$ 163 million (jul-sep/94).

The exchange rate started to oscillate due the supply and demand, until the government came again in the market, since the Brazilian exports would be very harmed if the Real overvaluation continues. One of the government's important presences in the exchange market was by the Mexican's crisis. Thus, the government avoided an exchange rate overvaluation, to levels that could damage the efforts of prices' stabilization.

The persistence of commercial deficits and the unstable situation in the international finance markets, like speculative movements, could make vulnerable the external sector of Brazilian economy. In that way the government adopted a group of monetary measures destined to reduce domestic absorption. Besides, in the ambit of exchange policy, restrictions were eliminated with relationship to the exchange contracting in exports.

To decrease the uncertainties, the government introduced alterations in the control form of exchange policy, formalizing a "flotation band" of the Real in terms of Dollar, known as "exchange band". With that system, the monetary authority assumed the commitment of intervening whenever the exchange rate reached the inferior and superior limits of the band and could also act in another moments to avoid inadequate oscillations of rates. That system allows larger flexibility to the government, since it allows certain oscillation level of exchange rate, without intervention. For economic agents, the great advantage is to plan its operations in a defined margin of currency flotation. Since the flotation limits are relatively small, there is not place to speculative behavior. Even so, inadequate oscillations of exchange rate can be avoided quickly by exchange auctions in the market.

Since it was established in 1995, the exchange band experienced little modifications. The changes in the parameters of the exchange rate flotation in any moment meant alterations in the exchange policy. The orientation is that the exchange rate evaluation must contemplate, also, the domestic market conditions and, from abroad, the behavior of prices, as well as of the Dollar in the international market.

The government has been moving forward in the exchange liberalization, facilitating citizens relationship with the exterior. Standing out the elimination of several limits of foreign currency acquisition for expenses abroad, such as tourism, educational purposes, health treatment, relatives' maintenance abroad and use of credit cards; besides natural persons, the permission to the juristic ones also acquires immobile abroad; the increase of limits for banks to realize operations of Brazilian investments abroad, without previous government authorization.

4.3. Crisis of East Asian countries

In late October, early November 1997, the internal economic context was influenced strongly by the crisis of East Asian countries. The successive fall in the stock exchange and the devaluation process of the currencies of those countries created an atmosphere of larger instability in the international finance market, whose impact extrapolated the emergent countries' economies.

The effects of that turbulence in the capital markets are not completely defined, could provoke yet a reduction in the international liquidity besides the decline of interest in investing in emerging markets

In the Brazilian case, the consequences were the net exits of resources applied in the capital market. Movement associated a lot of times to the search for profits against damages incurred in another markets.

The East Asian crisis emerged exactly when the Brazilian economy tried to keep ascending trajectory of the productive activity, reduction of the inflation rates and tendency to stabilization of commercial deficits. The industrial output in September 1997 is shown more vigorous in the sectors, which produce capital and intermediary goods, with reduction of importance the sector of durable consumer goods. But the government was forced to raise the interest rates and to announce fiscal measures to restrain the consumption and to avoid the abrupt exit of foreign capitals.

4.4. Exchange rate and Brazilian exports

As effect of the Asian crisis and overvalued Real, the Brazilian companies are less competitive in the external market. Without hope that the government devaluates the national currency, the exporter companies begin to adopt measures in order to guarantee their place in the international trade.

As an example, companies that traditionally exported to Asia had decreased their indent. Thailand can offer products of direct competition to the Brazilians for a price 10% smaller than ours, a result of 46% devaluation in Thai currency and of the largest proximity with the consumer market, that reduces the transport costs. We have to look for new markets as the emergent of Africa and the reinforcement in MERCOSUL.

To have an idea, 43% of the Brazilian exports of fowl is to Middle East, but France is taking this market. Besides the relationship between Dollar and Franc is more favorable to the exports, the French producers rely on the government's heavy subsidies to increase its sales in Middle East.

Finally, most of the Brazilian exporters' complaints are about the exchange rate, overvalued here and devalues in Europe and Asia.

