World Review of Business Research
Vol. 2. No. 3. May 2012. Pp. 1 – 11

A Historical Overview of the United States Economy 1950 - 2011: Four Lessons for Brazil

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The economy of Brazil has exploded in recent years, and the country is positioned to emerge a strong player on the global stage. At this juncture, the potential for success or failure is enormous; the stakes have never been higher. Sixty years ago, another economy stood on this same threshold with a new emerging middle class anxious to experience prosperity and a higher standard of living. What lessons can Brazil's economy learn by considering the actions of the United States over the last sixty years? Can Brazil avoid the pitfalls America did not? This paper will outline four core areas for Brazil to consider in light of America's experiences from the 1950's through today. While the two countries are vastly different in many ways, the areas discussed are universal to both: Consumerism / Consumer Debt, Government Entitlement Programs / National Debt, Inflation, and Personal Savings.

JEL Codes: E52, E62, and F43

1. Introduction

In 2008 the United States entered into the most severe economic recession in over fifty years. It would end up being the longest downturn since the Great Depression, officially lasting two years, though the negative impacts remain prevalent throughout the country at the time of this paper. The statistics are staggering. Since January 2007 the number of individuals unemployed six months or longer rose 438%. Business investment dropped 31%, and perhaps most telling, consumer confidence fell 77% over the same time period. (Stone 2011) Many were left wondering, "how the world's second largest economy (behind only the European Union) found its self in such a disastrous position."

Rewinding sixty odd years, one would find the United States economy on the verge of explosive growth and endless possibility, a condition mirrored by the economy of Brazil today. Valuable lessons, both positive and negative, can be learned by identifying steps taken by the United States over the past six decades, lessons which could assist Brazil to avoid the pitfalls and challenges currently facing the United States. Brazil, it has long been said, is the country of the future – and always will be. Perpetually on the brink of economic boom, Brazil has repeatedly failed to rise to the challenge and emerge as a dominate player on the world stage. Finally, however, all indications are that Brazil's time has come and the Brazilian people are ready. The opportunity has never been greater, the potential for failure never stronger, the time to pause and consider the past never more prudent.

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This study assumes that Brazil will continue its near exponential growth and soon face problems associated with the developed world. No past or current studies have considered the fiscal and monetary parallels between the United States and Brazil. The psychological differences between the United States and Brazil have been researched, and provide some of the limitations to this study (Rosen 1964). We hope to take valuable lessons away from a historical overview of economics and the United States in order to provide insight and clarity for the future of Brazil. Will Brazil finally be able to distinguish itself on the world stage?

This paper has four sections. Each section draws similarities between the United States and Brazil for each topic of discussion.

First section: Here we discuss debt and consumerism through a historical overview of macroeconomics. The emergence of a middle class and availability of credit are of utmost importance in this discussion.

Section two: A focus on each governments approach to eliminating income inequality, and the resulting increase in public debt.

Section three: A discussion on the inflationary pressures that both countries have faced, as well as the dangers of inflation looming in Brazil.

Section four: A focus on the importance of managing public debt to avoid the burden of future government spending to fall on its citizens.

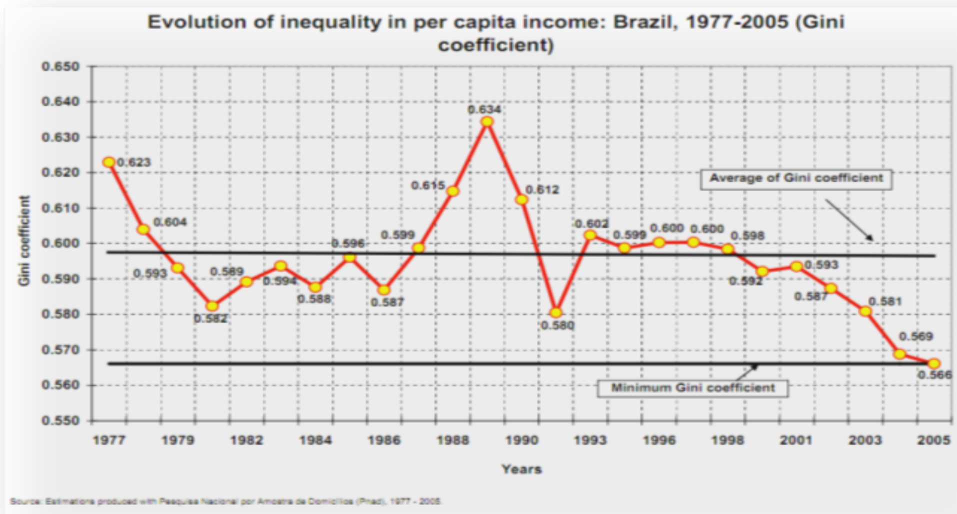
2. The Rise of the Middle Class: Debt and Consumerism

The economic direction of the United States has long been rooted in the theory first purported by John Maynard Keynes during the Great Depression of the 1930s. At its core, the Keynesian Model advocates aggregate demand management through governmental intervention in free markets. Keynes argued that it is the role and responsibility of the government to mitigate the adverse effects of economic recessions. (Keynes 1936) Challenged by neo-classical economists who argued that the markets always correct themselves in the long run, Keynes famously responded, “In the long run, we’re all dead.” Keynes model was a massive paradigm shift and gave rise to a new economic discipline: macroeconomics. He argued that when recessions bring unemployment and subsequent lower personal income, the government must ‘stimulate’ the economy through spending of its own, coupled with expansionary monetary policies by the central bank. (Keynes 1936) It was this belief in government intervention that directly led to Roosevelt’s New Deal and the beginning of massive governmental spending on ‘aggregate demand management.’ For the first time in the nation’s history, under President Roosevelt’s leadership, the country assumed debt for purposes other than fighting a major war.

Paul Krugman, Princeton University economist, Nobel Prize winner, and noted Keynesian scholar, contends that there was a second, equally important, historical economic event, aside from the Great Depression. The rise of the middle class out of what he refers to as The Great Compression. Krugman maintains that prior to the New Deal and governmental Keynesian economic policy, the gap between the rich and the poor was substantial. Through the intervention of the federal government, he argues, this gap was compressed and a new social class was created: the middle class. Empowered by union organization and the seemingly unending need in the United States for housing and infrastructure improvements, this new demographic would drive economic growth in the country for the next twenty five years. (Commonwealth Club of CA 2007)

Brazil is experiencing the rise of their own middle class in much the same way. Where there was once a considerable gap between the rich and poor, this discrepancy is shrinking. Figure one illustrates the GINI Index, a measure of income distribution within a given country. Brazil ranked 11th in the world in 2009 (rating of 49.3) for income distribution equity. This represents a remarkable improvement from Brazil's poorest rating of .634 in 1989.

Figure One



Additionally, Brazil currently enjoys a relatively low unemployment rate of 6.5%, with 66% of its 101.7 million strong labor force working in industry (Trading Economics 2011). Unemployment has continued to fall within the country quarter after quarter, leading to competition among businesses to hire workers. This has led Brazil to raise their national minimum wage once again, most recently an increase of 5.3%, further driving millions of Brazilians from poverty towards the middle class (Bryson 2011). The increase of formal labor laws should ultimately lead to an increase in formal employment, a reduction of overall unemployment, and a decrease in inequality and formal wage premium (Almeida & Carneiro 2007). Thanks to the unique situation of exponential demand for consumerism and new products, the unemployment rate does not seem to be as damaged as Almedia & Camerio would expect. The need for skilled labor shows no signs of slowing either, with Brazil set to host the Summer Olympics and the World Cup in 2012 and 2014 respectfully.

The importance of this emerging middle class is the same for Brazil today as it was the United States in the 1950's, contributing to increased production and purchase of durable goods. For the first time, the 1950s saw millions of Americans purchasing homes, new cars, and their first in home washers and dryers. As a result, the American economy exploded. The same is true today in Brazil; credit is booming as more and more move out of poverty into the middle class. It is estimated that lending inside Brazil increased an additional 15-20% in 2011 alone. (The Economist 2011) Brazilian household debt is currently 13% of gross domestic product, and has doubled since 2000. (Chain Bridge Investing 2010) Additionally, bank credit cards have tripled since 2004 and retailer cards have quadrupled. Total consumer loans have risen six-fold in just eight years to $495 billion, a figure representing 46% of Brazil's total GDP. (Bloomberg Businessweek 2011) Clearly Brazilians have a taste of consumerism, yet this spending represents only a part of the total economic story in Brazil today. A new government initiative, one also embraced by America in her past, looms large.