4.5. Brazilian international reserves: the maintenance limits of Real

The Brazilian exchange reserves stayed relatively stable and, without a doubt, in quite comfortable levels, even with the crisis of currencies and stock exchanges of the Asian tigers; and the rest of the world.

The reason for that is the trust that great part of foreign investor has in the Brazilian currency stability. Besides, even the investor in foreign funds with a registration at the Brazilian stock exchange, leaving the Brazilian portfolio as happened during most difficult days, when the stock exchange falls and the crisis of Asian tigers, most of the foreign investors still thinking that Brazil is one of the most important - or the most important - emergent economies in the world.

What I want to present here is not the stock exchange crisis or the possible flight of foreign capital, but the consistency or not of the Brazilian exchange policy.

"Specialists" affirm that Real overvalued if compared to US Dollar about 20% up to 25%. If such fact is true, the purchase power of our exports would only be retaken if there was a devaluation from 20% up to 25%.

Other "specialists" believe that the Brazilian exchange overvaluation not just compared with the US Dollar, but with a basic basket of currencies, would oscillate between 7% and 10%.

The question is: if the government devalues the exchange by 15%, for example, would we be obtaining a result proportionally superior in the Current Account of our Balance of Payments? The answer would be "no", especially because the Brazilian exports are growing continually, although the imports still larger than our sales abroad.

Another point would be: if Dollar be devaluated 15% with respect to Real, would the rate of internal inflation arise in the same proportion? The answer is, seemingly, no, because in spite of the exchange anchor be considered the sustenance base of Brazilian monetary stability, the inflation doesn't arise because the strong desindexation that happened in the economy of our country. Thus, the stability in fact is sustained by the break in the inflationary memory as a consequence of the end of official indexation generalized at the whole country.

It is evident that an exchange massive devaluation could create a rise movement in the prices of imported products and others products that, manufactured in the internal market, have a high composition of imported raw materials. But the devaluation would not have more strength because certain sectors as electronics and automobiles are with relatively high stocks and, in some cases, in elevation process.

Another subject that could be discussed: which limit of safety should Brazil have in its exchange reserves, to allow an effective exchange anchor? The answer coming from discussion among specialists says that it would be around 22 up to 25 billion Dollars. Now, if our exchange reserves are today more than the double of those values, it is easy to suppose that the margin of the government's maneuver in the current exchange policy is much wider than we can imagine.

Official data of IMF show that in May 1997, when our reserves were US\$ 57,2 billion, Brazil was in the eighth world position, overcoming United States, France, England and Italy.

Therefore, it could conclude that the limits of the Brazilian exchange reserves in the sustenance of the monetary stability of Real are based more in the generalized economy desindexation than in the volume of such reserves.

5. The International Finance Crisis and Capitalism

In spite of fleeing now from the specific theme, exchange or balance of payments, I take the initiative of approaching a subject that, if considered in a wide way, is running into the freedom. Freedom in all the aspects and, why not, exchange?

The financial crisis that has been affecting the Asian economies, from Thailand to South Korea, going through powerful Japan has been bringing to the world capitalist concerns about the close future of the most developed economies.

It is a serious crisis, if we consider the amount of losses since the beginning of world crisis in stock exchanges: nothing less than US\$ 1.7 trillion , twice-Brazilian GDP of the year 1997.

The financial crisis that affected the stock exchanges, such as Tokyo and Hong Kong, also affected the Brazilian economy, because volatile capitals that are applied in the Brazilian finance market began a fast return movement causing damages in our exchange reserves (US\$ 8.3 billion). Anything that is not avoidable, besides rise in interest rates and unpleasant fiscal measures.

But, what really matters in this evaluation are not also the recessive effects of high interest rates or the recessive effects of a "fiscal package". What matters here are the lessons of the recent history of the world economic system from the birth of the two great poles, the capitalist and the communist, until now.

As essence, the communist system (or the State present heavily in the economy) dropped as a castle of sand. Therefore, it exists today just as viable in the international scenery, the capitalist system as form of economic coexistence for the people.

The socialist alternative of State no more exists, what turns the capitalist road, in fact, the only acquaintance as viable in the short, medium and long terms.

And what has been happening with the capitalist system from the 1929 crisis up to 1998? The answer is simple: to each crisis, doesn't matter what is its economic, political and social cost, the capitalist system has been strengthening. Starting from the fall of stock exchange in 1929, when the great crisis forced the interference of State in the market through the New Deal, under president F. D. Roosevelt, going by Lord Keynes's theory, the capitalist system strengthens.

Besides the great disturbance of 1929, when million of workers got fired in the United States, the world suffered another great disturbance: Second World War. The conflict destroyed part of Europe, left the economies of France and England in poverty. The Marshall Plan saved Europe partly. What we see nowadays is easy to understand: the capitalist system allowed Japan and Germany to become, respectively, second and third larger potencies of the world. Italy also makes a part of the "Group of the Seven Richer Countries" (G-7) of the world, while any nation that adopted the socialist idea showed development, either from the economic or social point of view.

The Soviet Union, even being one of the victorious of Second World War and even having extended the limits of the communist system to Eastern Europe, was not developed economically and still crumbled in a chaotic economic and social situation.

China, "communist" is today a nation that moves forward quickly for the capitalist system.

Vietnam restored diplomatic relationships with the Americans and capitalist companies are investing in that country.

The examples of radicalism into Marxism that I remember now are Cuba and North Korea. Cuba receives yet foreign tourists to improve its precarious survival conditions, while North Korea starves - literally speaking - being under international humanitarian measures of help, inclusively from its American enemies.

The recurrent crises of the capitalism exist and they will always exist. In 1987, the New York Stock Exchange dropped with more violence than in October 1929. But the recovery was much faster than imagined. The crisis of Mexico, in December 1994, caused financial losses and scared the world, but Mexico recovered itself and the capitalist economy followed its course.

The current Asian crisis is larger than the Mexican crisis, by territorial extension, by damages caused to investors all over the world. It should also be a more durable crisis than the Mexican. However, if we observe the lessons of the recent past, it will also pass and the capitalist system will still strengthen more.

Therefore, the lessons that come from history of the universal capitalism, show us that to each crisis the system strengthens. It won't be different from this time. And, under all the aspects, we have always to walk in order to reach freedom, and the non intervenience of the State in the economy.

6. Final Remarks

"BRAZIL NEVER SELLS ITSELF ABROAD. BRAZIL JUST LETS ITSELF BE BOUGHT" ("O Brasil nunca se vende no exterior, apenas deixa-se comprar"). With that sentence attributed to the president of the Brazilian

Central Bank, Mr. Gustavo Franco, I would like to close the present work. Saying that about 40 years ago the Brazilian participation in the world exports oscillates around 1%. During this period our competitiveness (it is worth to say, the rate of productivity growth compared with the one of our partners), was deteriorating continually.

That nothing had of accidental, because it elapsed directly of market conditions generated by the "economic lock" that eliminated the competition and the incentives to the technological dynamism. A timid capitalism like this, for the half, cannot work. Then, screamed sectors of the economy: "at any given exchange rate, it will always be 30% overvalued..." ; with the competitiveness in decline, it was more and more necessary undervalue the exchange rates (or more and more subsidy or more and more salary squeeze) to produce the same exports.

Like a terminal drug addict, the country needed larger doses of the same drug to get the same satisfaction level. It might be clear that the competitiveness cannot be established by inflationist exchange policies or salary squeeze.

As soon as the exceptional conditions of the eighties were reverted concerning to the unreal exchange rates, salary squeeze and recession, we returned to a lukewarm performance, as observed in 1996/1997 and so many times in the past. There is no doubt, therefore, that the causes of this bad performance of exports are much more remote than ones that people affirms thereabout. We are planting seeds for a true solution for the problem of our competitiveness. We are creating necessary conditions for a good export performance in consistent bases. On one side, the opening of economy forces companies to be competitive, because it became a survival condition, that doesn't necessarily make them exporters. For that, it is necessary to embrace themselves in something called "promotion of exports", an activity typically Asiatic that we neglected for a long time because our obsession for self-sufficiency.

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