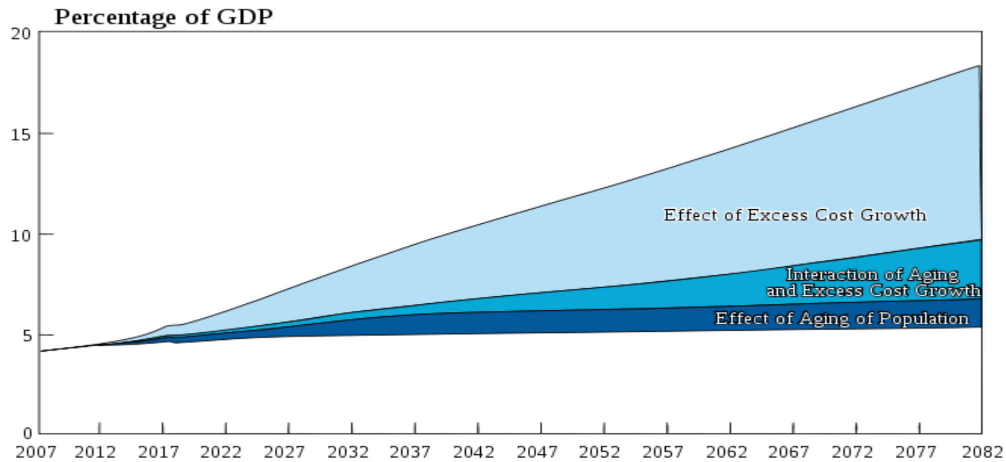
3. The War On Poverty: Sharing The Prosperity And The Burden

In his state of the union address in 1964, President Lyndon Johnson announced new legislation aimed at combating poverty within the country. At the time of the speech, the poverty rate in the United States was 19%. As part of LBJ's vision of a 'Great Society', Congress passed the Economic Opportunity Act, which allocated significant federal funds to address the needs of the poor including access to health care, education, and other social programs. In 1965, President Johnson increased the government's commitment to social programs by signing the Social Security Amendments of 1965 into law, thus creating what would become Medicare and Medicaid. The financial obligations of these programs, combined with social security started under Roosevelt, would prove astronomical. The costs of Medicare alone doubled every four years from 1966 to 1980. (Frum 2000) In less than fifty years, total Medicare spending ballooned to over 20% of total federal spending. The Congressional Budget Office indicates that:
Future growth in spending per beneficiary for Medicare and Medicaid—the federal government's major health care programs—will be the most important determinant of long-term trends in federal spending. Changing those programs in ways that reduce the growth of costs—which will be difficult, in part because of the complexity of health policy choices—is ultimately the nation's central long-term challenge in setting federal fiscal policy. (Congressional Budget Office 2008)

In order to pay for these new governmental responsibilities, congress began assuming more debt and for the first time since the build up to World War II some twenty-five years earlier, debt reached 50% of the nation's total gross domestic product, over $317 billion dollars. (Chantrill 2011) In just 15 years, the nation had seen its federal debt jump an alarming $60 billion dollars, but this 23% increase was just the beginning. Figure two illustrates the projected federal spending on Medicare and Medicaid as a percentage of GDP through the year 2082. What began as an effort to alleviate poverty and provide every American citizen with basic healthcare in their retirement or disability, has become the single largest federal budget line item. It is evident that the level of expenditure is not sustainable at current tax and spending levels.

Figure Two

Projected Federal Spending on Medicare and Medicaid (% GDP)



- It is the of spending per individual that will have the most impact rather than the / demographics of an aging population.*ratequantity*
- "Excess cost growth" refers to the extent to which the increase in health care spending for an average individual exceedss the growth in per capita GDP.
- "Interaction..." refers to the effects of excess cost growth and the aging of the population, which result in greater growth in spending than wo result from either factor separately.
- "Aging of population" refers to demographic shifts, such as increasing average population age and life expectancy.

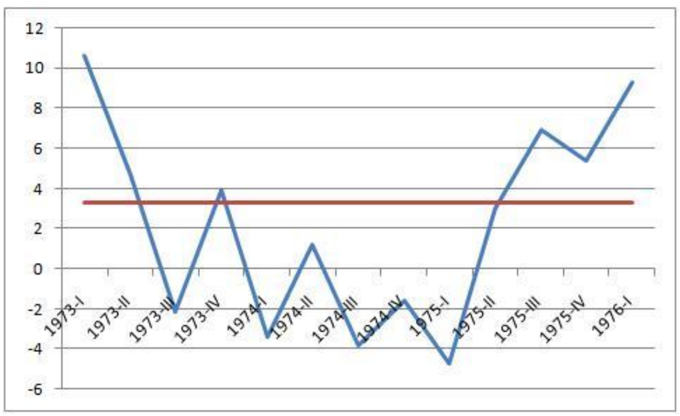
Source: Congressional Budget Office

Like Johnson in the 1960s, Brazil's government has also announced its intention to address poverty within the country. Through the creation of two government programs, Bolsa Familia and Fome Zero, the Brazilian government hopes to improve access to education and social mobility for those living below the poverty line. The initial results are impressive. The CIA World Fact Book reports that poverty fell 22% within the country between 2003 and 2009. In order to implement the second phase of the proposed Bolsa Familia initiative, the Brazilian government secured a $200 million dollar loan from the World Bank. In the past, federal debt in Brazil has not been a strong concern, however recent trends are beginning to raise alarm. Much like the spike in Brazilian consumer debt, Brazilian federal debt has seen a sharp increase. In August 2010 the national debt, including internal and external debt, rose 1% in less than a month to over $891 billion USD. (Versiani 2010) At the end of fiscal year 2010, federal debt had reached 60.8% of GDP, ranking Brazil 31st in the world for total debt, with over $300 billion owed to other countries, ranking 26th in the world (CIA World Factbook 2011). This is alarming, as debt concerns have been at the center of many developing economies' recent financial crises. (Goldstein 2003)

4. Inflation: The Destroyer of Wealth

As the United States moved on from the 1960s, with the decade's wars on poverty and Vietnam, to the decade of the 1970s, times were hard. A stubborn recession gripped the nation from 1973-1975, caused by the expenses of these wars, the rise of other industrialized nations, which increased competition around the world, and an oil crisis. (The National Bureau of Economic Research 2011) Gross domestic product growth fell by over three percent, and unemployment reached over nine percent. Normally in times of severe recession, the one silver lining is that prices remain low or fall; a natural counterbalance to inflation – the byproduct of an overheating economy. The recession of the 1970s was unique, however, in that the United States faced one of the most difficult economic situations possible; stagflation. A combination of 'stagnant' economic growth (recession) with rising inflation, stagflation forced the misery index (combination of unemployment and inflation rates) in the country to its highest recorded levels ever, reaching 21.98% in 1979. (Frum 2000) The cause of this inflation was the oil embargo of 1973, a response by OPEC to the United States decision to rearm the Israeli military. Around the world gasoline was rationed and subsequent prices on all goods rose dramatically. While no one could have predicted the oil embargo, or the stagflation it created, the dangers of inflation provide a valuable lesson. Facing skyrocketing prices, the Federal Reserve had no choice but to raise interest rates substantially to knock down inflation. In the midst of a painful economic slowdown, the economy was forced even lower. Figure three shows the collapse of gross domestic product growth during this period, as the economy shrank from 10% growth at the beginning of 1973 to -4% growth in 1975.

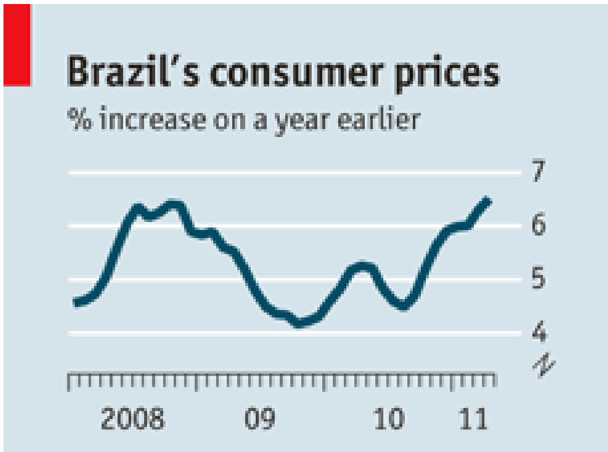
Figure Three



While the inflation of the 1970s can be partially dismissed by the unforeseen energy crisis, the inflation of the 1980s was a direct byproduct of an overheating economy and a populous unwilling to slow down the 'good times.' The decade become known as the 'go-go eighties' and it lived up to the moniker, with GDP growth between 1983 and 1989 averaging nearly 5% a year. (Trading Economics 2011) This growth was fueled in large part through massive tax cuts and substantial government budget deficits. Reaganomics was the kick start the American economy may have needed to get back on track after the 1970s, but this booming economy produced the negative by-product of inflation at a rate near 6% for the decade, double the target rate established by the Fed. (Inflationdata.com 2011)

Brazil is no stranger to the destructive nature of inflation. Like many countries in South America, Brazil has seen its currency fall and prices rise at alarming rates throughout its history. Between 1980 and 2010, the average inflation rate in Brazil was a staggering 445.98 percent, with a historical high of 6821.31 in April of 1990. (Trading Economics 2011) The cause of this rampant inflation was not an overheating economy, but rather a government forced into printing money at an unsustainable rate as the value of the currency eroded. Today, the inflation rate in Brazil is a manageable 6.5%, due in large part to the recovery of the currency, and a government determined to rein in runaway inflation. The rapid growth of the Brazilian economy does pose an eminent threat however, as for the first time Brazil faces inflation caused by economic success, rather than economic desperation. With the emerging consumerism of the new middle class, prices have skyrocketed in Brazil in just two years. Figure four shows this troublesome trend as the country's strong employment numbers could lead these prices to become 'entrenched' with little chance of them falling. (The Economist 2011)

Figure Four



5. Savings Rate: Why Save When It Is Not Raining?

The basic premise of Keynesian aggregate demand management is simple: in times of recession, deficit spending is acceptable in order to spur on the economy. In times of boom/growth, governments, and the subsequent populous, need to operate at a surplus, which is set aside for the next inevitable downturn. While the United States, and most global economies for that matter, has mastered the first part of the theory, Americans have yet to implement the second.

Personal savings in the United States has declined steadily from a high in 1943 of over 25% to a historical low of -.4% in 2005. There are many opinions on the cause of this decline. Some economists point to the Wealth Effect, which holds that consumers spend more, and save less, as their assets appreciate in value. Given the relatively steady economic growth within the United States, it stands to reason that saving would suffer. Still others blame the rampant tide of consumerism, where once thrifty individuals who would save and then purchase what they wanted, now opt for instant gratification and rising levels of consumer debt. Regardless of the cause, the negative impact is devastating.

A recent study found that an average American born in 2011 would be unable to retire until at least the age of 80. (Powell 2011) Americans are not preparing for the future, and are relying on the government to provide for them in their old age more and more.

Estimates range wildly, but by the year 2050, most analysts agree that the Federal Budget will consist almost entirely of debt service and entitlements like Social Security and Medicare/Medicaid, with no funds available for any other discretionary spending. (Creadon 2008) Additionally, the low amount of savings forces the Federal Reserve to provide cash strapped banks with additional funds for lending, further increasing the inflationary burden and government debt. With interest rates at historical lows, there is little or no motivation for anyone to save in America today. What little return earned is subsequently eroded away by inflation. Investors are forced into riskier positions in order to secure the necessary returns on capital.

Saving in Brazil is discouraged as well. In 2009, the government announced plans to tax savings accounts with balances higher than $23,900 USD in an attempt to spur consumer spending in the country. (Dantas & Goodman 2009) Brazil currently consumes 63% of its GDP, with savings/investment a mere 16.4%. (News N Economics 2010) This ranks Brazil the lowest of the BRIC nations in savings, and, for a developing country, this trend is troublesome. While China, for example, reports saving 31% of its income, Brazilian consumers are much more inclined to buy now, and worry about the future later, saving a mere 10% of their incomes. In a recent survey, 52% of Brazilians indicated that they cannot afford to put anything into savings, while in India, a much poorer populous, only 2% report not saving. (Global Sherba 2011).

6. Research Limitations

Many of the factors we have discussed have pointed to the fact that Americans and Brazilians tend to have the same mindset towards the future. Bernard Rosen provided insight into the fact that Brazil's repeated failure may be a result of distinct psychological differences when compared to the United States. He found that Brazilians:

Are less achievement oriented than their US counterparts
Are less future oriented than other developed countries
Place less importance on future gratification (focus on the now) than the US
Place lower importance on work than the US

Because of these significant results, we must be aware that a country's emergence to become a world power is infinitely complex. Factors such as these psychological traits are an important reminder that there are still substantial differences between Brazil and the United States.

7. Conclusion

While no two economies are exactly alike, the rise of Brazil is strikingly similar to the rise of the US economy in the 1950s. The economic growth of both was deeply rooted in rich reserves of natural resources, and a strong, emerging middle class resulting from the compression of income inequity. There are four key lessons that Brazil must consider moving forward, lessons observed first hand over the last sixty years in the United States.

Consumerism/Debt: As the poor make their way up the social ladder to the middle class, it is only natural that they will want to enjoy the benefits of their new found station. The proper use of consumer debt is a clear challenge in this regard. As it did in the United States, Brazil's consumer debt is exploding, as is the fear of default. The Brazilian government raised the taxes paid on consumer loans recently, in an attempt to slow down credit purchasing, and yet consumer credit continues to rise dramatically. (Bloomberg Businessweek 2011) Andrew Storfer, President of Anefac, a San Paulo association of finance professionals, summed up the challenge this way, "These are people with no experience of credit. There is no culture of managing debt." Brazilians must be wary to not live beyond their means and the government must take continued steps to educate the users of consumer credit on the risks involved.

Government Entitlement Programs / Debt: Allowing all the citizens of Brazil to take part in the prosperity produced by the economy is a noble and just goal. Just as President Johnson sought to make a better life for all Americans, Brazil's efforts in this area are commendable. It is critical, however, that the Brazilian government understands the long term financial implications of entitlement programs, and not just the short term cost/benefit analysis. The commitments made by congress in the 1960s to provide all American's basic medical coverage in retirement has now become an obligation capable of bankrupting the country. Across the globe, from the United Kingdom to Greece, countries are learning the ramifications of failing to deliver on promised entitlements, and the challenges of a populous unable or unwilling to take care of itself financially.

Inflation: The natural result of any rapidly growing economy is inflation, a fact facing all of the B.R.I.C. nations today. While no stranger to inflation, Brazil is facing the old advisory from a new vantage point: economic success. It is possible to 'succeed yourself to death', and Brazil must manage this new economic outpouring carefully as it moves forward. The recent sharp increase in prices is an indication that persistent inflationary pressures are a real threat. The situation requires strong leadership and a willingness to make the difficult decision of slowing the economy down. Failure to do so could lead to an 'economic hangover' much like the one the United States is currently suffering from. Too often, economies worry more about unemployment and less about inflation, a dangerous mistake as either one is capable of destroying the stability of a country's economy.

Personal Savings: Keynes himself acknowledged that his theory created what has become known as the Savings Paradox. When consumers save and delay consumption, the economy suffers in the short term. However, failure to save limits future investment, stifling economic expansion, and the economy suffers in the long term. The classic "live for today vs. plan for tomorrow" dilemma is created, and individual economies must decide for themselves which path to take. It is also clear that Brazil, like America before her, has a predisposition to living for the moment. Whether it is a cultural phenomenon or a reflection of a populous experiencing wealth unknown previously, the results will be just as damaging to Brazil as they have been to the United States: rising federal entitlement programs, rising national debt, increasing rates of default and foreclosure, more reliance on foreign direct investment, and a weakening position in the global economy. These four lessons offer Brazil a chance to avoid some of the pitfalls America's economy did not. What lies ahead is unknown, but the next sixty years will prove just as interesting to Brazil and her citizens, as the last sixty years have been to America.

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